

Budget Deficit and the Crisis of the Public Finance in Poland

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Introduction. The present crisis of the public finance with its deepen in of the budget state deficit in Poland has caused animated economic discussions about its origin reasons and negative effects which Polish government will must be manage the next years with. Surely, it will be a truism and insufficient explanation of this subject when it affirmed that the high increase of budget deficit became a main reason of state financial problems. That statement automatically implicate another following questions:

- Is occurring budget deficit being inseparably connected to crisis of the public finance? But, a budget deficit is not exceptional component in budgets of many developed countries or many developing countries living trough the economic growth.
- The most suitable question is then: How growth of the deficit can say, that is the main reason of the crisis?
- Budget deficit never arise from a void, there have to appear other factors, which determine it, so contribute to indirect creation of the crisis in this way. Is budget deficit a homogenous process?
- So, if there are exist, in fact, maybe it means that budget deficit is only a next stage or a symptom of approaching crisis?
- Generally, is there any possibility or connection between current crisis the of public finance in Poland and high level of budget deficit?

As it seen, the foregoing questions indicate about complexity of the analysed subject. Even if we are trying to get to the point of it, only partly we will have to take into consideration of many variety factors: economic, legal, social or political which are connected and affecting themselves. This is why on the basis of the mutual relationships many domestic market economies and whole world market economy are operating, making big communicating vessels system. Even a little change one of all is causing chain reaction of the whole system. Defining all the factors bringing about the budget deficit, analysing current situation of Polish economy additionally, it makes possible to get to the heart of the matter, in which helps us chart 1- „the causal chain reaction of budget deficit in Poland”. Many reasons involved there and their varieties (origin - secondary, indirect – direct, legal – economic – social) let to give us negative answer about homogeneity of the budget deficit. The limited size of this paper cannot give us a sufficient explanation of all reasons, that’s why the author tries to focus his attention on these which are the most important. However, at the beginning of this paper, it is possible to venture to express an opinion that all the factors causing decreased budget revenue without a correction of budget expenses scale at the same time created highly negative balance of Polish budget state in 2001 and lots of problems with a budget bill of 2002. Furthermore, wrong economic assumptions during creating the 2001 budget bill, wrong budget policy in the middle of its execution and lack of state financial discipline brought about two amendments in July

and December last year by rising budget expenditure and thereby level of the budget deficit of 60,6 %, comparing to this value in budget act before amendments (graph 1).

In the end of the introduction we have to look at another important issue, which can be essential for the following analysed problems later. Namely, it is meaning about the relations between budget state deficit, deficit of the whole public finance sector and economic deficit. The paper treats budget state deficit mostly; which is a component of these values. That paper's conception can be a ground for charging with some included explanations are not credible until the end in the light of global character of public finance. In author's opinion it won't diminish of the science credibility of the paper. According to the Ministry of Finance data of 2001 the budget deficit of Poland is almost 90 % of the whole economic deficit that proves about its enormous influence on Polish public finance. But in these fragments of the paper, where it turns out sensible it will be taken into consideration the budget deficit value of the whole public finance sector.

The budget deficit reasons. A thesis that the present crisis of the public finance in Poland has been determined only by the events from 2001 is directly incorrect. The causal chain reaction model has mentioned above, relates to multistage process, beginning with the events (in meaning: reasons) origin - indirect, with long-termed nature, until their effects, which are secondary – direct reasons at the same time (II stage). Due to shorter term of results appearance that last ones, they already directly reflect getting worse economic situation of the country. Lack of preventive activities at the Ist and IInd stage consequently leads until moment, where the budgeted revenues sources – of the largest public fund – sudden decrease themselves. Simultaneously, unchanged scale of budget expenditure and their frequently growth, it shows itself negative budget balance. Obviously, when it doesn't exceed of planned value in the periods of time and there are exist financial sources it cannot still talk about the crisis yet. The probability of its appearance grows along with the degree of escalating direct reasons (stage IInd).

The reasons correlation of time variety, that has been presented above, is a confirmation of the term – „chain reaction” that the author has used. Certainly, the model can be divided into even more stages, depending on the extend of the details in the analysed process. Under the discussed circumstances we have to explain an essence of the creation mechanics of budget deficit and crisis of the public finance. Below, the author tries to prove of its working, analysing individual trends that affect whole current economic situation of Poland.

1. Labour market. Currently, extent of unemployment rate in Poland is the one of the most important social, economic and political problems. One ought to put emphasis on its effects, which are very intense especially for the budget state. Namely, when an unemployment rate is rising up much more than government expectations then, not only a spending side of budget is rising, but also revenue stream is much less on title of lost tax incomes from people who have been dismissed. In this moment they are not „the source of financial support of a budget” but „the source of financial load of it”.

This year, in January of this year, the registered unemployment rate ran into 18 % of active population (graph 2). In the justification of National Budget Act of 2002, Polish Cabinet's expecting that its continual growth is going to be in 2004, when the GDP¹⁷⁸ dynamics will approach to 4 %. Negative situation of the labour market in Poland have been caused by many factors and at the same time they are big loads

¹⁷⁸ GDP- gross domestic product

for employers i.e.: high taxes and social security contributions, non-flexible labour code, strong favouring employees' rights, unclear and complicated legal regulations making difficulties with beginning and running a business (legal area). Additionally, the population boom of 80's that participants entering into productive age, is a negative impulse.

2. Corporate sector. Mentioning the legal area, in which operate Polish enterprises, one ought to refer their economic area too. In IIIrd quarter of 2001 the dynamics growth of sold production of industry was running at 0,8 % only in relation to 6,8 % value in the year 2000. Such low level has been caused with a decrease in households' incomes and thereby drop in rate of domestic demand (graph 3). According to graph 3, in the face of declining tendency of domestic demand and import growth rate ensured an increase of export. As a matter of fact, its growth rate decreased last year but it still has remained at high level. Some of experts explain the situation that enterprises in the face of low demand for goods on the domestic market, look for their place on the foreign markets. This is a positive forecast of the balance of foreign trade in the future, especially as if we pay attention to the fact that in 1998 took place a sudden slump in external trade with countries from the East Europe (Russia, Belarus, Ukraine). It doesn't mean current situation is completely satisfactory. A balance of export and import from January to November of 2001 amounted to 12,8 billion of USD¹⁷⁹ to the second one advantage. Profitability of foreign trade turnover would be better if the level of Polish exchange rate in relation to foreign exchanges wasn't still as high as it was.

