Investing in Poland

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Warsaw seeks path beyond low-cost growth model

Country faces painful challenges as it enters post-communist 'adolescence', reports *Henry Foy*

ArcelorMittal's sprawling steel plant on the industrial outskirts of Krakow, Poland's second city, is an emblem of the country's economic boom.

Inefficient and outdated during its years as a state-run plant, it was bought by the world's largest steelmaker just before Poland's 2004 entry into the EU. A record investment by the company of $381m a few years later made it Europe's most modern hot strip mill.

But in August, the plant shut down, halted by a power shortage in the EU's sixth-largest economy caused by unusually hot weather.

That a spell of strong sunshine could cripple one of Poland's biggest and most valuable businesses, along with other large factories across the country, jarred with the country's image as the EU's powerhouse of economic growth, a country that — as any Polish politician will tell you — uniquely within the EU avoided recession after 2008 and has far outpaced Europe's negligible average annual rate of expansion since then.

But the first power cuts since the dark days of communism were a startling reminder that, despite a wildly successful 25 years of democracy and a decade of EU membership, Poland must continue to invest and develop if the next 25 years are to be as celebrated as the last.

Becoming complacent and not continuing to reform "is a real danger for Poland", says Adam Uszpolewicz, chief executive of Aviva Poland, one of the country's largest insurers. "The country has been resting on its laurels over the past few years," he says. "Fine, 3 per cent growth is very good in comparison with the rest of Europe. [But] Poland should be growing at 5 per cent."

Even so, compared with a few decades ago, the country is in good shape — power cuts notwithstanding.

Power house: Poland requires more investment to fuel growth — Reuters

Its economy is expanding at a steady clip of around 3.3 per cent, and development indicators are all moving in the right direction. Exports, private consumption, construction and industrial output are rising, and the country recently left the EU's excessive deficit procedure — a Brussels-run "naughty club" for those whose spending is excessive in relation to tax receipts.

The largest EU country in eastern Europe by population, size and economy, Poland has become the key destination for many regional investment portfolios, commonly described by the oxymoron "safe-haven emerging economy".

It has steadily climbed up the World Bank's rankings for ease of doing business, from 72nd in 2010 to 32nd in the world in the 2015, leaving it placed one below France and one above Spain. And infrastructure has improved so much in the past two decades that its smooth motorways and high-speed railways are unrecognisable to Poles who remember entire days spent in the car driving along rutted roads between major cities.

But many say more needs to be done.

The capital market, while good by regional standards, still lags behind expectations. Poland's energy, mining and agriculture industries — big employers and contributors to the economy — still need reforms to compete with western rivals. And, most importantly, the country has been slow in promoting an innovation- and ideas-led economy while weaning itself off the low-cost-labour driven growth model that served so well until now.

"Although many of these can be described as longer-term challenges, concrete decisions and actions cannot wait," says Mamta Murthi, country head for central Europe and the Baltics at the World Bank.

Poland's spending on research and development is just 0.9 per cent of GDP

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Inside

Pawel Tamborski

Buoyant Law and Justice likely to oust ruling party

General election Voters are eager for change after eight years of centre-right rule, says *Henry Foy*

A year ago, as Poland prepared for an extended 12 months of political campaigning, few outside the Warsaw bubble were familiar with Ewa Kopacz or Beata Szydło.

By October, one of these women will be elected prime minister after the EU's first electoral battle between two female party leaders.

After years of relative stability, in the past year Poland has reacquainted itself with political disruption. It has seen a change of prime minister, president, parliamentary speaker (twice), and some of its biggest political figures toppled, sacked or retire.

Next month, Ms Szydło's populist rightwing Law and Justice party is favourite to end eight years of rule by Ms Kopacz's centre-right Civic Platform after winning the presidential ballot in May, turning the country's political leadership on its head in the space of five months.

"What has been spoiled for eight years by the outgoing Civic Platform party needs to be fixed," Ms Szydło told her party's summer convention.

Between September 2007 and September 2014, under the leadership of Donald Tusk, Civic Platform did not lose a single national election. After Ms Kopacz took command of the party following Mr Tusk's appointment as president of the European Council, it lost two in eight months.

Though personally popular, Ms Kopacz lacks the easy charm and charisma of Mr Tusk, and her premiership has struggled to resonate with voters. But the government she inherited deserves much of the blame. After seven years in office, Civic Platform began to appear to some voters as arrogant, out-of-touch and complacent.

It has been embarrassed following the release of recordings allegedly detailing government ministers making backroom deals, and much-trumpeted statistics showing Poland's economic growth since 2007 — while impressive — meant little to many citizens, mainly in rural areas where the boom has failed to improve their lives significantly.

The rival Law and Justice party, which ran the country from 2005 to 2007, has used its time in opposition to address the economically disenfranchised — such as pensioners and the low paid — many of whom feel excluded from the fruits of a 20 per cent rise in GDP per capita since 2007.

While its tumultuous two years in office a decade ago were marked by euroscepticism and conservatism, it has sought to tone down its more rightwing positions that alienated many moderate voters, and sought to paint itself as a more youthful, energetic operation.

