Public finance consolidation in Poland

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This paper offers an overview of the public finance consolidation in Poland between 2009 and 2015. Motivation to scrutinise developments in public finance consolidation arose from conclusions that the ongoing economic crisis eroded fiscal stability and might hamper economic growth. Thus, the struggle with budget deficits appearing in each of the V4 (Visegrad) countries, particularly in Poland, requires assessment. The necessity of fiscal consolidation comes from two legal sources: the first is the EU's corrective arm of the Stability and Growth Pact – Excessive Deficit Procedure – which started in 2009; the second is the fiscal brake implemented in the Polish constitution.

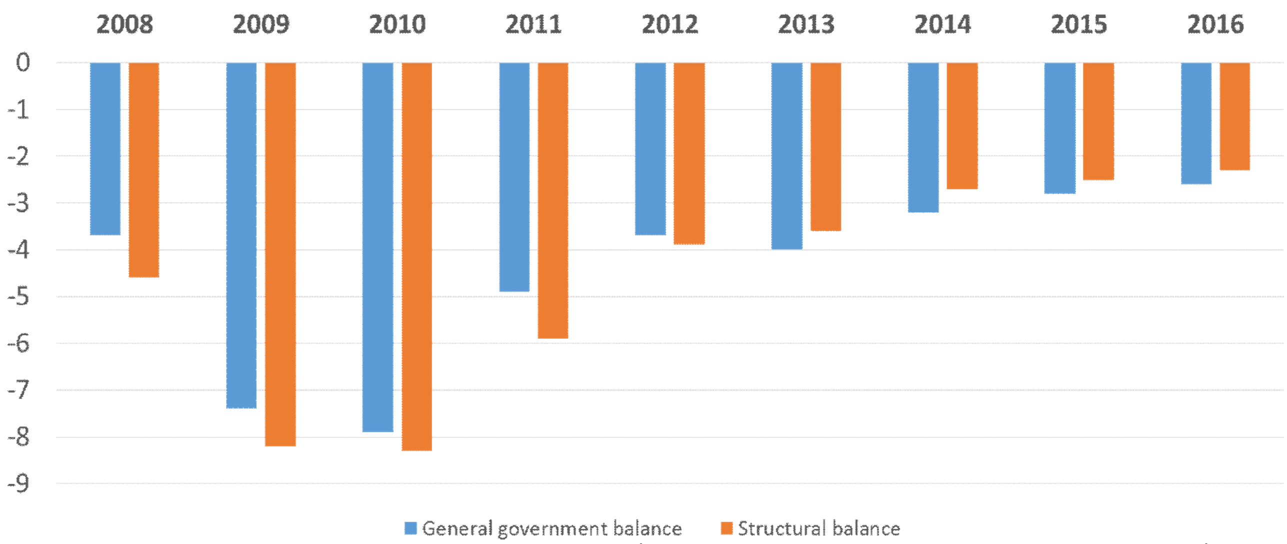
The overview of the fiscal situation in Poland

As in the other V4 states, Poland's budgetary situation worsened significantly in 2009 as a result of the global economic crisis, leading to the European Commission's decision to start the Excessive Deficit Procedure[1] (only a year after the closure of the previous EDP, started in 12 May 2004 and then introduced by the European Council).[2] The interesting fact was that, contrary to the other V4 countries, the deterioration of the fiscal situation in Poland in 2009 was accompanied by positive (but much weakened) economic growth.

The Commission gave the Polish government three years (by 2012) to repair the excessive deficit, which meant that Poland needed to prove a fiscal effort of 1.25 percentage points annually and bring the deficit down to below 3% of GDP. Despite the Commission's positive assessment in 2012,[3] in 2013, due to worsening external conditions the EDP, the program in Poland was maintained, with an updated deadline of 2014. At the end of 2013, the Council decided to extend the goal of reducing the deficit to under 3% of GDP to 2015.[4] In May 2015, the Commission – by estimating that Poland's efforts to decrease the deficit under 3% of GDP were effective – ended the procedure.[5]

1 SEC(2009) 864, Brussels 24.06.2009; Council Decision of July 2009 on the existence of an excessive deficit in Poland (2009/598/EC).
2 SEC(2004) 828, Brussels 24.06.2004; Council Decision of 5 July 2004 on the existence of an excessive deficit in Poland (2005/183/EC).
3 COM(2012) 4, Brussels 11.01.2012.
4 COM(2013) 393, Brussels 29.05.2013; Council Decision of 10 December 2013 establishing that no effective action has been taken by Poland in response to the Council Recommendation of 21 June 2013 (2013/758/EU).
5 COM(2015) 243, Brussels 13.05.2015.

