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## Article

# Fiscal Policy in Poland in the Times of Crisis - Origins and Consequences

Comparative Economic Research. Central and Eastern Europe

## Provided in Cooperation with:

Institute of Economics, University of Łódź

*Suggested Citation:* Krajewski, Stefan; Krajewska, Anna (2011) : Fiscal Policy in Poland in the Times of Crisis - Origins and Consequences, Comparative Economic Research. Central and Eastern Europe, ISSN 2082-6737, Łódź University Press, Łódź, Vol. 14, Iss. 2, pp. 79-100, <https://doi.org/10.2478/v10103-011-0012-4>

This Version is available at:

<https://hdl.handle.net/10419/259074>

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## **Fiscal Policy in Poland in the Times of Crisis - Origins and Consequences**

### **Abstract**

*The present crisis has forced almost all countries to introduce an active economic policy. A lot of attention has been paid to fiscal policy and taxes in Poland. The measures taken in Poland differ considerably from global standards and decisions concerning taxes have been generally political in nature. The paper presents solutions in fiscal policy applied in Poland and explains the specificity of Poland's economy and its anti-crisis policy.*

### **1. Introduction**

The theory of economics presents definitely diversified views on the origins of crises. There are two radically different opinions. According to the first, crises occur because governments excessively restrict market mechanisms. The economy can achieve the state of equilibrium only through the decreased state intervention and free market mechanisms. These views, dating back to classic economics have been reflected in many later trends (Neo-classics, Monetarists). The impact of such approach on the economic policy in the times of current crisis has been severely limited in many countries.

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According to another approach crises are a consequence of the weakness of market mechanisms and overcoming them requires increased state interference. This reasoning stems from the concept of John Maynard Keynes, whose views were rejected in the mid-1970s in the aftermath of the 1973 – 1975 crisis and supplanted by Neo-classic theory. Today, however, we are observing the renaissance of these trends which, in many countries, begin to form the basis for economic policies.

Most countries seem to focus on activities aimed at preventing economy against too rapid economic fluctuations and reacting promptly at the sight of first symptoms of crisis. Previously, they focused on removing negative effects of the downturn. The current crisis shows that it is not always successful. However, one should generally appreciate the pace of legislative change, its large scope, and the involvement of large financial resources. This is evident in the U.S. and the European Union countries. Against this background Poland presents an entirely different attitude, where the legislative procedure takes a very long time, the scope of change is modest, and the resources insignificant.

## **2. The Anti-crisis Policy in the USA and European Union**

The countries of the Western Europe apply anti-crisis policy of short-term demand fiscal and monetary policies and long-term policy, which is defined as a developmental intervention. Short term actions relatively quickly affect economy (e.g. within few months) and focus on demand aspects (they tend to increase demand). A wide range of instruments is involved, (tax system, government expenditure) within fiscal policy and (regulation of interest and exchange rates) within monetary policy. There is a widespread belief that active fiscal policy may be more effective in reviving economy and monetary policy in preventing it overheating. There are many doubts raised in the theory of economy whether such short term demand policy is effective. Mistakes can be made causing such negative effects which undermine legitimacy of actions taken. Despite these reservations and uncertainties, fiscal and monetary instruments are used on a wide scale (the latter to a smaller degree) during the present crisis in the USA and countries of Western Europe. Poland is an exception in this respect – actions are taken on a small scale here. There are fears that they might lead to undesired results. This paper will present evaluation of such different approaches.

The present crisis is often compared to the biggest downturns of 1929 – 1933 and of 1973 – 1975 and this justified due to the scale of difficulty and geographical coverage. No other crisis did have an adverse effect on so many

countries at almost the same time. One should note that these two great downturns revealed so many problems, difficult to explain and overcome, that in consequence economic theories of the past have been replaced with new doctrines. The prompt dissemination of John M. Keynes' theory after 1929 – 1933 and Milton Friedman's after 1973 – 1975 is a symbol of radical changes. Therefore it seems justified to expect distinctive change of economic doctrine setting out the shape of global economic policy. Monitoring present actions one may expect that the new doctrine will refer to J.M. Keynes' views and will introduce more state regulation of economy and perhaps also increase the role of the state as an owner. Such prospects are rejected or rather reluctantly adopted in Poland. However, it seems impossible that Polish politicians and liberal economists manage to convince most economists to their ideas.

Apart from demand and short-term fiscal and monetary measures, the second element of anti-crisis policy is considered, the so-called development interventionism, which affects supply aspects of economy in the long-term. This involves state intervention in:

- Development of technical infrastructure (e.g. highways, airports, high-speed trains, telecommunications),
- Development of social infrastructure (such as education and high quality health services),
- Support of national technical ideas (science, research and development programs),
- Stabilisation of money supply.

It is popular belief that development intervention is the right way to increase the resilience of the economy to downturn. In this respect, Poland has successfully achieved only the stable money supply but still faces:

- embarrassing indolence in the construction of highways (a maximum of several dozens of kilometres per year),
- underdeveloped air transport (all Polish airports combined handle less passengers than a fairly large airport in Western Europe),
- a complete lack of high-speed railway lines,
- low level of health care and higher education (the best Polish universities rank low on the global list of best universities),
- low level of expenditure on education (about 0.57% of GDP, where most countries spend 2 - 3%).

But also issues related to the effectiveness of development intervention the present crisis raises many questions and doubts. It is not self-evident that countries with a good level of infrastructure are undergoing the crisis smoothly.

