

# THE DEBT CRISIS IN POLAND AND ITS IMPACT ON SOCIETY

Gavin Rae

AKADEMIA LEONA KOŹMIŃSKIEGO ul. Jagiellońska 57/59, 03-301, Warsaw, Poland

## **ABSTRACT**

This paper considers the question of public debt and how it impacts upon other areas of socio-economic life in Poland, in the context of the recent global economic crisis. It begins by placing Poland's public debt in its historical context that reaches back to the Communist period. One result of the large debt incurred during this time, was that Poland became indebted and dependent upon creditors in the West. This dependency helped to shape its neo-liberal economic policy from the late 1980s. This has resulted in a large deactivation of labour that has placed a huge burden on the country's public finances. Furthermore, the creation of a compulsory private pension system at the end of the 1990s, sucked large amounts of money out of the government's budget and swelled the country's public debt. Since the outbreak of the economic crisis, Poland has avoided a recession through increasing public investment by utilising available EU funds. However, due to internal and external limits on the size of its public debt, the government is being pressured to reduce this spending that threatens to suppress growth and further increase unemployment. In order to create more fiscal room, the government has partly dismantled the compulsory private pension system, which has temporarily reduced public debt. Poland already has high levels of poverty and social exclusion, with large sections of society inadequately supported with social benefits and services. Any further reduction in public and social spending could have serious negative consequences for large sections of society.

# CONTENTS

## **1. Economic Crisis and Public Debt**

## **2. Public Debt in Poland Before the Economic Crisis**

- 2.1: Sources of Poland's Public Debt
- 2.2: Public Debt during Communism
- 2.3: Transition to Capitalism
- 2.4: Income and Revenue
- 2.5: Neo-Liberalism and Pension Reform

## **3. Impact of the Economic Crisis**

- 3.1: Slowdown in Economic Growth
- 3.2: Growth in Deficit and Debt
- 3.3: Pressures to Reduce Public Debt
- 3.4: Demographic Trends and 'Hidden Debt'
- 3.5: Neo-Liberal Reform
- 3.6: Reversing the Pension Reform

## **4. Public Debt and Economic/Social Investment**

- 4.1: Does Public Debt Matter?
- 4.2: Public Investment and Growth
- 4.3: Social Spending, Poverty and Exclusion

## **5. Conclusions**

## 1. ECONOMIC CRISIS AND PUBLIC DEBT

The global economic crisis that broke out in 2008 has been accompanied by a huge increase in public debt. Between 2007 and 2010 aggregate net public debt in the world increased from \$23,000bn to \$34,000bn, with the IMF predicting that this will rise to \$48,000 by 2015. This growth of public debt has been most pronounced in the world's advanced economies. For example, public debt per capita in the USA is predicted to grow from \$19,400 in 2007 to \$41,000 in 2015; and is expected to reach \$75,900 in Japan by 2015. <sup>i</sup>

The growth in public debt has been particularly pronounced in the European Union, where it has become a focus of the economic crisis in many countries. In the first quarter of 2013, public debt in the EU had reached 85.9% of GDP and in the eurozone 85.2%. Public debt has soared in many of the Southern European countries (and Ireland) that have been disproportionately affected by the economic crisis: Greece 165%, Italy 130%, Portugal 127% and Ireland 125%. On the other hand some other EU countries (amongst them those that were severely hit by the economic crisis) maintain very low levels of public debt as a proportion of their GDP (Estonia 10%, Bulgaria 18%, Luxemburg 22%). As we shall see Poland currently has a ratio of public debt of 58% that is significantly below the EU average. <sup>ii</sup>

The relationship of public debt to economic growth has become a matter of intense discussion. Neo-classical economists have tended to argue that public debt is a cause of economic slowdowns and persistent recessions, as high levels of public spending and debt crowd out the private sector and reduce its profits. Reinhart, Reingart and Rogoff (2012) have argued that countries with large public debt experience persistent stagnation and that the line of causality runs from high public debt to economic slowdown (the tipping point for them is when public debt crosses 90% of GDP). <sup>iii</sup> These ideas have been replicated by Kobayashi (2013) who states that large public debt discourages governments from tackling fiscal consolidation, which in turn represses economic growth. <sup>iv</sup> These theories of 'crowding out' and 'debt overhang' have been disputed by a number of economists who have found no long-term causal connection between public debt and economic growth. <sup>v</sup>

The huge rise in public debt, following the global financial crisis, was partly caused by the bailout of many banks and financial institutions that found themselves on the verge of collapse. <sup>vi</sup> The ensuing economic slowdown and rise in unemployment, further suppressed government income and raised expenditures, which swelled public debt and government deficits. Many governments introduced policies of austerity (i.e. raising taxes and cutting public and social spending), ostensibly as a means to reduce levels of public debt. The experience of the past few

years has shown that rather than reducing government deficits and debt, austerity policies tend to have the opposite effect as economic growth is suppressed and the situation on the labour market worsens. In many cases the economic crisis and rise in public debt have been used as justifications for introducing a new wave of neo-liberal reform, aimed at further dismantling the structures of the welfare state and placing the burden of the economic crisis onto working people, the vulnerable and the poor.

## **2. PUBLIC DEBT IN POLAND BEFORE THE ECONOMIC CRISIS**

### **2.1 Sources of Poland's Public Debt**

Poland's public debt can be traced to four main sources, which help to explain its size and composition. By looking at these we can also understand the interconnection between public debt, the wider economy and the situation of different social groups. The four main sources of Poland's public debt are:

1. The debt crisis during the Polish People's Republic (PRL) from the 1970s and the subsequent writing off of part of this debt. The indebtedness incurred during this time partly instigated a wave of neo-liberal reforms introduced from the end of the 1980s.
2. The socio-economic consequences of the neo-liberal shock-therapy reforms introduced at the beginning of the transition from Communism, particularly the huge deactivation of labour.
3. The introduction of a compulsory private pension pillar at the end of the 1990s that swelled public debt and whose partial dismantling has recently been one of the government's main strategies for reducing public debt.
4. The effects of the recent global economic slowdown.

### **2.2 Public Debt During Communism**

From the mid-1970s the Polish government embarked upon a strategy of economic development, through using credits from western banks to fund investment projects and raise living standards. Boosted by the flow of petrodollars, western banks were offering pro-western countries in the third world, and relatively autonomous governments in Central-Eastern Europe (CEE) (e.g. Poland and Romania), cheap loans. Although it was envisioned that these loans would help Poland to modernise its industrial sector and produce high quality consumer goods, the credits tended to be spent on supporting old industries, increasing salaries and importing raw materials and products from the west. This brought a partial increase in economic growth,

but also resulted in the balance of trade deficit shifting from a surplus of 451.2m zloty in 1971 to a deficit of 8.9m zloty in 1975, with foreign debt growing from \$1.2bn to \$7.6bn during the same period.<sup>vii</sup>

In the second half of the 1970s western banks began to pressurise the Polish government to repay its loans. In 1976, the government announced a series of food price rises that were halted by a wave of strikes and demonstrations. In the late 1970s western bankers were urging the government to reduce subsidies on certain basic consumer products and pay off its debts through exports. This helped to spark the huge Solidarity strikes at the beginning of the 1980s, which eventually resulted in the Polish government implementing Martial Law from December 1981 (which lasted till July 1983).

Between 1982 and 1989 Poland only paid an average of 20-30% of its required debt repayments. Poland's indebtedness had made it increasingly dependent upon western banks and financial institutions. In 1986 Poland joined the IMF and was required to introduce a series of structural reforms in order find resources to pay its debt. During the second half of the 1980s the 'Communist' government had already introduced a package of wide-ranging market reforms and Poland was the only country inside the Eastern Bloc to undergo an economic recession before the transition to capitalism.

### **2.3 Transition to Capitalism**

The transition from Communism, negotiated at the round-table talks in 1989, both resulted in a reduction of the debt incurred during Communism, whilst paving the way for the creation of new public debt. Poland was only the second European country in the post-war period to have large parts of its foreign debt written off.<sup>viii</sup> In 1991 it made an agreement with the Paris Club (that represented the main state creditors) to reduce its debt in half and three years later it came to a similar arrangement with the London Club of commercial banks, agreeing that its foreign debt would be paid off by 2024.

The cancellation of large parts of the debt incurred during Communism was replaced by the growth of new public debt created as a result of policies introduced from the end of the Communist period. The introduction of the shock-therapy reforms in 1990, led to a huge deactivation of labour that has remained a hallmark of contemporary socio-economic life. *Table 1* shows how a large section of labour has been de-employed over the past couple of decades. Unemployment, which had officially hardly existed during Communism, had risen to nearly 15% of the workforce and peaked at almost 18% just prior to EU entry. In the next few years unemployment steadily declined, although it began to rise again following the outbreak of the

global economic crisis and by 2013 stood at more than 13%. Large, entrenched structural unemployment exists in Poland, with 46% of the jobless defined as being long-term unemployed.<sup>ix</sup>

The unemployment figure only reflects part of the overall deactivation of labour. While at the end of Communism 83.5% of those over 15 were in paid employment, presently this figure is just over 50%, having fallen to just 45% prior to EU entry. A further way of understanding this is to consider the activity rate in Poland (that includes all those over 15 years of age who are neither employed nor registered as unemployed) with over 40% of the Polish workforce defined as being economically inactive throughout the transition.

Poland also has the highest number of workers in the EU employed on so-called 'junk contracts' - i.e. non-fixed, temporary contracts. Whilst the average share of workers employed on such contracts in the EU stands at less than 15%, in Poland it exceeds 27%. Furthermore, this has increased by more than five times since the beginning of the century, with just over 5% of workers employed on these 'junk contracts' in 2000. Over 60% of workers aged under 25 are employed on 'junk contracts'. This is further compounded by the large number of self-employed workers in Poland. 19% of all those working are self-employed, which is the fifth highest number in the EU after Greece, Italy, Portugal and Romania.

