

Report

PERSPECTIVES FOR POLAND

The Polish Economy
from 2015–2017 Against
the Background of the Previous
Years and Future Forecasts.

Summary in English.

The full Polish text
of the report is available at:
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INTRODUCTION

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Poland's economic development should be seen in a historical perspective. Until 1989, the backwardness of our country relative to the West had been increasing for centuries: the process lasted 300 years. Other countries, one after another, were entering the path of accelerated, modern development, based on expanded economic freedom, market competition, and increased spatial and social mobility of their people. However, most of Poland's territory was left behind. The gap increased in the times of imposed socialism – that system replaced private property with a monopoly of state property and the market with a command and control mechanism (central planning). Without exception, it brought terrible economic results everywhere. Its greatest weakness, apart from the massive shortages, was an extremely low level of innovation which is best measured by an increase in productivity. The nationalization of the economy means that the decisions of ruling politicians and their subordinate officials play a dominant role in investments (and current production). It kills creativity and therefore innovation.

All of the countries burdened by socialism regressed enormously in comparison with the analogous states of the West. In 1950, Poland had an income per capita similar to Spain; in 1990 we had only 42% of theirs. Similar comparisons can be made between East and West Germany, not to mention North and South Korea.

A regime that deprives its people of economic freedom condemning them to queues and backwardness can only sustain itself through stupefying, lying propaganda and intimidation executed by its political police, militia, compliant prosecutors, and judges. In other words: socialism was – and must have been – a dictatorship. It proves impossible to be reconciled with the rule of law and civic freedoms. This system collapsed in Poland in June 1989 – and a little later in other countries of Central and Eastern Europe.

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Yet in the first half of 1989 I did not expect, as probably a large majority of the people in Poland, that socialism, the repressive system stifling development, would disappear within my lifetime. Its collapse made what was previously impossible possible: a radical extension of individual freedoms, the introduction of the rule of law, and consequently an accelerated development of Poland, i.e., a reduction of the huge economic and civilizational gap to the West. It was a great opportunity given to us by history.

Initially, it seemed that all the former Soviet bloc countries went along the same route: towards democracy, the rule of law, and a market economy. However, after a few years their trajectories began to diverge. For example, in 1994 Lukashenko, after winning free elections in Belarus, reversed democratic reforms and froze pro-market changes, making this country a quasi-socialist dictatorship. Central Asian countries, especially Turkmenistan and Uzbekistan, followed the same path. In Russia, Vladimir Putin, after winning the elections of 1999, gradually reduced civil liberties and the rule of law to the point where truly free elections became impossible. At the same time, he expanded the scope of state ownership, and private entrepreneurs learned that their success is determined by connections with Kremlin. This meant the oligarchization of the economy.

Such fundamental deviations from the initial direction of changes ceased to take place in Central and Eastern European countries, however, Hungary (since 2010) and Poland (since 2015) have recently become exceptions.

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There are many thorough comparative studies examining the stability and growth of the former socialist economies (see, for example, Åslund, Djankov, 2014). Basic data about this can also be found in this report. These studies and data do not leave any doubt, to anybody with good will and logical thinking, that in the context of other countries Poland has achieved great economic success: we have reduced by a large part the vast distance to the West that existed in 1989.

Available studies also show what was crucial to this economic success. The most important factor was early, radical and broad market reforms coupled with strong macroeconomic stability that was necessary because of the galloping inflation inherited in 1989. In principle, until 2015 these reforms had not been reversed but only – at various speed – supplemented. Equal, perhaps even more radical market reforms were introduced by Estonia, Latvia, and Lithuania – with similarly positive effects on the growth of their economy.

Another cause of Poland's economic success was the fact that our economy had not seen any downturns since the transformational recession of

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1990–1991, the smallest among all reforming ex-socialist economies. This not only distinguishes us from other post-socialist countries, but also globally: of all the more developed countries, only Australia has grown without recession since 1991. The main reason for this stability of growth in Poland is monetary and supervisory policy that prevented the rapid growth of bank credit, meaning booms which end in collapses (see S. Gomułka in this report).

Poland's success after 1989 did not only have an economic dimension. Other indicators also radically improved at the same time – to a large extent due to the progress of the economy. The mortality rate of infants decreased over four times. The anticipated life expectancy at birth increased by nearly seven years. Social indicators place Poland even higher in international rankings than the economic ones.

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Past success does not guarantee future results. Sometimes forces of economic stability and growth weaken, while the state policy does not counteract, or even worse, deepens the trend. Such a threat to Poland was already visible in 2013 (cf. Balcerowicz, 2017). It became even more distinct in later years. Therefore in August 2015, experts of FOR presented a report entitled: The Next 25 Years. What Should Be Done so that Poland Catches Up With the West.

The report outlines the main factors that, if unopposed, can slow down the economic growth of our country – or even collapse it by bringing about a fiscal crisis. These are: the size of the working age population, decreasing due to demographic reasons; a low rate of investment, especially in the private sector; as a consequence, a reduced rate of productivity growth rate (efficiency). Negative effects of these phenomena are compounded by the fact that many of the pro-efficiency changes in our economy were already implemented during market reforms, and further changes require greater private investment and further reforms.

Against this background, the report describes three possible scenarios for the development of the Polish economy:

1. A variant of reforms that will sustain its growth.
2. A variant which lacks adequate reforms, which means a gradual slowdown in the economy.
3. A variant where the absence of reforms is combined with anti-reforms that undermine the pace of growth and stability of the Polish economy. Under this scenario, the gradual slowdown would necessarily be deeper and the risk of a crisis greater than in scenario 2, not to mention variant 1.

Since Law and Justices' [PiS] takeover in the fall of 2015, we have been dealing with the third, the worst, scenario. This is what this study describes. The consequences of the economic policies, both good and bad, are appearing

with a delay. The favorable economic situation left by the predecessors and the economic upturn in the EU countries help to conceal these damages, but they will come out eventually.

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Each report in this study includes its summary. I will therefore limit myself to a few words of comment.

Stanisław Gomulka, a prominent expert on the issues of long-term economic growth, emphasizes in his paper the key role that the transfer and adaptation of technology play in backward countries that want to catch up with the developed world. This is possible only for a market economy based on private property. Under such an institutional framework, the higher the investment rate and the scale of associated innovation – the faster the gap closes. A high rate of investment can be financed by sufficiently high national savings. This is the case of the Asian tigers, including the largest and the most recent of them, China. If domestic savings are low because widespread social spending discourages saving, rapid economic growth is possible only if these savings (and investments) are supplemented by a large influx of foreign capital, preferably in the form of foreign direct investment. This is the case of Poland and other countries of our region. To act towards reducing domestic savings, for example by maintaining a large, chronic deficit in public finances – and at the same time to repel foreign capital – constitutes a recipe for the gradual destruction of opportunities for the further economic development of our country. And this is the policy of PiS.

The consequences of economic policies, both good and bad, are appearing with delay.



Aleksander Łaszek and Rafał Trzeciakowski present a comprehensive and insightful report on investment in Poland against a broad comparative basis. Already before the change of government in 2015, the rate of investment, especially of the most efficient, private investment, was low. However, it was offset by a rapid increase in efficiency brought about by radical market reforms started in 1989. These factors of acceleration are getting exhausted while new ones require larger private investments, which, in turn, needs further market reforms.