Rivals: Ewa Kopacz (left) and Beata Szydło (right) are competing to serve as prime minister from October

> Polls suggest Szydło could be prime minister without the need for a coalition

"It is strikingly obvious how, in terms of working out what Polish voters want to hear, Law and Justice has used its eight years in opposition more productively than Civic Platform used its time in power," says Michal Szuldrzynski, political editor of Rzeczpospolita, a leading Polish daily newspaper.

Latest polls suggest Law and Justice is on track to win more than 40 per cent of the October 25 vote, with Civic Platform trailing by between 15 and 20 per cent — a result that would make Ms Szydło prime minister without the need for coalition.

Key proposals include repealing a recent increase to the country's retirement age and doubling the income tax threshold alongside possible new taxes on banks and supermarkets. Rival politicians say the proposals are fiscally unsound.

Political analysts say the role of party leader Jaroslaw Kaczynski in any possible Law and Justice government will be crucial to its ideology and intentions.

Mr Kaczynski, a former prime minister and for many the personification of the party, stood aside to allow the relatively unknown Andrzej Duda to compete for the party in May's presidential election. He also passed over the chance to be prime minister again by nominating Ms Szydło for the top office in October.However the 66-year-old is expected to wield a large amount of influence behind the scenes of any Law and Justice-led government.

Mamta Murthi, country director for central Europe and the Baltics at the World Bank, says a new party in charge could respond to an increased level of debate around social issues that has surfaced during the election campaign.

"We see scope for increased effectiveness of public spending and for more efficient tax collection," Ms Murthi says of a possible change in government.

She adds: "We can also expect Poland to share its rising prosperity with the poorest and most vulnerable members of society."

Outside the two main parties, a clutch of political movements are failing to make gains, and the country's leftwing parties appear likely to struggle to muster enough votes to enter parliament, and could face political annihilation.

Warsaw seeks path beyond low-cost growth model

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which hit $548bn last year — the lowest ratio of any large EU economy, and less than half the 2 per cent EU average. "Even if the country follows the expected convergence path, the income gap [with western Europe] is still large . . . It will be nearly a generation before Poland catches up," Ms Murthi adds. "That is relatively long. I am sure Poland's aspiration is to do this faster."

Making the transition to an economy that is based primarily on traditional if modernised industries will not be easy. Much of the country's growth in manufacturing and services can be attributed to its high productivity and low wages.

In 2012, the average Polish manufacturing worker took home $8 an hour. Since 2008, unit labour costs in Poland have marginally fallen, in contrast to leading manufacturing-led economies in Asia, for example.

That is partly because of a surge in flexible-hour and temporary job contracts. Of the 30 developed OECD countries, only Chile has a higher proportion of short-term workers. This may keep costs down for employers, but it creates a distortion between headline economic growth and what people feel in their pockets, and discourages the training that Poland needs to continue improving the skills base of its workforce.

"At the root of Poland's success is the flexibility and competitiveness of the economy." says David Reid, a London-based portfolio manager of the BlackRock Emerging Europe investment trust. "Its skilled workforce and proximity to key markets mean the competitive advantage is increasing, rather than decreasing."

There are encouraging signs of a shift. Poland's IT industry is worth an estimated €16bn a year, and its value is rising. Amazon recently joined the likes of Samsung in setting up a development centre in the country, while Google will soon open another of its "campus" innovation clusters in Warsaw.

3% Poland's growth rate - among the EU's top three fastest

0.9% Poland's spending on R&D, the lowest of major EU economies

"Central to its success is the country's young, eager and well-educated workforce," says Don Grantham, president of central and eastern Europe for Microsoft. "Approximately 15,000 IT students graduate in Poland every year and several forecasts see Poland as one of only two UN countries with a reliable increase in the number IT specialists produced by 2020."

But while it looks to catch up with western rivals, the country should also keep looking over its shoulder. Other central and eastern European states, slower out of the blocks after the collapse of communist rule, are looking to emulate and even surpass Poland.

"Poland is at the heart of a set of countries that are competing as well as co-operating with each other," said BlackRock's Mr Reid. "Romania, in particular, is snapping at [Poland's] heels and let's face it, they have a good role model to look up to."

Structural reforms are vital for success

Economic policy

The story so far has been good, but there are the dangers of complacency and populism, writes *Neil Buckley*

Few dispute Poland's stunning economic success in recent years. Since 2007, its economy has grown by a third, compared with little more than 2 per cent for the eurozone.

Central to its success has been a comparatively well-handled post-communist transition, which made Poland an attractive investment destination. That, in turn, transformed it into a low-cost manufacturing centre supplying western Europe and tied in to Germany's powerful export machine.

But threats to its growth model loom. Some businesspeople fear that the rightwing Law and Justice party, if it leads the government after elections in October, could ape some of the "unorthodox" polices adopted by Viktor Orban's Fidesz party in Hungary.

Economists add that structural reforms are needed if the country is to sustain its economic success. Poland must also decide whether to move towards adopting the euro as EU rules require or — in light of the Greek crisis — stay out as long as possible.

"Poland's economy has been a great success relative to other post-communist countries for the past 25 years," says Leszek Balcerowicz, who masterminded Poland's early 1990s economic reforms, "but past successes do not guarantee future success."

For now, the outlook remains positive. Second-quarter growth was slightly below forecasts at 3.3 per cent, according to Poland's statistics office, but was still among the EU's top-three fastest.