Since the beginning of the current crisis most countries of major importance for the global economy carry out active and expansionary fiscal policy aimed at stimulating investment and consumer demand. Since the beginning of the current crisis most countries of major importance for the global economy carry out active and expansionary fiscal policy aimed at stimulating investment and consumer demand. Hundreds of billions or even trillions of dollars and euros flow into economies. This leads to a sharp increase in the budget deficit, accounting for example, from a few to several per cent of GDP in one year in the U.S., UK and Ireland. Consumer demand is stimulated by lowering taxes (directly or indirectly), but mostly for low-income people (because of their high propensity to consume). ). In order to speed up flow of money and shopping, President George W. Bush gave the poorest citizens vouchers worth U.S. \$ 180 billion. This solution was continued by President Barack Obama and some European countries. For example, José Luis Zapatero, Spanish Prime Minister along with additional money asked the public to spend the money as soon as possible, and if they had no idea what to buy, advised them to spend it for parties in expensive restaurants. New programs in infrastructure arise, financed with public funds. In the U.S., President Obama is preparing very expensive reforms in health care and education, constructing and expanding highways and the Internet, supports environmental investments, including those directed towards reducing the greenhouse effect. Similar steps (although often on a smaller scale), are taken by the European Union and other countries (Switzerland, Norway). Sometimes Poland may benefit from these additional funds, provided it is capable of spending these funds during the crisis (hundreds of millions of euros for construction of facilities reducing CO<sub>2</sub> emissions in Belchatow and the construction of the port for deliveries of liquefied gas in Swinoujscie). The money must be spent by the end of 2010. Some banks and other financial institutions receive huge subsidies and, eventually, also companies from the real sphere (spectacular decisions concerning General Motors). In practice, this is a return to the nationalization of important economic entities in the financial and real spheres.

But here arises a dilemma. How should the state react towards entities over which it takes control (these are usually very large entities, of key importance for the economy). Should the state:

- be a passive investor, but then lose its ability to influence the remedial programs and select executives, which can lead to waste of public resources and public disapproval (potential voters) or
- be an active investor, who affects the composition of supervisory and management boards, and recovery plans and determines salaries of managers (usually the upper limit). Public opinion is generally more willing to accept

this latter approach. It means limiting the role of market mechanisms in favour of administrative action. However, this poses a threat of decreasing effectiveness in the long term.

The tax system is considered as an important source of financing active fiscal policy. Some countries (USA, UK) have already increased the tax burden. Increased taxes will also play an important role in programs restoring budgetary balance in the future. Leading U.S. economists, including Nobel Prize winners Joseph Stiglitz, Edmund S. Phelps, and Paul Krugman encourage using such measures.

Jeffrey Sachs, a well-known in Poland American economist (in the early 1990's a principal adviser to the Polish government on international economic issues and who had a major impact on the views of Poland's Minister of Finance, Leszek Balcerowicz and his program) has undergone an interesting and surprising change of his views. Currently, Jeffrey Sachs, while assessing the economic policy in the U.S, states: "Ronald Reagan poorly diagnosed stagflation and took course for future disaster. Together with his colleagues he wrongly concluded that the problem lay in government regulation and in high taxes and allowances ... by cutting taxes, Reagan made it impossible for us, for a whole generation, to invest in basic infrastructure. Financial deregulation on a large scale, initiated in his time, led to the current disaster ... In the 1990s share of tax revenues in GDP was still low, and Washington continued to deconstruct social security system and rapidly deregulated financial market"(Sachs, „Gazeta Wyborcza”, 2008). The government of George W. Bush has been similarly assessed, mainly due to tax cuts. J. Sachs believes that America must overcome an aversion to taxes and says: "... our problems require a reliable fiscal program, which would provide for an increased share of tax revenues in GDP in the next decade ... Money must be found for urgent investments at home and overseas. The increased tax base may be the only source...."

### **3. The GDP and Public Finance in UE between 2007 and 2009)**

Data on the GDP growth in EU countries indicate that the crisis was demonstrated to the greatest extent in the Baltic countries. These countries were regarded as leaders of transformation. In the years 2006 - 2007 these countries recorded a GDP growth rate of 10% and higher. The collapse of the economy became strongly apparent in those countries already in 2008 (a decrease of GDP by 4-5%), and in 2009 a negative growth rate reached 18% in Latvia and 14% in Estonia and Lithuania). Also previously stable countries: Denmark, Germany, Austria, and Sweden in 2009 recorded a 5% drop in GDP, and Finland up to 8%.

Poland was the only EU-27 country which recorded a positive growth rate of 1.7% of GDP and appeared as a "green island" against other EU countries in the deep crisis.

EU countries (except Ireland and United Kingdom) were characterised by a high proportion of public expenditure in GDP. Between 1998 and 2007 these countries launched various disciplinary measures to reduce public spending. The data in Table 2 indicate that these actions have produced a clear effect in 11 of the 15 countries of the "old EU". Public expenditure did not decrease during this period only in Ireland, Greece, Portugal, and United Kingdom.

