

# POLAND'S ECONOMIC CREDIBILITY INDEX

SECOND EDITION



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EDITION**

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Adam Balcer  
Bartłomiej Biga  
Agnieszka Chłoń-  
-Domińczak  
Sławomir Dudek  
Tomasz Geodecki  
Jakub Głowacki  
Maciej Grabowski  
Jerzy Hausner (red.)  
Jacek Męcina  
Leszek Pawłowicz  
Marta Penczar  
Andrzej Rzońca



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[www.sklep.oees.pl](http://www.sklep.oees.pl)

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**Dagmara Pędrak - Pelczyk**

Language and technical proofreading:  
**Jakub Kędzior**

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**Karolina Korbut, Katarzyna Krauze**

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**Monika Woźniak**

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**MAIN PARTNERS:**



**PARTNERS:**

Dr Irena Eris



NowyStyl

**MEDIA PARTNERS:**

DZIENNIK  
GAZETA PRAWNA

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# Preface

The report „Poland’s Economic Credibility Index – 2nd edition” was created thanks to the cooperation of the European Financial Congress (Europejski Kongres Finansowy, EKF) and the Open Eyes Economy Summit (OEES). For the first time, in an abridged version, it was presented at the EKF taking place on 05 June 2023 in Sopot. The full version of the report was announced on 22 November 2023, at the eighth edition of the OEES Congress in Krakow.

The report was developed by a team consisting of:

- Adam Balcer, programme director, the Jan Nowak-Jeziorański College of Eastern Europe
- Bartłomiej Biga PhD, Cracow University of Economics
- Professor Agnieszka Chłoń-Domińczak PhD, Vice Rector for Academic Affairs, SGH Warsaw School of Economics
- Sławomir Dudek PhD, President and chief economist of the Institute of Public Finance, Warsaw School of Economics
- Tomasz Geodecki PhD, Cracow University of Economics
- Jakub Głowacki PhD, Cracow University of Economics
- Maciej Grabowski PhD, President of the Board, Centrum Myśli Strategicznych
- Professor Jerzy Hausner PhD, chairman of the OEES Program Council, GAP Foundation, editor of the report
- Professor Jacek Męcina PhD, University of Warsaw, advisor to the board of the Lewiatan Confederation
- Professor Leszek Pawłowicz PhD, Coordinator of the European Financial Congress, University of Gdańsk

- Marta Penczar PhD, EKF–Research Project Coordinator, Centrum Myśli Strategicznych, University of Gdańsk
- Professor Andrzej Rzońca PhD, SGH Warsaw School of Economics
- Piotr Górski and Monika Liszewska – co-authors of the results of expert qualitative research

We would like to extend our thanks to a large group of experts – representatives of the academic community, public administration bodies, non-governmental institutions, the financial sector, consulting companies, and organizations of entrepreneurs who shared their knowledge and opinions during the qualitative research.

The authors would like to thank the Economic Council of the Speaker of the Senate. In February 2022, the Council issued a statement, in which it drew attention to the threat resulting from deterioration of Poland's economic credibility and the need to develop an index of our country's credibility.

The publication was created in cooperation and with the support of: the Warsaw School of Economics, the Małopolska School of Public Administration of the University of Economics in Krakow, the Lewiatan Confederation, and the Institute of Public Finance.

The publisher also thanks the benefactors of the Report: Multico, the Economic Freedom Foundation, Dr Irena Eris SA, and Soonly.

# Introduction

The first report, entitled „Poland’s Economic Credibility Index”, was the reaction of our authors’ team to the institutional changes which began in Poland in 2016 and exerted a negative impact on the country’s economic policy and stability of operating conditions of enterprises. It was then that in Poland began a process of limiting autonomy of institutions which, under ordinary conditions, take advantage of their autonomy to support the balance in the economy and stability of business conditions. We then decided to analyse the impact of ongoing institutional and economic policy changes on Poland’s economic credibility. **The aim of our analyses was to determine the extent to which the country’s changing economic credibility affects assessment of foreign and domestic business with regard to whether the authorities of our country ensure balance in the economy and stability in the operating conditions of enterprises.** Such analyses are relevant because the declining economic credibility of a country creates uncertainty, which inherently reduces rates of return on investments expected by enterprises. One of the most important effects observed in Poland is the decline in the share of corporate investment in GDP.

Since the publication of the previous report „Poland’s Economic Credibility Index”, the situation has not changed for the better. The process of erosion of the quality of institutions has continued, and excessive fiscal expansion has resulted in growing state debt – largely beyond control of the Sejm. Unrestrained public expenditure has, by its very nature, resulted in an increase in fiscalism taking various forms. These phenomena

have raised concerns about further developments in the economy and the related concerns about instability of the operating conditions of enterprises. **In such situation, our authors' team felt obliged to develop another report documenting the process of deterioration of the quality of institutions and economic policy pursued in Poland.** This is a disturbing phenomenon because its continuation will lead to a decline in the growth rate of production efficiency, which will result, especially in a country like ours, one with a rapidly aging population, in the fading of the economic growth dynamics and slowdown in the process of decreasing economic growth which has continued since the early 1990's development gap that divides us from highly developed countries.

At the same time, it is necessary to take into account the rapidly growing level of regional and global uncertainty, manifested by the occurrence of subsequent economic shocks, while the previous ones have not been effectively contained, or at most moderately mitigated (global financial crisis, pandemic, disruption of global supply chains, migration waves, invasion of Russia to Ukraine, energy shock, or war in the Middle East). We live in times of polycrisis. **The country's economic credibility of the state is always important.** In times like these, it is fundamentally important. Its noticeable deterioration limits the possibilities of counteracting the crisis.

Restricting the autonomy of institutions in Poland has paved the way to a growing scale of economic interventionism, aimed at maximizing the current GDP growth rate and the government's electoral popularity, rather than at improving economic efficiency. **Excessive economic interventionism causes the gradual disabling of market mechanisms, which, for obvious reasons, adversely affects the long-term growth rate.** Maintaining such trend of change may support the use of fiscal and monetary expansion for stimulating economic growth. If current trends continue, for example, inflation may remain

higher and more persistent than it would be under conditions, in which the economic policy is run by the book.

For the reasons mentioned above, in this year's edition of the Report, we will start considering the category of the state's economic credibility from stability of the financial system. However, it should not be subjected to a mental pattern. This is an issue that requires operational definition and practical adjustment of instruments. Context is always key. For example, with large exchange rate fluctuations, the volatility of interest rates should be low.

Stability is not the opposite of flexibility. However, flexibility cannot mean unlimited discretion. It must be related to something: objectively (e.g. instruments) and process. **If everything is allowed, over time nothing can be achieved. Then there is no public policy, including the economic policy, and what remains is politicking - a political game that further weakens economic credibility.** The field of reasonable decision-making flexibility is determined by the actual anchoring of decisions in specific rules. Not everything can be fluid.

This is one of the reasons why monetary policy should not respond directly to short-term growth fluctuations. Monetary stimulation of growth is at least questionable in the monetary policy horizon, and at the same time it may contribute to the disruption of macroeconomic balance. It resembles hypertension, which must be counteracted immediately, otherwise it is impossible to treat something else.

**High inflation leads to disappearance of certain state functions, especially those related to economic stabilization and social cohesion.** It results from the strong dependence of persons in power on the inflation money. The inflation premium offers additional opportunities and a sense of decision-making freedom. However, the freedom is in fact gradually narrowing. The inflation money is not suitable for systematic investment. To do business, including the political one, yes. Inflation conflicts society, disorganizes various social groups, and

weakens their formal representations. It also increases political clientelism. Instead of a well-thought-out and regulated redistribution, there is chaotic auction. All this means that the importance of long-term and development forms of capital, including social capital, is weakening. And above all, the tendency to invest with a longer time horizon is declining. This blocks the short circulation of hot inflation money.

Allowing significantly elevated inflation, well above the inflation target, inevitably results in the state imposing an „inflation tax” on households and enterprises. This tax is automatically related to a noticeable loss of purchasing power of income and savings. In order to give this issue – closely linked to the reduced economic credibility of the state – appropriate importance for our Report, we have included, as an annex, the article by Stanisław Kluza and Andrzej Sławiński (2023), in which the authors discussed this issue in detail.

**Maintaining the country’s current and long-term economic credibility becomes impossible if the institutions responsible for stabilizing the economy - such as an independent central bank - are weakened and dismantled.** There is the following interdependence here. If activities of the state, for political reasons (as precisely described by Kluza and Sławiński on the basis of the example of countries ruled by populists) and economic reasons, deviate from the established rules of normativity on various levels (e.g. limiting the independence of judges or circumventing the fiscal rule on expenditure), they ultimately weaken the stabilizing role of the economic institutions. Which in practice also means weakening the country’s credibility. At the same time, limiting the above-mentioned rules is aimed at obtaining a large scope of freedom in conducting current economic policy, especially the monetary and fiscal policy. If, as a consequence, there is a significant economic disruption of the economic balance in various fields, the weakened economic institutions of the state are unable to effectively perform their stabilizing functions. This directly affects the country’s credibility



and the stability of the economic system, including the financial system. Negative consequences interpenetrate, accumulate, and build up. The systemic ability to restore stability is undermined. Without recovering and strengthening the normative order, it is impossible to counteract this situation. It remains to undertake further control and intervention activities (in the name of improving the social, political, and economic situation) disrupting further components of the market mechanism (e.g. administrative price formation, leading to market deficits and speculation). The state, in a functional way, compensates for the decline in its economic credibility by aggressively expanding its domain and empire. In practice, it combines the role of a regulator and an actual owner in the same fields, i.e. it decides authoritatively in its own matters and for its own benefit. However, it is neither order nor its guarantor in the proper measure. Because through such extraordinary measures, the focus falls apparently on restoring macroeconomic balance, but it is not this method that will lead to such end. The balance will not be maintained, and the dynamics of the the balance's deepening will be only locally weakened. And at the same time, the normative and market order is replaced by a broader interventional, political, and administrative system, the constitutional-democratic order is replaced by authoritarianism of will and political power, and order and stability are replaced step by step by chaos and uncertainty. And this means a trap; when trying to get out of it, one falls even deeper.

It is important to recognize the importance of the country's economic credibility in three different but interpenetrating horizons – short-, medium- and long-term. **Reducing economic credibility of a country exerts a negative impact on effectiveness of the economic policy and efficiency of the economy in each of these horizons.** The current functioning of the market and the housing loan may serve as a good example. In this case, systemic financial risk clearly overlaps with systemic legal risk as a result of undermining the rule of law. And this

spreads, infects, and impairs other areas of the economy. In particular, the crisis in the housing market may be coupled with the banking crisis. This, in turn, is a serious threat to stability of public finances, as the share of domestic banks reaches almost half in the Polish treasury bond market. At the same time, excess liquidity in the banking sector blunts the effectiveness of monetary policy instruments.

Such effects are particularly dangerous if they affect functionality of long-term segments of the country's financial system, a classic example of which is the instability and insolvency of the pension system taking place in times of very unfavourable demographic trends for Poland – absolutely and comparatively.

Long-term consequences of diminishing economic credibility are usually revealed gradually and with a significant delay. For example, it takes 7–8 years for the negative effects of increasing consumption at the expense of investment to outweigh short-term positive effects. One should also remember that such negative effects lead to permanent structural weakening of the economic growth potential, and ultimately, to stagnation.

**In a situation of the country's declining economic credibility, there is no room for medium- and long-term economic policy strategically aimed at meeting key development challenges.** There is no space or resources to conduct it systematically. It is being replaced by ad hoc interventions and, at best, large, prestigious public investment projects such as the CPK Central Communication Port. Taking into account our and foreign experiences, even if we assume that expensive projects have economic and development justification, it is quite impossible to think that they will actually prove to be effective and successfully completed. On the contrary, one should assume that many of them will be included in the set of textbook examples of „sunk costs” and great waste.

The example of the recent years' Poland may be used to trace the above-mentioned process of degradation of the country's economic credibility and its general result, which is the

formation of an authoritarian–statist economic system. This process in Poland is also deepened by the external–military threat resulting from the war in Ukraine and intensified global confrontation. The consequence of this threat is justified emphasis on the expansion of the country’s defence potential and a sharp increase in financing thereof. However, this financing is primarily of a debt nature, through loan financing of large-scale arms imports. A point in a professional discussion is the defensive effectiveness of such a solution, which relies only to a small extent on its own production base and its own technological innovation. But it is undoubtedly becoming an additional factor disturbing the economic balance.

**We conclude the substantive introduction to the Report with key theses about the importance of the country’s economic credibility:**

- The market economy is based on the credibility of a country.
- The country’s credibility is the foundation of predictability in business activity and other areas of collective life.
- High credibility of a country prevents ignorance, negligence, improvisation, and makeshift solutions. Low credibility means a high probability of fiasco and failure of economic ventures undertaken by a country.
- High economic credibility of a country, especially of its institutions, in an automatic way stabilizes the country’s economy and financial system. The weakening of credibility means that the economy becomes more sensitive and less resistant to various types of shocks.
- The country’s low credibility increases economic risk and risk premiums, which inhibits economic activity and increases its costs. It may also push the country into a debt spiral.
- The opposite is uncertainty. However, while uncertainty of behaviour (the principle of limited trust) is to some extent an unavoidable risk experienced by everyone, uncertainty of the rules

of collective life – which means low credibility of a country – significantly increases such personal uncertainty.

- If business (entrepreneurship) is too closely linked to the country, not only is the market mechanism disrupted, but the economic policy relying on the market's activity fails.
- Destroying state institutions is a consequence of the discretionary limitation of the independence granted thereto by law. This inevitably leads to institutional conflicts and competence disputes.
- The monetary policy must be predictable. Its instability invites speculation. A country fulfills its task in the sphere of money if inflation remains within the acceptable fluctuation band and, at the same time, there is no significant macroeconomic imbalance in the economy.

But it does not mean that the process of erosion of Poland's economic credibility can be reversed by merely repairing narrowly understood state institutions. It is still necessary to stop the nearly decade-long process of departure from the standards and values which are characteristic of democracy. Only when these norms are alive and widely accepted, can we count on state institutions to act pro publico bono, and not be guided by the short-term interests of the current government.

# How the index was created – methodology

There have been two approaches applied in this year's edition of the economic credibility index: (1) **according to the methodology used in 2022** and (2) **in a comparative approach for four countries of the Visegrad Group: Poland, the Czech Republic, Slovakia, and Hungary**.

## **WEP (Poland's Economic Credibility) according to the 2022 methodology**

1. Similarly to last year, the purpose of this part of the index is to indicate changes which have occurred in Poland's credibility over the last 15 years. The reference point for determining the index in each year is the average value of selected indicators (solely for Poland) from the period 2008–2022. The index will thus answer the question: **what does Poland's current economic credibility look like in comparison with previous years?**

## **WEP in the comparative perspective**

2. The aim of this part of the index is to present Poland's credibility as compared to three other countries of the Visegrad Group (V4), i.e. the Czech Republic, Slovakia, and Hungary. The reference point for calculating the index is the average value of indicators in the period 2008–2022 in all V4 countries. As a result of the calculations, a ranking of V4 countries is created in various areas of the index. The index answers the question: **is**

## Poland's economic credibility is higher/lower in comparison with other V4 countries?

Due to the fact that for some of the indicators used in the 2022 WEP there was no data available for the remaining three countries, the authors constructed a slightly different set of measures for WEP in a comparative perspective. The detailed methodology of the second approach is presented below.

**TABLE 1.** Total WEP Index value according to the 2022 methodology.

2014	2015	2016	2017	2018	2019	2020	2021	2022
-0,05	0,27	-0,05	0,22	0,17	-0,23	-1,17	-1,70	-4,35

Source: own study

**TABLE 2.** Total WEP Index value in comparative terms for the V4 countries

WEP 2023 (V4)	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,06	-0,24	-0,23	-0,22	-0,37	-0,88	-0 81	-2,65
The Czech Republic	0,45	0,51	0,55	0,62	0,70	0,52	0,38	-1,65
Slovakia	-0,07	0,22	0,07	0,07	0,19	0,04	0,01	-1,42
Hungary	-0,18	-0,23	-0,30	-0,38	-0,43	-0,48	-0,82	-2,88

Source: own study

Comparative analysis for the V4 countries was carried out in **8 areas, which consisted of 31 dimensions of assessment**. Their arrangement is shown in Figure 1.

The index creation procedure consisted of several phases. The first step was to collect available and reliable measures which could parameterize economic credibility in all 4 analysed countries as objectively as possible. For this purpose, there were selected over 100 indicators, which come from various national and international databases. The indicators were subjected to a **2-step verification procedure**, which includes in particular:

1. calculation of **the coefficient of variation** in the years 2008–2022 according to the formula:

$$V = \frac{s}{\bar{x}}$$

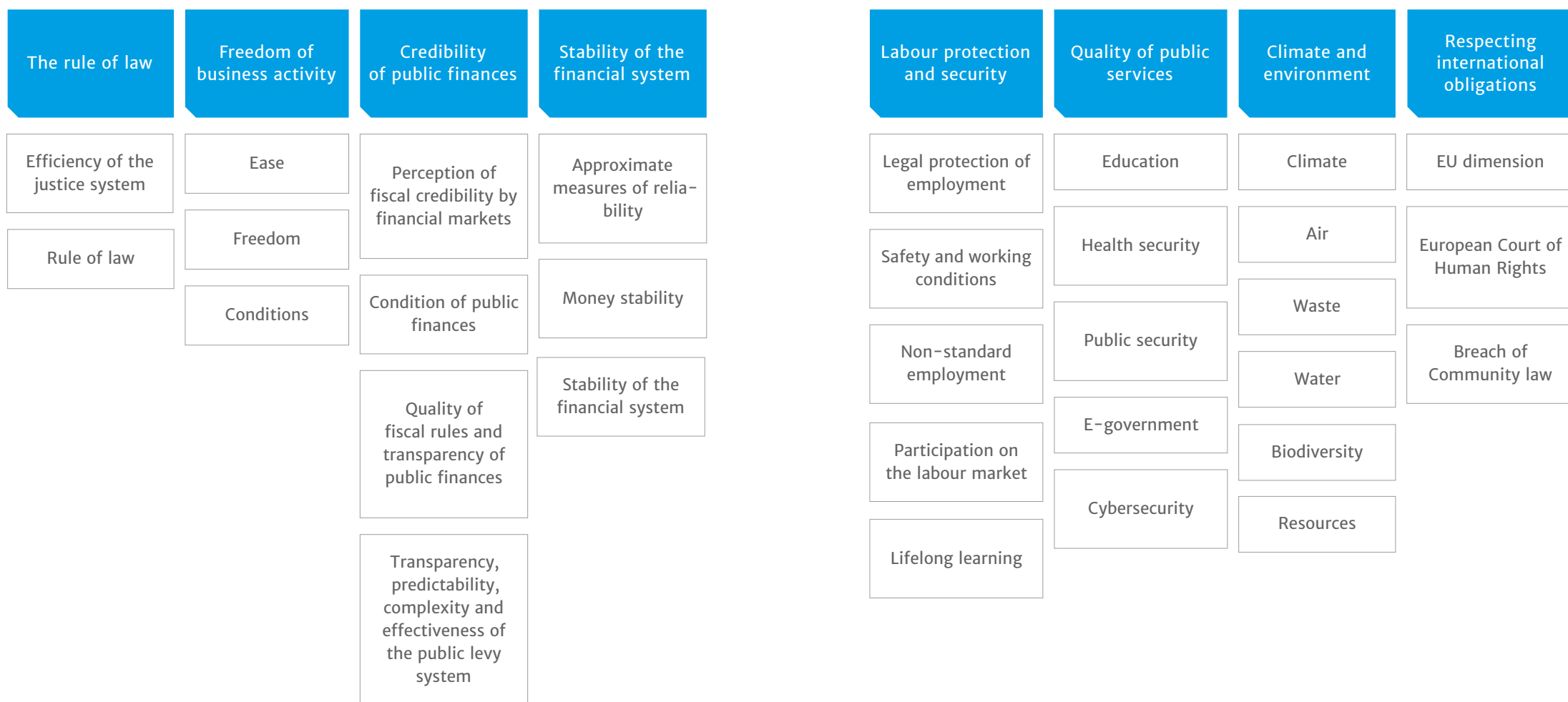
where:  $s$  – standard deviation,  
 $\bar{x}$  – arithmetic average

The low coefficient of variation was the basis for rejecting this measure due to the fact that it did not differentiate the observed phenomenon over time and therefore did not have adequate information value;

2. conducting a **correlation analysis** between all indicators, which allowed us to reject measures which are closely related to each other and hold the same or similar information value.

Positive assessment was given to **81 indicators**, each one of them having been classified as a **stimulant** (an increase in its value means a positive impact on the level of economic credibility) or a **destimulant** (an increase in its value means a negative impact on the level of economic credibility).

FIGURE 1. System of areas and dimensions of the assessment of the economic credibility index of the Visegrad Group countries



Source: own study



The measures have been **normalized** according to the formula:

$$x' = \frac{x - \text{median}}{\text{quarter deviation}}$$

where:  $x'$  – normalized value,  
 $x$  – source value of the indicator

This enabled mutual comparison of indicators expressed in different measurement units. The normalized values gave basis for building sub-indices in individual dimensions and areas, and then the final index of the country's economic credibility. The sub-indices were built with the use of weights assigned to individual indicators and dimensions. The total index was created by assigning appropriate weights to the analysis areas (see the table below). Information with regard to the weights adopted for calculation of individual dimensions and measures is provided in the section „Weights adopted for calculating the index”.

**TABLE 3.** Weights assigned to WEP analysis areas

Area	Weight
I. Rule of law	10 percent
II. Freedom of business activity	10 percent
III. Credibility of public finance	20 percent
IV. Stability of the financial system	20 percent
V. Labour protection and security	10 percent
VI. Quality of public services	10 percent
VII. Climate and environment	10 percent
VIII. Respecting international obligations	10 percent

Source: own study

The final value of the index is synthetic information about changes occurring in a given year in comparison with the average level of all 4 countries of the Visegrad Group. **A negative index value stands for a regression** in relation to the average value from the years 2008–2022, a **positive index value means an improvement** in relation to the average value defined in such manner, and **0 means no changes**. A detailed interpretation of the results is presented in the table below.

TABLE 4. Index interpretation

Index value	Interpretation: What happened to economic credibility?
$WEP < -2$	very significant drop
$-2 < WEP < -1$	significant drop
$-1 < WEP < -0,5$	average drop
$-0,5 < WEP < 0$	small drop
$WEP = 0$	no change
$0 < WEP < 0,5$	small improvement
$0,5 < WEP < 1$	average improvement
$1 < WEP < 2$	significant improvement
$WEP > 2$	very significant improvement

Source: own study

## Weights used for calculating the index (in percent)

### I. Rule of law

Dimension 1. Legislation	–
Dimension 2. Efficiency of justice system	50
Dimension 3. Rule of law	50

Source: own study

Efficiency of justice system	Average duration of proceedings in the first instance (civil and commercial cases) (in days)	50
	Average duration of proceedings in the second instance (civil and commercial cases) (in days)	50
Rule of law	Enforcement of provisions	30
	Limitations on government powers	40
	Level of government openness	30

Source: own study

### II. Freedom of business activity

Dimension 1. Ease	50
Dimension 2. Freedom	25
Dimension 3. Conditions	25

Source: own study

Ease of running a business	Registered new business entities per 100 persons aged 15-64	25
	Cost of electricity (USD per 1 kWh)	25
	Concentration of the banking sector (assets of the three largest banks/total assets)	25
	Government subsidies to public and private entities (percentage of GDP)	25
Economic freedom	Economic freedom according to the Heritage Foundation	100
Conditions	Quality of institutions (quality of governance) (Worldwide Governance Indicators)	25
	Basic infrastructure	25
	Scientific infrastructure	25
	Educational infrastructure	25

Source: own study

### III. Credibility of public finances

Dimension 1. Financial markets' perception of fiscal credibility	25
Dimension 2. The state of public finances	25
Dimension 3. Quality of fiscal rules, quality and transparency of the public finance system, disintegration of public finances	25
Dimension 4. Quality and transparency of the tax system	25

Source: own study

Financial markets' perception of fiscal credibility	Average credit rating of the country from the three most important rating agencies	33
	Five-year CDS contracts	33
	Long-term interest rate spread (to Germany)	33
State of public finances	Public debt (percentage of GDP)	20
	Nominal deficit (percentage of GDP)	20
	Structural deficit (percentage of GDP)	20
	Compliance with rules (0/1)	20
	Deviation from rules (pp. GDP)	20
Quality of fiscal rules, quality and transparency of the public finance system, disintegration of public finances	Standardised fiscal rules index (ECFIN)	25
	Independent Fiscal Institutions Index (ECFIN)	25
	Medium-term budgetary frameworks	25
	The difference between the government's national deficit and the deficit according to the scope of the EU methodology	6,25
	Result of entities outside the budget (percentage of GDP)	6,25
	Bonds instead of subsidies (percentage of debt)	6,25
	Debt outside parliament's control - indicator (percentage of debt)	6,25
Quality and transparency of the tax system	International Tax Competitiveness Index	50
	Law Barometer – Grant Thornton – tax law	50

Source: own study

#### IV. Stability of the financial system

Dimension 1. Direct	25
Dimension 2. Indirect	25
Dimension 3. Threats for monetary stability	25
Dimension 4. Threats for stability of the financial system	25

Source: own study

Approximate measures of reliability	Inflation expectations	50
	Share of cash in M3 money supply	50
Threats to the country's credibility in the area of monetary stability	Volatility of core inflation	25
	Square deviation above target	25
	Square of output gap	25
	Square of deviation of money supply dynamics from dynamics of potential GDP increased by inflation target	25
Threats to the country's credibility in the area of stability of the financial system	Dynamics of receivables from the non-financial sector in comparison with dynamics of potential GDP increased by inflation target	33
	Share of receivables from the public finance sector in banks' assets	33
	Deviation of real interest rates from natural interest rate	33

Source: own study

## V. Labour protection and security

Dimension 1. Legal protection of employment	20
Dimension 2. Safety and working conditions	10
Dimension 3. Non-standard employment	20
Dimension 4. Participation in the job market	30
Dimension 5. Life-long learning	20

Source: own study

Legal protection of employment	Employment contracts for a fixed period	50
	People with 12 months of work experience or less (aged 25 or over)	50
Safety and working conditions	Accidents resulting in absences of more than 4 days	50
	Fatal accidents	50
Non-standard employment	Part-time employment (as a percentage of total employment)	50
	Precarious employment	50
Participation in the job market	Total employment rate (20-64 years)	20
	Employment rate of women (20-64 years)	40
	Employment rate of persons aged 55-64)	40
Life-long learning	Participation rate in education and training in the 4 weeks preceding the survey	100

Source: own study

## VI. Quality of public services

Dimension 1. Education	25
Dimension 2. Health	30
Dimension 3. Safety	25
Dimension 4. E-government	10
Dimension 5. Cybersecurity	10

Source: own study

Education	Points scored in the PISA ranking (average)	33
	Percentage of people with less than primary/primary and lower secondary education (levels 0-2)	33
	Public expenditure on education by level of education and programme orientation – as a percentage. GDP (levels 1-8)	33
Health	Self-assessment of one's health – poor/very poor health (total 15+, percent of the population)	50
	Expected years of healthy life in absolute terms at birth	50
Safety	Homicides (per 100,000 inhabitants)	25
	Robberies (per 100,000 inhabitants)	25
	Sexual violence (per 100,000 inhabitants)	25
	Share of national defence expenditure in GDP	25
E-government	E-government Development Index	100
Cybersecurity	Global Cybersecurity Index (rank)	100

Source: own study



## VII. Climate and environment

Dimension 1. Climate	25
Dimension 2. Air	15
Dimension 3. Waste	15
Dimension 4. Water	15
Dimension 5. Biodiversity	15
Dimension 6. Resources	15

Source: own study

Climate	Share of energy from renewable sources	40
	Greenhouse gases – tons of CO <sub>2</sub> equivalent per inhabitant	60
Air	Number of premature deaths related to air pollution	50
	Emissions of air pollutants	50
Waste	Municipal waste generated per capita	50
	Total amount of waste per inhabitant	50
Water	Treated municipal sewage per capita	30
	Water consumption per person m <sup>3</sup> /person	40
	People using sewage treatment plants	30
Biodiversity	Farmland Birds Index	50
	Index of implementation of environmental conventions	50
Resources	Energy productivity – euro per kilogram of oil equivalent	80
	Gross domestic product per material footprint (2015 PPP) – US dollars per kilogram	20

Source: own study

## VIII. Respecting international obligations

Dimension 1. EU dimension	33,3
Dimension 2. European Court of Human Rights	33,3
Dimension 3. International arbitration	33,3

Source: own study

EU dimension	Judgments of the CJEU finding failure to fulfill obligations by a Member State	33
	New cases in the CJEU with regard to finding failure	33
	New preliminary rulings at the CJEU	33
European Court of Human Rights	Applications examined by the ECtHR	33
	Judgments issued by the ECtHR	33
	Key ECtHR judgments not implemented by a given country	33
Breach of Community law	Number of new infringements of Community law initiated by the European Commission against a given country	100

Source: own study



# The rule of law

## Importance of the rule of law for the country's economic credibility

The rule of law, i.e. universal observance of legal norms, is a necessary condition for the economic credibility of the state. **Moreover, the state is obliged not only to enforce law-abiding behaviour from other participants in economic life, but it must respect the established rules as well.** Problems with the rule of law, however, result in a high level of uncertainty, which directly affects the increase in business costs. While this issue is not always easy to grasp, legal instability or expected difficulties in enforcing payments are well reflected in company margins. These are significant risks that entrepreneurs must properly manage. Therefore, problems with the rule of law and its breach are a pro-inflation factor.

## Index of the country's economic credibility in the area of the rule of law according to the 2022 methodology

Its impact on prices has been noticeable despite the fact that Polish entrepreneurs demonstrate high adaptability to operate in an unfavourable institutional environment. For this reason, despite somewhat disastrous legislation and the poorly functioning justice system, most economic indicators in Poland seem

relatively good. Yet, one should remember that many phenomena signalled in the Poland's Economic Credibility Index, in particular those related to the rule of law, are cumulative and will intensify – i.e. they are to be seen even before severe consequences appear. In this understanding, implementation of the demands of a democratic state of law is not limited to ensuring protection of rights and freedoms of an individual. It is a general structure promoting social and economic development.

The game theory allows us to clearly show effects of deficiencies in the area of the rule of law. Without clear standards and an effective system for enforcing them, it is not possible to provide individual actors with sufficiently strong incentives for cooperative behaviour. Then, even entities willing to „play fair” often change their strategy or limit their activity. In some situations, one may function effectively in spite of the bad law, as evidenced by the Coase Theorem, according to which – under certain conditions – allocation of production factors can be effective regardless of the legal norms in force.

However, one should remember that the conditions mentioned by Roland Coase (1960, pp. 1–14) are extremely difficult to achieve – in a specific situation, transaction costs must be extremely low, which happens quite rarely in economic reality. Moreover, allocation, as an attribute of the market economy, should be accompanied by long-term adaptive capacity, which determines restructuring of the economy, and which is revealed by a permanent increase in its potential. Without the rule of law, however, this crucial capability disappears.

The topic of the economic effects of the rule of law (or lack thereof) is discussed primarily within the framework of New Institutional Economics. This approach allows for capturing the impact of non-economic factors on the economic phenomena. Among them, one of the most important is law, but it cannot be understood narrowly, i.e. only as the law in books, but – in accordance with what legal realists have already postulated – as the law in action. From this perspective, in order to assess

the country's economic credibility, it is not enough to check whether key legal acts have the appropriate content. There is a need to analyse the broad context of their actual functioning. This reasoning must include both legislative issues (concerning not only the content of legal provisions, but the process of creation thereof), law enforcement (in particular the quality of the judiciary), as well as binding the state authorities by law (transparency and professionalism of activities thereof and compliance with the rules).

Only a comprehensive analysis of these categories allows for determination of the impact of issues related to the rule of law on the economic credibility of a country. It should be noted that there are many studies indicating that the rule of law understood in this way exerts a significant influence on economic issues (Michel 2020). The role of the justice system is most often emphasized (Nunn and Trefler 2014, pp. 263-315). Interestingly, this regularity is observed in various cultural contexts (Haini 2020, pp. 519-542).

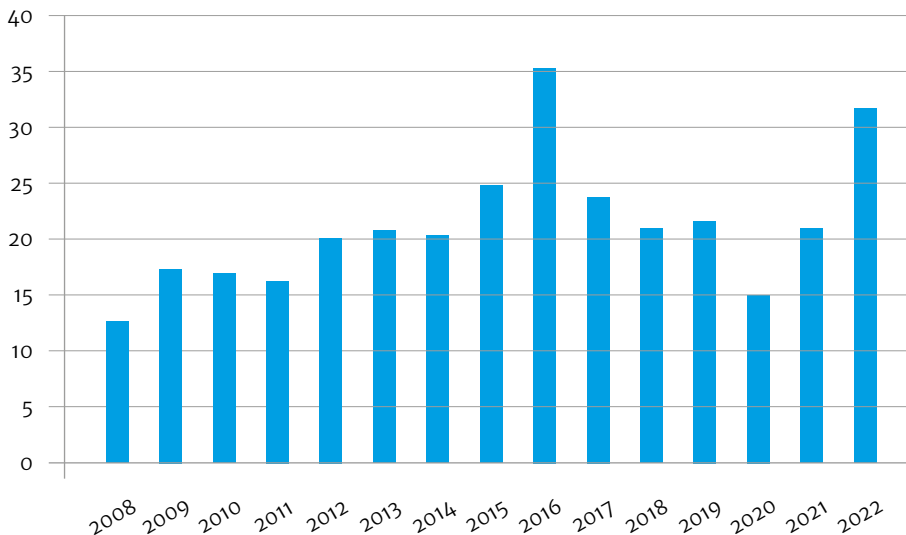
The rule of law has also been the subject of numerous international comparisons. Particularly noteworthy is the „Rule of Law Index” implemented as part of the World Justice Project. Speaking to its advantage is the fact that it has been published for many years and its methodology captures many aspects related to the rule of law. For these reasons, some of the indicators of that study have been included in the Poland's Economic Credibility Index. As a side note, it is also worth mentioning that the pandemic years resulted in a general weakening of rule of law indicators in most countries. However, the scale of this trend and effects thereof have only now been the subject of research (Balmori de la Miyar 2021, pp. 401-428).

There are three dimensions making up the area of the rule of law: **legislation**, **efficiency of the justice system**, and **the rule of law**.

## Dimension 1. Legislation

In this dimension of the rule of law, making international comparisons proves extremely difficult. This is due to the differences in the law-making process across various countries (significant differences are found even in relatively similar countries of the Visegrad Group). However, analysis of changes against time within a specific country is possible. And so, when looking at the first indicator – the number of pages of legal acts which entered into force, it is clear that for years now, Poland has been struggling with the problem of excess legislation – in 2022, it was over 30,000 pages' worth of legal acts – by 50% more than in the previous year and twice as much as in 2020. Moreover, this increase is mainly due to the number and volume of regulations (in the years 2021 and 2022, the number of pages of acts was similar – about 3,000 pages in the case

**CHART 1.** Number of pages of legal acts taking legal effect in individual years in Poland



Source: Grant Thornton, [barometrprawa.pl](http://barometrprawa.pl)

of regulations, and this number increased from almost 17,000 to over 28,000 pages).

This phenomenon is clearly unfavourable, not only due to the inability of cutting through such a large volume of regulations, but also due to the fact that an increasing number of issues is regulated by lower-level acts, the issuance of which is accompanied by much weaker control mechanisms. The authors of the Law Barometer indicate that last year, this result saw an increase chiefly as a result of extremely extensive environmental regulations with regard to habitat protection. However, even if we did not take into account this part of the adopted law, we would still have over 17,000 pages' worth of legal acts that entered into force in 2022. In this context, it is not surprising that business communities are increasingly demanding clear and stable regulations. This is currently an even more strongly emphasized postulate than those relating to the amount and collection of tax burdens.

The next adopted indicators also show other weaknesses of the legislative process in Poland – in the case of 42 percent of laws there has been no documented consultation process, although it should be noted that in the previous four years this indicator was even higher – in 2020 it amounted to as much as 68%. The percentage of laws, in which the authors did not respond to the submitted comments is also unsatisfactory – in 2022 it was 43% – more than in the previous three years, but at the same time much less than in the years 2014–17, when there were no comments referring to as much as half of the opinions.

Circumventing important elements of the legislative process and the fictitious nature of consultations result in the need for numerous amendments, which in turn increase the number of pages of legal acts taking legal effect. A significant number of amendments leads to neither stakeholders nor the government having the „processing capacity” enabling their participation in reliable consultations. And so a vicious circle occurs. In consequence, despite engaging enormous resources – both



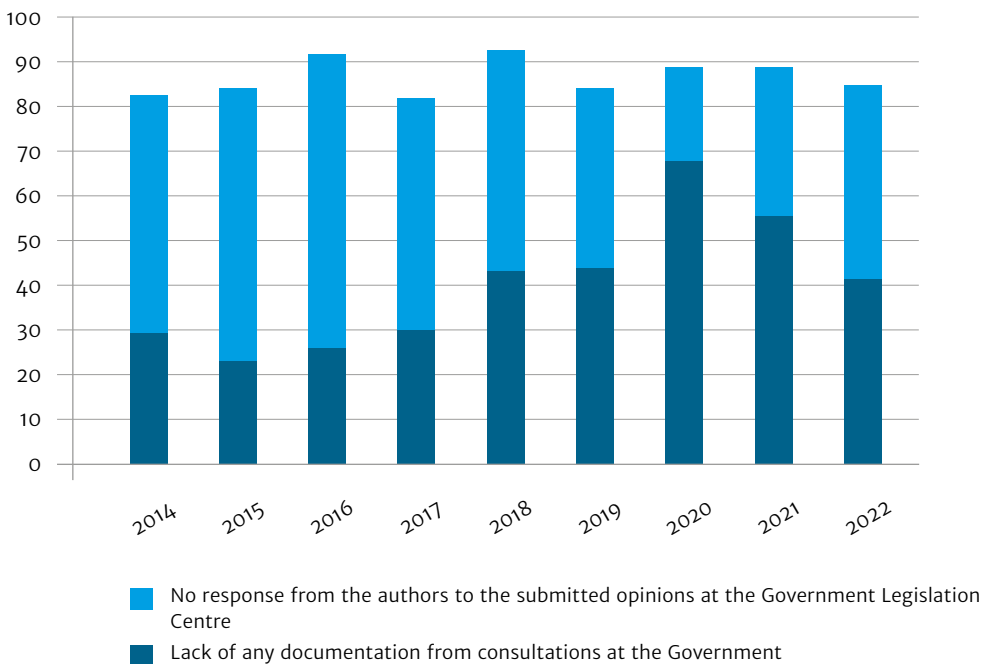
in creating the law (government, parliament) and in observing it (entrepreneurs, individuals), the quality of the legal environment remains one of our main problems.

## Extended index of the country's economic credibility in the area of the rule of law

### Dimension 2. Efficiency of the justice system

In order to ensure international comparability, in relation to the justice system, this index edition uses data of the European Commission for the Efficiency of Justice (and not from the

**CHART 2.** Percentage of draft laws for which there are no documented public consultations and for which the authors of such draft laws do not respond to submitted opinions (percentage)

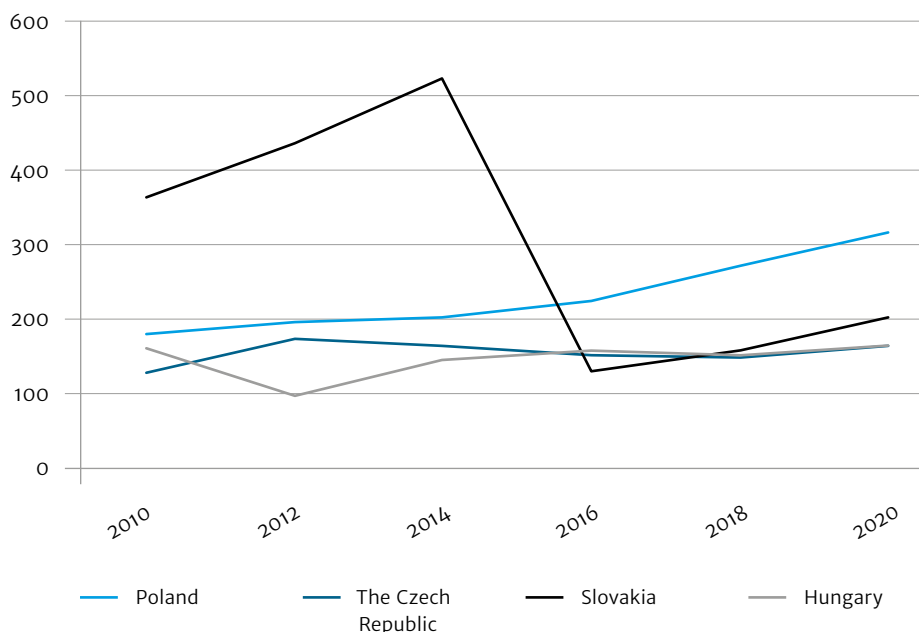


Source: Grant Thornton, [barometrprawa.pl](http://barometrprawa.pl)

Polish Ministry of Justice, as in previous years). A certain limitation of this data lies in the data being reported every two years. However, this is enough to show the outrageous lengthiness of proceedings in Polish courts. In 2020, average duration of civil and commercial proceedings in the first instance was 317 days, and in other Visegrad countries it ranged between 165 and 204 days. We come last also in the second instance – an average of 188 days, while in the Czech Republic it is 79, in Hungary 116, and in Slovakia 177 days.

