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Macroeconomic policy regime in Poland

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Abstract

The goal of this paper is to analyse the economic development of Poland using the concept of macroeconomic policy regimes (MPRs). Six elements of a MPR will be identified: foreign economic policy, industrial policy, the financial system, wage policy, monetary policy and fiscal policy. Examining the functionality of the development of these elements applied to Poland is a further aim of this paper. The functionality of the development of the MPR elements will be analysed on the basis of the fulfilment of the objectives, as well as the use of the proposed instruments and strategy assigned to every element of MPR. Due to space limits, we are going to focus on the former in this paper.

Taking into consideration that Poland is an emerging and a relatively open economy, foreign economic policy and industrial policy play very significant roles in restructuring of the economy towards production and exports of high value-added products, which would enable the country to follow a growth path consistent with an external balance. The financial needs of the manufacturing sector and particularly of the producers and/or exporters of high-end products need to be satisfied by the financial system, whose stability needs to be secured with the help

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of monetary policy. The latter is, moreover, in charge of providing low-cost finance and maintaining the stability of the exchange rate. Stabilising the inflation rate would be given to wage policy. Fiscal policy's main tasks would be to correct aggregate demand shocks and reduce income inequality.

1. Introduction

This paper attempts to provide a contribution to the empirical literature about macroeconomic policy regimes (MPRs) analysing the economic development of Poland using the concept of MPR. According to this concept, both policies and institutions play an important role in explaining the economic development of a country. A MPR consists of policies (foreign economic policy, industrial policy, wage policy, monetary policy and fiscal policy), the financial system and the institutional frameworks in which the economies are embedded.² In emerging countries, which have been the primary focus of my latest work, six elements of a MPR can be identified: foreign economic policy, industrial policy, the financial system, wage policy, monetary policy and fiscal policy. The development of these elements will be examined within the context of the given institutional framework and the most important institutional changes which took place from the mid 1990s onwards. The functionality of the development of the MPR elements in Poland will be analysed using a normative model set in Section 3.

I chose Poland as a case study for the reason that it is firstly, the single country, which managed to avoid a financial crisis and sliding into a recession amidst the latest EU financial, economic and sovereign-debt crises. Furthermore, it is a country which has maintained a certain level of capital controls albeit it joined both the OECD and the EU. The third reason is that Poland is comparatively to the other Central Eastern European Countries (CEECs),³ a large economy. Fourthly, both during the times of the Soviet Union and today, Poland has maintained a relatively large industrial sector.

In a nutshell, the analysis of the functionality of the development of MPR in Poland since the mid 1990s shows that owing to the significantly

² This definition of a MPR for an emerging economy draws on Kazandziska (2013). Herr&Kazandziska (2011), as well as Heine, et al. (2006) define MPR for industrial countries.

³ Here under CEECs we mean the ten countries, which entered the EU in 2004 and 2007: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

large manufacturing sector, Poland has had an improvement of the trade balance, but not the current account balance *per se*. The country seems to lack behind the EU level with regards to the production and exports of high value-added products. As a result of the financial system regulations and the maintenance of a certain level of capital controls the financial system was able to escape a major banking or financial crisis. Monetary policy was periodically able to provide a low-cost finance to the financial system. The central bank seemed to have been torn between its goals of maintaining price level stability and keeping the exchange rate stable using the interest rate as a main instrument. The conduct of wage policy in Poland was restricted due to the very limited power of trade unions and employers' associations, particularly at the sectoral or national level and the limited efficacy of the alternative instruments of wage coordination (extension of collective agreements or minimum wages), which resulted in low collective bargaining coverage and a low level of wage coordination. Fiscal policy often showed stop-and-go development. After adopting the Euro Plus Pact in 2011, the fiscal policy turned particularly restrictive in the period 2012-2013, which has had a negative impact on the economic growth. The high income inequality of disposable income shows that the redistributive policies of the government had a limited success in favouring income distribution towards low-income and low-wealth households.

In section 2 the focus will be put on the methodology used in this paper. Section 3 sketches the outline of a normative model of a MPR on the basis of which the functionality of the MPR development in Poland will be assessed. In the section that follows a separate analysis of the MPR elopements will be provided. The last section concludes.

2. Notes on the methodology

To start with, the concept of MPR is of a qualitative nature. As we shall also see below, this concept is also of highly complex and comprehensive nature, using both economic policies and institutions in the process of explaining the economic development of a country. Furthermore, due to the unavailability of long-run, continuous and cross-country comparable data for certain variables, there are limitations to the conduct of a reasonable econometric analysis. Hence, the methodology of this paper includes a brief review of the primary literature related to MPRs.

Moreover, a Tinbergen type of approach is used, whereby I identify objectives, instruments and strategies for all the individual elements of MPR. The analysis of the fulfilment of the assigned objectives and the use

of instruments and strategies entails the use of specific indicators. Hereby, statistical data analysis and use of descriptive statistics is conducted.

The elements together with their assigned objectives, instruments and strategies form one normative model, on the basis of which the functionality of the MPR in Poland will be evaluated. The development of a MPR element is considered functional if the elements of MPR met the objective(s) assigned and if they reached the goal using the specific instruments and the strategy allocated to them. Due to limited space, I will concentrate mostly on the first criterion – the achievement of the goals assigned for each element of MPR.

The model proposed in this paper draws significantly on Kazandziska 2013, where it has been more comprehensively elaborated. Kazandziska 2013 puts a focus on the development of MPR in the Latvian economy. We have to be well aware of the many peculiarities in the economic, political or social development in the individual countries. However, due to the significant amount of similarities among the Central Eastern European countries (CEECs), the normative model for an emerging country developed in Kazandziska (2013) can be also applied to the Polish economy. Nonetheless, the country-related specific features and developments, which have played an important role into forming the MPR in Poland, will naturally not be disregarded.

3. Outline of the model

As described earlier in the text, MPR is defined as a set of policies (foreign economic policy, industrial policy, wage policy, monetary policy and fiscal policy), the financial system and institutions in which the economies are embedded (Kazandziska, 2013). Applied to emerging countries, we can identify the following elements of a MPR: foreign economic policy, industrial policy, the financial system, wage policy, monetary policy and fiscal policy. The functionality of each of these elements will be analysed on the basis of the fulfilment of the objective(s) assigned to it. Furthermore, the major institutional changes, which have had a significant impact on the development of the particular elements, will also be addressed.