All this means that a large section of employees in Poland have little protection and also that employers are not required to pay social insurance and cover the benefits of their workers, as they are for workers employed on permanent full-time contracts. For example, the self-employed usually opt to pay the lowest level of national insurance, meaning both that they are destined to receive the lowest level of pension in the future and also that the National Insurance Fund (ZUS) is further starved of funds. National insurance levels are presently set at a flat-rate, with the self-employed paying the same rate as large, profitable companies. An inevitable consequence of this situation is that a significant group of workers simply opt out of the system altogether and operate partly or entirely on the black-market. This leaves them without any health or social insurance and further reduces the amount of money going into ZUS, thus contributing to the growth of public debt.

*Table 1: Employment, Activity and Unemployment Rates by Gender*

	1995	2000	2005	2010
<b>Employment Rate:</b>				
General	50,7	47,4	45,2	50,4
Men	58,5	55,2	58,5	58,1
Women	43,7	40,3	43,2	43,4
<b>Activity Rate</b>				
General	58,4	56,4	54,9	55,8
Men	66,5	64,3	62,8	63,4
Women	51,1	49,2	47,7	47,3
<b>Unemployment Rate</b>				
General	14,9	15,5	17,6	12,3
Men	13,6	14,2	16,6	-
Women	16	18,1	19,1	-

## 2.4 Income and Revenue

This huge deactivation of labour has meant that a large share of government income is spent on supporting those without work. *Figure one* shows the breakdown of current government expenditures in Poland. We can see that 46% of all spending is allocated to grants and subsidies, which primarily includes payments to the Social Insurance Fund (FUS). If we then analyse how social spending is distributed (*figure two*), in relation to other EU countries, we discover that a very large relative share of expenditures is allocated to pensions and very little spent on unemployment benefit. Also, we can see how health care spending is well below the average of that in the EU and CEE. This distribution of public spending has a significant impact on the living standards of different social groups, which we shall return to later on in this paper.



Figure 1:

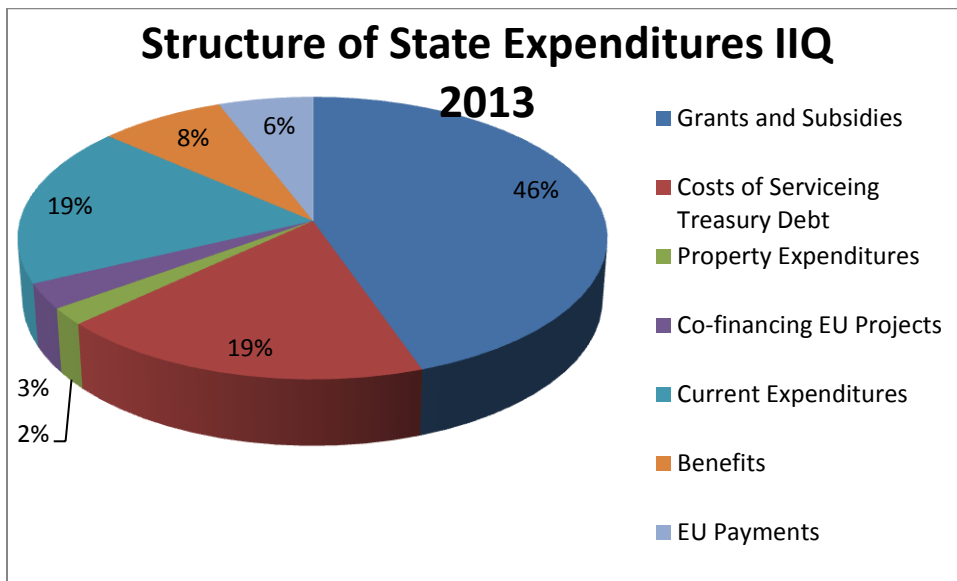
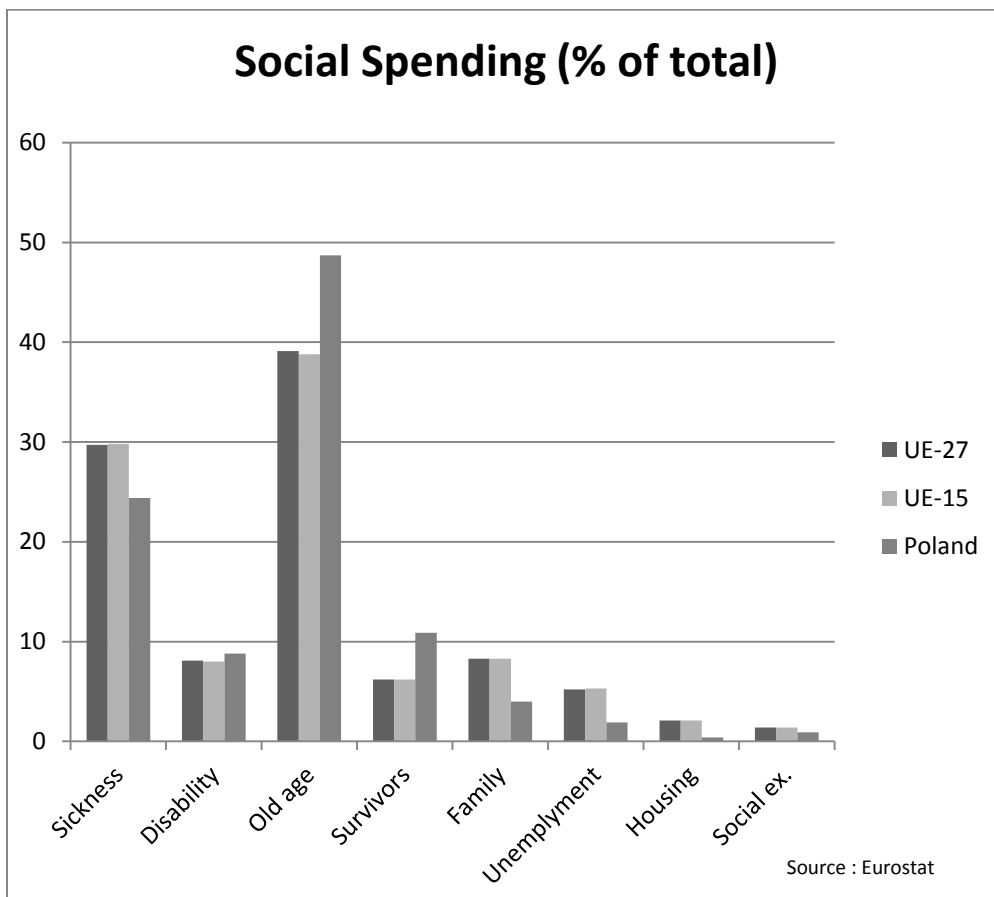


Figure 2:



The other side of public finances, that influences public debt, is government income. *Table 2* compares the Polish taxation system to that in Western Europe and neighbouring countries in CEE, as of the first quarter of 2012. In general terms the income tax rate and corporation tax rates are far higher in Western Europe than in CEE, whilst VAT is slightly lower in Western Europe than in CEE. Furthermore, the highest rates of income tax are found in Western European countries and the lowest rates paid in CEE countries; a trend which is reversed for VAT. The Polish tax system is close to the CEE model, although its top rate of income tax is relatively high compared to some other CEE countries, although only a very small percentage of tax payers enter this band.

*Table 3* shows how in the mid-1990s a progressive income tax system was maintained, with the top income tax rate raised to 45% in 1994, although this had been reduced back to 40% by 1998. However, a decisive shift towards a more regressive income tax system came in 2008, when the personal income tax system was changed from 3 to 2 bands. The top income tax rate was cut by 8% to 32%, whilst the bottom band was lowered by just 1% to 18%. Although the top rate of personal income tax is relatively high compared to some other CEE countries, this reform essentially introduced a flat-tax rate in Poland, as just 1.5% of income tax payers now pay the top rate (while previously 10% had done so). \*A similar trend is observable in changes to the business tax (CIT) in Poland. Up until the mid-1990s, CIT was actually higher in Poland (40%) than the average in Western Europe. In 1997 and 1998 the business tax rate was progressively cut, eventually reaching 27% in 1998. The most fundamental change occurred just as Poland was entering the EU in 2004, when it was reduced to 19%.

*Table 2: Top statutory income tax rates and standard VAT rates (%)<sup>xi</sup>*

	<b>Personal Income Tax</b>	<b>Corporation Income Tax</b>	<b>VAT</b>
<b>EU 15 Average</b>	49	28	21
<b>EU10 Average</b>	21	17	22
<b>Poland</b>	32	19	23
<b>Highest</b>	<i>Sweden: 56.6</i>	<i>France: 36.1</i>	<i>Hungary: 27</i>
<b>Lowest</b>	<i>Bulgaria: 10</i>	<i>Bulgaria: 10</i>	<i>Luxemburg: 15</i>

**Table 3: Personal Income Tax Rates in Poland(%)**

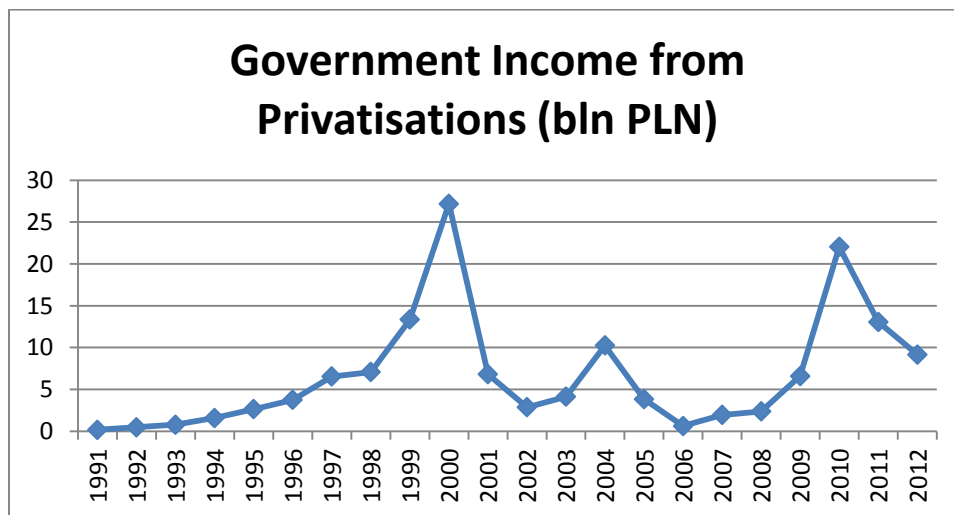
<b>1992</b>	<b>19</b>	<b>30</b>	<b>40</b>
<b>1994</b>	21	33	45
<b>1997</b>	20	32	44
<b>1998</b>	19	30	40
<b>2008</b>	18		32

**Table 4: Corporation Income Tax Rates in Poland (%)**

<b>1990</b>	40
<b>1997</b>	38
<b>1997</b>	36
<b>1998</b>	34
<b>1998</b>	30
<b>1998</b>	28
<b>1998</b>	27
<b>2004</b>	19

Alongside taxation, a major source of government income over the past couple of decades has come through the privatisation of assets inherited from Communism. *Figure 3* reveals how there have been two major peaks of privatisation. The major surge in privatisation was from the late 1990s, with the proceeds from privatisation peaking at around 27bn złoty in 2000 before falling sharply in 2001. The second occurred following the outbreak of the global economic crisis, rising to more than 21bn złoty in 2010 (see below).