Radoslaw Bodys, chief economist at PKO Bank Polski, forecasts growth will speed up to between 3.5 and 4 per cent in the second half. Poland will also benefit from a renewed inflow of the EU funds that in the past decade has helped transform infrastructure.

Mr Bodys says the penetration of key export markets continues to improve. Even though food exports fell to Russia after Moscow banned many EU foodstuffs in retaliation for western sanctions, Poland's food exports have still grown overall as it increased them to other markets.

Poland has been particularly successful in increasing exports to markets outside its top 20 existing ones, adds Mr Bodys — so reducing its previously excessive reliance on the eurozone.

"One characteristic of Poland that many people miss is that it has a very similar economic structure to Germany," he says, with small and medium-sized enterprises accounting for about 70 per cent of employment, and 50 per cent of GDP.

"Most of the interesting stuff that is happening in the economy is among those SMEs," Mr Bodys says. He adds that an election victory for Law and Justice, known by its Polish initials as PiS, might result in a bigger fiscal stimulus for the economy than if the governing Civic Platform retains power. That could boost growth — although it has budgetary implications.

But some influential figures are cautioning against any Law and Justice government copying the kind of populist measures taken by Mr Orban in Hungary. "Orbanism is a bad policy — and by the way, Orban is not popular in Poland," says Mr Balcerowicz.

"But despite that, [Law and Justice] is proposing some Orban reforms," he adds, noting that the party has talked of policies such as a bank levy and "sectoral" taxes on certain branches of the economy.

Katya Kocourek, senior associate at Stroz Friedberg, a risk management group, suggests PiS would face constraints in taking too many pages out of Mr Orban's book.

"I think Law and Justice has been impressed by the popularity ratings of Orban and his party," she says. "But they know they can't completely alienate Germany, because Germany is an important trading partner."

However, the biggest preoccupation for Mr Balcerowicz and some other economists is that Poland should not become complacent. Without reforms, he says, falling employment levels prompted by Poland's deteriorating demographics, a low national investment ratio and declining productivity growth risk producing a "considerable slowdown in long-run growth".

Measures are needed to increase employment among both young and old, he says. Also vital are policies to cut regulations and sometimes poor legislation that are discouraging investment, and to increase competition in sectors still dominated by state-controlled companies.

"Reforms are much more important than trying to rush into the eurozone," he adds.

Debate over Poland's future euro membership was rekindled two years ago when the eurozone seemed to be stabilising. But this year's Greek crisis has made Poles question the benefits.

No guarantees: Leszek Balcerowicz

"Unfortunately, following the public debate, [support for] the euro has collapsed dramatically," says Bartosz Milaszewski, managing partner at RSM Poland KZWS, an audit firm. "Nowadays, only 25 per cent of people in Poland want the euro instead of the zloty, but 70 per cent are against."

Among the main parties, PiS is, if anything, less enthusiastic than Civic Platform, adds Ms Kocourek: "The debate over euro adoption is likely to be postponed indefinitely if PiS returns to power, even if as part of a coalition government."

Risk aversion hampers further economic progress

Research and development

Country still struggling with productivity conundrum, writes *Andrew Kureth*

At first glance, Poland's economy seems an unmitigated success. GDP per capita has doubled to $14,422 since it joined the EU in 2004. It was the only EU country to weather the global economic crisis without falling into recession.

Foreign investment has flowed in — last year it was $13.8bn, lower than the pre-crisis average but still high enough to rank Poland within the top 20 international investment destinations in the world, according to the United Nations Conference on Trade and Development.

Much of that money has gone into a rapidly developing business services sector, which employs more than 150,000 people. Between 2007 and 2013 the country also received EU grants totalling €101bn ($114bn), which helped vastly improve infrastructure.

But Poles have higher aspirations. For all its growth, Poland's GDP per capita is well below the EU average of $36,317, according to World Bank data. Hundreds of thousands of workers move to western European countries each year in search of higher wages, creating an immense drain of skills and intelligence.

Poland has come as far as it has largely as a result of implementing western technologies and processes, and acting as a sub-supplier for western multinationals. To improve incomes and expand its economy, Poland will have to move up the value chain by fostering high-tech ingenuity.

Innovation has been an oft-repeated theme in business and government circles for several years, but the message is slow to filter through.

Fewer than half of private companies plan to spend more than 3 per cent of turnover on research and development this year, while 13 per cent do not plan to spend anything at all on R&D, according to a recent report from Deloitte, a consultancy. A full 64 per cent said they had no R&D strategy.

Poland still only spends 0.9 per cent of GDP on R&D, totalling around $5bn a year. Its richer, more innovative neighbour Germany, spends an impressive 2.85 per cent. The European Commission's Innovation Union Scorecard, which ranks EU countries according to their level of innovation, puts Poland well below the EU average at fourth from bottom.

So what must Poland do to close the gap? Experts point to a number of factors, including simplifying its byzantine innovation grant system and implementing tax incentives for research and development.

It is the only country in the region not to offer R&D tax credits, according to Magdalena Burnat-Mikosz, who leads the innovation consulting team at Deloitte in Warsaw.

Greater co-operation between business and academia — two spheres in Poland that are notoriously suspicious of each other — would also be welcome.