And yet the policy of PiS (deterioration of law, increasing arbitrariness of its enforcement) intensifies uncertainty thereby undermining incentives for private investment. At the same time, the more effective, private sector is displaced by the less effective state sector, because it is politicized by nature, as described in Chapter 5.

Wiktor Wojciechowski analyzes the changes in the labor market in Poland in the years 2015–2017 – comparing them with previous periods and with other countries. He shows how two reforms – the limitation of early retirement options in 2009 and the gradual extension of the retirement age to 67 years started in 2013 – resulted in a visible improvement of the labor market: rising employment and a declining unemployment rate. The policy

of PiS, especially the reduction of the retirement age and the introduction of “Family 500+” program, works conversely: it increases the number of people out of work and reduces the number of people employed. This must undermine the growth of our economy and intensify problems in public finances, which required repairs even before the PiS’s takeover.

Public finances are discussed by Aleksander Łaszek and Rafał Trzeciakowski. In their paper they demonstrate that although some expenditures fell (mainly expenditure on pensions and education due to falling numbers of students and teachers), in the years 2007–2015 our deficit remained high, and as a result public debt grew faster than the GDP. The takeover of a large part of funds from OFE (Open Pension Funds) did not help because its effects could not have lasted. Public finances were the weakest point in the economic heritage that PiS took over from its predecessors. PiS’s policy, instead of healing public finances, harms them further by increasing annual spending up to almost PLN 40 billion in 2018 (the effects of the “Family 500+” program and the lowering of the retirement age). Another contributory factor will be a slowdown in economic growth – approaching with



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high probability as an effect of the anti-growth policy discussed in Chapters 1, 2, 3 and 5. Thus the PiS policy is leading, on the one hand, to accelerated growth of the public debt and, on the other, to the slower growth of our economy in the long term. This combination is unmanageable and creates a risk of increasing disturbances.

Despite many reforms, Poland’s economy was subject to a greater range of state intervention (mainly in the form of state ownership and anti-market regulations) than economies of other OECD countries. A chance to catch up with the West would be provided by reforms removing the burden of statism. Instead, since the end of 2015, anti-reforms have been introduced, increasing the share of the state sector and ousting private companies through various forms of nationalization and discriminatory regulations. Some of them are a form of regulatory expropriation. This is accompanied by the development of state monopolies and the creation of autarkic systems within the framework of the expanding state sector. These and other forms of reversing Poland’s economic system towards the model introduced earlier by Vladimir Putin are described in the chapter by Barbara Błaszczuk.

All this overlap with an attack on the rule of law, unprecedented in our history after 1989: the introduction of laws that contravene the highest law – the Constitution. Some of these regulations target the fundamental institutions of the rule of law – the Constitutional Tribunal and the common courts. This process threatens both civil liberties and the economy. The latter is mainly due to increased uncertainty which is lethal for private investment (Analysis 12/2017: Without independent courts the economy is developing slower and civil liberties are at risk).

To sum up: Poland has entered a dangerous turn in history. As many well-informed and active citizens as possible are needed in order to avoid a serious, historical setback. I hope this work will contribute.

25 October 2017

LITERATURE

Åslund A., S. Djankov (2014), *The Great Rebirth: Lessons from the Victory of Capitalism over Communism*, the Peterson Institute for International Economics, Washington DC

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SUMMARY OF THE REPORT

Witold Gadomski

In the last 25 years, the Polish economy has grown faster than the economies of Western Europe and the US, which enabled a significant reduction of the distance separating us from richer countries. Annual GDP growth in the years 1992–2011 was 4.1%, which was the best result among those Central and Eastern European countries that started to transform at the same time as Poland. But in the second half of the twentieth century, several countries achieved faster growth, which allowed them to join the group of high-developed countries. Also, some post-communist countries experienced faster growth than Poland. But only the Polish economy has been growing stably so far, without financial crises and recessions. The growth was achieved despite a relatively low rate of savings and investment rates – lower than the average in the European Union and significantly lower than the average in Central and Eastern Europe.

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Rapid growth at a relatively low rate of investment resulted from strategies of radical market reforms and stabilization that triggered a broad transfer of technology and pro-efficiency structural changes. Poland also benefited from the backwardness rent: employment in inefficient agriculture was decreasing; state-owned industrial and extractive enterprises that incurred losses and sometimes had a negative added value were either privatized or liquidated. Their resources were taken over by private entities. Several million workers who left agriculture and outdated state industry have found work in more efficient services and private industrial undertakings. This process was possible and ran faster than in other countries of our region due to the well-designed and implemented liberalization and privatization of the economy, the rapid opening of the Polish market to the competition of foreign companies and products, the establishment of well-functioning market institutions: banks, the stock exchange and bodies of financial supervision.

Foreign capital played a key role in the transfer of innovation and supplemented the low level of national savings. Foreign investors brought better technology and more efficient organizational structures with them. They introduced companies from Poland into international distribution and cooperation networks. Relatively small investments were making a high return, which translated into high GDP growth. Thanks to the market reforms and also to the opening of Poland to foreign markets, Polish exports have grown at an average annual rate of 11.6% in current dollars over the past 25 years – faster than South Korea's exports at the time.

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International financial institutions and Polish and foreign economists agree that the factors helping the rapid growth of the Polish economy are becoming exhausted, which threatens to slow down growth and prolong the period of catching up with the richest. Simple reserves, consisting of moving resources to more productive areas of the economy, are shrinking. The barriers to development, resulting from unfinished reforms and errors accumulated over the years in economic policy, have also become more visible.

AVERAGE GDP GROWTH IN POLAND AND GERMANY

	1992–2000	2001–2008	2009–2016
Poland (%)	5.0	4.0	3.0
Germany (%)	1.6	1.3	1.0
Surplus of Poland (pp)	3.4	2.7	2.0

Source: Own study on the basis of data from IMF (October 2017)

Depletion of simple growth reserves makes it impossible to maintain – and even less to increase – the current growth rate as long as the investment rate remains relatively low. The conclusion is clear – the Polish economy should invest more.

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In the short term, investment expenditures are primarily affecting demand – they are an important component of domestic demand, and their growth (no matter how efficient and in what way attained) can contribute to GDP growth. This fact prompts some governments to stimulate GDP growth through public investment (and / or an increase in the public sector deficit). Another way to stimulate an investment may be subsidies or tax reliefs for certain types of investments (e.g. housing), low interest rates or special regulations to finance certain investments. Such a policy may lead to bubbles in respective markets (real estate, shares). Stimulating short-term investment growth may have a political goal – improving the economic climate before the election.

The short-term growth of investment and GDP, stimulated by the government, often has negative effects in the long run.

- It gives an illusion that the economy is in a good condition and hence the necessary structural reforms are postponed indefinitely;
- The average effectiveness of the investment falls because investment decisions are made on the basis of arbitrary state policies rather than signals coming from the market; both the potential and the real long-term growth of GDP are thus reduced.