**Table 1. Real GDP growth rate (2006-2009)**

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>Belgium</b>	2.7	2.9	1.0	-2.8
<b>Bulgaria</b>	6.5	6.4	6.2	-4.9
<b>Czech Republic</b>	6.8	6.1	2.5	-4.1
<b>Denmark</b>	3.4	1.6	-1.1	-5.2
<b>Germany</b>	3.4	2.7	1.0	-4.7
<b>Estonia</b>	10.6	6.9	-5.1	-13.9
<b>Ireland</b>	5.3	5.6	-3.5	-7.6
<b>Greece</b>	5.2	4.3	1.0	-2.0
<b>Spain</b>	4.0	3.6	0.9	-3.7
<b>France</b>	2.2	2.4	0.2	-2.6
<b>Italy</b>	2.0	1.5	-1.3	-5.0
<b>Cyprus</b>	4.1	5.1	3.6	-1.7
<b>Latvia</b>	12.2	10.0	-4.2	-18.0
<b>Lithuania</b>	7.8	9.8	2.9	-14.7
<b>Luxembourg</b>	5.0	6.6	1.4	-3.7
<b>Hungary</b>	3.5	0.8	0.8	-6.7
<b>Malta</b>	3.3	3.9	2.7	-1.9
<b>Netherlands</b>	3.4	3.9	1.9	-3.9
<b>Austria</b>	3.6	3.7	2.2	-3.9
<b>Poland</b>	6.2	6.8	5.1	1.7
<b>Portugal</b>	1.4	2.4	0.0	-2.5
<b>Romania</b>	7.9	6.3	7.3	-7.1
<b>Slovenia</b>	5.9	6.9	3.7	-8.1
<b>Slovakia</b>	8.5	10.5	5.8	-4.8
<b>Finland</b>	4.4	5.3	0.9	-8.2
<b>Sweden</b>	4.3	3.3	-0.6	-5.3
<b>United Kingdom</b>	2.8	2.7	-0.1	-4.9
<b>UE-27</b>	3.2	3.0	0.5	-4.2

Source: Eurostat, Date of extraction Feb.14, 2011, <http://epp.eurostat.ec.europa.eu/>

EU struggles with disciplining public finances show that these expenditures are characterised by a high degree of inertia. The reduction of the absolute size of public spending as well as inhibiting their growth rate and the share in GDP, was in practice accomplished with great difficulty, gradually and produced modest results (Krajewska 2008a, pp.71-78). For this reason, public finance theorists often emphasise the relevance of the Wagner law, formulated yet in the late nineteenth century, on the steady growth of public expenditure. This stems largely from the fact that the level of public expenditure is determined by many factors that are not only economic but also historical, political and sociological. However, as soon as the first signs of the crisis appeared we saw the increased activity in EU countries in terms of counter-cyclical policies. All EU countries see an increase in budgetary expenditure, although the pace of change is clearly differentiated. Public expenditure between 2007 and 2009 in the countries of the "Old EU" (EU 15) increased steadily by 4 - 6 percentage points. The situation in the new countries of the Commonwealth was much more diverse. The largest expansion of public sector expenditure was recorded in the Baltic countries (an increase of 8-10 percentage points in the period under consideration), although these countries from the beginning of transition pursued a very restrictive fiscal policy and have consistently sought to reduce public spending. Poland (along with Hungary and Bulgaria) is within the group of countries which during the crisis increased public spending to the least extent. This did not protect Poland from growing budget deficit and public debt. Some countries, however, fell into a serious debt trap. In five EU countries, the deficit exceeded 10% of GDP (Latvia, France, Italy, Ireland, Greece), and public debt of 100% of GDP (Greece - 126.8%) and Italy 116.0%).



**Table 2. Total general government expenditure, public deficit, and public debt**

Total general government expenditure - % GDP													Public deficit - % GDP			Public debt - % GDP		
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2007	2008	2009	2007	2008	2009
<b>Belgium</b>	50.4	50.2	49.1	49.2	49.8	51.1	49.4	52.3	48.6	48.4	50.2	54.2	-0.3	-1.3	-6.0	84.2	89.6	96.2
<b>Bulgaria</b>	39.4	40.0	41.3	40.9	39.6	39.1	38.5	39.7	34.4	39.7	37.6	40.6	1.1	1.7	-4.7	17.2	13.7	14.7
<b>Czech Rep.</b>	43.2	42.3	41.8	44.4	46.3	47.3	45.1	45.0	43.7	42.5	42.9	45.9	-0.7	-2.7	-5.8	29.0	30.0	35.3
<b>Denmark</b>	56.3	55.5	53.7	54.2	54.6	55.1	54.6	52.8	51.6	50.9	52.0	58.2	4.8	3.4	-2.7	27.4	34.2	41.4
<b>Germany</b>	48.0	48.1	45.1	47.6	48.1	48.5	47.1	46.8	45.3	43.6	43.8	47.5	0.3	0.1	-3.0	64.9	66.3	73.4
<b>Estonia</b>	39.5	40.1	36.1	34.8	35.8	34.8	34.0	33.6	33.6	34.4	39.9	45.2	2.5	-2.8	-1.7	3.7	4.6	7.2
<b>Ireland</b>	34.5	34.1	31.3	33.1	33.4	33.2	33.6	34.0	34.4	36.8	42.7	48.9	0.0	-7.3	-14.4	25.0	44.3	65.5
<b>Greece</b>	44.3	44.4	46.7	45.3	45.1	44.7	45.5	44.0	45.5	46.5	49.2	53.2	-6.4	-9.4	-15.4	105.0	110.3	126.8
<b>Spain</b>	41.1	39.9	39.1	38.6	38.9	38.4	38.9	38.4	38.4	39.2	41.3	45.8	1.9	-4.2	-11.1	36.1	39.8	53.2
<b>France</b>	52.7	52.6	51.6	51.6	52.6	53.3	53.2	53.4	52.7	52.3	52.8	56.0	-2.7	-3.3	-7.5	63.8	67.5	78.1
<b>Italy</b>	49.2	48.2	46.2	48.0	47.4	48.3	47.7	48.2	48.7	47.9	48.8	51.9	-1.5	-2.7	-5.3	103.6	106.3	116.0
<b>Cyprus</b>	36.7	36.8	37.0	38.2	40.2	45.0	42.8	43.6	43.4	42.2	42.5	45.8	3.4	0.9	-6.0	58.3	48.3	58.0