Figure 3:



## 2.5. Neo-Liberalism and Pension Reform

Between 1997 and 2001 a right-wing coalition government introduced a package of neo-liberal policies that significantly worsened public finances and have had a long-term impact upon public debt. The increase in privatisation from the late 1990s, meant that the size of the state sector declined from over 50% to less than 45% of GDP during the term of this government. This coincided with a sharp slowdown in economic growth (declining from 7% in 1995 to 1% in 2001) and a rapid rise in unemployment (up from 10.3% in 1997 to 17% in 2001). In turn social expenditures rose from 4.5% of GDP in 1996 to 6% in 2001.

The slowdown in economic growth and increase in social expenditures worsened the state of public finances. However, this was initially controlled through harnessing the proceeds gained from privatisations. From 1998, new regulations stated that money earned through privatisations could not be used as a source of revenue for the government, but rather was a means for financing its budget deficit. Up to and including 2000, the budget deficit was maintained at around just 2% of GDP, despite worsening economic conditions. However, by 2002 this had more than doubled to over 5% of GDP, as revenue from privatisations slumped (figure 3).

During this time, a new constitution was introduced in Poland that includes a balanced budget amendment. This caps public debt at 60% of GDP and states that the government cannot take on any financial obligation that could cause this limit to be exceeded. In order to ensure that this

level is not breached Poland has a self-imposed debt threshold of 55% of GDP, and the government must take action to balance the budget if this level is crossed.

This right-wing coalition government also implemented a series of reforms intended to further liberalise the country's public services. For the purposes of our discussion on public debt the most important of these is the pension reform.

As discussed above, the major failing of the transition was the huge deactivation of labour. Soaring unemployment was partly controlled, at the beginning of the transition, through a corresponding increase in the number of pensioners and retirees, in a bid to maintain the necessary social stability to complete the shock-therapy reforms.<sup>xii</sup> The worsening situation on the labour market and lack of sufficient unemployment benefits, also ensured that some groups of workers (such as miners, teachers, police officers and soldiers) took up their right to retire early.

All of these pressures meant that the dependency ratio – that is the ratio of pensioners and retirees to employees – rose sharply. Between 1989 and 1995 this grew from 18% to more than 23%; and whilst in 1989 there were 39 pensioners and retirees per 100 employees this had risen to over 60 by 1995.<sup>xiii</sup> In turn this led to a steep increase in public expenditures on pensions, doubling as a percentage of GDP from 6.6% in 1989 to 12.6% in 1991. As a percentage of government expenditures, funds devoted to pensions had reached 54% by 1994. The state was forced to increasingly cover the pension funding gap, with subsidies to ZUS growing as a share of total pension expenditures from 1% in 1991 to 10% in 1995.<sup>xiv</sup>

The growing strain on state budgets increased pressure for public pension spending to be cut. In 1999 a radical reform of the pension system was implemented, which introduced a compulsory private pension pillar.<sup>xv</sup> Advocates of this reform assumed that this reform would bring a number of benefits such as:

- valorising pensions;
- decreasing state expenditures on pensions and controlling public spending;
- encouraging people to work longer;
- linking a person's future pension to individual contributions and thus inciting people to invest more in their own pensions;
- helping to build capital markets in Poland by providing new sources of capital to be invested on the country's burgeoning stock-market.

One of the major incentives for this reform was the wish to lessen the long-term burden upon the state to provide for people in their retirement. However, in doing so, the system placed new pressures on the government's budget. This is because while part of people's salaries has been transferred to private pension funds, the government has continued paying for current public pensions. This double-burden upon the pensions system has had a considerable impact upon the country's public debt.

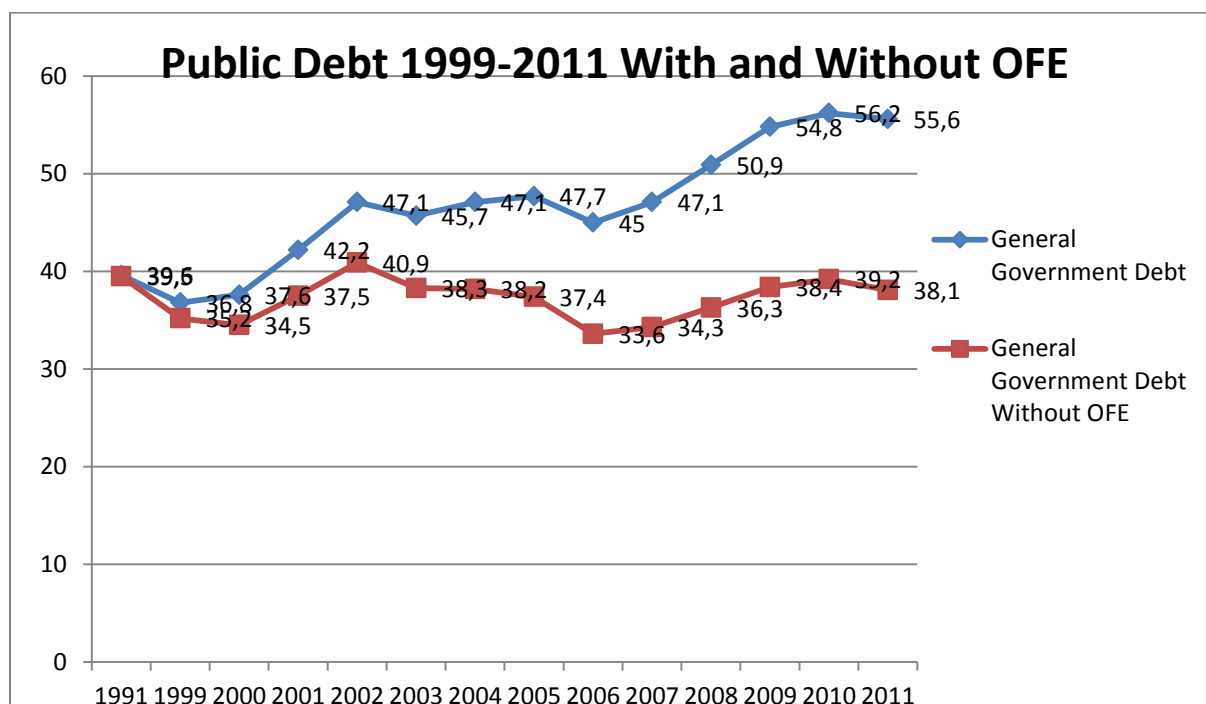
Essentially all of the assets and shares of the private pension companies (OFEs) have been financed through increasing public debt. Since the introduction of the compulsory private pension scheme in 1999, around 40% of all pension payments have gone to the private pension companies, (read: financial markets) whilst the government has been required to borrow more to meet its obligations of paying current pensions.<sup>xvi</sup>

*Table 5* displays the estimates of the Finance as to how much the payments to the compulsory private pension pillar contributed to Polish public debt between 1999 and 2012. By 2012 the accumulated amount added to public debt by transfers to the private pension funds had reached over 279bn złoty, or 17.5% of total GDP. *Figure 4* shows looks at the size of public debt in Poland with and without these payments. As we can see, by 2011 public debt had reached 55.6% of GDP, however if the transfers to the private pensions funds had not been made this would have stood at only 38.1% of GDP.

*Table 5:*

**Effect of the 1999 Pension Reform on Public Debt**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>BLN PLN</b>	2.6	12.0	24.1	37.7	52.0	68.3	87.1	109.2	137	163.7	196.5	232.9	260.6	279.4
<b>% GDP</b>	0.4	1.6	3.1	4.7	6.2	7.4	8.9	10.3	11.4	12.8	14.6	16.4	17.1	17.5

Figure 4:<sup>xvii</sup>

### 3. IMPACT OF THE ECONOMIC CRISIS

#### 3.1 Slowdown in Growth

Although the global economic crisis severely affected most countries in CEE, Poland enjoys the status of being the only EU member state not to have undergone a recession over the past few years (see *table 6*). Poland's GDP rose on average by 3.7% between 2008 and 2011, with growth slowing to just 1.6% in 2009. Poland was able to avoid an economic recession due to a unique combination of internal and external factors. The most important of these was its ability to increase government spending and in particular raise public investment, thereby least partially offset the decline in private investment.