In the long term, the impact of investment on growth consists in the creation of productive assets, which increases the production potential of the economy. While in the short term the efficiency of investments (additional production generated by investment outlays) is of little importance, it is of prime importance for long-term growth. Inefficient investments stimulate domestic demand in the short run, but in the longer perspective they do not contribute to production increase necessary to finance investment loans. They are therefore damaging to long-term economic growth.

Large investment outlays happened in countries with a centrally-managed economy. For some time, this created an illusion of rapid economic growth, especially of an increase in industrial production. The lack of market verifi-

cation made the government unable to assess the effectiveness of individual investments. In fact, investment decisions were often of a political nature. They aimed to create a potential for the arms industry, change the social structure in conservative regions, and create benefits coming from central investments (like population growth or higher allocations of goods in short supply and in result boosting local authorities) for selected cities. In the People's Republic of Poland, the rate of investment fluctuated around 30%, and in 1975 it exceeded 35% (assuming the statistics were at all reliable at the time: another methodology applied to national accounts then). Some of the projects were financed with foreign loans and an increase in hard currency export proceeds was necessary for their repayment. But the efficiency of investments was so low that repaying even a relatively small amount of loans (about USD 20 billion in 1980) turned out to be impossible, especially since the interest rate increased. The experience of countries with a nationalized economy, centrally managed, and of some market economy countries where government policy stimulated investment without economic justification, leads to a clear conclusion: the allocation of capital that does not take market mechanisms into account, leads to a waste of capital, financial crises, and in consequence inhibition of growth.

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Professor Stanisław Gomułka, the author of the report “Poland's Economic Growth in the Global and Long-Term Perspective: Until 2015, the Last Two Years, Forecasts” challenges frequently expressed opinions that, up to now, the main development engines of the Polish economy were low innovativeness and a cheap labor force. He shows that the innovativeness of the Polish economy has been high for the last 25 years. The measure of innovation is the rate of GDP growth per employee or per hour. This indicator grew in Poland faster than in the US and Western Europe, although spending on research and development is much higher there than in Poland. This growth is mainly due to the transfer of technology and know-how connected with inflows of foreign investment. Professor Gomułka gives examples of countries that for a long time maintained higher growth than Poland: Ireland, South Korea, Japan, China. All of them had a much higher rate of investment. Ireland owes this to a significant influx of foreign investment, East Asian countries to domestic investments financed by national savings. Neither model of development could be implemented in Poland. Professor Gomułka draws attention to the low level of national savings, which is one of the main barriers to economic development. The reason for the low overall savings are the negative savings of the public finance sector (resulting from the deficit) and very low household savings. Practically the only source of domestic savings is the corporate sector. Without raising the rate of savings, it will be impossible to significantly increase the rate of investment. Thus a program is needed that eliminates the public finance deficit, strongly encourages private savings of households and businesses, maintains public investment at a current relatively high level and stimulates foreign direct investment larger than at present.

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Difficulties in finding skilled workers are one of the reasons for the low level of investment in Poland. Although entrepreneurs, in response to the labor deficit, might prefer more capital-intensive technologies and thus increase their investments, they refrain from this because of the uncertainty surrounding the legal and institutional environment.

According to the report of Aleksander Łaszek and Rafał Trzeciakowski, “Investments and Growth of the Polish Economy. Not Enough Private Investment” this uncertainty has increased significantly due to actions of the current government. Faced with rapidly changing regulations and subsequent restrictions on economic freedom, entrepreneurs are not able to assess the profitability of individual projects and consequently they withhold investment.

The authors describe a number of government actions that have a negative impact on the rate of investment and the long-term growth of GDP. In addition to the decisions that reduce the supply of labor, the authors mention: the ban on land trade, subsidies to unprofitable (mainly state-owned) enterprises, support for small and under-performing companies and the whole of agriculture at the expense of large companies, where productivity and capital expenditures are clearly higher. Łaszek and Trzeciakowski positively evaluate the actions of the government to seal the tax system, but some of them, such as the option to confiscate a company whose employees are suspected of criminal fiscal offenses, dramatically increases the risk of business and investment. In addition, the abolition of the independence of the Constitutional Tribunal and the attempt by the ruling party to take control of the common courts mean that property rights are not duly protected, which leads to the postponement of investments.

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According to Wiktor Wojciechowski’s report “The Labor Market. The Impact of Actions After the Elections of 2015: Accelerated Decline in the Workforce”, the number of working age people in Poland has been decreasing since 2012. This is due to natural demographic processes. In the coming decades, the increase in the number of people aged 65 and over in Poland will be one of the highest among all the EU states. Due to actions taken by the previous government – to reduce early retirement and raise the statutory retirement age, the rate of employment had been rising since 2010, especially for those of pre-retirement age. The employment activity rate thereby increased, which prevented a significant decrease in employment and a slowdown in economic growth. But even a gradual increase in the retirement age commenced in 2013 would not prevent a decrease in the number of working-age people in the years to come. This number would have decreased by more than one million by 2025. Due to the restoration of the previous retirement age, the decrease in the number of people of working age will deepen – by an additional 0.5 million people by 2025.

While almost all the countries in the EU have been successively raising the retirement age, the retirement age for women in Poland is the lowest in the EU. International institutions and rating agencies have taken a negative view of the government decision to reduce the retirement age.

This will worsen the balance of public finances – by approx. 0.8% of GDP in 2020 and by 1.4% of GDP in 2040. The cumulative cost of lowering the retirement age, taking the economic downturn due to lower employment and investment into account, is 3.6% of GDP over the next five years and over 10% of GDP by 2030.

The shortages in the labor market are also intensified by the “Family 500+” benefit program. In spite of the exceptionally favorable situation on the labor market, the participation of women aged 25–44 years declined in Poland. This most probably reflects the effects of these benefits on women’s inclination to remain on the labor market. If in mid-2017 the rates of labor market participation of women in this age group remained at the level observed in mid-2015, the number of working women would be higher by about 80,000. The risk of labor market exit is especially high among women with a low level of education, who are more likely to give up their job search than those who are better-educated.

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According to the report by Aleksander Łaszek and Rafał Trzeciakowski, “Public Finances: Harming Instead of Healing,” many actions of the current government will have a negative impact on public finances. The government priority in the area is to seal the tax system and improve tax collection, especially of the VAT. These measures, initiated by the previous government, are correct, but the methods used – increased penalties, bureaucracy, and tax inspection – undoubtedly hamper business. Before the end of the year, it is difficult to assess the extent to which the government actions (primarily by the Ministry of Finance) will increase tax revenues. But an entire series of other decisions – bigger social spending, lower retirement age, and a declaration of larger spending on national defense – will have a negative impact on public finances.

EU directives oblige Poland to reduce its structural deficit under 1% of GDP. This goal (Medium-Term Budgetary Objective, MTO) has not been achieved, and this government is postponing – as the previous one did – its implementation in the subsequent updates of the Convergence Plan.

The authors note that the continuing deficit of the public finance sector is deepening the problem of low savings of the public finance sector in Poland, and a high structural deficit is increasing Poland’s sensitivity of to shocks in the world economy, which lead to a slowdown in GDP growth.