What is more, in Poland the deterioration of these results is most visible. Back in 2010, proceedings in the first instance lasted „mere” 180 days, and in the second instance – 45 days. This means that

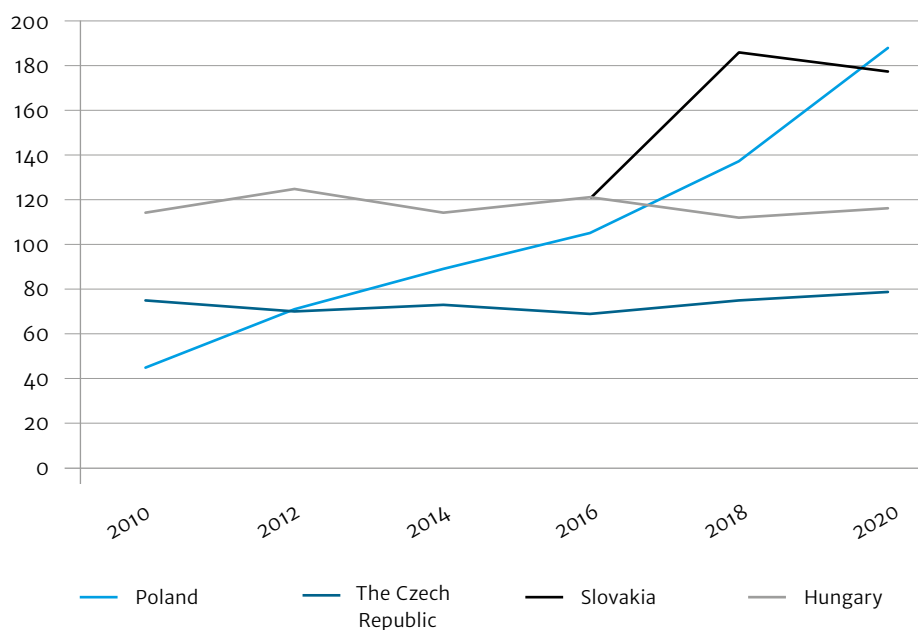
**CHART 3.** Average duration of proceedings in the first instance (civil and commercial cases) (in days)



Source: Tableau Public, <https://public.tableau.com/app/profile/cepej/viz/EfficiencyEN/Efficiency>, dostęp 25.10.2023 r.

over a period of 10 years, average duration in the first instance has increased by 76%, while cases in the second instance last four times longer (sic!). One should also bear in mind that obtaining a final judgment oftentimes does not end the case. Enforcement issues, which frequently come into play at this point, do not support building the economic credibility of our country. This is evidenced

**CHART 4.** Average duration of proceedings in the second instance (civil and commercial cases) (in days)



Source: Tableau Public, <https://public.tableau.com/app/profile/cepej/viz/EfficiencyEN/Efficiency>, dostęp 25.10.2023 r.

by the widespread use of enforcement actions undertaken outside the official state system.

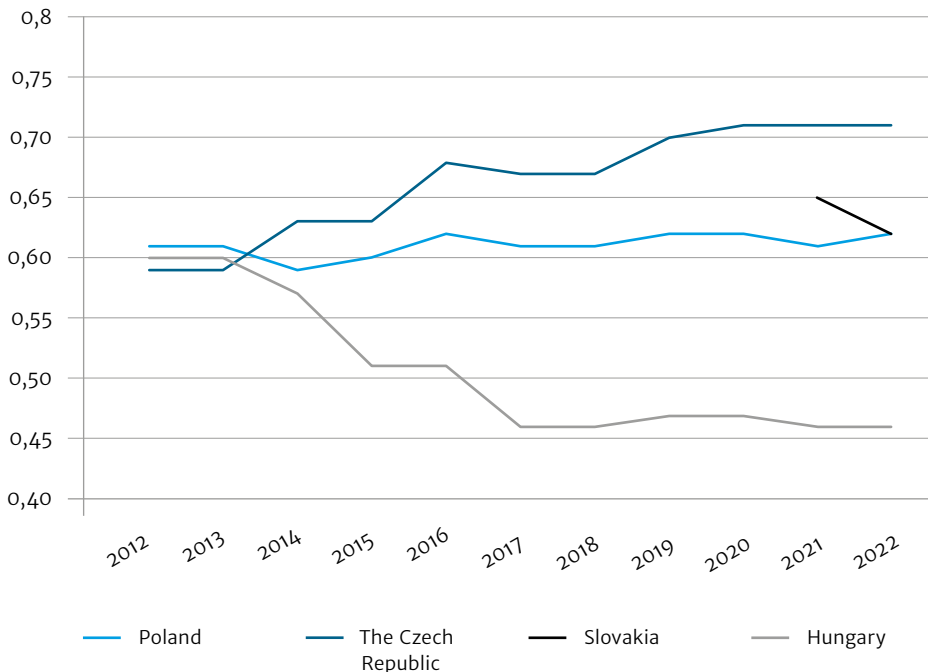
A country will not come across as reliable if, for many months, it has been unable to provide an entrepreneur with the possibility of collecting monies from the outstanding invoice. It is the slowness of the justice system and dishonest contractors not

being stigmatized strongly enough that make business transactions extremely risky.

### Dimension 3. Rule of law

The rule of law constitutes the third dimension. Data included in the calculations was sourced from the Rule of Law Index, which enables international comparisons (although the available data for Slovakia covers the last two years). In this edition, however, the „meritocracy” dimension was dropped, as it did not allow for comparisons with other countries. Instead, added to the rule of law was the „level of government openness” indicator, which allows for determination of the extent to which expert verification of the country’s activities is possible.

CHART 5. Level of enforcement of regulations

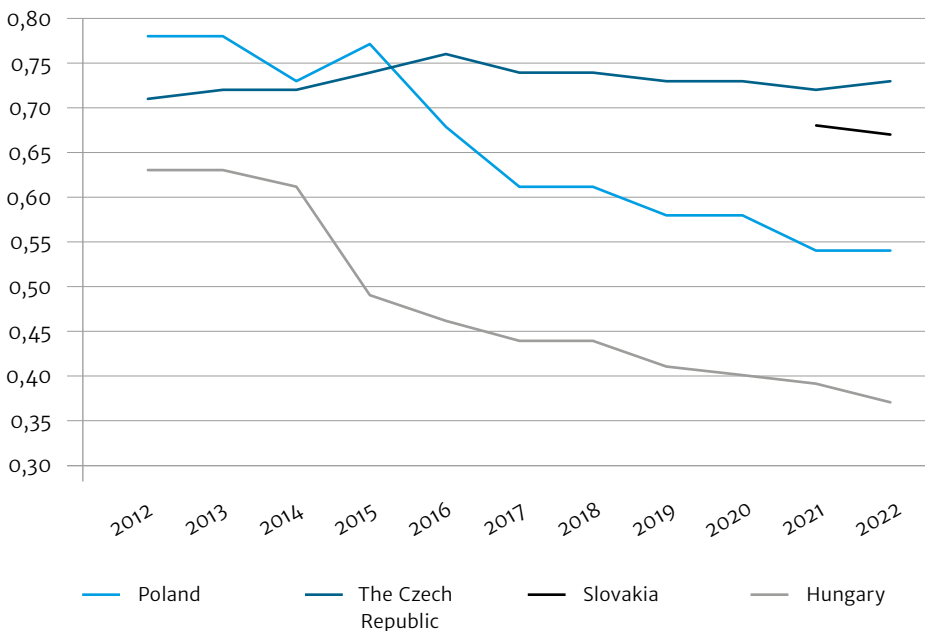


Source: World Justice Project, annual Rule of Law Index

The first indicator of the „rule of law” area determines the level of enforcement (on a scale of 0–1). Taken into account is not only the effectiveness of implementing and enforcing regulations, but also whether such regulations are just. In Poland, this indicator has for years been stable at around 0.6, which is, at most, a moderately satisfactory result. We take the 31st place out of 140 countries analysed. We score considerably better than Hungary (0.46), similarly to Slovakia (0.62) and clearly worse than the Czech Republic (0.71).

**A key component of the country’s credibility is the extent to which a country respects the rules it establishes - in other words, the extent to which persons in power respect the established limitations (not only those of the political regime).** The „limitation of government powers” indicator also

**CHART 6.** Limitation of government powers

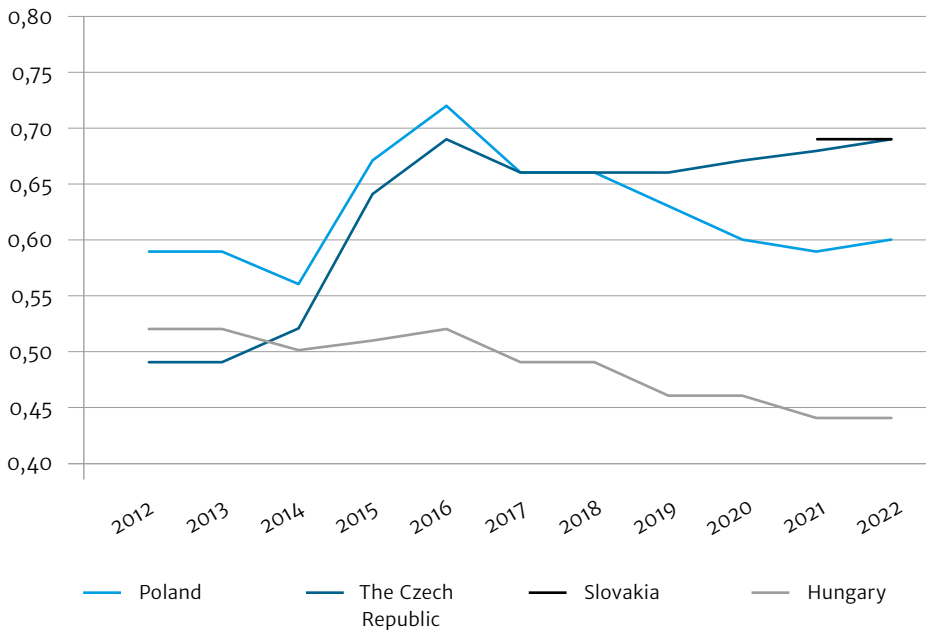


Source: World Justice Project, annual Rule of Law Index

includes the issue of holding decision-makers accountable and the ability of an independent press to counter the government. In this case, since 2016 Poland has been scoring worse and worse than in previous years. Today the score is 0.54, while in 2015 it was still 0.77. This places as at the 66th position out of the 140 countries subjected to the survey. Hungary does fare much worse (0.37), but Slovakia and the Czech Republic fare much better – 0.67 and 0.73, respectively.

The third indicator in this area concerns government openness. It includes, among others: the extent to which the government shares information which allows citizens to exercise control over public affairs. In the case of Poland, this indicator was 0.60 in 2022. In recent years, the level has been stable, although significantly

**CHART 7. Level of government openness**



Source: World Justice Project, annual Rule of Law Index

lower than the results recorded in the years 2015–2018. Similarly to previous cases, Hungary is rated the worst in the Visegrad Group (0.44), while the Czech Republic and Slovakia are rated better than Poland (both countries with a score of 0.69).

Analysis of indicators in this area shows a somewhat bad situation in Poland. There has been deterioration in many issues related to the rule of law, although the Rule of Law Index' authors themselves point to this trend as a global one. However, the examples of the Czech Republic and Slovakia evidence that it is possible to maintain significantly better results. **The case of Hungary, on the other hand, serves as a warning that makes it possible to understand harm caused by reducing the country's economic credibility by deviating too much from the standards of a democratic state of law.** This is visible not only in the symbolic dimension, but also in many important economic indicators discussed in detail in the following chapters of the Index.

**TABLE 5.** Impact of the level of the rule of law in Poland on the country's economic credibility compared to the Visegrad Group countries

I. Praworządność	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	0,57	0,50	0,05	0,49	0,38	-0,03	-0,39	-0,43	-0,94	-1,17	-1,05
The Czech Republic	0,05	-0,08	0,57	0,88	1,60	1,38	1,37	1,64	1,68	1,67	1,72
Slovakia	-1,03	-0,10	-1,37	-1,37	-0,06	-0,06	-0,51	-0,51	-0,64	0,31	-0,02
Hungary	-0,01	-0,16	-0,52	-1,43	-1,58	-2,20	-2,12	-2,17	-2,27	-2,44	-2,49

Source: own study

The above table shows that Poland's Economic Credibility in the area of the rule of law is average against the other Visegrad Group countries. This is largely due to the disastrous situation in Hungary, where indicators determining the rule of law have seen enormous declines. The Czechs, however, fare much better than us and have been slowly but consistently improving their results in recent years. Slovakia has also seen some improvement, although the difference here is not that big, and some comparisons are made difficult by incomplete data available for this country.

## Summary

The global decline in indicators related to the rule of law cannot be treated as an excuse for the deteriorating rule of law in Poland. A democratic state of law is a structure not only for the good times, but also – and perhaps even primarily – for the bad times. It is in such moment that guarantees of compliance with appropriate standards can save the country from the most severe consequences. Then, even in conditions of strong shocks, the state's credibility may strengthen much faster.





# Freedom of business activity

## Importance of freedom of business activity for the country's economic credibility

Freedom of economic activity is one of the basic human freedoms. It guarantees the autonomy of human will and promotes the effective use of production factors.

**The first of the analysed dimensions of economic freedom is the ease of doing business.** From the point of view of transaction cost economics, it is necessary to distinguish those institutions of capitalism which protect market transactions and the markets where economic exchange takes place. In our opinion, this category in the last year's Index edition included the ease of starting, running and closing a business, which was based on indicators from the World Bank's Doing Business series.

It should be noted that in addition to the unquestionable elements of this ranking, such as the ease of paying taxes or obtaining a building permit, it also includes the issues of minority investors and protection of compliance with contracts. This makes us realize that economic entities may have opposing interests, and that market institutions were established to ensure their proper balance. Yet protecting the interests of minority investors means that the scope of freedom of other

investors decreases. Economic law interferes with the freedom of contract in the name of values other than the full scope of freedom of one of the parties to the relationship. Why? Because markets are social constructs, and without restrictions (e.g. sanctions for breach of contract or fraud), parties would be afraid to enter into a transaction. They would have to incur additional, high costs to check the contractor. Court institutions or appropriate clauses in the contract (which are also treated as institutions in transaction cost economics) reduce transaction costs and make it easier for the parties to conduct business, despite the applicable restrictions.

Douglas C. North (1991, pp. 97–112) calls market institutions the man-made constraints shaping economic and social interactions. Ironically, it is easier, i.e. with greater freedom, to conduct business in conditions when we know that these limitations exist. When we know that any breach of law by our contractor will be prosecuted and our interest as that of a party to the contract will be protected. For this reason, in the first dimension of our area, we do not consider it justified to treat restrictions on the freedom of contract as a restriction of economic freedom<sup>1</sup>. It is therefore forbidden to employ children, to reward workers for their job below the minimum wage, and to throw out waste without paying the fee.

<sup>1</sup> An interesting discussion on collision of norms shaping economic life was held in „Rzeczpospolita” at the turn of March and April 2021 by L. Balcerowicz and E. Łętowska. The former rightly argued that „no harm comes to those who want it”, and customers were free to decide to take out a loan in Swiss francs. In turn, E. Łętowska pointed out that the stronger party (banks) should have made every effort to make customers aware of dangers associated with the exchange rate risk, and therefore, when it did not make such efforts, the Court of Justice of the EU questioned validity of such agreements. See: L. Balcerowicz, *Destrukcyjne odszkodowania dla frankowiczów*, „Rzeczpospolita”, 18 March 2021; E. Łętowska, *Krajobraz po czy przed bitwą o franki? Polemika z prof. Balcerowiczem*, „Rzeczpospolita”, 23 March 2021; L. Balcerowicz, *Sprawiedliwość i państwo prawa*, „Rzeczpospolita”, 1 April 2021; E. Łętowska, *Kto pyta, nie błędzi. Polemika z prof. Balcerowiczem*; *Profesor prawa odpowiada profesorowi ekonomii*, „Rzeczpospolita”, 6 April 2021.

In developed countries, further restrictions in this area have been introduced over the last two hundred years. And although not everyone shares the view that the changes have gone in the right direction, developed countries do have the greatest limitations in this respect. While an owner of a stall in Tunis is probably more free in organizing their workplace than the owner of a stall at a market in Hamburg, one intuitively understands that the latter enjoys a greater scope of choice with regard to the directions of business development and the use of one's own capital. The negative dimension of freedom, i.e. freedom from coercion, is included in the second criterion.

**The second criterion called freedom is also one of the essential elements of measuring the freedom of business activity.** It is based on measuring the extent to which we can freely use our property in a given economy. Property protection is embedded in the logic of a well-functioning market mechanism to such an extent that it is often identified as the economic freedom. Ownership guarantees receiving remuneration for human activity. Lack of such certainty prevents individuals from operating, which has a fundamental impact on long-term economic growth and competitiveness of economies.

The close connection of economic freedom with the protection of property and the right to dispose thereof prompted J. Gwartney to propose the definition of economic freedom of individuals as a situation in which „the property they acquire without the use of force, fraud, or theft is protected against appropriation by others and they can use it in freely, exchange it, or transfer it to someone, as long as their action does not infringe the identical rights of others” (Gwartney, Lawson, and Block 1996, p. 11). According to the then formulated definition, the index published in subsequent reports on economic freedom in the world measures the degree to which public policies and state institutions are supportive of this freedom.

**The third element of the economic credibility index in the area of freedom of business activity is conditions.** The

issue of resources to which domestic economic entities have access is of fundamental importance for the smooth course and increasing efficiency of economic activity. After all, access to the technological base, but also to basic resources – qualified employees and infrastructure, determines to a significant degree the ability of entrepreneurs to increase efficiency of their operations. For the system of assessing the country's economic credibility, this means that, in addition to the quality of the institutional environment and economic freedom, access to human capital resources and modern infrastructure is also an important component of economic freedom. The assessment of this dimension was based on the Worldwide Governance Indicators of the World Bank and the World Competitiveness Yearbook of the IMD Institute for Management Development in Lausanne.

### **Index of the country's economic credibility in the area of the country's economic credibility according to the 2022 methodology**

Taking into account the indicated concepts, we have constructed a synthetic index of the freedom to conduct business and conclude contracts (freedom). In order to maintain comparability with the previous edition of Economic Credibility Index, we have based it on the same indicators, with the exception of the ease dimension, which was based on the suspended World Bank Doing Business ranking. In the 2023 Economic Credibility Index edition:

#### **Dimension 1. Ease**

It was based on 4 indicators equivalent to the indicators used in the World Bank ranking in the Doing Business series

## Dimension 2. Freedom

It was based on economic freedom indicators published in the report *The Economic Freedom of the World*, by the Heritage Foundation

## Dimension 3. Conditions

It was based on 2 groups of indicators:

- institutional – here, the base indicators are the indicators of the World Bank from the Worldwide Governance Indicators series;
- infrastructure and human capital – adopted as the base indicators are the IMD World Competitiveness Yearbook infrastructure quality indicators<sup>2</sup>.

The base data were converted into ranking places among the European Union countries and calculated against 100. This means that if Poland took, for example, the 19th position among 27 EU countries, its place in the ranking is approximately 70 out of 100. This is helpful in situations where the number of countries in the rankings is not always 27.

In order to avoid arbitrariness of assessment in this year's edition, all data in the dimension ease are so-called „hard” data, i.e. they are not based on opinions, but reflect real values (the number of new companies, cost of kWh, degree of concentration in the banking sector, percentage of GDP allocated to subsidies).

The synthetic result for the entire area is -0.66 and is negative, which means that in 2022 it was slightly less favourable than in the entire 2008–2022 period (see TABLE 6).

<sup>2</sup> The original concept of measuring individual elements of the infrastructure and institutional environment with the use of the Global Competitiveness Report of the World Economic Forum (WEF) was abandoned due to the change in the methodology of this report series.

**TABLE 6.** Synthetic value of the credibility index and its dimensions calculated for Poland

	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Credibility Index Value for Dimension I (Ease)	-1,12	-0,47	-0,01	-0,29	-0,40		0,16	0,99	0,10	0,30	0,38	0,15	-0,32	-0,53	-1,33	-0,53
Credibility Index Value for Dimension II (Freedom)	-1,70	-1,95	-1,22	-1,22	-0,73		-0,24	0,24	0,97	1,22	0,97	0,73	0,24	0,24	0,00	-0,49
Credibility Index Value for Dimension III (Conditions)	-1,27	-0,99	0,15	0,12	-0,01		0,10	0,66	1,31	0,81	0,66	0,15	0,17	0,11	-0,71	-1,15
Value of Credibility Index for the Freedom of Activity Area	-1,30	-0,97	-0,27	-0,42	-0,38		0,04	0,72	0,62	0,65	0,60	0,29	-0,05	-0,18	-0,84	-0,66

Source: own study

Deterioration of the indicator value in the dimension **ease** in 2022, on the basis of data from the World Competitiveness Yearbook ranking and the World Bank, was caused by:

- low number, and lower in comparison to the entire period, of registered business entities per 1,000 inhabitants;
- relatively favourable (low) cost of electricity for business clients per kWh in comparison with the EU, but higher than in the entire period;
- relatively favourable (low) in comparison with the EU, but higher than in previous years, bank concentration index (the World Bank data), which, according to the assumption, is to allow for obtaining a loan more easily;
- relatively favourable (low) rate of government subsidies for private and public entities in relation to GDP in comparison with the EU and identical one to the entire period, intended to reflect the discretion of the government's activities.

Deterioration of the value of the **freedom** indicator in 2022 compared to 2021, resulting in Poland's decline from 19th to 21st position in the Heritage Foundation's economic freedom ranking among the EU countries, was caused by:

- deterioration of: government's honesty, growth in public spending, monetary policy, freedom of foreign trade and freedom to conclude contracts on the labour market;
- improvement in respecting property rights and freedom of doing business.

Deterioration of the indicator value in the dimension **conditions** was caused by:

- decrease in the value of the World Bank's WGI good governance index (Worldwide Governance Indicators), based on six sub-indices: freedom of speech, political stability, government effectiveness, rule of law, quality of regulations, and corruption (down from 21st to 23rd place in the EU);
- deterioration of infrastructure assessment indicators (primary and educational) and stabilization of the scientific infrastructure assessment indicator published by the Institute for Management Development (IMD) in Lausanne in the World Competitiveness Yearbook ranking.

It is worth noting that assessments in the dimension **conditions** are not based on the so-called „hard data”, but on the opinions of surveyed entrepreneurs. As the authors of the WGI indicators note, relying on managers' assessments is justified because they decide whether or not to invest in a given country. Deteriorating, but relatively not the worst, indicators of the ease of doing business and economic freedom will not generate economic growth if foreign investors and local entrepreneurs misjudge the conditions for doing business.

The data presented in Table 7 illustrate development of individual indicators constituting the Poland's Credibility Index



**TABLE 7.** Values of partial indicators as the place of Poland in the ranking of European Union countries, converted into values from 1 (first place) to 100 (last place).

	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Ease</b>																
1.1. Registered new business entities	100	100	89	89	93		89	75	86	89	89	93	88	88	88	92
1.2. Cost of electricity	24	36	35	50	42		31	15	19	19	11	12	31	38	38	35
1.3. Concentration of the banking sector	18	7	7	7	7		7	7	11	7	7	7	11	11	11	11
1.4. Government subsidies	12	12	15	12	19		8	15	19	15	22	27	23	27	85	19
<b>Freedom</b>																
2.1. Economic freedom	93	96	86	86	79		71	64	54	50	54	57	64	64	68	75
<b>Conditions</b>																
3.1. Quality of institutions (governance)	89	75	68	68	68		68	64	64	68	75	79	79	75	79	82
3.2. Basic infrastructure	64	67	66	64	68		60	56	38	49	44	46	49	60	75	79
3.3. Scientific infrastructure	73	81	57	59	60		65	57	54	59	54	52	49	48	56	57
3.4. Educational infrastructure	53	49	41	41	42		38	33	25	25	32	49	49	49	55	63

Source: own study

in the area of Freedom of Business Activity in comparison with the European Union countries.

### **Extended index of the country's economic credibility in the area of freedom of business activity**

In this year's edition of WEP, we are showing how the situation is shaped in terms of freedom of business activity in Poland in relation to other Visegrad countries: the Czech Republic, Slovakia, and Hungary (see CHARTS 8–22).

The general economic freedom index, which is still positive in comparison with the other economies, although its value slightly exceeds zero, consists of:

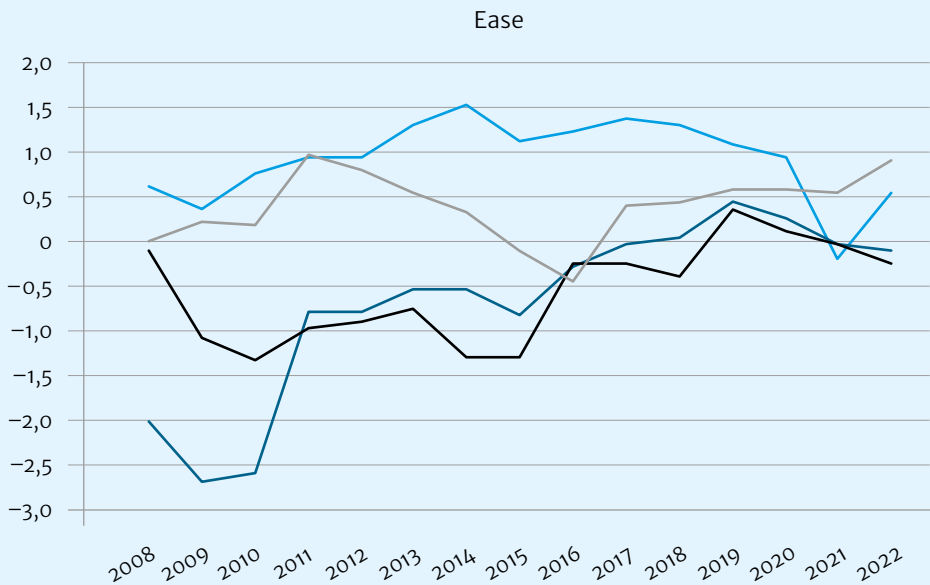
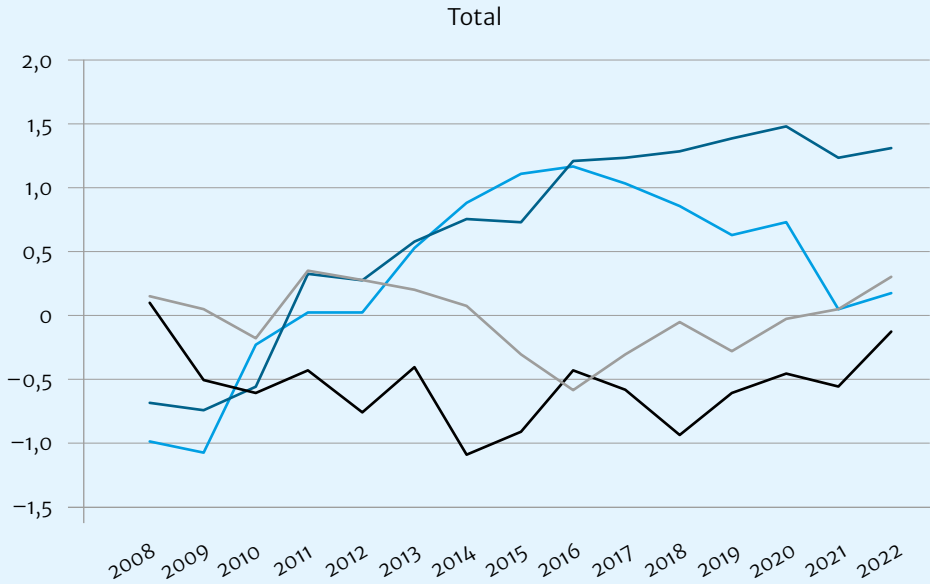
- deterioration in the ease of doing business indicators in comparison with other Visegrad countries, where the category leader, i.e. Poland, was taken over by Hungary;
- stagnation of the value of the economic freedom index, in which not only is there a large distance from the leader (Czech Republic), but in 2022 Slovakia overtook Poland in this ranking;
- significant deterioration in the assessment of conditions dimension, i.e. quality of the institutional environment and infrastructure – especially basic and educational one; only in Slovakia the conditions for doing business were rated (slightly) worse.

**As a result, while in the years 2013-2016 we competed with the Czech Republic for the title of regional leader in terms of freedom of doing business, at the beginning of the third decade of the 21st century even the second position in the Visegrad Group has appeared difficult to achieve.**

### **Summary**

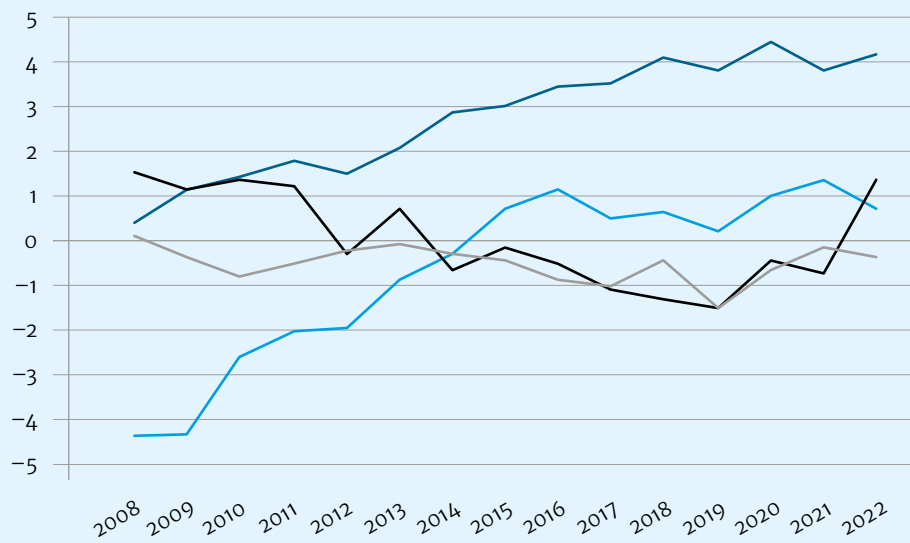
In the ease of doing business dimension, it is quite surprising that Poles, considered enterprising, are becoming the least

**CHARTS 8–11.** Total assessment and ratings in individual dimensions of freedom of business activity in Poland, the Czech Republic, Slovakia and Hungary in the years 2008–2022

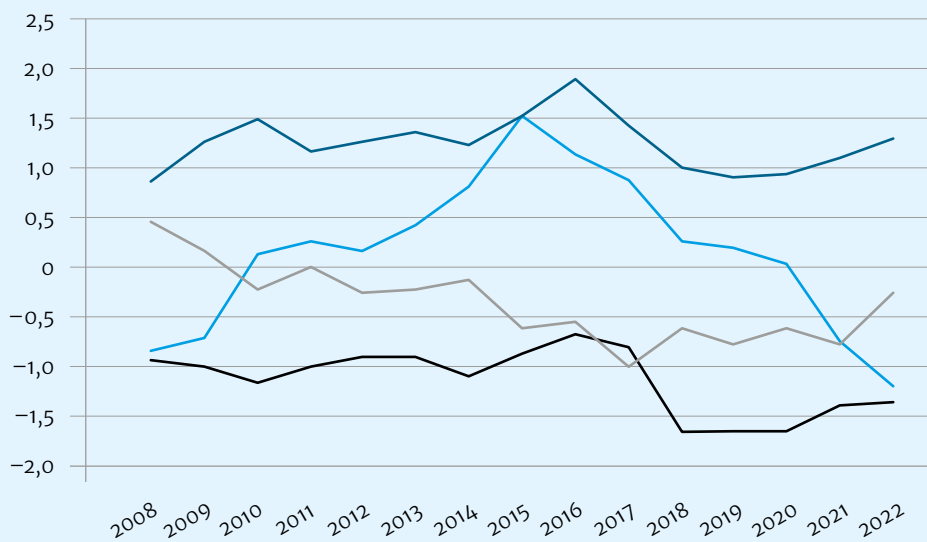


— Poland     
 — The Czech Republic     
 — Slovakia     
 — Hungary

### Freedom



### Conditions



Source: own study on the basis of indicators adopted to assess subsequent dimensions

willing to start a business in Europe. The expert research ahead of the 2023 European Financial Congress confirms what reports on business conditions have been showing for years: the most frequently mentioned are instability of tax and employment regulations along with low court efficiency and rising labour costs. In recent years, the pandemic and inflation have added to the factors increasing uncertainty of the environment. However, the latter factors, similarly to the previous ones, operated in the same way in other European countries, but the tendency to set up companies in Poland in comparison with other EU countries has remained as low as before. However, labour and energy costs in Poland are growing faster than in other European countries.

Therefore, although chaotic introduction of the income tax reform in 2022 and uncertainty related to the war on the eastern border are undoubtedly risk factors, persistence of remaining at the tail end among the EU countries suggests that the barriers blocking entrepreneurship of Poles are of a permanent and structural nature. While Poland's position in terms of economic freedom compared to other Visegrad countries has been quite favourable, clear deterioration in the assessment of business conditions is also striking. This assessment is based on the deteriorating condition of basic, educational, and scientific infrastructure in the eyes of investors, as well as government quality indicators, including: rule of law and quality of regulations. Therefore, it seems that the most urgent areas for improvement in the field of freedom of economic activity are the efficiency of the justice system and quality of economic regulations discussed in the previous area. Any improvement in the last field will be difficult without broader inclusion of entrepreneurs' representation in the legislative process.

Table 8 presents synthetic indicators of the development of individual dimensions of freedom of business activity in Poland in comparison with the other Visegrad Group countries.

**TABLE 8.** Impact of freedom of business activity in Poland on the country's economic credibility in comparison with the Visegrad Group countries

Total	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,98	-1,07	-0,23	0,03	0,03		0,53	0,90	1,12	1,17	1,03	0,87	0,65	0,73	0,06	0,17
The Czech Republic	-0,68	-0,74	-0,56	0,34	0,29		0,59	0,76	0,74	1,21	1,23	1,30	1,40	1,48	1,23	1,33
Slovakia	0,10	-0,50	-0,61	-0,43	-0,74		-0,40	-1,08	-0,90	-0,42	-0,59	-0,94	-0,60	-0,46	-0,54	-0,13
Hungary	0,15	0,05	-0,17	0,35	0,28		0,20	0,07	-0,30	-0,58	-0,29	-0,04	-0,27	-0,03	0,05	0,30
Ease	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	1,905	0,39	0,75	0,95	0,96		1,30	1,53	1,14	1,22	1,37	1,30	1,09	0,94	-0,18	0,56
The Czech Republic	-2,00	-2,68	-2,58	-0,79	-0,79		-0,55	-0,54	-0,81	-0,27	-0,01	0,06	0,45	0,28	-0,03	-0,10
Slovakia	-0,10	-1,07	-1,32	-0,97	-0,90		-0,73	-1,30	-1,29	-0,25	-0,23	-0,39	0,36	0,11	-0,04	-0,24
Hungary	0,02	0,22	0,19	0,97	0,79		0,56	0,35	-0,09	-0,44	0,42	0,45	0,60	0,57	0,55	0,91
Freedom	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-4,35	-4,33	-2,59	-2,04	-1,98		-0,89	-0,29	0,68	1,11	0,50	0,62	0,20	0,99	1,35	0,74
The Czech Republic	0,41	1,14	1,41	1,78	1,47		2,08	2,87	3,05	3,47	3,53	4,08	3,78	4,44	3,84	4,20
Slovakia	1,53	1,15	1,35	1,23	-0,29		0,74	-0,65	-0,16	-0,53	-1,07	-1,32	-1,50	-0,41	-0,71	1,35
Hungary	0,10	-0,40	-0,83	-0,53	-0,22		-0,10	-0,29	-0,41	-0,89	-1,01	-0,47	-1,50	-0,65	-0,16	-0,35
Conditions	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,84	-0,71	0,15	0,28	0,17		0,42	0,80	1,53	1,13	0,88	0,25	0,20	0,03	-0,75	-1,19
The Czech Republic	0,87	1,28	1,51	1,16	1,26		1,37	1,25	1,51	1,90	1,43	1,00	0,93	0,93	1,12	1,31
Slovak	-0,92	-1,01	-1,17	-1,00	-0,88		-0,89	-1,08	-0,87	-0,67	-0,81	-1,65	-1,64	-1,65	-1,39	-1,36
Hungary	0,46	0,16	-0,22	-0,01	-0,24		-0,23	-0,13	-0,60	-0,55	-0,99	-0,61	-0,77	-0,61	-0,75	-0,27

Source: own study based on indicators adopted to assess subsequent dimensions



# Credibility of public finances

## Importance of credibility of public finances for the country's economic credibility

The country's credibility is strongly related to the credibility of public finances and vice versa. If our trust in the country and the authorities is low, it has a negative impact on our trust in the system of public levies and the fulfillment of tax obligations (so-called tax morality). **If public finances are non-transparent, both trust in institutions dealing with public finance management and confidence in the effectiveness of spending public funds are low.**

One may find a concept of „fiscal credibility“ in the related literature. However, there is no single and precise definition thereof. Fiscal credibility is directly related to expectations regarding the ability to service public debt. Therefore, an important condition for ensuring fiscal credibility is that the ratio of public debt to GDP does not threaten the intertemporal solvency of the government (Blanchard and Cottarelli 2010).

What level of debt is safe? There is no clear answer to this question. “The level of public debt is considered safe if it can be expected that the government can reduce such debt or at least stabilize it under most circumstances – including persistently



unfavourable ones – by using fiscal policy without resorting to default, increased inflation (inflation tax), or restructuring debt” (Dudek, Kotecki, and Wojciechowski 2021).

**The level of public debt should be such that there is fiscal space enabling to take action in the event of unexpected events so that important interests of the state can be protected.** For example, we must ensure fiscal space to take action in connection with the pandemic or threats to internal or external security. **The state’s fiscal capacity should not be absorbed to the maximum, there must always be a margin of safety for unforeseen circumstances.**

The latest research by Keyser and Paczos (2023) for 46 economies indicates that the limit value of the debt to GDP ratio at which fiscal risk increases is 54–60%. This corresponds to the debt limit provided for in the European rules and the limit in the Polish Constitution. However, one should also bear in mind that fiscal problems may arise while the level of debt is significantly lower. Such situation was observed, for example, in Romania (the so-called „Romanian scenario”) (Dudek, Kotecki and Kurtek 2022). Despite a debt-to-GDP ratio of around 30 percent, government bond yields skyrocketed to around 11–12 percent after the 2008 financial crisis. Romania was unable to issue debt at reasonable yields on the domestic market and was forced to seek help from the International Monetary Fund (IMF) and the European Commission (as did Greece and Hungary).

Lack of economic credibility in the area of finance leads to higher debt servicing costs, to the need for a larger share of foreign debt due to the lack of trust in the local currency, and to turning to more speculative investors. Public finances are then very sensitive to various types of turmoil in the economy or financial markets. They are not immune. As a consequence, there occurs permanent imbalance in public finances, and ultimately loss of solvency and a financial crisis. This, in turn, increases the likelihood of socially „painful” spending cuts and tax

increases, an economic crisis, recession, increased unemployment and inflation, and ultimately a decline in society's well-being.

For the country's credibility index, the concept of credibility of public finances has a much broader dimension than the macroeconomic approach, i.e. „fiscal credibility“. The scope of this economic category is significantly broader than the external perspective or the perspective of financial markets and rating agencies.

### **Extended index of the country's economic credibility in the area of credibility of public finances<sup>3</sup>**

We analyse the country's economic credibility in the area of public finances in four dimensions:

**Dimension 1.** Perception of fiscal credibility by financial markets,

**Dimension 2.** The state of public finances and compliance with the EU fiscal rules,

**Dimension 3.** Quality of fiscal rules, quality and transparency of the public finance system,

**Dimension 4.** Transparency, predictability, complexity, and effectiveness of the public levy system.

When creating the index in these four dimensions, we decided to assign the same weight to each of them.

<sup>3</sup> Methodology for constructing the extended state economic credibility index in the area of public finance credibility is very similar to the 2022 methodology, which is why the study includes only the extended version thereof.

## Dimension 1. Perception of fiscal credibility by financial markets

This dimension includes 3 indicators:

- average credit rating of the country,
- five-year CDS contracts,
- difference in the national long-term interest rate compared to Germany.

The same weights of  $1/3$  were adopted for the three indicators included in this area.

**The first indicator is the average credit rating of the country from the three most important rating agencies: Standard & Poor's, Moody's and Fitch.** Each of these agencies codes its ratings with the use of letter designations, but on a slightly different scale. Germany received the highest rating (from all agencies), i.e. AAA. The credit rating (rating) of Poland's long-term government debt in foreign currency is, according to the three above-mentioned agencies, A2, A- and A-, respectively. For the Czech Republic it is AA-, Aa3 and AA-, Hungary is BBB-, Baa3 and BBB, respectively, and Slovakia is A+, A2 and A. Therefore, the rating scales of these institutions are unified on a linear scale from 1 to 21, where 1 is the lowest rating and 21st highest. Then one average rating was calculated. **Currently, the unified rating for Poland is 15.3 points on a scale of 21, which is approximately 73% of the highest rating, e.g. that of Germany.** Among the analysed countries, the Czech Republic has the highest rating – 18 points (85.7%), second comes Slovakia – 16.3 points (77.8%), and the lowest score was given to Hungary – 13 points (61.9% of the maximum). The unified average rating was taken from the IMF database (Kose, Ayhan, Kurlat, Ohnsorge, and Sugawara 2022).

**The purpose of the ratings is to assess the solvency of a country. The lowest rating means that the country is insolvent**

**and bankrupt. The highest rating means high credibility and certainty of investing in treasury debt instruments.**

In this respect, the perception of rating agencies is diverse, the Czech Republic's rating is the highest and is growing, Slovakia's rating has decreased slightly, but is the second highest in this group of countries. After being downgraded in 2016, Poland's rating returned to pre-2016 levels and remains stable. Hungary's rating was at a very low level in 2014–2015 and has been rising since then, although it falls significantly behind other countries. However, in 2023, S&P lowered the rating for Hungary from BBB to BBB-.

Rating agencies conduct their assessments periodically, therefore, this area should be supplemented with current market indicators. **Hence, the second indicator is the current valuation of five-year CDS (Credit Default Swaps) contracts.**

Taken into account was the average in a given year, which allows for a relatively easy comparison of the probability of losing financial liquidity in a given country.

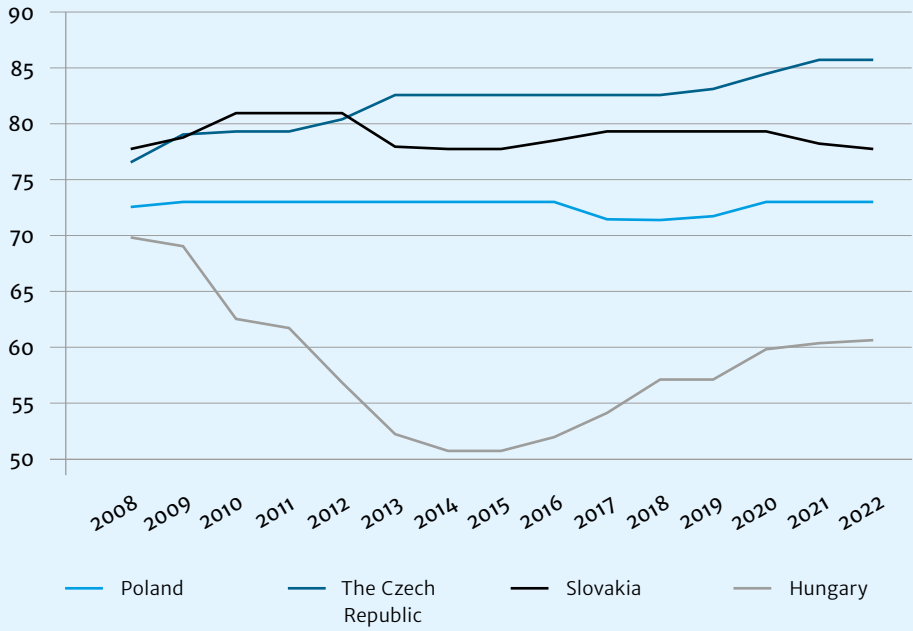
Five-year CDS contracts point to a sharp increase for Poland and Hungary in 2022. In Hungary, they increased from approximately 51 bp in 2021 to approximately 146 bp in 2022, and in Poland, respectively, from 42 bp to to over 114 bp.

