PROBLEMS OF POLISH PUBLIC DEBT – STATE BEFORE COVID-19

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1 Introduction

• **Polish economy -** a high level (potential) of growth in the period 2015 – 19 (average about 4,5% per year).

It was an effect of: * **good economic situation in EU** countries, * **financial transfers from EU**, * **direct foreign investments in Poland** and significant level of budgetary deficit of central government (CG) during first 3 years of the period.

As a result - the public debt/GDP ratio has been decreased to approx. 46% (ESA'2010 system) at the end of 2019 year; the deficit of the public sector was also significantly lower during last two years 2018 – 19.

• **However, main problems of Polish public debt are still valid and will be significantly escalated after expected recession. The main problems before COVID-19 were as follows**:

- **low rating, high level of servicing costs** (profitability) of debt,
- **high ratio of foreign debt** of the central government,
- **high level of debt in foreign currency**,
- **lack of long term optimal debt strategy**,
- **not adhesion to EURO zone**.

• **The position of public debt in Poland - rather poor in comparison with non-crisis EU countries (satisfying of EU requirements**), including neighbor countries like Slovakia and Czechia. The position was much better at the end of previous century.

• **In 2020 year an expected rate of GDP growth - negative, about -4%, while deficit of public sector will achieve about 7 – 9%** (of GDP); **as a result public debt will achieve 57,5%** of GDP (forecast of European Commission, June 2020 year).

• **Financial policy of Poland requires thorough reform, especially government expenditures side - wastefulness of public funds has to be stopped**. It is **not easy problem - many fields requires higher granting, especially: natural environment, pensionable system, health systems,** etc. The problem of accede to the EURO zone is also valid.

• **The purpose of the paper - presentation the problems of public debt in Poland, taking into account effects of COVID-19, and indication of directions of improvement**. The main directions:

- **development and application of optimal middle-term and long-term debt strategy**,

- **consistency with EU requirements of stability and growth**,

- **accede to EURO zone**.

Table 1. **Deficit and debt of central government and local governments in Poland**, in 2016 – 2019 years (mill. of Polish zlotys).

Content	2016	2017	2018	2019
GDP	1861148	1989351	2120480	2273556
Deficit/Surplus of general government	-44162*	-29200*	-4933	-16828
% of GDP	-2,4	-1,5	-0,2	-0,7
Deficit/Surplus of central government	-47427*	-72212*	-11491*	-27134
% of GDP	-2,5	-3,6	-0,5*	-1,2
Deficit/Surplus of local Governments	-5034*	2042*	6695*	-4417
% of GDP	0,3	0,1	-0,3	-0,2
Deficit/Surplus of national social insurance funds	-1769	40970	13253	14723
% of GDP	-0,1	2,1	0,6	0,6
Debt of central government and local governments	1009965*	1007126*	1035703*	1045122
% of GDP	54,3	50,6	48,8	46,0

The data from the Table 1 indicates the following conclusions:

1) The deficit of general government sector (central and local governments, national social insurance founds): 16828 mill. of zlotys (2019 year), i.e. **0,7% GDP** - significantly lower than in 2016 and 2017 years. **The deficit of the central government: -1,2%** GDP, local governments -0,2% (cumulatively -1,4%), national social insurance funds surplus 0,6%;

2) **deficit of the central government** -27134 mill. of zlotys, i.e. **higher than in 2018** (-11491 mill. of zlotys, i.e. 1,2% GDP);

3) **deficit of local governments** 4417 mill of zlotys, i.e. lower than in previous year (6695 mill of zlotys); **deficit from last two years 2019, 2018 higher than surplus in 2016 and 2017 years**;

4) **national social insurance funds - surplus 14723 mill. zlotys, i.e. 0,6% GDP – similar** as in previous year 2018;

5) **the debt of general government sector 1045122 mill. zlotys, i.e. higher than in previous year** (1035703 mill. zlotys); in relation to GDP the debt: 48,8% and 46,0% respectively. **Decrease of the relation** at the end of 2019 year is an effect of: **GDP growth together with increase of price level**, **increase of tax level (and)revenues** and **surplus of social insurance funds**.

