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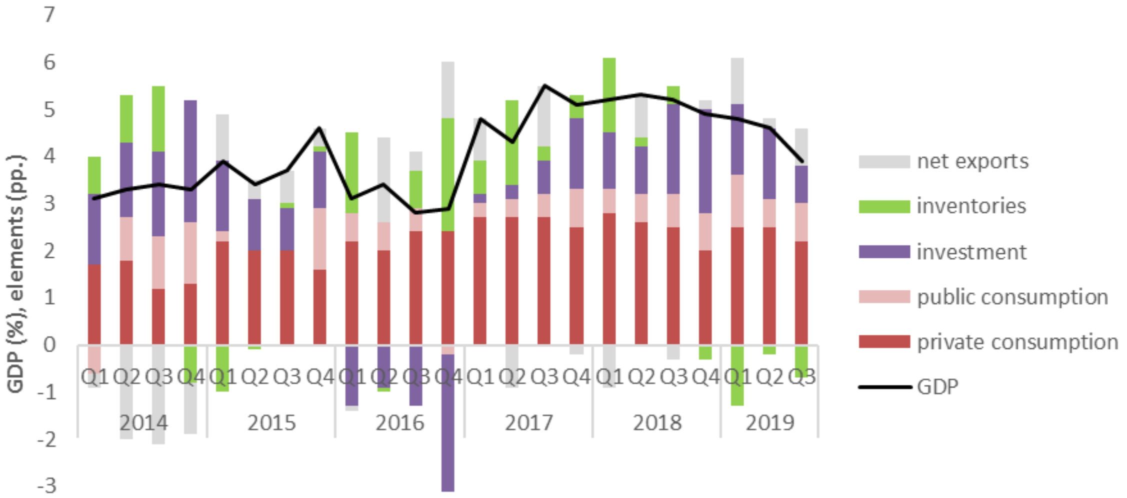
THE CHALLENGES OF COUNTERCYCLICAL POLICY IN POLAND

The electoral campaign has at last ended. This time a lot of effort was made to convince the voters that the large flow of social transfers will be safeguarded only by the ruling party – and at the same time without increasing the budget deficit. Unfortunately, the arithmetic is uncompromising: increasing expenditure can be either covered by the larger flow of revenues or by higher deficit. During its first term, Law and Justice (*Prawo i Sprawiedliwość*, PiS) picked low-hanging fruits on the revenue side, partially due to extremely favourable business cycle, partially because of general trends, such as improved VAT collection. This period could have been also used to reduce the Polish debt – it, however, happened to a limited extent. Poland recorded one of the smallest reductions in structural general government deficit in Europe.

On the final stretch of the electoral campaign it turned out that gaining marginal voters is achieved by offering new forms of targeted support, which – unsurprisingly – require additional revenues. Expectations that generous social transfers will entail an additional burden on entrepreneurs were quickly mitigated by the announcement that entrepreneurship will be subject of next public programme. Apart from its overall assessment, it should be mentioned that was targeted mainly at the SME sector, accounting for over 95% of all companies, and thus, a significant group of voters. Unfortunately, questions regarding the sustainability of such developmental model in the period of economic downturn were barely heard.

Figure A. Annual GDP dynamics and its components 2014-2019



Source: Own elaboration based on Statistics Poland.

Now is the time when the economic downturn has to be faced. According to Statistics Poland, dynamics of the Polish GDP is significant lower than a year ago – recent data point (for 2019Q3, issued in Nov 2019) records 3.9% y/y, while a year ago it was 5.2% y/y (→ Figure A). In this light, the probability of a smooth downturn in 2020 is significantly reduced – first because of the observed trajectory, and second because of the growth structure. It seems that neither consumption nor investments are robust motors of the economy anymore. The former is quite striking since the preconception of social spending programme was fiscal stimulus. The latter is still better than 2016 when the input to GDP was negative. Government investment spending will doubtlessly be reduced due to the schedule of EU-funded spending. Keeping in mind that at the time when the future of global economy – and thus, our exports – is uncertain, little bang for the buck in consumption and failure in investment herald troubles.