*Table 6: Basic Economic Indicators*<sup>xviii</sup>

	2007	2008	2009	2010	2011	2012	2013 <sup>A</sup>
GDP GROWTH RATE	<b>6.8</b>	<b>5.1</b>	<b>1.6</b>	<b>3.9</b>	<b>4.5</b>	<b>1.9</b>	<b>1.3</b>
INVESTMENT (% GDP)	<b>21.6</b>	22.3	<b>21.2</b>	<b>19.9</b>	<b>20.2</b>	<b>19.1</b>	<b>18.2</b>
AGGREGATE CONSUMPTION	<b>4.6</b>	6.1	<b>2.0</b>	<b>3.4</b>	<b>1.6</b>	<b>1.0</b>	<b>0.8</b>
UNEMPLOYMENT RATE	<b>9.6</b>	7.1	<b>8.1</b>	<b>9.7</b>	<b>9.7</b>	<b>10.1</b>	-

A: figures for 2013 are forecasts

Government expenditure continued to increase in Poland throughout the crisis, rising from 15.1 billion euros in 2008 to 16.5 billion euros in the first quarter of 2012. The level of government expenditure in Poland is slightly above the EU average, standing at around 49% of GDP. One of the most important actions of the government was to increase public investment by utilising available EU funds. Poland was the single largest recipient of EU funds from the 2007–2013 budget, as it was liable to receive up to 67 billion euros in structural and cohesion funds. This sum increased to 82 billion euros once the designated national government funds were added. This helped the government to instigate large investments in the country's infrastructure, particularly in preparation for the Euro2012 football championships. As a share of overall investment, public investment increased from 35% to 43% between 2005 and 2010. This has ensured that although private investment fell sharply throughout the crisis, Poland's overall investment rate only declined slightly (by 0.08%) in 2009, whilst in other years it continued to rise. The biggest increase in investment was in the area of buildings and infrastructure, which increased from 1.8 billion euros in 2005 to 3.1 billion euros in 2010.

Although Poland has so far avoided recession since the outbreak of the economic crisis, economic growth slowed and the situation on the labour market worsened. Furthermore, the rate of economic expansion began to slow again from 2012, after rising in 2010 and 2011. This decline in economic growth was primarily due to a sharp fall in public investment. Between 2011 and 2012 public investment shrank from 5.7% to 4.6% of GDP. This decline looks set to continue, with investments in roads expected to be around 15bn złoty in 2013, down from 18bn in 2012 and 23.6bn zloty in 2011. Financial pressures have resulted in local governments reducing their investments to 36bn złoty in 2013, down from 40bn 2012 and 41.2bn in 2011. This decline in public investment has primarily been caused by the ending of funds coming into Poland through the EU's present budget and the tightening of government spending as public debt edges towards its self-imposed limits.

### **3.2 Growth in Deficit and Debt**

As a percentage of GDP public debt grew in Poland by around 10% between 2008 and 2012 (*figure 4*).<sup>xix</sup> This was significantly less than in most other EU countries, where it rose on average by around 25%. In some countries that were worst affected by the economic crisis public debt soared, exceeding 80% in Ireland, 50% in Portugal and 40% in Britain, Spain and Greece.

A country's public debt is strictly connected to its budget deficit. In turn a government's deficit is strongly dependent upon macro-economic factors, which determine government income and



expenditures. The ability of the Polish government to maintain public debt within the existing external and internal limits over the long term is therefore largely dependent on whether it can increase economic growth and improve the situation on the labour market. *Figure 5* shows changes in public finances throughout the period of the economic crisis. As we can see the budget deficit in Poland grew sharply from 1.9% in 2007 to 7.9% in 2010. However, the budget deficit then began to decline, standing at 3.9% in 2012. The government has predicted that after having a budget deficit of 3.5% in 2013, this will then decline to 3.3% in 2014, 2.7% in 2015 and 1.6% in 2016. This prediction is based upon an assumption that economic growth will speed up, exceeding 4% in 2016.<sup>xx</sup>

The recent decline in the budget deficit has not been achieved through increased economic growth. Economic growth slowed significantly in 2012, a trend that has continued in 2013. We can also see in *figure 5* how government income reduced between 2010 and 2011 (Eurostat does not yet provide data for 2012). If we take a look at government income in the second quarter of 2013 (the last quarter for which the Ministry of Finance provides detailed information) we can see how government income continued its fall. During this quarter government income was 7.4% (5.8bn złoty) less than it had been a year earlier; with the amount of money gained through VAT, PiT and CiT all declining (the largest reduction was in CiT, which reduced by around 3bn złoty).<sup>xxi</sup> We can further understand this fall in government income by returning to *figure 3* that details government revenue through privatisations. The government significantly increased the number of privatisations from 2010, with revenue from privatisations reaching over 20bn złoty in 2010 (the highest amount since 2000). It has since however significantly fallen, standing at less than 10bn złoty in 2012.

The budget deficit was brought down primarily through reducing government expenditures. This is not discernable in *figure 5*, which shows how central government expenditure has essentially remained stagnant. However, while central government expenditures have remained stagnant over the past few years, local government spending has markedly decreased.

Public Debt in Poland

Figure 4<sup>xxii</sup>

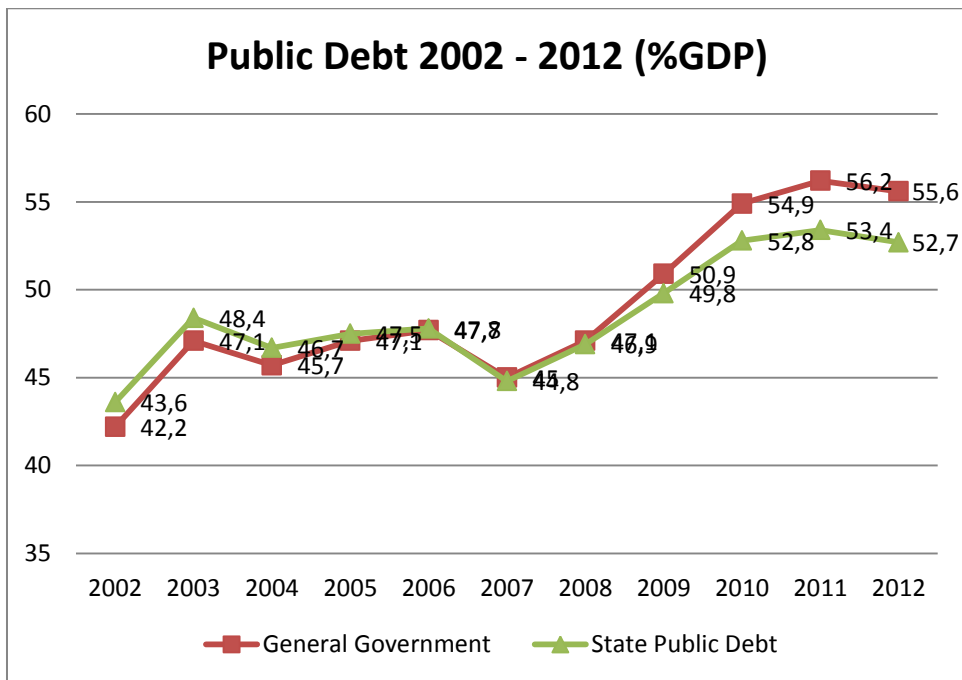
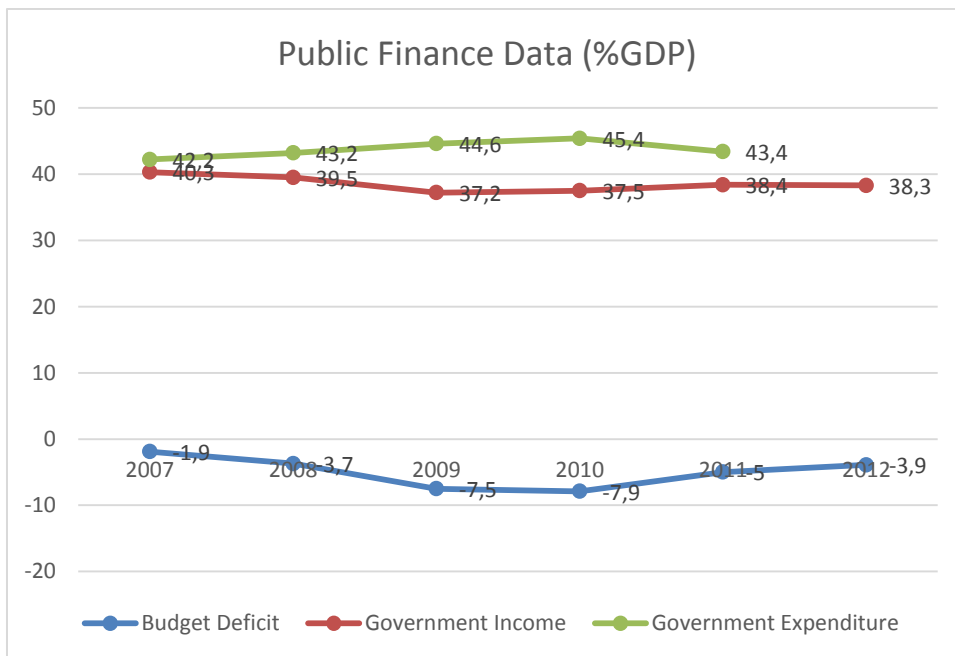


Figure 5<sup>xxiii</sup>



Over 1/3 of all government expenditures are made by local governments. Local governments provide funds for a number of essential public services, spending the most on education (29%); transport and communication (18%) and social help (12%). Furthermore, the public investment

surge of recent years has largely been funded by local governments, through which the majority of EU funds flowed.