• **The position of deficit and debt of the public sector** - end of the 2019 year - **much better than after last world financial crisis**. However, **decrease of the debt/GDP ratio - slow** taking into account growth of GDP during last 4 years (GDP'2019/GDP'2015 – 26,3% curr. pric.).

• **The experience of COVID-19 shows that improvement of the position has weak basis because of significant increase of expenditure side** of the government budget (the significant part of expenditures - social transfers - appropriated in electoral years). Some of them are not addressed to target groups and do not take into account possibility of negative shocks in economy. **As a result: the rating of the country - not enhanced** in 2019-20, **high profitability of treasury bonds and instability of exchange** rates of Polish zloty.

• **Current, low level of deficit of general government not pick Poland out to other EU countries**. In 2019 year **16 EU countries had surplus**, while **21 countries had lower deficit** (Table 3, Section 3). Moreover, **some countries with low deficit had also low level of debt, i.e. significantly lower than 60%**.

Table 2. **Government public debt of Poland** (Polish method. and ESA'2010 **) and deficit of the public sector** (ESA), in 2000 – 2019 years, as % of GDP.

Year	Deficit ESA' 2010	Public debt – Polish method.	Public debt ESA'2010	GDP growth in %
2000	3,0	37,7	36,5	4,6
2001	5,1	38,8	37,3	1,2
2002	5,0	43,6	41,8	2,0
2003	2,5	47,4	46,6	3,6
2004	5,0	46,7	45,0	5,1
2005	4,0	47,5	46,4	3,5
2006	3,6	47,8	46,9	6,2
2007	1,9	44,8	44,2	7,0
2008	3,6	46,9	46,3	4,2
2009	7,3	49,8	49,4	2,8
2010	7,3	52,8	53,1	3,6
2011	4,8	53,4	54,1	5,0
2012	3,7	52,7	53,7	1,6
2013	4,1	53,3	55,7	1,4
2014	3,6	49,9	50,4	3,3
2015	2,7	48,7	51,3	3,8
2016	2,4	51,9	54,2	3,0
2017	1,5	48,5	50,6	4,8
2018	0,2	47,0	48,9	5,1
2019	0,7	44,0	46,0	4,1

Statistical Yearbooks of Republic of Poland (GUS), EUROSTAT - government statistics.

• **Polish public debt achieved the lowest level in 2000 year – 36,5%** of GDP (ESA’2010 system); **real growth** of GDP **4,6%, deficit – 3%** of GDP (not under excessive deficit procedure of EC). **During last years of the previous century: reduced and restructured Polish foreign debt** (in foreign currencies), **established new low regulations constraining debt level**: **the restriction on debt/GDP ratio in the constitution** (60%) and **two “preventive thresholds”, the levels 50% and 55% in the public finance low** (currently 50% level is omitted). **Also improved - debt strategy and management** (PHARE projects).

•**During initial 5 years of XXI century** the level of deficit – high, as **a result of breakdown of GDP growth** in the years 2001, 2002 and **high level of servicing costs** of the public debt. **The costs result from high inflation level and low rating of treasury securities. The debt (as % of GDP) extended nearly by 10 percentage points – to the level 46,4%.**

• **Improvement of economy and increase of the public sector revenues took place in 2007 year – it was mainly the effect of accession to EU and decrease of tax level** (VAT from 23% to 22%). The **debt level was 44,2%, GDP growth – 7%, deficit of the public sector – 1,9% and the country was not under excessive deficit procedure**.

• **Next several years - world financial crisis**, decrease significantly GDP growth. **The result - debt growth to the level 55,7**% of GDP in 2013 year, i.e. **above the threshold 55%. Deficit** of the public sector **exceeded 7%** in 2009, 2010 years and the country was permanently under excessive deficit procedure. **High deficits - results of low GDP growth** because of low tax revenues of state budget and local authorities budgets; **low GDP growth correlated with low level of foreign direct investments**.