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Professor Barbara Błaszczyk describes the process by which politicians take over control of the economy in her report “Changes in the Institutional Sys-

tem of the Polish Economy. Ousting Private Ownership and the Market by the State Under the Framework of the Good Change”. The author describes the process of gradual nationalization, accompanied by the slogan of “polonization” or “domestication” of enterprises belonging to foreign owners. “These are just arguments for the masses,” says Barbara Błaszczuk. The aim is to further enlarge those assets over which the state has control so that politicians can make investment decisions that ignore market conditions. In addition to overt nationalization, the government uses the methods described in the report as quasi-nationalization – for example, taking advantage of privileged and dispersed non-state shareholders. The government completely controls the executive bodies of many companies. Another tactic is to oust the private sector and the market through anti-libertarian regulations.

The policy of reversing privatization will have detrimental consequences. Opaque property structures, where politicians play a dominant role, have been arising and will continue to arise. The progressing nationalization discourages domestic and foreign entrepreneurs from creating new businesses and increasing investments. The strong expansion of the state sector and regulations restricting the free functioning of business may jeopardize the normal operation of the private sector in the economy and its development. This process, after reaching a critical level, can change the nature of the entire economic system and destroy its stability.

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The economic program of the government the so-called Responsible Development Strategy, announces the acceleration of economic growth by increasing the investment rate to 22-25% by 2020 and maintaining its level at 25% after 2030, as well as recapitalizing the industries arbitrarily classified by the government as innovative and creating high added value. After two years of PiS rule, this goal is still far away. The average annual GDP growth rate in the period from the fourth quarter of 2015 to the second quarter of 2017 was 3.5%, while the average rate in the years 2008–2015 (under the rule of the Civic Platform and the Polish Peasants Party) was only slightly lower: 3.2%. And these were the years of the global financial crisis and the recession that hit almost the whole of Europe. For the last two years, the main factor of GDP growth has been consumption. Household consumption in the first half of 2017 increased by more than 5% while investment outlays remained at the same level as a year earlier and are significantly lower than in the first half of 2015. This stimulus allowed GDP growth to accelerate this year, but without growth in capital and employment, it will not last. The main parameter, showing the degree of implementation of the assumed strategy – the investment rate – fell to the lowest level in 20 years.

The current government policy not only fails to meet the stated objectives – to accelerate long-term GDP growth and exports and increase wages, but create additional barriers instead. In addition, it is internally inconsistent, as it is aimed at increasing consumption at a faster pace than the growth

of the GDP, while at the same time the government declares its intention to increase the rate of investment and reduce the inflow of foreign capital to Poland. For obvious reasons raising the share of consumption and at the same time the share of investment in GDP is only possible if the economy will benefit more from foreign savings, which would make it more dependent on foreign capital. This, in turn, is contrary to the government's declared intention to base the development of the economy primarily on domestic capital.

The main, if not the only, idea of the government on how to raise investment rates and accelerate economic growth is to increase the investments of state-controlled entities.

In previous years, governments also took decisions about investments by subordinate companies, regardless of their profitability. But the process of political interference has grown in strength under the government of the United Right. In June 2017, PZU and the Polish Development Fund finalized the acquisition of a controlling stake in Pekao SA, which practically means the nationalization of the second largest commercial bank and subjecting it to political control. A symbolic signal of this change was the termination by Pekao SA of the long-term cooperation agreement with WOŚP (the Great Orchestra of Human Charity) – an institution disliked by the politicians currently in power. The government announces massive investments financed by state banks and funds without presenting profitability analyses. Projects include the Central Airport (a cost of PLN 20–30 billion), a canal across the Vistula Spit, a nuclear power plant, passenger ferries, and electric car factories. Even if most of these announcements will not be realized due to the lack of funds and technical capabilities, attempts to undertake them without presenting a credible analysis of profitability will lead to the waste of Poland's slim capital resources.

An important vehicle for the financing of politically determined investments is the Polish Development Fund, which is to be recapitalized by the state budget. Paweł Borys, the president of the Fund, said that the capital of the entire PFR group would exceed PLN 14 billion, which, according to him, would allow for assets in the amount of around PLN 100 billion to be created. The fund borrows on the market, issuing bonds to finance projects indicated by politicians. This is a return to the practices from the period of the Polish People's Republic. If the projects financed by the fund fail to reach a rate of return allowing its debt to be financed, the repayment will be financed by the state, threatening the uncontrolled growth of the public debt.

**POLAND'S
ECONOMIC GROWTH
IN THE GLOBAL
AND LONG-TERM
PERSPECTIVE:
UNTIL 2015, THE LAST TWO
YEARS, FORECASTS**

Stanisław Gomułka

STANISŁAW GOMUŁKA

Economist, lecturer of London School of Economics and Political Sciences 1970–2005, Member of Poland Academy of Sciences, in the years 1989–2002 advisor to ministers of finances of Poland. Polish negotiator with the Paris and London Clubs on the reduction of Polish foreign debt, member of the so-called Strategic Group of the Deputy Prime Minister Balcerowicz. Former deputy finance minister, consultant of OECD, IMF, European Commission on Eastern Europe, the Chief Economist of BCC.



SUMMARY

In the long run, the pace of economic development is determined by two main factors: the percentage change in the number of persons employed and the pace of quality changes, also called innovativeness. Innovativeness is measured by the rate of GDP growth per employee or per man-hour. Countries catching up with the world's leading technology often have a higher rate of innovation. They owe this not only to high expenditures on research and development but also to the absorption of the innovation pool that has accumulated in the leading countries over the decades. What is necessary to make such an absorption possible, are investments in fixed assets as well as the appropriate qualifications of employees, and the good quality of the institutions. All these factors depend on economic policy.

Contrary to often expressed but mistaken views, the innovativeness of the Polish economy has been high in the last 25 years. The investment rate was relatively low compared to other countries of our region, but sufficient to systematically reduce the percentage of the income gap with the most developed countries.

According to World Bank data, in 1989 the GDP per capita at purchasing power parity in Poland was 30.1% of the United States', and in 2016 rose to 48.4% of the US level. This big success in catching up is a direct result of the transformation done in part before 1989, but mostly in the years 1989-1993.

In recent decades, some countries have been developing and catching up with world leaders faster than Poland. Ireland owes this to a great influx of foreign direct investment, while Japan, South Korea, China, and India – primarily to a very high rate of domestic and national savings. The strategies of these countries are difficult to replicate, but they illustrate the importance of investment for growth in innovation and productivity of the economy.

In Poland between 1992 and 2016, the ratio of total savings and investments to GDP ranged between 15% and 25%. This allowed an average annual GDP growth rate (also GDP per capita) of 4.1% to be achieved. Relatively low levels of domestic savings (especially of households) were supplemented by external savings – foreign investment, and EU funds which finance around 10% of the domestic investment. After 2022, the inflow of these funds may fall significantly.

Some post-communist countries of Central and Eastern Europe have experienced periods of faster growth than Poland, but their long-term growth has declined as a result of the recession triggered by the global financial crisis. This especially applies to the Baltic States, as well as to Bulgaria and Romania. In these countries there was a very rapid increase in bank loans in the period 2004–2008, which ended in a banking crisis. In Poland, the growth rate of loans was much lower, and our country escaped the financial crisis, which became the main reason why it maintained positive GDP growth in 2008–2009.