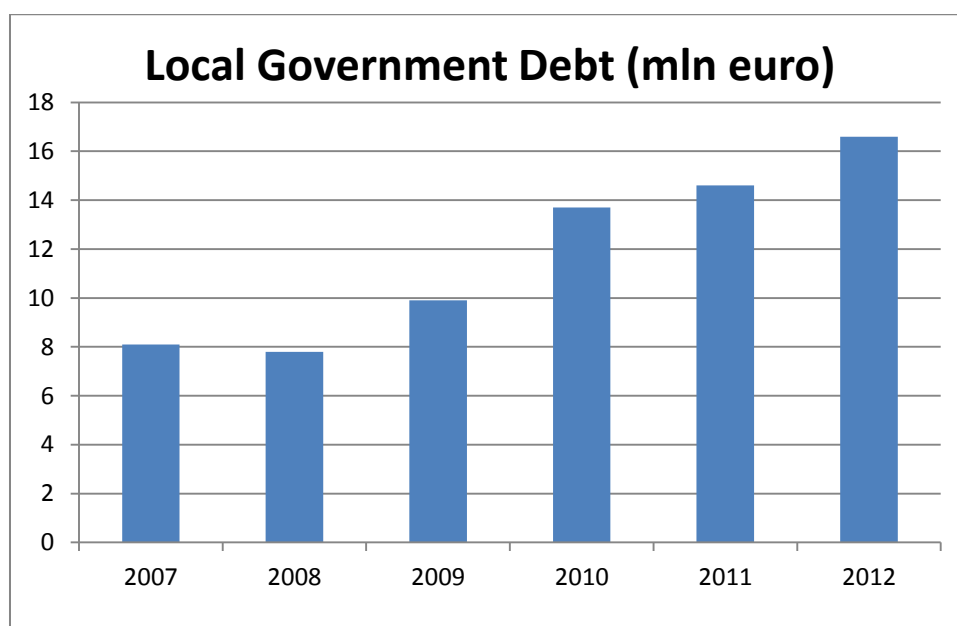
*Figure 6* shows how the deficits of local governments grew rapidly between 2008 and 2012. Between 2007 and 2010, the number of local governments that had a budget deficit increased from 1,046 to 2,490, before falling to 1,952 in 2011. From 2011 the government brought in a new regulation that all local governments must balance their income and current expenditures. In this way the central government is attempting to pass the responsibility of cutting its budget deficit and debt onto local governments.

These new restrictions have meant that many local governments have reigned in their spending over the past couple of years. Local government investments fell from 44.24bln złoty in 2010 to 42.43bln złoty in 2011 and then 35.61bln złoty in 2013. The problems for local governments are compounded by their lack of income. This has not just been caused by the effects of the economic slowdown, but by changes to the tax laws enacted in 2009 (see above), which caused a decline in revenue from PiT and CiT that is shared between central and local governments. However, whilst the central government has been able to partly offset this loss through raising indirect taxes, local governments do not have the power to do this.<sup>xxiv</sup>

If local governments continue to restrict their spending then this could have a serious effect on the Polish economy and local communities. The lull in public investment in recent years can partly be explained as a temporary stage as funds from the EU's 2007-2013 budget end and those from the 2014-21 budget have not yet arrived. If however local governments are unable to release the necessary funds needed to fully utilise EU structural and cohesion funds then Poland's economic growth will be depressed and essential investment in local infrastructure not carried out.<sup>xxv</sup>

The decrease in local government spending is already having a negative effect on some important public services, particularly education. Many local schools have been threatened with closure, in particular primary schools in small towns and villages. . In 2012 local governments passed resolutions intended to close 727 schools, which are particularly concentrated in the poorer rural areas of the country.<sup>xxvi</sup>

Figure 6<sup>xxvii</sup>:



### 3.3. Pressures to Reduce Public Debt

Despite having relatively low public debt in comparison to most other EU countries, there are still a number of pressures on the Polish government to bring it down. These include:

1. The rising costs of servicing the debt that are accentuated as an increasing share of it is held abroad.
2. External and Internal regulations that place limits on the size of the country's public debt.

As shown in *figure 4* public debt rose sharply following the outbreak of the global economic crisis, with the cost of servicing the government's debt rising from 2% of GDP in 2008 to 2.6% in 2012. In June 2013 the share of public debt held in foreign currencies crossed the 30% mark, with the percentage of this held in euros rising to more than 69%. The relative healthy state of the Polish economy has meant that the country has been generally positively assessed by the international rating agencies and the profitability of its bonds has reduced, meaning it pays less when borrowing abroad. However, the volatility of the global economy means that this can quickly change and international markets and institutions continually exert pressure upon the Polish government to bring down its public debt and enact reforms it deems desirable.

The second pressure on the government to reduce its public debt comes from internal and external regulations. We have already considered the public debt rule, anchored in the Polish constitution, that prevents public debt from rising above 60% of GDP and requires governments to introduce a balanced budget if it exceeds 55%. Additionally Poland has recently introduced four-year rolling fiscal plans, in order to provide medium term fiscal guidance.

Poland is also required to follow the public debt regulations of the EU. According to art. 26 of the Treaty of the European Union an excessive debt procedure may be carried out against a member state if its government deficit is above 3% of GDP or its general government debt is above 60% of GDP. If the Council of the European Union decides to initiate this procedure, it issues recommendations of actions that the country should take to reduce its deficit. Although not a member of the Eurozone, Poland has also voluntarily signed up to the EU's fiscal compact, which states that a country's annual structural deficit must not exceed 0.5% of its nominal GDP. Non-complying countries could be fined by the European Court of Justice, with a penalty equivalent of up to 0.1% of the country's GDP.

A structural deficit is defined as that portion of a country's budget deficit that is not caused by changes in its economic cycle. In 2013, Poland's structural deficit stood at around 3% of GDP, with the government predicting that it will fall to 2% by the end of 2014.<sup>xxviii</sup> In April 2013, the Polish government submitted its convergence programme for 2012-16 and national reform programme for 2013 to the European Council. Due to the economic slowdown, the Council judged that the Polish government's forecasts for deficit reduction were over-optimistic and that it would not be able to meet its medium term objectives of bringing down its structural deficit.<sup>xxix</sup>

### **3.4 Demographic Trends and 'Hidden Debt'**

As discussed at the beginning of this paper, the idea has been propagated that growing public debt is the root cause of the global economic crisis. This point of view is usually combined with arguments for cutting public spending and reducing social welfare services and benefits. It is also sometimes argued that the actual size of public debt is higher than it appears, as there is a large amount of so-called hidden debt. This hidden debt is made up of implicit liabilities, connected to demographic projections, which add up to future obligations of the state to make payments on such things as pensions and health care.<sup>xxx</sup> It is argued that this is effectively debt, despite the fact that no bond is associated with the promise. Hidden debt is formed once the future benefits that a generation is expected to receive is less than the payments that it is currently making. Such arguments have been deployed in Poland, due to negative demographic trends and projections.

We can identify two major demographic trends in Poland over the past two decades. On the one hand life expectancy has steadily increased, rising between 1990 and 2011 from 77.6 to 80 for women and from 69.7 to 72.1 for men. Yet, moving in the other direction has been the birth rate had fallen to just 1.38 by 2011. Alongside the mass emigration following Poland's entry into the EU (it is estimated that the number of Poles staying abroad for at least two months rose from 1m in 2003 to 2.3m in 2007) this has led to a dramatic fall in the growth rate of the population. For whilst the population of Poland increased from 32.7m in 1970 to 38.1m in 1990, over the next 10 years it only grew by 100,000 to 38.2m.<sup>xxxix</sup> One major social effect of this demographic change has been the disproportionate increase in the number of people above the age of retirement. During the past two decades the proportion of those aged under 14 has reduced by almost a half, whilst those who are 65 or above has increased by just over 3%. If this were to continue, then it would provide a major challenge to the government and public sector.<sup>xxxix</sup> According to the estimates of the Polish government, the proportion of citizens of working age compared to those over the age of retirement is set to grow from 2.6 in 2006 to 1.5 in 2030.<sup>xxxix</sup>

### 3.5 Neo-liberal Reform

The proponents for a new wave of neo-liberal reforms and extensive public sector cuts combine the arguments that large public debt lies at the root of the crisis, that this is further hampering sustained long-term economic growth and that the size of Poland's public debt is higher than appears due to negative demographic trends. This leads to the argument that the most urgent task for policy makers is to reduce this public debt through a comprehensive package of spending cuts and liberal economic reforms.

The most consistent representatives of this point of view are grouped around the former Finance Minister (and architect of the shock-therapy reforms at the beginning of the 1990s) Leszek Balcerowicz in his think-tank Civil Development Forum (FOR).<sup>xxxix</sup> In recent years they have proposed a package of reforms that include: speeding up privatisation, halting salary raises for teachers, abolishing subsidies for mines, abolishing subsidies for new born children, reducing unemployment benefit, raising the age of retirement and making it equal for men and women, withdrawing pension privileges for farmers, miners and uniformed workers, not increasing maternity leave and reducing subsidies for funerals.<sup>xxxix</sup>

FOR has been critical of Donald Tusk's Citizen Platform government (that has been in power since 2007), which avoided implementing a sustained programme of austerity during its first term in office. After returning to office in 2011, the three largest rating agencies made it clear that if the new Polish government did not introduce the structural reforms that it deemed necessary then it could face a downgrade.<sup>xxxix</sup> It was in this atmosphere that PM Donald Tusk

made his opening speech to the new parliament, setting out his government's priorities for its next term in office. He prioritised the reduction of the government's debt, aiming to bring public debt down to 42% of GDP by the end of 2015 and the budget deficit to just 1% by the end of its present term in office. A series of reforms were then introduced, one of which concerned the raising of the pension age. This law came into effect from the beginning of 2013, with the pension age increasing by one month every four months (i.e. three months annually). This will lead to the retirement age reaching 67 by 2020 for men and 2040 for women (these had previously stood at 65 and 60 respectively). It is hoped that this will reduce pension expenditures and increase labour activity, particularly for the elderly. However, although the government has implemented a series of further public spending cuts (such as freezing public sector wages and moving away from some universal benefits) these have not been at a level to significantly reduce public spending.

### **3.6 Reversing the Pension Reform**

The issue private pensions has become one of the main dividing points in Polish politics and taken centre stage in the discussion about how to control public debt. The call from within the government to at least partially reverse the private pension reform first came out of the Ministry for Work and Social Policy in 2009. Despite opposition from some within the government, the Minister of Finance then identified it as a means to bring down public debt, describing the private pension system as being 'a cancer, which attacks reform and has risen to a gigantic size, damaging the whole pension system and now public finances.'<sup>xxxvii</sup> Eventually, the government decided in 2010 to reduce the payment from ZUS to OFE from 7.3% to 2.3% of a person's income, with the proviso that this would rise to 3.5% by 2017. This resulted in public debt falling in 2011 for the first time in 6 years.