Graph 1. Fiscal balance in Poland in 2008–2016 (% GDP)



Source: Spring Economic Forecast 2009, DG ECFIN, Brussels; Spring Economic Forecast 2015, DG ECFIN, Brussels.

The global economic crisis affected even the fiscal stability of Poland. The general government balance deteriorated from around 3.5% of GDP, in 2008, to 7.5%, in 2009, (Graph 1). It was caused by the drastic decrease of revenues with stable expenses. A slightly more negative balance occurred in 2010, as the structure of the expenses was not timely adjusted to the economic conditions of the new crisis. The structural deficit (which is independent from the business cycle and one-off measures), during 2009–2010, exceeded even 8% of GDP.

The first effects of the fiscal consolidation were visible in 2011, when both types of debt decreased: the general government balance fell to 4.9%, while the structural deficit dropped to 5.9%. In 2012 and 2013, the deficits did not exceed 4% of GDP, but they still failed to reach the EDP goal of 3% of GDP.

Graph 2. The public debt in Poland in 2008–2016 (% GDP)

Source: Spring Economic Forecast 2009, DG ECFIN, Brussels; Spring Economic Forecast 2015, DG ECFIN, Brussels.

The public debt grew sharply from 46.6% of GDP, in 2008, to 49.9% of GDP, in 2009, and continued to rise in 2010, when it reached 53.6% of GDP. In 2011, the debt growth pace decelerated, and the debt level amounted to 54.8% of GDP. In 2012, the first effects of fiscal consolidation were visible in terms of public debt – Poland noted its first debt decrease since the beginning of the crisis to 54.4% of GDP. The debt, however was still unsustainable, and grew in 2013 to 55.7% of GDP. In 2014, the debt decreased to around 50% of GDP. The projections for 2015 and 2016 foretell a slight increase, to near 51% of GDP.

The conditions of fiscal consolidation

The pre-consolidation situation in Poland was relatively difficult and determined the design of the strategy to decrease the excessive deficit. The biggest constraint to cut deficit was the considerable inflexibility of public expenses. In 2009, around 72% of public expenses were fixed – most of them were determined by other regulations than the budget law, including the pension system, subsidies to the local administration authorities, and military spending, broadly regulated in the act on reforming Poland's army. Other fixed spending were the planned public debt repayments, the contribution to the EU budget and the contributions to international institutions. Another problem was the fact that the government had little influence on the fiscal situation of the local administration units, thus limiting the consolidation efforts to the government level.[6]

The other important factor affecting consolidation design was the inflow of EU budget allocations to Poland, which required co-financing from the Polish beneficiaries of these funds. In a considerable part of these funds, the local administration units were spending this EU capital, and the co-financing caused their heavy indebtedness, thus further limiting the government consolidation effort on the local level.

The EU budget also had an important impact on consolidation design. Because Poland wanted to prove it could spend EU money and thus maintain a fast development pace, the national investment plans in infrastructure assuming a huge allocation from the EU budget could not become a target for a consolidation. The conditions of public finance consolidation clearly showed that the most straightforward way to reduce a deficit is in the revenues, not in the expenses.