An additional factor that made it possible to maintain growth during the global crisis was a significant fiscal loosening caused by the decisions of Jarosław Kaczyński's government in 2007 – to a total of nearly 3%, which was spread over the years 2008–2009. However, the positive effect of this stimulus was accompanied by a negative one: a significant increase in the public debt. By contrast, it is difficult to estimate the impact of the significant depreciation in the zloty, which supported exports but weakened imports and increased inflation.

Factors that have provided relatively high long-term growth in Poland's GDP are gradually disappearing. In particular, a major problem is the decline in the number of people in working age, low occupational activity, low savings and national investments. The government of the Unified Right, seeing the problem of falling GDP growth, wrongly defined its causes and presented an internally contradictory economic program.

According to the government's Strategy for Responsible Development, the Polish economy may be in the "middle-income trap" because it is not innovative and its growth has been based on a cheap labor force rather than on modern production. Meanwhile, data shows that the Polish economy is very innovative, while wages in relation to productivity and production costs do not differ from those in Western Europe. The current government erroneously considers foreign investment to be a factor detrimental to the development of the Polish economy. Although it boasts about successive contracts with foreign corporations, government propaganda attacks foreign capital, which gives conflicting signals to international investors.

The government, implementing its policy, greatly modified its electoral program – resigned from helping borrowers of mortgages denominated in Swiss francs and from raising the common tax-free amount. Thus an immediate collapse of public finance was avoided. Nevertheless, the pursued policy stifles long-term growth instead of supporting it. The declared goal is to increase the rate of investment, but the current government's actions are geared towards increasing consumption. It is not possible to simultaneously raise the rate of investment and the rate of consumption.

A number of government actions – such as the "Family 500+" program and lowering the retirement age – deepens the problem of labor shortage. The government does not present any ideas (e.g. on facilitating economic immigration from Ukraine and Belarus), which could mitigate problems arising from the shrinking labor force in Poland. The ongoing deficit of state finance, which in the period of rapid GDP growth should fall to zero, reduces domestic savings and hence the ability to finance investments.

In the next 3 to 5 years, with the current economic policy, we should expect a growth rate close to 3% per year, falling to about 2.5% later, and later to about 1.5%.

The pursued policy
stifles long-term growth
instead of supporting it.



The paper presents three scenarios for long-term economic development up to the 2030s and 2040s. In the main scenario, the GDP per capita growth rate will reach 2.5% by 2030, and 2% by 2030–2040. In the optimistic variant these rates are higher by half a percentage point, and in the pessimistic variant lower by half a percentage point. Each variant corresponds to a different version of the economic policy, which affects the number of employees and the share of investment in the national income. All three variants of the forecast are indicative. Under the optimistic scenario, the number of working persons does not decrease, which entails the need to raise the retirement age and accelerate the economic migration to Poland. There is also a need for policy that has a zero public finance deficit and stimulates household savings.

The policy of the PiS government is consistent with the pessimistic variant of economic development. Jarosław Kaczyński himself thought that for him a decrease, even by one percentage point, of the growth rate would be an acceptable price for “pushing through my vision of Poland.” This is the same difference as between Option I and Option II.

INVESTMENTS AND GROWTH OF THE POLISH ECONOMY. NOT ENOUGH PRIVATE INVESTMENT

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SUMMARY

The rate of investment has an impact on economic growth both in the short and the long term. In the short term, what counts is the size of investment expenditures, which are a component of domestic demand. The results: the amount of productive capital that has been produced and, as a consequence, the size of productivity increase are crucial, and much more important, in the long run.

In the short term, investments are among the most volatile components of domestic demand, and their fluctuations are an important source of booms leading to further economic downturns. Apart from the increase of state investments, a source of booms and downturns may also be a policy that stimulates investment in selected sectors (industrial policy) or of a certain type, most often housing investments. The scale of booms and downturns is often deepened by the policy of keeping interest rates too low, for example in Ireland, Spain and the Baltic states in recent years.

In the long run, the key role is played by the high efficiency of investment as it allows to significantly increase the stock of productive capital even when the rate of investment is moderate. The strong protection of property rights and limitations on the influence of politicians on economic decisions, i.e. a large range of economic freedom, enables the high efficiency of investment. Gwartney et al. (2006), analyzing the impact of private investment on growth in 85 countries between 1980 and 2000, estimate that the same increase in investment in countries with large economic freedoms has a 74% stronger impact on GDP growth than in countries of lesser economic freedom.

The effectiveness of investments depends on who is investing and what incentives are involved.

- Private investors, driven by their profits, are motivated to choose the most profitable investments and implement them as effectively as possible. Both the economic account and limited resources available to private investors also force them to close investments that proved to be unsuccessful in the course of their implementation.
- Politicians and officials who decide on state investment do not risk their own property and are guided by a political interest, not economic calculations. The lack of rigid budgetary constraints allows for the constant subsidizing of projects that have proved to be unsuccessful, however the conclusion of which could be politically costly as it would amount to an admission of error.

In the case of state investments (both by the public sector and by state-owned enterprises), the influence is direct – politicians and officials decide on investments. In the case of the private sector, economic policy can create conditions conducive to the development of businesses (a broad range of economic freedoms) or try to stimulate investment in specific sectors

through a system of subsidies and preferences (so-called industrial policy). International experience shows that the development of businesses is helped by a large range of economic freedom, stable and clear regulations, including taxation law, as well as the efficient and independent judiciary. State investment plans (industrial policy), despite some success, suffered a definite setback throughout the world in the second half of the 20th century (Bukowski et al., 2017). In Latin America attempts to speed up the development by domestic investments aimed at replacing imports hampered productivity growth. French champions and large projects did not accelerate their development as compared with Germany, that did not pursue the same policy. Similarly, in South Korea the coordination of investments by the state proved to be no better than its lack in Taiwan, but it increased sensitivity of the Korean economy during the Asian crisis in the second half of the 1990s. To this day it reflects in the low productivity of small and medium-sized enterprises.

The investment rate in Poland is low compared to the other countries of the region, which is mainly due to the low investment rate of enterprises: in the years 2000–2015 the investments of enterprises in Poland were lower by 5 percentage points of GDP than the regional average (11.2% of GDP vs. 16.2% of GDP). Low business investments are directly related to the small size of the enterprise sector in Poland. Although the business sector in Poland has been growing steadily, it remains small compared to the countries of the region. In 2014, only 35% of the working population was employed in enterprises employing 10 or more people (and respectively 5% in state-owned enterprises) which was the lowest rate in the region. In Poland, compared to the countries of our region, more people work outside the enterprise sector: in agriculture, the grey sector and atypical forms of employment.