<b>Latvia</b>	40.2	41.9	37.3	34.6	35.6	34.8	35.8	35.6	38.1	35.7	38.8	43.9	-0.3	-4.2	-10.2	9.0	19.7	36.7
<b>Lithuania</b>	40.1	39.9	39.1	36.8	34.7	33.2	33.3	33.3	33.6	34.8	37.4	43.6	-1.0	-3.3	-9.2	16.9	15.6	29.5
<b>Luxembourg</b>	41.1	39.2	37.6	38.1	41.5	41.8	42.6	41.5	38.6	36.2	36.9	42.2	3.7	3.0	-0.7	6.7	13.6	14.5
<b>Hungary</b>	50.4	48.4	46.8	47.2	51.2	49.4	48.7	50.2	52.0	50.0	48.8	50.5	-5.0	-3.7	-4.4	66.1	72.3	78.4
<b>Malta</b>	43.0	43.1	41.0	43.1	43.2	47.9	45.6	44.6	43.6	42.4	44.8	43.9	-2.3	-4.8	-3.8	61.7	63.1	68.6
<b>Netherlands</b>	46.7	46.0	44.2	45.4	46.2	47.1	46.1	44.8	45.5	45.3	46.0	51.4	0.2	0.6	-5.4	45.3	58.2	60.8
<b>Austria</b>	54.0	53.7	52.1	51.6	51.0	51.5	54.0	50.2	49.4	48.5	48.8	52.3	-0.4	-0.5	-3.5	59.3	62.5	67.5
<b>Poland</b>	44.3	42.7	41.1	43.8	44.3	44.7	42.6	43.4	43.9	42.2	43.2	44.4	-1.9	-3.7	-7.2	45.0	47.1	50.9
<b>Portugal</b>	40.8	41.0	41.1	42.5	42.3	43.8	44.7	45.8	44.5	43.8	43.6	48.2	-2.8	-2.9	-9.3	62.7	65.3	76.1
<b>Romania</b>	35.8	39.2	38.6	36.2	35.0	33.5	33.6	33.6	35.5	36.2	38.2	41.0	-2.6	-5.7	-8.6	12.6	13.4	23.9
<b>Slovenia</b>	45.7	46.5	46.7	47.6	46.3	46.4	45.8	45.2	44.5	42.4	44.1	49.0	0.0	-1.8	-5.8	23.4	22.5	35.4
<b>Slovakia</b>	45.8	48.1	52.1	44.5	45.1	40.1	37.7	38.0	36.6	34.3	35.0	41.5	-1.8	-2.1	-7.9	29.6	27.8	35.4
<b>Finland</b>	52.9	51.7	48.3	47.8	48.9	50.1	50.0	50.2	49.0	47.2	49.3	56.2	5.2	4.2	-2.5	35.2	34.1	43.8
<b>Sweden</b>	58.8	58.1	55.1	54.5	55.6	55.7	54.2	53.9	52.7	51.0	51.5	54.9	3.6	2.2	-0.9	40.0	38.2	41.9
<b>UK</b>	39.5	38.9	39.1	40.2	41.1	42.1	42.9	44.1	44.2	44.0	47.4	51.7	-2.7	-5.0	-11.4	44.5	52.1	68.2

Source: Eurostat, Date of extraction Feb. 14, 2011, <http://epp.eurostat.ec.europa.eu/>

#### **4. Fiscal Policy and Taxes in the Countries of the “Old” European Union (EU-15)**

It is generally accepted, that the fiscal function of taxes is the most important one. Taxes are levied so that the state can achieve social and economic goals. Non-fiscal tax functions, especially redistributive, allocative and stabilizing began to play a big role along with the rising popularity of Keynes' theory. Tax system that emerged after World War II seriously considered tax extra-fiscal functions. This was reflected in progressive tax, income tax allowances, and tax exemptions and deductions, as well as in diversified consumption tax rates. Such tax structure made it possible to employ taxes as automatic stabilizers. It also allowed the implementation of the stimulatory and the allocative function of taxes.

The Neo-Liberal doctrine approach to taxation is different. It clearly emphasizes that taxes should be neutral, the extra-fiscal functions of taxes should be limited, taxes should be reduced and tax exemptions abolished. The representatives of the supply-side economics were the most explicit in their expectations towards taxes. Their postulates were put to practice by Ronald Reagan and Margaret Thatcher. This path was followed in many West European countries by implementing the tax reforms of the 1980s. Tax progressivity was reduced. The scope of tax reduction was increasingly reduced. The lowering of income tax rates was coupled with expanding the tax base. Taxes for the richest households were gradually reduced and the burden of taxes was shifted on indirect taxes and social security contributions. Still, the tax systems in the “Old” Europe were diversified both in terms of income tax rates, the number of tax thresholds and income tax exemption amounts. Here are some examples, in 2008 in Ireland and Great Britain there were only two tax rates (respectively 20%, 41% and 20%, 40%) and 17 tax rates in Luxemburg (from 6% to 46%). There were also substantial differences in terms of tax - free income: from EUR 1830 in Ireland up to EUR 35530 in Sweden (Krajewska 2010, pp. 84, 87). The attempts to harmonize VAT rates failed too, the standard rate varies from 15 to 25% and the reduced rates and the scope of their application vary considerably.