Maciej Sadowski, CEO of Startup Hub Poland

However, there is a more pernicious, deeply rooted problem: risk aversion, especially in government organisations meant to promote innovation, and in the large, state-owned companies awash with cash that could promote innovation through research and development.

Maciej Sadowski is chief executive of Startup Hub Poland, which works to match high-tech start-ups from around the region with funding and mentoring.

He argues that while some government officials have realised the importance of supporting innovative activities, many others still shy away from the uncertainty. "Some high-ranking officials have told me that they could not support our project because their success depended on not making any mistakes. It was depressing," he says.

While Poland's largest state-owned companies have been directed by the government to spend more on innovation, their chief executives are loath to spend money on uncertain ventures, the failure of which could lead to political scandal. "There has been talk for a long time that big state-owned companies would establish venture capital funds and invest in innovative projects," says Mr Sadowski. "So far, they're like yeti — no one has seen one."

Moreover, Poland's start-up ecosystem is still nascent. Funding is an issue: while accurate figures are hard to come by, everyone agrees that the pool of money available to new enterprises is far smaller than in countries such as the UK or Germany.

However, the number of venture capital firms and seed-level funders has grown quickly in recent years, and an influx of €10bn in EU financing dedicated to innovation will mean there should be plenty of money to go around for small, high-tech businesses.

"We do not need more financing for seed rounds and 'A' rounds," says Zygmunt Grajkowski, managing partner at Giza Polish Ventures, an Israeli-Polish venture capital fund. "What we need is to activate international venture capital for 'B' rounds."

More necessary than funding, say experts, is an increase in the mentoring and know-how that could help Polish start-ups take their ideas to the local, and eventually to the global, markets.

Mr Grajkowski says: "What Polish start-ups need is a rebalancing from an ability to innovate to ability to execute. Our start-up founders usually have great ideas and smart innovations, but they don't focus on making them competitive in the market."

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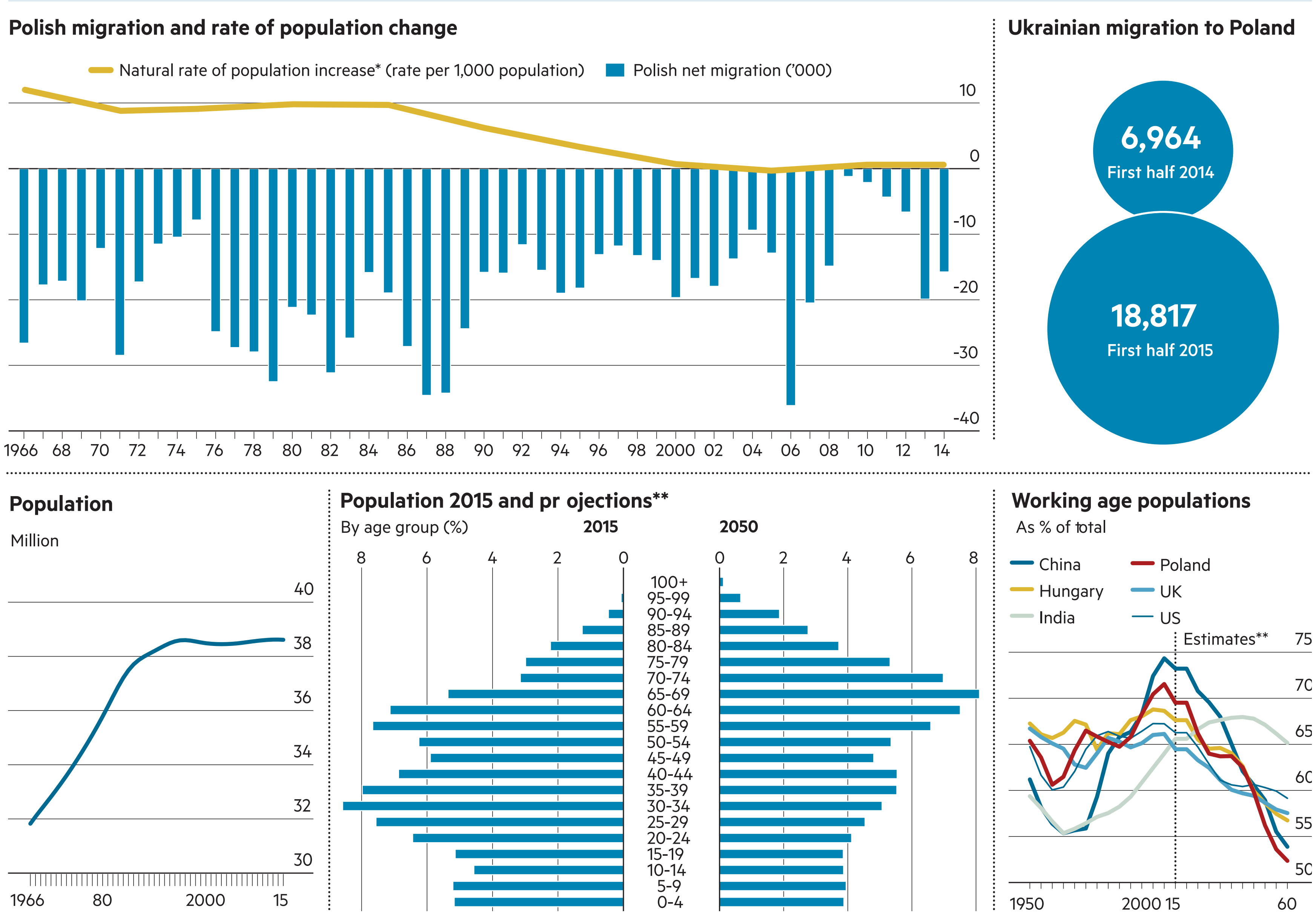
Shrinking population heralds labour shortage