Despite this partial reform, the government has still had to bear the burden of paying for current state pensions whilst transferring a significant proportion of its income to the OFEs. At the end of 2013, the parliament approved a new law (due to come into force in February 2014) to bring down its public debt through introducing a new reform of the private pension system. This involved shifting 51.5% of the assets held by the OFEs (which are mainly government bonds) to the state pay-as-you-go system. Further planned actions include banning the OFEs from investing in treasuries and treasury-guaranteed fixed income securities, although allowing them to be freer to invest in other more risky equities. Furthermore, during the ten years prior to an individual's retirement a person's funds held by OFE will be transferred to ZUS. Finally, between April and July 2014, every client of OFE must decide whether they want to continue investing in OFE at all or have the whole of their pension payment put into ZUS. If an individual does not

declare their preference during this time, then their payments will be automatically directed exclusively to ZUS. Although this reform does not amount to a complete abolition of the compulsory private pension system, it does significantly dismantle it, which will result in an immediate reduction in public debt.

#### 4. PUBLIC DEBT AND ECONOMIC/SOCIAL INVESTMENT

##### 4.1. Does Public Debt Matter?

The argument that public debt is the major cause of the present global economic crisis is erroneous. Prior to the outbreak of the global economic crisis private debt soared, as credit became available to ever widening sections of society as a temporary means to keep the economy growing. In the USA private (that is household and non-financial company) debt equalled 168% of GDP by the end of 2007, three times larger than government debt. The major debt bubble instigating the economic crisis was therefore private not public. Nevertheless, alongside the disproportionate rise in private debt, public debt also continued to increase. For example, central government debt within the Eurozone countries grew (in 2011 prices) from just under €4.6bn in 1999 to over €7.8bn in 2010.<sup>xxxviii</sup> As we have seen above, central government debt also rose steadily in Poland prior to the crisis. However, the major increase in public debt has in most cases been a *result* of the economic crisis, due to depressed growth, rising unemployment, increased social expenditures, bank-bailouts and quantitative easing.

There is no decisive evidence to suggest that high levels of public debt in themselves repress economic growth. Governments are sovereign bodies that have the authority and powers which others do not have (e.g. through raising taxes or issuing money). Debt can be a means to accumulate resources needed to instigate investments that can have huge future economic and social benefits. There is a logical argument for supporting the government increasing its debt during a period of economic regression or stagnation, in order to fund the public investments needed to counter negative economic cycles and depressed rates of private investment.<sup>xxxix</sup>

The reasoning that hidden debt is a threat to economic stability, and that such things as public expenditure on pensions need to be slashed, is also flawed. There is no justification for setting a target for the debt-to-GDP ratio as an aim of economic policy. There is also no reason that one part of the government cannot run perpetual deficits (such as on pensions) as long as others have surpluses. The advocates of intergenerational accounting do not take into account the real assets (such as infrastructure) left by other generations.<sup>xl</sup> It also tends to focus on demographic trends (which can change) and not on the labour activity rates. Much of the potential fiscal gap



being created by the ageing of society could be closed if the employment rate (particularly of young people) was raised.

However, no country lives in an economic bubble but is incorporated into a globalised economy. Those countries that lie on the peripheries of the global economy (such as Poland and other countries in CEE) are especially threatened by a flight of capital and/or a withdrawal of foreign investment. International financial institutions and transnational bodies (such as the EU) place pressure on these countries to bring down their public debt and introduce prescribed economic reforms. Whilst its present level of public debt should not be of particular concern to Poland, the pressure placed on it by international markets and institutions (reflected in its own constitution) compels it to prevent this debt from rising, thus restricting its public spending.

#### **4.2 Public Investment and Growth**

We have already considered how a major factor helping Poland to avoid a recession, since the outbreak of the economic crisis, has been its ability to raise its level of public investment. This is an example of what Keynes termed the 'socialisation of investment', whereby the government needs to step in to drive economic investment at a time when private companies are not themselves investing. Whilst this increase in public investment in Poland may not have been at a level needed to return the economy to its previous rate of economic growth, nor reverse the negative trends in the labour market it was sufficient to prevent an economic decline and to some degree protect its economy from the worst effects of the crisis.

From 2012, this rate of public investment began to fall, due to the reduction in EU funds coming into Poland and the ending of investment projects connected to the preparation of Euro2012.<sup>xli</sup> From this year a new EU budget comes into force; out of which Poland will have access to around €500bn (adjusted for inflation), which equals €1,890 per head, €82 more than that received out of the 2007-13 budget. Importantly, the Polish government also managed to negotiate that the level of EU money used to finance an investment project will remain at 85%; and that the EU will continue to cover the VAT paid on any EU financed investment project. This provides new opportunities for the government to once again raise its rate of public investment and increase economic growth.

It was partly for this reason that the government pushed through its reform of the compulsory private pension system. The reduction in public debt means that it can potentially free the money needed to gain access to these funds and begin new investment projects. A number of problem stands in the way, not least whether there will be enough room within local governments' budgets to put forward the necessary capital to co-fund new investments.

Concurrently, if these funds are not spent in a productive way (i.e. on investments that bring future economic and social returns) then this expenditure could simply result in the further expansion of the country's deficits and debt. There is some concern that the shift in emphasis, within the new EU budget, towards raising innovation rather than spending on investment projects, will mean that the rate of public investment in Poland will not be raised to the same extent that it had been during the previous budget.

#### **4.3: Social Spending, Poverty and Exclusion**

The huge deactivation of millions of labourers in Poland over the past couple of decades, and placing of millions more in conditions of precarious employment has had a serious impact upon the country's public debt. This has partly been due to the reduction in government income and also because of the necessity to provide benefits for those excluded from the labour market.

Across the OECD, taxation and social transfers reduce inequality by around 25%. As previously discussed, the Polish taxation system is skewed towards indirect taxes, that are more regressive than direct income taxes, thus reducing their redistributive impact. Therefore, although the overall tax burden in Poland is average in relation to other OECD countries, its redistributive impact is low.

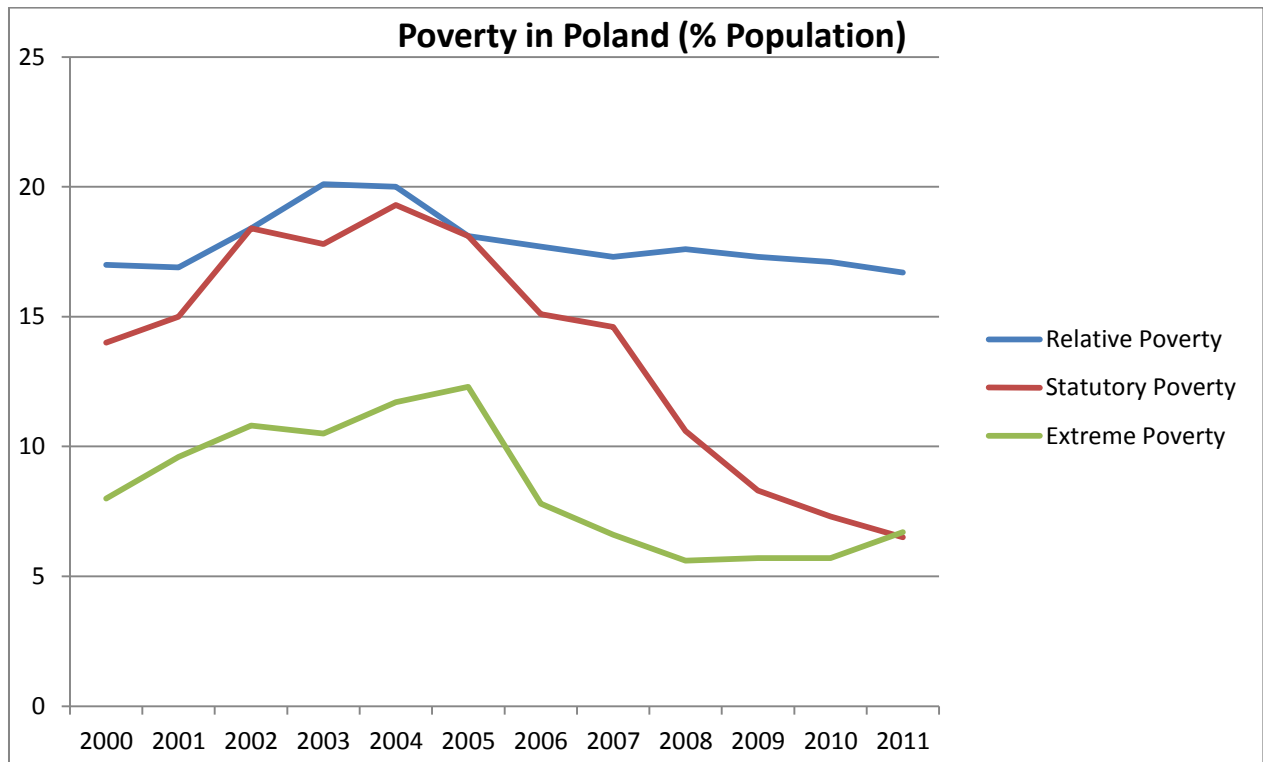
While taxation makes up about one-quarter of the redistribution of wealth, the remaining three-quarters is gained through cash transfers (such as unemployment benefits, family benefits and pensions). However, social transfers in Poland are well below the EU average in absolute terms and many excluded social groups receive very low social protection. This distribution of social spending has a significant impact on the levels of poverty amongst different social groups.

*Figure 7* shows a clear trend in changing poverty levels in Poland.<sup>xlii</sup> According to all the measurements of poverty, deployed by the Polish Statistics Agency, poverty grew sharply from 2000 until Poland entered the EU in 2004, it then steadily declined until the outbreak of the global economic crisis, before once again levelling out or slowly increasing. In spite of these changes, the levels of relative and absolute poverty remain similar in 2011 to what they had been in 2001 (we shall consider statutory poverty below). Poverty most affects those families in which at least one person is unemployed. In those families with one unemployed member, 11.5% were below the statutory poverty line, which rose to one-third of families with 2 or more members without work. However, due to the low income levels of many workers in Poland, just over 9% of those engaged in physical work live below the statutory poverty line (slightly above the 9% who are below the absolute poverty line).