The tax reforms, performed in the spirit of liberal school recommendations, have been introduced gradually and with high resistance (on the principle that "taxes do not like revolution"). However, reducing tax progression and tax deductions as well as lowering the upper tax thresholds led to two negative effects:

1. reduced government revenues from taxes and limited ability to reduce the budget costs led to an increase in public deficit and public debt,
2. the new tax structure led to a greater social differentiation.

The current crisis has deepened these effects and confirmed the saying well-known among economists: “When in fear, Keynes is dear”. This was reflected in President Obama’s anti-crisis package and then followed by many governments in Western Europe with anti-crisis packages covering new tax systems. These packages included such activities as (Taxation Trends, 2009, pp. 13-19):

1. increased tax exemption amount in many countries (e.g. EUR 40 000 in Sweden),
2. reduced bottom PIT rate (used in many countries, including Denmark, France, Germany),
3. the introduction or increase of the pro-family tax reforms (the Netherlands)
4. the indexation of tax threshold (for example, in Luxembourg 9% in all brackets),
5. the introduction of the new additional top PIT rates (e.g., in Great Britain a new 50% income tax rate on income in excess of £150000 as of April 1, 2010 – prior to that rate was 40%),
6. improved collection of taxes - better tax systems (Italy).

These measures were justified as follows: the tax relief for the poor will increase their consumption demand and stimulate economy. However, raising taxes for the rich will not reduce their consumption, and therefore will not harm the economy; to the contrary it will only result in reduced savings.

The decisions on VAT and excise rates are not so precisely oriented. The standard VAT rates were temporarily reduced in some countries (Germany, Great Britain, Spain, Portugal, and Greece). Preferential VAT rates were also reduced (e.g. for construction services in Belgium and for catering services in France). However, many countries temporarily increased the excise tax on certain products and increased the standard VAT rate (Ireland) (Taxation Trends, 2009, 13-19).

## **5. Fiscal Policy and Taxes in Poland**

The Government persistent endeavours not to relax the fiscal policy have been characteristic of the recent economic policy in Poland. While justifying this approach the Government usually uses three arguments:

- a) high Government deficit (over 3.0% GDP) would prevent Poland’s entry into the Euro Zone in 2011 or 2012;
- b) the costs of financing the deficit would be very high because Poland would have some difficulty in selling securities in the international market on

favourable terms (competitive securities from other countries, the weak condition of the Polish currency);

- c) high repayments would burden the budget and would excessively undermine the investment potential of economy in the future and seriously affect its competitive position for many years to come.

This economic policy was manifested by the endeavours to keep public deficit below 3 per cent of GDP. To achieve this under the conditions of relatively slow growth of revenue, serious attempts were made to reduce expenses (i.e. the “looking for 1.5 per cent of GDP savings in the Ministries” campaign at the end of 2008). This concept meant in practice that the budgetary measures could not significantly and selectively stimulate consumption and investment. The scope of subsidies and subventions was not extended either.

The difference between economic policy pursued in Poland and that in most other countries tends to reflect and question those who chose the appropriate approach in the times of crisis. In Poland this problem was clearly posed by Jacek Rostowski, the Minister of Finance, who at the beginning of September 2009 stated that “...the results of the Polish economy please all. They even please more because during that year Poland chose the entirely different road than the countries of Western Europe and the United States. Our results are the evidence that we have chosen the right road during the crisis and that our road proved to be the only one effective” (Rostowski 2009). This is an important observation that should be analyzed and verified.

It seems that this statement can be interpreted in three ways:

- 1) the procedure adopted in Poland can be successfully applied in other countries contributing effectively to overcoming the crisis;
- 2) Poland is actively pursuing the economic policy tailored to special conditions within the country and these experiences cannot be applied abroad on a larger scale;
- 3) Poland’s economic policy during the crisis was characterized by low activity and relatively favourable economic situation due to the special characteristics and conditions that are rare in other countries.

Most arguments favour the third interpretation. The most important of them involve:

1. The Polish economy takes advantage of the so-called “backwardness rent” consisting of:
  - a) The financial sector is relatively underdeveloped. It achieves good results based on the traditional, proven instruments. This weakens the negative effects of crisis and delays their occurrence. The impact of the financial sector on the real sector is still limited. This was proved by the fact that in 2008 only 26 per cent of small and medium-sized

- enterprises benefited from loans (Raport, 2009) although enterprises of that size in most countries are generally strongly dependent on external financing;
- b) connections with international markets are still relatively modest. For example, in Poland exports account for 40 per cent of GDP, while in many countries of the “Old” European Union, even in the Czech Republic they are above 70 per cent (Statistical Yearbook, 2009, pp. 875-887). This implies that the effects of the collapse of economies of the developed countries are not felt in Poland to the same extent;
  - c) as one of the least developed EU countries, Poland benefits from abundant, external financial assistance, in excess of EUR 10 billion per year (Poland is a biggest beneficiary of EU aid funds).
2. Poland receives significant financial resources from abroad, mainly from the European Union. The funds are assigned for:
    - a) the infrastructure investments promoting entrepreneurship, innovation, and environmental protection;
    - b) consumer spending (EU farm subsidies, sustaining employment, severance pay for laid off employees).
  3. High GDP growth rate before the crisis (5-6 per cent annually) slows down the fall of Poland’s economy.
  4. Decisions to reduce taxes taken just before the crisis, considerably increased demand, especially the consumer demand. These decisions involved:
    - a) the reduction of corporate income tax in 2004 (from 27 per cent to 19 per cent) resulted in reduced budget revenues equivalent to 0.8 per cent of GDP,
    - b) the reduction of pension contribution 2006- 2007 (from 13 per cent down to 6 per cent) resulted in reduced budget revenues equivalent to 2 per cent of GDP,
    - c) the introduction in 2007 of the pro-family income tax allowance which made it possible to deduct expenses for bringing up children from personal income tax,
    - d) the introduction in 2009 of a two-tier PIT scales (18 and 32 per cent) in place of the previous (19, 30 and 40 per cent) scale, resulted in reduced budget revenues equivalent to 1.5 per cent of GDP).