3. Economic growth. Probably, the most forcible factor that shows economic situation is the changes dynamics of GDP. In Poland, its rate growth dropped up to 4,8 % in 1998 comparing with 6,8 % in 1997 (graph 4). Then, it was just a disturbing symptom of approaching crisis, which apogee it has been experienced by Polish economy and state public finance. That situation has forced government to undertake definite of activities. The problem is shown by the following fact: The 2001 National Budget Act planned 5,1 % growth of GDP but during its execution, it has turned unfeasible (according to CBS¹⁸⁰ data a real growth rate in 2001 was running at 1,1 %). This year Polish government predicts only 1 % growth. One should return to the issue that has been mentioned at the beginning of this paper. Surely, during the first half of the last year there were occurring processes (direct reasons) that real values seriously threatened with loosing of budget state cash flow. After the first half of the year revised economic forecasts reduced GDP rate of growth up to 2,3 %, it was ensured faster increase of unemployment rate and getting worse financial situation of enterprises affected ability to tax payments. These changes caused considerable ranges in execution of budget incomes and expenditure. In the face of budget slump, the government proposed to the Polish parliament the amendment of National Budget Act. The amendment passed in July of 2001 and concerned reducing of planned incomes and increased budget deficit of 43,8 % (graph 5). Obviously in this situation, it was much harder to reduce of expenditure and to keep budget deficit on planned level for the sake of some constant budget expenditure. Undoubtedly, one component of the budget redistribution mechanism – stream of budget incomes – wasn't as much as cover „demand” of stream budget expenditure and thereby causing unplanned budget deficit. The second amendment of state budget in December 2001 increased of budget deficit up to 7,8 billion of USD with the help of expenditure

¹⁷⁹ All amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN). Ministry of Finance and Central Bureau of Statistics.

¹⁸⁰ CBS- Central Bureau of Statistics

rising. Ratio legis of this amendment, according to argumentations of the Cabinet, was avoiding of loosing the state budget cash flow, destabilisation of public finance and possibility to make current state payments.

Aside from characterized above reasons influencing the balance of state budget and Polish economy condition, it can enumerate another ones: high cost of social reforms (social security, health, education), slowing down of privatisation and restructuring process of enterprises, insufficient fiscal discipline and public expenditure rationalization in public sector. One ought to take notice of decrease in budget revenues and increase of the tax arrears too.

From 1998, it has been noticed process of incomplete execution of tax budget incomes in relation to planned values (graph 6). In 2001, if parliament hadn't amended of state budget, tax incomes execution would have amounted to only about 86 %.

Next, according to Finance Ministry data (table 1), last year was characterising by 33 % growth of tax arrears. The mentioned fact can prove about raised scale of state fiscalism and thus can cause deepen of the black economy. These trends are heightened by unclear of tax law or too high tax rates.

The effect of budget deficit. The problem of high budget deficit doesn't concentrate on its reasons only. It's necessary to make oneself aware of its negative results too, which will be appeared next years. One of the first direct one, that has already signalled its presence, has been problem with a preparation of the 2002 budget bill, and to be precise, with a balance of it. Undoubtedly, present Finance Minister has been stood face to face with dilemma of deficit finance: way of state budget cuts and increasing of budget revenue what means charging of taxpayers or with the help of state securities issue, thereby deepening of high state public dept, which will be financial ballast for Polish society in longer prospect of time. It has been chosen compromise option. On the one hand, reducing budget deficit up to 9,5 billion of USD, it has been decided to introduce many fiscal solutions. They have been concerned stopping reduction of taxation rates and partly abolition of personal tax relieves, taxing of capital gains (collected on the personal bank accounts or invested in purchasing of state securities), increasing of VAT of some consumer goods. It didn't avoid of budget cuts of some budget fields too. On the other hand, Finance Minister will be forced to increase issue of state securities. Its value is running into 7,7 billions of USD, that gives about 82 % of all financing sources of the budget deficit (table 2). For the most part, this year's value of negative budget balance will increase of the total amount of national public dept¹⁸¹ which is assessed at 86,5 billions of USD (table 3). Thereby, budget deficit is not only a current budget load but in the form of public dept exerts far-reaching effect on state public finance.

Analysing above data, in this moment it will be justified to answer asked earlier question: What size of budget deficit value does influence real crisis of the public finance?

Undoubtedly, it would be mistake to answer without any doubts and announcing exact values. Every domestic market economy is characterising its own specificity, too many factors, affecting themselves are forming of economy conditions and which have been confirmed by model of "causal chain reaction". Such indicators, needed to define budget deficit value, could have been membership conditions of monetary union including in Maastricht Treaty, just referring to public finance deficit and public debt, i.e.:

- state public dept value non-exceeding of 60 % of GDP,
- budget deficit value of public finance non-exceeding of 3 % of GDP.