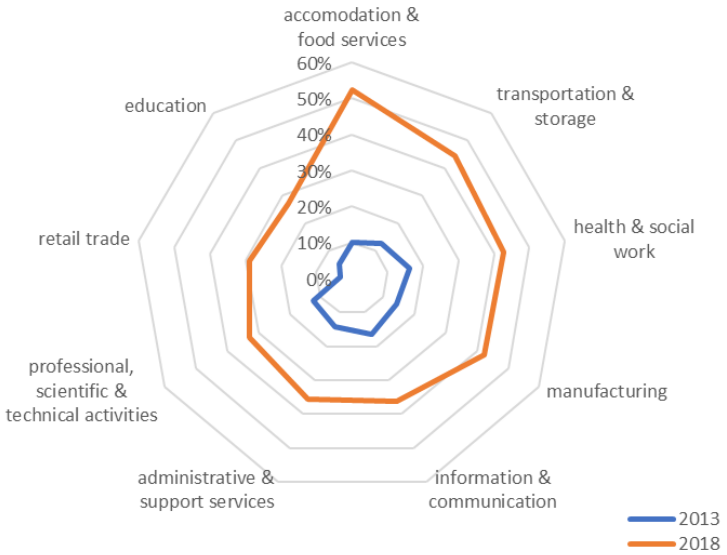
The challenges arise not only from the need to conduct countercyclical policy, but also because the resources for it had not been accumulated, while the fiscal space is limited due to expenditure rule. Even more confusing is the observation that these resources could have been used for a significant transformation of the Polish economy from cost-competing to product-competing one. We argue that such transformation (even more necessary, keeping in mind the promise of a significant shift in the minimum wage) simply has to be implemented, and further obstruction is no longer possible, not to mention it would be costly. Its implementation before the downturn would constitute sound countercyclical policy. However, regardless of the costs it has to be implemented now. From the political viewpoint, this might be only slightly more difficult since streamlining the legislation is no longer possible (opposition winning in the Senate, left-wing party challenging the government in the area of social expenditures and right-wing nationalistic party contesting the national character of developmental policy).

Unsurprisingly, Poland is struggling with structural issues that most likely cannot simply be mitigated by the slowdown. Let us briefly discuss three of them:

1. deficits of skilled workers and high labour costs

while demographic ageing is an obvious long-term policy challenge, at least in the short run this issue may be properly addressed. With unemployment below the natural levels one should search for other reserves, of which the most promising are the inactive: effective retirement age is far below the (low in international comparisons) legal retirement age, the school-work transition is not smooth, while social programmes have increased the opportunity cost of childbearing and childrearing. There is also no interest in improving either the matching mechanisms on the labour market, or the system for life-long learning oriented at filling the current and future needs of the economy. Last but not least, no political will can be mustered to create a sound migration policy. It is therefore not a surprise that high unfilled demand drives up labour costs, which is among the most severe challenges of doing business in Poland, regardless of the sector and company size (→ Figure B).

Figure B. Skilled labour shortages as a barrier of doing business for the company