In 2004, the government headed by Prime Minister Leszek Miller cut the CIT rate from 27% down to 19%. At the same time, natural persons running businesses and settling their taxes under the general rules (i.e. progressively) were allowed to switch to a flat rate of 19%. In 2004, this opportunity was used by 159,977 taxpayers. By 2008, their number almost tripled, growing to as many as 463,115 taxpayers.

The year 2004 was a good time for Polish economy. The country's GDP grew by 5.3%, in the enterprise sector the growth rate in gross profit on sales increased by 6%. Given the circumstances, enterprises did not urgently need governmental support offered at the cost of the state budget. The reduction in CIT should be interpreted as an obvious gesture of good will made by the post-communist prime minister towards the business community, however one depriving the budget of part of its revenues. As estimated, in the wake of the decision CIT revenues were lower by PLN 8-10 billion a year between 2004 and 2009.

Another thing one has to bear in mind is that on 1 May 2004 Poland became an EU member state. If Poland had behaved as the "old" Community members did, a more probable course of events would have been increases in tax liabilities. This opinion is based on the decisions Ireland, Greece, Spain and Portugal made on entering the European Union. The countries were then the most similar to Poland in terms of their economic development and economic structure. All of them increased the tax burden for the whole economy (as measured by budget revenue to GDP ratio) during the first five years after accession. They strove to increase their allocations to infrastructure (to boost their economies' competitiveness), to raise funds necessary to support EU-funded structural programmes and made efforts to comply with the social pressure on meeting the requirements of the European Social Charter, which is in force in the European Union (Krajewski, 2009, p. 303). Poland and the other new member states opted for a different model. This group of countries started with tax cuts and handling repossession claims, hoping that the EU funds would help them solve their problems without excessive sacrifices.

In 2006, Minister Zyta Gilowska initiated a substantial reduction in the pension contribution rate. Between 2006 and 2007, the rate decreased from 13% to 6%, i.e. by as much as 7 percentage points (5.5 p.p. of the reduction falling to the employees and 1.5 p.p. to the employers). As a result, the public finance sector suffered a serious financial loss, estimated at PLN 23-24 billion a year.

This situation makes us ask the same question again – was the operation necessary? Average gross wages were rising in that period at 5-6% a year, so no additional steps were necessary to increase them. Although the operation distinctly improved employees' disposable incomes, they neither noticed the change nor appreciated it. Entrepreneurs did not perceive the reduction in the pension contribution rate as an act tangibly diminishing the tax wedge, either. From their perspective, the following decrease in the labour costs was really minimal. The whole operation had political roots and its intended goal was to distribute the additional, unexpected surplus in budget revenues. The deputy

prime ministers representing the coalition parties, Roman Giertych and Andrzej Lepper, being aware that extra funding was available, were already starting to give money away, promising it to teachers, pensioners, and farmers, but minister Gilowska was faster. She decided to give presents to everyone.

In 2007, the government introduced a family allowance that allowed the taxpayers to deduct the amount of PLN 1,145.08 from their income tax. After a year, the amount was raised to PLN 1,173.70 PLN. In 2007, the family allowance option was exercised by 3,973,668 taxpayers, i.e. 16.43% of their total number. The deducted allowances totalled PLN 5,431,984 thousand PLN, i.e. 13.52% of the income tax net of social insurance contributions. Owing to the allowance, the costs of rearing 6,017,284 children were partly reimbursed. An average deduction per taxpayer was 1,367 PLN and per child 903 PLN (Informacja, 2008, p. 33). A year later, 4,205,909 taxpayers (17.21%) decided to exercise this option. The total amount deducted due to the allowance was 6,043,553 thousand zlotys (i.e. 11.76% of the income tax). The allowance was used to reimburse the rearing costs of 6,357,837 children. The average amounts of deductions were PLN 1,437 per taxpayer and PLN 951 per child (Informacja, 2009, p. 32).

The family allowance is the most noticeable, pro-family feature of tax policy in Poland. The Polish tax system operated before 2006 was not friendly to families and clearly differed from those used in other countries (Krajewska, 2008b). The tax-free amounts are limited; the bottom tax threshold (first 19% and then 18% from 2009) is high compared with those functioning in other countries. Tax relieves for families (allowing the taxpayers to cover the costs of their children commuting to schools, tuition fees for child education in primary and vocational non-public schools, and for tertiary education) were first limited and then liquidated. Therefore, the family allowance is a step in the right direction, however insufficient. Besides, the allowance is designed differently than its EU equivalents. It is deducted from tax due and not from income, so parents have to have appropriately high incomes to be able to use it. This means that the allowance favours well-off families with many children, while most multiple-children families in Poland are quite poor. It is difficult to understand why the Law and Justice Party (PiS) that declares its pro-family orientation enacted an allowance of such construction.

Owing to another PiS initiative, natural persons have been allowed since 2009 to settle their taxes according to two tax bracket: 18% for incomes to 85,528 PLN and 32% above that level. This change is estimated to reduce budget revenues by PLN 16-17 bn.