**In the Czech Republic and Slovakia, CDS rates also increased, however, they are at a low level, approximately 16 bp and 44 bp, respectively. Such strong increase in CDS quotes in Hungary and Poland is a dangerous signal and evidences deterioration of economic credibility of these countries.**

**The third indicator is the difference in the national long-term interest rate compared to Germany, i.e. the so-called „spread” of the yield of 10-year bonds to the yield of German bonds.** The average for the year was also taken into account.

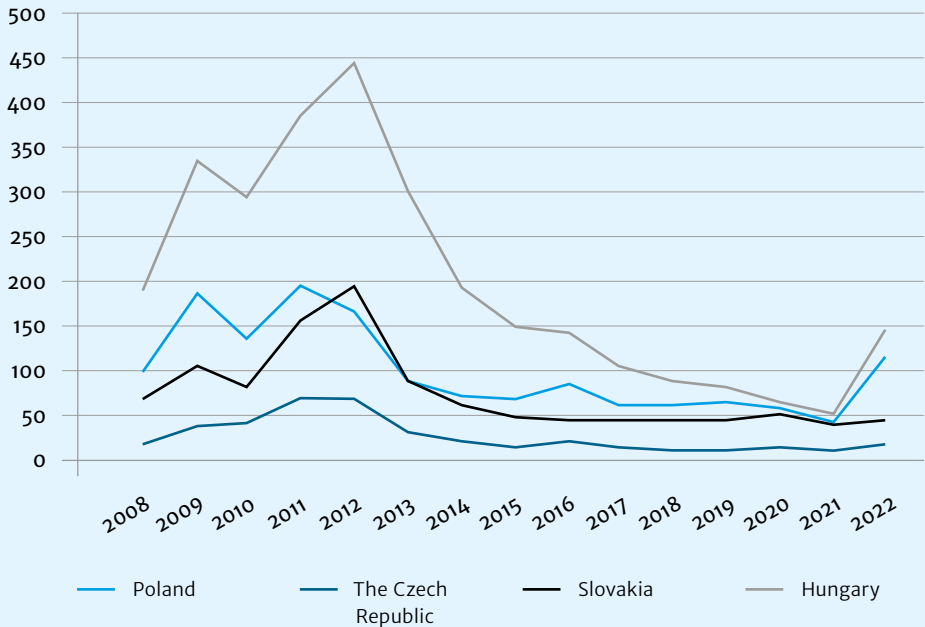
In Hungary, the spread to German bonds increased from 3.4 pp to 6.4 pp, and in Poland from 2.3 pp to approx. 5 pp. This means an increase of 3 pp, and 2.6 pp, respectively. In the Czech Republic and Slovakia, spreads also increased, but on a much

**CHART 12.** Average country credit rating (highest=100)



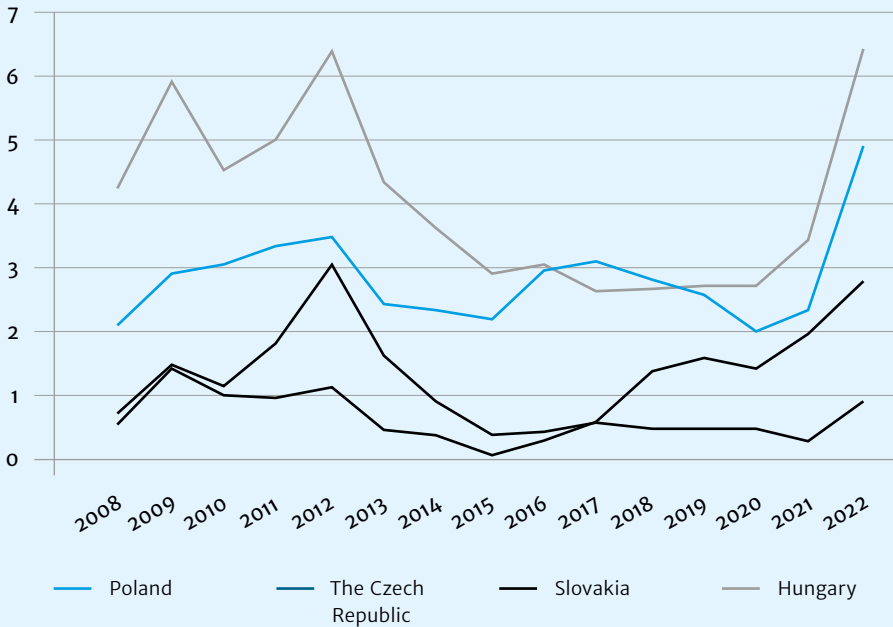
Source: IMF

**CHART 13.** 5-year CDS (Credit Default Swaps) contracts in basis points



Source: IMF

**CHART 14.** 10-year bond spread against Germany (basis points)



Source: Eurostat

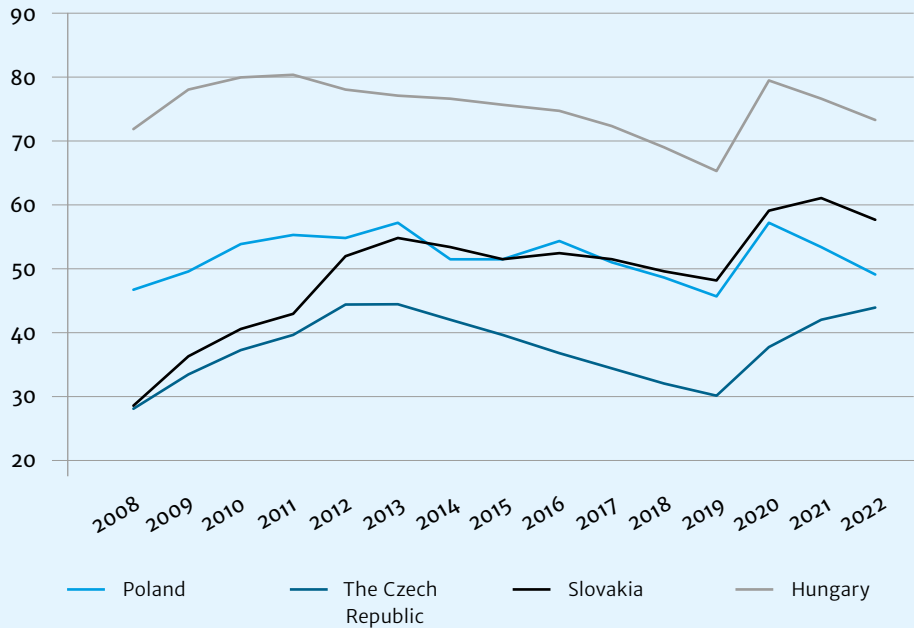
smaller scale, i.e. 1 pp. and 0.6 pp. Thus, the spread of the 10-year bond yield to the German bond yield also shows a strong deterioration in the economic credibility of Hungary and Poland.

In total, this dimension in 2022 in all analysed countries contributed to deterioration of credibility, however, deterioration in the Czech Republic and Slovakia was much smaller than that in Poland and Hungary.

### **Dimension 2. The condition of public finances and compliance with EU fiscal rules**

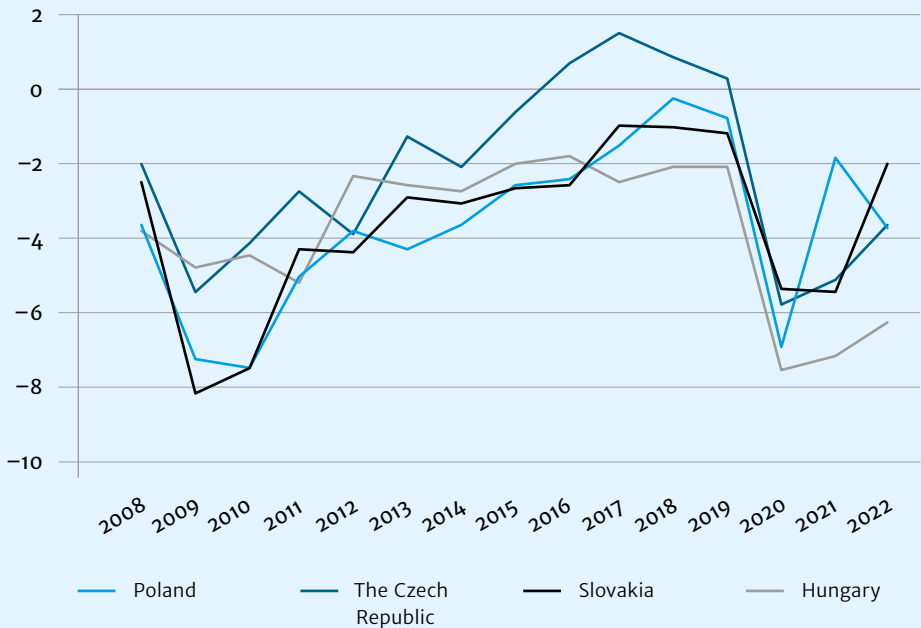
- There were adopted 5 indicators in this dimension:
- public debt – percentage of GDP
- nominal result – percentage of GDP

**CHART 15.** Public debt – ESA2010 (percentage of GDP)



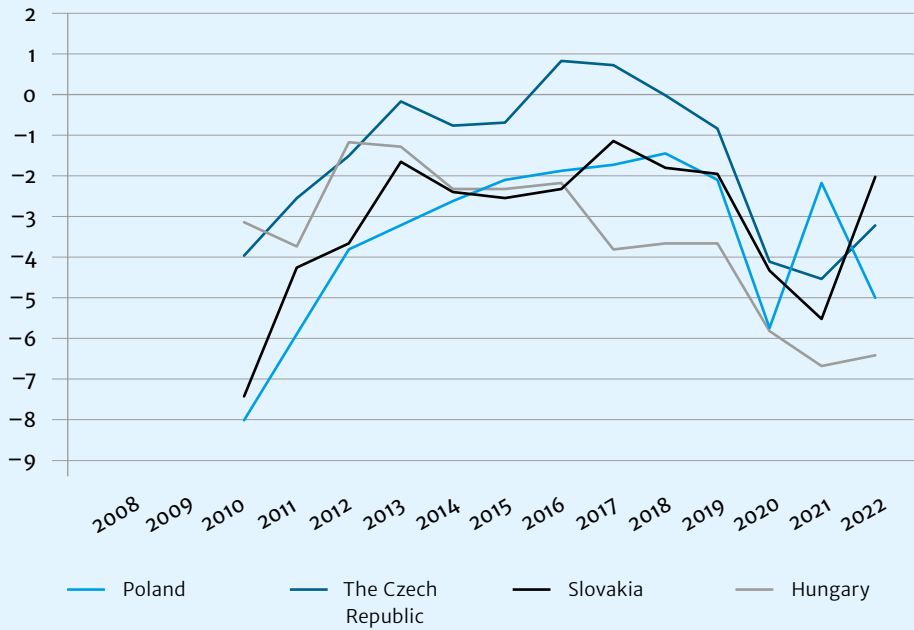
Source: Eurostat, AMECO – ECFIN

**CHART 16.** Nominal deficit (percentage of GDP)



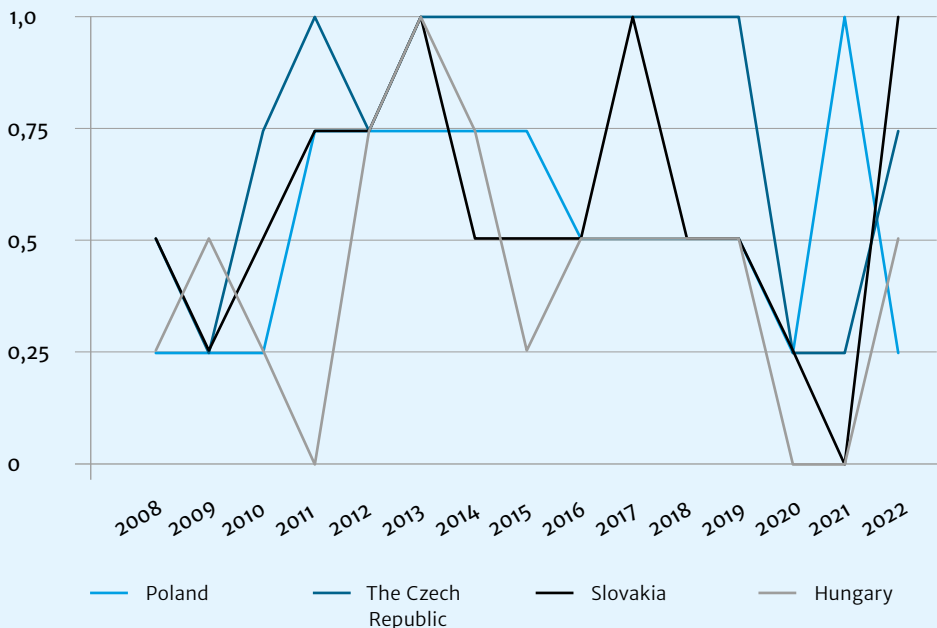
Source: Eurostat, AMECO – ECFIN

**CHART 17.** Structural deficit (percentage of GDP)



Source: Eurostat, AMECO – ECFIN

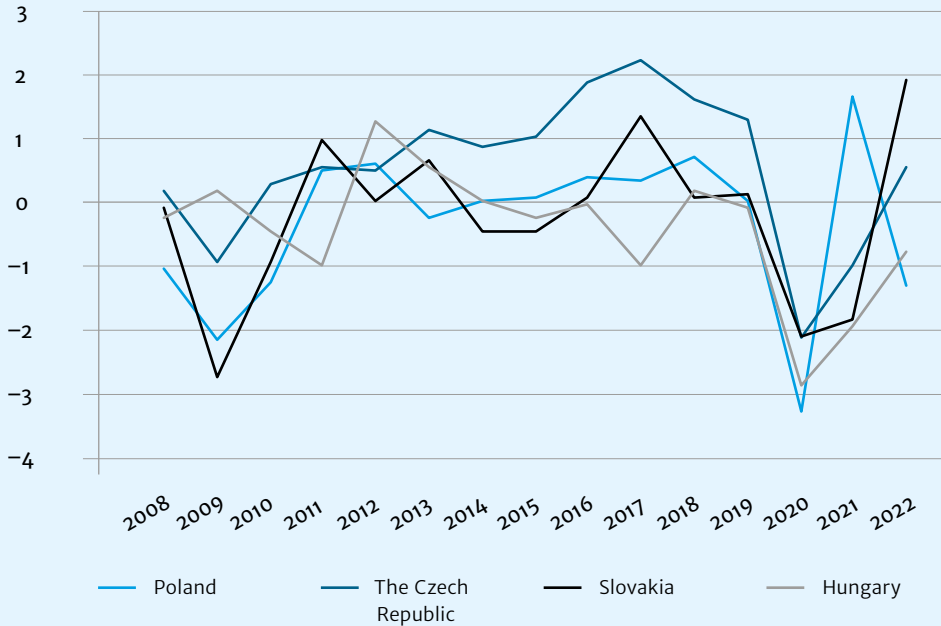
**CHART 18.** Index of compliance with EU budget rules (0/1)



Source: EFB



**CHART 19.** Deviation from EU budget rules (pp. GDP)



Source: Eurostat, AMECO – ECFIN

- structural result – percentage of GDP
- index of compliance with EU budget rules (0/1)
- deviation from EU budget rules (percentage of GDP)

Individual components in this dimension were given equal weights (1/5).

In 2020, as a result of the pandemic, both the deficit and public debt in the analysed countries increased significantly. The deficit exceeded the reference value of 3%. The structural deficit was also above the medium-term budgetary objective (MTO=1%). However, the European Commission applied a general exit clause to all countries, therefore, the excess was possible and the excessive deficit procedure (EDP) was not implemented.

Since then, the debt-to-GDP ratio has been decreasing except for the Czech Republic, where the ratio before the pandemic was

30% and has now increased to 44%, and remains the lowest among the analysed countries. It should be borne in mind that in Poland and Hungary the decline in the debt-to-GDP ratio is largely due to high nominal GDP pumped up by high inflation. In the case of Poland, if it were not for increased inflation, the debt-to-GDP ratio would not have decreased, but increased to approximately 56% (see Dudek, Kotecki in Benecki, Dudek, Kotecki 2023). This improvement is also due to the post-pandemic rebound in the global economy, which means that it is not sustainable, as shown by the structural deficit, i.e. the deficit cleared of one-off effects and the economic situation. Unfortunately, in Poland, following improvement in 2021, the structural deficit increased significantly in 2022 and amounts to nearly 5% GDP. In Hungary it is 6.4 percent of GDP, in Slovakia 2 percent, and in the Czech Republic 3.2 percent. **A high and growing structural deficit clearly indicates the deterioration of the country's economic credibility.**

This dimension also includes two synthetic indicators measuring the degree of compliance with the European budgetary rules. These indicators are calculated by the Secretariat of the European Fiscal Board separately for 4 budgetary rules. Compliance with rules is measured in terms of: the nominal deficit rule (3% of GDP), debt rule (60% of GDP), structural deficit rule (smaller than the medium-term objective), and in terms of the so-called expenditure „benchmark”, i.e. the expenditure rule (Larch, Malzubris and Santacroce 2023, pp. 32-42). Compliance with the rules is measured on a zero-one scale, 1 - rule fulfilled, 0 - rule not fulfilled. Additionally measured is deviation from rules in GDP (in pp). For the purposes of this study, we calculate the average indicator from 4 partial indicators. However, in the event of a deviation from the debt threshold, the adjustment rate over 20 years (1/20) is used. In total, contribution of this area to the index value in this dimension is negative for both Poland and Hungary.

TABLE 9. Exceeding the EU budget rules (percentage of GDP).

Country		Fiscal rule	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	Deficit – 3 proc.		-0,6	-4,3	-4,5	-2,0	-0,8		-1,3	-0,7	0,4	0,6	1,5	2,8	2,3	-3,9	1,2	-0,7
	Debt – 60 proc.		13,3	10,2	6,0	4,9	5,2		2,9	8,6	8,7	5,5	9,2	11,3	14,3	2,8	6,4	10,9
	Structural deficit – 1 proc.		-2,1	-4,0	-0,1	1,6	1,6		0,1	0,1	0,0	-0,3	-0,4	-0,2	-1,1	-4,1	3,0	-3,3
	Expenditure rule		-2,0	-0,9	-0,7	2,2	1,6		0,1	0,6	0,7	-0,3	-0,2	-0,2	-1,6	-5,1	2,1	-1,7
The Czech Republic	Deficit – 3 proc.		1,0	-2,4	-1,2	0,3	-0,9		1,7	0,9	2,4	3,7	4,5	3,9	3,3	-2,8	-2,1	-0,6
	Debt – 60 proc.		31,9	26,6	22,9	20,3	15,8		15,6	18,1	20,3	23,4	25,8	27,9	30,0	22,3	18,0	15,9
	Structural deficit – 1 proc.		-1,3	-1,8	0,6	0,9	0,6		0,9	0,2	0,3	1,8	1,7	1,0	0,2	-3,3	-0,9	0,8
	Expenditure rule		-0,5	-0,8	0,6	0,0	1,5		1,1	1,5	0,4	0,9	1,4	0,3	0,3	-3,4	-1,8	1,2
Slovakia	Deficit – 3 proc.		0,5	-5,1	-4,5	-1,3	-1,4		0,1	-0,1	0,3	0,4	2,0	2,0	1,8	-2,4	-2,4	1,0
	Debt – 60 proc.		31,4	23,6	19,4	16,8	8,3		5,3	6,5	8,3	7,7	8,5	10,6	12,0	1,1	-8,0	2,2
	Structural deficit – 1 proc.		-1,0	-2,9	-0,7	2,7	0,1		1,5	-1,3	-0,6	-0,3	0,7	-1,1	-0,7	-2,8	-1,7	3,0
	Expenditure rule		-1,4	-4,1	0,5	1,8	0,9		0,7	-0,7	-1,8	-0,1	2,3	-1,0	-1,2	-3,2	-2,8	3,7
Hungary	Deficit – 3 proc.		-0,8	-1,7	-1,4	-2,2	0,7		0,4	0,2	1,0	1,2	0,5	0,9	1,0	-4,5	-4,1	-3,2
	Debt – 60 proc.		-8,5	-11,4	-9,2	-5,2	-0,5		0,4	0,2	-0,2	0,0	2,1	3,7	5,4	-11,4	-6,3	-0,7
	Structural deficit – 1 proc.		0,5	1,4	-1,4	-1,1	2,1		0,4	-0,6	-0,5	-0,3	-2,1	-0,4	-0,5	-2,6	-1,4	-0,2
	Expenditure rule		-0,2	1,8	1,5	-0,3	2,4		1,3	0,5	-1,5	-1,0	-2,3	-0,1	-1,0	-3,7	-1,7	0,4

Source: ERB „Compliance Tracker“. Green: rule fulfilled, red – rule not fulfilled

### Dimension 3. Quality of fiscal rules, quality and transparency of the public finance system

In this dimension, there were 7 indicators adopted for analysis:

- Standardised fiscal rules index
- Index on the scope of IFI tasks
- Index on the quality of medium-term budgetary frameworks
- debt of entities spending outside control of the parliament – (percentage of total debt according to ESA)
- difference between the national deficit and deficit according to the EU methodology (percentage of the central sector deficit according to ESA)
- difference between the national deficit and deficit according to the EU methodology (percentage of GDP)
- using bonds instead of subsidies – (percentage of the central sector deficit according to ESA)

Equal weights (1/7) were adopted for the seven factors included in the analysis of this dimension.

In this area, there were applied three synthetic indices measuring the quality of the public finance system, calculated by the European Commission (ECFIN) as part of the „Fiscal governance database” project<sup>4</sup>. The project concerns fiscal rules, independence of fiscal institutions (IFI), the so-called fiscal councils, and medium-term budgetary frameworks (MTBF). The database is updated annually through questionnaire replies from the Member States and international financial institutions<sup>5</sup>.

Well-designed fiscal rules are characterized by a number of desirable features. In order to capture these characteristics, DG ECFIN has constructed an index of the strength of a given

<sup>4</sup> Fiscal governance database, [https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/fiscal-governance-database\\_en](https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/fiscal-governance-database_en), accessed on 25 Oct 2023

<sup>5</sup> ....

fiscal rule, which reflects information on: (i) the legal basis, (ii) the binding nature of the rule, (iii) monitoring bodies, (iv) corrective mechanisms, and (v) resistance to shocks. On the basis of partial data, a comprehensive, time-varying indicator of fiscal rules is constructed for each Member State. The higher the index value, the stronger the fiscal rules. The stronger and well-designed the fiscal rules, the higher the economic credibility of the country.

Since 2015, DG ECFIN has run the Scope of Fiscal Institutions Index (SIFI), or Fiscal Councils, which aims at measuring the scope of tasks performed by these councils. The SIFI Index consists of six separate groups of tasks: (1) monitoring compliance with fiscal rules; (2) macroeconomic forecasting; (3) budget forecasting and calculating policy costs; (4) stability assessment; (5) promoting fiscal transparency; and (6) normative recommendations for fiscal policy. The index ranges from 0 to 100, where 100 stands for the optimal structure of the fiscal council. In countries where there are independent, competent fiscal councils, the country's economic credibility is high.

DG ECFIN also looks into the existing medium-term budgetary frameworks in the EU Member States, the so-called long-term planning. In order to be credible, public finances should be planned in the medium-term perspective. DG ECFIN has developed a quality indicator for the medium-term budgetary framework, which is updated annually. It captures quality of national medium-term fiscal frameworks with the use of five criteria: (i) the range of targets/limits contained in national medium-term fiscal plans; (ii) linking these targets/limits to annual budgets; (iii) involvement of the national parliament in drawing up of the plans; (iv) involvement of independent fiscal institutions in preparation thereof and (v) the level of detail of such plans. The index value ranges from 0 to 1. The higher the value, the higher the quality of the long-term planning system.

**Taking into account the fiscal council, Poland performs exceptionally poorly. One may say that the council is virtually**

**non-existent, though some of its functions are performed by the Supreme Audit Office, e.g. by means of assessing implementation of the budget.** But it only partially fulfills all the desired functions (17.5 points on a scale from 0 to 100). Long-term planning has also deteriorated. In these two areas, Poland performs the worst among the analysed four Visegrad Group countries. Poland fares better in terms of the strength of fiscal rules. The index rates highly, for example, the fact that the debt rule is included in the constitution. However, this index does not take into account accounting tricks and the practice of circumventing national fiscal rules and underestimating the state budget deficit.

The subsequent indicators measured the scope of circumvention of the constitutional definition of state public debt, the practice of circumventing the state budget deficit, and the practice of underestimating the state budget deficit.

In Poland, public discussion on the budget focuses on this part of public finances. **An average individual may think that the state budget is tantamount to the entire state finances.** However, this is not the case. Moreover, the state budget is less and less reflecting the state of public finances in general, which results from various activities aimed at and resulting in less and less transparency of changes in their condition.

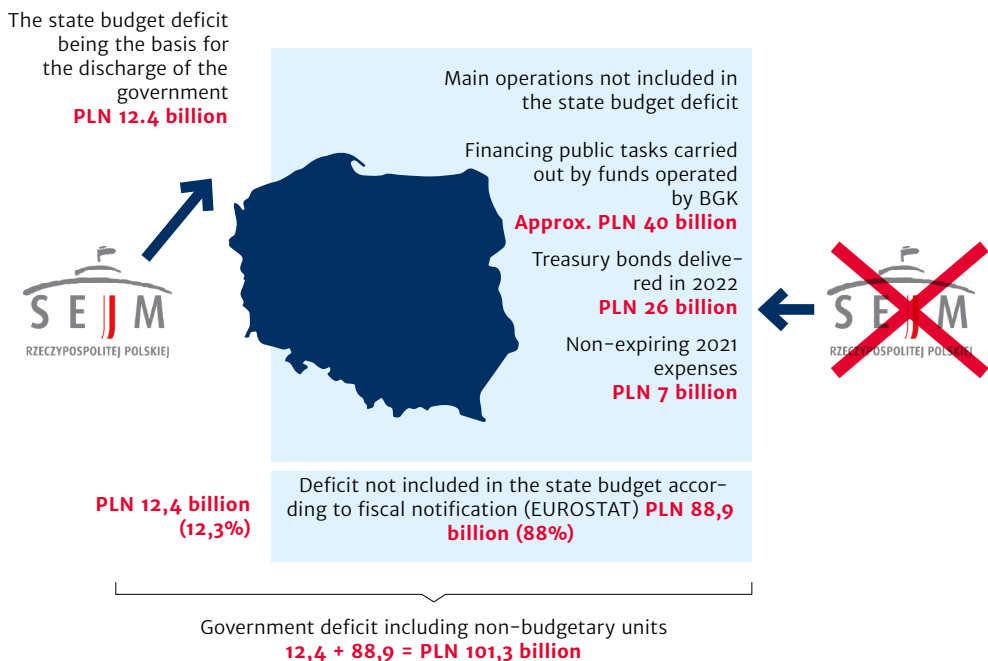
**The state budget consists only of central entities, mainly ministries, which perform key public functions, but do not cover the entire state finance sector.** The central budget itself does not include, among others: local government units, health fund, social insurance fund, and many other segments of the public finance sector. The division of public finances into three subsectors, i.e. central, local government, and social security, is common in many countries and used in the European methodology. Economists have long known that the state budget is, in fact, the equivalent of the central budget. But in recent years, the „state budget” has not been stretching to all „central” entities. Moreover, in recent years, there have been created several

units and funds, with billions of zlotys at their disposal, not included in the state budget and therefore beyond the control of the parliament. These are funds in Bank Gospodarstwa Krajowego (BGK) and the Polish Development Fund (PFR).

Therefore, in this area, used as an indicator was the difference between the state budget result and the central sector result according to the European methodology (ESA). Importantly, this measure is calculated for all EU countries and in this respect we are able to make comparisons with other countries. Here, used as an indicator was the result generated by extra-budgetary entities not included in the national budget process<sup>6</sup>.

<sup>6</sup> B9\_OB - Net lending (+)/ net borrowing (-) of other central government bodies, table 2a, Fiscal notification – April 2023 „Reporting of Government Deficits and Debt Levels in accordance with Council Regulation (EC) N° 479/2009, as amended by Commission Regulation (EU) No 220/2014 and the Statements contained in the Council minutes of 22/11/1993”

**FIGURE 2. Grey zone of the 2022 budget**



Source: Benecki R., Dudek S., Kotecki L. (2023). Zagrożenia nadmiernego długu publicznego, edycja 2023, Chart 1, Warszawa, Instytut Odpowiedzialnych Finansów i Instytut Finansów Publicznych

According to the data of the Ministry of Finance, the state budget deficit in 2022 amounted to PLN 12.6 billion, i.e. (0.4% of GDP) in comparison with the assumed PLN 29.9 billion in the 2022 Budget Act. In 2021, the state budget deficit was more than two times as high and amounted to PLN 26.4 billion (1% of GDP). **The comparison of these numbers may suggest that the situation of the public finances is excellent. Unfortunately, this is not the case, because the real state budget deficit is many times higher, as evidenced by the data sent to Eurostat.** In the report on the Budget Act submitted to the Sejm, the government

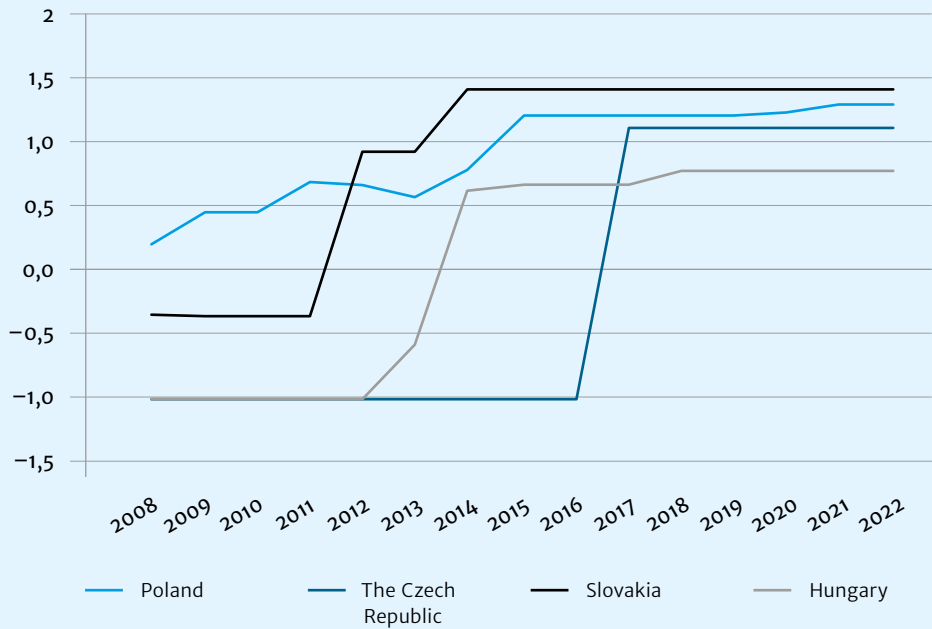


showed approximately 12 percent of the real government deficit, because the actual deficit is approximately PLN 101 billion (see FIGURE 2). The grey zone of the central budget measured by the deficit is 88%, and this indicator is systematically increasing. **The scale of opacity is so great that there has occurred an unprecedented situation: for the first time in history, the College of the Supreme Audit Office did not provide a positive recommendation concerning the discharge of the government in the implementation of the 2022 Budget Act.**

At the national level, financial transparency is also measured as the difference between debt according to the national methodology and debt according to the ESA2010 methodology. This difference shows the scale of debt in entities and funds disbursing public funds outside the control of the parliament. This debt also falls outside the constitutional definition of debt. **Recently, the scale of debt beyond the constitutional definition has increased significantly. At the end of 2021, almost 1/5 of the debt was outside this definition.**

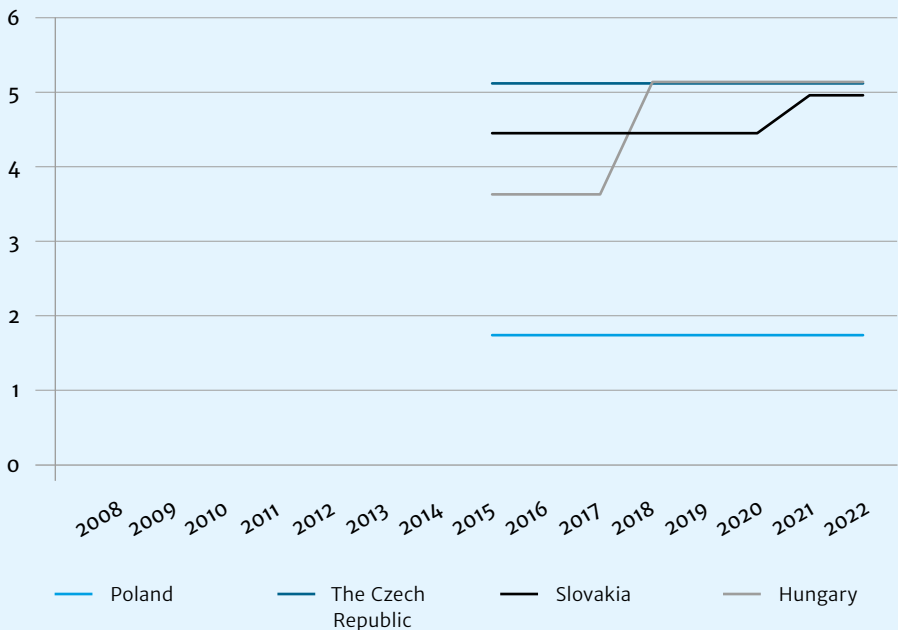
An indicator of circumventing the expenditure rule and the state budget is the practice of giving out treasury bonds. It involves issuing treasury bonds only for the purpose of their transfer to other entities from the public finance sector, instead of subsidies (NIK 2021, 2022, 2023). This operation lowers the state budget result and, when bonds are transferred to entities not falling under the SRW expenditure rule, it helps to circumvent the expenditure rule. An example is the transfer of bonds to the public media as an alleged compensation for low revenues from radio and television license fees. **The situation is rather bizarre: individual public media entities, for example Radio Koszalin, receive a certain pool of treasury bonds from the State Treasury: these institutions must set up brokerage accounts to service these bonds, incur additional costs related thereto, bonds are then cashed in (sold), and the funds obtained through such sale are spent on the statutory purposes of these entities.** In the past, these operations

**CHART 20. Standardized Index of Fiscal Rules**



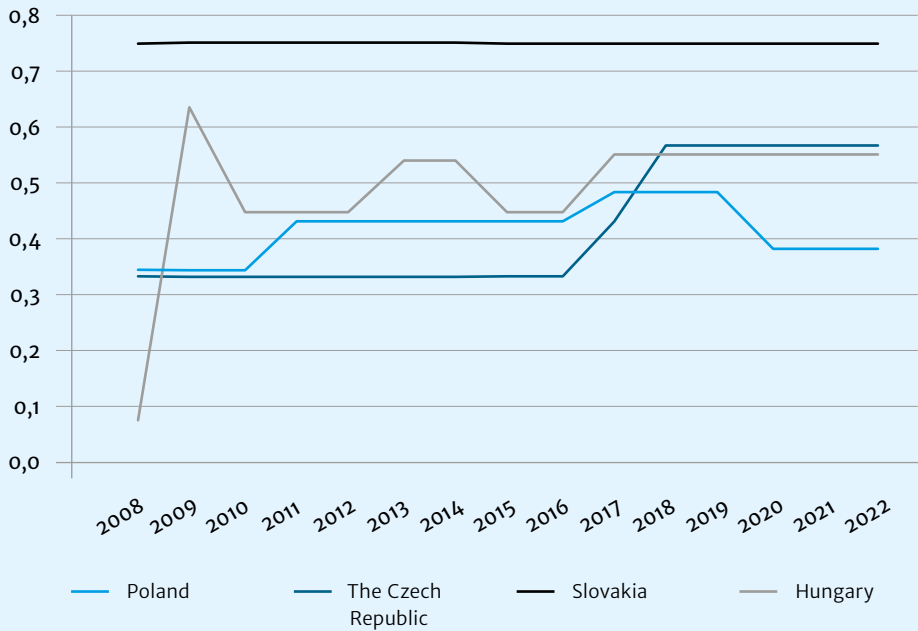
Source: own study

**CHART 21. Index of the scope of tasks of independent fiscal institutions**



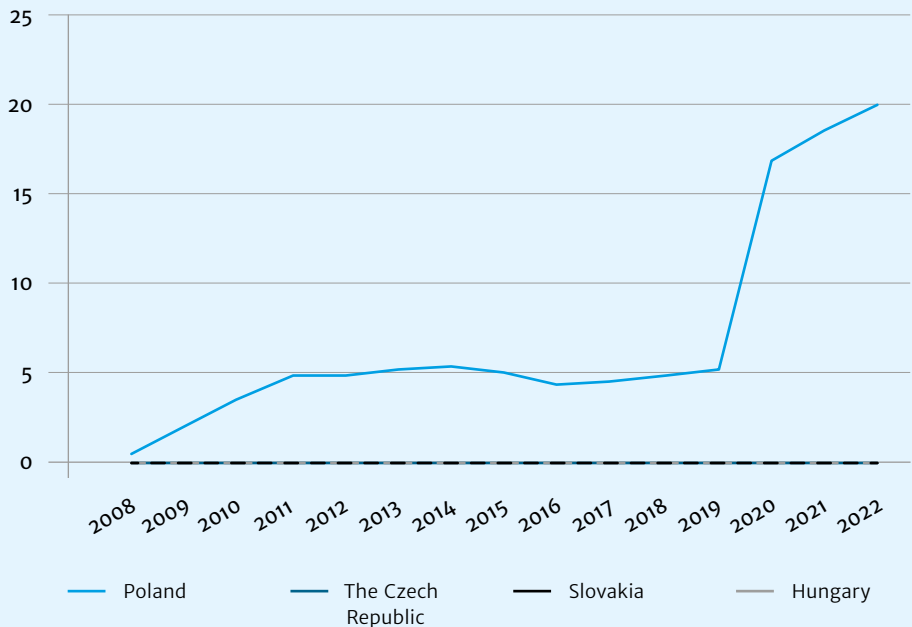
Source: own study

**CHART 22.** Quality index of the medium-term budgetary framework



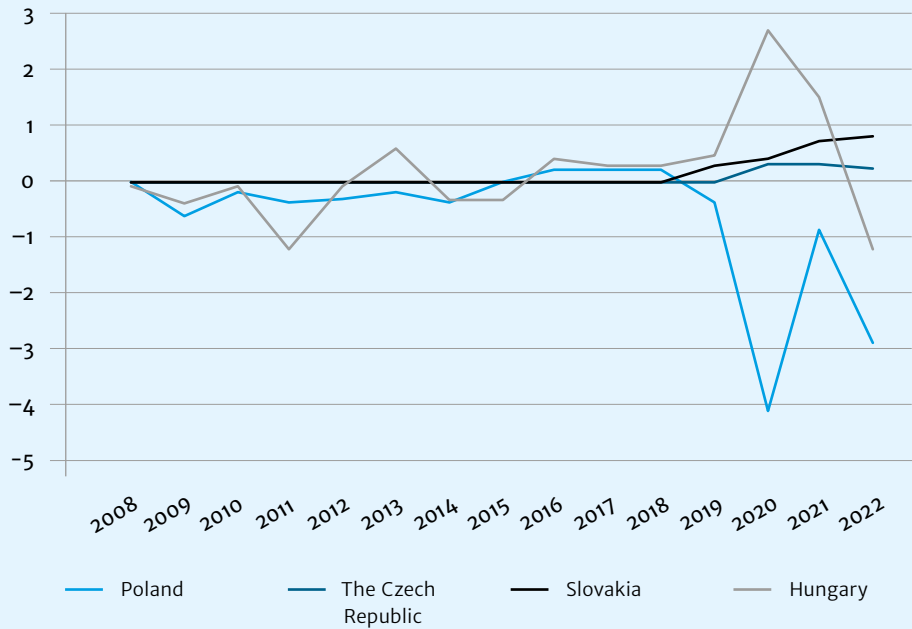
Source: own study

**CHART 23.** Debt in entities spending outside the control of parliament (percentage of debt)



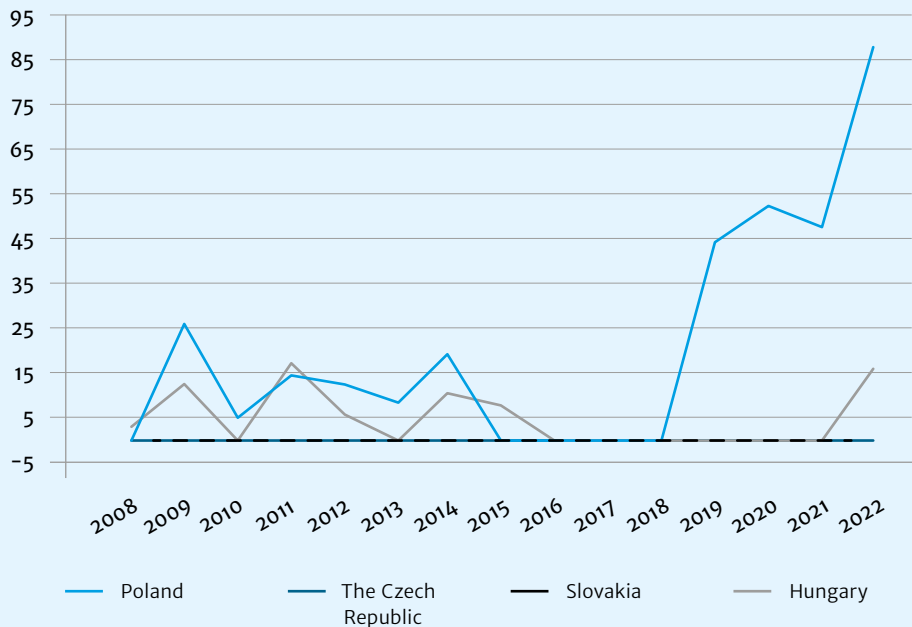
Source: own study

**CHART 24.** Deficit outside the state budget (percentage of GDP)



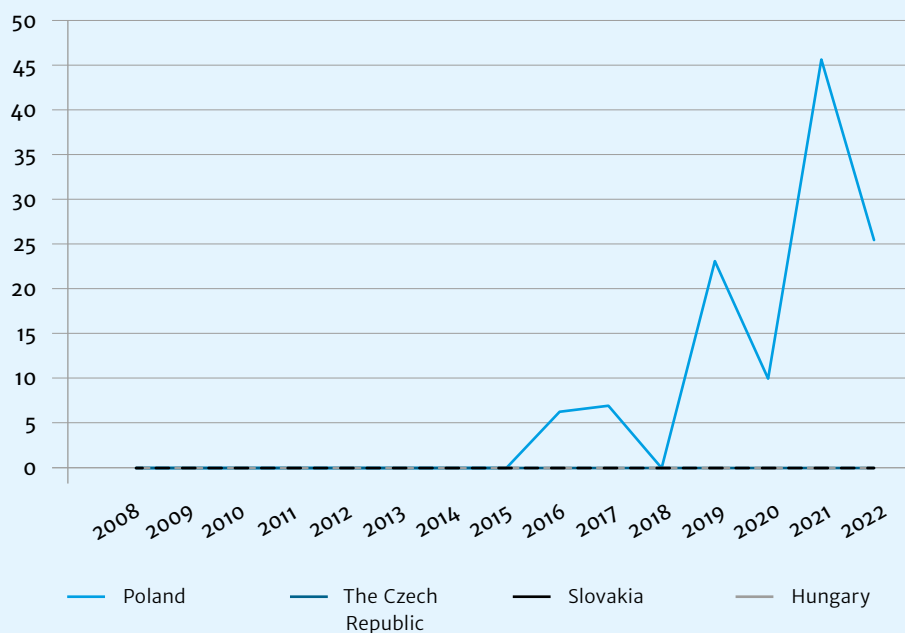
Source: own study

**CHART 25.** Deficit outside the state budget (percentage of full deficit)



Source: own study

**CHART 26.** Bonds distributed instead of subsidies (percentage of deficit)



Source: own study

would be carried out with the use of a standard budget subsidy. The number of entities receiving hidden subsidies in this form is growing rapidly. Instead of subsidies, bonds are received by, among others, universities, the Polish Baltic Sea Shipping Company, the National Media Institute, the CPK Central Communication Port, and recently, mines. The administrator receives these bonds only to immediately cash them and spend on the performance of statutory tasks. As a result, the state budget reduces its expenses by the value of these bonds (see Dudek, Kotecki, Kurtek 2022 and Benecki, Dudek, Kotecki 2023).