The consolidation effort – expenses in 2010–2014

The consolidation effort could be done on the revenue side as well as the expenses side. A total consolidation effort in 2010–2014 in both amounted to 3.3 percentage points of GDP.[7]

Regarding expenses: the government adopted a comprehensive set of measures. The earliest ones included the modification of fiscal rules for local administration units. The new regulation (Art. 242 of the Public Finances Act), in 2011, introduced a new rule concerning the balanced budget for local units, changed in 2013 into individual debt limits rule, based on the 3-year moving average of the debt value. The new rule included some exceptions to exclude from the debt in order to maintain the absorption rate of the structural funds.[8]

In 2011, the government introduced a new rule limiting the pace of growth of discretionary and fixed expenses by 1% a year. That same year, the government froze remunerations in public administration, with exceptions for teachers, university staff, judges, public prosecutors, firemen, Government Protection

6 Gajewski P., Skiba L., *Problemy polityki fiskalnej w Polsce na drodze do strefy euro w kontekście uwarunkowań i doświadczeń innych państw*, Narodowy Bank Polski, Warsaw, November 2010.
7 Rada Ministrów, *Wieloletni Plan Finansowy Państwa na lata 2015–2018*, Warsaw, April 2015.
8 Ibidem.

Bureau, border and prison guards.[9]

The other important group of tuned expenses is linked with the pension and social security system. Since 2009, the entitlements for early retirements were limited. But, an even more crucial change was the extension of the retirement age from 62 to 67 years for women and from 65 to 67 years for men. Funerary benefit was reduced to 4,000 PLN, and a new income criterion was introduced regarding the one-off childbirth benefit ("becikowe"), which amounted to 1,000 PLN. The government limited access to sickness benefits for soldiers and other government services, judges and public prosecutors.[10]

The consolidation effort – revenues in 2010–2014

The reforms on the revenue side had a moderate effect (0.7 percentage points in 2010–2014) due to weakening domestic demand. But certainly without these changes, the revenues would shrink excessively.

Starting in 2009, the government froze the PIT thresholds (18%/32%) in nominal terms. This also applied to tax free earnings in Poland, currently amounting to around 736€ a year. Additionally, the government increased the disability contribution paid by the employers by 2 percentage points. The child tax reliefs and tax Internet relief were limited.[11] The government also limited the possibility to deduct 50% of revenue costs of for copyrights.

Regarding the VAT, in 2011, the government temporarily changed the rates: a reduced rate from 3% to 5% for food, books, and press; a reduced rate from 7% to 8% (i.e., for construction services)[12], and a regular rate from 22% to 23%. In order to prevent the negative impact on the poorer citizens, the government moved food from a 7% reduced rate to a 5% reduced rate.[13]

The government put efforts on the tax base, broadening and simplifying the taxation. This included a limitation of tax deduction for things such as buying trucks and fuel designed for them. The government also introduced a solidary responsibility in VAT of the buyer for tax liabilities of those selling steel and steel products, fuels or unprocessed gold.

The excise duty for oil, fuel and cigarettes was increased. The government introduced a tax on natural resources (copper and silver since 2012) and an auction system for CO2 emission allowances. The fees for road usage through the ETC system were increased.

Another important change was the transfer of specific assets (mainly public debt securities) from the private obligatory pension funds to the public one.[14]

A fiscal brake

Poland's public finances are constrained by a debt brake, which is written into the Polish

9 Ibidem.
10 Ibidem.
11 Ibidem.
12 A full list of items taxed with a reduced 7% (and afterwards 8%) rate is available here: http://aktyprawne.poznajpodatki.pl/wp-content/uploads/2013/04/vat_2012_zal_3.pdf (in Polish) (Accessed 18.05.2015). Please note, that food products are transferred to the 5% reduced VAT rate, which is not included in this document.
13 Rada Ministrów, *Wieloletni Plan…,* op. cit.
14 Ibidem.

constitution (Art. 215, section 5). The goal of the debt brake is to limit the debt-to-GDP ratio to 60%, maximum. The design of the fiscal brake foresees a few precautionary thresholds. The first, set at 50% of GDP, introduces a rule that the deficit-to-revenues ratio cannot exceed the corresponding ratio in the previous year. This threshold has been suspended since 2013.

A next threshold, at the level of 55% of GDP, foresees a set of precautionary activities: the next budget project should exclude the government deficit or it should assure the decrease of public debt; it freezes the remunerations in public administration; it limits raises in pension payments; it precludes the budget lending to any other units; it freezes the expenditures of the crucial government units („Kancelaria Sejmu i Senatu", Supreme Court etc.); it limits the expenditures of the local authorities. The government is obliged to review the expenditures and propose a recovery plan.