The above tax cuts seriously strained the public sector's revenues. Table 3 presents the estimated financial impacts of tax reductions in Poland. The data



show that the public sector's revenues fell by PLN 38-40 billion in 2008 and by PLN 55-56 billion in 2009. The incomes available to households and enterprises increased by the same amount, most of which were allocated to consumption and investments. This means that the demand-boosting policy with measures typically employed in periods of recession and crisis was launched in Poland ahead of time, even before the crisis appeared. Naturally, even though the measures were not intended as pre-emptive, their favourable effects coincided with the crisis coming to Poland.

**Table 3. Financial impacts of tax cuts in Poland**

Years	Decision	Lower public sector's revenue
2004	CIT reduced from 27% to 19%	PLN 8-10 bn a year
2006-2007	pension contribution reduced from 13% to 6%	PLN 23-24 bn a year
2007	a family allowance deductible from PIT	PLN 5.5 bn – 2007 PLN 6.0 bn – 2008
2009	introduction of two brackets of PIT: 18% and 32%	PLN 16-17 bn
2008	cumulated effects of tax cuts	PLN 38-40 bn
2009	cumulated effects of tax cuts	PLN 55-56 bn

Source: calculated by the authors, based on the GUS and Ministry of Finance data.

At the same time, the present government could take credit for the relatively good economic situation taking no anti-crisis actions. Poland was the only country in Europe in 2009 to show a positive rate of economic growth. It must be remembered, though, that demand did not collapse owing, at least partly, to the earlier tax cuts made by the Democratic Left Alliance (SLD) and PiS. The Polish economy was additionally stabilised by structural funds flowing from the Community and by the so-called „advantages of backwardness”, i.e. its underdeveloped banking system, a relatively small volume of consumer and enterprise loans, rather unsophisticated banking instruments (banks could profit enough operating traditional instruments) and relatively weak ties between Poland's economy and foreign markets.

It is also worth stressing that in Poland, as in the other transitional economies, reductions in income taxes are accompanied by increases in indirect taxes (VAT and excise tax). The data presented in Table 4 show, however, that in Poland this process develops much faster than elsewhere.

**Table 4. Indirect taxes as the proportion of total tax revenue (%)**

Years	Poland	EU-15	EU-10 <sup>2)</sup>	EU-27
1995	38.3	35.1	39.0	37.2
2000	38.8	35.2	40.3	37.6
2001	38.8	35.1	39.8	37.4
2002	40.3	35.5	40.1	37.8
2003	40.9	35.0	40.9	38.3
2004	41.5	35.8	41.5	38.8
2005	42.3	35.8	42.7	39.1
2006	42.8	35.8	41.4	39.1
2007	41.7	35.3	41.4	38.4
1995-2007 difference	+3.4	+0.2	+2.4	+1.2

<sup>1)</sup> Inclusive of contributions to social insurance

<sup>2)</sup> Without Malta and Cyprus

Source: calculated based on Taxation trends in the European Union..., p. 255.

Although indirect taxes are fiscally efficient, easier to collect and less painful (as they are built into prices), there is one significant disadvantage to them: because they are degressive, the tax burden moves onto the poorer strata of the society. As a result, social inequalities become more distinct.

Statistical investigations into the redistributive consequences of consumer taxes in Poland between 1995 and 2006 demonstrate that (Dobrowolska, 2008):

- 1) The burden of indirect taxes paid by households increased in the period in question from 7.48% in 1995 to 11.23% in 2006.
- 2) The poorest households usually paid more in indirect taxes. Average tax burdens borne by selected income decile groups were as follows:  
I – 11.88%,  
X – 8.87%.
- 3) The extending gap between tax burdens carried by the I and X decile groups proves that indirect taxes are becoming increasingly regressive. In 1995, the tax burden on households in the X decile group was by 2.9 p.p. smaller than that in the I decile group. By 2006, the difference increased to 5.28 p.p.
- 4) The preferential VAT rates fail to perform a distributive function, because households in different decile groups benefit from lower VAT rates to a similar degree.

- 5) As a result of further adaptation of Polish VAT and excise taxes to EU requirements the poorest households and farmers will have to carry the heaviest tax burden.

Despite the above effects of indirect tax rises, the taxes can be expected to grow. The reason is the fast swelling budget deficit in Poland, from PLN 24.3 billion in 2008 to PLN 52.2 billion projected for 2010 (exclusive of expenditures necessary to repair the damage caused by the flood). Prof. Witold Modzelewski, director of the Tax Studies Institute, estimates that VAT will grow from 22 to 24%. An excise tax on cigarettes, alcohol and energy will also have to be increased (Modzelewski, 2010).

There are no visible signs, in Poland's economic policy, of active policies that could be regarded as the reaction to symptoms of crisis. The State Treasury guarantee for bank deposits (necessitated by the decisions of other EU countries) cannot be regarded as one. A modest state support for operations of the banking system (credit campaign) or some credit facilities for entrepreneurs cannot be regarded as such either.

It is typical that the so-called anti-crisis package in Poland took a very long time to develop, and was delayed, but could have played a positive role, in the development of labour relations.