Demographics

A fall in the number of school pupils signals a switch from a youthful to an ageing population, writes *Zosia Wąsik*



FT graphic Sources: Central Statistics Office of Poland; UN; Thomson Reuters Datastream; UN Population Division * Birth rate less death rate ** UN

This September, not every Polish pupil will return to the same classroom — with too few children, some schools have closed.

Last year, nearly 200 educational institutions were shut across Poland. It is a sign of problems ahead: today, there are not enough children to fill Polish schools; in 15 years, there will not be enough workers to sustain the economy.

At present, Poland's population stands at more than 38m people. The country's demographic profile bulges in the middle, indicating plenty of people of productive age. What should worry politicians, economists and taxpayers is its slender foundation.

According to the European Commission, between now and 2060, the population will shrink by 5m from 38m people, accompanied by a significant change in the country's age structure. Many of those who work now will live long past retirement and the duty to support them will fall on the smaller number of today's young people.

Maciej Duszczyk, professor at the Warsaw-based Centre of Migration Research, explains that even though Poland was one of the most youthful societies in Europe a few years ago, it could become one of the most mature within two decades.

He describes Poland as a "laboratory" watched around the world. "There will be a lot of people in their 80s and very few professionally active workers. How will the pensions and social security systems react? What will family relations look like?" asks Mr Duszczyk.

Poland's Ministry of Labour and Social Policy says it has already taken steps towards dealing with this demographic gap. Young families are encouraged to have children, and over the past four years the work leave available to new parents has more than doubled from 22 weeks to 52 weeks.

The ministry's other key strategy has been the introduction of policies that support so-called "active ageing". In 2013 the government increased the retirement age to 67 for men and women, up from 65 and 60 respectively. Warsaw knows it is vital that older people work and remain active in society as long as possible before becoming dependent on the state's care.

But Professor Irena Kotowska from the Warsaw School of Economics says the changing demographic structure is a challenge for the country's business leaders as well as government administrators.

"There will not be a lot of young workers, so the companies will have to figure out how to use the available workforce: older people and those with health problems who are willing to work, or immigrants, with a different working culture. And this group will become more diverse," says Ms Kotowska.

> 'I came to England, as did many other Polish people, to make my life easier'
> Aneta Zimny

What makes the Polish demographic challenge particularly strained is vast emigration. After Poland's accession to the EU in 2004, more than 5 per cent of Poles left the country — most in search of jobs, higher salaries and better social welfare.

Exacerbating the problem, those who emigrate are often skilled or professionals in their most productive age, like 36-year-old Aneta Zimny, a nurse who has been working in Guildford for a year. "I came to England, as did many other Poles, to make my life easier. Finally, I can afford to pay bills, good food and other little pleasures like theatre or cinema. I have two kids, I have to care for their financial stability," she says.

The impact of this outflow is apparent on the Polish labour market. A third of employers struggle to find suitable people to fill vacancies, according to a 2014 survey by ManpowerGroup, a recruitment specialist.

The categories with the biggest shortages published by the Ministry of Labour and Social Policy includes labourers, office technicians and care assistants — jobs that match those typically performed by Poles abroad.

But there is a queue of foreigners eager to fill the gap. Since the beginning of the conflict in eastern Ukraine, the number of Ukrainians who want to work in Poland has risen 200 per cent, says Mr Duszczyk. In the first six months of 2015, almost 19,000 Ukrainians were granted temporary or permanent permission to stay in Poland.

Natalia Panchenko from Open Dialog, a foundation that helps Ukrainians settling in Poland, said that regardless of their education or professional experience, 90 per cent of these immigrants start in the lowest paid jobs. "They are babysitters, care assistants, cleaners, labourers. They often get seven to eight zlotys (€1.90) an hour. They are fine with that; they believe it is the most they can get in a foreign country," she says.

But to secure their jobs in the EU, Ukrainians have to overcome the labyrinth of Polish bureaucracy and rules.

Marta Górczyńska of the Helsinki Federation for Human Rights comments: "Each immigrant receives permission to work in a specific place. If they want to change it, they have to ask for another permission and wait for it. In the meantime, they may lose the right to stay in Poland. Employers know that and often abuse their position."

Legal changes aside, there are small things that could make Poland friendlier to immigrants. "I would start with translating the webpage of the Office for Foreigners into proper English," she quips.

Anniversary of bishops' letter is time to take stock

COMMENT

Tony Barber

It is in the nature of historical anniversaries to wax and wane in importance and to change subtly in meaning. The perspectives of each generation supplement and reshape those of its forerunners.

So it is with a groundbreaking letter of reconciliation that Poland's Roman Catholic bishops sent to their German counterparts on November 18 1965.