In emerging countries as open economies, foreign economic policy and industrial policy will be assigned quite important objectives. The former will be given the tasks of reducing the current account deficits and achieving a balanced current account, and reducing the capital flow

volatility.⁴ The reduction in current account deficit is in the long-run to be achieved through exports of high-tech, high value-added products, which will improve the terms of trade.⁵

Here comes industrial policy to the fore by supporting the revival of the manufacturing sector, particularly the production of high value-added products, which in the long-run can improve the terms of trade and the current account. The government spending on research and development (R&D) and various forms of state-aid can be used to support certain sectors/firms, which are involved in the production and/or exports of high-end products, which could increase the income elasticity of exports.

The financial system needs to support this growth strategy based on external balance, by providing a sufficient finance to the manufacturing sector, particularly to the targeted industries/firms (which, produce and/or export high value-added products). Being that the subject of our analysis are emerging countries, whereby banks play a dominant role in the provision of finance, supply of a sufficient amount of finance in the form of credit will be of a paramount importance. The financial system also needs to secure the stability of the financial sector through diverse regulations diverting credit away from the speculative sectors (real-estate, construction sector) especially in times of an asset-price bubble.

Wage policy's main task would be to provide a stable wage anchor and thus, help secure the stability of the inflation rate. A necessary precondition for a functional wage policy is wage coordination within and among sectors, which can be achieved through sectoral or national wage bargaining, supported by extension of collective agreements and minimum wages.

Monetary policy would be in charge of providing low-cost finance to the financial system,⁶ securing the stability of the latter and, especially

⁴ Current account deficits lead to drainage of foreign exchange reserves and, particularly in emerging countries they can reduce the credibility of the domestic currency and monetary policy. However, export-led growth strategies to achieve current account surpluses are only possible for individual countries (see for instance, Onaran&Galani, 2012 for more elaboration). Reduced capital volatility serves the aim of preventing financial and currency crises, as well as creating conditions for a more stable investment by the private sector.

⁵ Devaluation can only under certain conditions and mostly in the short- to medium-run, bring positive results (some of the conditions are: low/no dollarization, low level of external debt, stable wage anchor, and low exchange-rate-pass-through, so that the currency can devalue in real terms). Thirlwall (1979, 2013), McCombie&Thirlwall (1999) added also that the devaluation would have to be continuous so that the positive net effects are not only short-lasting. However, if nominal wages continuously lag behind nominal devaluation and the exchange-rate-pass-through is high, the wages of the workers in real terms will erode, which is politically and socially unsustainable.

⁶ Low-cost finance is to be mainly provided through low real interest rates.

important in emerging countries, providing a stable nominal exchange rate anchor.⁷ Providing low-cost finance, mostly provided through low real interest rates is also supportive for the stabilisation of interest payments on the public debt and thus opens more room for manoeuvre for fiscal policy.

Two major objectives will be assigned to fiscal policy: reducing shocks to aggregate demand (mostly by government spending, because of its high fiscal multiplier) and reducing income inequality (through tax and transfer policies)⁸.

It is noteworthy to mention that all the elements need to be coordinated for the most optimal functioning of one MPR.

4. Macroeconomic policy regime of Poland

In the next section we are going to briefly analyse the main drivers of economic growth in Poland, followed by the examination of the individual elements of MPR and the functionality of their development. Due to data unavailability for the earlier years, the period under observation starts in 1995 and ends with 2013.

4.1. Economic development

After declining at a rate of 7 per cent in 1991, the Polish economy recovered a year later, experiencing a positive growth of 2.5 per cent. Until the late 1990s, the economy grew on average at a rate of about 6 per cent (Eurostat 2015). The growth during this period was predominantly driven by the domestic demand. Both private consumption and investment have had a significant contribution to the economic growth. However, government consumption seems to also have had an important impact (Table 4.1).

In 1998 the economy showed the first signs of a slowdown as a consequence of the Asian and later on, the Russian financial crisis. The economy grew at a much lower pace amidst the European and world economic slowdown. During the years of economic downturn, growth

⁷ Exchange rate regime in the form of form of fixed (or close to fixed) exchange rate is recommendable (Kazandziska, 2013, Priewe&Herr, 2005).

⁸ Income redistribution towards low-income and low-wealth households can potentially stimulate consumption and thus, economic growth, as these households have a relatively high marginal propensity to consume (see for instance, Hein&Truger, 2014).

Building comprehensive welfare systems is also an important goal of fiscal policy. However, due to space constraints, we are only going to focus on the two other objectives of fiscal policy.

remained positively largely due to private consumption expenditure and net exports. Smaller, but positive contribution was made by government consumption. From 2003 until 2007 the economy had a relatively stable growth. From 2008 until 2009, the Polish economy felt some of the negative effects of the European and world financial and economic crisis. But, the economy managed to avoid sliding into a recession owing largely to the positive growth of government consumption and to a lesser extent, to the private consumption. In 2009, net exports improved as a result of the currency devaluation and the undervaluation strategy that followed. In 2011, the government resorted to a pro-cyclical fiscal policy which had a contractionary effect on the economy in 2012 and 2013.

Table 4.1 Contributions of the components of aggregate demand to GDP (growth rate, per cent)

	1995-1999	2000-2003	2004-2007	2008-2013
Private consumption	3.8	1.6	2.7	1.7
Gross fixed capital formation	2.5	-0.6	2.1	0.5
Government consumption	0.6	0.5	0.8	0.4
Net exports	-1.6	1.3	-0.8	0.9

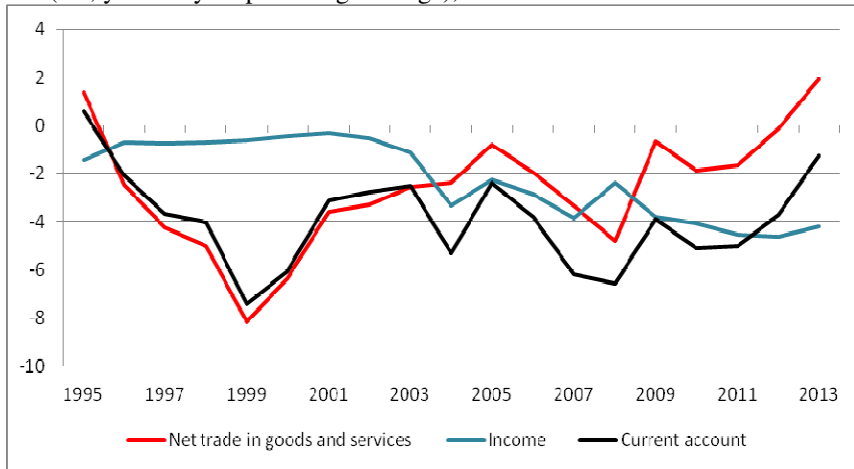
Source: Eurostat 2015, author's calculation