¹⁸¹ NPD- national public dept

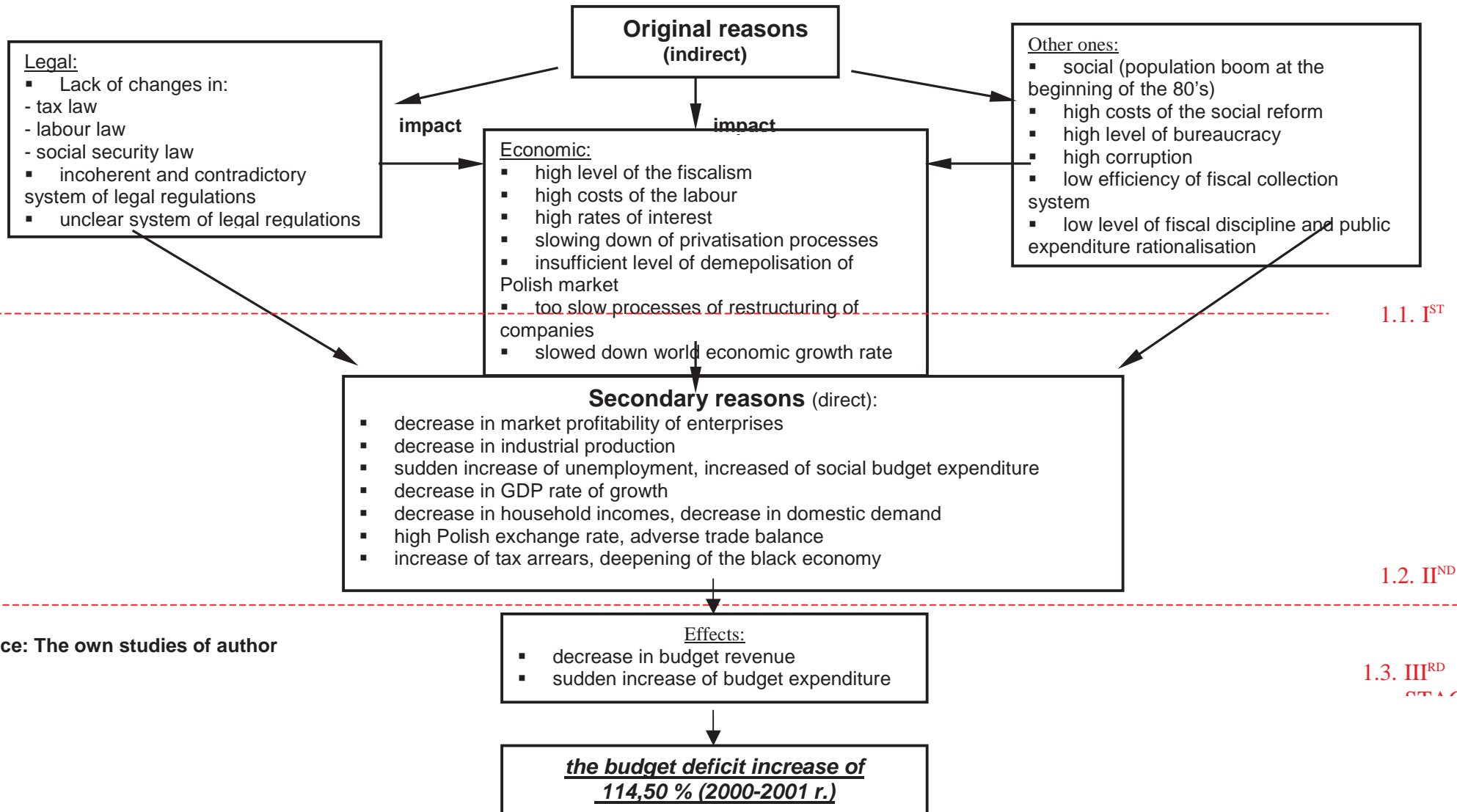
Taking these relations into consideration it's not allowed to forget about one thing. Not all European Union countries are members of monetary union, some of them because of not meeting above conditions, some of them as a result of their own independent decision (Great Britain). Besides, presently German government has problems with keeping of budget deficit value within the confines of above conditions but it can't be said outright that German economy is experienced by a large crisis and at the most there are opinions of its regress.

Poland, taking into consideration of its aspirations for the European integration and its intentions of joining in monetary union within three years of union membership, has been meeting only the first of these conditions today. The relation of NPD to GDP amounted to 44,6 % last year, but this year it is has been planned that this one will be running at 48,6 % (graph 7). A 4 % increase has been caused by deepen growing of debt of local government sector and state budget deficit of 2001. This deepen growing are caused with the negative relation of economic deficit to GDP (graph 8). The analysis of coursing factors from the graph 8 is probably a bookish example of the interaction between deficit and crisis of public finance and also strong argument for consistent aspirations with reducing of the negative budget balance.

Final conclusions. In defiance of pretences, current crisis of public finance in Poland is able to reveal its positive parts. Polish enterprises are trying defend themselves against decreasing in domestic demand and are looking for new abroad markets and the fear of present crisis is forcing them to dropping of the costs of labour, increasing of efficiency and the same increasing of them own profitability. It has been awaiting changes for long time now in tax law, labour law, of regulations making easier beginning and running a business, in present situation, will become, let's hope that, economic priorities of Polish government. That character is going to possess government document entitled: „The Business - first of all”. It requires also changes of public finance in range of budget expenditure structure and rationalisation toward limiting of public funds wasting, limiting of formation round budgeted institutions, reducing of social expenses and increasing of outlays on developmental fields: education, transport, computer science.

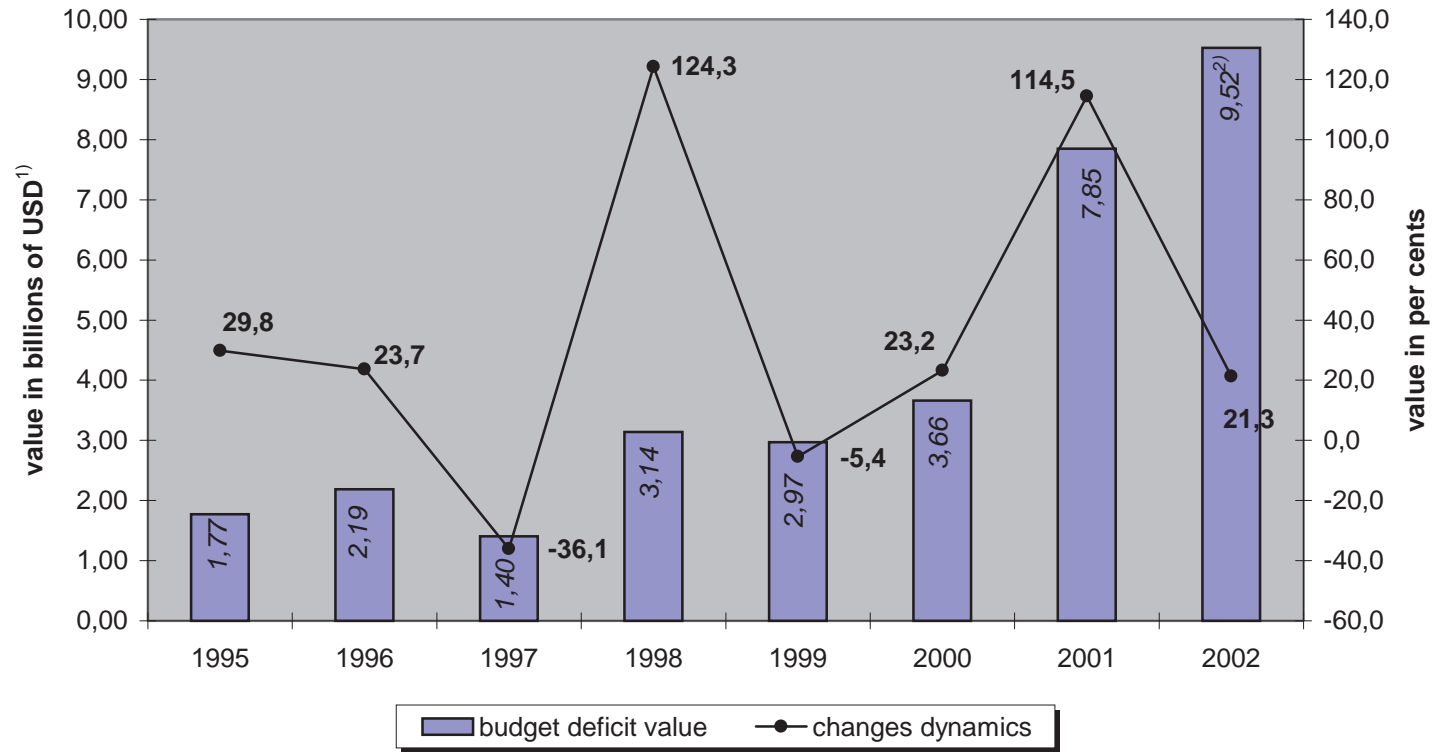
Referring to the title of the paper, author has tried to prove that budget deficit affects the state economic situation. Depending on its level, we can estimate in what kind of conditions state public finance are or budget deficit is going to be threatened in the future. Most of economists have been agreed that one ought to try to reduce its value and first of all it should be fist step in process of struggling strategy against crisis.