On its 50th anniversary, this letter will be celebrated in Poland and Germany as a courageous, far-sighted initiative and a foundation stone of the close partnership that at last binds the two nations after their blood-soaked 20th-century encounters.

But 30 years ago, when I lived in Warsaw, the 20th anniversary of the letter attracted little notice. Poland was still in the grip of communism. The authorities had imposed martial law four years previously to suppress the independent Solidarity trade union.

State propaganda depicted West Germany as teeming with rightwing nationalists, devoted to the revanchist vision of reclaiming former German territories awarded to Poland at the end of the second world war.

The bishops' letter offered forgiveness for German sins against Poles, committed primarily during the war, and requested reciprocal forgiveness for Polish sins against Germans. It was a noble, Christian message.

In 1985, however, it seemed no more likely than in 1965 to have practical implications for Poland's place in Europe. For the defining realities of the times were the Berlin Wall and the division of Europe into a democratic, capitalist west and a Soviet-controlled, communist east.

At best, the Polish bishops' letter seemed an eloquent example of the church's willingness, at the height of the cold war, to defend its fundamental teachings. This invited vicious abuse from the communist party, but also unsettled ordinary Poles who still felt bitter or apprehensive about Germany.

A quarter of a century has now elapsed since the collapse of communism in central and eastern Europe. Poland has emerged as one of the region's most confident and vigorous democracies. Membership of the west's most important clubs, Nato and the EU, enhances its security and prosperity. The transformation of the country's internal and international situations allows us to view the bishops' letter in a different light.

The letter was an early step towards Polish-German friendship. But it also appears today as an act of moral imagination whose scope was greater than most people understood back in 1965. The letter is imbued with the hope of a refounded Poland, brave enough to tell painful historical truths to itself. Over the past 25 years, it has served as an impulse behind Poland's search for reconciliation not only with

> The letter was an early step towards Polish-German friendship. It was also an act of moral imagination greater than most people understood

Germans, but also with others, notably Jews and Ukrainians.

In the case of Poland's Jewish community, most of which was annihilated in the Holocaust, this effort passed a milestone in July 2001. Aleksander Kwasniewski, Poland's then president, made a public apology for a massacre of hundreds of Jews which Poles in the eastern town of Jedwabne carried out in July 1941 under the shadow of Nazi occupation.

This effort acquired a new dimension with the opening last year in Warsaw of the Museum of the History of Polish Jews. The emphasis of this $120m project is on the central role occupied by Jewish culture, from the Middle Ages on, in Poland's national history. At a popular level, much of Polish society is engaged in an exciting rediscovery of its partly Jewish roots. Stereotypes of Poland as a hotbed of European anti-semitism are out of date.

Moves towards reconciliation have also taken place between Poles and Ukrainians. One purpose is to heal wounds caused by ethnic cleansing campaigns that each side launched against the other during the civil war fought in the mid-1940s in the borderlands of Volhynia and eastern Galicia. Another goal is to achieve Poland's long-term ambition to integrate Ukraine into the world of free-market, liberal democracies, just as Poland itself was welcomed after 1989.

This explains Poland's strong support for Ukraine's independence and territorial integrity after Russia annexed the Crimean peninsula in March 2014 and intervened in support of separatists in eastern Ukraine. However, Poland's firm stance against Russia has complicated relations with other neighbours and partners.

In the central European quartet known as the Visegrad Group, the Ukraine crisis has revealed the Czech Republic, Hungary and Slovakia to be less enthusiastic than Poland about applying tough economic sanctions on Russia.

Polish politicians, prominent in supporting the pro-democracy Maidan movement that toppled Ukraine's old order in February 2014, are now conspicuous by their absence from the Normandy Four, a group trying to find a solution to the Ukraine conflict.

So, not everything in Poland's neighbourhood is rosy. Relations with Belarus and Lithuania are also prickly, largely because of concerns about conditions for ethnic Poles in these two countries. But the vision of a different, better Poland, to which the bishops' letter gave expression in 1965, is most certainly alive.

End to uncertainty after election should boost investment

Capital markets

Political uncertainty has damped dealmaking through the country's capital markets, writes *Henry Foy*

Stock markets are normally flat during the lazy summer months, but in Warsaw the lull has dragged on significantly longer. And the problem is political.

Stunned by a decision 18 months ago by the Polish government to shift $51bn of private pension funds into state control, the market has digested two defeats for the ruling party in local and presidential elections in the past 12 months, and now the prospect of a further defeat in a parliamentary vote in October.

"Last year was very quiet [for investment]," says Pawel Tamborski, chief executive of the Warsaw Stock Exchange, the region's largest by capitalisation and turnover. "This was because of question marks over pension funds. It was solved because the market has begun to understand how the new reality works.

"In the first half of 2015, the market did more, in terms of IPOs, than in the whole of 2014. And there was a strong pipeline for the second half of the year," adds Mr Tamborski. "I say 'was' because there are some question marks caused by declining sentiment. People are watching, many investors are in a wait-and-see position."

Civic Platform, liberal centre-right party that has run Poland for the past eight years, is trailing its more populist rightwing opposition Law and Justice party in the polls. Both speak of the importance of supporting business, but market watchers remain nervous.

Given the power the government wields through its controlling stakes in the leaders of many of the country's main industries, many businesses eyeing new financing are waiting to see who wins on October 25.