4.2. Foreign economic policy

Foreign economic policy in Poland has been shaped by the Polish entry in the OECD in 1995 and the EU accession in 2004. These events had as a consequence institutional changes with a profound impact on the development of the MPR in Poland, such as liberalisation of the trade and capital account. With regards to the latter, Poland followed a path of a gradual deregulation (Sadowska-Cieślak, 2003). The Foreign Exchange Law passed in 1998, stipulated that non-residents were allowed to purchase domestic short-term securities and derivatives only with a foreign exchange permit granted by the National Bank of Poland (Janc&Marszalek, 2014). Poland kept most of the restrictions, particularly on short-term capital flows until 2002. In 2002 the government adopted a new law, according to which the majority of the restrictions on capital flows to and from the rest of the EU and OECD countries were lifted. In 2007 also many barriers on capital in- and outflows related to a securities trade to and from third countries were also eliminated (Janc&Marszalek, 2014).

Albeit the Polish government has kept a certain level of capital controls even until today, the size of the net capital flows has been quite significant, which had repercussions on the development of the current account.⁹

Figure 4.1 Development of the current account, trade and income balance in Poland (net, year-on-year percentage change), 1995-2013



Source: National Bank of Poland, author's calculations.

The first objective of foreign economic policy is to reduce the current account deficits and achieve a balanced current account in the medium- to long-run. The current account in Poland was in deficit during the whole period of analysis, from 1995 until 2013 (Figure 4.1). From the mid until the late 1990s, the current account deficits increased mainly due to the rise in the trade deficits. From 2000 until 2005 the trade deficit was reduced, which led to a reduction of the current account deficits until 2003. In the period thereafter the deficit of the income account started rising as a consequence of the primary income deficits. From 2006 until 2008 we can observe an increase of the trade and current account deficits. The period that follows is marked by a reduction of the trade deficits (mostly due to a faster decline of imports compared to exports) and an improvement of the current account balance. However, in all these years the decline of the trade deficits was not sufficient to compensate for the increase of the deficit in the income account, which resulted in current account deficits. One important point to make here is that the decline of the trade deficits was

⁹ The Chinn-Ito index of capital account liberalisation equalled to 0.06 in 2011 (the latest data available), whereas the index in the EU-countries on average had a value of 2.44, which is close to the highest value of 2.48 (Chinn&Ito 2006, 2001).

highly as a result of the fall of imports below exports. Furthermore, the export structure has not been advantageous (the share of high-technology exports in total manufactured products was only less than 4 per cent on average in Poland, while in the EU the former equalled to 17 per cent) (author's calculation based on World Bank 2015).

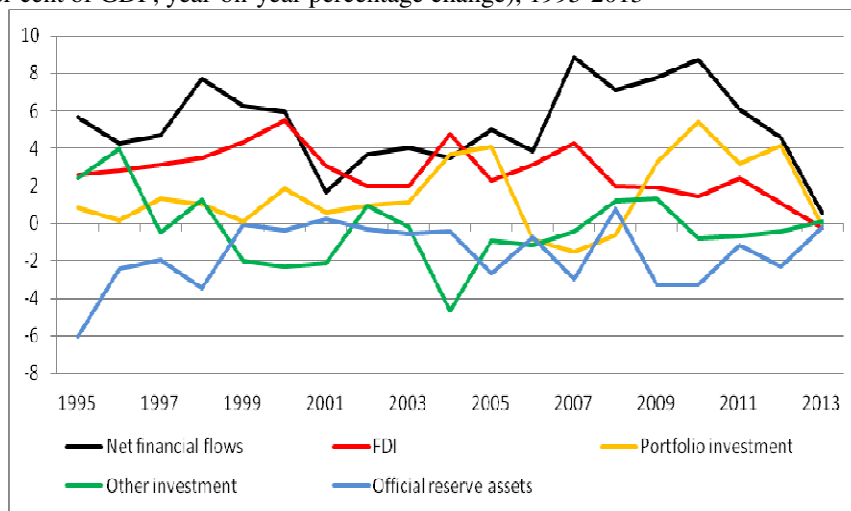
Hence, we can argue that the first objective of foreign economic policy to reduce current account deficit and achieve a balanced current account, was not achieved.

Reducing the capital flow volatility is the second task assigned to foreign economic policy. Figure 4.2 shows that the volatility of capital flows in Poland increased after the mid 1990s. Net capital flows increased particularly until the Russian financial crisis in 1998. The latter accompanied by the downturn in the other European countries in 2000/2001 caused a withdrawal of capital. The period until 2006 was marked by a relative stability. However, in 2007 and in 2009/2010 a very strong rise in net capital inflows can be spotted due to the fact that all member countries of the EU experienced a recession and Poland was the only country that managed to escape entering a recessionary scenario. Thus, international investors saw a very attractive opportunity in investing in Polish assets. Yet, from 2011 onwards, there has been a strong decline in net capital inflows.

If we take the standard deviation as a measure of capital flow volatility, we can see that Poland had a slightly higher volatility than the countries in the EU.¹⁰ Until 2007 international capital entered mostly in the form of FDI. The reason for this was that long-term flows were liberalised before short-term capital flows (IMF 2008). In 2007 most of the restrictions on capital in- and outflows were lifted, which led to a rise in portfolio flows. From 2008 onwards FDI lost some of its momentum and portfolio flows picked up. In 2013 both net FDI and portfolio flows declined.

¹⁰ The standard deviation of the net capital flows for the period 1995-2013 in Poland amounted to 2.2, while the former had a value of 2.0 in EU-15 (unweighted average, author's calculation based on Eurostat 2015).

Figure 4.2 Development of net capital flows and their composition in Poland (per cent of GDP, year-on-year percentage change), 1995-2013



Source: Bank of Poland, author's calculation

Hence, we can conclude that, firstly, foreign economic policy only intermittently was able to reduce the current account deficits, but over the years, current account balance was not achieved. Secondly, a certain stability of capital flows was achieved until about 2006; however, in the period thereafter as net portfolio flows strongly increased, a higher volatility of net capital flows is to be observed.