According to the Minister of Finance there would be two important methods of behaviour in the anti-crisis package (Rostowski 2009):

1. Restrained Government spending. Wages in the public sector in 2010 are to be kept at the 2009 level and material and investment expenditures are to be reduced by 10 per cent. Fiscal discipline is to be maintained in the whole public finance sector. It is clear however, that the efforts that inhibit the expenditures have not produced expected results. The soaring public deficit is expected due to drastic reduction in Government revenue. The budget deficit is likely to be nearly 4 per cent and the public finance deficit (central and local governments deficits put together) equal to 8 per cent of GDP. This increasingly difficult budgetary situation (and in public finance too) indicates that one should not expect additional supply of money to overcome the crisis<sup>1</sup>. Chances for the future active interaction are in practice low.
2. The program of privatization on a large scale, which should influence the budget in the next two years, is expected to bring budget revenue to almost

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<sup>1</sup> For example, Poland has been the only country in which Opel cars are made, which has not supported financially this production. Poles have not created incentives to buy new cars, what a number of EU countries have done. It is an impressive evidence of our inaction, but perhaps also of our weaknesses.

3 per cent of GDP. Successful implementation of this program, called “the reform” by the Minister of Finance, will determine Poland’s public debt, which in relation to GDP may exceed 55 per cent limit in 2010. This would mean the collapse of the current fiscal policy in Poland and enormous economic difficulties (it is difficult to drastically reduce payroll, so there would be no money to invest).

This situation will probably prompt the sale of the best national “silverware”: the largest and most profitable companies owned by the State (oil and gas processing, mining and copper processing) at relatively low prices. One cannot expect that such measures would be generally accepted. Would it be better to sell government securities, even under relatively unfavourable conditions?

One can see here how delicate and unstable the Polish economic policy is and how uncertain the future of Poland’s economy, despite optimistic declarations made by many politicians and economists.

For the Polish economy (in the near future) it is crucial to prevent the sharp increase in unemployment (currently around 12 per cent) and to prevent decrease in consumption. This depends largely on the attitude and actions of the Government. So far, the Government unilaterally assumed that the collapse will not take place in these fields because of two reasons: the interplay of favourable circumstances (as mentioned above) and the high efficiency of information and media coverage, making the public (including the business community) aware, that the situation of the Polish economy is and will be relatively stable (the main argument is the increase in GDP)

It seems that this second aspect has played a positive role and some entrepreneurs have been convinced not to cut down employment because the economy has not been breaking down quickly and will return to the path of sustained growth, whereas the re-acquisition of appropriate staff takes time and considerable resources. In many households, despite the understandable anxiety about the future, there are no signs of serious reduction in consumption because the belief prevails that there is no real threat of job insecurity or the concern of declining income.

The mood, however, may deteriorate, especially if it appears that the Government has lost control over the deficit and GDP begins to decline. Therefore, efforts should be made to:

- quickly show that the anti-crisis package is operating smoothly and on a large scale,
- lower interest rates to curb the growth of the Polish Zloty exchange rate and to create conditions conducive to exports,

- improve access to relatively cheap consumer and investment credits (lower interest rates, ease the criteria for granting credits, and extend the government credit guarantees).

## 6. Conclusions

The most developed countries of the global economy have followed an active and expansionary fiscal policy aimed at stimulating investment and consumption demand since the beginning of the current crisis. Additionally, the economies have been supplied with hundreds of billions or even trillions of dollars and euros. This has led to a sharp increase in the budget deficit, for example, from a few to several percent of GDP in one year in the U.S., UK and Ireland. Consumer demand has been stimulated by lowering taxes (directly or indirectly).

Changes in the Polish tax system have been moving in a direction other than the tax reforms in the EU-15. Tax cuts carried out between 2004 and 2009 were to a large extent random and were motivated by political considerations. In practice, it turned out, however, that they triggered the demand mechanisms that made the economic crisis in Poland run smoother than in other countries. However, in 2010, lower Government revenues due to tax cuts led to a significant increase in public sector deficit (about 8% of GDP).

In Polish conditions, one cannot apply the tax system on a major scale to overcome the crisis. The announced VAT increase (up to 23% over the next three years) as of 2011, can increase revenue by only 0.3 to 0.4% of GDP. In this concept, implemented over many years, economic development is promoted. The basis of this concept is to create facilities (including financial), designated directly for entrepreneurs. The reduction of their tax burden is very important here. This is a controversial solution, not applied (at least not to the same extent as in Poland) in most countries, especially the developed and democratically governed.) Western tax systems tend to spread the burden across all social groups with different income levels. When lowering taxes, generally the low income social groups are affected and when increasing taxes, the high income social groups are involved. In Poland, the opposite is true.

In most countries of the "old" EU and in the U.S.A. taxes (including business taxes) are relatively high, and the promotion of entrepreneurship is more focused on the creation of infrastructure conducive to economic development (highways, airports, telecommunications, Internet, indigenous technical thought, education on high level, good health care). Funding for these

purposes comes from relatively high taxes. Poland has still poorly developed infrastructure, which clearly hampers its economic activity.

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**Streszczenie****SPECYFIKA POLITYKI FISKALNEJ W POLSCE W OKRESIE KRYZYSU –  
JEJ PRZYCZYNY I KONSEKWENCJE**

*Obecny kryzys skłonił niemal wszystkie kraje do prowadzenia aktywnej polityki gospodarczej. W USA i krajach UE dużą wagę w pobudzaniu gospodarki przypisuje się polityce fiskalnej i podatkom. Działania podejmowane w Polsce odbiegają od standardów światowych, a decyzje dotyczące podatków mają z reguły charakter polityczny. W artykule podjęta jest próba przedstawienia rozwiązań z zakresu polityki fiskalnej podejmowanych na Zachodzie oraz wyjaśnienia specyfiki polskiej gospodarki i prowadzonej polityki antykryzysowej.*