Chart 1. The causal chain reaction of budget deficit in Poland



Source: The own studies of author

Graph 1. Budget deficit and its changes dynamics in years 1995 – 2002

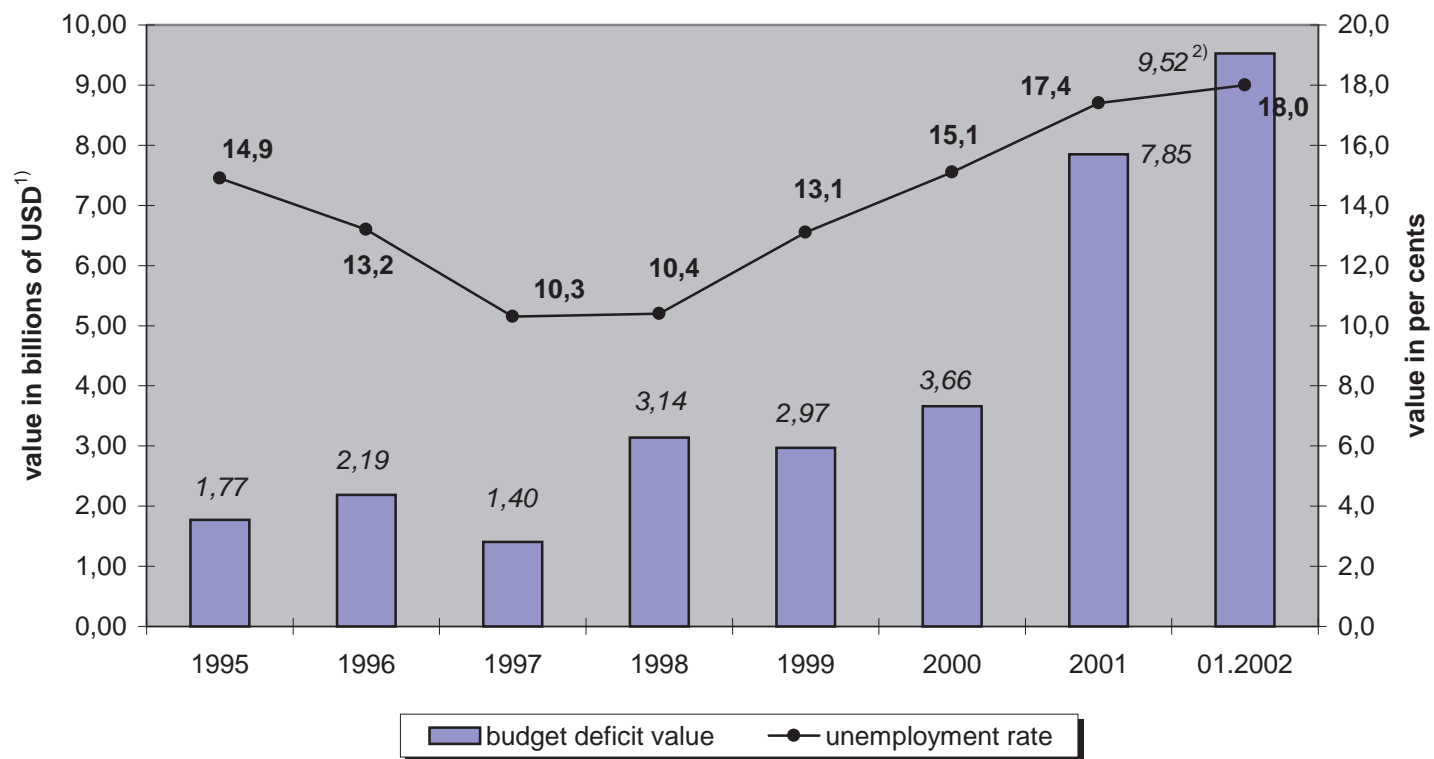


¹⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)

²⁾ budget deficit value in National Budget Act of 2002

Source: National Budget Act of 2002, Central Bureau of Statistics and Ministry of Finance