This practice totally distorts the image of public finances, even in the narrower sense of the national methodology. Such activity generates additional costs for entities receiving bonds, and also generates additional debt management costs for the Ministry of Finance since the Ministry must divide these issues into various types of instruments so as not to disturb the functioning

of the market, because these „gifted” entities almost immediately get rid of these bonds. **This is a curiosity unheard of anywhere in the world.** In 2020, the scale of these operations amounted to PLN 18.3 billion, in 2021 it was PLN 22.3 billion, and the 2022 emission amounted to PLN 26 billion.

In none of the analysed countries are there two definitions of public debt, or the procedure of issuing bonds is used. **This makes our credibility very low compared to these countries.** If there are extra-budgetary entities in other countries, they generate surpluses rather than debt, such as in the case of the Czech Republic and Slovakia.

**In this area, Poland has seen significant deterioration. We fall behind other countries. Even Hungary is in a much better situation than Poland. Due to the circumvention of existing fiscal rules and the creation of extra-budgetary funds, credibility of public finances in Poland has significantly deteriorated in terms of transparency.**

#### **Dimension 4. Transparency, predictability, complexity, and effectiveness of the public levy system**

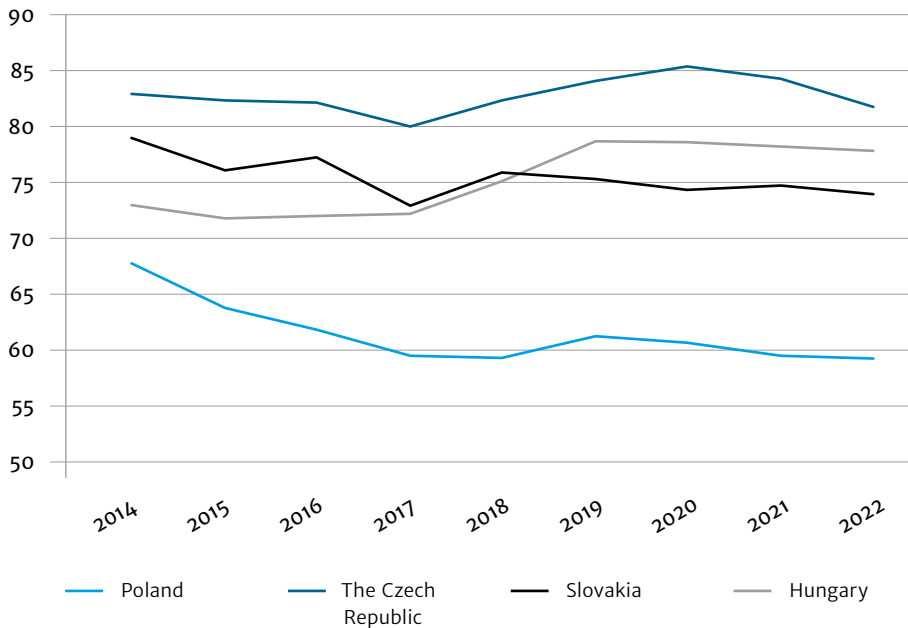
There was 1 indicator used in this area:

- International tax competitiveness index

The „International Tax Competitiveness Index” is developed by the Tax. **According to this index, Poland's score is the worst among the analysed countries** (Bunn 2023).

It should be noted here that there is a cognitive gap when it comes to measuring the complexity of predictability and transparency of tax systems. Unfortunately, the World Bank's Paying Taxes study has been suspended and there are no alternative studies in this area.

**CHART 27.** International Tax Competitiveness Index (pp, indeks)



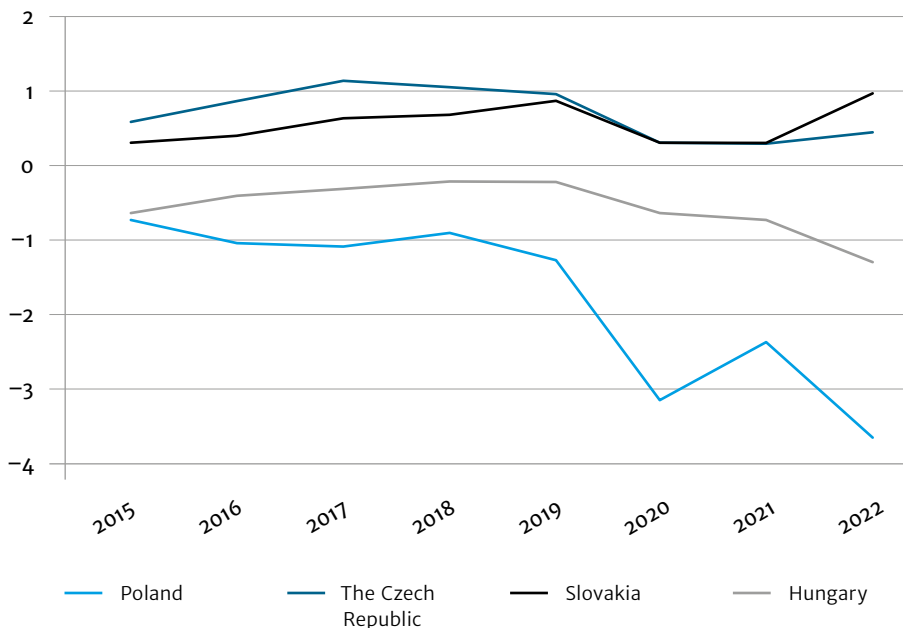
Source: own study

## Summary

### **Data analysis evidences last year's deterioration of the country's credibility in the area of public finances both in Poland and Hungary.**

In the Czech Republic and Slovakia, the value of the indicator is positive and has increased in 2022. It amounts to 0.46 and 0.96 points, respectively. In Hungary and Poland, economic credibility has been systematically declining for several years, but in Poland the WEP indicator in public finances is almost three times lower than in Hungary. In 2022, the credibility index in the area of public finances amounted to -3.65 points, while in 2018 it was approximately -1 point. In Hungary, this indicator currently stands at -1.28 points (as compared to -0.21 points in 2018).

**CHART 28.** Economic credibility in the public finances area.



Source: own study

**TABELA 10.** Economic credibility in the public finances area.

	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,73	-1,03	-1,08	-0,91	-1,26	-3,17	-2,39	-3,65
The Czech Republic	0,59	0,87	1,15	1,06	0,98	0,33	0,32	0,46
Slovakia	0,35	0,44	0,64	0,68	0,87	0,35	0,33	0,98
Hungary	-0,64	-0,38	-0,31	-0,21	-0,23	-0,63	-0,71	-1,28

Source: own study.





# Stability of money and the financial system

## Importance of stability of money and the financial system for the country's economic credibility

The years 2021–2022 were a period of strong inflation growth. They bared fragility of the country's economic credibility in terms of stability of money and the financial system. The shocks caused by disruption of global supply chains during the COVID-19 pandemic and Russia's aggression against Ukraine were broader than changes in relative prices – everywhere, they led to an increase in the average price level. This increase did not result solely from price increases directly affected by the shocks, but spread widely to other price categories. Central bank inflation targets proved to be poor nominal anchors. However, it was not only the result of shocks. Central banks themselves jeopardized their credibility with their activities undertaken during the pandemic. The increase in inflation was largely due to the unprecedented monetary expansion that accompanied and largely financed the very large increase in public spending in response to the pandemic.

The coming years will be a period in which countries will be in great need of economic credibility in the area of monetary stability and the financial system. This will be a period of containing

inflation. How quickly it will return to a low level and at what costs in the form of a temporary, but possibly persistent increase in the unemployment rate (or economic inactivity) this return will be paid for, will largely depend on and reflect the economic credibility (Bursian and Faia 2018).

For the global economy, this will also be a period of serious shocks. Tightening of the monetary policy in the United States, one of the strongest in history in terms of both the pace and scale, will eventually lead to deterioration in the world's most important economy. This deterioration, in turn, will weaken economic conditions in other economies, where aggregate demand is also constrained by increases in central banks' own interest rates. The global economic downturn, narrowing availability of financing as well as much higher costs of such financing in comparison with the previous two decades, will expose weaknesses of many economies. Whether these weaknesses are not going to turn into serious problems or even crises will depend on the country's economic credibility.

In the near future, the deficit of credibility and the inability to strengthen it will be costly. Meanwhile, the credibility deficit is particularly difficult to remove in periods of economic downturn (Ehrmann, Soudan and Stracca 2013) and pessimistic moods (Albinowski, Ciżkowicz and Rzońca 2014). This is a serious challenge, especially in countries where citizens do not trust each other (Angino, Ferrara and Secola 2022). Nevertheless, this task is not doomed to failure. Central banks must stick to their mandate while systematically explaining how monetary policy aimed at low inflation over the medium term stabilizes the economy (Ehrmann, Georgarakos, and Kenny 2023). Although knowledge about both the determinants of credibility and effective communication of central banks remains limited, it has broadened significantly in recent years. The most recent review of research in this area has been developed by Blinder, Ehrmann, de Haan, and Jensen (2023).

## **WEP index in the area of monetary stability and the financial system according to the 2022 methodology**

The country's economic credibility in the area of stability of money and the financial system, measured in exactly the same way as last year, has recorded another deep decline in Poland, on an unprecedented scale. As a result, the credibility index has reached its lowest value in the history of measurement. In three of the four dimensions in which it is measured, the credibility deficit has never been so profound. These were dimensions: direct – measured by the percentage of respondents negatively assessing activities of the National Bank of Poland, indirect – focusing on the effects of the country's credibility (or lack thereof) in the area of monetary stability and the financial system, and the dimension referring to threats to the country's credibility in the area of monetary stability. In the case of dimension covering threats to the stability of the financial system, only the years 2008–2009 saw a worse result, i.e. in the acute phase of the global financial crisis. This time, however, unlike then, the threats in this area are not the consequence of an external shock, but to a large extent result from the internal policy.

## **Extended WEP index in the area of monetary stability and the financial system**

Extending the credibility measurement to three additional countries has meant, in the area of monetary stability and the financial system, that a need arose to abandon one (direct) dimension and two data categories. Behind these changes stands unavailability of appropriate data, i.e. either their complete absence or fundamental differences in the value of the information they contain. The first problem concerns the percentage of respondents negatively assessing activities of the central bank, and the second – the ratio of price to book value of

**TABLE 11.** Value of Poland's economic credibility index for the area of stability of the financial system and money

	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Credibility Index Value for Dimension I (Direct)	-0,49	-1,75	0,64	0,14	0,14		0,00	-0,18	0,00	0,82	1,77	0,64	-3,18	0,41	-1,36	-7,91
Credibility Index Value for Dimension II (Indirect)	0,00	0,74	0,48	0,50	1,16		1,23	1,41	1,41	0,87	-0,16	-0,53	-0,86	-1,45	-2,38	-2,38
Credibility Index Value for Dimension III (Threats to monetary stability)	-2,45	-0,57	0,15	-0,76	-0,37		-0,10	0,11	0,60	-0,20	0,64	0,09	-0,83	-2,09	-3,27	-27,34
Credibility Index Value for Dimension IV (Threats to stability of the financial system)	-3,41	-2,33	0,68	-0,92	0,19		1,47	0,76	-0,04	-0,14	-0,28	-0,62	-1,19	-1,10	-0,50	-2,16
<b>Value of Credibility Index for the area of Stability of money and the financial system</b>	<b>-1,59</b>	<b>-0,98</b>	<b>0,49</b>	<b>-0,26</b>	<b>0,28</b>		<b>0,65</b>	<b>0,53</b>	<b>0,49</b>	<b>0,34</b>	<b>0,49</b>	<b>-0,10</b>	<b>-1,52</b>	<b>-1,06</b>	<b>-1,88</b>	<b>-9,95</b>

Source: own study.

banks listed on the stock exchange. The analysed countries differ significantly both in terms of the importance of the capital market (although in none of them it is very high) and the role these banks play therein.

Three other categories of data were slightly modified in order to render them as comparable as possible between countries and to cause that the result of this comparison would make economic sense. Inflation expectations of enterprises have been replaced by inflation expectations of households, which for all analysed countries are measured according to a uniform methodology and published by Eurostat. In turn, in the case of the

core inflation variability index of 15%, the trimmed average has been replaced by net inflation. This is a measure of core inflation published by the central bank of each analysed country. There are, however, differences between countries in the manner of its definition. These are smaller than in the case of other measures. Broadly speaking, it is inflation after excluding price categories that are most often subject to shocks independent of monetary policy, such as food and energy prices. Finally, the real interest rate on deposits has been replaced by the deviation of the real interest rate from the natural interest rate, i.e. the interest rate that characterizes the long-term equilibrium in a given economy. The same real interest rate brings about different effects in a country with a higher potential GDP growth rate and greater impatience of households than in a country where the potential GDP growth rate is lower and households are more patient. Since the natural interest rate is an unobserved quantity, and among the variables that directly influence it, it is measured according to a uniform methodology for all surveyed countries and only the dynamics of potential GDP is published periodically, we decided to abandon the direct estimation of the natural interest rate and we based the index measurement on an assumption that the real interest rate is as often above as it is below the natural interest rate.

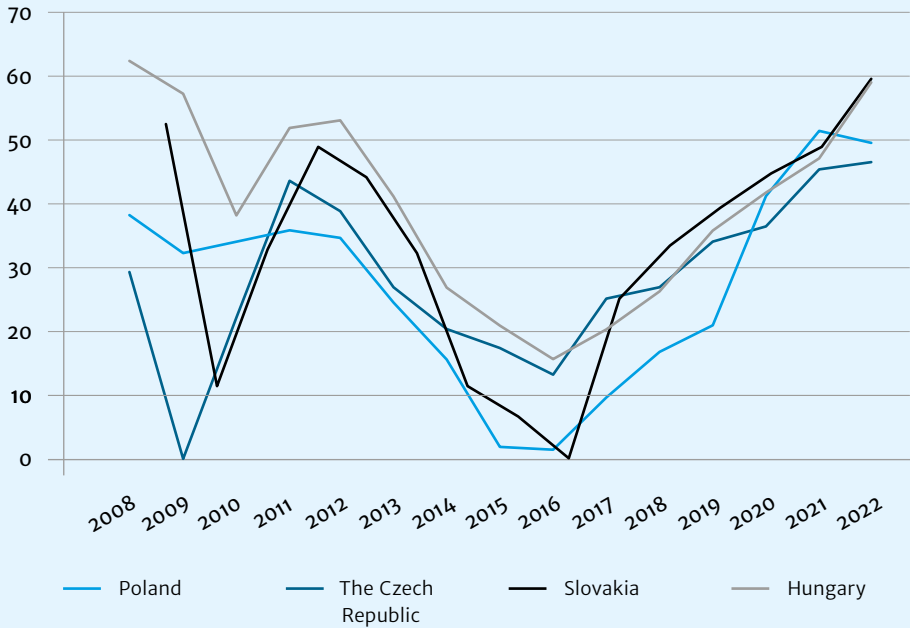
## **Dimension 2. Indirect**

In none of the analysed countries did the central bank manage to anchor inflation expectations. Nowhere did the households believe in assurances of the monetary authorities that the increase in inflation was only temporary. Last year, however, the outflow of deposits from banks and their replacement with cash slowed down, although no such outflow was observed in the Czech Republic in previous years. Let us recall that if the state is credible in the area of the financial system, people should not be afraid to keep their money in banks. As a result, the

importance of cash in relation to the total money supply should decrease, because in such conditions it is a less secure form of money, less convenient in making payments, and usually burdened with a higher opportunity cost.

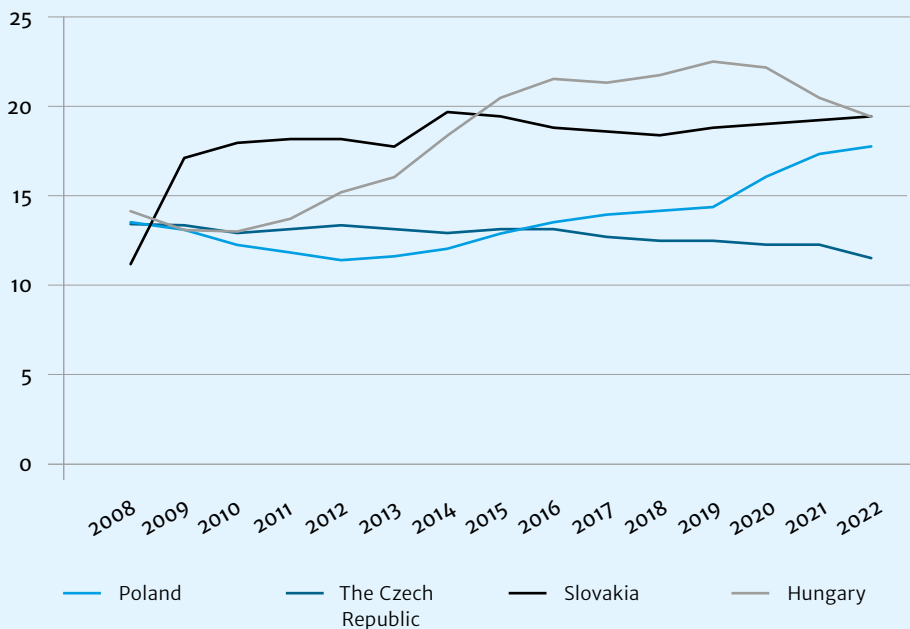
Development of indicators indirectly measuring the country's credibility in the area of monetary stability and financial system in the years 2008–2022

**CHART 29.** Inflation expectations of households



Source: Eurostat

**CHART 30.** The share of cash in the M3 money supply



Source: CNB, MNB, NBP, NBS

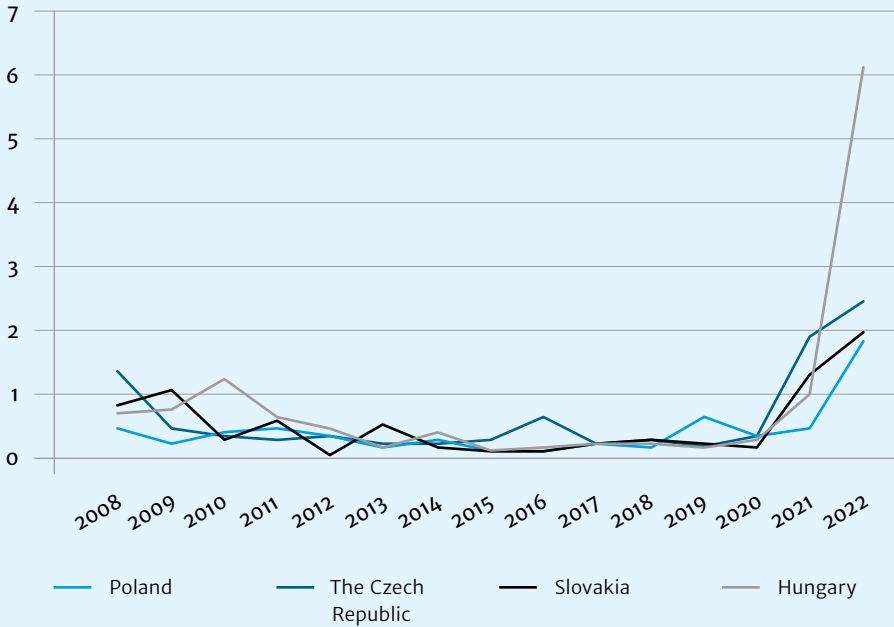


### Dimension 3. Threats to the country's credibility in the area of monetary stability

The threats to price stability are illustrated primarily by high volatility of core inflation. It means that it is difficult for households and enterprises to predict price changes, even in relation to general trends. Credibility of central banks is also affected by the large scale of inflation deviation from the inflation target. It no longer fulfills the role of a nominal anchor. Nevertheless, some positive trends are observable, thanks to which it will soon be easier for central banks in the analysed countries to rebuild their credibility. The pressure on inflation from the aggregate demand side has faded away. Outside Hungary, the money supply dynamics also slowed down sharply. But its decline was particularly deep in Poland. This was caused not only by increases in interest rates, which in Poland were on a smaller scale and started later not only in comparison with Hungary, but also with the Czech Republic. The so-called credit holidays played their role in decreasing the interest rates as well. They limited access to credit for many households because they showed banks that they would be burdened by the materialization of any macroeconomic risk, including those that the banks had not included in the loan price.

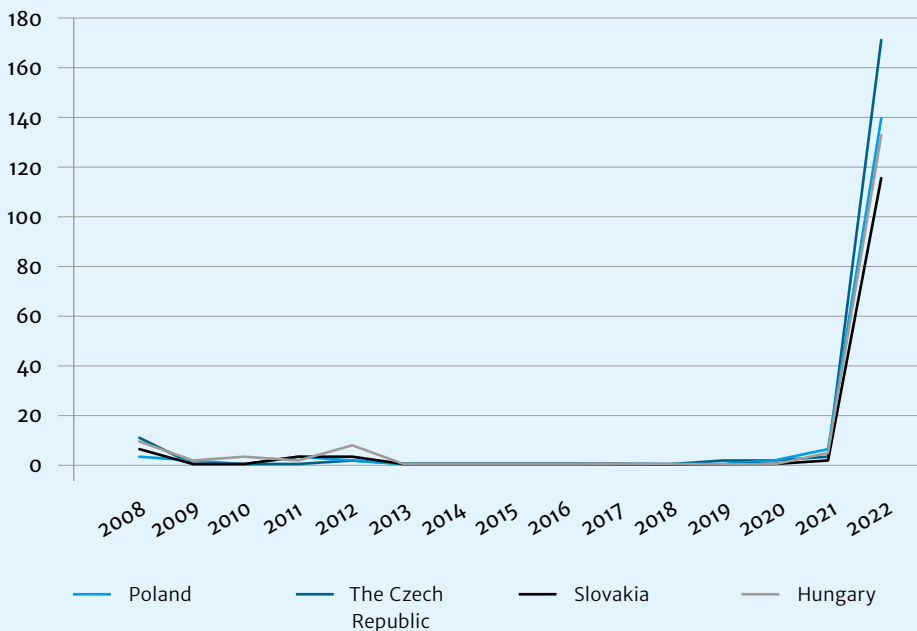
Development of indicators relating to threats to the credibility of the country in the area of monetary stability in the years 2008–2022

**CHART 31. Volatility of net inflation**



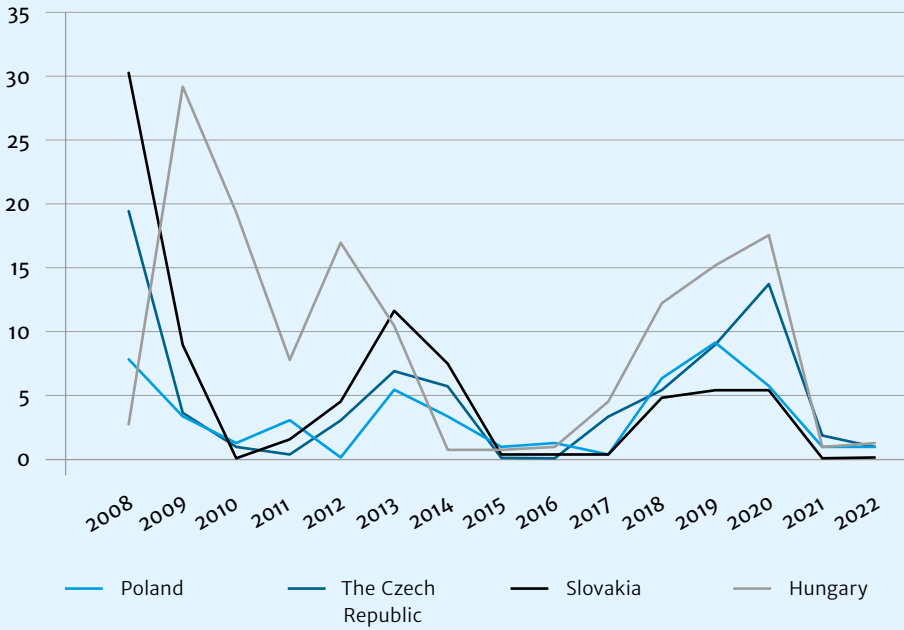
Source: CNB, MNB, NBP, NBS

**CHART 32. Square of inflation deviation above target**



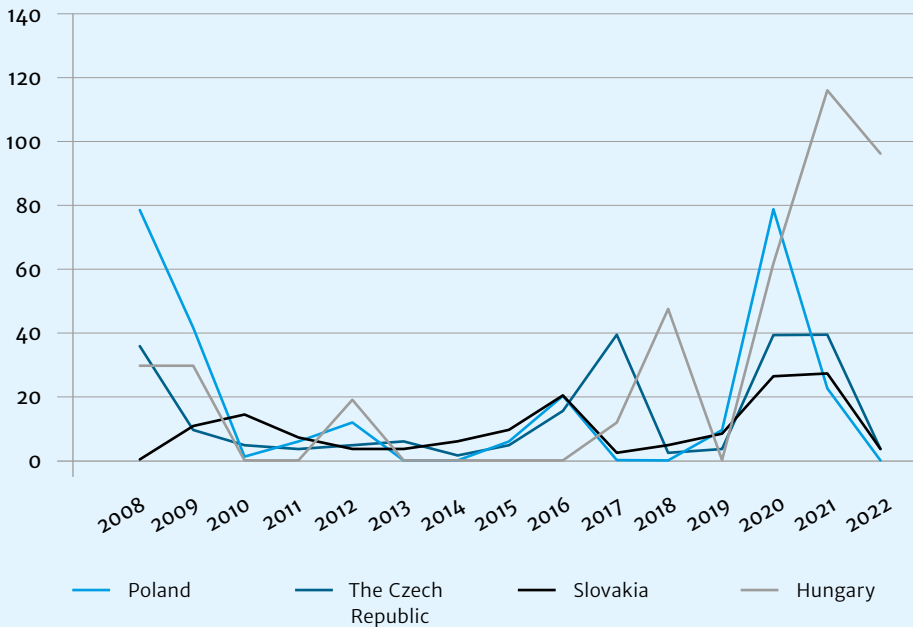
Source: Central Statistical Office and statistical offices of the Czech Republic, Slovakia, and Hungary

**CHART 33. Square of output gap**



Source: CNB, MNB, NBP, NBS

**CHART 34. Square of deviation of money supply dynamics from dynamics of potential output, increased by inflation target**

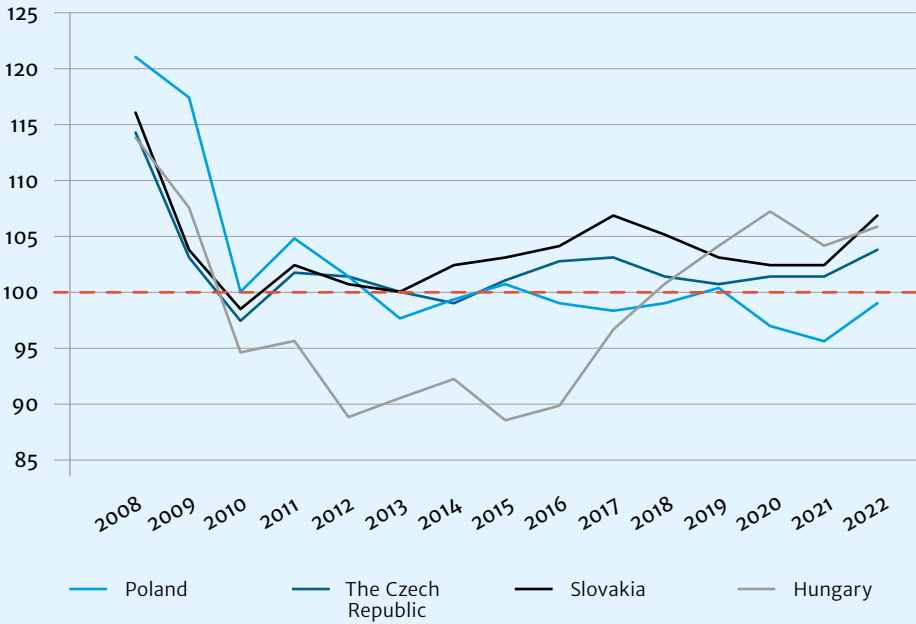


Source: CNB, MNB, NBP, NBS and the European Commission

#### Dimension 4. Threats to the country's credibility in the area of financial system stability

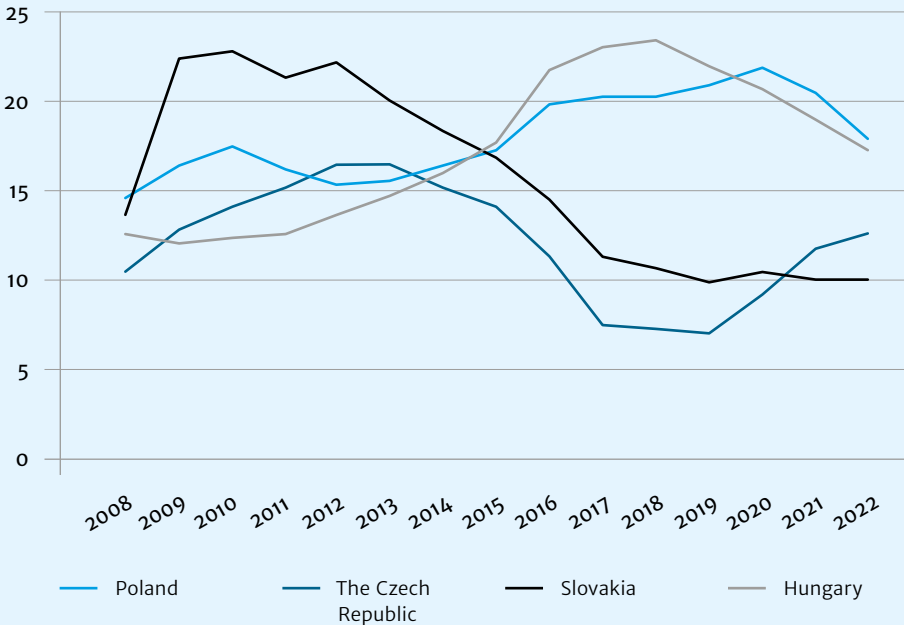
A common threat to stability of the financial system in all countries is the deeply negative real level of interest rates. However, increases in nominal interest rates prevented the outflow of deposits, which is taken into account in the first dimension measuring the country's economic credibility in the area of monetary stability and the financial system. In Poland and Hungary, strong connections between banks and the state are also a problem. The share of Treasury securities in banks' assets may have decreased in these countries, but this was largely due to the decline in bond prices accompanying interest rate increases. At any rate, this share remains high. As a result, the health of banks depends chiefly on stopping the growth of imbalance in public finances, and the ability to finance lending needs – on the „health” of banks. Excessive credit growth is not a threat anywhere. Its dynamics is particularly low in Poland, where for many years it has remained below the dynamics of potential GDP, which is an approximation of the long-term growth rate of the economy. In other words, the importance of credit in the Polish economy, which has never been high, is systematically decreasing.

**CHART 35.** Dynamics of receivables from the non-financial sector compared to dynamics of potential GDP, increased by inflation target



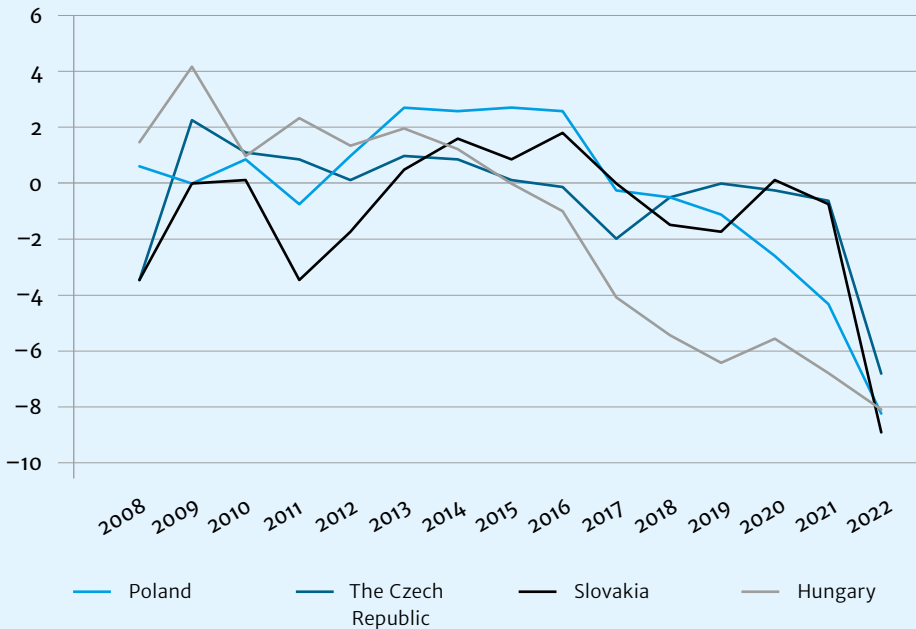
Source: CNB, MNB, NBP, NBS

**CHART 36.** Share of receivables from central and local government institutions in banks' assets



Source: CNB, MNB, NBP, NBS

**CHART 37.** Deviation of real interest rate from natural interest rate



Source: CNB, MNB, NBP, NBS

## Summary

In summary, last year's sharp increase in inflation – and its volatility – led to credibility deficit in the area of monetary stability and the financial system in all countries in the region. Its collapse occurred not only in Hungary, where the deficit was visible already in 2016, or in Poland, where it has been increasing since 2019, but also in Slovakia and the Czech Republic. The last of the mentioned countries, if looking into the entire period covered by the analysis, was the credibility leader in this area

TABLE 12. Index and sub-indices of the country's credibility in the area of the financial and monetary system stability in 2008–2022

Indirect measurement	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,06	0,24	0,32	0,32	0,43		0,83	1,13	1,56	1,45	1,03	0,70	0,50	-0,64	-1,27	-1,27
The Czech Republic	0,32	1,56	0,70	-0,23	-0,05		0,49	0,77	0,88	1,06	0,62	0,58	0,28	0,22	-0,13	-0,07
Slovakia	-0,24	0,43	-0,59	-1,32	-1,12		-0,54	-0,03	0,20	0,59	-0,42	-0,70	-1,04	-1,29	-1,50	-1,96
Hungary	-1,18	-0,80	0,01	-0,66	-0,96		-0,61	-0,47	-0,55	-0,52	-0,67	-0,99	-1,53	-1,71	-1,65	-1,96
Threads to monetary stability	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-2,54	-0,81	0,14	-0,68	-0,20		0,14	0,19	0,42	0,04	0,44	0,12	-0,84	-1,94	-1,56	-25,76
The Czech Republic	-4,90	-0,29	0,13	0,30	-0,26		-0,13	0,01	0,32	-0,38	-0,65	-0,02	-0,34	1,72	-3,01	-32,09
Slovakia	-3,57	-1,36	0,09	-0,84	-0,16		-0,75	-0,09	0,36	0,15	0,40	-0,06	-0,14	-0,39	-1,57	-21,72
Hungary	-2,55	-3,15	-2,72	-0,73	-2,66		-0,17	0,18	0,54	0,48	-0,14	-1,42	-0,60	-2,25	-3,81	-31,69
Threads to stability of the financial system	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-2,40	-2,19	0,20	-0,67	0,27		1,11	0,83	0,56	0,54	-0,09	-0,18	-0,60	-0,57	-0,65	-1,79
The Czech Republic	-2,07	0,57	0,93	0,20	-0,04		0,34	0,54	0,21	0,15	0,05	0,64	0,86	0,49	0,21	-1,65
Slovakia	-2,59	-0,93	-0,23	-1,42	-0,88		-0,11	-0,05	-0,14	0,14	-0,33	-0,41	-0,10	0,35	0,20	-2,30
Hungary	-1,03	0,46	1,42	1,59	2,17		1,99	1,49	1,53	0,75	-0,98	-1,88	-2,42	-2,55	-2,22	-2,60
Total index	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-1,67	-0,92	0,22	-0,34	0,17		0,69	0,72	0,85	0,68	0,46	0,21	-0,31	-1,05	-1,16	-9,61
The Czech Republic	-2,22	0,61	0,58	0,09	-0,12		0,23	0,44	0,47	0,27	0,01	0,40	0,27	-0,34	-0,97	-11,27
Slovakia	-2,13	-0,62	-0,25	-1,19	-0,72		-0,47	-0,06	0,14	0,29	-0,12	-0,39	-0,43	-0,44	-0,96	-8,66
Hungary	-1,58	-1,16	-0,43	0,07	-0,48		0,40	0,40	0,51	0,24	-0,60	-1,43	-1,51	-2,17	-2,56	-12,08

Moreover, Poland did enjoy a six-year period during which it was the region's leader in this respect. These were the years 2012–2017, a period which, considering the delays in transmission of monetary impulses to the economy, was influenced by the central bank's decisions from 2010–2015. Although the credibility built then turned out to be unstable, these years show that in Poland the state is also capable of being credible in the area of monetary stability and the financial system.





# Labour protection and security

## Importance of work protection and safety for the country's economic credibility

Labour protection and security are an important area of economic credibility. The right to work, the sense of security related to relations with employers and the conditions of work are important pillars of the state's policy. **The definition of the right to work, provided for by Art. 23 of the UN Universal Declaration of Human Rights, states, among other things, that everyone has the right to work, to freely choose work, has the right to just and satisfactory working conditions and to protection against unemployment.**

The European Pillar of Social Rights (EFPS)<sup>7</sup>, adopted by the European Union in 2017, also addresses rights related to work and employment, including through equal opportunities and access to employment (including education, training and life-long learning, gender equality, equal opportunities, and active support for employment), and fair working conditions (safe

<sup>7</sup> [https://commission.europa.eu/system/files/2017-12/social-summit-european-pillar-social-rights-booklet\\_pl.pdf](https://commission.europa.eu/system/files/2017-12/social-summit-european-pillar-social-rights-booklet_pl.pdf), accessed on 25 October 2023.

and flexible employment, remuneration, information on employment conditions and protection in the event of dismissal, social dialogue and employee involvement, work-life balance, health, safe and well-adapted working environment, and data protection). The 'Action Plan for the European Pillar of Social Rights' adopted in 2021 set out three main objectives for the implementation of the Pillar by 2030, two of which relate to the labour market:

- at least 78 percent persons aged 20–64 should be employed,
- at least 60 percent all adults should participate in training every year.

Dimensions and indicators included in the area labour protection and security also take into account the rights specified in the EPSR.

Events that took place in recent years, including the COVID-19 pandemic and Russia's aggression against Ukraine, have had an impact on the labour market in developed countries. **In its 2023 assessment, the Organization for Economic Co-operation and Development (OECD) indicated that the labour market recovery after the pandemic has lost momentum and employment and unemployment have stabilized.** Although the quality of the labour market has improved in many dimensions, high inflation resulted in a decline in real wages – due to comparability of the indicator, we have decided not to supplement it with wage dynamics, however, should these trends continue, it may be considered in the coming years.

**Index of the country's economic credibility in the area of occupational protection and safety according to the 2022 methodology**

**In 2023, the European Commission indicates that employment in the EU countries was growing in 2022, although Poland was one of the countries where the employment growth was one of the lowest.** At the same time, the condition of the

labour market is influenced by long-term demographic trends related to the low fertility rate observed for many years, which result in gradual shrinking of labour resources. In Poland, the population loss by 2050 will be the largest in Europe (a drop of as much as 8%), which will result in a decline in economic growth potential, predicted to reach up to 9%. Therefore, it is important to properly use labour resources and to engage people in the labour market as fully as possible. **The European Commission also points out that the main challenge in Poland is work segmentation.** One of the instruments hindering provision of workers with appropriate social protection is fictitious self-employment. At the same time, civil law contracts are the most common instrument replacing full-time employment, and data suggest that 20-30 percent employees are bound by insecure contracts. This challenge has also been taken into account in the construction of the economic credibility index in the area of labour protection and security.

### **Extended index of the country's economic credibility in the area of work protection and safety**

As part of the economic credibility index, we have distinguished five dimensions of labour protection and security:

**Dimension 1.** Legal protection of employment

**Dimension 2.** Safety of working conditions,

**Dimension 3.** Non-standard employment

**Dimension 4.** Labour market participation

**Dimension 5.** Lifelong learning.

#### **Dimension 1. Legal protection of employment**

This dimension includes indicators showing what proportion of employees have been bound by contracts offering less legal protection in comparison to the type of contract that guarantees the greatest protection, i.e. an employment contract for

an indefinite period. There are two groups of employees: those employed for a fixed period and those working for less than 12 months, who, in accordance with the Polish Labour Code, enjoy limited protection and access to social rights (e.g. with regard to the notice period or the right to leave).

### **Dimension 2. Safety of working conditions**

The indicators used in calculations concern consequences of accidents at work and occupational diseases, both related to long sick leave (4 days or more) and fatal accidents. They inform how working conditions affect the health risks of employees.