Women are overly affected by poverty, due to the high level of deactivation of female labour and the relatively low wages that women receive in comparison to men. Extreme poverty is most pronounced in the countryside, with the percentage of farmers living in extreme poverty equalling 13.1% in 2011 (up from 8.9% in 2010). Those who have no paid income and do not receive sick benefits or pensions suffer the highest level of absolute poverty (21.9%). The level of absolute poverty also rises markedly in families that have more children, with 24% of families with 4 children or more living in absolute poverty, compared to just 2.3% of those with one child.

Children are at particular risk of poverty in Poland. In 2011, 10.5% of those under 18 years of age lived in households whose income was below the statutory poverty line and 9% below the absolute poverty line. This means that 31% of all those categorised as living in absolute poverty in Poland are under 18 years of age, whilst they make up around 20% of the whole population. Contrary to common perceptions, elderly people are relatively well protected from poverty. Just 4% of those aged above 65 live below the statutory poverty line and 3% below the absolute poverty line. Therefore, elderly people make up 7.5% of all those living in absolute poverty, whilst they account for one seventh of the whole population.

Figure 7<sup>xliii</sup>:



As a huge section of Polish society now stands outside of the labour market, the availability and distribution of benefits greatly affect the distribution of poverty. The restrictions on public spending, placed on it partly by regulations and concerns surrounding public debt levels, means that government spending on essential social services and benefits is limited. Any future austerity measures of cutting social spending in Poland would have severe social consequences and would result in further sections of society being pushed below the poverty line. Below is a summary of some of the most essential spending on social benefits in Poland.

### *Unemployment benefits*

The threat of poverty for the unemployed in Poland is particularly acute. Only 16.7% of all the unemployed receive unemployment benefits, which is given to claimants for a set period of time (between 6 and 12 months) and is of an amount below the relative poverty line.<sup>xliv</sup>

### *Sickness Benefits*

One result of this low availability of unemployment benefit, was the emergence of a large group of deactivated labourers living on sickness benefits.<sup>xlv</sup> In 2000, there were almost 3.5m people living on sickness pensions, although this had more than halved by 2010 to 1.5m. This was partly the result of the rise in employment levels in the country and the large-scale emigration that followed EU entry. However, it was also caused by the implementation of tighter regulations when applying for such benefits.

### *Pensions*

While the number of those on sickness benefits has sharply declined, the amount of pensioners has continued to grow (increasing from 4.6m in 2000 to 6.9 in 2010). The relatively high amount spent on pensions by the Polish government means that pensioners receive the highest level of benefits (averaging 1,755 zloty in 2010), thus cushioning this deactivated labour group from the worst effects of poverty. However the move in 1999 from a repatriation to an individual capital pension system (which has not been reversed by the recent government reforms) will result in future pensions, particularly for lower earners, being up to a half lower than at present, thus potentially sharply increasing levels of poverty amongst the elderly.<sup>xlvi</sup>

### *Women and Family Benefits:*

The deactivation of women in Poland was accompanied by the dismantling of many child care facilities and benefits. As a result women, particularly elderly women, have taken up a major share of child care responsibility in the country. This has been part of the general move away from the state pursuing an active welfare policy, that encouraged women into the workforce,

towards one where a large amount of social welfare is delivered through the family. Throughout the transition the Polish childcare policy has been characterised by its low extensiveness and quality of services, combined with low generous benefits that are difficult to gain access to.<sup>xlvi</sup>

In 2004 the government introduced a universal payment for parents of new-born children. However, this was only a one-off payment of 1000 zloty, a sum which has since not been raised. From 2013, this will be turned into a targeted benefit for families with a monthly income below 1,200 zloty.<sup>xlvi</sup> In October 2012, the government announced that it intends to extend maternity leave from 6 months to 12 months (with mothers liable to receive full pay during the first six months and 80% of their salary during the second six months.) It is hoped that this will encourage couples to have more children, although it could also further increase the deactivation of women in the labour market as these benefits are targeted mainly at mothers.

#### *Agricultural Subsidies:*

Poverty in Poland has a strong rural character, with unemployment highest in the countryside. Millions of ex-state farm workers became reliant upon their small, often subsistence based farms, which exist as a form of basic social security. The largest concentrations of those living on benefits are in the rural areas where state farms had once operated. For example, of the 20 municipalities where more than 20% of the population are on benefits, 10 are in the Warminsko-Mazurskie province (in 2 of these this rises to over 30%)<sup>xlvi</sup>.

After joining the EU, incomes in the agricultural sector began to increase, partly due to the availability of EU subsidies that already equal around 50% of farmers' income. From the end of 2005 until May 2011, Poland received around 139bn zloty in agricultural subsidies, of which 78.6bn zloty came in the form of direct subsidies. This has raised the income of those living in the countryside and helped to develop the infrastructure of some of the poorest regions in the country, creating an estimated 34,000 jobs in rural areas.<sup>1</sup> As noted above, however, this has not prevented a rise in poverty amongst some farmers since the outbreak of economic crisis, returning in 2011 to its highest level since 2005.

#### *Social Benefits:*

Social help is also available for individuals and families on very low incomes. Until October 2012, such benefits were accessible for a family (2 adults and 2 children) whose income did not cross 1,404 zloty and for a single person whose income was not above 477 zloty. These limits (which are the same as the statutory poverty line) are set by the government every 3 years, yet in 2009 the government did not raise it from the position established in 2006. This helps to explain why the statutory poverty index declined so sharply from 2006, with the Polish Statistics Agency

estimating that if it was defined according to the real cost of goods and services then the level of statutory poverty would actually have stood at 11.4% in 2012 instead of 6.5%.

This ensured that large numbers of people were pushed out of the benefits system, with an estimated 1 million children losing their right to benefits between 2004 and 2012.<sup>li</sup> In fact, for the first time in 2012, the percentage of those living in households below the statutory poverty line was actually greater than those receiving benefits. From October 2012 the government raised the threshold to 1,824 złoty for families and to 542 złoty for single persons. This was set according to prices existent in 2010, and therefore by 2015 some of those living below the absolute poverty line may not even be eligible to claim social benefits.<sup>lii</sup>

### *Health Spending*

Health expenditures as a proportion of GDP have risen from 4.8% at the beginning of the transition to 6.9% in 2011. Meanwhile, public expenditures, as a share of total health care spending, has decreased from 91.7% to 71.7%, although this has essentially remained stagnant since the mid-1990s. As technologies develop and populations age, so there is a need for more expenditure on health care. In relative terms Poland spends less than the OECD average (9.5%), having the fourth lowest rate of health expenditure out of all the OECD countries, below neighbouring states such as the Czech Republic (7.5%) and Hungary (7.9%).<sup>liii</sup> Furthermore, Poland has the second lowest level of health expenditures per capita out of all the OECD countries after Mexico.

## **5. CONCLUSIONS**

The size and character of public debt has historical origins reaching back to the period of Communism. The accumulation of large debt, through acquiring loans from abroad, placed the Polish economy in a dependent relationship with its creditors in the West. Although a large proportion of this debt was written off in the early 1990s, Poland had already embarked on a course of neo-liberal reform before the collapse of Communism which was then continued through the implementation of the shock-therapy reforms. One result of these reforms was the huge deactivation of labour that placed an unbearable pressure upon the country's public finances as income reduced and expenditures soared.

Partly in response to this reality, a new wave of neo-liberal reforms was introduced at the end of the 1990s. These reforms further repressed growth and increased the rate of unemployment. Meanwhile the creation of a compulsory pension system (based upon a model being promoted by international

financial institutions such as the World Bank) led to a sharp increase in public debt. With Poland adopting strict laws on controlling its public debt, there has been intense pressure to reduce public spending.

Despite these compulsions, Poland has been able to avoid a recession, since the outbreak of the outbreak of the global economic crisis, largely through increasing government spending and raising the rate of public investment. This<sup>5</sup> has been possible partly due to the large sum of EU structural and cohesion funds coming into Poland, since it joined the Union in 2004. However, the possibility of Poland being able to maintain its public spending, and take advantage of the EU funds available in the 2014-21 budget, is threatened as public debt nears its constitutional limit. It is for this reason that the government has begun to dismantle the compulsory private pension system, which immediately reduces its level of public debt.

The reform of the private pension system has eased the problem of public debt rather than solved it. Poland remains under pressure to maintain its public debt below levels laid out in its own constitution and by international institutions. Although Poland has fared relatively well, in comparison to many other European economies over the past few years, economic growth is depressed and deactivation on the labour market and levels of poverty high. It is therefore likely that public debt will continue to grow over the next few years, which could result in a future fiscal crisis. Poland already has some of the highest levels of poverty and social exclusion inside the EU and its levels of social benefits and services are at an extremely low level. Any further reduction in this spending or significant slowdown in economic growth would have severe consequences for large sections of society.