In the next section, a due attention will be paid to the sectoral composition of the economy and the functionality of industrial policy in restructuring the economy in order to improve the terms of trade and the current account.

4.3. Industrial policy

There are various uses and definitions of the concept industrial policy. In this paper industrial policy is used to signify a policy aimed at particular industries/firms that could raise the economic welfare of the whole economy (Chang, 1994, 2006, 2010). In the EU-terminology, it is the so-called 'vertical' or 'sector-specific' policy.

In Poland industrial policy was highly connected to the privatisation process. This has been the first important institutional change that shaped industrial policy in Poland. It was aimed at recovering some very crucial sectors, which had financial difficulties and at privatising or transforming

the enterprises, which operated in sectors, which had a potential for high profitability and expansion in future (like, pharmaceuticals, chemical industry, metal industry, telecommunications and the energy sector) (Błaszczuk et al., 1997). The success of these programmes was due to a lack of resources and a clear strategy quite limited. Only in the National Development Programme for 2016-2020 the government for the first time emphasized the need to support the high-technology sectors (Council of Ministers of the Republic of Poland, 2012).

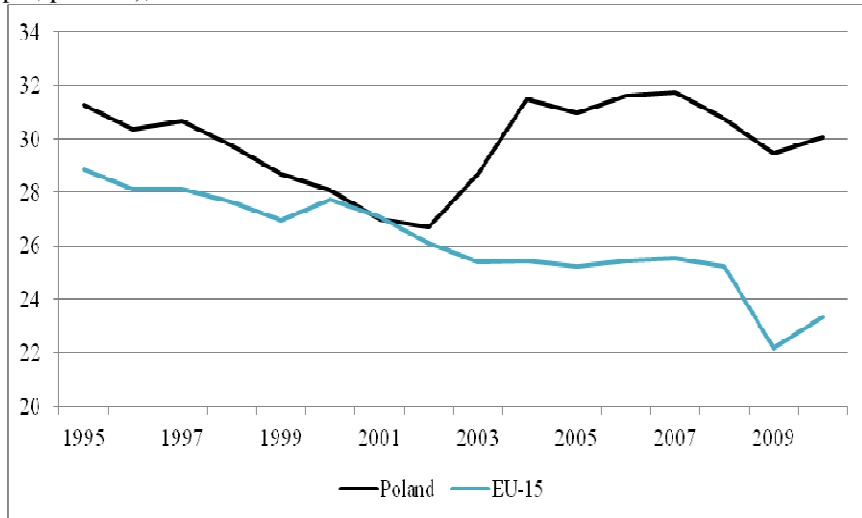
A second important institutional change was the accession of Poland in the EU. The EU membership entailed a restriction on the part of ‘vertical’ or ‘sector-specific’ industrial policy, as it is considered harmful for the ‘healthy’ competition among enterprises. Under the EU-law emphasis is put on the so-called ‘horizontal’ policies, which are universal policies, not favouring any particular industries or firms (Lech, 2007).¹¹ Thus, upon joining the EU, Poland had to adjust its industrial policy according to the EU guidelines.

Industrial policy in our model has one very important role: reviving the manufacturing sector. We are going to analyse the development of the manufacturing output-total output ratio, which is going to show us the share of this sector in the total economy. Similarly to other CEECs and to the EU countries, Poland also experienced a decline in this ratio in the second half of the 1990s (Figure 4.3). By the early 2000s the share of this sector in the total output increased but the rise was not very impressive. Only in 2004 was manufacturing able to reach the same level relative to total output, which it had in 1995. It stayed around this level until today. One more important point to make is that the share of the high-technology manufacturing sectors in the total output was lower in Poland than the EU-average.¹²

¹¹ Such ‘horizontal’ policies are supporting the development of SMEs, investment in R&D and training programmes and environmental protection.

¹² The share of high-technology manufacturing sectors in total output equalled to 3.9 per cent in Poland and to 5.4 per cent for the EU-countries for the period 2000-2010 (unweighted average, author’s calculation based on Eurostat 2015).

Figure 4.3 Manufacturing sector output in Poland and EU (share of total output, per cent), 1995-2010



Source: Eurostat, author's calculation

This section can be concluded by arguing that industrial policy was able to stop the declining trend of the manufacturing sector. Yet, the output of the latter recovered at a very low pace. In the conduct of industrial policy in the sense of 'vertical' policy, the Polish government was highly constrained by the EU-Treaties beginning from 2004 onwards. In its recent reports, the government emphasizes the role of high-technology sectors for the economic development of the country. But, targeting of specific industries/companies is not part of the agenda.

4.4. Financial system

With the adoption of the Act on the National Bank of Poland and the Banking Law in 1989, the foundations for the functioning of a two-tier banking system were laid. The financial system in Poland (similarly to the other CEECs and many emerging countries) is predominantly bank-based, whereby bank loans are the single most important source of finance for the firms.¹³ Banks also own the largest share of assets in the financial system.¹⁴

¹³ In 2010 over 50 per cent of the firms in the economy (excluding the financial and insurance sectors) used banks as a source of finance (Eurostat 2015).

¹⁴ For instance, between 2005 and 2008, banks owned 75 per cent of the total assets in the financial system (EBRD, 2009, pp. 13).

The assets of the banking system in Poland are also predominantly foreign-owned.¹⁵

The main tasks of the financial system in the model presented in Section 3 are to provide a sufficient finance to the business sector and to maintain the stability of the financial system. The analysis of the fulfilment of the first task will encompass mostly the banking sector loans being that banks have been the most important providers of finance in Poland. The indicator we are going to look at is the corporate loans-GDP ratio.¹⁶ On a more general note, we can say that until 2006, the growth of total credit in the economy has not been very high (Figure 4.4). The reason for the relatively poor credit growth is the sluggish development of the corporate credit amidst the Russian and European crises in the period 1999-2001 and even a decline of the corporate sector credit in 2004-2005. In the period after 2007 corporate credit picked up, largely due to the elimination of most barriers to the capital flows and owing to the strong capital inflow. Yet, this growth was rather short-lived. In 2010 and 2011 as a result of the European financial and economic crisis corporate sector credit declined.¹⁷ During the latest economic downturn there has been a decline in demand in the side of the companies for loans. However, during the periods of rising economic growth when also the household credit increased (for instance, between 2002 and 2004), firms seem to have faced a financial constraint and a stronger credit rationing by the banking sector.¹⁸

On the other hand, the household sector credit-GDP ratio showed a trend of stable increase throughout the whole period (except in 2010, when it stagnated).