### **Dimension 3. Non-standard employment**

The third dimension concerns non-standard employment, which the European Commission sees as one of the main challenges of the labour market in Poland. There are two groups of employees included in this dimension. The first of them are part-time employees. The second group are individuals with precarious employment, understood as employees whose contract length does not exceed 3 months.

### **Dimension 4. Labour market participation**

This dimension deals with participation of three groups on the labour market – firstly, all individuals aged 20–64, i.e. those who are potentially able to work. The second group consists of women within the same age limits, and the third – of persons aged 55–64. This allows us to assess how well the labour market uses available resources, taking into account groups that are exposed to the risk of lower employment.

## Dimension 5. Lifelong learning

The fifth dimension includes involvement of adult persons in various forms of lifelong learning, which evidences the labour market policy supporting development of skills that can potentially protect against the risk of job loss resulting from the lack of competencies expected by employers.

When calculating the economic credibility sub-index in the area of employment protection and security, to ensure the possibility of international comparison, taken into account have been indicators published by Eurostat.

A total of 10 indicators were included. The first three dimensions contain two indicators, the fourth – three, and the fifth – one. In order to estimate the synthetic indicator, it was necessary to adopt weights for both individual indicators and dimensions. In the first three dimensions, the indicators are assigned the same weights (i.e. a half for each of them). At the same time, due to the fact that the indicators included in these dimensions are destimulating (i.e. the higher their value, the more unfavourable the situation), the weights assigned to these indicators are negative. The indicators adopted in the fourth and fifth dimensions are stimulants, i.e. the weights assigned to these indicators are positive. In the fourth dimension, i.e. participation on the labour market, more weight (40%) was assigned to indicators concerning employment of women and people aged 55–64, and less weight (20%) was assigned to the total employment rate. All indicators in the mentioned dimension are considered to be stimulants. In the fifth dimension, there is one indicator with a weight of 100%; it is also an indicator of a stimulating nature.

This year's edition of the index also maintains the same weights for individual dimensions used to estimate the synthetic partial index for the area. These weights are as follows:

- Legal protection of employment – 20%

- Safety and working conditions – 10%
- Non-standard employment – 20%
- Participation on the labour market – 30%
- Lifelong learning – 20%

The adopted weights are not equal. **A higher weight** was assigned to the dimension related to participation on the labour market, which takes into account key indicators from the perspective of monitoring labour market effectiveness, also used to monitor implementation of the labour market strategy in the European Union.

**TABLE 13.** Synthetic value of the credibility index for the area of safety and working conditions and its dimensions for Poland

	2014	2015	2016	2017		2018	2019	2020	2021	2022	Zmiana 2022/2021 (pkt)
WEP value in 2022 for Dimension I	-0,57	-0,17	-0,45	0,04		0,43	1,31	3,03	3,81	3,68	-0,13
WEP value in 2022 for Dimension II	0,05	-0,15	0,08	-1,36		-0,35	1,04	1,15	1,15	1,15	0,00
WEP value in 2022 for Dimension III	-0,72	-0,46	0,06	0,43		0,67	1,33	1,90	2,67	2,66	-0,01
WEP value in 2022 for Dimension IV	-0,51	-0,17	0,17	0,53		0,77	0,88	1,05	1,71	2,03	0,32
WEP value in 2022 for Dimension V	-0,83	-1,67	-1,33	-0,83		2,00	0,50	-1,33	1,50	1,50	0,00
Credibility index value for the area Labour Protection and Security	-0,57	-0,53	-0,29	-0,05		0,82	1,00	1,15	2,23	2,29	0,07

Source: own study based on indicators adopted to assess subsequent dimensions

However, **lower weight** was assigned to the dimension related to safety and work conditions<sup>8</sup>.

The synthetic indicator for the entire area in 2022 is 2.29 and is positive, i.e. its value is more favourable than in the reference period 2008–2022 (Table 13). In comparison with 2021, the value of this indicator increased slightly (by 0.07 points). The increase in the value of the indicator results primarily from **improvement of the indicator in dimension IV - participation on the labour market**, where there is a visible increase in the employment rate in general, but also in employment of women (from 75.4% in 2021 to 76.7% in 2022) and persons aged 55–64 (from 54.7% in 2021 to 56.4% in 2022) – these are the highest values recorded in the analysed period.

However, worth noting is the simultaneous **decrease in values of indicators for dimensions I and III**, i.e. legal protection of employment and non-standard employment, despite the increase in employment rates. The obtained result confirms challenges for the Polish labour market related to employment segmentation, as indicated by the European Commission.

### **Extended index of the country's economic credibility in the area of labour protection and security**

Significant extension of this year's WEP edition is the comparison of the indicator value in Poland to the Visegrad countries: the Czech Republic, Slovakia, and Hungary. Table 14 and Charts 49–54 present the development of the synthetic WEP indicator in the area of labour protection and security, on the basis of the adopted methodology (the reference level refers to

<sup>8</sup> In estimating the second edition of the indicator, data for the years 2008–2022 were used, with the exception of the safety and working conditions dimension, for which data until 2020 are available. For analytical purposes, it was assumed that these data were the same in subsequent years.

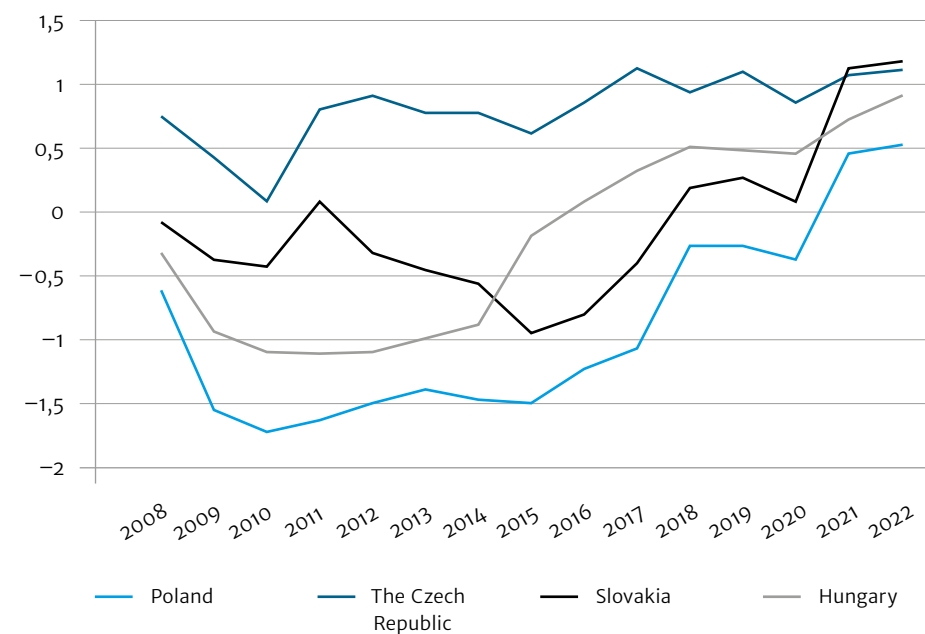


**TABELA 14.** Synthetic value of the credibility index for the area of labour protection and security in the Visegrad Group countries

	2008	2009	2010	2011	2012		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,60	-1,55	-1,71	-1,61	-1,50		-1,38	-1,45	-1,48	-1,23	-1,06	-0,26	-0,26	-0,35	0,46	0,53
The Czech Republic	0,76	0,45	0,09	0,80	0,92		0,78	0,78	0,63	0,86	1,12	0,94	1,09	0,86	1,07	1,12
Slovakia	-0,07	-0,38	-0,42	0,09	-0,31		-0,44	-0,55	-0,94	-0,79	-0,39	0,20	0,26	0,09	1,13	1,18
Hungary	-0,32	-0,93	-1,09	-1,10	-1,08		-0,97	-0,87	-0,19	0,09	0,32	0,50	0,49	0,46	0,72	0,92

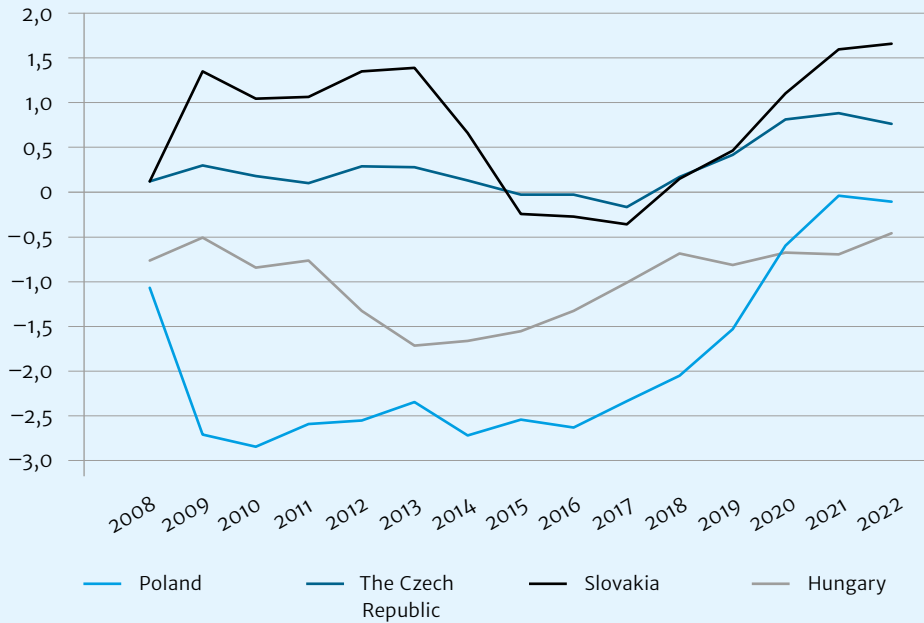
Source: own study based on indicators adopted to assess

**CHART 38.** Total WEP assessment for the area of labour protection and security in Poland, the Czech Republic, Slovakia, and Hungary in the years 2008–2022



Source: own study based on indicators adopted to assess subsequent dimensions

**CHART 39.** Total WEP assessment for the area of occupational safety and protection in the dimension of legal employment protection in Poland, the Czech Republic, Slovakia and Hungary in the years 2008–2022



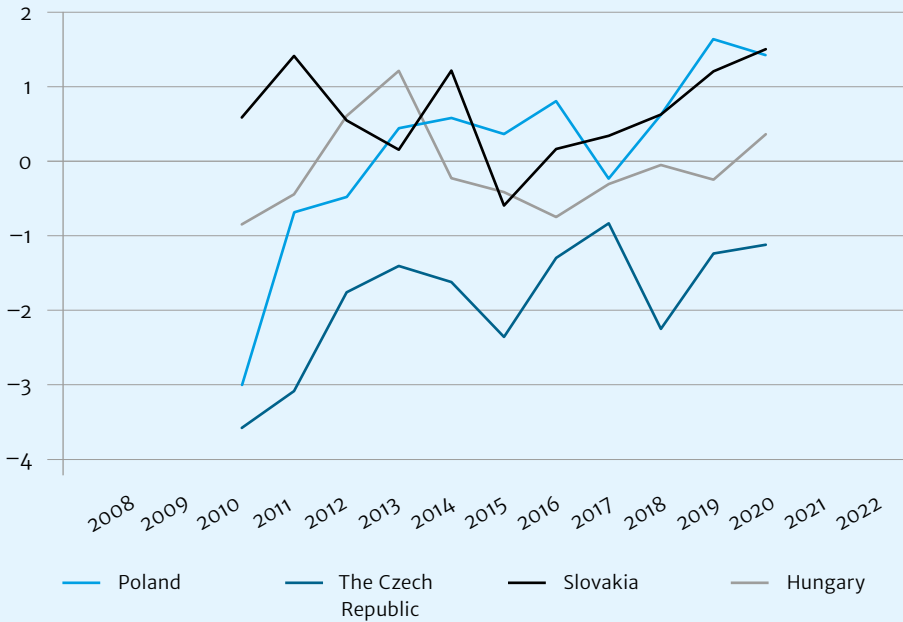
Source: own study based on indicators adopted to assess subsequent dimensions

the values of indicators in four countries in the analysed period, i.e. 2008–2022) <sup>9</sup>.

The total WEP score evidences that the indicator value for Poland has been the lowest in the entire group throughout the analysed period. At the same time, in recent years (after 2015) we have observed an improvement in the total rating in all countries, the fastest in Poland and Slovakia. In the Czech Republic, the value of the indicator was the highest until 2020, but

<sup>9</sup> In order to maintain comparability over time, data in the dimension of lifelong learning in 2022 were assumed at the 2021 level (changes introduced in the methodology of the data published by Eurostat make it impossible to compare results over time).

**CHART 40.** Total WEP assessment for the area of labour protection and security in the Dimension of safety and working conditions in Poland, the Czech Republic, Slovakia, and Hungary in the years 2008–2022



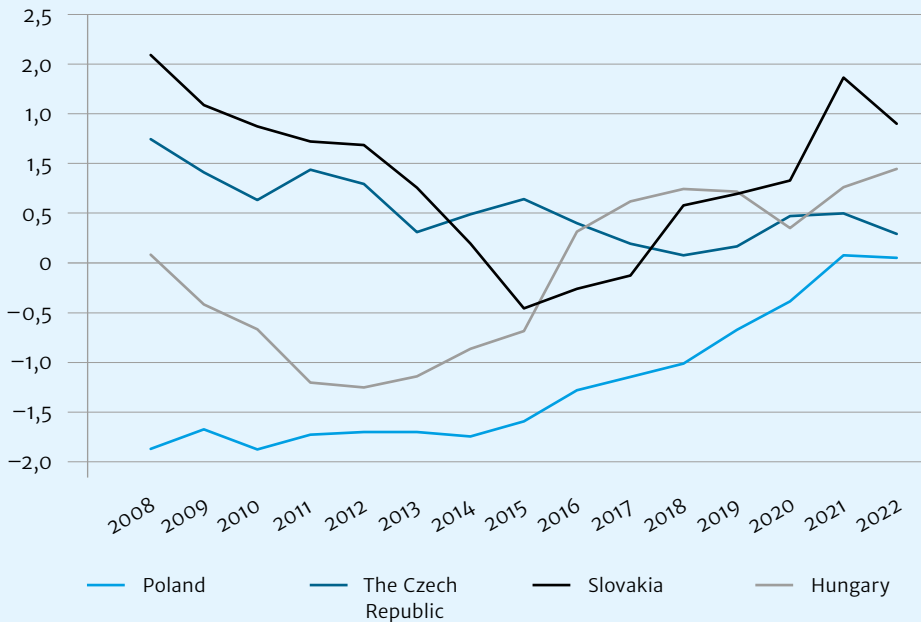
Source: own study based on indicators adopted to assess subsequent dimensions

its value did not change significantly. Over the last two years, the best situation in this area has been recorded in Slovakia.

It is worth looking at how the total assessment of economic credibility in the area of employment protection and security is influenced by its assessment in individual dimensions, which is presented in Charts 2–6.

The level of **legal protection of employment** (CHART 39), in accordance with the adopted methodology, is the best in Slovakia and the Czech Republic, where practically throughout the entire period subject to analysis (except for 2015–2017) these values remained positive, which means that they were above the median for the value observed in the discussed period in four countries.

**CHART 41.** Total WEP assessment for the area of labour protection and security in the dimension of non-standard employment in Poland, the Czech Republic, Slovakia, and Hungary in the years 2008–2022

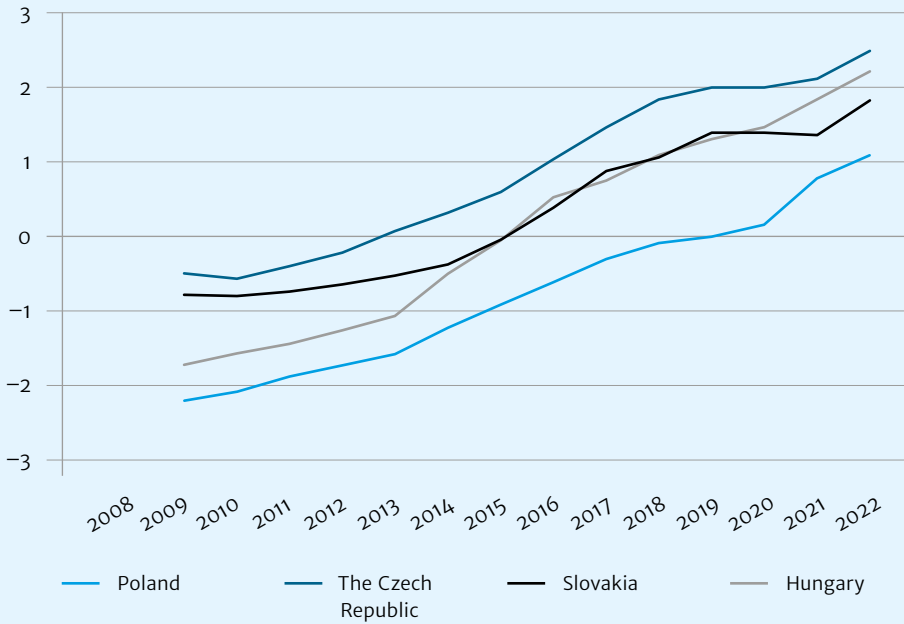


Source: CNB, MNB, NBP, NBS

The values for Poland in 2021 and 2022 are more favourable than those observed in Hungary and are close to the median.

In terms of **safety and working conditions**, the highest indicator values are observed in Poland and Slovakia, and the worst in the Czech Republic. It is worth emphasizing that in Poland the greatest improvement in the WEP assessment in the dimension of safety and working conditions is clearly visible, especially in the years 2010–2013, while in the case of Hungary and Slovakia the WEP values in this dimension remain at a similar level (around the median plus/minus one quarter deviation).

**CHART 42.** Total WEP assessment for the area of labour protection and security in the dimension of labour market participation in Poland, the Czech Republic, Slovakia, and Hungary in the years 2008–2022

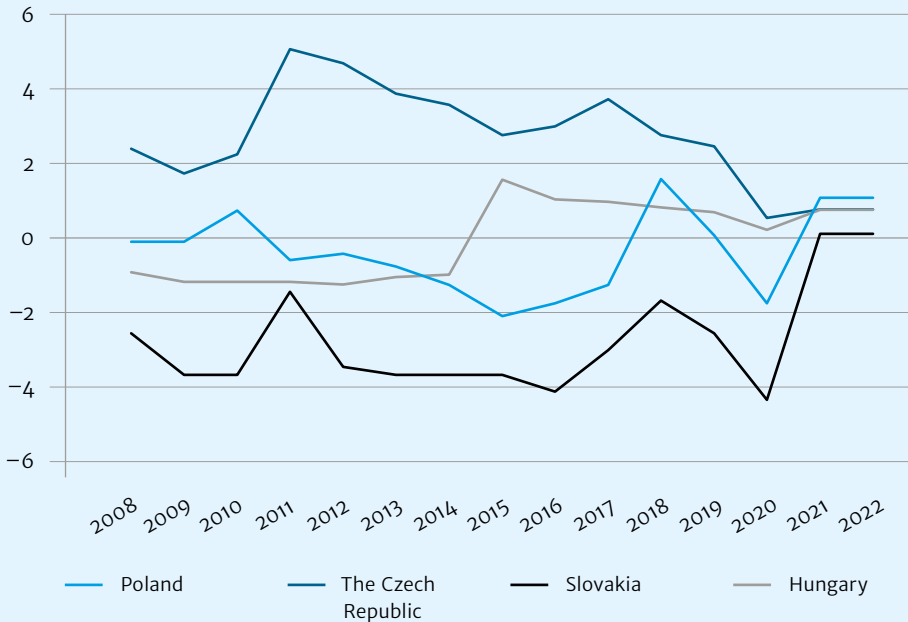


Source: Central Statistical Office and statistical offices of the Czech Republic, Slovakia, and Hungary

In the dimension related to **non-standard employment**, the situation in Poland is again the least favourable for the entire analysed period (CHART 41). At the same time, from 2008 to 2021, an improvement in the value of the indicator was observed, and in 2022 – its slight decline. Slovakia appears to be in the most advantageous situation, where since 2015 there has been a significant improvement in the occurrence of forms of non-standard employment monitored under the WEP.

In the dimension related to **participation on the labour market**, a stable improvement in the index value has been observed, resulting from the growing employment rates in the Visegrad Group. The highest WEP rating in the dimension of participation

**CHART 43.** Total WEP assessment for the area of labour protection and security in the dimension of lifelong learning in Poland, the Czech Republic, Slovakia and Hungary in the years 2008–2022



Source: Central Statistical Office and statistical offices of the Czech Republic, Slovakia, and Hungary

on the labour market throughout the entire period is in the Czech Republic, and the lowest – in Poland.

The last dimension included in the area of occupational health and safety is **lifelong learning**. In the case of this dimension, for most of the observed period, the situation was the best in the Czech Republic and the worst in Slovakia. In 2021, the WEP rating in this dimension is the highest in Poland. At the same time, it is worth emphasizing that, compared to the average in EU countries, participation in various forms of lifelong learning for adults in the Visegrad countries is very low.

## Summary

**Assessment of economic credibility in the area of labour protection and security indicates that in recent years the situation in Poland has been more favourable than the 2008-2022 average.** Although it is worth emphasizing that in 2022, the index growth dynamics decreased, mainly due to stagnation of the situation in dimensions related to legal protection of employment, non-standard employment, as well as job security. **Despite the improvement, the assessment of Poland's credibility in this area is worse than that of the other Visegrad countries, which have both higher employment rates and higher legal protection of employment.** Non-standard employment is also less common in these countries than in Poland. This means that there is less work segmentation.





# Quality of public services and public infrastructure

## Importance of quality of public services for the country's economic credibility

Quality of public services plays a key role in shaping citizen satisfaction and in the effective functioning of state administration, as well as it affects citizens' trust in state institutions and the effectiveness of fulfilling public tasks. Additionally, ever increasing social expectations and dynamic technological changes (Jensen, Andersen, Holten 2019; Kuziemski and Misuraca 2020) pose major challenges to public administration in this area.

The modern economy is global, and Poland must compete with other countries for investors, trade partners, and clients. High quality of public services is an asset for the country's image, as it contributes to increasing its competitiveness (Grigorescu, Lincaru, Pîrciog and Chițescu 2019; Ruzekova, Kittova and Steinhauser 2020; Żuczek 2022). Economies based on a qualitatively high level of education, innovation, and health care attract attention and gain trust. **Therefore, it is the task of the government to take care of the quality of provided**

public services in order to build and maintain a positive image in the international arena.

Foreign investors look at a country not only from the perspective of favourable business conditions, but also see a well-organized and effective public sector. This, in turn, boosts their willingness to invest their capital in a given country.

Entrepreneurs need a stable and efficient environment, in which they can conduct their activities. Effective administration, reliable law enforcement, good regulations and transparent procedures simplify running business activities. **Where entrepreneurs are able to rely on public services available at a high level, they are more willing to invest, develop their companies, and create jobs.**

High quality of public services also translates directly into the quality of life of citizens. This affects the level of society's

TABLE 15. Value of Poland's economic credibility index for the area of quality of public services

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Education	0,85	-0,77	0,00	-0,45	0,02	0,00	0,16	0,12	0,12
Health	0,51	0,26	0,80	0,87	0,84	1,16	-0,54	-1,50	-1,50
Public safety	-0,27	0,72	0,21	0,33	0,04	0,05	1,29	0,54	0,54
Environment	0,01	-0,23	-0,48	-0,81	-0,20	-0,08	-0,73	-0,73	-0,73
E-government	0,00	0,00	-0,72	-0,41	0,00	0,74	2,14	3,40	3,96
Cybersecurity	0,15	0,00	-0,41	-1,49	-1,98	-4,35	-7,76	-24,27	-33,10
	2014	2015	2016	2017	2018	2019	2020	2021	2022
WEPI Index for quality of public services	0,30	-0,03	0,09	-0,09	0,08	0,10	-0,26	-1,43	-1,84

Source: own study

satisfaction, and satisfied citizens are more socially active and involved in public affairs. **High quality public services influence citizens' trust in state institutions, which in turn promotes greater acceptance of public policies and social stability** (Carter and Bélanger 2005; Grimmelikhuijsen and Knies 2017). Improving the quality of public services contributes to increasing the efficiency of public administration through better use of resources and reducing bureaucracy.

## WEP index in the area of monetary stability and the financial system according to the 2022 methodology

In the area of the quality of public services, Poland's economic credibility calculated according to the 2022 methodology has declined even more. **While the indexes for the dimensions education, public health and safety, and environment have remained at a similar level, a further increase in credibility in e-government and a simultaneous strong decline in cybersecurity are observed.** This second dimension is largely related to the outbreak of the war in Ukraine, which generated a very large increase in cyberattacks. It translated into a very strong decline in credibility both in 2021 and 2022.

## Extended WEP index (for the V4 group of countries) in the area of quality of public services and public infrastructure

Similarly to other WEP areas, public services also required some changes to the set of indicators which were used for calculations. This was caused by no access to data enabling international comparison. Additionally, the environment was separated from public services and made a separate area of analysis in this edition. Therefore, in the WEP 2023 edition, economic credibility with regard to the quality of public services and public infrastructure is measured in five dimensions<sup>10</sup>:

- Dimension 1.** Education
- Dimension 2.** Health security
- Dimension 3.** Public safety
- Dimension 4.** E-government
- Dimension 5.** Cybersecurity

<sup>10</sup> In comparison with the last year's ranking, the environment dimension has been made a separate area subject to analysis.

## Dimension 1. Education

**Education** was assessed with the use of 3 indicators:

- average score in the international PISA competence test for 15-year-olds,
- percentage of persons with primary and lower secondary education,
- public spending on education (percentage of GDP).

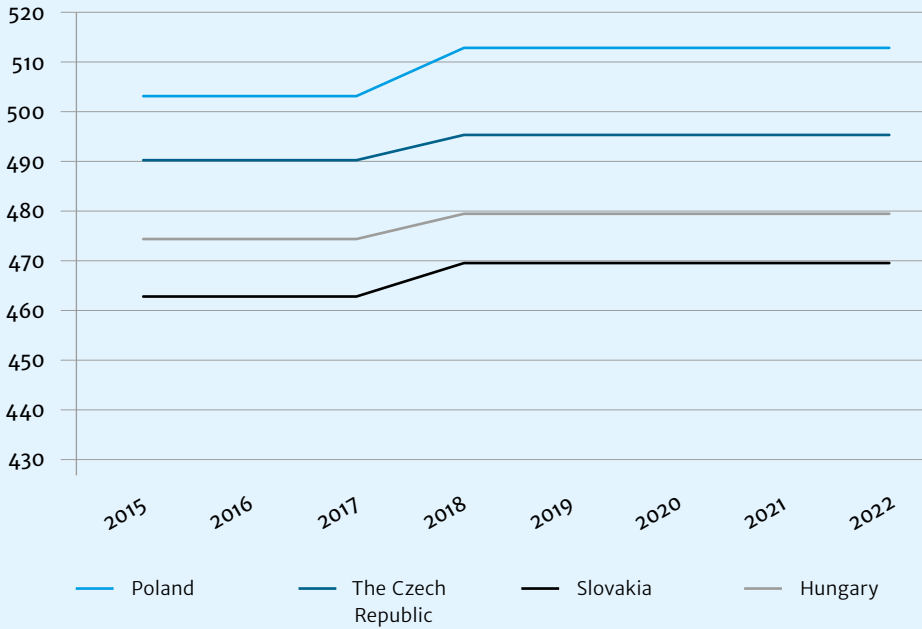
So far, results of Polish students in the PISA tests have been quite good, however, attention should be paid to the significant risk of deferred effects of the educational policy. **Taking into account the decline in relative public expenditure on education, as well as the change in organization of the education system, which shortened the period of general education according to the same core curriculum by one year, subsequent editions of the examination of skills of students over 15 years of age may unfortunately render worse results.**

TABLE 16. WEP index for the area education

	2015	2016	2017	2018	2019	2020	2021	2022
Poland	1,24	1,19	1,01	1,16	1,21	1,29	1,28	1,29
The Czech Republic	-0,04	-0,07	-0,30	0,05	0,58	0,88	0,92	0,88
Slovakia	-0,61	0,04	-0,91	-0,66	-0,65	-0,53	-0,50	-0,45
Hungary	-1,15	-1,28	-0,94	-0,98	-1,07	-1,24	-1,18	-1,12

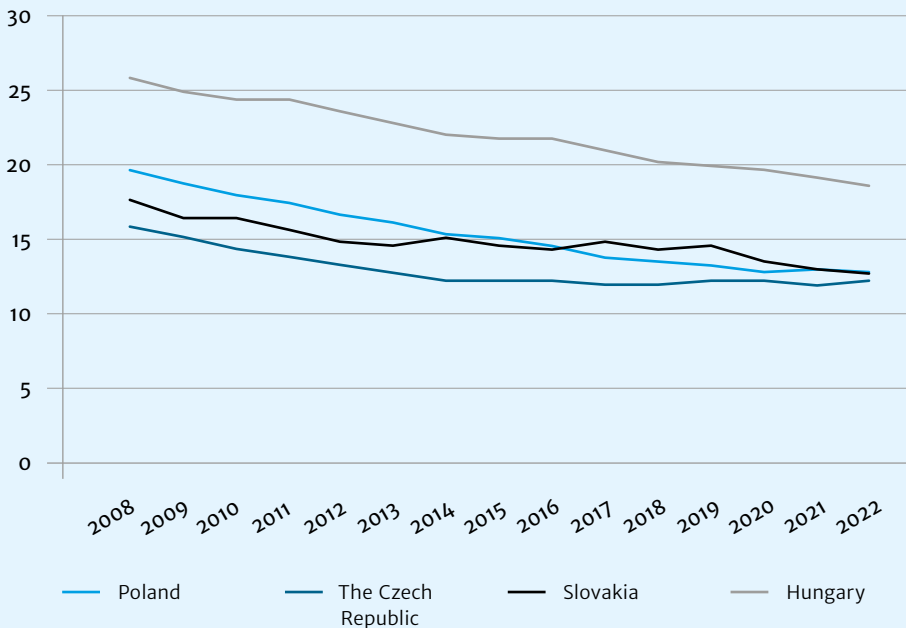
Source: own study

**CHART. 44** Points scored in the PISA ranking (average of 3 criteria)



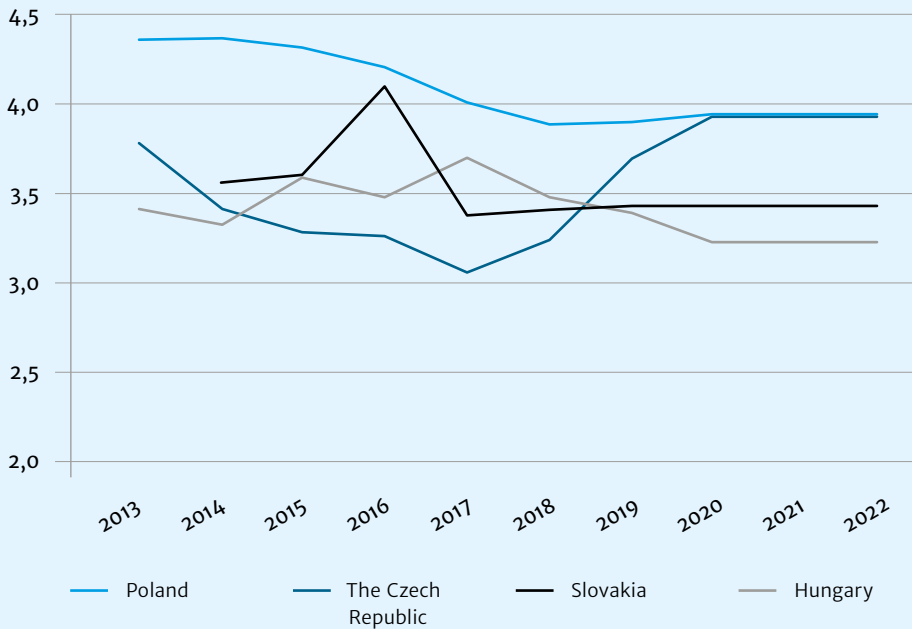
Source: own study

**CHART 45.** Percentage of people with primary and lower secondary education



Source: own study

**CHART 46.** Public spending on education (percentage of GDP)



Source: own study

## Dimension 2. Health

The dimension **health** was analysed with the use of 2 indicators:

- percentage of the population which assesses their health as poor or very poor,
- years of healthy life in absolute value at birth.

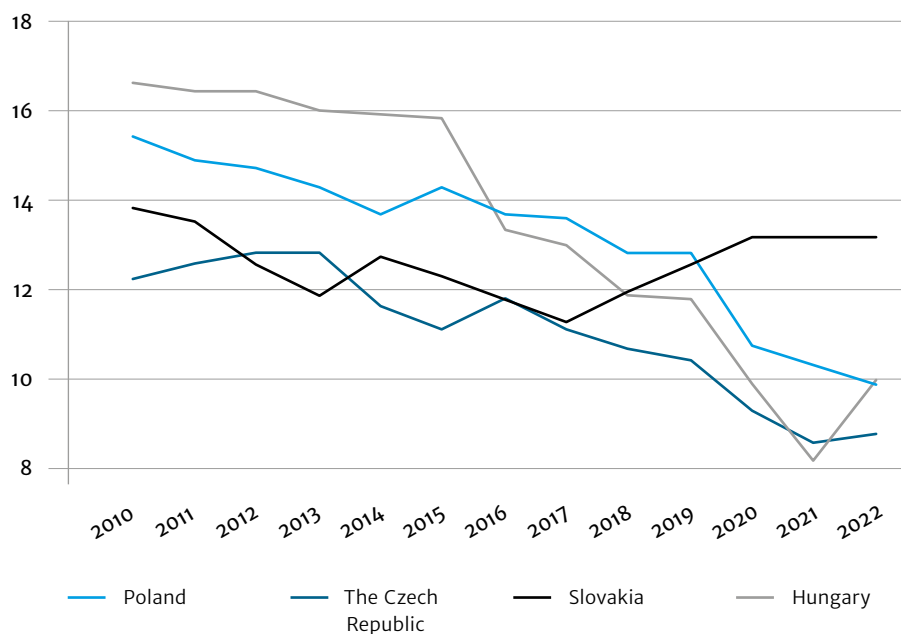
If we compare the four Visegrad Group countries in terms of health security, the situation of Slovakia is clearly worse. The remaining countries present a similar level. An interesting phenomenon influencing these results is people's better assessment of their health since 2020. This is probably related to the COVID-19 pandemic, which has slightly changed the reference point for this subjective indicator.

TABLE 17. WEP index for health

	2015	2016	2017	2018	2019	2020	2021	2022
Polska	-0,55	-0,09	-0,21	0,18	0,20	0,95	1,14	1,30
Czechy	0,95	0,73	0,67	1,06	1,05	1,41	1,69	1,61
Słowacja	-0,95	-0,43	-0,43	-0,62	-0,84	-0,98	-0,98	-0,98
Węgry	-1,58	-0,48	-0,29	0,30	0,45	1,33	2,00	1,29

Source: own study

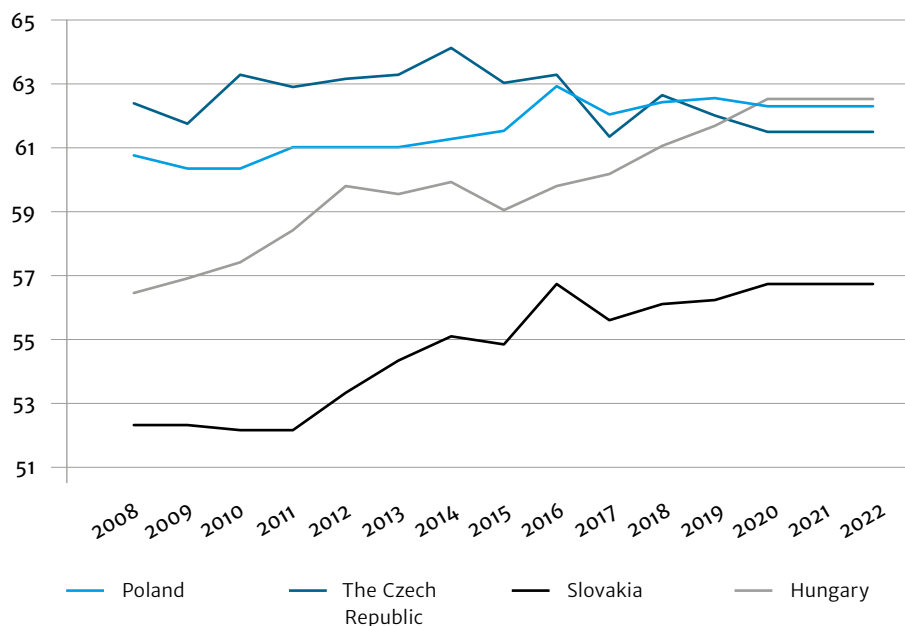
CHART 47. Percentage of the population perceiving their health as poor or very poor



Source: own study



CHART 48. Years of healthy life in absolute value at birth



Source: own study

### Dimension 3. Public safety

The following indicators influenced the value of the index in the **public safety** dimension:

- number of homicides per 100,000 residents,
- robberies per 100,000 residents,
- sexual violence per 100,000 residents,
- national defense spending (percentage of GDP).

**The table below shows improvement in public safety, which is characteristic not only for Poland, but also for the other analysed countries.** Certain deterioration in police statistics since 2020 is a somewhat interesting phenomenon. The sub-index for

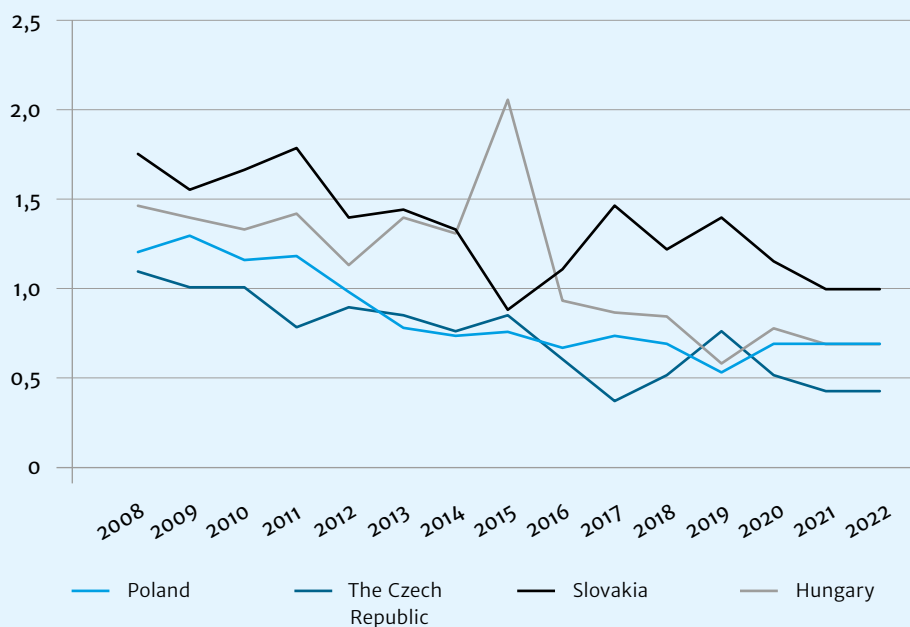
this dimension does not fully reflect this trend, as expenditure on national defense has been systematically increasing in recent years and in Poland it exceeded 2% of GDP (for other countries this indicator ranges from 1.4 to 1.7 percent).