The business sector in Poland is very diverse, both in terms of investment size and efficiency. This is clearly visible in the data for 2015:

- The largest share of employment belongs to micro-enterprises, formally classified as the household sector (3.7 million people). These companies invest very little (on average PLN 8 thousand a year per worker) and although they use their small capital efficiently, they have very low labor productivity (usually PLN 72 thousand per worker).
- The second largest group is constituted by national private companies, employing 10 people and more, which employ 2.4 million people altogether. Their investments are also low (on average PLN 23 thousand per employee), but thanks to high efficiency they are able to achieve high productivity (average PLN 113 thousand per employee).
- Foreign companies, with a workforce of 1.6 million, are characterized by high capital expenditure (on average PLN 33 thousand per employee) and high labor productivity (on average PLN 153 thousand per em-

The investment rate in Poland is low compared to the other countries of the region, which is mainly due to the low investment rate of enterprises



ployee). Their characteristic feature is a strong integration within the global supply chains, therefore they provide 2/3 of Polish exports, although their share in employment is only 1/3 (excluding micro-enterprises). Positive influence of foreign companies is not limited to high productivity – their cooperation with domestic entities and the rotation of employees speed up the transfer of technology to the Polish economy. “Polityka Insight” (2016) estimates that the Polish economy has grown by an additional 15.6% over the last 25 years due to foreign investment.

- State-owned companies, meaning those owned in over 30% by the state or local authorities, still employ over 0.7 million people. Their investments are three times higher than those of domestic private companies and two times higher than foreign capital companies’: on average PLN 67 thousand per employee. But that does not translate into a proportionally higher labor productivity (on average PLN 161 thousand per employee). Moreover, their total factor productivity is only 0.6 of that what domestic and foreign private companies achieve. A part of the difference is explained by the sectors in which state-owned companies are concentrated (e.g. capital-intensive energy sectors). However, international comparisons and in-depth studies taking sectoral differences into account also point to a low efficiency of state-owned companies.



The ability to maintain the current rate of economic growth at a low investment rate is waning.

After 1989, the faster and deeper liberalization than in other countries in the region, enabled Poland to rapidly increase productivity, resulting in the fastest GDP growth in the region despite a low investment rate. This increase was due to the elimination of inefficiencies inherited from socialism and the transfer of workers from agriculture to more productive sectors. Between 1995 and 2015, when comparable data is available, over two-thirds of the increase was due to transformations in the corporate sector employing ten or more people – inefficient state-owned enterprises being replaced by more efficient private companies, both domestic and foreign.

The ability to maintain the current rate of economic growth at a low investment rate is waning. While there is still some room for growth due to the still high employment in agriculture and state-owned enterprises, it is much lower than 25 years ago, and the declining number of people at working age further lowers the potential of the Polish economy. These problems are deepened by the policy of the current government, which hampers further structural change, deepens the negative impact of demography on the labor market and negatively affects private investment. Up to now, the development of private companies and their investments have been inhibited by many barriers that have limited the efficiency of capital and labor in the Polish economy.

- Subsidies, both in the form of subventions and tax incentives, slow down the transfer of workers from the least developed sectors to those that de-

velop. One extreme example is over PLN 40 billion per year of subsidies (more than two thirds of that are national funds) to agriculture where productivity is seven times lower than in the enterprise sector. Taxpayers' money is also spent on retaining workers in unprofitable coal and lignite mining, which received PLN 136 billion in subsidies and subventions between 1990 and 2012 (Bukowski and Śniegocki, 2014). The policy of subsidizing selected sectors means a higher tax burden on the rest of the economy.

- Wide state ownership and numerous regulations restrict competition, hampering growth of the most efficient companies. In 2013 the OECD assessed that the scope of state ownership in Poland is the largest in the EU, and the restriction on competition in services is the fourth most rigorous. According to estimates by Bouis and Duval (2011), in the perspective of 10 years, this has reduced Polish GDP by as much as 15%.
- Unpredictable changes in the law, especially on taxation, force companies to be more cautious, which also inhibits their investment and growth. According to estimates of Grant Thornton, Poland has the most variable law in the European Union. In 2012–2014 the Polish state produced almost 56 times more regulations than Sweden and 11 times more than Lithuania. As a result, in the years 2009–2011, for over 20% of entrepreneurs in Poland, the biggest barriers to running a business were the tax regulations, while in other countries of our region less than 10% of companies pointed to this factor.
- If these barriers are overcome, the next limiting factor for investment will be a low rate of domestic savings which hinders its financing. Domestic savings are low due to low household savings and chronic public finance deficit (more about it in the FOR 2017 report). Scarce savings are supplemented by substantial transfers from the EU, but they will be reduced and will gradually disappear after 2022.

The problem of low investment level in private enterprises has deepened since 2015. Despite stable economic growth, Poland is in the disgraceful group of five EU countries where in the second quarter of 2017 investment in enterprises and households was lower than two years ago. In total, we estimate that in 2017 the gap in private and household business investment generated by unpredictable government policy will amount to between PLN 30 and 40 billion.

The policy of the current government negatively affects the investment of private companies through many channels. While some activities may have a positive impact (the fight against gray zone and VAT fraud), negative effects prevail, including the following:

- A further decline in the quality of legislation and the increase in regulatory uncertainty. The Parliament of the VIII term beats all records in the number of adopted laws – according to estimates of Grand Thornton, in 2017 more than 35 thousand pages of new legislation will come into

force, compared with less than 26 thousand pages in 2014. At the same time, due to a circumvention of existing regulations (the government misusing the parliamentary legislative initiative), new laws are passed at record rates and without public consultation. Entrepreneurs are withholding their investment not knowing what rules will be in force in a few months.

- The corruption of law is accompanied by an attack on the independence of the judiciary. Both the subordination of the Constitutional Tribunal to the ruling party and the attacks on the common courts weaken the conviction of entrepreneurs that they can count on the independence of the courts in disputes with the state.
- Investments of private companies are hindered as these companies are being ousted by state-owned enterprises, as exemplified by the strengthened monopoly of the Polish Post or resignation from cooperation with private suppliers by the Ministry of Defense.
- Government policy supports not only state-owned companies but also inefficient micro-enterprises (for example, banning the creation of pharmacy networks), which undermines the potential for growth and increased investment of the most productive companies.
- The government is also blocking structural changes by its policy of subsidizing agriculture and mining, hindering the transfer of workers to more productive sectors. In agriculture this policy is even more exacerbated by the ban on land trade, which de facto attaches farmers to their land, preventing them from selling it and thereby reducing the value of their property.
- The increase in the share of state ownership in the banking sector and the marginalization of the stock market undermines the role of private financing which, combined with the government's pressure on the growth of policy-driven financing, hinders the effectiveness of investments. After the nationalization of Bank Pekao S.A., the share of state-owned banks in the sector's assets rose to almost 40%, which is the highest level in the region with the exception of Slovenia, where the politicization of banks led to a costly financial crisis. The lack of respect for the rights of minority shareholders by the State Treasury and the uncertain future of OFEs (Open Pension Funds) reduce the attractiveness of the stock exchange as a place of investment and source of capital for companies.
- A record increase of social spending by 1.2 percentage points of GDP between 2015 and 2017, related to the implementation of the "500+ Family" program, and by another 0.4 percentage points in 2018 (the effect of lowering the retirement age, which will mount up in subsequent years), exert pressure towards an increase either of taxes or debt of the state, which hampers the financing of private investments.
- The pressure on tax increases led to dangerous precedents of sectoral

taxes (the bank tax, the discussed but not implemented tax on trade). Moving away from general taxation rules to sectoral tax surcharges means that investors in every sector are at risk of being subject to some sectoral tax in the future.