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- <sup>i</sup> Why Government Debt Burdens Really Matter, Financial Times, October 13 2013 (<http://tinyurl.com/nyagl5x>)
- <sup>ii</sup> Eurostat Newrelease, 114/2013 (<http://tinyurl.com/mhwzsr>)
- <sup>iii</sup> Reinhart, et al (2012) 'Public Debt Overhangs: Advanced Economy Episodes Since 1800', Journal of Economic Perspectives, 26/3, pp 1399-1436
- <sup>iv</sup> Kobayashi, K, 'A Theory of Public Debt Overhang' (<http://tinyurl.com/ojf4lk5>)
- <sup>v</sup> Hendron et al (2013) 'Does high public debt consistently stifle economic growth? A critique of Reinhart and Rogoff, Cambridge Journal of Economics 2013, 23/1
- <sup>vi</sup> By 2009 it was estimated that the global cost of the bank bail-out had reached around \$11 trillion – equal to \$10,000 for each citizen living in the world's richest countries. (<http://news.bbc.co.uk/1/hi/business/8249411.stm>)
- <sup>vii</sup> Slay, B (2000) 'The Polish Economic Transition: Outcome and Lessons' Communist and Post-Communist Studies 33: 49-70
- <sup>viii</sup> Germany was granted a waiver on its external debt, including the deferral of interest payments, from 1947 to 1952 as the Marshall Plan was implemented. In 1953, the U.S. also imposed the London Debt Agreement on its wartime allies, which wrote off Germany's external debt (<http://tinyurl.com/q3qmf2e>)
- <sup>ix</sup> Statistical Yearbook of the Republic of Poland, Central Statistical Agency, 2011
- <sup>x</sup> Szumlewicz, P (2011) 'Reformy podatków sprzyjają najbogatszym' in 'Podatki', Krytyka Polityczna, Warsaw.
- <sup>xi</sup> Eurostat Newsrelease, 77/2012 (<http://tinyurl.com/cf4du66>)
- <sup>xii</sup> Retirees here refers to those who had retired from work due to illness or disability and receiving state benefits
- <sup>xiii</sup> Zawadzki, E and Ciura, G (1997) 'Sytuacja Rodzin (Gospodarstw Domowych) Emerytów i Rencistów W Latach 1989-1995' Warsaw: Kancelaria Sejmu Biuro Studiów i Ekspertyz (<http://tinyurl.com/3fm7qj9>)
- <sup>xiv</sup> Cain, Michael J.G. and Aleksander Surdej, 1999, "Transitional Politics or Public Choice? Evaluating Stalled Pension reforms in Poland," in Cook, Orenstein, and Rueschemeyer, eds., (1999).
- <sup>xv</sup> The blueprint for the private pension system evolved in Latin America, more precisely in Augusto Pinochet's Chile in 1980. In 1994 the World Bank published a key report – 'Averting the Old Age Crisis' – that supported the establishment of a three-pillar pension system and it began to openly promote this model. Between 1981 and 2007 over 30 countries fully or partially replaced their state funded pension systems, with individual private savings accounts. This included a number of CEE countries, such as the Baltic States, Bulgaria, Hungary, Poland and Slovakia.
- <sup>xvi</sup> Oręziak, L ' OFE i inne plagi polskie' Salon24 (<http://tinyurl.com/lxymzex>)
- <sup>xvii</sup> Source: Ministry of Finance
- <sup>xviii</sup> Source: Eurostat
- <sup>xix</sup> The Polish government counts public debt according to the general government methods, whilst the EU calculates it as state public debt. The main difference between the two methods is that the latter includes National Road Fund, resulting in a higher level of recorded public debt. Zalega, D, 'Skąd się bierze polski dług publiczny?' Le Monde Diplomatique (Edycja Polska), 6/64, June 2011
- <sup>xx</sup> 'Ekonomiści: rząd dopuszcza wysoki deficyt budżetu', Puls Biznesu, 30 April 2013 ([TinyURL.com/ptrkx25](http://TinyURL.com/ptrkx25))
- <sup>xxi</sup> Informacja Kwartalna o Sytuacji Makroekonomicznej i Stanie Finansów Publicznych w II Kwartale 2013' Polish Ministry of Finance, Nr 4 / 2013 (<http://tinyurl.com/l82mqhc>)
- <sup>xxii</sup> Source: Eurostat
- <sup>xxiii</sup> Source: Eurostat
- <sup>xxiv</sup> 'Local governments will have hard time passing budgets', Obserwatorfinansowy, 10 September 2013, (<http://tinyurl.com/lfb9vxx>)
- <sup>xxv</sup> The EU budget (2014-21) is also concentrated more on raising innovation rather than on increasing investment.
- <sup>xxvi</sup> 'Likwidacja szkół. Aż 727 placówek na liście' Money.pl 28 February 2013 (<http://tinyurl.com/qj8z7m8>)
- <sup>xxvii</sup> Source: Eurostat
- <sup>xxviii</sup> Deficyt strukturalny w 2014 r. ok. 2 proc. PKB – Rostowski, "TMS Brokers", 1 March 2013 (<http://tinyurl.com/ppgs9ra>)
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- <sup>xxix</sup> 'Council Recommendation on Poland's 2013 national reform programme' European Council, 29 May 2013 (<http://tinyurl.com/pay7tqa>)

<sup>xxx</sup> The idea of hidden debt has developed out of *generational accounting*, which emerged at the beginning of the 1990s and claims to predict the future fiscal effects of payments to current and future generations.

<sup>xxxi</sup> Statistical Yearbook of the Republic of Poland, Central Statistical Agency, 2011

<sup>xxxii</sup> Those above the age of retirement in Poland currently equals 13% of society (EU average 17%), which is predicted to rise to 26% in 2030 (EU average 27%). In line with present trends, the Polish population is expected to decline by 7 million people between 2060. During this time those of working age (15-64) will fall by 11 million and those above the age of retirement will grow by 6



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million. This would mean that those above the age of retirement in Poland would equal 36% of society, which would be the highest in the whole of the EU. (Szumlewicz, P, 'Pytania o reformę emerytalną' Gazeta Wyborcza, 17 March 2012 (<http://tinyurl.com/pjb9xpj>))

<sup>xxxiii</sup> 'Polska 2030' The Chancellery of the Prime Minister, 2008 (<http://tinyurl.com/d44ucn4>)

<sup>xxxiv</sup> <http://www.for.org.pl/>

<sup>xxxv</sup> Rae, G. 2011. 'Poland's Stalled Pension Reform. How Reform of the Private Pension System has Shaped Public Policy Debate'. Paper delivered at ESPNET conference, September 8-11 2011 (<http://tinyurl.com/k8pa2fs>)

<sup>xxxvi</sup> Tusk did not even attempt to conceal that the main purpose of his speech was to appease the financial markets, stating 'I do not hide the fact that the aim of this is to stabilise the financial situation of Poland. This is positive for the reputation of Poland and connected to the security of our bonds.' ('A Speech for the Rating Agencies' Beyond the Transition, 19 November 2011 (<http://tinyurl.com/kd5p7fn>))

<sup>xxxvii</sup> Rostowski's criticism of the OFE is particularly striking, considering that he was both economic adviser to Leszek Balcerowicz when he was Finance Minister from 1989-91; and also ran the macro-economic council in the Ministry of the Economy between 1997 and 2001 (i.e. when the pension reform was implemented.)

<sup>xxxviii</sup> Paradoxically, the introduction of neo-liberal policies have tended to increase public debt. While, for example, the Thatcher government managed to reduce government spending in the UK (with total managed expenditure (TME) decreasing by 5.9% (£83bn) during the first ten years in government) total government debt actually increased from £98bn to £157bn during this period. Furthermore this all occurred during a time when government finances were boosted by soaring North Sea oil revenues - which equalled 3.2% of GDP in 1984/85.

<sup>xxxix</sup> Kalecki, M. 2010. 'Political Aspects of Full Employment'. Monthly Review (<http://tinyurl.com/cp9ood2>)

<sup>xl</sup> Galbraith et al. 2009. 'The Case Against Intergenerational Accounting' Public Policy Brief, The Levy Economics Institute of Bard College No.98 (<http://tinyurl.com/27j8qbo>); Williams, J & Rhodes, A. 2011. 'A critical assessment of generational accounting and its contribution to the generational equity debate' International Journal of Ageing and Later Life, 6(1): 33-57

<sup>xli</sup> Many of the investments connected to euro2012 were not in the long term interests for economy and society and have left large deficits for local governments. This is particularly the case for the stadiums build for the tournament, that were funded by central and local governments without using EU funds.

<sup>xlii</sup> All statistics included in this section from now on (unless otherwise stated) are taken from 'Ubóstwo w Polsce w 2011'. 2011. Polish Statistics Agency (<http://tinyurl.com/qcouhvw>).

<sup>xliii</sup> Source: Polish Statistics Agency

<sup>xliv</sup> In 2010 unemployment benefit equalled 632.31zł, whilst the relative poverty line was 665zł and the absolute poverty line 466zł.

<sup>xlv</sup> Sickness benefits are on average higher than unemployment benefits, equalling 1,300zł in 2010.

<sup>xlvi</sup> 'W rentowej pułapce', Przegląd, 21/2011 (<http://tinyurl.com/knqbm5>) <http://www.przegląd-tygodnik.pl/pl/artykul/rentowej-pulapce>:

<sup>xlvii</sup> In a comparative study of Polish child care policy in CEE, Poland was found to exclusively fit to a model described as *implicit familialism*. This means that its policies are formally neutral, whilst assuming that the state should not interfere with the family carrying out its task of educating children. The state does not attempt to suggest where care should be located nor does it try to mobilise women in the labour market. Due to gender inequalities and the lack of childcare facilities and benefits, the responsibility for bringing up children is left almost exclusively to the family, primarily women. (Szelewa, D & Polakowski, P. 2008. 'Changing Patterns of Childcare in Central and Eastern Europe, Journal of European Social Policy, May 2008 vol. 18 no. 2 115-131)

<sup>xlviii</sup> '100zł na dziecko becikowe zostaje o staremu', Gazeta Wyborcza, 4 October 2012 (<http://tinyurl.com/obtct7s>)

<sup>xlix</sup> Poverty and Social Exclusion in Poland, Social Watch, 2010 (<http://tinyurl.com/q8q7v28>)

<sup>i</sup> 'Polska wieś bogaci się dzięki dotacjom', Rzeczpospolita, 1 July 2011, (<http://tinyurl.com/psrf5rd>)

<sup>ii</sup> 'Człowiek jest zbędny, gdy nie może kupować' Gazeta Wyborcza, 4 July 2012, (<http://tinyurl.com/myut7qp>)

<sup>iii</sup> 'Pomoc będzie... nieskuteczna. Nowy Obywatel, 21 July 2012, (<http://tinyurl.com/plmuron>)

<sup>iiii</sup> OECD (2013), "Total expenditure on health", *Health: Key Tables from OECD*, No. 1. (10.1787/hlthxp-total-table-2013-2-en)