• **The country did not apply recommendations of EC –** the effect of the excessive deficit procedure. There was no sanctions for such the attitude because Poland does not belong to EURO zone. T**he debt/GDP ratio was decreased artificially by: high inflation rate close to 5% (h**igh inflation increases tax revenues of the state budget, but also debt profitability and finally servicing costs of the public debt), **extinction of pension bonds, i.e. transfer of liabilities to the pension system, replacement of ESA'95 system by ESA'2010.**

• **The effect of transfer of liabilities ~7–8%** of GDP, the effect of **change of ESA version ~3%, totally about 10%. In the case of no transfer and continuation of the ESA'95**, **the debt would be higher than 60%!**

•**Next 5 years 2015 – 2019 - high economic growth in the EU and the world**; **in Poland** the **GDP growth 3,8% in 2015** year, **deficit of the public sector -2,7%** of GDP, i.e. below 3%. **The deficit below 3% was sustained to the 2019** year and **real GDP growth - significantly above 4%. As a result of GDP growth and increase of taxation level, the debt decrease to 46,0% of GDP at the end of 2019 year.**

• **Summing up the considerations** - the following features of Polish debt are important before COVID-19 epidemic disease:

- moderate level of debt at the end of XX century, but rather positive in comparison to majority of EU countries and neighbors of the country;

- loss of good position of public finance during world financial crisis; **the debt growth** (as percent of GDP) **was higher than average in UE countries and in EURO zone**;

- slight improvement of position of public finance - in the period 2014 - 2017 of high economic growth; **next two years have brought a better development, but rating of the country remains on the same low level**;

- high level of long-term profitability of treasury bonds, much higher than in EURO zone, with except of crisis countries.

• **Many problems of the public sector wait for solving and require increase of budget expenditures**, especially: **devastation of natural environment, very low level of natality, low level of pensions, weakness of public health service**. **Simultaneously, the public finance system has large burden of social transfers; they are rather ineffective because not appropriately directing. Such the situation requires reforms and improvement after COVID-19**. **Especially important are** the following areas: **establishing medium-term and long term optimal debt strategy, reconstruction of social transfers systems and accede to EURO zone.**

3 Polish debt – comparison with some EU countries

• The data about level of debt, deficit, rating and long-term profitability - basic features of indebtedness of any country. Such the data concerning Poland, some EU counties and averages for EU are presented in the paper (Table 3):

- average debt and deficit for EU’28, EU’19 and for selected countries in last year of the XX century, some years of the XXI century: 2007 (last year before crisis), 2010 (crisis year) 2012 (last year of the crisis), 2014, 2015, 2016, 2019 (good years of EU economy),

- selected countries: the largest EU economies (France, Germany, UK, Spain, Sweden), the highest debt countries (Greece, Portugal, Italy), the neighbors of Poland (Slovakia, Czechia, Hungary); for the countries are also presented: rating and profitability of long term treasury securities (in December of 2019 year).

• **The data from the table indicate the following conclusions:**

1^0. **The level of deficit of public sector in Poland after the crisis years, i.e. 2014 – 2016 was significantly higher than averages in UE’28 and EU’19**. The averages for EU were as follows: -2,0%, -2,3%, -1,7% (EU’28), -2,5%, -2,0%, -1,6%, (EU’19), while for Poland -3,7%, -2,7%, -2,2%. Last year 2019: -0,6%, -0,8%, -0,6%, but deficit of Poland results from surplus of the national social insurance funds equal 0,6% (without this subsector deficit equals -1,2%).

2^0. **Current rating of Poland A- (according S&P) is higher than in countries of debt crisis only.** It was not raised in 2019, although high GDP growth and low deficit. Therefore **- high costs of risk of treasury securities**.

3^0. **Profitability of Polish long-term treasury bonds, 2,03% at the end of 2019 year, are below profitability of countries in deep debt crisis**. Countries from EURO zone with debt level close to 100% of GDP, Spain and France: Spain 0,44%, France 0,04%. Profitability of Portugal securities - equal 0,41%, while debt 117,7%, rating BBB+ only. Moreover, **profitability of Polish bonds don’t satisfy requirements of accede to EURO.**

4^0. **Profitability of long term bonds in EURO zone - lower than in other EU countries**. E.g. Czechia has rating AA- (S&P) and profitability 1,51%, while Slovakia – profitability - 0,13% and rating A+. **It is the effect of EU'19 rating and monetary policy of ECB**.