Graph 2. Budget deficit value and unemployment rate in years 1995 – 2002

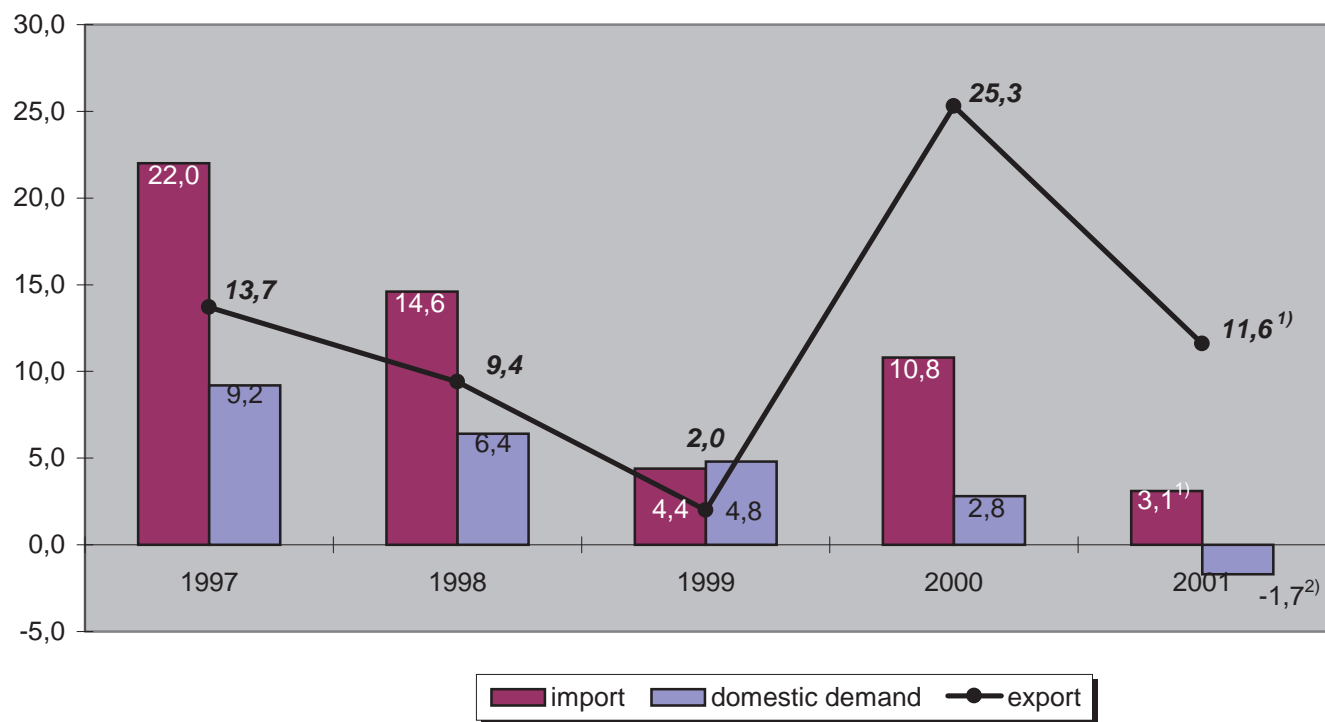


¹⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)

²⁾ budget deficit value in National Budget Act of 2002

Source: National Budget Act of 2002, Central Bureau of Statistics and Ministry of Finance

Graph 3. Changes dynamics of export, import and domestic demand in years 1997 – 2001 (in per cents)