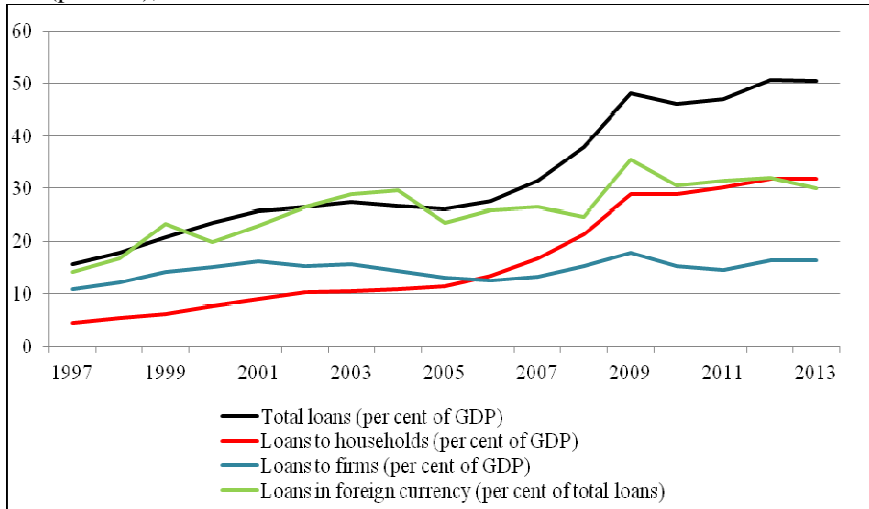
¹⁵ Between 2005 and 2008, 70 per cent of the total banking system assets (which includes the banking sector, stock market and bond market capitalisation) were foreign-owned (EBRD, 2009, pp. 13).

¹⁶ Corporate loans include both financial and non-financial corporation loans.

¹⁷ However, household credit relative to GDP seems to have grown over most of the years (except in 2010 and 2013).

¹⁸ In 2003 the share of firms, which perceived the access to finance to be the strongest obstacle to the firm's performance increased from 34.3 per cent in 2002 to 35.9 per cent in 2003 (World Bank's Enterprise Surveys data).

Figure 4.4 Development of loans per sector and loans in foreign currency in Poland (per cent), 1997-2013



Source: National Bank of Poland, author's calculation.

Maintaining financial system stability as the second task of this element of MPR will be assessed by analysing firstly, if there has been a banking crisis in the country. For this purpose, the banking crisis dummy from the Global Financial Development indicators database of the World Bank will be used.¹⁹ As this indicator had a value of zero in all the years, we can say that the financial system in Poland managed to keep away from a banking crisis. The share of foreign currency loans to the total loans will be the next indicator, which is going to show us the level of dollarization/euroisation in the country. In the case of Poland we can see that this ratio increased after 2004 (Figure 4.4). But, owing to the timely introduction of several financial system regulations, this ratio was contained at a level of around 30 per cent.

We can summarise this section with the arguments that firstly, the financial system met the objective of providing a sufficient finance to the business sector only partially. As to the objective of financial system stability, we can argue that the financial system has been able to achieve a relative stability owing to the various regulatory instruments.

¹⁹ Visit the website of the Global Financial Development indicators of the World Bank for more information (<http://data.worldbank.org/data-catalog/global-financial-development>). The banking crisis dummy can have a value of one or zero (if the country did or did not have a banking crisis, respectively).

4.5. Wage development/policy

We are going to begin this section by the argument that the conduct of wage policy has been restricted in Poland. There are several reasons for making this statement. First of all, wage bargaining, if at all, has been mostly conducted at a company-level (Visser, 2011). Very often due to the absence of trade-union representation, because of the conflict between a few trade-unions representing workers at the same company or the small size of the companies, collective bargaining even at a firm-level is absent and the managers often individually decide on the size of the workers' pay. The collective bargaining coverage still remains low relative to the other European countries.²⁰ The membership in trade union and employers' associations has also been quite modest.²¹ Sectoral or national wage negotiations are rare because of the very limited power and a lack of organisation of the social partners at a sectoral or national level. At the national level, social partners are essentially involved in the setting of the minimum wage within the Tripartite Commission on Social and Economic Affairs. Furthermore, from 1994 until 1994 the tripartite commission was also in charge of determining the target maximum increase of the average monthly wages in the public sector and in the private companies with more than 50 employees.²² The calculation of the wage increases took into account the projected GDP growth rate and the inflation rate. Although these target wage increases served only as guidelines for the companies in the private sector when negotiating the wage increases of their employees, the former were obligatory for the public sector (Wratny, 2006). Yet, wage coordination has remained at a low level in Poland (Visser 2011). The efficiency of the minimum wage policy and the extension of collective agreements have been also limited.²³

²⁰ The collective bargaining coverage in 2010 was 29 per cent in Poland, while in the EU it was around 60 per cent (unweighted mean average, author's calculation based on Visser, 2011).

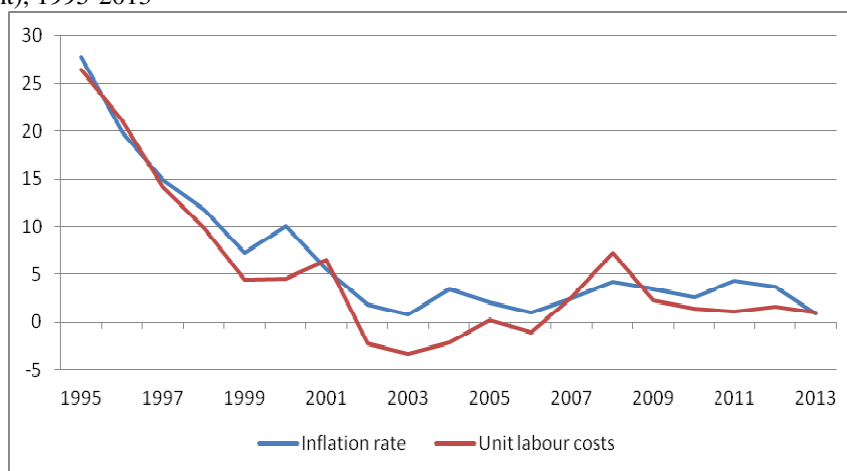
²¹ Trade union density was 14 per cent in 2010. Employers' associations organised only about 20 per cent of all the firms in 2007 (Visser, 2011).