The final 60% of GDP threshold assumes similar activities as the 55% of GDP threshold, but it also includes such government obligations as presentation of a recovery plan within one month of the announcement of the excessive debt level. The local administration cannot spend more than it obtains in a particular year and it cannot grant guarantees.

Hidden debts

Hidden debts, in general, refer to the financial liabilities owed to the future payments in the pension system. According to FOR, it includes liabilities to ZUS (public pension system), and, in 2013, amounted to around 3 trillion PLN and it was around 195% of GDP.[15] It also covers such items as the National Road Fund, which noted deficit in the previous years around PLN 2 bn,[16] but its liabilities amounted to totally around PLN 45 bn.[17] Although it is included in a debt count while using ESA 95 and 2010 methodology, still the national methodology used for debt brake does not include it and thus the obligatory measures to limit a debt were triggered later.

Some NGOs (i.e. Fundacja Republikańska) pointed the problem of externalizing the debt at the local level from the local administrative units to the special purpose vehicles, which do not count to the overall public debt.[18] The government imposed on the local authorities a debt constraint of 60% of their yearly incomes. While the local units were obliged to spend money for fixed specific activities (i.e. investment, health care etc.), they needed to gather means and avoid the official restrictions. The creation of new corporations which can borrow money from the market and simultaneously which operations did not burden the local budgets was a relatively popular solution.

Public opinion's audit on public finances

There is moderate awareness of the public finance issue in Poland. It should be stronger, as the data show a correlation between a perception of debt as a problem and debt level: the bigger the awareness the lower debt.[19]

In Poland, there are some grassroots initiatives regarding the improvement of public debt

[15] http://www.dlugpubliczny.org.pl/pl/metoda-liczenia (Accessed 18.05.2015).
[16] Report on Activities of Bank Gospodarstwa Krajowego in 2014, http://www.bgk.com.pl/annual-report
[17] http://biznes.gazetaprawna.pl/artykuly/729038,solska-szybciej-sie-zadluzamy-niz-rozwijamy-dlug-nas-dusi.html (Accessed 18.05.2015).
[18] Horała M., *Jak ukryć dług w gminie?*, Centrum Analiz Fundacji Republikańskiej, Warszawa 2011, http://cafr.pl/jak-ukryc-dlug-w-gminie/# (Accessed 18.05.2015).
[19] Golias P., *Public consolidation in Slovakia*, INEKO, 2015.

awareness. The first one is debt counter, initiated in 2010 and maintained by FOR (Forum Obywatelskiego Rozwoju). The counter is available online, at www.dlugpubliczny.org.pl; physically, it is visible in the centre of Warsaw in a few venues with the biggest traffic (to widely target public opinion). The counter provides a few figures: the official and hidden Polish debt, the official and hidden debt as a percentage of GDP, and the official and hidden debt per capita.

FOR estimates that the public outreach informs up to 6 million citizens a month. The functioning of this debt counter is discussed and promoted in the media (TV, radio, media portals, newspapers – even in the frontline). Based on the initial success of the debt counter, FOR launched an information campaign on the negative effects of the excessive debt.

The second interesting project that aims at raising public finance awareness is the map of the expenses prepared by the Fundacja Republikańska. The organisation evaluates the budget of the state and presents a comprehensive infographic where the public money is spent.[20] The project was launched in 2011. The organisation also started to develop a project and introduced the similar maps for the biggest municipalities. The reach of this project is, however, less ambitious than the debt counter.

Challenges

In May 2015, the Commission ended the EDP in Poland, which, on one hand, is positive information. On the other hand, it raises concerns about further public finance consolidation, especially when 2015 is a year of double elections – presidential and parliamentary. Regardless of the winning party, a relaxation in fiscal policy is highly possible, which could trigger a new EDP.

Still, a substantial part of Polish public expenses are fixed. The government should reduce this share to better accommodate the external shocks requiring sharp cuts in spending on the national and local level. It is also important to distinguish between what is to be cut and retained. One of the greatest concerns in Poland is the unemployment rate, which should be included in the design of future fiscal consolidation. The same applies to revenue side of consolidation – if some new items are necessary to introduce, they should not hamper the economic growth and employment.

[20] http://www.mapawydatkow.pl/ (Accessed 18.05.2015).