5^0. **Countries with current debt level below 50 – 60% and high rating have decreased significantly their level of debt after the end of world financial crisis. In EURO zone the leader is Germany – 14,7 proc. points, outside the zone Czechia – 11,4 proc. points. It was the result of refinancing of majority of debt with low or negative profitability**. **The debt of Poland (as % of GDP) was decreased only by 4,4 proc. points in this period; it was also increased in 2015, 2016 years. Thus, the difference between debt level in 2019 and 2000 years - 8,2 proc. points; forecasted debt level after COVID-19 ~57,5%.**

6^0. **The level of indebtedness in EU'28 and EU'19 is higher than in Poland**, but it is overstates by crisis countries. **Majority of the countries EU'19 have high ratings and in fact can service the debt higher than 60%.**

7^0. **The trend of debt/GDP ratio of Poland was in some periods reverse to EU;** e.g. in the period 2014 – 2017 took place increase by 0,2 proc. point, while decrease between 2012 and 2017 was only 3,1 proc. points. **Polish debt strategy has had no benefits from monetary policy of the ECB**.

8^0. **The level of profitability of Polish treasury securities hampers decreasing of debt/GDP ratio. Servicing costs of the debt are close to 1,5% of GDP and can increase in future – as a result of increase of inflation or exchange rates**.

9^0. **During the period 2014 - 2019 the average annual growth of GDP (constant prices) ~4,3%, but decrease of debt/GDP ratio only 4,4%** proc. points only. **Moreover, price growth was positive in this period and, therefore, nominal GDP level was significantly higher than for constant prices. Thus, the progress in debt reduction was weaker than average in EU.**

Table 3. Deficit and debt (as % GDP, ESA'2010) of selected EU countries, in selected years, profitability of long term treasury securities and their rating by S&P (end of 2019 year).

Year	2000	2007	2010	2012	2014	2015	2016	2019	Long term. profit., rating
UE-28, def. Debt	-0,1 60,1	-0,9 57,6	-6,4 78,9	-4,3 83,8	-2,0 86,4	-2,3 84,4	-1,7 83,3	-0,8 79,3	0,54 -
UE-19, def. Debt	-0,5 68,2	-0,7 65,0	-6,2 84,6	-3,7 89,7	-2,5 91,8	-2,0 89,9	-1,6 89,1	-0,6 84,1	-
Pol., def. Debt	-3,0 36,5	-1,9 44,2	-7,3 53,1	-3,7 53,7	-3,7 50,4	-2,7 51,3	-2,2 54,2	-0,6 46,0	2,03 A-
Franc., def. debt	-1,3 58,9	-2,6 64,5	-6,9 85,3	-5,0 90,6	-3,9 94,9	-3,6 95,6	-3,5 98,2	-3,0 98,1	0,04 AA
Germ.,def. Debt	0,9 58,9	0,2 63,7	-4,2 81,0	0,0 79,9	0,6 74,5	0,8 70,8	0,9 67,9	1,4 59,8	-0,30 AAA
UK, def. Debt	1,4 37,0	-2,6 41,7	-9,3 75,2	-8,1 84,1	-5,4 87,0	-4,2 87,9	-2,9 87,9	-2,1 85,4	0,78 AA
Italy, def. Debt	-2,4 105,1	-1,5 99,8	-4,2 115,4	-2,9 123,4	-3,0 131,8	-2,6 131,6	-2,5 131,4	-1,6 134,8	1,37 BBB
Spain., def. Debt	-1,1 50,8	1,9 35,6	-9,4 60,1	-10,5 60,1	-6,0 100,4	-5,3 99,3	-4,5 99,3	-2,8 95,5	0,44 A-
Port., def. Debt	-3,2 50,3	-3,0 68,4	-11,2 96,2	-5,7 126,2	-7,2 130,6	-4,4 128,8	-2,0 129,2	0,2 117,7	0,41 BBB+
Greec., def. debt	-4,1 104,9	-6,7 103,1	-11,2 146,2	-8,9 159,6	-3,6 178,9	-5,6 175,9	0,5 178,5	1,5 176,6	1,42 B+
Slov., def. Debt	-12,0 49,6	-1,9 30,1	-7,5 41,2	-4,3 52,2	-2,7 53,5	-2,6 52,2	-2,2 51,8	-1,3 48,0	0,13 A+
Hung, def. Debt	-3,0 55,3	-5,0 65,5	-4,5 80,2	-2,4 78,4	-2,6 76,6	-1,9 76,6	-1,6 75,9	-2,0 66,3	1,88 BBB-
Czech., def. Debt	-3,6 17,0	-0,7 27,5	-4,2 37,4	-3,9 44,5	-2,1 42,2	-0,6 40,0	0,7 36,8	0,3 30,8	1,51 AA-
Swed., def. Debt	3,2 50,7	3,4 39,2	0,0 38,6	-1,0 38,1	-1,6 45,9	0,2 44,2	1,1 42,4	0,5 35,1	0,07 AAA