The fall of private investment in 2016 was accompanied by a decline in public investment, but this was largely due to the end of the EU perspective (similar reductions occurred in other cohesion countries). On the other hand, government actions have had a direct impact on the decrease of investments in state-owned companies, more than PLN 5 billion lower in the first half of 2017 than two years ago.

25 October 2017

Government actions have had a direct impact on the decrease of investment in state-owned companies.



THE LABOR MARKET. IMPACT OF ACTIONS AFTER THE ELECTIONS OF 2015: ACCELERATED DECLINE IN THE WORKFORCE

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SUMMARY

A significant impact on the increase in the employment rate in Poland observed in recent years, including the period after the parliamentary elections of 2015, was exerted by two reforms extending occupational activity, which entered into force under the PO-PSL (Civic Platform and Polish Peasants' Party) coalition government: a significant reduction of options for early retirement since 2009 and the start of the gradual extension of the retirement age for women and men to 67 years as of 2013.

The immediate effect of limiting the availability of early retirement was a sharp increase in employment rates for people in pre-retirement age. The data from BAEL (Labor Force Survey) show that in the years 2010-2016 the employment rate for women aged 50-59 increased by more than 13 percentage points, and the rate of employment of men aged 55-64 by more than 10 percentage points. Although the employment rate in Poland is still lower than in the EU, the gap between Poland and the EU has decreased markedly.

Due to demography, the number of working age people in Poland has been decreasing since 2012. Without an increase in occupational activity, we would have seen a sharp decrease in the number of working people instead of its growth. As a result, slower economic growth, slower income growth and greater tensions in public finances would be inevitable. Since 2010, the number of working men and women in the 10 years prior to the current retirement age (i.e. 50-59 years for women and 55 to 64 years for men) has risen in Poland by 570,000. If employment rates in these oldest age groups remained at the level recorded in 2010, the number of employed in the economy would have fallen by 250,000.

In recent years, as a result of the gradual increase in the retirement age, there has also been an increase in the number of people working above the "old" retirement age (i.e. 60 for women and 65 for men). Compared to 2012, the number of people working in this age group increased by 200,000, while the number of people aged 20 and over increased by 890,000. This means that over one fifth of the total increase in the number of people employed in 2013-2017 can be attributed to the increase in the retirement age.

The Polish society is aging very rapidly and even a gradual increase in the retirement age started in 2013 would not prevent a decline in the working age population. This figure would have decreased by more than 1 million by 2025. As a result of the restoration of the old-age retirement age, the scale of decline in the workforce will be significantly steeper. For example, by 2025, this figure will shrink by more than 1.5 million, that is by 0.5 million more.

In the coming decades, the increase in the number of people aged 65 and over in Poland will be one of the highest among all EU countries. In light of numerous international experiences and empirical research, the low retirement age will reduce occupational activity in Poland. Although almost

all countries in the EU have successively raised the retirement age, the retirement age for women in Poland will be the lowest in the EU. International organizations, the International Monetary Fund, the OECD and the European Commission, as well as credit rating agencies, uniformly estimate that lowering the retirement age will contribute to deepening the inevitable reduction of the workforce, and as a result, to slowing down the growth of the Polish economy and increasing the tensions in public finances.

The lower retirement age means not only that there will be fewer workers, but also more pensioners and larger spending in the public sector. These changes will take place very quickly. By 2025, the number of people in the retirement age will be more than 500,000 greater than if extending retirement age were continued.

The analysis shows that as a result of the lower retirement age, already in 2020 the balance of public finances will decrease – mainly due to deterioration of the pension balance of the Social Insurance Fund – by approx. 0.8% of GDP (i.e. ca. PLN 16 billion in 2017 prices), and in 2040 by ca. 1.4% of GDP (i.e. about PLN 28 billion). In the first years after the retirement age is lowered, the deterioration of the balance of the Polish Social Security Fund will be relatively small due to the temporary inflow of funds from the OFE (Open Pension Funds) within the so-called slider mechanism, i.e. successive transfers of money from the OFE to the Social Insurance Fund in the period of 10 years before the worker reaches retirement age.

Lowering the retirement age will also result in a significant increase in the number of people whose pension from the Social Insurance Fund account will not be high enough to cover even the minimum pension. This means that lowering the retirement age will increase public spending on subsidies to the lowest benefits. It is estimated that this additional burden will be from 0.1% of GDP in 2030 to 0.4% of GDP in 2050.

The cumulative cost of lowering the retirement age, only in the next 5 years, is 3.6% of GDP and by 2030 it will reach over 10% of GDP. This estimate does not take the additional fiscal costs resulting from the higher yields on government bonds into account, which are likely to be required by investors due to growing public debt and poorer growth prospects.

It can be expected that lowering the retirement age will not only deepen the decline in the workforce, but will also hinder the investment dynamics. Lowering the retirement age occurs at a moment when more and more entrepreneurs are signaling problems in employment due to the lack of candidates. Given the growing human resources problems and the resulting increased wage pressure, entrepreneurs will limit the scale of their investments, which inevitably will also reduce the rate of productivity growth. A cautious estimate, which does not include the negative impact of increased public debt on the level of bond yields, i.e. the cost of raising capital, shows that the



The lower retirement age means not only that there will be fewer workers, but also more pensioners and larger spending in the public sector.

lower retirement age significantly slows down the development of the Polish economy. It can be estimated that as a result of lowering the retirement age, the GDP in 2025 will be lower by about 4% and in 2050 by about 11% as compared to the extension of the retirement age to 67 years.

Human resources problems in the labor market are also intensified by the “Family 500+” benefit program. Despite the exceptionally favorable situation on the labor market in the years 2016–2017, there was a decrease in the occupational activity of women aged 25–44 years. This decline likely reflects the impact of the benefits on women’s willingness to remain in the labor market. If, in mid-2017, the rates of occupational activity of women



Despite the exceptionally favorable situation on the labor market in the years 2016–2017, there was a decrease in the occupational activity of women.

in this age group remained at the level observed in mid-2015, the number of working women would be about 80,000 higher. The risk of exiting from the labor market is particularly relevant for women with a low level of education, who are more likely to give up their job search than those that are better-educated.

The experience of developed European countries shows that increasing fertility not only does not contradict an increase in women’s occupational activity but on the contrary, countries that have promoted the linking of labor market activity with parental responsibility have been the most successful in raising fertility rates. From this perspective, the “Family 500+” child benefit program introduced in Poland, inhibiting occupational activity, may also reduce fertility. This means that the effects of the program contradict its premises.

PUBLIC FINANCES: HARMING INSTEAD OF HEALING

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SUMMARY

In 2015 the government of the Unified Right inherited public finances in a bad but improving state.

The structural deficit of 2.6% of GDP was dangerously high and was among the highest in the EU, but was systematically declining.

The VAT gap was one of the largest in the EU, but the Standard Audit File adopted by the Parliament created a tool to limit it.