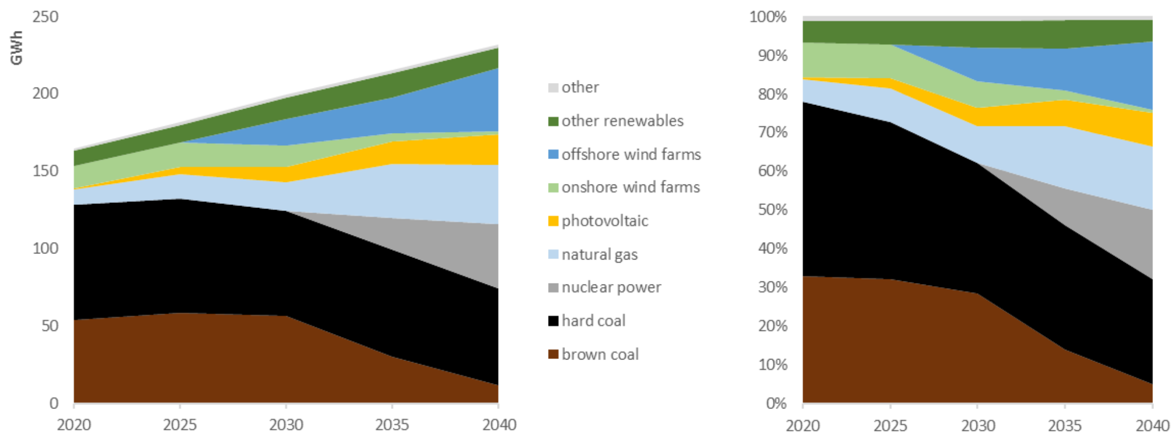


Source: Own elaboration based on Statistics Poland.

2. obsolete energy mix

businesses vary with regard to the use of energy in production processes between sectors and so varies their exposure to energy prices volatility. Keeping in mind the obsolete energy mix (→ Figure C) and high resistance to significant changes, the mid-term positive trend in energy prices is inevitable. As for 2019 and, presumably, 2020 this issue was solved with arbitrary price freezes for households and subsidies for smaller businesses, however, this is not a sustainable solution. Moreover, as in the case of temporary and political solutions, it generally increases the overall uncertainty among businesses. Since the price scissors between conventional sources and renewables will broaden favouring the latter, financial incentives become increasingly clear. Unfortunately, the sector is to a large extent public, and potential for leapfrogging is limited.

Figure C. Polish energy mix 2020-2040 – absolute (left panel) and relative terms (right panel)



Source: Own elaboration based on PEP 2019.

3. highly unstable law, its poor quality and poor social dialogue

Until 2019, the count of pages of new legal acts was increasing systematically. While this is not the optimal metric, the process of legislation was streamlined. This allowed to pass several bills almost overnight. Low priority assigned to the regulatory impact assessments and subsequent by-passing the social dialogue council led to introduction of a number of acts that are evidently detrimental to the overall economic environment. Among them: 2020 minimum wage (first government offer outbid the trade unions' one, and then once again was raised by the government soon before the elections) and removing the cap for social contributions (in 3 attempts). Unsurprisingly, both affect companies first and foremost, who have often at best a quarter to adapt to the new cost function.

The common denominator of the three abovementioned issues is their impact on long-term business uncertainty. This seems to be a theoretical issue, unless one observes its effects, in particular the propensity to invest. It is low at the moment and was uncommonly low in the expansion period, so that economic theory did not give much of a chance to improve it in a recession. While it is not clearly stated in the data, partial information allows to confirm the hypothesis that investments are highly concentrated in the economy. In other words, smaller entities, unable to offer competitive salaries, reliant on subsidies and struggling to hire legal assistance due to dynamically changing legal environment (in particular, taxation), are the ones which will not risk their businesses with long-term investment. Convincing them of the need to invest is necessary, if the state wants them to respond to new demands, increase international competitiveness and modernize the economy.

From this perspective the November expose of the Polish PM, Mr Morawiecki was disappointing. The diagnosis regarding the economic slowdown was only outlined, and in consequence, not much was discussed as a concrete anticyclical policy. The speech did not give straightforward answers to long-term developmental policy questions, either. While it was clearly stated that cost competition is no longer possible, that consumption as a motor of economy has to be strengthened by the investments (and the sources of these investments will come from additional labour cost burden, PPK), innovations have been treated pointwise, and improving business environment was limited to deregulation (both in quantitative and qualitative terms) and mysterious support package. Moreover, there is some slight reorientation towards more renewables, however, not compromising with conventional sources. Last but not least, in the area of labour market, recent achievements were emphasized instead of presenting the future plans. Unchanged is the positive attitude towards re-emigration – this is however highly questionable, whether Poland, experiencing a trough and being at risk of falling into a middle-income trap, can become a hospitable country for savings-rich re-emigrants. This, however, will be seen in a year at the earliest.