"There are a lot of private companies and entrepreneurs that are thinking about development, about capital raising," said Mr Tamborski. "After the elections, we expect the appetite from investors to be much clearer."

Poland saw just $400m worth of initial public offerings in 2014, a figure that is expected to rise steadily to $1.9bn by 2018, according to forecasts by Baker & McKenzie, a law firm.

In the first half of this year, 13 IPOs have cumulatively surpassed that 2014 total, including the €126m placement of Uniwheels, a German manufacturer, that for many confirmed Warsaw's position as a major European bourse.

But even after the electoral uncertainty has receded, Poland will still have some fundamental issues to tackle in terms of corporate finance and its capital market in general.

The country's levels of internal savings and household income invested in the wider economy are very low. Just 3 per cent of household savings are invested in the stock market.

And the large presence of the Polish state across its biggest listed companies deters some investors. This has restricted growth in liquidity — a gripe that many foreign investors have with the Warsaw bourse.

"What will become a big problem in Poland, and it is starting to be observed, is the lack of internal capital and savings" says Adam Uszpolewicz, chief executive of Aviva Poland, a leading insurer.

"Poles are still not saving enough, and there are not enough incentives for them to do so. And without domestically built capital, it will be difficult for the country to develop" Mr Uszpolewicz adds, calling on the government to draw up incentives and products to encourage savers.

Poll position: Pawel Tamborski, head of the Warsaw stock exchange, says the election will produce clarity on the appetite for further investment

Mr Tamborski hopes that the potential listings such as the Polish state-run postal service Polska Poczta, scheduled for this year, will bring new domestic private investors into the market.

But a decision by the state treasury to sell shares in companies that have already been floated may have more of a positive impact on the market.

Through its stakes in market bellwethers such as PKO BP, the country's biggest bank, and PKN Orlen, its biggest oil company, the Polish state holds 17 per cent of the total market capitalisation of the companies listed on the exchange.

> Many businesses eyeing new financing are waiting to see who wins the election on October 25

"The state's share too high," says Mr Tamborski. "Liquidity is a problem. The free float [at 48 per cent of market capitalisation] is too low and we would like to have it larger," he adds. "But we see growth . . . It is slowly increasing."

Where the stock market is losing out, Poland's banks are gaining. "There is huge competition from the banking sector due to high liquidity there and low interest rates," says Mr Tamborski.

And a small but growing private equity and venture capital industry regards the generational change in the management of companies set up 25 years ago after the fall of communism as an opportunity to snap up a slice of the country's corporate sector.

"Valuations are pretty attractive; [Poland] has been a somewhat underappreciated part of the emerging market space over the past decade." says David Reid, portfolio manager of the BlackRock Emerging Europe investment trust.

"The most important thing is to keep the investment climate favourable, so that private capital is encouraged to continue spending."

Russian apple ban triggers export rethink for farmers

Agriculture Tit-for-tat trade embargo prompts hunt for new food markets, writes *Adam Easton*

Core values: farmers protest against the impact of apple ban by Russia
Reuters/Kacper Pempel

Watching apple farmer Krzysztof Czarnecki on his ride-on lawnmower outside his large detached house, you might be surprised to learn he has been hit hard by Russia's ban on EU food products.

Mr Czarnecki's family's 60-hectare farm lies in Europe's largest apple growing area about an hour's drive south of Warsaw. Away from the house and warehouse, there is field after field of apple trees in neat rows.

For years, Mr Czarnecki sold most of his annual 1,000 tonne crop to Russia. That was until August last year, when President Vladimir Putin slapped a ban on EU food products in retaliation for western sanctions over Ukraine.

Apples are big business in Poland. The country was the world's largest apple exporter by weight in 2014, according to the Central Statistical Office of Poland. In 2013, 55 per cent of the crop went to Russia, so Poland's growers have been hit hardest by the embargo.

"The ban has had a big impact on Polish fruit growers," says Mr Czarnecki. "If you lose your biggest customer the effect is very negative. From being the biggest exporter in the world, we had our backs to the wall and we didn't know what to do with our apples."

Other apple buyers across Europe took advantage of the Russian ban to drive down the price for Polish apples. Mr Czarnecki said his income halved last year.

Some growers without sufficient storage space panicked and offloaded their stock at below production costs. Those that did have storage fared better, because they could wait until spring to sell, by which time prices had rebounded.

Polish growers also found a way to circumvent the embargo. Middlemen in non-EU countries including Serbia and Belarus were paid to change a delivery's documentation to enable it to be re-exported to Russia, says Marcin Hermanowicz, another apple grower.

"Everybody knows those apples were not for the customers there, but were re-exported to Russia. I heard it cost about €500 per lorry to change the papers.

"The big losers after the embargo were not only Polish growers, who were paid less for their apples, but also Russian customers, who had to pay more for the fruit," Mr Hermanowicz says.

Outside his modern packing warehouse, Mr Hermanowicz explains he redirected the bulk of his business away from Russia towards western European markets once Poland joined the EU in 2004.

Now he only exports about 15 per cent of his apples to Russia, but he still took a 25 per cent hit on his income last year, as the price of Polish apples dived.

Last year, he started to export more to new markets in the United Arab Emirates and Hong Kong and believes the Russian embargo may encourage others to follow suit.