²² Act of 16 December 1994 (Journal of Laws 1995, No. 1, Item 2 and amendments) on negotiating system of entrepreneurs' average wage increases and Act of 23 December 1999 (Journal of Laws 1999, No. 110, Item 1255 and amendments) on creation of wages in the public sector. These acts replaced the wage control tax law (called *popiwiek*), according to which sanctions in the form of higher taxes were to be paid by companies, which paid higher wage increases for their employees than the officially allowed rates (Kabaj, 1998).

²³ The minimum wage has been often used as a basis for the calculation of the wage increases particularly in companies, which have not been covered by collective agreements.

The most important task for wage policy is to maintain the stability of the inflation rate in the medium- to long-run. The first indicator we are going to look at is the inflation rate. In Poland we can observe a certain volatility of the inflation rate. Put into perspective, we can say that Poland had a higher volatility of the inflation rate compared to the EU countries.²⁴ There is a strong correlation between the development of the inflation rate and the unit labour costs, which is also confirmed in the case of Poland. Thus, we are going to analyse the development of unit labour costs next.

Figure 4.5 Inflation rate and the growth of unit labour costs in Poland (per cent), 1995-2013



Source: Eurostat 2015.

In the second half of the 1990s we can observe that the growth of the unit labour costs and the inflation rate slowed down (Figure 4.5). This was due to the narrowing down of the gap between the development of the nominal wages and productivity growth. From 2002 until 2006 the growth of unit labour costs turned even negative because of the clear wage moderation policies (Eurostat 2015). The depreciation of the zloty and the increases in import prices helped prevent a deflationary development (Eurostat, 2015). In the following years all through 2010 nominal wage growth picked up beyond the increases in productivity, which stimulated a

However, minimum wages have not contributed to higher wage coordination within or among sectors (Du Caju et al., 2008).

²⁴ The value of the standard deviation for Poland was 7.2, the one for the EU-countries amounted to 0.6 for the period 1995-2013 (author's calculation based on EU Commission, 2015).

rise in inflation. From 2011 until 2013 nominal wages grew at a pace close to the productivity growth.

To summarise, wage policy first of all, not faced certain constraints in Poland. Secondly, and connected to the first argument, due to the uncoordinated wage increases, the development of the inflation rate was not stable. Some alternative instruments of wage policy, which serve the purpose of increasing the wage coordination, like, minimum wages or extension of collective agreements, have been put in use, but the effects have been rather limited.

4.6. Monetary policy

As also established in Section 3.4, the first major institutional change, which had a great impact on the financial system and the use of monetary policy, is the creation of the two-tier banking system in 1989. The second very important institutional change happened two years later, when the National Bank of Poland decided to abandon the fixed peg exchange rate regime and adopt the crawling peg instead. The reason for this decision was the shortage of foreign exchange reserves (Borowski, et al., 2003).

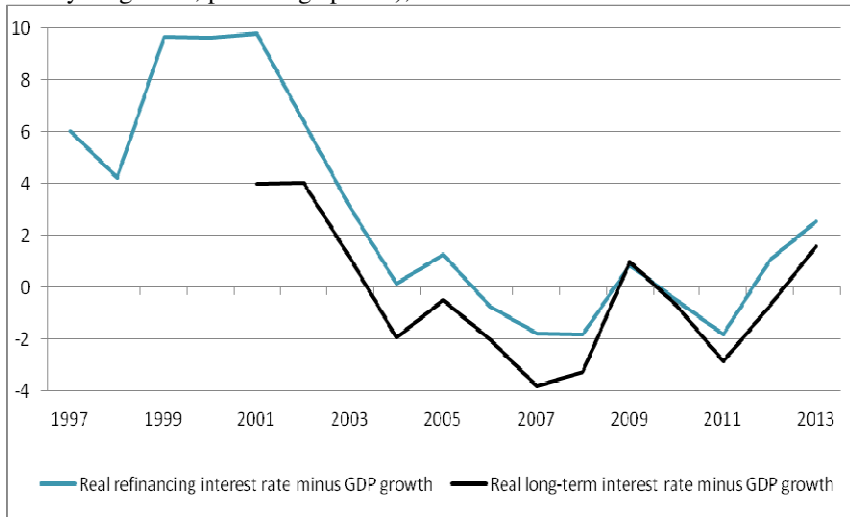
The surge in capital flows and the high costs of sterilisation led the central bank to switch to a crawling band in 1995 (Kokoszczynski, 2002). Chronologically speaking, the fourth important institutional change was the abandonment of monetary targeting as a monetary policy strategy of the central bank and the adoption of inflation targeting in 1998 (Kokoszczynski, 2002). The decision of the central bank to abandon the crawling band and let the currency float was the fifth important change taking place in 2000.

Three objectives have been assigned to monetary policy. The first task this policy is in charge with is ensuring the stability of the financial system. When we analysed the development of the financial system in Section 3.4, we could see that the institutions in charge of the financial system (the financial supervisory agencies, the government and the central bank) were able to relatively keep the financial system intact. Thus, we can argue that the first objective of monetary policy has been met.

The second objective of monetary policy is to provide sufficient low-cost finance to the banking sector. The indicators we are going to use, the real short-term interest rate minus GDP growth and the real long-term interest rate minus GDP growth, give an insight into the *ex-post* monetary

policy stance and the availability of low-cost finance. Until 2003, the (short-term and long-term) interest rates were higher than the GDP growth, which means that expansionary policy was ex-post restrictive for real investment and economic growth (Figure 4.6). From 2004 until 2008, the both ratios were negative, which means that monetary policy was expansionary. This could be also argued for the period 2010-2012.

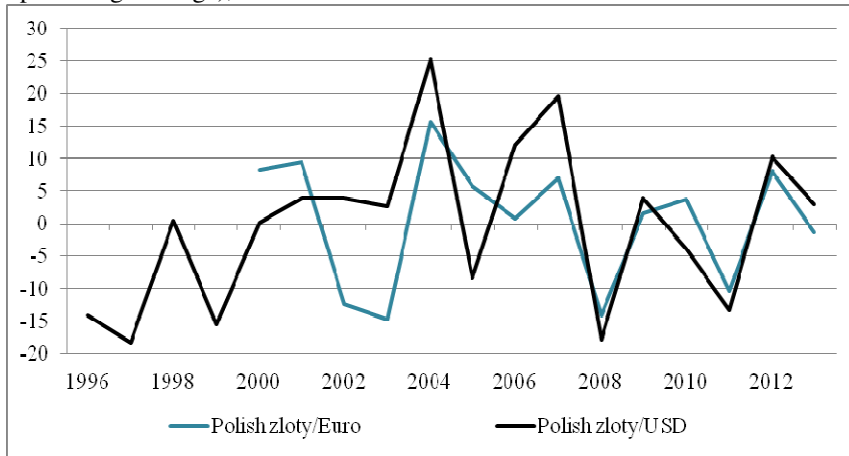
Figure 4.6 Real short- and long-term interest rate relative to GDP growth (year-on-year growth, percentage points), 1997-2013



Source: Eurostat 2014, author's calculation.