**TABLE 18.** WEP index for public safety

	2015	2016	2017	2018	2019	2020	2021	2022
Poland	1,15	0,96	0,94	1,18	1,17	1,60	1,37	1,37
The Czech Republic	-0,43	-0,14	-0,03	0,04	-0,12	0,32	0,43	0,43
Slovakia	0,01	-0,14	-0,42	-0,09	0,32	0,85	0,73	0,73
Hungary	-1,40	0,20	0,33	0,50	0,93	1,37	1,23	1,23

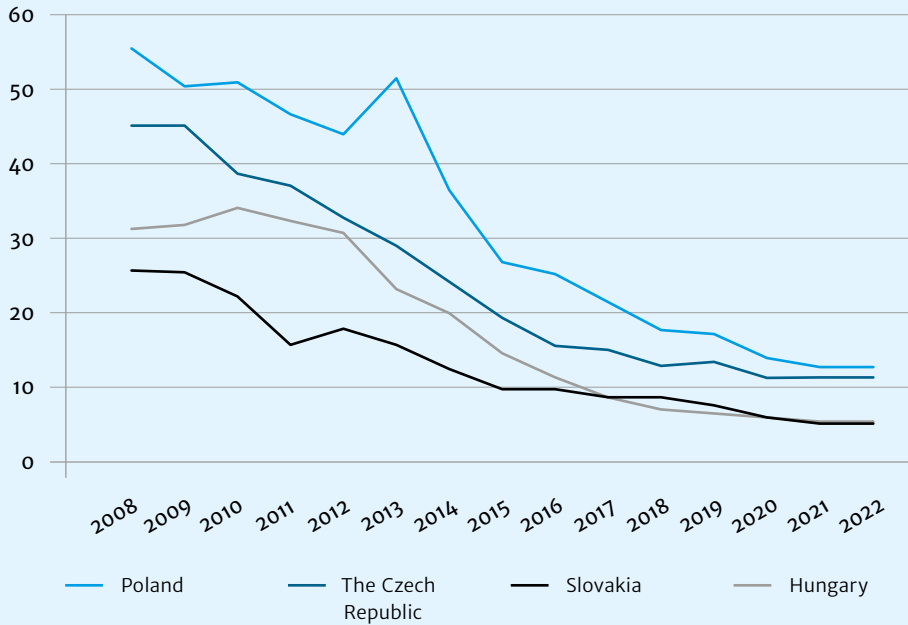
Source: own study

**CHART 49.** Number of homicides per 100,000 inhabitants



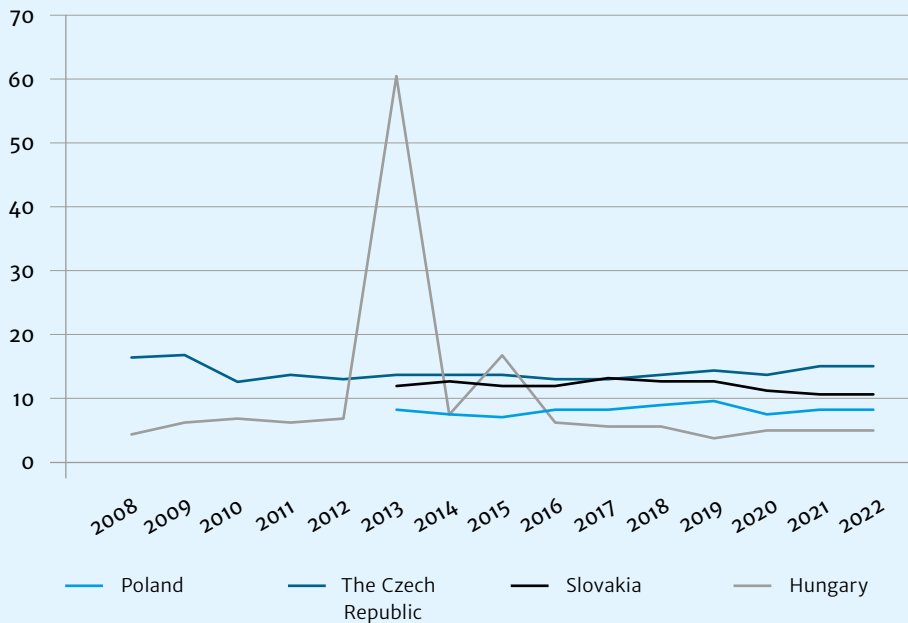
Source: own study

**CHART 50.** Robberies per 100,000 inhabitants



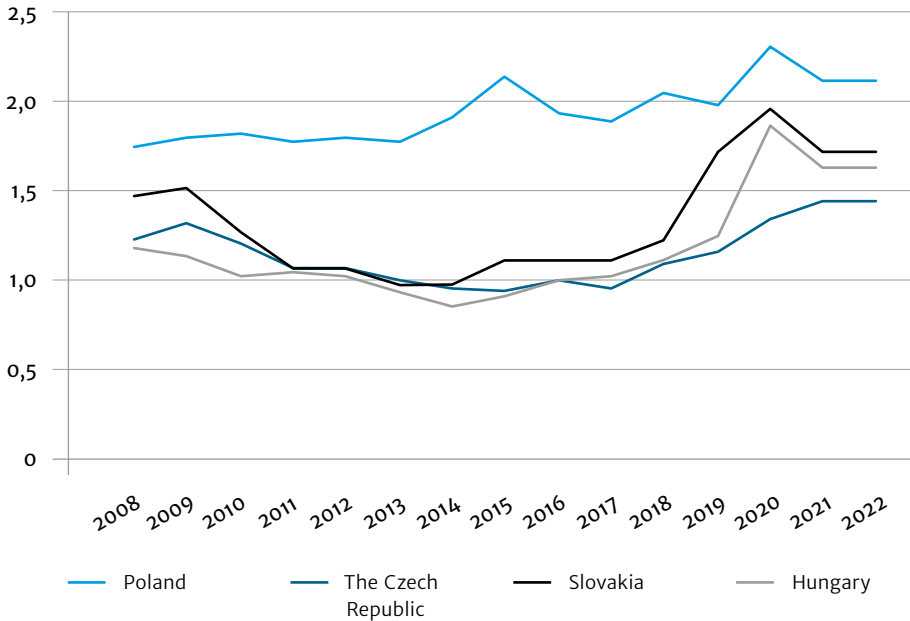
Source: own study

**CHART 51.** Sexual violence per 100,000 people inhabitants



Source: own study

**CHART 52.** National defence spending (percentage of GDP)



Source: own study

#### Dimension 4. E-government

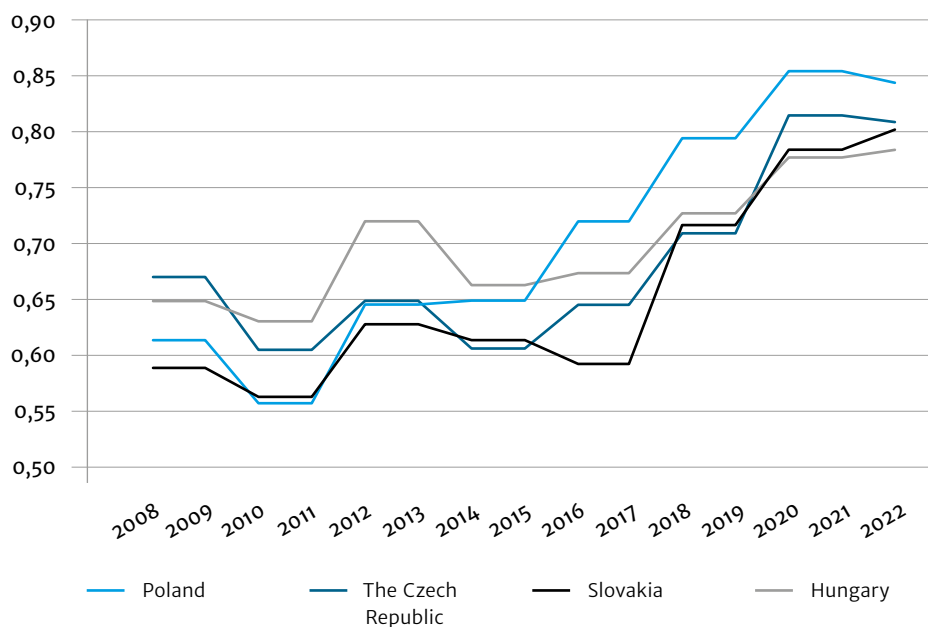
**E-government** is assessed from the perspective of the E-government Development Index conducted by the United Nations. **All Visegrad Group countries are systematically improving their results in this ranking, however, Poland unfortunately fell from the position of leader of this group in 2016 to the position of an outsider.**

TABEL 19. WEP index for e-government

	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,09	0,72	0,72	1,52	1,52	2,19	2,19	2,09
The Czech Republic	-0,98	-0,22	-0,22	1,02	1,02	3,10	3,10	3,00
Slovakia	-0,66	-1,03	-1,03	0,93	0,93	1,98	1,98	2,28
Hungary	0,19	0,47	0,47	1,81	1,81	3,06	3,06	3,27

Source: own study

CHART 53. Value of E-government Development Index



Source: own study

## Dimension 5. Cybersecurity

**Cybersecurity** is measured by the Global Cybersecurity Index, which assesses the country's engagement in five pillars: (1) legal measures, (2) technical measures, (3) organizational measures, (4) capacity development, and (5) cooperation. **Poland does well in this ranking. According to the latest ranking, it has been ranked 30th out of 182 countries included in the ranking.** Slovakia reached 34th position, Hungary 35th, and the Czech Republic 68th position.

TABELA 20. WEP index for cybersecurity<sup>11</sup>

	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,80	-0,80	0,53	1,60	1,60	1,33	1,33	1,33
The Czech Republic	-0,41	-0,41	0,00	-2,46	-2,46	-2,26	-2,26	-2,26
Slovakia	1,06	1,06	-5,41	-1,18	-1,18	0,12	0,12	0,12
Hungary	2,49	2,49	-2,10	0,52	0,52	0,00	0,00	0,00

Source: own study

<sup>11</sup> W porównaniu z WEP 2022, w tegorocznej edycji wykorzystano inny miernik do oceny obszaru cyberbezpieczeństwa (liczba unikalnych incydentów bezpieczeństwa zgłoszonych do CERT Polska vs miejsce w rankingu Global Cybersecurity Index). W związku z tą zmianą można zaobserwować nieco inny trend niż ten, który był zauważalny w zeszłym roku. Sytuację można zinterpretować w ten sposób, że poziom cyberbezpieczeństwa na świecie w ostatnich latach bardzo szybko się obniża. Słowacja i Czechy na tle innych krajów na świecie wypadają lepiej niż w latach wcześniejszych. Polska natomiast zrobiła pewien postęp w tym zakresie, jednak dużo mniejszy niż inne kraje V4.

## Summary

While analysing of the total value of the index for quality of public services we should appreciate that Poland has achieved quite a good result. However, one should also bear in mind the detailed issues raised above, especially within the field of education, crime rates, and the underutilized potential for the development of e-government.

**TABLE 21.** Total WEP index for the dimension Quality of public services and public infrastructure

	2015	2016	2017	2018	2019	2020	2021	2022
Poland	0,34	0,50	0,55	0,95	0,97	1,36	1,36	1,40
The Czech Republic	0,03	0,10	0,10	0,20	0,29	0,81	0,93	0,88
Slovakia	-0,39	-0,15	-1,10	-0,40	-0,36	-0,01	-0,03	0,01
Hungary	-0,84	-0,12	-0,40	0,20	0,33	0,74	0,92	0,74

Source: own study

**Despite progress, Poland continues to face challenges related to the quality of public services.** Insufficient coordination between institutions, insufficient human and financial resources and the lack of appropriate assessment of citizen satisfaction may negatively affect the quality of this type of services. Therefore, more and more attention should be paid to implementing quality management strategies in the public sector and increasing public participation in decision-making processes.

The above analysis of indicators and trends provides important guidance for public management activities to continuously improve the quality of public services. Despite development seen in Poland, there is a gap separating us from highly advanced

societies. Reducing it requires a radical increase in the level of intellectual capital to the extent that would allow us to change the position of our economy on a global scale. **That is why it is so important that education, as one of the universal public services, keeps up with the needs of economic, technological, socio-cultural development and megatrends.** In recent years, Poland has been able to boast a relatively good ratio of education expenditure to GDP. Polish students also performed well in PISA tests. However, what is worrying is the recently decreasing value of the schooling rate and the higher number of pupils and students per teachers and academic staff in comparison with the neighbouring countries (Poland – 14.5 persons, Czech Republic – 13 persons, Slovakia – 11.6 persons, and Hungary – 12.7 persons). **Public authorities should also ensure greater availability of teaching staff by using various incentives for taking up the teaching profession, of which there has been a great shortage in recent years.**

In terms of public safety, crime statistics are worrying and have worsened since 2020. It is worth following this trend and taking necessary countermeasures. **However, the biggest problem in Poland are crimes against family and care, the number of which has been growing dramatically since 2018 and the decreasing detection of economic crimes.**

**The development of e-government in Poland and other countries has been strongly stimulated in recent years by the COVID-19 pandemic.** Citizens were convinced to use remote forms of handling official matters, despite the very low quality of the ePUAP system. However, more and more Poles use various forms of e-government, which is also shown by other indicators (not included in the index).

We should also be aware that in the future provision of public service in Poland will be faced with challenges related to demographic changes, technological progress, and changing expectations of citizens. Development of information technologies may improve access to public services, but will also require



effective management of personal data and privacy protection. At the same time, demographic evolution, including population aging, will require adapting public services to new needs and requirements.



# Climate and environment

## Importance of climate and environment for the economic value of the country

In the modern world, the credibility of a country, including its economic credibility, must include the area of the environment and its protection. **Common aspirations of countries supported by adopted conventions and programmes show that the environment is becoming inextricably linked to the broader context of social and economic development<sup>12</sup>.** One should also bear in mind that the systemic approach emphasising complexity and interactions of phenomena in the environment does not replace the need of taking up traditional, specific actions aimed at eliminating local sources of environmental threats, but at complementing them. It is through implementation of environmental protection policy, that the EU countries, including Poland, have achieved a significant reduction in pressure on the environment by eliminating sources of pollution and emissions. The current pressure on the environment

<sup>12</sup> European Environment Agency, 2019, European Environment 2020 – state and outlook, Copenhagen

and its degradation is increasingly related to systemic, supra-local, and interconnected causes.

Evolution of the nature of environmental challenges is presented in the table below.

**TABLE 22.** Evolution of environmental challenges

Character of the challenge	concrete	dispersed	systemic
Characteristics	Linear relationship, cause and effect relationship; large, local sources	Cumulative causes; many sources, often regional	Systemic, interconnected, often global causes
In the spotlight, in the years	- in the EU in the 1970s and 1980s - in Poland in the 1990s	- in the EU in the 1980s and 1990s. - in Poland in the 21st century	- in the EU in the 1990s and 21st century - in Poland in the 21st century
Problems (examples)	Acid rain; surface water pollution	Transport emissions; smog; eutrophication	Climate change; loss of biodiversity
Dominating response	Actions and instruments for specific problems	Integrated activities; raising public awareness	Activity packages; systemic approach

Source: EEA 2010, European environment – state and outlook 2010: Synthesis, EEA, Copenhagen and own study

### **Index of the country's economic credibility in the area of climate and environment according to the 2022 methodology**

The above-mentioned evolution of environmental challenges renders the traditional, narrow approach insufficient. Long-term,

systemic challenges are being addressed, although restoring sustainability of ecosystems, improving quality of life, and limiting climate change take much more time than reducing local pressure on the environment. In Poland, both types of activities and challenges are still needed. The country's credibility within the field of the environment is manifested by the activities and effects of these activities in both types of threats: traditional ones, in which the pressure on the environment can be reduced and the damage contained, and systemic, complex ones, in which many causes lead to environmental degradation.

### **Extended index of the country's economic credibility in the area of climate and environment**

Therefore, the index concerning the country's credibility within the climate and environment area includes the two dimensions indicated above.

Taking into account availability of historical data for selected countries, i.e. Poland, the Czech Republic, Slovakia and Hungary, reliability and comparability of data sources and the purpose of the project, the index in the area of climate and environment was developed on the basis of databases from international and national organizations, from which the values were taken according to availability in May 2023. The main data sources are Eurostat, OECD, and Central Statistical Office. In a single case, there was used an own index concerning implementation of the main environmental protection and pollution prevention conventions. **From the point of view of the country's credibility, compliance with or failure to comply with international obligations, even if this merely means regular publication of reports showing trends in changes, is an action important from the point of view of the entire Report's purpose.** For both investors and their employees, the importance of the environmental dimension is ongoing and, as indicated above, long-term.

When proposing detailed solutions for the area climate and environment, e.g. assigning weights to individual dimensions and areas, there were used available sources and already existing, generally recognized sustainable development indicators, such as EDI – Environmental Development Index<sup>13</sup>, Living Planet Index<sup>14</sup>, Resource Governance Index<sup>15</sup>, and Environmental Vulnerability Index<sup>16</sup>.

The country's economic credibility in climate and environment area is analysed on the basis of seven independent dimensions:

**Dimension 1.** Climate

**Dimension 2.** Air

**Dimension 3.** Waste

**Dimension 4.** Water

**Dimension 5.** Biodiversity

**Dimension 6.** Resources

Ultimately, 13 indicators have been used for the purpose of calculating the climate and environment index.

### **Dimension 1. Climate**

The indicators in the dimension climate are: the share of renewable energy in total energy consumption and greenhouse gas emissions per person. The trends in both of these phenomena illustrate, on the one hand, long-term results of the country's activities within the field of climate protection, which affect the global dimension of the challenge, and, on the other hand, indirectly, illustrate economic prospects linked to the energy policy for the economy. **The energy industry remains**

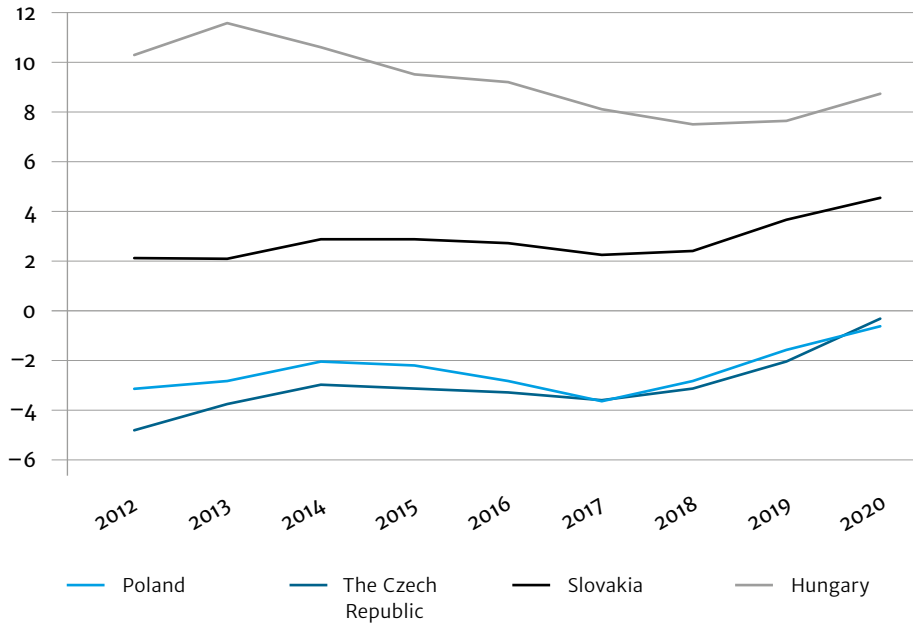
<sup>13</sup> <https://epi.yale.edu/>

<sup>14</sup> [www.livingplanetindex.org](http://www.livingplanetindex.org)

<sup>15</sup> <https://resourcegovernanceindex.org/>

<sup>16</sup> <https://pacific-data.sprep.org/dataset/progress-report-environmental-vulnerability-index-evi-project-progress-towards-global-evi-1>

CHART 54. Climate



Source: own study based on the Eurostat and OECD data

**the main emitter of greenhouse gases.** EU obligations and the European Green Deal, including the reformed ETS system, may become a direct burden on the economy, while opportunities related to implementation thereof may remain untapped. Therefore, this dimension illustrating credibility of a country implementing the climate policy, is also related to the current challenges influencing economic decisions.

Greenhouse gas emissions and energy production with the use of renewable sources, which make up the dimension Climate, indicate that in recent years there has been no significant change in the position of the analysed countries, resulting mainly from the persistent, significant difference in emissions per capita. Hungary, with significantly lower emissions, enjoys

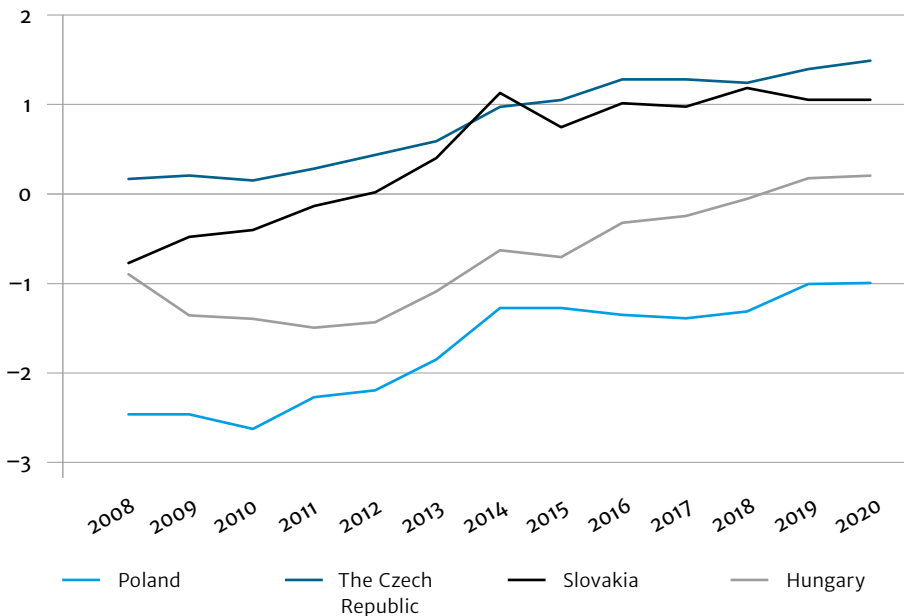
the most favourable situation in this dimension. Nevertheless, the sub-index is gradually improving in all countries.

## Dimension 2. Air

Used in the air dimension were two indicators, i.e. PM 2.5 emission and the number of premature deaths related to air pollution. Similarly to the calculation of other indicators, they were converted into values taking into account the population.

**Air pollution continues to exert a significant impact on the quality of life and health of citizens in Europe. Additionally, increased emissions affect ecosystems as they cause eutrophication through the deposition of excess nitrogen. In terms of air pollution in the analysed period, the most unfavourable situation is observed in Poland. The great-**

CHART 55. Air



Source: own study based on the OECD data



**est progress in this respect has been made in Slovakia. In Hungary, thanks to relatively low dust emissions, the situation is the best.**

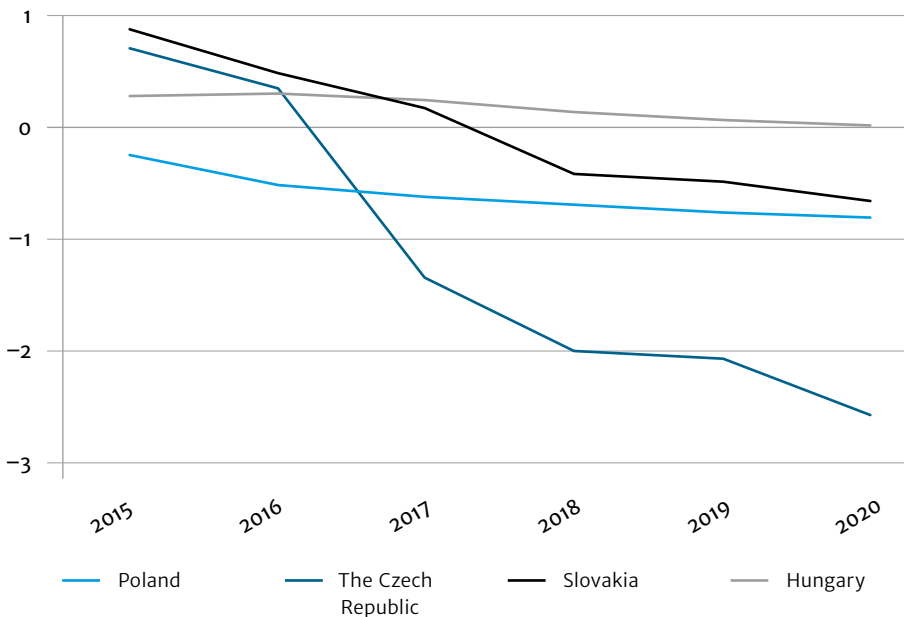
### Dimension 3. Waste

There were two indicators included in the waste dimension: the amount of total waste (i.e. waste from business activities and households) and generated municipal waste generated. Both values were calculated per capita.

**In relation to waste, past trends continue to be visible.**

Firstly, there was observed an increase in the total amount of waste generated in Europe (with large differences between countries). Secondly, the volume of waste was decoupled from the economic and population growth. Thirdly, waste management has been improving, by means of, among others, increasing

CHART 56. Waste



Source: own study based on the Eurostat and Central Statistical Office data

recycling rates and reducing dependence on landfills. Significant regional differences in the management and quality of recycled materials were recorded.

**In all analysed countries, the waste situation deteriorated, and it was in the Czech Republic that this process took place most rapidly. Deterioration was also observed in Poland, mainly due to the increasing volume of total waste.**

#### **Dimension 4. Water**

Indicators applied in calculating the water dimension include: total water consumption, share of the population covered by the sewage treatment process, and amount of treated sewage.

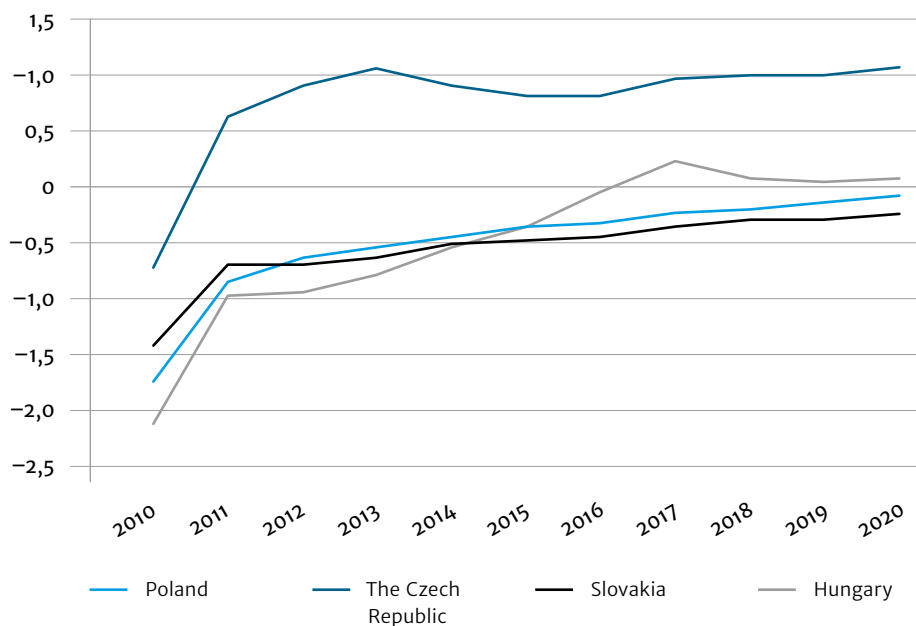
Growing demand for water in households, industry, and agriculture creates rapidly increasing challenges for the rational management of this resource.

**Uncertainty about future water availability and universal access thereto has been increasing on all continents.**

According to the World Economic Forum's report 'Water availability', water availability, water scarcity, and its management are among the main development risks. Global trends point to a relative decoupling of water use from the economic growth.

**Despite this, by the year 2030, water scarcity is expected to be up to 40% of the water demand.** Hence, appropriate water management, one that is multi-faceted and covers a wide range of issues, as well as ensuring appropriate quality of water, are of great importance for credible economic development.

CHART 57. Water



Source: own study based on the Eurostat data

**Water and sewage management is best developed in the Czech Republic.** In other countries, the index values are similar, which should mean that gradual improvement in this area occurs at a similar pace.

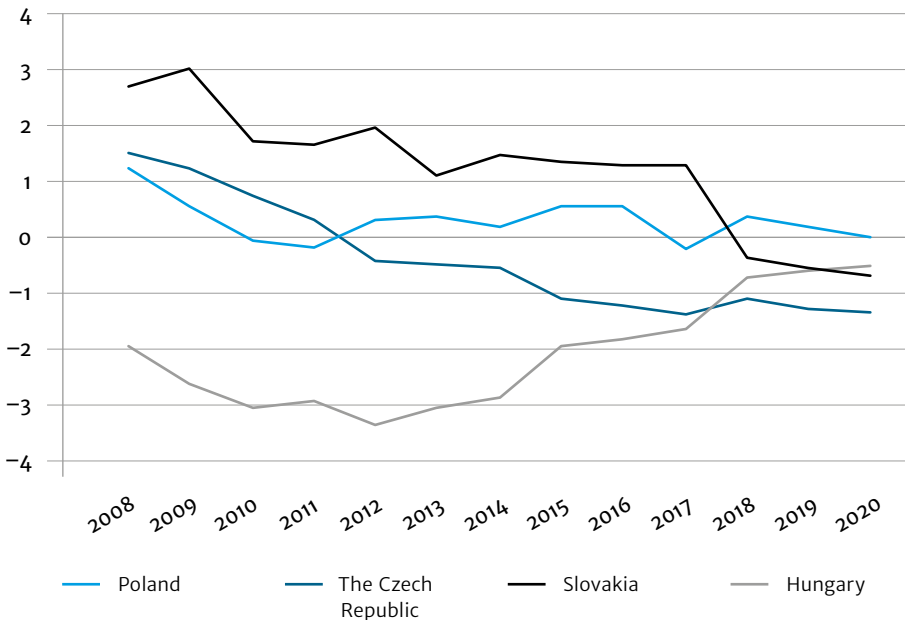
### Dimension 5. Biodiversity

Preserving biodiversity or limiting its degradation, as well as the challenges related to climate change, are becoming as important for the society and economy as clean water or air because of the value of ecosystem services and natural capital<sup>17</sup>.

<sup>17</sup> See e.g. Mizgajski A., 2010. Świadczenia ekosystemów jako rozwijające się pole badawcze i aplikacyjne, *Ekonomia i Środowisko*, Białystok; UN-ECE, 2018, *Forests and Water Valuation and payments for forest ecosystem services*; IPBES, 2019, *Global assessment report on biodiversity and ecosystem services of the Intergovernmental Science-Policy Platform on*

This aspect has been quite recently recognized in environmental protection. From the point of view of the country's economic credibility, it is a relevant one because the use of natural capital currently takes place at the expense of limiting its volume in the future, and therefore the possibility of using it by the future generations. For the purpose of analysis of the biodiversity dimension, there were used two indicators: FBI, i.e. the agricultural landscape bird abundance index, and the implementation index of the main environmental protection and pollution prevention conventions.

**CHART 58. Biodiversity**



Source: own study based on the OECD data and own indicator

Biodiversity and Ecosystem Services. E. S. Brondizio, J. Settele, S. Díaz, and H. T. Ngo (editors), Bonn

**Biodiversity has gradually deteriorated in all countries with the exception of Hungary. The fastest degradation occurred in the Czech Republic. No significant change of the situation has been seen since 2018.**

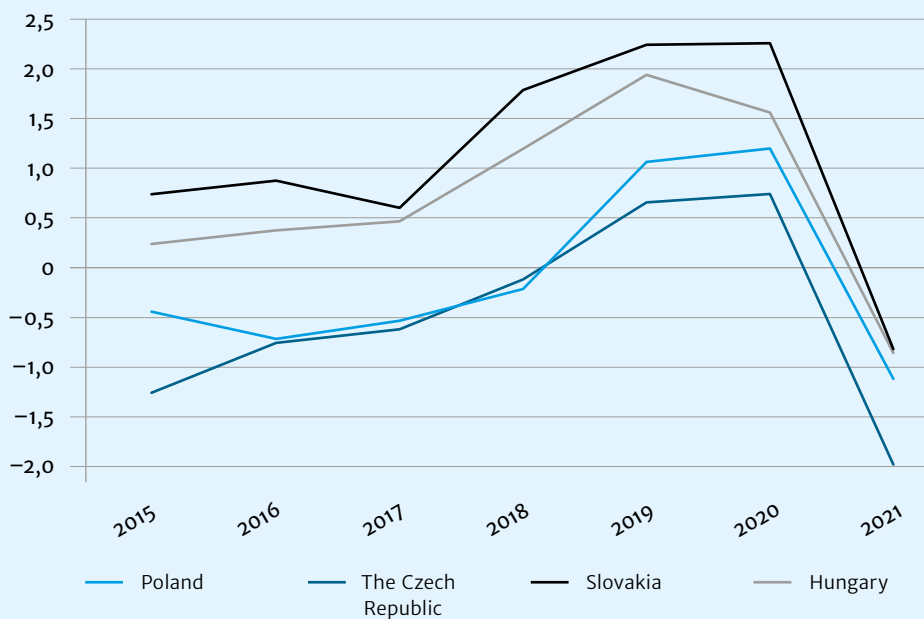
## **Dimension 6. Resources**

The resources dimension analyses the resource intensity of the economy and its energy consumption in a dynamic approach, i.e. over the years, and in a comparative approach, i.e. in comparison with other countries in the region.

The resources dimension relates to efficient management of resources and activities towards sustainable manufacturing and consumption. Historically, trajectory of the use and management of natural resources has been unsustainable. **The policy of resource efficiency and sustainable consumption and manufacturing promotes stronger economic growth, improves prosperity and its distribution, and reduces resource consumption**<sup>18</sup>. Activities in this area, by their very nature, do not bring results quickly, but require long-term systemic actions. The use of natural resources and energy is gradually improving in all countries. The situation in Slovakia is the most favourable, and the most favourable changes have occurred in recent years in the Czech Republic and Poland.

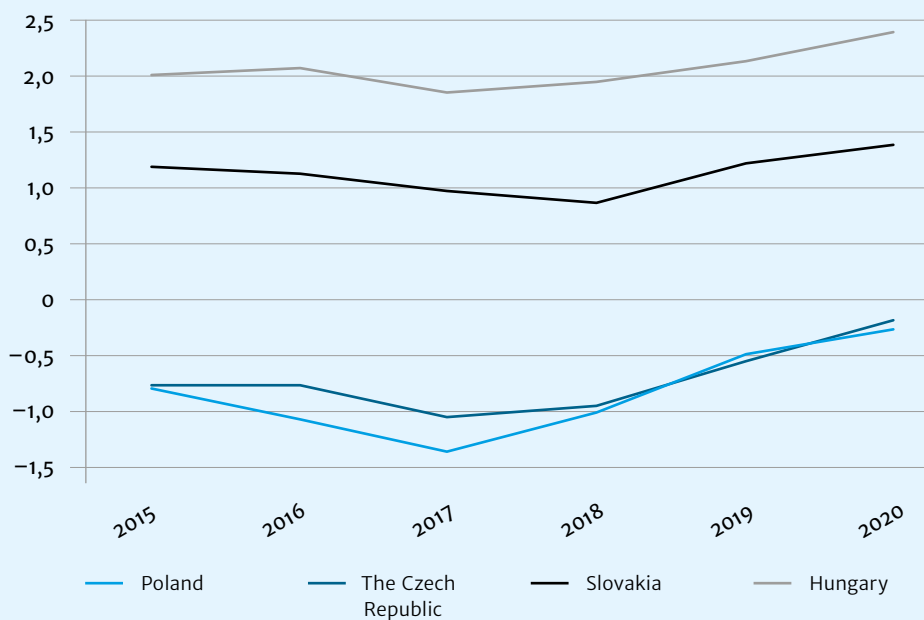
<sup>18</sup> See. e.g. IRP (2019). Global Resources Outlook 2019: Natural Resources for the Future We Want. Nairobi, Kenya.

CHART 59. Resources



Source: own study based on the Eurostat and OECD data

CHART 60. Total index



Source: own study

## Summary

The climate and environment dimensions have allowed us to compose a sub-index for the entire area. Credibility of countries in this area varies. Firstly, two countries, i.e. the Czech Republic and Poland, fare very similarly and much worse than the other countries, i.e. Hungary and Slovakia. This is mainly due to differences in emissivity, and more broadly, the climate sphere and the resources area, along with the weights assigned thereto. Secondly, there has been an improvement in the situation after 2017, clearly visible in all analysed countries. Thirdly, **Hungary clearly leads in the climate and environment area. Slovakia falls behind this leader, but it dominates even more clearly over the Czech Republic and Poland.** Environmental and climate challenges remain important for all countries in the region. **It should be added, however, that negligence in this area consisting in ineffective implementation of regulations, poor environmental monitoring and inspections, insufficient financial resources, as well as omissions result in growing, but often hidden environmental threats.** These only come to light in dramatic circumstances, such as the ecological disaster on the Oder River, fires in landfills, or the level of air pollution forcing the youngest and oldest inhabitants of a given area to stay in their homes.





# Respecting international obligations

## Importance of respecting international obligations for the country's economic credibility

The rule of law, which involves the Member States respecting the *acquis communautaire*, is fundamental to the functioning of the EU and the Single Market. The fundamental importance of Poland respecting international obligations is related to the fact that the Polish economy is characterized by a high level of internationalization (economic cooperation mainly with the EU countries: trade in goods and services, direct and indirect foreign investments, tourism, local border traffic, financial transfers from abroad, etc.) and with Poland's membership in the European Union (funds) and the resulting membership in the Single Market (free movement of services, goods, capital, and people).

## Index of the country's economic credibility in the area of respecting international obligations according to the 2022 methodology

Poland's credibility in terms of compliance with international obligations is shaped primarily by the policy of the Polish authorities [(implementation of international treaties and the EU legislation, including judgments of the Court of Justice of the EU (CJEU) and the European Court of Human Rights (ECtHR)] and changes in the Polish justice system and their compliance with international and EU legislation, as well as the functioning of the Polish judiciary (its jurisprudence in response to judgments of the European judiciary, its independence closely linked to the issue of the EU conditionality).

Changes in the judiciary have led to serious transformations in the personnel structure thereof. The National Council of the Judiciary, considered by European courts to have been elected contrary to fundamental rights (hence called the neo-National Council of the Judiciary), has in the last few years nominated almost 30 percent of the judicial composition in Poland (nearly 2,900 judges, as of mid-August 2023). All these appointments are legally flawed and the judgments of these judges may be challenged by means of a complaint to the ECtHR.

The importance of respecting international obligations resulting from the EU membership for Poland's economic credibility has increased significantly in recent years due to the introduction in December 2020 by the Union of the principle of conditionality to the Multiannual Financial Framework (MFF), i.e. the EU budget for the years 2021-2027, and to the Instrument for Recovery and Resilience (RFF) established in February 2021. The latter is to be implemented in the 2021-2026 period and is a response to the COVID-19 pandemic. The principle of conditionality is based on the „money for the rule of law” mechanism, in which transfers from the RFF and MFF have

been made conditional on compliance of the Member States with the rule of law.

The decision to freeze them is to be made by a qualified majority in the European Council (prime ministers/presidents). In the years 2021–2027, Poland is to receive a net amount of EUR 76 billion from the IFF. As part of the RRF, the government has prepared the National Recovery Plan (KPO). In order to achieve the objectives adopted in the National Recovery Plan, non-repayable funds are planned to be spent in the amount of nearly EUR 24 billion and over EUR 12 billion from the loan part granted on very favourable terms. In the current situation of significant slowdown of the Polish economy, MFF and the National Recovery Plan are a potential factor of recovery and growth.

**Currently, Poland's economic credibility in the context of international obligations is most negatively affected by the fact that, next to Hungary, Poland is the only EU Member State whose National Recovery Plan has not been unconditionally approved by the European Commission.** In December 2020, Poland and Hungary supported the introduction of the „money for the rule of law” mechanism, but already in 2021 appealed against it to the CJEU. On 16 February 2022, the CJEU issued judgments unfavourable to Poland and Hungary. In both decisions, the Court in Luxembourg found the EU regulation compatible with the Treaties and dismissed the complaints of Hungary and Poland. The Court emphasized that issues with the rule of law encountered in one Member State may affect financial interests of the entire Union, other members, and the proper implementation of the EU budget.

In June 2022, the EC presented three basic conditions for the so-called milestones (institutional liquidation of the Disciplinary Chamber of the Supreme Court, restoring independence of the disciplinary judiciary of judges, restoring illegally removed judges to adjudicate), the fulfillment of which made the commencement of the transfer of funds to Poland conditional.

The Polish government has committed to implementing these conditions, but so far it has done so only partially and to a very limited extent<sup>19</sup>.

Assessment of respecting by the Polish authorities of international obligations in the EU dimension should also be based on the jurisprudence of the European judiciary with regard to the rule of law in Poland. What should be taken into account is not so much the number of judgments, but primarily the importance of individual key judgments concerning fundamental matters, i.e. fundamental rights and, as a result, closely related to Poland's membership in the EU and the Single Market. **However, even in the case of quantitative statistical data, it can be seen that Poland and especially Hungary differ significantly from the Czech Republic and Slovakia in terms of the degree of compliance with international obligations in the key EU dimension.** According to the Index, in 2022, the indicator of respecting international obligations arising from the EU membership for Poland was -1.01, while for Hungary -1.51. For means of comparison, Slovakia obtained a result of +0.14 and the Czech Republic +0.12. On the other hand, one should note that in recent years, there has been a general negative trend in the region in this respect, manifested by deterioration of indicators in comparison with 2015. In 2015, when the Law and Justice party came to power, this indicator was -0.51 for Poland, and -0.82 for Hungary. The results of the Czech Republic and Slovakia are +0.81 and +0.70, respectively. Continuation of this negative trend will be equal to a return to the

<sup>19</sup> . In June 2022 and February 2023, the Polish Sejm passed amendments providing for, among others: liquidation of the Disciplinary Chamber of the Supreme Court, replacing it with the Chamber of Professional Responsibility, which is also legally questionable. President Andrzej Duda referred the amendment to the Constitutional Tribunal to assess its compliance with the Constitution. However, a conflict between the judges of the Tribunal with regard to the end date of the term of office of its president makes it impossible to gather a quorum and issue a judgment in this case.

situation from the first years following the accession to the EU. At that time, problems with respecting obligations arising from the EU membership were a consequence of the Visegrad Group countries' adapting to the new legal order. In 2008, according to the Index, the indicator of respecting international obligations related to the EU membership was -5.86 for Poland, the Czech Republic -2.25, Hungary -1.52, and Slovakia -0.25.

In 2022, the CJEU and EPTC significantly increased their judicial activity in matters related to the rule of law in Poland. **Throughout that year, they issued nine rulings on this matter, some of which were unprecedented.** In 2022, there was also an increase in the number of cases concerning problems with the rule of law in Poland referred to the EPTC. Information provided by the ECtHR at the beginning of 2023 showed that there have now been over 300 cases pending before the ECtHR with regard to various types of problems linked to the judiciary in Poland.

None of the judgments issued by the CJEU and the ECtHR in recent years with regard to the crisis of the rule of law in Poland – despite the imposition of financial penalties by both courts for lack of implementation – has been implemented by the Polish government in a general aspect, i.e. by eliminating the systemic problem through legal changes. Some judgments of European courts concerned economic matters and, as a result, had a direct impact on Poland's economic credibility. On 03 February 2022, the ECtHR issued a judgment in the case of *Advance Pharma v. Poland* (application no 1469/20).

In the judgment, the ECtHR maintained its negative assessment of the appointments of judges to the Supreme Court carried out at the request of the politicized National Council of the Judiciary. The Court confirmed that participation of the neo-KRS in the appointment process violated the right to a „tribunal established by law”, which is a key element of the right to a fair trial. On 09 February 2022, the CJEU issued a ruling related to the crisis of the rule of law in Poland in the case of

Sped-Pro v. Commission (T-791/19). The Tribunal dealt with the impact of breaching the rule of law in Poland on protection of market competition. Speed-Pro appealed against the Commission's decision to reject the complaint against the monopolistic practices of PKP Cargo. The main argument of the EC was that it was not competent to deal with the case because the case should be addressed to the Polish Office of Competition and Consumer Protection (UOKiK). Sped-Pro, however, concluded that state control over PKP Cargo, the dependence of the President of the Office of Competition and Consumer Protection on the government, and most importantly, serious doubts as to the independence of the Polish judicial branch constitute a justified basis for concluding that the European Commission, and not the Office of Competition and Consumer Protection, should investigate the complaint of Sped-Pro. The CJEU shared the arguments of the Polish company, finding that the Commission unjustifiably rejected its complaint and should deal with it for the reasons mentioned by Sped-Pro. This judgment of the Court confirms that the crisis of the rule of law in Poland has clear, long-term consequences (precedents) not

**TABLE 23.** Value of the credibility index for the area of Respecting international obligations

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Value of the credibility index for Dimension I	-6,57	-1,67	-0,01	0,41	-0,22	-0,27	-0,29	-0,56	-0,16
Value of the credibility index for Dimension II	-0,43	-0,30	-0,20	0,55	0,33	1,15	0,41	-0,29	-0,82
Value of the credibility index for Dimension III				-0,56	-0,10	0,30	0,37	0,13	0,13
<b>Value of the credibility index for the area of Respecting international obligations</b>	<b>-2,31</b>	<b>-0,65</b>	<b>-0,07</b>	<b>0,13</b>	<b>0,01</b>	<b>0,39</b>	<b>0,16</b>	<b>-0,24</b>	<b>-0,28</b>

Source: own study

only in criminal matters (European Arrest Warrant), but also in the economic sphere.

**Poland's credibility was weakened once again in 2022 by the ruling of the Constitutional Tribunal which undermined the EU law.** On 10 March 2022, the Tribunal found it inconsistent with the Polish Constitution for Polish and international courts to assess compliance with the Constitution and the European Convention on Human Rights, laws on the judicial system, jurisdiction of courts, and the act on the National Council of the Judiciary. This was another ruling of this type issued by the Court in recent years. As a result, on 15 February 2023, the European Commission decided to sue Poland before the CJEU in connection with breaching of the EU law by the Constitutional Tribunal.