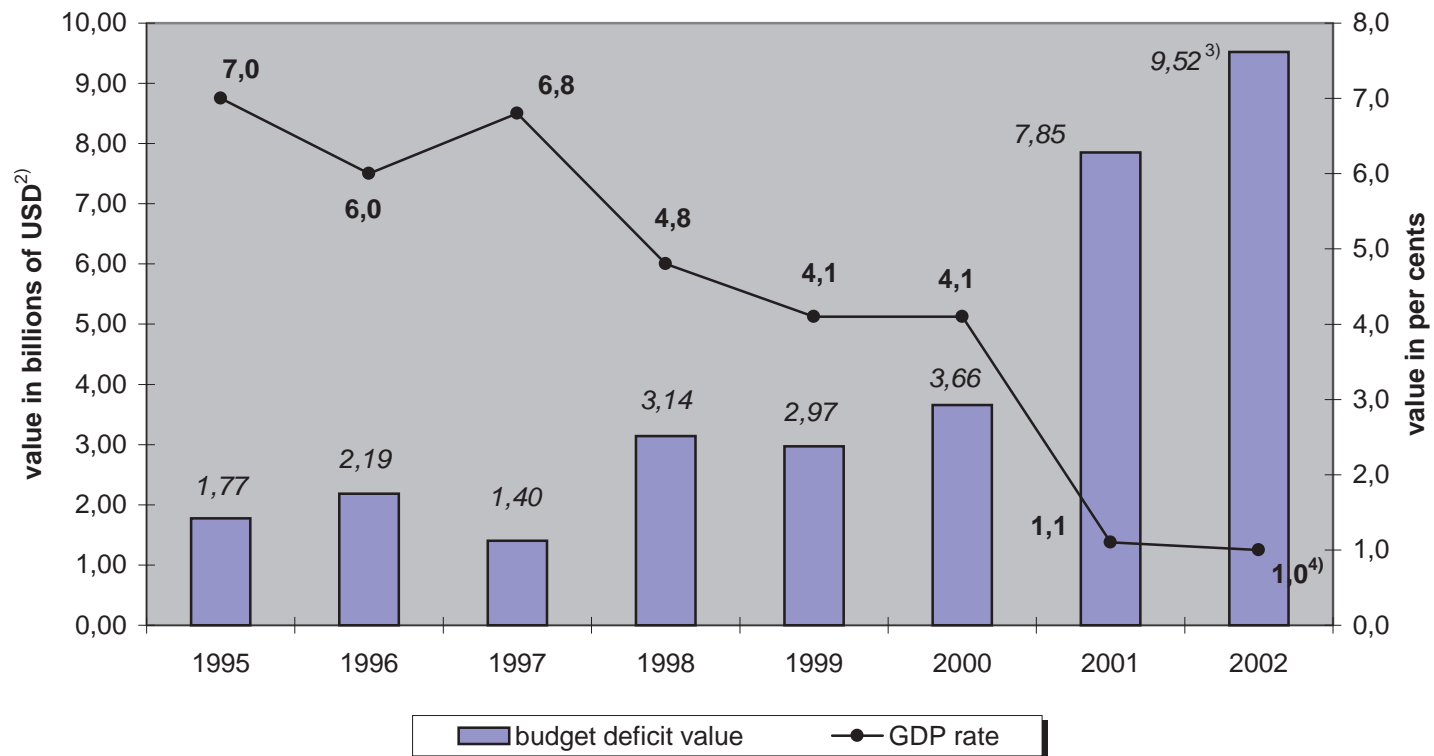


¹⁾ changes dynamics between January – November of 2001

²⁾ value of three quarters of 2001

Source: Central Bureau of Statistics

Graph 4. Budget deficit value and GDP¹⁾ rate in years 1995 - 2002



¹⁾ GDP- gross domestic product

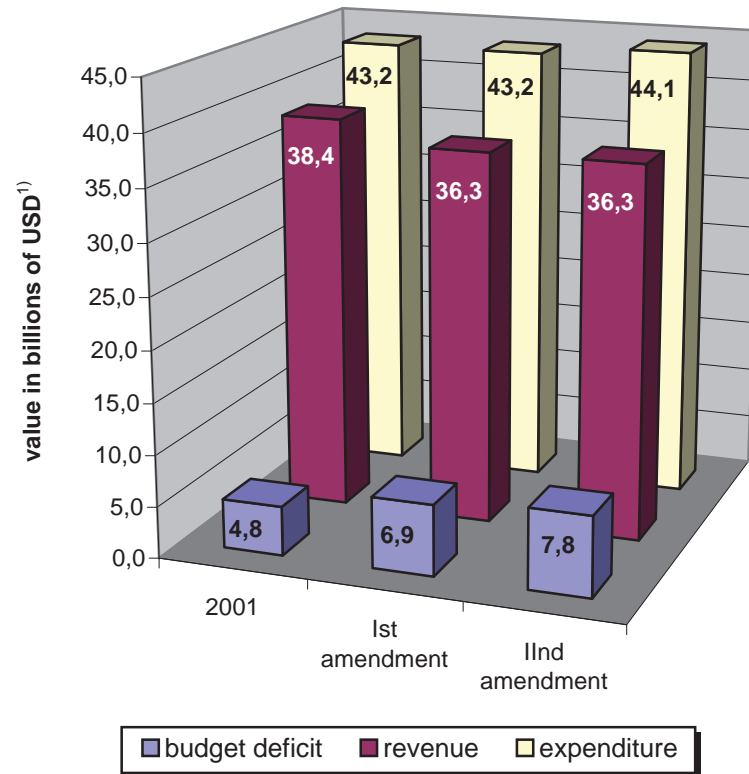
²⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)

³⁾ budget deficit value in National Budget Act of 2002

⁴⁾ GDP growth rate from justification of National Budget Act of 2002

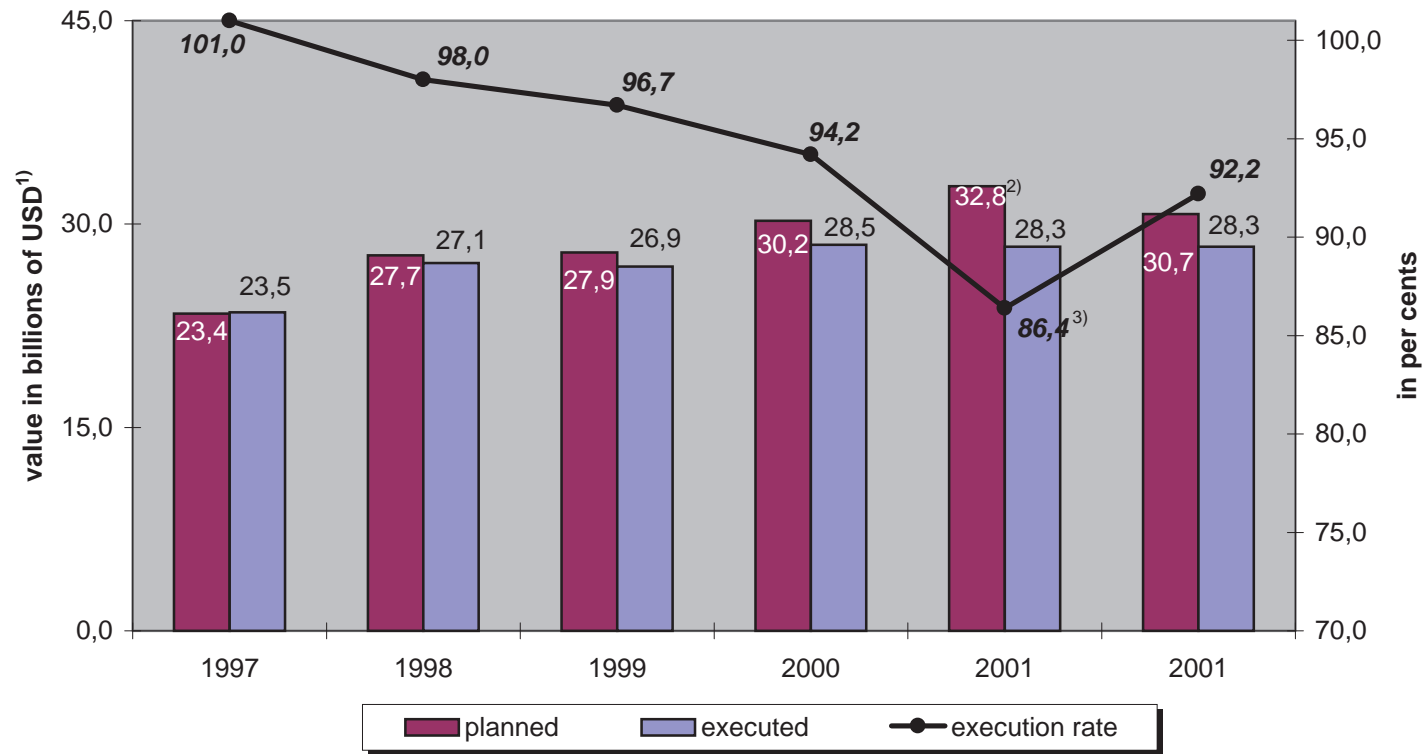
Source: Central Bureau of Statistics and Ministry of Finance

Graph 5. Amendments of National Budget Act of 2001



¹⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)
Source: National Budget Act of 2001

Graph 6. Tax revenues value in budget state in years 1997 – 2001



¹⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)

²⁾ planned tax revenues in National Budget Act of 2001 before 1st amendment

³⁾ percentage execution of tax revenues cutted on the basis of planned tax proceeds in National Budget Act of 2001 before amendment

Source: National Budget Acts of 1997, 1998, 1999, 2000, 2001 with the amendments, Central Bureau of Statistics and Ministry of Finance