The third objective of monetary policy is to preserve the stability of the exchange rate. Figure 4.7 shows that the exchange rate development between the zloty and the US Dollar, as well as between the zloty and the Euro has been relatively volatile. This can be argued both for the period prior and succeeding 2000, which is the year when the floating exchange rate regime was introduced. This means that the central bank's foreign exchange intervention was not successful enough so as to prevent fluctuations of the exchange rate, which then also had a negative impact on the competitiveness of the domestic companies.

Figure 4.7 Exchange rate between the zloty, US dollar and the Euro (year-on-year percentage change), 1996-2013



Source: Eurostat 2015

In a nutshell, we can conclude that monetary policy was able to protect the financial system from banking, currency or financial crises. Up to 2003, monetary policy was *ex-post* restrictive (real short- and long-term interest rates were above the rate of economic growth of the country). Only after 2004, was monetary policy conducive to investment and growth. This means that the second objective of monetary policy, providing a low-cost finance to the financial system, was only partially met. In spite of the various attempts of the central bank to stabilise the development of the nominal exchange rate through foreign exchange intervention, the fixed peg and the crawling peg could not be defended. The exchange rate development seems to have been relatively volatile in Poland.

4.7. Fiscal policy

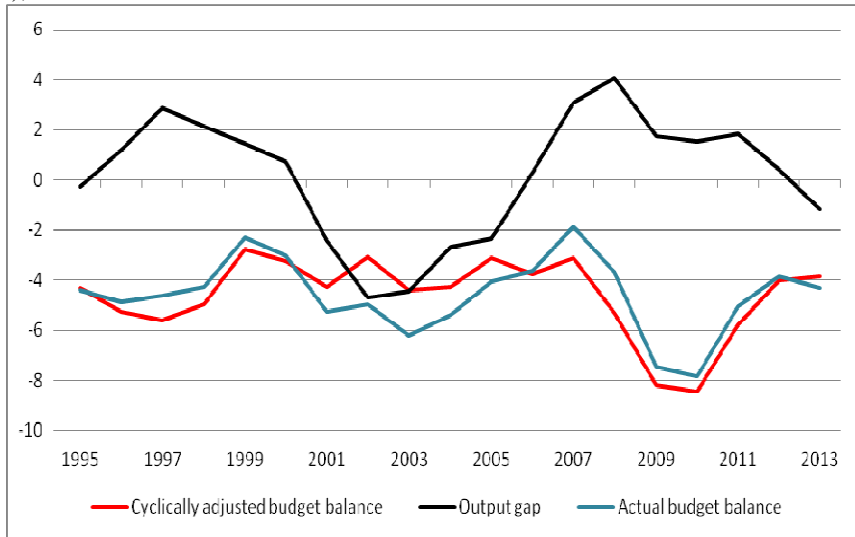
The first major institutional change, which had a profound effect on the functioning of fiscal policy was the accession of Poland in the EU in 2004 and the requirements of the Maastricht Treaty to meet the fiscal criteria of keeping the budget deficit below the limit of 3 per cent of GDP and public debt-GDP ratio no higher than 60 per cent in order to be able to join the European Monetary Union. The second major institutional change was the adoption of the Euro Plus Pact in March 2011, with which the government committed to a policy of a budget consolidation.

The first major objective of fiscal policy is to reduce the aggregate demand shocks in the economy both in the short- and long-run. One

indicator which can show us if the country has gone through a period of aggregate demand shock is the output gap. Between 1998 and 2002 we can observe a fall in the output gap, which signifies that the economy in this period was growing below potential output. During this time, the government attempted to reduce the budget deficits, which is also to be seen in the reduction of the structural (cyclically-adjusted) budget deficits. Hence, the government used pro-cyclically restrictive fiscal policy (Figure 4.8). Between 1999 and 2005, we can spot the stop-and-go fiscal policy, which postponed the economic recovery, although higher government spending was necessary to compensate for the increase in private sector saving (Figure 4.9). Only during the first two years of the recent economic slowdown in Poland (from 2008 until 2010), the government applied counter-cyclical expansionary fiscal policy. However, already in 2011, with the signature put on the Euro Plus Pact, the government deliberately resorted to budget consolidation amidst the economic slowdown.²⁵ The pro-cyclical fiscal policy stance in 2012-2013 did not only weaken the effects of the automatic stabilizers, but also had a negative impact on the economic growth.

²⁵ In the report from December 2014, the Polish government states that it undertook the following measures to consolidate the budget: it reduced the size of the discretionary public expenditures, it increased the retirement age for men and women, it eliminated the early retirement programmes, it froze the public sector wages and increased the value-added tax (Government of the Republic of Poland, 2014).

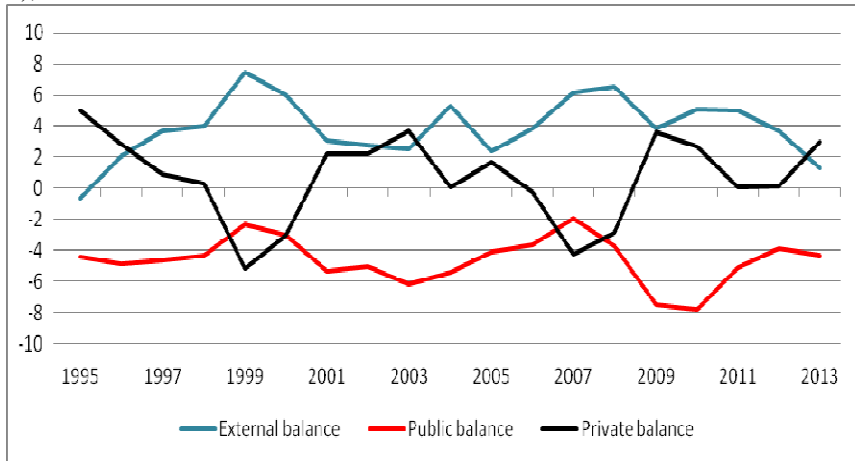
Figure 4.8 Output gap, actual and structural budget balance in Poland (per cent), 1995-2013¹⁾



Notes: ¹⁾ The cyclically-adjusted budget balance and the output gap are calculated relative to potential GDP. Actual budget balance is given as a share of GDP.