In its complaint, the EC found that due to irregularities in the appointment of the President of the Constitutional Tribunal and three of its judges, it did not meet the requirements of an independent and impartial court. The Commission also found that, as a result, persons and institutions participating in proceedings before Polish courts were deprived of full guarantees of effective judicial protection. This complaint is unprecedented as for the first time the EC is suing a Member State before the CJEU, accusing it of losing its legality by its constitutional court.

## Extended index of a country's economic credibility in the area of respecting international obligations

Value of the credibility index for the area of respect for international obligations shows some fluctuation tendencies (deterioration, improvement, deterioration) in the period 2014-2022. There is certainly a visible negative trend, which means deterioration of credibility in recent years, i.e. since 2019. In individual dimensions I, II, III, similar fluctuation trends can be observed, but to a different extent. The most important issue when reading these indicators correctly, however, is to take into account that the indicators as such do not show the scale of the problem. They do not take into account fundamental differences between individual judgments and adjudications, i.e. their different importance for Poland's functioning on the international arena within the EU and, as a result, their importance for respecting by the Polish authorities of international obligations. This issue is presented in detail in the descriptive part.



The country's economic credibility in the area of respecting international obligations is analysed in the following dimensions:

**Dimension 1.** The EU dimension

**Dimension 2.** European Court of Human Rights

**Dimension 3.** Breach of Community law

### Dimension 1: EU Dimension

This dimension includes three indicators:

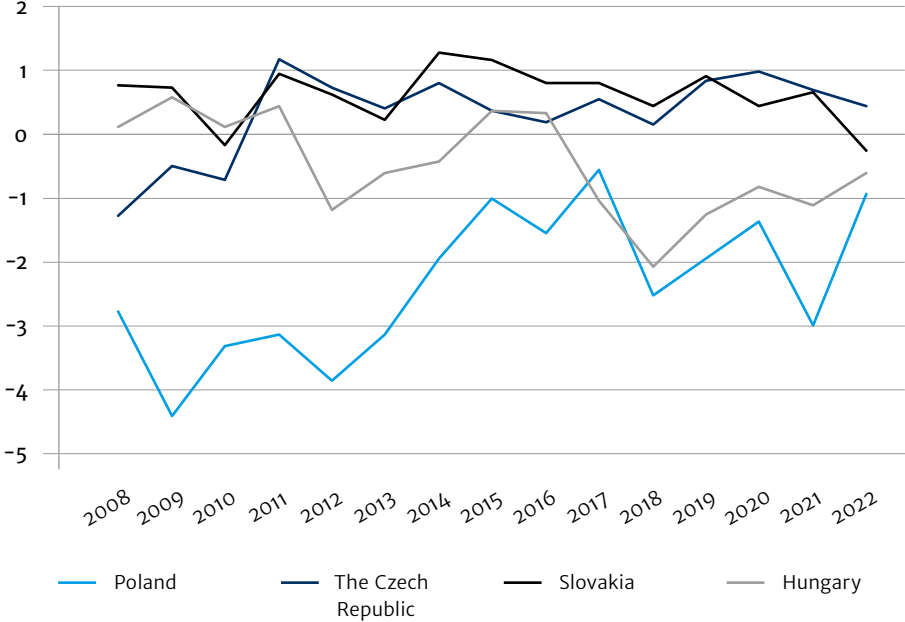
- Judgments of the CJEU finding a breach in fulfilling obligations by a Member State
- New cases in the CJEU with regard to finding a breach
- New references for a preliminary ruling at the CJEU

TABELA 24. EU Dimension

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Polnd	-2,76	-4,41	-3,31	-3,13	-3,87	-3,13	-1,95	-1,01	-1,55	-0,55	-2,51	-1,93	-1,37	-3,00	-0,93
The Czech Republic	-1,27	-0,48	-0,71	1,18	0,75	0,41	0,80	0,36	0,18	0,57	0,15	0,85	0,97	0,69	0,43
Slovakia	0,78	0,73	-0,15	0,95	0,64	0,24	1,29	1,18	0,80	0,80	0,46	0,92	0,46	0,67	-0,25
Hungary	0,13	0,59	0,13	0,43	-1,16	-0,60	-0,42	0,38	0,33	-1,04	-2,07	-1,27	-0,83	-1,11	-0,60

Source: own study

**CHART 61. EU dimension**



Source: own study

**Dimension 2: European Court of Human Rights**

This dimension includes the following indicators:

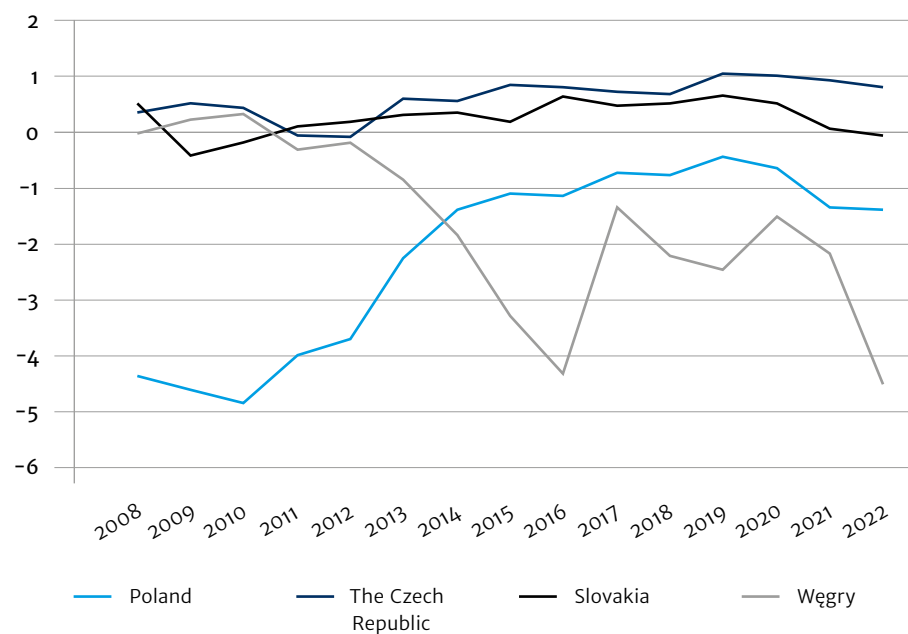
- Claims commenced by the ECtHR
- Judgments issued by the ECtHR
- Key ECtHR judgments not implemented by a given country

TABLE 25. European Court of Human Right

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-4,38	-4,62	-4,85	-3,97	-3,71	-2,24	-1,40	-1,11	-1,15	-0,75	-0,78	-0,44	-0,65	-1,34	-1,39
The Czech Republic	0,36	0,52	0,45	-0,06	-0,09	0,59	0,57	0,84	0,80	0,73	0,69	1,05	1,02	0,91	0,79
Slovakia	0,50	-0,42	-0,17	0,10	0,20	0,31	0,34	0,19	0,65	0,46	0,50	0,66	0,51	0,08	-0,04
Hungary	-0,04	0,25	0,33	-0,33	-0,19	-0,86	-1,86	-3,30	-4,30	-1,34	-2,21	-2,46	-1,52	-2,16	-4,51

Source: own study

CHART 62. European Court of Human Rights



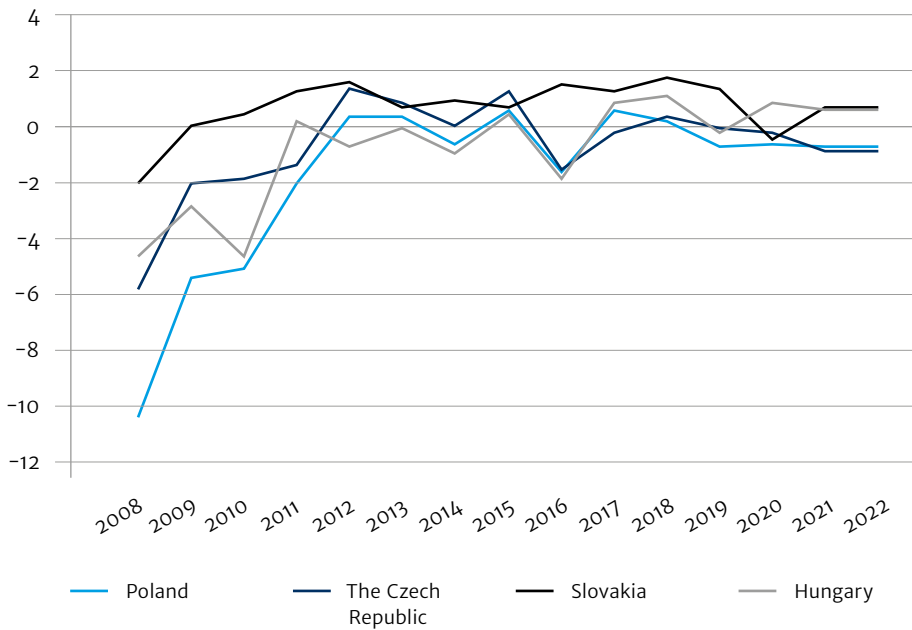
Source: Grant Thornton, barometrprawa.pl

### Dimension 3: Breach of Community law

This dimension includes one indicator:

- Number of new breaches of Community law initiated by the European Commission against a given country

CHART 63. Breach of Community law



Source: own study

TABLE 26. Breach of Community law

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-10,43	-5,44	-5,05	-2,03	0,33	0,33	-0,59	0,59	-1,64	0,59	0,20	-0,72	-0,59	-0,72	-0,72
The Czech Republic	-5,84	-2,03	-1,90	-1,38	1,38	0,85	0,07	1,25	-1,51	-0,20	0,33	-0,07	-0,20	-0,85	-0,85
Slovakia	-2,03	0,07	0,46	1,25	1,64	0,72	0,98	0,72	1,51	1,25	1,77	1,38	-0,46	0,72	0,72
Hungary	-4,66	-2,82	-4,66	0,20	-0,72	-0,07	-0,98	0,46	-1,90	0,85	1,11	-0,20	0,85	0,59	0,59

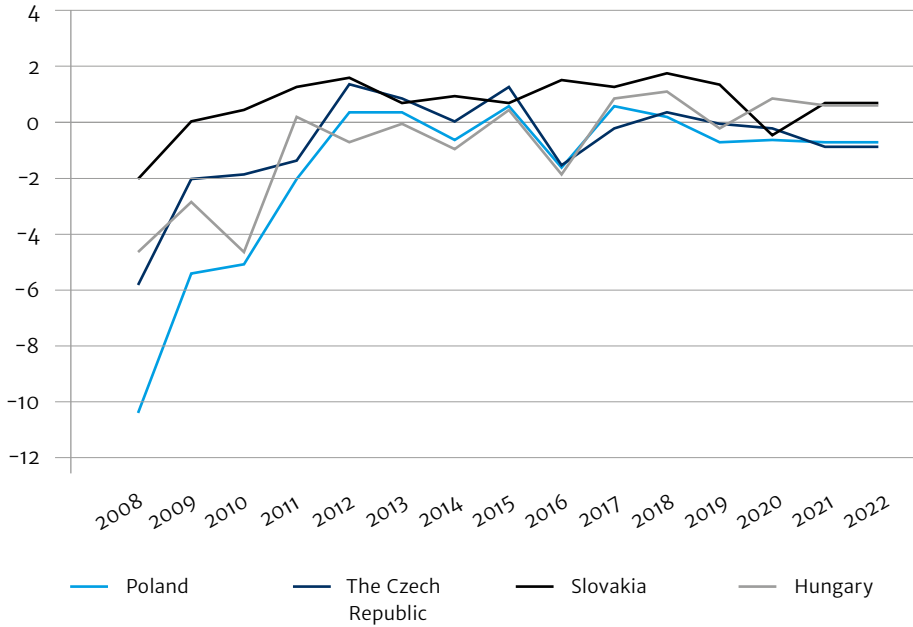
Source: own study

TABLE 27. Value of the economic credibility index (total) for the area “Respecting international obligations” - Visegrad Group

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-5,86	-4,82	-4,40	-3,04	-2,42	-1,68	-1,31	-0,51	-1,45	-0,23	-1,03	-1,03	-0,87	-1,69	-1,01
The Czech Republic	-2,25	-0,66	-0,72	-0,08	0,68	0,62	0,48	0,81	-0,18	0,37	0,39	0,61	0,60	0,25	0,12
Slovakia	-0,25	0,12	0,05	0,77	0,83	0,42	0,87	0,70	0,99	0,83	0,91	0,98	0,17	0,49	0,14
Hungary	-1,52	-0,66	-1,40	0,10	-0,69	-0,51	-1,09	-0,82	-1,96	-0,51	-1,06	-1,31	-0,50	-0,89	-1,51

Source: own study

CHART 64. Total index



Source: own study

## Summary

**The CJEU and ECtHR rulings issued in 2022 with regard to the rule of law crisis in Poland confirm that personnel and institutional changes in the Polish justice system are inconsistent with Poland's obligations arising from EU membership.** They lead to chaos in the legal system and, consequently, to uncertainty in the position of participants in court proceedings, including investors from other EU countries. EU investors operate within the framework of European legislation and cannot refer to arbitration clauses contained in bilateral investment treaties with Member States denounced by Poland due to its accession to the EU. These investors must therefore seek

protection before common courts in Poland (as the EU courts), but their independence is beginning to be questioned.

**Poland clearly stands out from other EU countries in terms of its low level of compliance with international obligations arising from the EU membership.** In this respect, Hungary is the country closest to Poland. In Central Europe, there exists a fundamental difference between Poland, and between especially Hungary, on the one hand, and the Czech Republic and Slovakia, on the other, in terms of: the use of EU funds, attitudes towards the conditionality mechanism, the jurisprudence of the European judiciary on the rule of law and disputes with the EC, the European Parliament and governments of the Member States on these issues. Prague and Bratislava have clearly supported the principle of „money in exchange for the rule of law” and use the RFF funds at the EU average level (approximately 30% – as of June 2023). The Czech Republic and Slovakia do not have any serious disputes with institutions and the Member States with regard to the rule of law.

**The more judges appointed by the neo-KRS will adjudicate in the Polish justice system, the more complaints will be submitted by domestic and foreign citizens and companies to the ECtHR.** Parties dissatisfied with the judgments issued with participation of these judges will, when justifying their complaints to the ECtHR, refer to the previous jurisprudence of the Strasbourg Court with regard to the crisis of the rule of law in Poland. What speaks to the attractiveness of complaints to the ECtHR is the new policy of the order in which cases are heard by the Court in 2021. It assumes priority treatment of the so-called impact cases, i.e. matters of systemic importance. The new policy has already been applied in the speedy, by the standards of the ECtHR, examination of cases relating to the crisis of the rule of law in Poland. For example, the Advance Pharma case was settled in just over two years. This scenario will become even more likely if the president, along with

the unconstitutionally established National Council of the Judiciary, is going to continue nominating further neo-judges to judicial positions.

**The judgment of the CJEU with regard to the complaint of the European Commission concerning illegality of the Constitutional Tribunal will have huge consequences for Poland's economic credibility.**

The CJEU will probably find that the Polish Constitutional Tribunal is not independent and constitutes an active threat to the legal order of the entire EU.

It is expected that the new Polish government formed after the October 2023 elections will try to implement this ruling by passing acts reforming the Tribunal, however, these acts are expected to be blocked by the president's veto or by referring them without the President's signature to the politicized Constitutional Tribunal. Then, the CJEU may impose much larger financial penalties on Poland (several dozen million euros a day, not one million as in recent years). These fines will be deducted by the Commission from the MFF funds allocated to Poland. Should the President block the acts restoring the rule of law, release of funds from the National Recovery Plan may be prevented for the subsequent two years.

Even the transfer of EU funds to Poland may come into question if the president keeps on blocking laws concerning reconstruction of the rule of law.

Programmes for implementation of investments with the use of funds from the EU budget for 2021–2027 are approved by Polish institutions at the national level, including at the local government one. However, there is no guarantee that these funds will actually reach Poland if the president vetoes justice reforms, since all the conditions of the Charter of Fundamental Rights (including the rule of law) have to be met. The regulation of the European Parliament and of the EU Council does not give the European Commission any room for manoeuvre in this matter. Thereunder, the European Commission will not return to the EU Member State funds spent as part of investments



carried out with partial participation of EU finances until such Member State meets all basic conditions.



# Threats to Poland's economic credibility in the coming years - results of a qualitative study

## Qualitative research methodology

A qualitative study was conducted with a view to identifying potential threats to Poland's economic credibility within the next three years. Therefore, it complements the quantitative analysis.

The study was conducted on the basis of the modified Delphi method of group expertise. There were invited representatives of the academic community, public administration bodies, non-governmental and financial institutions, consulting companies and organizations associating entrepreneurs to join the group of experts. **The experts shared their knowledge and experience pro publico bono, expressing only their own views and not those of the institutions, in which they work.**

The study consisted of two stages:

- Stage I: 17 April 2023 – 11 May 2023,
- Stage II: 12 May 2023 – 16 June 2023

In the first stage, the experts identified three most important threats to Poland's economic credibility in individual areas of the index. **At this stage, we received responses from 111 experts who indicated a total of 325 threats.**

The indicated factors were grouped into homogeneous classes. Aggregation of threats made it possible to develop a list of the most important threats in individual areas.

**TABLE 28.** Number of threats to Poland's economic credibility after grouping

Lp.	Area of Poland's economic credibility index area	Liczba zidentyfikowanych zagrożeń
1	Rule of law	9
2	Freedom of business activity	10
3	Public finances and the tax system	12
4	Stability of the financial system and money	10
5	Labour protection and security	13
6	Quality of public services and public infrastructure	15
7	Climate and environment	15
8	Respecting international obligations	12

Source: own study

In the second stage, the experts assessed significance and importance of grouped and aggregated threats to Poland's economic credibility and the likelihood of their materialization.

Each expert had 100 points at their disposal to divide between threats in terms of their importance. The higher the number of the awarded points, the greater the importance of a given threat to Poland's economic credibility within the next three years. Additionally, study participants gave their subjective assessment of the probability of occurrence of each threat (from 0 to 100%). The results obtained from 114 experts were averaged. In this way, there was created a map of threats to Poland's economic credibility for each of the eight analysed areas. The graphic presentation of aggregated opinions involves placing circles on the chart, with the average probability indicated on the abscissa axis and the average threat weight on the ordinate axis. The diameter of the circles is the average of products of values: probability and weight. Therefore, the larger the diameter of a circle, the greater the overall importance of a given threat.

As a supplement to the threat map, there has been provided the percentage of experts pointing to a given factor.

## The most serious threat factors

### Rule of law

In the area of the rule of law, there were identified 9 threats.

1. Politicization of law interpretation (violation of constitutional principles of governance) combined with lack of compliance with the EU law
2. Lack of transparency and breach of rules in the law-making process combined with politicization of the law-making process

3. Personnel policy based on nepotism combined with limited transparency of the government's activities
4. Instability of legal regulations
5. Decrease in the efficiency of the judiciary
6. Institutional destruction of the justice system
7. Lack of control by local government bodies which are business partners of business entities
8. Limiting local government units' own revenues in the context of the growing centralization of the state apparatus
9. Lack of trust in the National Bank of Poland

**The experts identified primarily threats related to the institutional destruction of the justice system.** Attention was drawn to the growing conflict in the broadly understood justice system, leading to the so-called legal dualism, as well as changes in the Constitutional Tribunal and limiting the role of the Supreme Court.

**The experts also pointed to threats related to the lack of transparency and breach of rules in the law-making process.** Emphasized were, among others: limiting the process of giving opinions and consultations on draft legal regulations, including both social and expert consultations, abuse of the separate procedure, or unjustified shortening of the legislative process and *vacatio legis*. According to the experts, this threat is linked to politicization of the law-making process, which manifests itself in the use of legal regulations to pursue one's own political interest.

**A significant group of threats indicated by the experts concerned instability of legal regulations.** At stake here are not only frequent changes in legal regulations, but also their

sudden nature. As an example, the experts pointed to tax law, which was changed during the tax year.

Moreover, a significant threat to the rule of law, according to the experts, is **the decline in efficiency of the judiciary**, as well as **politicization of interpretation of law**, which is manifested, on the one hand, by politically advantageous interpretations of existing legal regulations, and, on the other hand, by lack of compliance with the EU law.

Other threats included:

- personnel policy based on nepotism combined with limited transparency of the government's activities,
- lack of control of local government bodies which are business partners of business entities,
- lack of trust in the National Bank of Poland.

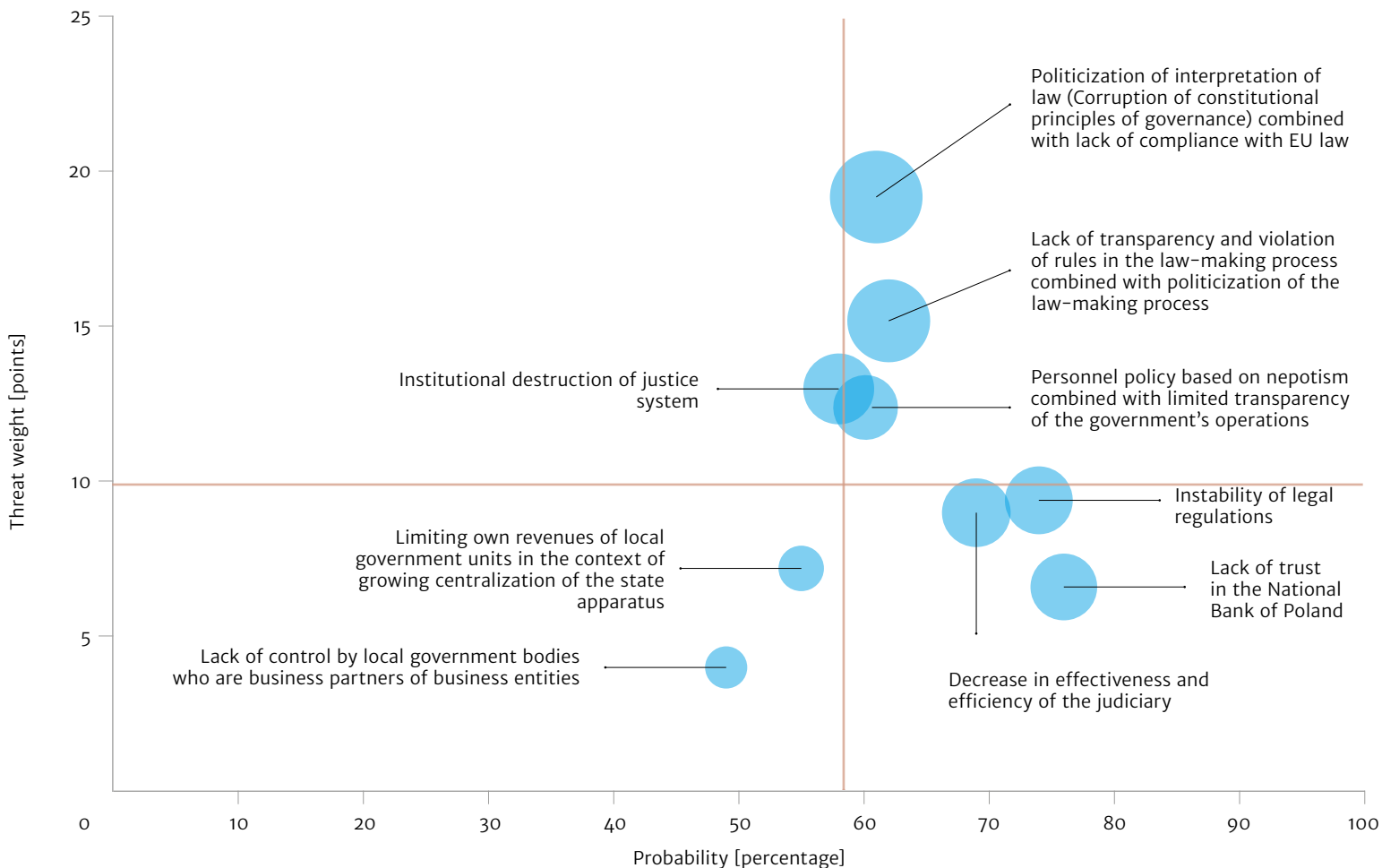
**The most significant threat to the rule of law in the next three years will be politicization of the law interpretation.**

The importance of this factor was assessed by the experts at 19.2 points. At the same time, it is one of the factors whose probability of occurrence was assessed by the experts at the above average level (61% with an average of 58%).

**The second most important threat is the lack of transparency and breach of rules in the law-making process combined with politicization of the law-making process.** The average importance of this factor was rated at 15.2 points. and probability of its materialization was estimated at 62%.

**Additionally, a significant threat to the rule of law is a personnel policy based on nepotism combined with limited transparency of the government's activities** (weight 12.4 points with probability of occurrence of 60%).

CHART 65 Map of threats to Poland's economic credibility in the area of the rule of law within the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor

\*\* size of a circle indicates the average of the product of the weight and probability of occurrence of a given



## Freedom of business activity

In the area of freedom of business activity, there were identified **10** threats.

1. Ineffectiveness and unpredictability of the law-making system
2. Ineffectiveness and inefficiency of the judiciary
3. Lack of coordination of the fiscal and monetary policy
4. Lack of stability and transparency of the tax system
5. High costs of running a business, including rising labour and energy costs
6. Excessive bureaucracy
7. Excessive state interference in the conditions of running a business
8. Growing political and economic risk (related to the pandemic, war, and tense relations with the EU)
9. Risk related to the energy transformation
10. Interference of politicians in the activities of state-controlled enterprises

Among threats to the Poland's economic credibility within the area of freedom of business activity, the experts identified primarily threats related to the law-making process. **In this context, ineffectiveness and unpredictability of the law-making system were pointed out.** Emphasis was put on high variability of business conditions resulting from frequent changes in law, which, combined with the low quality of introduced regulations, increases

the risk of running a business and may tone down the willingness of enterprises to invest. Secondly, there was pointed out the **lack of stability and transparency of the tax system**, manifested not only by high complexity of existing regulations, but also by their frequent changes, the introduction of which is not preceded by an appropriate information campaign.

The experts also pointed to threats related to the **ineffectiveness and inefficiency of the judiciary**, being a consequence of lengthy court proceedings, but also of concerns about effectiveness of court decisions in the face of the institutional destruction of the justice system.

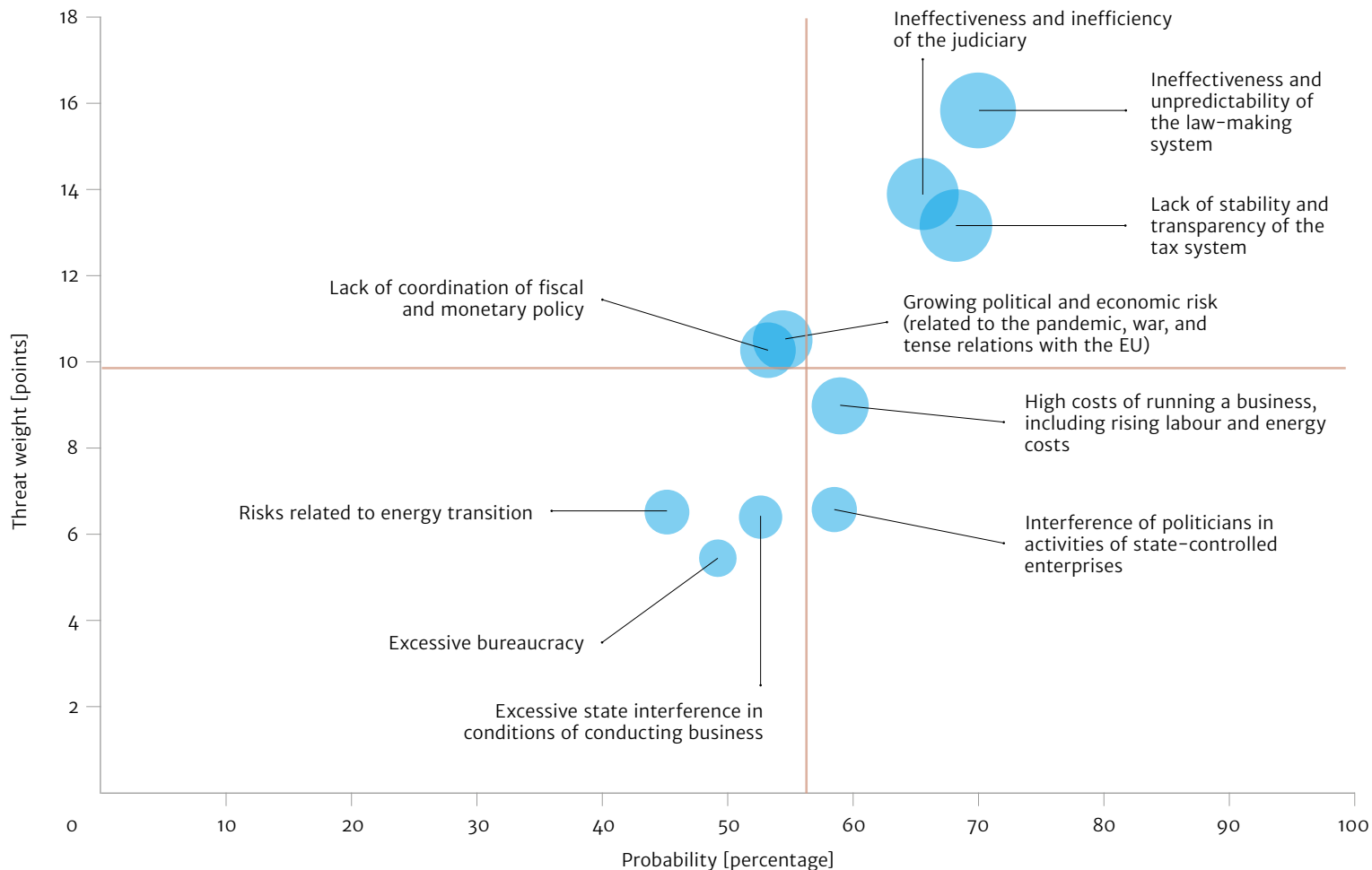
The experts also listed the following significant threats to freedom of economic activity:

- risk related to excessive state interference in conditions of conducting a business, as well as interference by politicians in activities of state-controlled enterprises,
- factors related to the growing political and economic risk, including threats resulting from the deteriorating economic situation or the war in Ukraine,
- excessive bureaucracy,
- high costs of running a business and high labour costs,
- risks related to energy transformation and climate,
- lack of coordination of fiscal and monetary policy.

The experts identified three threats characterized by above-average importance and probability of occurrence in the next three years.

**The most significant threat to freedom of business activity in Poland are ineffectiveness and unpredictability of the law-making system.** The experts assessed importance of this threat at 15.9 points. It is also a threat with the highest probability of materialization of 70%. At the same time, it is one of the two factors indicated by all experts participating in the study (along with the growing political and economic risk).

**CHART 66.** Map of threats to Poland's economic credibility in the area of freedom of business activity within the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor

\*\* size of a circle indicates the average of the product of the weight and probability of occurrence of a given

**The second most important threat is ineffectiveness and inefficiency of the judiciary**, which was assigned an average weight of 13.9 points and probability of 66 percent.

**Another group of threats with a significant impact on the freedom of running business activity includes the lack of stability and transparency of the tax system.** The importance of this factor was rated at 13.2 points with probability of occurrence of 68%.

### **Public finances and the tax system**

In the area of public finances and tax system, there were identified **12** threats.

- 1.** Lack of transparency and stability of public finances combined with an increase in the scale of extra-budgetary financing
- 2.** Complicated, non-transparent, and ineffective tax system, combined with low tax morality of citizens
- 3.** Increase in costs of servicing public debt resulting from, among others, the high share of treasury bonds in commercial banks and extra-budgetary financing, and the need to finance borrowing needs abroad
- 4.** Low quality of public administration services resulting from limited opportunities to employ and retain highly qualified employees
- 5.** Instability and lack of predictability of the tax system
- 6.** Ineffective structure of budget expenditure combined with extensive social policy
- 7.** Conflict with the European Union resulting in limitation of EU funds

8. Growing fiscal burdens related to demographic changes, energy transformation, and military spending
9. Activities aimed at circumventing applicable fiscal rules, including the constitutional limit of public debt and prudential expenditure rule
10. Politicization of the justice system
11. Ineffective financing system of the local government
12. Politicization of the financial safety net

**Among threats to Poland's economic credibility in the area of public finances and the tax system, the experts identified primarily factors related to the complicated, non-transparent, and ineffective tax system, combined with low tax morality of citizens.** The experts listed among others: lack of transparency of applicable legal regulations and lack of uniform tax interpretations, which increase the risk of errors and may increase the scale of fraud.

**In the context of the tax system, the experts also pointed to threats resulting from its instability and lack of predictability.** On the one hand, these threats result from frequent changes in applicable regulations, and on the other hand, they are an effect of the lack of clear, long-term directions of the tax policy.

**Another group of factors relates to broadly understood public finances. In particular, the experts pointed to threats resulting from the lack of transparency and stability of public finances combined with the increase in the scale of extra-budgetary financing. Moreover, emphasised was the risk associated with activities aimed at circumventing applicable fiscal rules, including the constitutional limit of public debt and prudential expenditure rule.** As a

result, assessment of the condition of public finances in Poland is significantly difficult, which is manifested, among others, by: growing difference between the treatment of debt in the PDP and ESA 2010 methodologies.

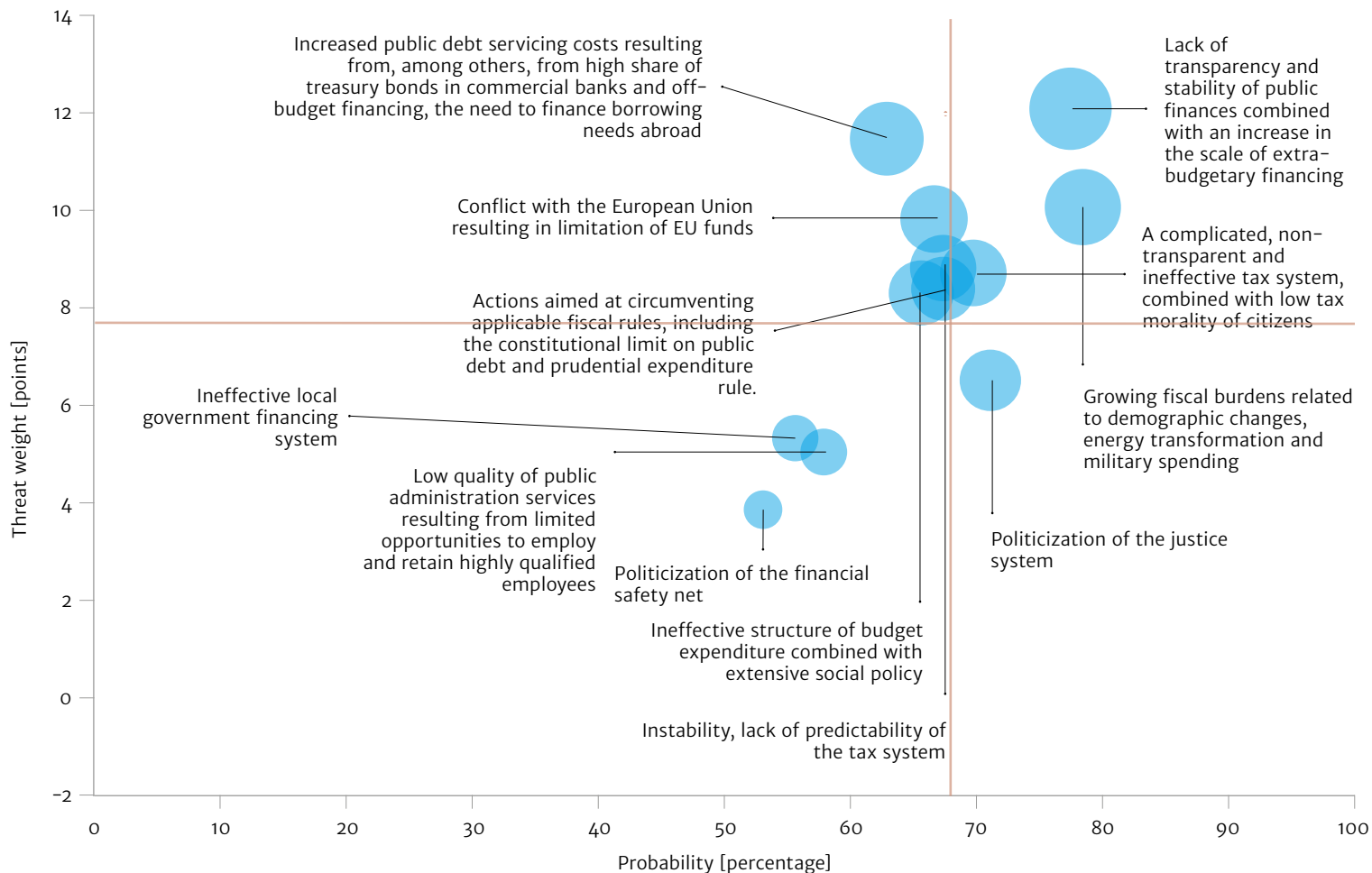
According to the experts, Poland's economic credibility in the area of public finances and the tax system will also be affected by factors related to the structure of budget expenditure. **Firstly, there were identified threats resulting from the ineffective structure of budget expenditure combined with extensive social policy. Secondly, emphasis was put on growing fiscal burden related to demographic changes, energy transformation, and military spending.**

The experts have also identified threats resulting from:

- increase in the costs of servicing public debt resulting from, among others, the high share of treasury bonds in commercial banks and extra-budgetary financing, or the need to finance borrowing needs abroad,
- low quality of public administration services resulting from limited opportunities to employ and retain highly qualified employees,
- conflict with the European Union resulting in a limitation of EU funds,
- politicization of the justice system,
- ineffective local government financing system,
- politicization of the financial safety net.

**Over the next three years, the key threat to Poland's economic credibility in the area of public finances and the tax system will be the lack of transparency and stability of public finances combined with an increase in the scale of extra-budgetary financing.** This factor was given the highest weight (12.1 points) and the second highest probability of materialization (78%). This is also one of the factors indicated by all experts participating in the study.

**CHART 67.** Map of threats to Poland's economic credibility in the area of public finances and tax system within the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor

\*\* size of a circle indicates the average of the product of the weight and probability of occurrence of a given

**The group of threats of above-average importance and probability also includes growing fiscal burdens related to demographic changes, energy transformation, and military spending (weight of 10.1 points).** The experts claim that, at the same time, this is the factor with the highest probability of materialization (79%).

**In the three-year perspective, Poland's economic credibility in the area of public finances and the tax system may also be limited by the complicated, non-transparent, and ineffective tax system, combined with low tax morality of citizens (weight 8.7 points and probability 70%).**

### **Stability of the financial system and money**

In the area of stability of the financial system and money, there were identified **10** threats:

- 1.** Increased burden on the banking sector resulting from, among others, manual control of the banking sector's activities disrupting market mechanisms,
- 2.** Legal risk related to mortgage loan agreements (CHF, WIBOR),
- 3.** Decreased effectiveness and credibility of the monetary policy,
- 4.** High level of inflation,
- 5.** Expansionary fiscal policy combined with an increase in the scale of extra-budgetary financing,
- 6.** Nationalization of commercial banks,
- 7.** Lack of transparency and politicization of financial safety net institutions,



8. Deterioration of the situation on capital markets, including the treasury and corporate bond markets,
9. Increased cyber risk,
10. Destruction of the justice system.

**The threat to Poland's economic credibility in the area of stability of the financial system and money comes primarily from factors related to the reduced effectiveness and credibility of the monetary policy.** On the one hand, the experts pointed to the lack of effectiveness of activities undertaken by the central bank in the fight against inflation, resulting from there being no coherence between the monetary and fiscal policy. On the other hand, emphasis was put the risk related to the loss of credibility of the National Bank of Poland, including through restrictions on access to information. **These threats are related to another factor identified by experts: the lack of transparency and politicization of the financial safety net.**

**The experts also pointed to legal risks related to mortgage loan agreements.** Included here are both loans denominated in foreign currencies (mainly Swiss franc loans) and loans based on the WIBOR reference index. **Additionally, Poland's economic credibility in the area of the financial system and monetary stability may be limited by an increase in the burden on the banking sector resulting from, among others, manual control of the banking sector's activities, disrupting market mechanisms.**

**The experts also paid attention to the risks resulting from expansive fiscal policy combined with an increase in the scale of extra-budgetary financing.** It reduces confidence of investors in the domestic market and, consequently, leads to an increase in the cost of debt financing. **The experts also mentioned deterioration of the situation on capital markets, including the treasury and corporate bond markets,**

## as a potential threat to stability of the financial system and money.

Among other threats to Poland's economic credibility in the area of the financial system and monetary stability, the experts listed:

- high level of inflation,
- nationalization of commercial banks,
- increase in cyber risk,
- destruction of the justice system.