Table 1. Tax arrears in years 2000 - 2001

	2000 thousands of USD ¹⁾	2001 thousands of USD	change '00-'01 % (in per cents)
VAT	500 336,2	805 887,8	61,1
CIT	182 205,9	185 255,9	1,7
PIT	53 253,4	66 801,4	25,4
Payment and local tax	8 955,4	7 965,4	-11,1
Dividend	33,0	91,4	176,5
Property tax	524,3	705,5	34,5
Customs	24 481,7	1 309,8	-94,6
The other ones	40 723,4	12 333,0	-69,7
Total	810 513,3	1 080 350,2	33,3

¹⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)
Source: Ministry of Finance

Table 2. State budget deficit and its financing sources in years 2001 – 2002

Detailed list 1	2001 PE ¹⁾	2002	03:02
	in billions of USD ²⁾		%%
	2	3	4
National financing	10 444,3	9 242,9	88,5
1. Gross receipts from privatisations	2 414,3	1 571,4	65,1
2. Government securities	8 636,0	7 729,6	89,5
3. Loans given	19,4	-29,5	x
4. Compensations	-588,0	-666,7	113,4
5. Paying off the commitments of A.W.R.S.P. ³⁾	64,6	65,0	100,5
6. Other gross receipts and expenditure	0,0	0,0	-
7. Balance of finance transferring to next year and deposits	-102,0	573,1	x
Foreign financing	-2 669,4	280,9	x
TOTAL	7 774,9	9 523,8	

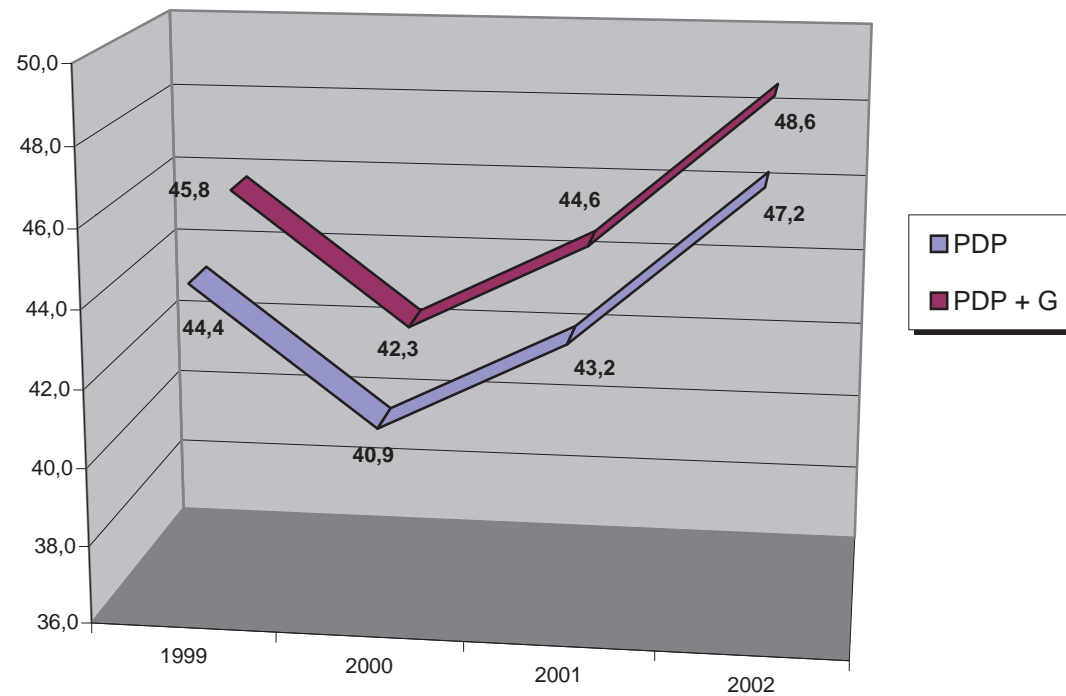
¹⁾ PW – planned execution

²⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)

³⁾ A.W.R.S.P. – The Government Agency of Agricultural Property

Source: Ministry of Finance

Graph 7. National Public Debt (NPD)¹⁾ in relation to GDP in years 1999 –2002²⁾ (in per cents)



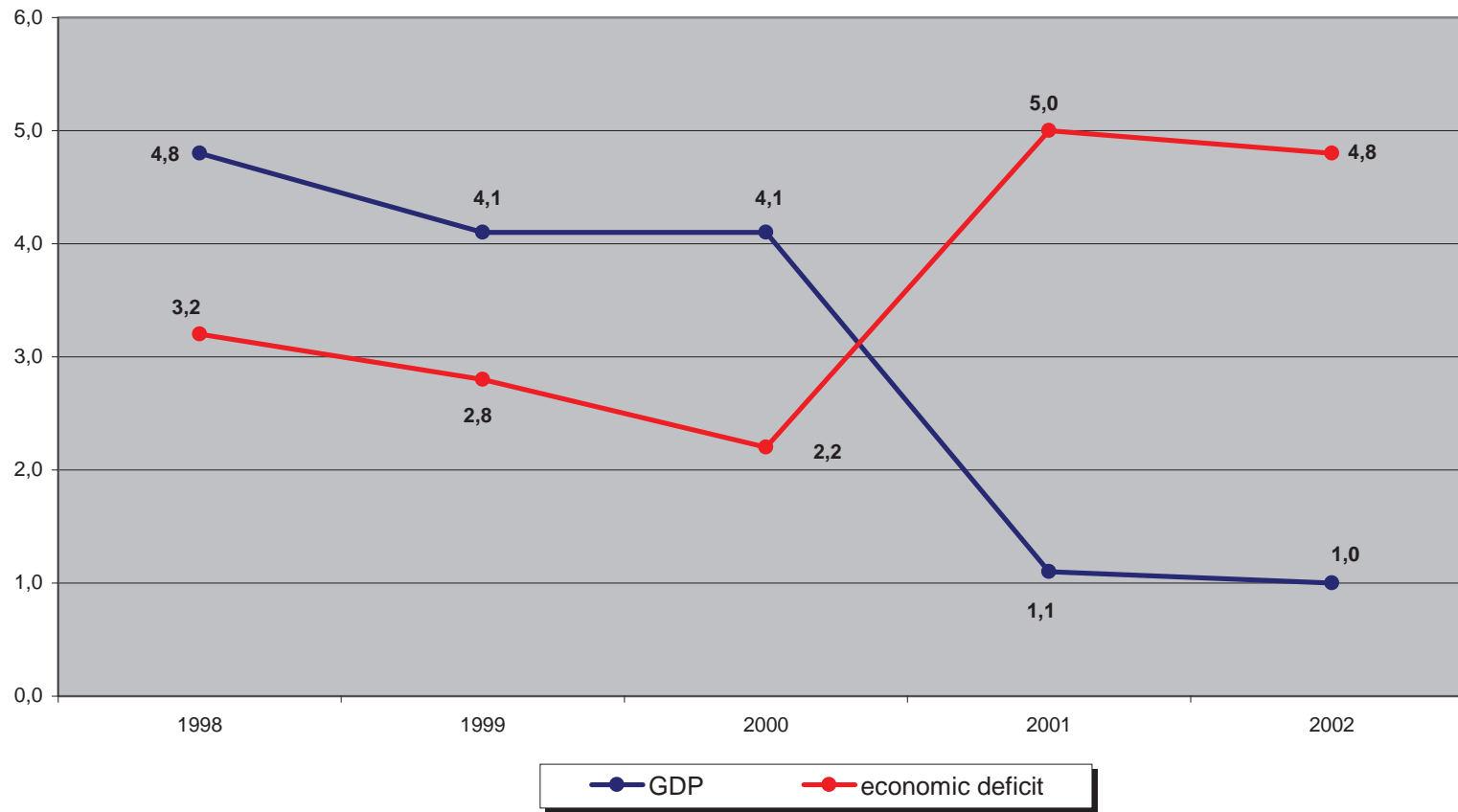
¹⁾ NPD is defined as Debt of Public Finance Sector which consists of: debt of state government sector and debt of local government sector