Source: Eurostat 2014.

Figure 4.9 Financial balances of the different sectors in Poland (per cent of GDP), 1995-2013



Source: Eurostat 2015, author's calculation

The second objective of fiscal policy is to reduce the income inequality in the country. The Gini index of market income shows us the size of the income inequality before adjusting for taxes and transfer payments. The

paper by Paci et al. (2004) shows that the Gini index of market income increased from 0.379 in 1994 to 0.407 in 2004. The OECD database shows that the income inequality, measured as pre-tax and transfer income inequality, was reduced between 2004 and 2009.²⁶ Yet, according to the same database, Poland had a higher pre-tax and transfer income inequality than the EU-average (OECD database).

However, also if we look at the Gini index of disposable income, we can see that Poland has had higher income inequality than the EU-average (Eurostat, 2015). Income inequality measured as post-tax and transfer income inequality, increased between 1994 and 2004 from 0.308 to 0.317 (Paci et al., 2008). In the following years the income inequality was lowered owing to the increase in pension transfers.

Thus, we can derive the following conclusions regarding the functionality of fiscal policy. Firstly, although it had some counter-cyclical properties in single years, fiscal policy seems to have been pro-cyclical during most of the years of an economic slowdown. This has certainly delayed the economic recovery. Secondly, although reduced since 2004, income inequality, both measured as Gini index of market and disposable income has been higher in Poland than in the EU-members.

5. Conclusions

This paper had the aim to explore the economic development of Poland and to assess the functionality of the development of its macroeconomic policy regime using a normative model briefly sketched in Section 3. According to this model, foreign economic policy and industrial policy are given major tasks of restructuring the economy towards production and exports of high-technology, high value-added products, which would serve the purpose of improving the terms of trade and the current account in a structural and more sustainable way. Foreign economic policy is furthermore, given the significant task of maintaining a relatively low volatility of capital flows, which particularly in open economies like Poland, seems to be of a paramount importance for the stability of the financial system, the stability of the domestic currency and for preserving a more stable investment climate in the country. One of the main goals of the financial system is to provide a sufficient finance for the companies, particularly operating in the targeted high-technology sectors. The second major task of this MPR element is to protect the financial system from

²⁶ According to OECD, in 2004 the Gini index of market income in Poland was 0.57, while in 2009 it amounted to 0.47 (OECD statistical database).

major disturbances and maintain its stability. Providing a wage anchor and thus, maintaining the stability of the inflation rate is assigned to the wage policy. Assuming that the wage policy was able to stabilise the inflation rate and that the monetary policy was successful in providing a nominal exchange rate anchor, the stability of the real exchange rate development and thus, the competitiveness of the domestic companies can also be sustained. Caring for the financial system as well as provision of low-cost finance for the financial system by relatively low real interest rate policy stability are also tasks of monetary policy. Fiscal policy has been assigned two major tasks: combating aggregate demand shocks and reducing income inequality.

The case of Poland shows that:

1. There was a tendency of rather stable net capital flows until 2006. However, after most of the capital flow restrictions were eliminated, portfolio flows became more attractive and with that capital flow volatility increased. Thus, the task of foreign economic policy in maintaining the capital flow stability was relatively better fulfilled in the years preceding 2006, compared to the years thereafter.

2. Foreign economic policy was only occasionally able to reduce the current account deficits owing to the reductions in the trade deficits. However, the reduction of current account deficits did not occur due to structural improvements in the terms of trade, but mostly due to devaluation or as a result of a decline of imports in the periods of economic downturn. Throughout the years, income account deficits have been accumulating, which necessitated even bigger efforts to achieve a balanced current account.

3. Industrial policy did not seem to play an active role in the process of restructuring the economy towards production and exports of high value-added products. In the 1990s, the former was mainly concentrated in the area of privatisation and transformation of the large public-owned companies and banks. After 2004, the EU-accession seems to have played a crucial role in restricting industrial policy in the sense of 'vertical' or 'sectoral' policy.

4. In most of the years was the financial system able to provide the needed amount of finance. However, during the years succeeding the Russian financial crisis (from 2000 until 2005),

there seems to have been a higher credit rationing towards firms, while the households were still able to receive the loans needed.²⁷

5. Owing to the various and very importantly, pre-emptive regulatory measures, the financial system was able to prevent the occurrence of asset-price bubbles, prevent capital flight during the economic downturns and thus, relatively maintain the financial system stability.

6. Monetary policy supported the financial system in securing its stability. But, with regards to providing low-cost finance to the financial system, monetary policy until 2003 was restrictive. Real interest rates were higher than the GDP growth rate, which speaks of a failure of the central bank to provide a low-cost finance during these years. After 2004, monetary policy turned expansionary. The reason for this development is the attempt of the central bank to meet several goals with one instrument: the nominal short-run interest rate: fighting inflation, combating asset-price increase, while following an exchange rate peg and monetary targeting (and later on inflation targeting) as a strategy.

7. The central bank was not able to secure a more stable development of the exchange rate because of the shortage of foreign exchange reserves and a relatively open capital account.

8. Decentralised wage bargaining, weak trade unions and employers' associations and low collective bargaining coverage (because of the limited impact of the collective agreement extension mechanisms and of the minimum wage) disabled the conduct of a functional wage policy in Poland. Wage policy was not able to provide a stable wage anchor and thus, to prevent a volatility of the inflation rate.

9. Fiscal policy was often pro-cyclical. Especially during the economic downturns of 2000/2001 and 2012/2013, the government decided to consolidate the budget and cut public expenditure, which postponed the economic recovery.

10. Income redistribution policies as a part of fiscal policy were able to reduce income inequality; however, the effects of these policies seem to be less impressive than in the EU-countries.

Hopefully, this analysis of the MPR development in Poland is going to stimulate further theoretical modelling of MPR of emerging countries, as

²⁷ We do not mean here that there has not been any credit rationing towards households. But, households, which met the prevailing standards of creditworthiness, were most likely to receive a loan (compared to the firms).

well as empirical research of the development of MPR in other CEECs or other emerging countries.

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