Source: EUROSTAT (ec.europa.eu/eurostat/data/database), 9.04.2020 r.

4 Accede to EURO zone – some consequences for Polish public debt, monetary policy and economy

• **The crucial problem for Polish debt policy is accede to EURO zone – accordingly to the accession treaty**. As it was mentioned, **profitability of treasury securities and servicing costs are significantly lower in EURO zone – as the result of high rating and monetary policy of ECB**.

• **The problem has been discussed broadly by many authors**. **Important analysist, from the point of view of politics, macro-economy and financial policy, presents prof. S. Gomułka (Gomułka S. 2019), while empirical – statistical examination - by Goczek Ł., Mycielska D. (2014).**

• **Prof. Gomułka:**

- **shows unquestionable benefits from the accede to EURO** and determines it possible date;
- **also groundlessness of reservations: loss of sovereignty in monetary and fiscal policy and necessity of achieving of EU level of earnings**;
- **EU is the union of sovereign countries**, with complete competence in low creating and its amendments. **Fiscal requirements from Maastricht treaty are not restrictive**, while low rules do not disorder institutional structure of the countries. **Recommendations and sanctions - launched only in case of not satisfying of requirements of fiscal stability**;
- **increase of earnings level depends on productivity of labor**; in Poland it is currently the effect of transfer of innovations from leading countries;
- **accede to EURO zone makes easier the access to credit market with low interest rates** and assimilation to countries – leaders of EU; the „assimilation" relates also to fiscal and monetary policy;
- **Polish economy is now quite opened – the sum of import and export is close to GDP value**, which indicates high level of exchange rate risk for Polish zloty; foreign trade is growing all the time.

• **The author reminds also main reasons of last financial crisis**: **the excessive public indebtedness**, **excessive increase of wages** causing decreasing of competitiveness and **excessive risk in large sectors of banking system**. **They are still valid. Simultaneously, the monetary policy of ECB after the last world crisis results in conditions for decreasing of public debt in majority of European countries and for whole Union.**

• **The problems of independence of Polish monetary policy of ECB have been examined with the use of econometric approach in the paper Goczek Ł., Mycielska D. (2014).** The authors present results of modeling of independency of the monetary policy on the basis of VAR models expressing dependence of the rate WIBOR (daily, weekly, monthly) at inter-bank market and EURIBOR rate. The hypothesis about lack of independence states existence of long-term one-sided connection (without feedback) which is not simultaneous. **The models developed by the authors have been statistically estimated and positively verified with statistical tests.**

• **The basic conclusions are as follows**:

- there is no basis for rejecting of hypothesis about existence of one-sided co-integrated dependency between rates WIBOR and EURIBOR, i.e. rates in EU are not in long-term convergence with rate in Poland,

- there is no base for rejection the hypothesis about convergence of rates in Poland and EU,

- a premium for risk of investments in Poland is positive,

- independence of monetary policy in Poland does exist, but is confined.