The government of the Unified Right has significantly increased public spending over the past two years by introducing the “Family 500+” program and lowering the retirement age. Most public spending grows at a rate close to GDP, which for the past two years has increased by over PLN 50 billion. The PiS government increased its expenditures additionally, primarily through:

- The “Family 500+” program, which despite a very heavy burden on the state budget (PLN 24 billion per year), will, in light of the experience of other countries, contribute only insignificantly to the stated goal of increasing fertility.
- Lowering the retirement age, which for women is the lowest in Europe, not only exacerbates the state of public finances (by PLN 8 billion only in 2018, growing in subsequent years), but also decreases the number of potential employees in the Polish economy, deepening the impact of demography on the labor market.

The rise in public spending is only partially offset by a sustained increase in state revenue.

The bank tax increases the state’s revenues by PLN 4 billion, but hinders the development of the banking sector, adversely affecting Poland’s economic growth.

Of the PLN 30 billion of VAT revenue increase between 2015 and 2017, approximately PLN 10 billion is due to pure economic growth. Of the remaining amount, only PLN 5- billion can safely be considered as durable. Between PLN 5 billion and 7 billion are one-off revenues, and the sustainability of the remaining part of the increase in VAT receipts will only be verified by the next economic downturn.

Of the PLN 43 billion increase in revenues from income taxes, ZUS (Social Insurance Institution) and contributions to the NFZ (National Health Fund), over half (PLN 25 billion) results from GDP growth. The remaining part is the effect of the freezing of PIT rates, which constitutes an effective tax increase (PLN 2 billion), and higher tax collection rates, whose durability will be verified by an economic slowdown (PLN 15 billion).

At the same time, the increasing repressiveness of the tax administration

and the unpredictability of the law (the departure from general taxation rules by the introduction of arbitrarily set sectoral taxes) have increased uncertainty for businesses, resulting in a decline in private investment.

The overall effect of PiS' actions in the period 2015–2017 is, according to IMF estimates of October 2017, the largest increase of all EU countries in the public debt in relation to GDP: by 3.1 percentage points and an increase of structural deficits inherited from previous governments from 2.6% of GDP to 3% of GDP. The good situation of the world economy, which many EU countries use to strengthen their public finances, in Poland only masks the bad state of the public finances.

The estimation that the structural deficit will increase from 2.6% of GDP in 2015 to over 3% of GDP in 2017 is a prudent one. Estimates of the structural deficit depend on assumptions about the potential rate of economic growth, and this is limited by successive government actions, such as lowering the retirement age, replacing the private sector by the state or restricting competition within sectors of the economy.

The deepening structural deficit has two negative consequences:

- It reduces the rate of domestic savings, which hampers the financing of enterprises' pro-growth investment. This deepens the problem of the declining rate of growth of the potential GDP.
- It increases the sensitivity of Poland to external shocks, meaning that one – two years of strong economic downturn will increase Poland's public debt dangerously close to the constitutional threshold of 60% of GDP, making the government choose between reducing spending and raising taxes or breaking the Constitution.

CHANGES IN THE INSTITUTIONAL SYSTEM OF THE POLISH ECONOMY.

**OUSTING PRIVATE
PROPERTY AND THE
MARKET BY THE STATE
UNDER THE FRAMEWORK
OF THE “GOOD CHANGE”**

Barbara Błaszczuk

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SUMMARY¹

In recent years in Poland, we can observe a process of reversing privatization and abandoning the private market economy, which in essence constitutes the destruction of the achievements of over 25 years of our systemic transformation. This article describes measures to reduce the share of the private sector in the economy, and to support the growth of the state domain – either by expanding the area and intensity of direct state ownership supervision, or by increasing state control over the functioning of non-state entities through special regulations and other instruments of economic policy as well as restrictions on market competition.

One way to increase the state sector is nationalization directly reducing the share of the private sector in the economy. Although thankfully the Polish state does not resort to forced expropriation, it is very willing to take advantage of the possibility of purchasing companies from corporations withdrawing from the Polish market. These purchases are motivated by a purposeful policy of the government to expand their ownership, primarily in the energy, banking and infrastructure sectors, but also in others. This is accompanied by the slogans of the “polonization” or “domestication” of enterprises owned by foreign owners. The analysis shows that this “economic patriotism” is only a disguise for the masses. The real intention of the state is the further concentration of ownership in order to gradually become independent from the market, make the economy depend on the government’s decision and use its resources for political and economic purposes.



The state, using its privileged shares that provide voting rights and special powers to appoint members of management and supervisory boards, acts to the detriment of minority shareholders.

Another way is to increase state intervention in companies that are only partly owned by the Treasury, which I call quasi-nationalization. The state, using its privileged shares that provide voting rights and special powers to appoint members of management and supervisory boards, acts to the detriment of minority shareholders. The same is true when it uses companies

in which it has a majority stake to subsidize inefficient state mining, thus delaying the necessary restructuring; or when it supports pro-government private media by buying economically unjustified advertising. All this leads to the replacement of good morals and corporate governance with something that can be described as a “pattern of corporate disorder.” The price to be paid for it is the loss of investor confidence in Polish shares, especially in shares of companies with Treasury ownership.

Yet another method is to oust the private sector and the market through anti-libertarian regulations. There are several types of regulatory actions in this category, which fundamentally hamper private sector activity in the economy, drastically change its rules and, in some cases, physically liquidate

¹ I would like to express my gratitude to Marcin Zieliński for his help in research and editorial work.

a part of the sector. The first type is the introduction of regulations that significantly impede the normal operation of private companies, burden them with additional costs and lower their cost-effectiveness. The second type of regulations restrict access to the market for certain entities or exclude non-state actors from the market. The third type consists of such drastic changes in the regulatory framework of certain segments of the market, or even whole sectors, that fundamentally undermine their economic sense, disrupt the current business environment and ruin their long-term investment plans. Such actions may lead to the so-called regulatory expropriation: companies voluntarily withdraw from a market due to unprofitable operating conditions.

The current policy of reversing privatization can prove to be very harmful for several reasons. Firstly, since the beginning, its implementation aggravates the conditions for doing business in mixed-ownership companies with state involvement (and their market environment) by introducing fuzzy, non-transparent ownership structures and often imposing non-business objectives on companies, which undermines their integrity and leads to a deterioration of corporate governance and an ensuing decrease in efficiency. Secondly, actions on nationalization may discourage investors (foreign and domestic) from creating new businesses, and induce those already in our country to leave. This can lead to a reduction of Poland's credibility, as it undermines trust in stable and legally protected private property rights. Thirdly, strong state sector expansion and restrictions on the free functioning of business may jeopardize the normal operation of the private sector of the economy and its development. As a result of the combination of all these processes, the effects of reversing privatization, when they reach a critical level, can change the nature of the entire economic system and destroy its stability.

FOR, the Civil Development Forum Foundation, was founded in 2007 by Prof. Leszek Balcerowicz to protect freedom and promote truth and common sense in public debate.

Our aim is to increase the economic awareness of Poles, their active support for economic freedom and the level of the rule of law in Poland.

We realize our goals through analytical activities (publication of reports and analyzes), education (economic education based on FOR projects) and communication (organization of information campaigns). At the initiative of FOR, a public debt meter was launched, drawing attention to the ever-growing debt of the state.

We actively cooperate with non-governmental organizations in Poland and abroad. In our work we adhere to the principles of openness, nonpartizanship, and integrity.

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