²⁾ value planned in National Budget Act of 2002

³⁾ G – predictable payments as a result of giving guarantees by public sector institutions

Source: National Budget Act of 2002, Central Bureau of Statistics and Ministry of Finance

Graph 8. Economic deficit of public finance and GDP rate in years 1998 – 2002¹⁾ (in per cents)



¹⁾ values planned in National Budget Act of 2002

Source: National Budget Act of 2002, Central Bureau of Statistics and Ministry of Finance

Table 3. National public debt (NPD)¹⁾ value in years 1999 – 2002²⁾

	2000	2001	change	2002	change
	millions of USD ³⁾	millions of USD	in per cents (%)	millions of USD	in per cents (%)
1. State government sector	64 546,8	71 455,0	10,7	81 822,7	14,5
1.1. Domestic debt	35 382,1	46 191,0	30,5	55 593,5	20,4
1.2. Foreign debt	29 164,7	25 264,0	-13,4	26 229,2	3,8
2. Local government sector ³⁾	2 232,6	3 446,0	54,3	4 660,5	35,2
Total debt (NPD)	66 779,4	74 901,0	12,2	86 483,2	15,5

¹⁾ NPD is defined as Debt of Public Finance Sector which consists of: debt of state government sector and debt of local government sector

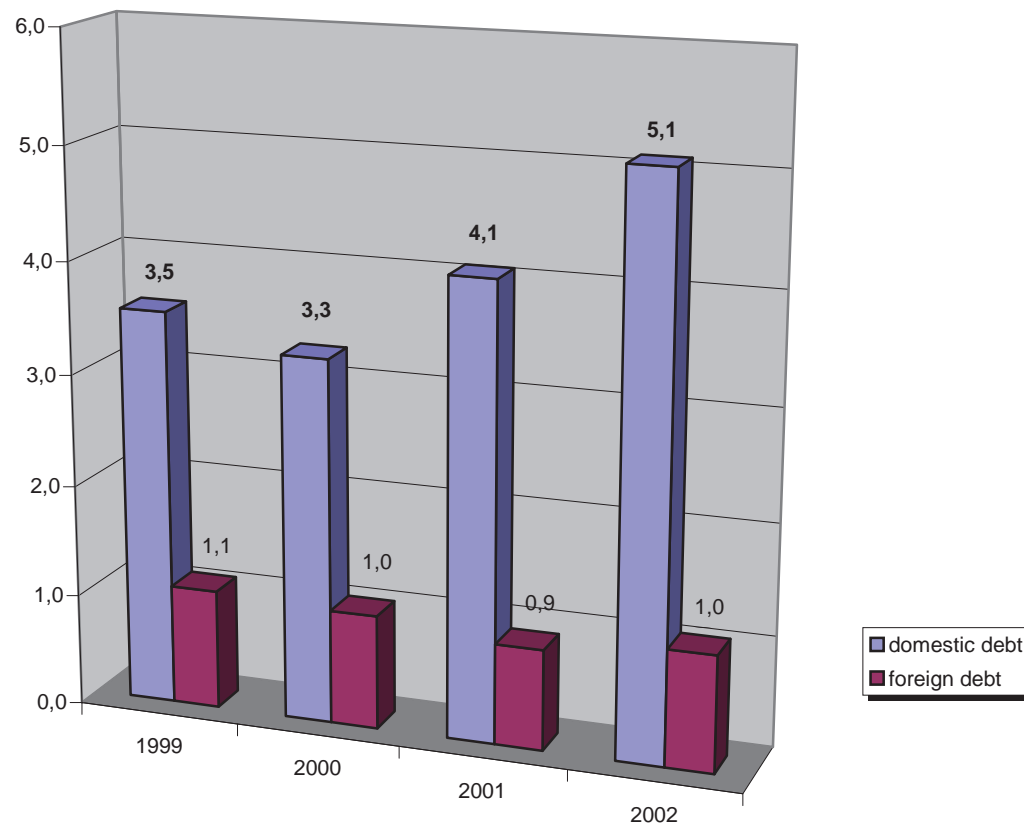
²⁾ Budget Bill of 2002

³⁾ domestic debt of local government sector, which in accordance with the Polish law, cannot get into debt to foreign entities

⁴⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)

Source: Central Bureau of Statistics and Ministry of Finance

Graph 9. Costs of public debt servicing in budget state in years 1999 – 2002¹⁾ (in billions of USD²⁾)



¹⁾ values from Budget Bill of 2002

²⁾ amounts are converted into American dollars (USD) at the exchange of 1 USD = 4,2 Polish zloty (PLN)

Source: Central Bureau of Statistics and Ministry of Finance