The results show that ECB influences significantly monetary policy of NBP, i.e. the thesis that accede to EURO zone will cause lack of independence is not true.

• **Current political declarations does not indicate the perspectives of accede to EURO; moreover COVID-19 has finished the time period of rapid economic growth.**

• **Financial policy of Poland during last four years was “wasteful” – similarly to some countries suffering from crisis of public finance** - especially during political elections. **The public sector expenditures in last three years increased more than economy (GDP), while during earlier six years – the growth was lower**.

• **The high increase took place for social transfers; in 2019 year the „cost” for one person achieved 2312 zlotys. This value is comparable to the health expenditures (2727 zlotys) or the education expenditures (2824 zlotys). Some social transfers are not addressed to target groups of society and does not come up to expectation; e.g. 500+ did not increase a birth-rate** (in fact it decreased in 2019 year).

5 Summary and conclusions

• **The main problems of public debt of Poland before COVID-19 wait still for constructive solutions. They comprise: low rating and high servicing costs, high level of foreign debt of Central Government, high level of debt in foreign currencies in conditions of variability of exchange rates of zloty, not satisfying of all requirements of accession to EURO zone and lack of intention to accede, lack of optimal strategy of debt in middle- and long-term period**.

• **The financial policy of Poland, with the higher growth of budgetary expenditures than economy growth (during last three years), does not foster of solving these problems**. Especially, significant part of the expenditure side are inflexible social transfers and expenditure for defence of the country. **The direction of indebtedness of Poland after international financial crisis was not consistent with other countries of UE**, especially in terms of decreasing of debt profitability and servicing costs. **Poland has not determined date of accede to EURO area, i.e. belongs to small group of countries without common currency and low GDP level**. **The debt strategy of EU countries with healthy public finances indicates efficient directions of debt strategy for Poland.**

• **The pandemic disease COVID-19 is a kind of extremal shock for public finances** – income side of the central budget, local budgets and national social insurance funds decrease drastically, while expenditures – increase to unexpected large scale. **The GDP growth of Poland in 2020 year will be negative (recession) about – 4%, deficit level will achieve about 7 – 9% of GDP, the public debt – about 57,5% of GDP** (forecasts of GDP and debt/GDP ratio - EC, the April 2020 year). It is a cost of inactive time of some part of economy, health safety, work safety and firms safety. **But also the cost of lack of ability to absorb such the shock by public finance sector.**

• **The main purpose of economy of the country and public finance sector in the period after COVID-19 is efficient, competent removing of effect of the shock. It is also necessary to meet requirements of Polish low and UE low, especially the procedure of excessive deficit. It is suggested also to strengthen Polish low in the following directions (for more details see Klukowski 2019):**

- to apply ESA'2010 system (for deficit and debt) as a base in low restricting debt level in Poland;

- to introduce to Polish law constraining debt level the following rules: * **obligation for application of recommendations of EC resulting from procedure of excessive deficit**, * **to approve strategic targets about debt level, especially: servicing costs below 0,5% of GDP, no deficit rule except servicing costs in the years of potential growth of GDP (according to evaluation of the Central Bank of Poland)**, * **no increase of debt/GDP ratio in periods of GDP growth higher than 1%**, * **obligation for approving of the program of debt repayment, which exceeds servicing costs**, * **obligation for supervision of optimality of debt strategy (middle- and long-term) and debt management by commission of independent (non-government) experts.**

• **Such the regulations are in general consistent with EU rules and similar to countries having health public finance, e.g. Germany, Sweden,** etc.

• **Some problems require indispensable solving in a time-horizon as short as possible:**

- **achieve the rating at least A+** (according to S&P),
- **decreasing of servicing costs to the level below 1%** of GDP,
- **start of accede to the EURO zone**,
- **reduction of debt/GDP ratio to the level from 2000 year** (36,5%).

• **Also the expected transfers for recovery of EU countries after pandemic disease COVID-19 has to be properly directed –** not for populistic purposes.

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