"A good thing about the embargo is that not only our company but other Polish companies started to look for new markets and they are not looking at Russia so much as before because of the political factor," Mr Hermanowicz says.

"Markets are available in Africa and Asia. It's just not possible to win them in one year. We need to grow new varieties, get the health and safety agreements," he adds.

The government has been promoting Polish food products abroad and is seeking bilateral agreements to enter new markets, according to Zofia Krzyzanowska, counsellor general at the Ministry of Agriculture.

Canada has opened its market to Polish apples, while Japan and Ukraine now accept Polish beef.

The state also helped out financially. When the embargo was imposed, the government compensated Polish growers for their losses from the state budget. Mr Czarnecki says he received 800 zlotys (€190) per hectare.

An EU programme also enabled the government to buy about 15 per cent of the apples destined for Russia to give away to charity.

> Russian customers were also big losers after the embargo
>
> Marcin Hermanowicz

The Russian embargo remains in force, but Mrs Krzyzanowska is not so pessimistic about this year's prospects.

"Based on last year's experience, the growers can wait for a better price or just export to Serbia if they have the same channel from last year," she says. "Now, there is no rush and the growers don't expect so many problems."

The ban did have an impact. The value of food exports to Russia has dropped by more than two-thirds from €100m a month before the embargo to about €30m a month so far this year.

But Russia accounts for just 4 per cent of Poland's food exports, compared with the UK and German markets, which make up about 80 per cent.

According to a BGZ BNP Paribas bank report, the value of Polish food exports actually increased by 4.5 per cent to €21.3bn in 2014, thanks to increased exports to France and Belgium as well as Serbia and Belarus. The bank also estimates that Polish food exports will rise in value by about 8 per cent this year as a result of rising food prices.

Business must learn to trust if economy is to grow

OPINION

Olga Grygier-Siddons

The year 2004 was an important one for Poland as it joined the EU and its transformation into a thriving market economy was accelerated.

That year coincided with a big change in my personal life: my return to Poland with my British husband and two children after 23 years of living in the UK.

I had left Poland in 1981 as an 18 year old, just before martial law was imposed under communism. I still have painful memories of the poor standard of living and economic destruction I witnessed when I next visited Poland in 1989.

Today, I feel lucky to have been a part of the remarkable change and economic success that Poland has enjoyed during this "adolescent" phase of its development as a free-market economy in Europe.

Poles have embraced democracy. We have adopted good practices from our western allies. We have worked hard and GDP has grown every year — even during the global financial crisis.

The big question today is: How can the country sustain this momentum and continue to thrive?

Within Poland, there is a growing consensus that it and neighbouring countries in central and eastern Europe must change from "cost advantage" economies to "value creation" economies based on knowledge and innovation.

Much has been said about the structural changes required to make this happen: higher R&D spending; better linkage of academic research to the needs of industry; wider access to venture funding; and a more business friendly environment.

These are important contributory factors. However, for innovation to take root, there also needs to be significant progress in the way businesses and other institutions are managed.

Poland requires more progressive and emotionally intelligent leadership and less of the traditional "big boss" micromanaging culture that we inherited from the past.

Innovation springs from diversity — of ideas and of people. It flourishes within a culture of leadership that encourages creativity and open communication. It requires a balanced focus on both IQ and "EQ".

The best leaders I work with encourage ideas from all ranks within an organisation and they allow for greater autonomy to solve business challenges.

In this region, I often meet and observe senior executives who prefer to play to their IQ, or intellectual, strengths. They come up with the smart ideas themselves and then direct and control employees to implement their instructions. This usually gets the job done efficiently, but leaves no space for innovation.

Changing this style of management is not easy, because central and eastern European countries tend to be "low trust" cultures. Indeed, low trust is probably the biggest barrier to innovation in Poland.

> Poland requires more progressive and emotionally intelligent leadership and less of the 'big boss'

Low trust dominates how business and government affairs are conducted. Systems and processes are designed on the assumption that parties will not behave well or tell the truth, and so vast resources are wasted dealing with red tape and bureaucracy.

True, such practices are clear and transparent — most Poles would say "at least we know where we stand" — but they are not conducive to testing new ideas and pushing boundaries.

Building trust is essential — among employees, customers, suppliers, academic institutions and government entities.

Collaboration is central to innovation. The knowledge-based economy to which we aspire can grow most readily from alliances and an ability to find "win-win" outcomes even in the most difficult of circumstances. Trust is at the heart of that and trust cannot be built without good leadership and role models in all areas of society.

Workplace diversity also contributes to innovation. Generally speaking, gender diversity in business and politics is improving in Poland. The largest political parties are both led by women, for example. There are growing numbers of women in top business positions, although most big companies operating in Poland are still managed by men at the chief executive level.

I firmly believe this will change.

International diversity in the workforce is also a weakness in Poland and other countries in the region. Our countries cannot afford to become insular.

Poland's journey since 2004 has been a huge success. To sustain this momentum, it must innovate to compete with economies that have been established for many centuries, where not only financial capital but also values and culture have been passed from one generation to the next.

Poland, as an adolescent nation with rising living standards, must strive towards a maturity beyond our 25 years as a market economy.

Olga Grygier-Siddons is chief executive of PwC central and eastern Europe