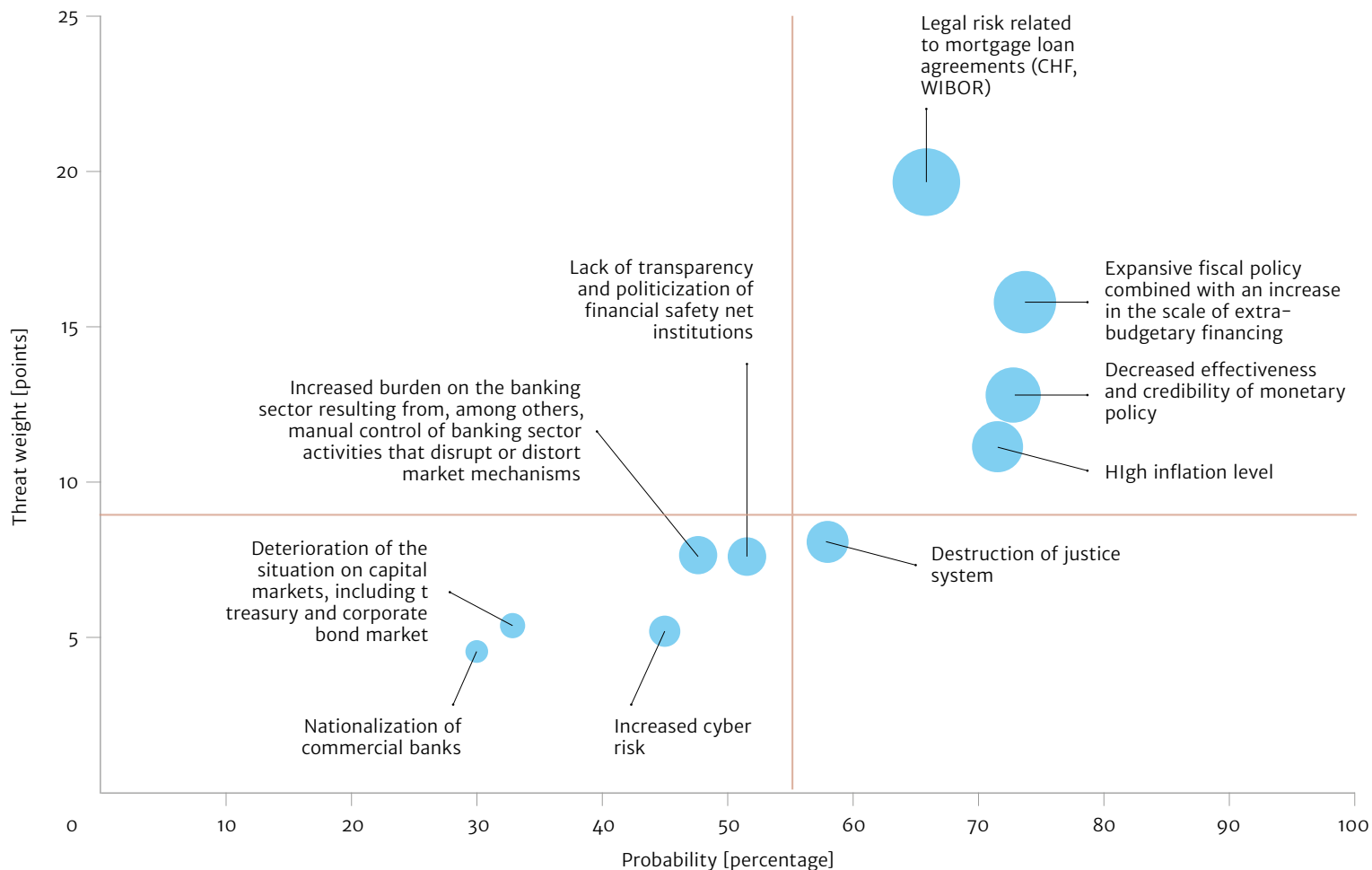
**Firstly, of crucial importance will be the legal risks associated with mortgage agreements.** The weight of this factor was assessed at 19.7 points, and probability of occurrence was 66%. One should emphasise that this was the only factor indicated by all experts participating in the study.

**The second most important threat is expansive fiscal policy combined with an increase in the scale of extra-budgetary financing (15.8 points).** At the same time, it is the threat with the highest predicted probability of materialization (74%).

**Another factor included in the group of threats of the highest importance and probability of materialization in the next three years is the risk related to a reduction in effectiveness and credibility of the monetary policy.** The experts have given this threat an average of 12.8 points and probability of 73 percent.

The above threat is related to another risk indicated by the experts as a factor which may significantly limit stability of the financial system and money within the next three years. This threat results from the high level of inflation, to which there was assigned an average weight of 11.2 points and probability of 72 percent.

**CHART 68** Map of threats to Poland's economic credibility in the area of stability of the financial system and money within the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor  
 \*\* size of a circle indicates the average of the product of the weight and probability of occurrence of a given

## Labour protection and security

In the area of labour protection and security, there were identified **13** threats.

1. Supply barrier on the labour market
2. Lack of flexibility on the labour market – insufficient adjustment of employee qualifications and competences to the dynamically changing needs of the economy
3. Weakness of organizational culture
4. Lack of solutions taking into account cultural diversity of employees
5. Underfunding of science and education
1. Growing segmentation of the labour market resulting from the impact of various economic and institutional factors
6. Lack of appropriate migration policy
7. Growing importance of non–standard employment and lack of precise regulations in this area
8. Growth of the grey zone amid deteriorating economic conditions
9. Weakening of the position of employees on the labour market due to decline in real wages amid deterioration of the economic situation
10. Lack of appropriate incentives resulting in a low employment rate among the group of disadvantaged persons with difficulties on the labour market

**11.** Difficulties in reconciling family and professional life, resulting in low professional activity of women

**12.** High labour costs

The experts noticed primarily the risk resulting from **difficulties in recruiting employees**. In this context, the supply barrier on the labour market (1) manifests itself in: the lack of qualified labour force, unfavourable demographic structure, as well as in insufficient solutions supporting professional activity of persons near retirement age (including ergonomic equipment of enterprises, adaptation of workstations to the needs of older persons, educational activities). Moreover, the **lack of flexibility on the labour market** is a significant challenge (2). Employee qualifications and competences are insufficiently adapted to the dynamically changing needs of the economy and requirements of the modern labour market, in particular those related to ongoing technological change, automation processes and in the area of digital competences. Considered as a threat and barrier is the relatively **low interest in the need to constantly improve qualifications and status on the labour market**, while flexibility on the labour market requires lifelong learning.

Problems related to recruiting employees are also intensified by **the lack of appropriate incentives to employ disadvantaged persons** (with difficulties on the labour market, e.g. persons with disabilities), resulting in a low employment rate in this group of persons (11).

Another threat lies in **underfunding of science and education** (5). This situation causes systematic deterioration of the financial situation of persons working in this field in relation to the level of remuneration in the corporate sector. As a result, various institutional and economic factors, including those related to high inflation and diversified wage policies in various sectors of the economy, lead to **increasing segmentation of the labour market** (6).

Experts also pointed to **difficulties in reconciling family and professional life** as contributing to the low economic activity of women (12). **Barriers related to the employment of women** continue to make it difficult for them to enter and stay on the labour market, thus limiting their professional aspirations and development potential.

In the longer term, Poland's economic credibility will be limited by **the lack of appropriate migration policy** (7). Demographic forecasts for Poland show that a quick increase in the supply of labour resources without a well-planned immigration policy is not possible. Moreover, the decline in labour resources will be particularly severe in the 2030s, which will significantly limit development opportunities of Poland.

In the experts' opinion, another significant threat is **the weakness of organisational culture** (3). It manifests itself in: an autocratic management style, lack of attention to employee well-being (e.g. health, mental, financial), lack of sensitivity to the culture of occupational health and safety, and lack of employers' activities aimed at adapting working conditions to the aging society.

Poland's economic credibility may also be limited due to:

- growing importance of non-standard employment and the lack of precise regulations in this area (e.g. persons working via digital platforms) (8) – non-standard forms of employment limit job stability and professional development opportunities,
- high labour costs (13),
- lack of solutions which would take into account the cultural diversity of employees resulting from internationalization of the labour market in Poland (4) – lack of activities aimed at developing cooperation skills at work in multicultural environments may result in currently unforeseen difficulties in the future,
- growth of the grey zone in conditions of deteriorated economic situation (9) – in the grey zone there is no formal protection of safety and working conditions, therefore employees are not

able to use social security systems (health, pension, sickness, or accident) and are not subject to protection provided for by the labour law (issues of health and safety, minimum wage, working time, holidays, dismissals),

- weakening of the position of employees on the labour market due to the decline in real wages in conditions of deteriorated economic situation (10) – the risk of employees losing protection and job security in exchange for stabilization of real wages.

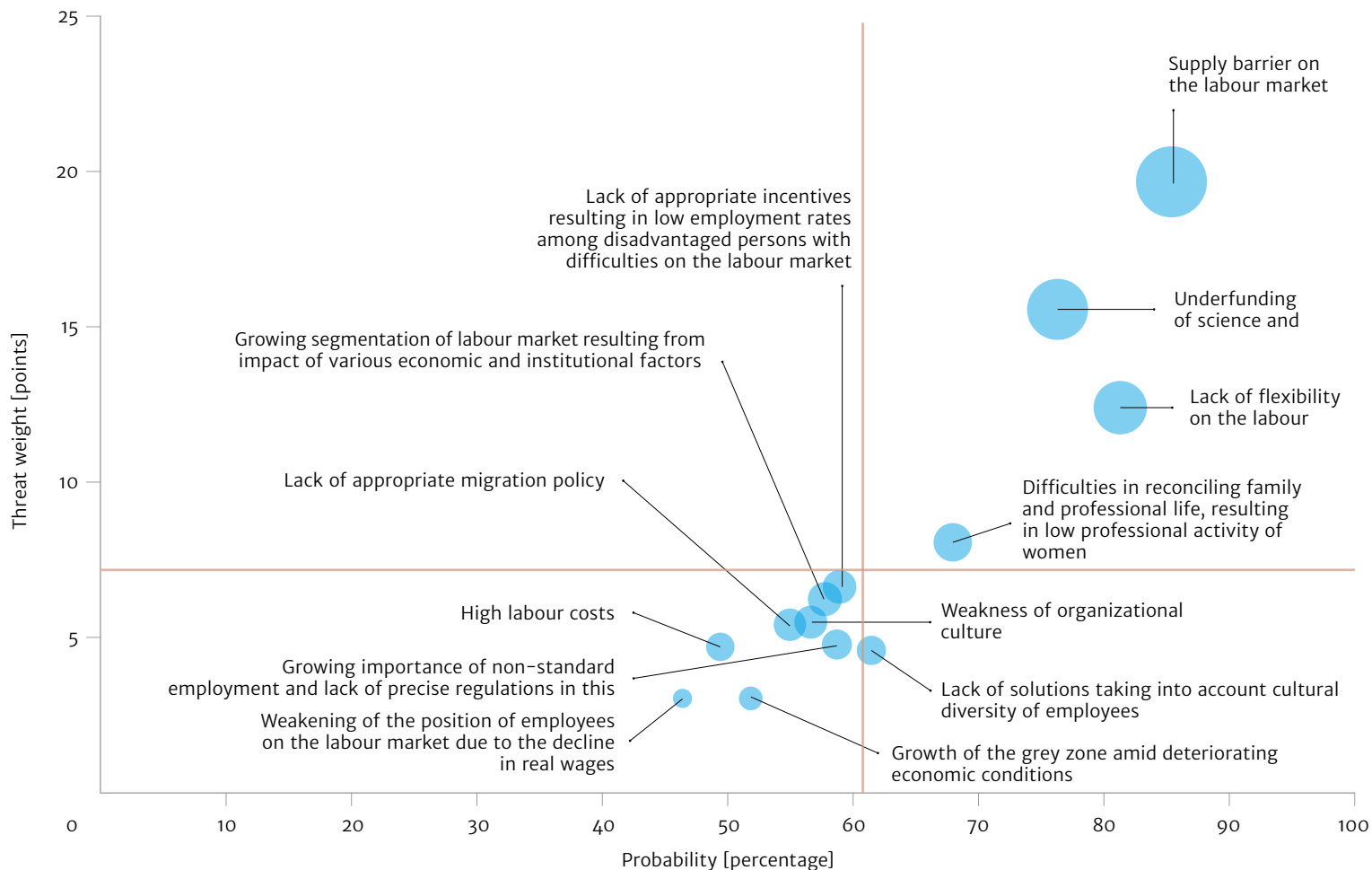
**Results of the threat analysis in the area of labour protection and security indicate that the greatest threats within the next three years are:**

- supply barrier on the labour market (problems with obtaining qualified labour by enterprises, unfavourable demographic structure of the labour market, lack of sufficient solutions supporting professional activity of persons near retirement age): average weight score of 19.7 points (highest rated threat) with estimated probability of level of 85 percent,
- underfunding of science and education: average score of 15.6 points with estimated probability of 76 percent,
- lack of flexibility on the labour market – insufficient adjustment of employee qualifications and competences (supply of labour resources) to the dynamically changing needs of the economy (including lifelong learning, especially in the area of digital competences): average weight score of 12.4 points with an estimated probability of 81 percent.

**The most important threats in this area also include difficulties in reconciling family and professional life, which results in the low professional activity of women.** The predicted probability was estimated at 68%, and the impact of this risk was assessed by the experts at 8.1 points.

The above-mentioned key threats to Poland's economic credibility in the area of labour protection and security [factors (1), (2), (5)], in addition to the highest weights and probabilities,

CHART 69 Map of threats to Poland's economic credibility in the area of labour protection and security in the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor  
 \*\* size of a circle indicates the average of the product of the weight and probability of occurrence of a given



were also characterized by the highest percentage of expert recommendations.

### **Quality of public services and public infrastructure**

In the area of quality of public services and public infrastructure, there were identified **15** threats.

- 1.** Lack of coherent and credible health care policy resulting in limited access to health services
- 2.** Lack of systemic solutions related to financing of education
- 3.** Cybersecurity threats in the context of securing access to data and transmission thereof, in operation of entities and public administration, electronic media, etc.
- 4.** Threats resulting from insufficient level of financing of public services
- 5.** Insufficient level of education and preparation of staff managing the state apparatus
- 6.** Threats to public safety resulting from ignoring and long-term neglect within the field of environmental protection
- 7.** Low quality and organizational inefficiency of public infrastructure, requiring implementation of rationalization activities and operational models
- 8.** Unreliability of the education system in terms of developing key competences on the labour market
- 9.** Multi-level management deficit – division of work and responsibility between government administration and local government

10. Real decline in wages in the public sector in comparison with the private sector
11. Threats resulting from lack of sufficient justification for implementation and proper maintenance of part of the water and sewage infrastructure
12. Low expenditure on science and R&D
13. Discrimination and intolerance in various aspects of life
14. Lack of trust in units supervising and monitoring the quality of public services
15. Increase in prices of all fee-based public services as a result of high inflation and the resulting limited access to them by economically disadvantaged social groups

The threat which particularly worries the experts is **the lack of a coherent and credible health care policy** resulting in limited access to health services (1) within the next three years. The quality of health services and their availability is deteriorating due to ever lengthening queues to specialists. The insufficient level of financing translates into an increase in the debt of hospitals, which leads to deterioration of the financial condition of a large group of medical entities and prevents them from taking out loans from banks, thus pushing them to bank-like institutions. Improving the situation in the area of health care is also hampered by the lack of appropriate databases and medical registers, which make quantitative effectiveness research impossible. Analyses based thereon could be useful in better targeting of financial resources. Another issue raised on this occasion was also the lack of activities aimed at adapting the health system to the needs of an aging society. Over the last 60 years, the average life expectancy in Poland has increased by approximately 10 years, which resulted in the share

of persons aged 65+ in the total population increasing from 5.8% (1960) to 19.1 percent (2022).

The experts also raised the issue of **the lack of appropriate systemic solutions in the field of financing education** (2). In their opinion, the threat here includes, among others: decline in the quality of education in public education at every stage thereof. As a result, development opportunities of the young generation are stratified at the primary and secondary levels depending on the parents' wealth and the ability to finance private tutoring. In addition, staff shortages in public education resulting from the outflow of experienced staff (retirements), lack of incentives for young people taking up work in education, the growing position of private schools, loss of the prestige of the teaching profession and an unclear division of responsibilities between the central and local administration in terms of responsibility for education financing.

**Another identified threat results from the insufficient level of financing of public services**, including: due to the increase in defence spending and public debt servicing (4). This situation intensifies the phenomenon of „creeping” privatization of public services. Moreover, the increase in prices of all fee-based public services as a result of high inflation leads to **limited access to them by economically disadvantaged social groups** (15).

The experts also emphasized the importance of the **threat to public safety resulting from ignoring and long-term neglect within the field of environmental protection**, especially air quality and surface water as well as waste management (6).

Threats also include **the insufficient level of education and preparation of staff managing the state apparatus at the national and regional levels** (5). Efficient and competently functioning public administration requires high qualifications. However, **low financial motivation** combined with the actual decline in wages in the public sector in comparison with the

private sector (10) make any improvement of the situation in this area quite difficult.

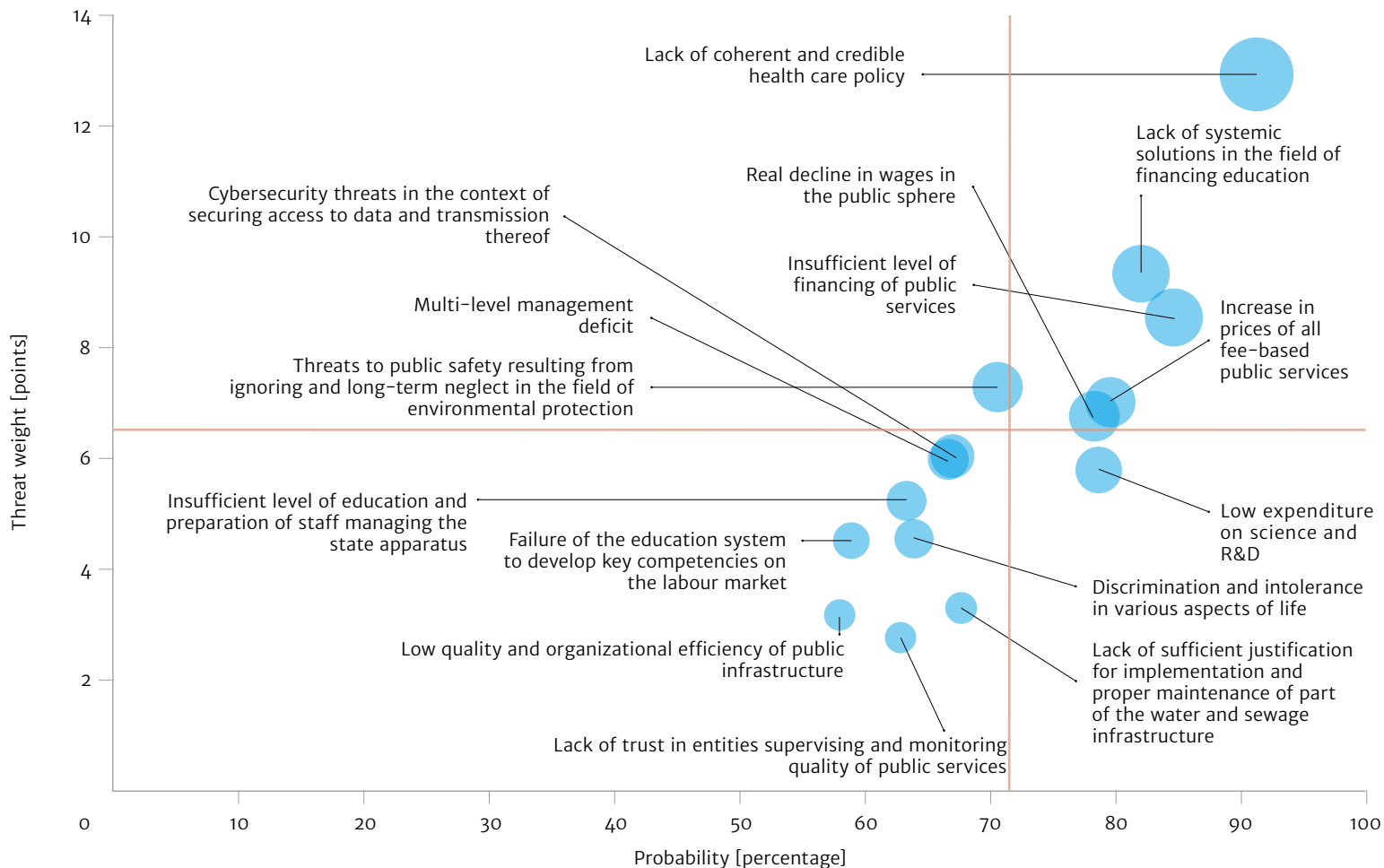
Moreover, the experts suggested that Poland's economic credibility may be subject to limitation, among others, for the following reasons:

- cybersecurity threats in the context of securing access to data and transmission thereof, in operating of entities and public administration, electronic media, etc. (3),
- multi-level management deficit – including: in terms of the division of work and responsibility between government administration and local government (9), which is manifested in decentralization of tasks and responsibilities while centralizing resources and regulatory authority,
- low expenditure on science and R&D (12) – decrease in expenditure in relation to GDP,
- discrimination and intolerance in various aspects of life (13),
- unreliability of the education system in terms of developing key competencies on the labour market – including: loss of cooperation between academic staff in engineering and technical fields with economy and administration (8).

The map for the area of quality of public services and public infrastructure presents a group of the five key threats in the three-year perspective. These are:

- lack of a coherent and credible health care policy (weight of the threat at 13.0 points, probability of occurrence 91%),  
lack of systemic solutions within the field of financing education (9.4 points and 82%, respectively),
- threats resulting from the insufficient level of financing of public services with an average weight of 8.6 points and probability 85 percent,
- increase in prices of all fee-based public services as a result of high inflation and the resulting limited access to them by economically disadvantaged social groups (7 points with probability of 80%),

**CHART 70** A map of threats to Poland's economic credibility in the area of quality of public services and public infrastructure within the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor  
 \*\* size of a circle indicates the average of the product of the weight and probability of occurrence of a given

- real decline in wages in the public sector in comparison with the private sector, to which experts assigned an average of 6.8 points and assessed the probability at 78%.

**The lack of coherent and credible health care policy resulting in limited access to health services, lack of systemic solutions in financing of education and threats resulting from the insufficient level of financing of public services were characterized by the highest values in all three analysed dimensions, i.e. in terms of importance, probability, and percentage of expert indications.**

### **Climate and environment**

In the area of climate and environment, there were identified a total of **15** threats.

- 1.** Lack of a coherent and comprehensive national vision of long-term (2050) economic development which would take into account the EU's climate and energy policy
- 2.** Increasing pressure on water resources and increasing risks to human safety related to access to water
- 3.** Limitation of foreign investments due to the high share of the so-called „dirty” energy
- 4.** Inconsistency of regulations and weak enforcement of environmental protection regulations, as well as their inconsistency, among others: with regard to the environmental impact assessment system, and spatial development regulations
- 5.** Obstacles in the development of renewable energy sources
- 6.** Low efficiency of energy and resource use

7. Too low pace and high costs of deep thermal modernization of existing buildings
8. Decline in biodiversity
9. Domination of the Polish energy industry by nuclear power plants
10. Progressive transformation of the Earth's climate system
11. Inadequate air quality in numerous Polish cities, which exerts a negative impact on the quality of life and health of society
12. Risk related to failure to release funds from the National Recovery Plan and delay in implementation of the new 2021–2027 EU perspective
13. Channeling the largest rivers for the purposes of development of river transport, requiring huge costs and increasing the risk of flooding
14. Insufficient effectiveness of the education system, economy, and public management in stimulating innovations allowing the country to adapt to global changes in the social, ecological, and economic system
15. Lack of a systemic approach to the use of the existing analytical support in administration and lack of its systemic strengthening, in the conditions of increasing the scope of formal and legal requirements in climate policy and, consequently, the number, scope, and degree of complexity of tasks

**When identifying factors posing a risk to Poland's economic credibility in the area of climate and environment, the experts emphasized threats related to the lack of a coherent and comprehensive national vision of long-term**

**(2050) economic development**, which would take into account the EU's climate and energy policy. In this context, there were mentioned, among others: lack of a strategy to abandon the use of fossil fuels and reduce greenhouse gas emissions, transition to a low-emission and ultimately climate-neutral economy, as well as lack of a coherent energy transformation plan which would include social costs.

**The experts also pointed to the growing pressure on water resources and the increased risk to human safety related to access to water.** Emphasis was put on the fact that Poland is one of the countries with the lowest water resources in Europe, which is additionally characterized by high variability, the phenomenon being associated with periodic excesses and deficits of water in rivers.

**Further threats are related to obstacles in development of renewable energy sources (RES).** These include restrictions resulting from maintaining subsidies for fossil fuels or problems with connecting small renewable energy installations to electricity distribution systems.

**An important group of factors listed by the experts also related to the threat of limiting foreign investments due to the high share of the so-called „dirty energy”.** High carbon footprint indicators combined with the lack of realistic strategies to reduce them may result in lower competitiveness of enterprises operating on the domestic market and their attractiveness from the point of view of foreign investors.

**The decline in biodiversity may also pose a threat to Poland's economic credibility in the area of climate and environment.** The experts emphasized risks arising from, among others: creating the so-called monocultures, i.e. large cultivated areas of one species, industrial farming, or inappropriate policy of the State Forests, consequently leading to landscape changes and fragmentation of habitats and species.



Among the remaining threats to Poland's economic credibility in the area of climate and environment, the experts identified the following factors:

- inconsistency of regulations and poor enforcement of environmental protection regulations (concerning air quality, water, waste management, soil protection and biodiversity), as well as their inconsistency in terms of, among others, the environmental impact assessment system and spatial development regulations
- low efficiency of energy and resource use, which contributes, on the one hand, to higher costs of running business (waste) and, on the other hand, poor preparation for implementation of a circular economy (too high material, water and energy consumption in the broadly understood economic and municipal sphere)
- too low pace and high costs of deep thermal modernization of existing buildings (including problems with modernization of energy-inefficient small heating systems)
- domination of the Polish energy sector by nuclear power plants (with a simultaneous lack of competences in this field), requiring huge investments in power grids and pumped-storage power plants
- ongoing transformation of the Earth's climate system, affecting the economy, society, and ecosystems, both on a global and regional scale, forcing a change in the current economic model
- inadequate air quality in many Polish cities, exerting a negative impact on the quality of life and health of society
- risk related to failure to release funds from the National Recovery Plan and delay in implementation of the new 2021-2027 EU perspective (e.g. the FEnKS programme - European Funds for Infrastructure, Climate, Environment), negatively affecting efficiency and timeliness of the transition to a low-emission economy
- channelling of the largest rivers for the purposes of development of river transport, requiring huge outlays (PLN 100 billion) and increasing the risk of flooding

- insufficient effectiveness of the education system, economy, and public management in stimulating innovations allowing the country to adapt to global changes in the social, ecological, and economic system
- lack of a systemic approach to the use of the existing analytical support in the administration and lack of its systemic strengthening, in the conditions of increasing the scope of formal and legal requirements in the climate policy and, consequently, the number, scope and degree of complexity of tasks

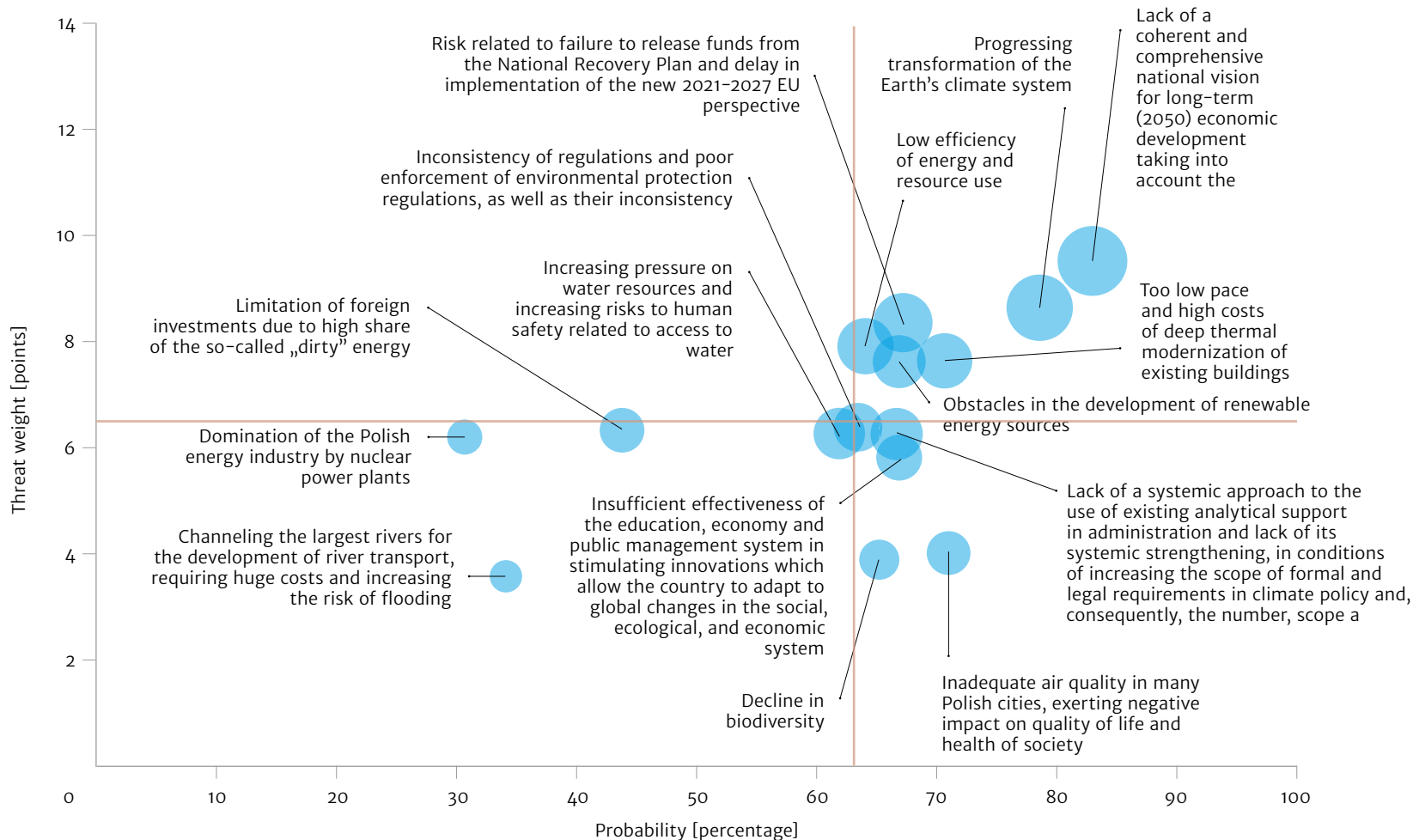
**According to the experts, the most important threat to Poland's economic credibility in the area of climate and environment is the lack of a coherent and comprehensive national vision of long-term (2050) economic development which would take into account the EU's climate and energy policy.** The weight of this factor was assessed at 9.5 points. This is also the factor with the highest predicted probability of materialization – 83%.

**The second most important threat is the ongoing transformation of the Earth's climate system,** exerting influence on the economy, society and ecosystems, both on a global and regional scale, and forcing a change in the current economic model. The average weight of the above threat was 8.6 points, with materialization probability of 79%.

**Threats of above-average importance and probability of occurrence also include:**

- risk related to failure to release funds from the National Recovery Plan and delay in implementation of the new 2021–2027 EU perspective – weight 8.3 points, probability 67%,
- low efficiency of energy and resource use, which contributes, on the one hand, to higher costs of running business (waste) and, on the other hand, poor preparation for implementation of the circular economy – weight 7.9 points, probability 64%,

CHART 71 . Map of threats to Poland's economic credibility in the area of climate and environment within the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor  
 \*\* size of a circle indicates the average of the product of the weight and probability of occurrence of a given

- obstacles in the development of renewable energy sources (e.g. maintaining subsidies for fossil fuels, problems with connecting small renewable energy installations to electricity distribution systems) – weight 7.6 points, probability 67%,
- too low pace and high costs of deep thermal modernisation of existing buildings (including problems with modernisation of energy-inefficient small heating systems) – weight 7.6 points, probability 71%,
- inconsistency of regulations and poor enforcement of environmental protection regulations – weight 6.4 points, probability 63%.

### **Respecting international obligations**

There were **12** threats identified in the area of respecting international obligations.

- 1.** Breach of the Treaty of the European Union and the Treaty on the Functioning of the European Union in the scope relating to the rule of law combined with the financial consequences of the above-mentioned breaches (suspension of disbursement of EU funds, National Recovery Plan)
- 2.** Breach of the European Convention on Human Rights combined with failure to implement the ECtHR judgments
- 3.** Failure to respect the principle of primacy of the European Union law, in particular in connection with the jurisprudence of the Polish Constitutional Tribunal from 2021
- 4.** Deprivation of the Constitutional Tribunal's ability to function due to delegitimization of this Tribunal and its cooperation with the Sejm majority

5. Loss of Poland's credibility as a member of international organizations (European Union, Council of Europe) and the international community as a result of undermining the principle of honouring agreements
6. Disturbance of good-neighboring relations with other countries
7. Institutional destruction of the rule of law system and breach of the principle of legal certainty
8. Primacy of politics over law in the activities of the legislative and executive authorities
9. Limiting independence of state institutions and bodies (including the Prosecutor's Office, control bodies (Supreme Audit Office), competition bodies (Office for Competition and Consumer Protection), Parliament)
10. Failure to respect horizontal principles regarding implementation of the EU funds, including the EU Charter of Fundamental Rights
11. Politicization of the position of prosecutor general
12. Activities motivated by political interests limiting civil and political rights

**Recommendations of the experts allowed us to distinguish two groups of threats.** The first one includes threats in the international dimension. These relate primarily to the breach of the Treaty of the European Union and the Treaty on the Functioning of the European Union in the scope of the rule of law, combined with financial consequences of the above-mentioned breach, including in particular the suspension of the payment of EU funds from the National Recovery Plan (1). In this context, there were discussed issues of non-respecting the obligations set out in Art. 2 and 19 of

the Treaty on European Union, insofar as these provisions oblige the Member States to respect the principle of the rule of law and to ensure fully effective judicial protection.

There was identified a significant threat being a consequence of failure to respect the principle of primacy of European Union law, in particular in connection with the jurisprudence of the Polish Constitutional Tribunal from 2021 (3), with regard to questioning the compliance of ratified acts of international law with the Constitution of the Republic of Poland, including international regulations with regard to judicial standards. Experts also highlighted the risks arising from breach of the European Convention on Human Rights combined with the failure to implement ECtHR judgments (2). There was raised a question of importance of failure to respect and implement the judgments of the European Court of Human Rights with regard to the ability of the Polish justice system and Polish courts to guarantee the fundamental right to a fair trial.

**Other threats listed in the first group include:** loss of Poland's credibility as a member of international organizations (European Union, Council of Europe) and the international community as a result of undermining the principle of honouring agreements (5), failure to respect horizontal principles with regard to the implementation of EU funds, including the EU Charter of Fundamental Rights (10) and disruption of good-neighbourly relations with other countries (6).

**The second group are threats of a national nature.** First of all, the risk related to the institutional destruction of the rule of law system and violation of the principle of legal certainty was identified, including: as a result of the introduction of dysfunctional changes in the National Council of the Judiciary, delegitimizing this body, and the introduction of changes in the Supreme Court and common courts aimed at subordinating them to the executive authority (7). Experts also emphasized the importance of the threat resulting from limited independence of state institutions and bodies, including the prosecutor's office,

control authorities (NIK), competition authorities (UOKiK) and the parliament (9). **Factors posing a threat within the second group also include:**

- depriving the Constitutional Tribunal of its ability to function due to delegitimization of this Tribunal and its cooperation with the Sejm majority (4),
- activities limiting civil and political rights motivated by political interests (12),
- politicization of the position of the prosecutor general (11), primacy of politics over law in the activities of the legislative and executive authorities (8).
- The map developed for the discussed area shows five threats of above-average importance.

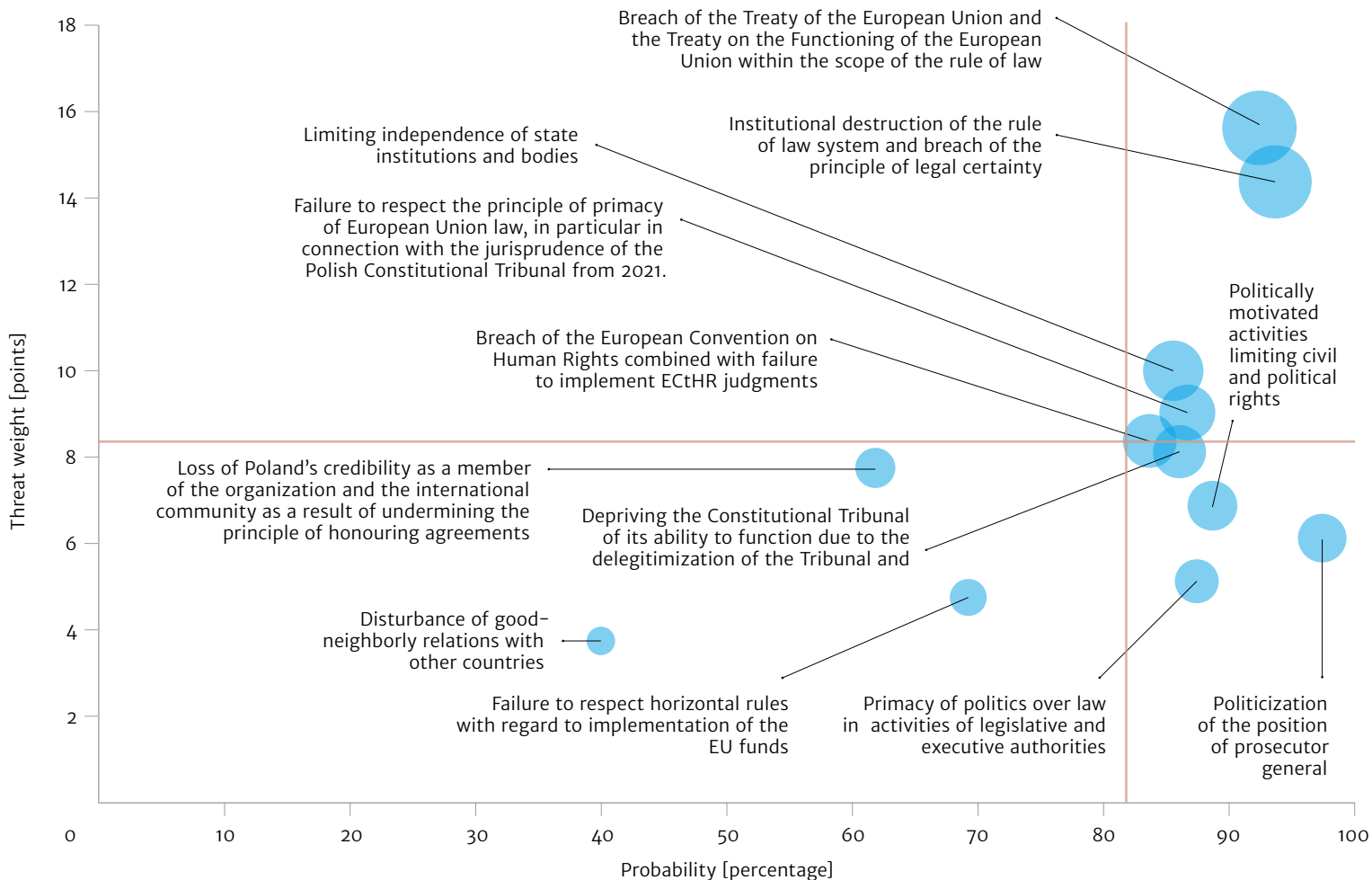
**According to the experts, the following two factors pose by far the greatest threat:**

breach of the Treaty of the European Union and the Treaty on the Functioning of the European Union within the scope concerning the rule of law, combined with the financial consequences of the above-mentioned breaches (threat severity 15.6 points, probability of occurrence 93%),  
institutional destruction of the rule of law system and breach of the principle of legal certainty (weight 14.4 points with probability of 94%).

In addition, the experts listed factors with above-average values of threat severity and probability of occurrence:

- limiting independence of state institutions and bodies, including, among others, prosecutor's office, Supreme Audit Office, Office of Competition and Consumer Protection, parliament (threat weight 10 points, probability of occurrence 86%),
- failure to respect the principle of primacy of European Union law, in particular in connection with the jurisprudence of the Polish Constitutional Tribunal from 2021 (9 points with probability of 87%),

**CHART 72** A map of threats to Poland's economic credibility in the area of respecting international obligations within the next three years



\* lines on the map were drawn on the basis of the average importance of threats and average probability of occurrence of a given factor

\*\* wielkość kółka oznacza średnią iloczynu wagi i prawdopodobieństwa wystąpienia danego zagrożenia



- breach of the European Convention on Human Rights combined with failure to execute its judgments with an average weight of 8.4 points and probability of 84 percent

It is worth emphasizing that the two greatest threats to Poland's economic credibility in the area of respecting international obligations, i.e. factors (1) and (7), in addition to very high values of weights and probability, were also characterized by the highest percentage of expert recommendations.

## Summary

In individual chapters, we pointed not only to the conclusions resulting from the quantitative analysis, but – through their interpretation – to important and often disturbing economic phenomena. In this chapter, our intention is to present in a synthetic approach conclusions with regard to the economic policy and the economy itself resulting from our Index. We will complement this reflection with a set of recommendations, which – in our opinion – should be practically implemented with a view to increasing Poland's economic credibility.

We will begin by recalling the basic message that the Report conveys, i.e. the value of the Poland's Economic Credibility Index itself.

**TABLE 28.** The WEP index value for Poland according to the 2022 methodology

2014	2015	2016	2017	2018	2019	2020	2021	2022
-0,05	0,27	-0,05	0,22	0,17	-0,23	-1,17	-1,70	-4,35

Źródło: opracowanie własne

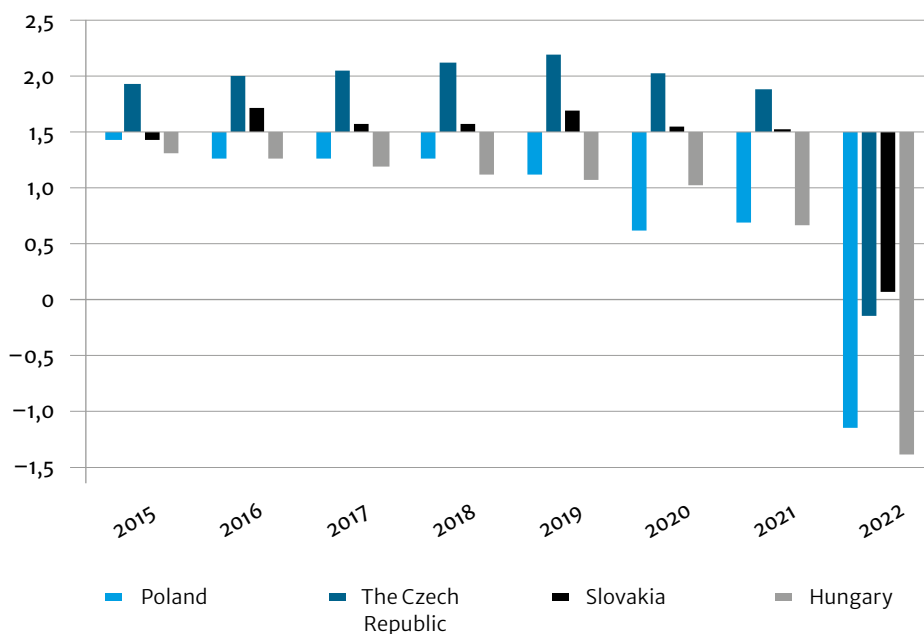
Crucial for this year's report is the WEP index for the V4 countries.

**TABLE 30.** Index value in the comparative system (V4 countries)

	2015	2016	2017	2018	2019	2020	2021	2022
Poland	-0,06	-0,24	-0,23	-0,23	-0,37	-0,88	-0,81	-2,65
The Czech Republic	0,44	0,51	0,55	0,62	0,70	0,52	0,38	-1,65
Slovakia	-0,07	0,22	0,07	0,07	0,19	0,04	0,01	-1,42
Hungary	-0,18	-0,23	-0,30	-0,38	-0,43	-0,48	-0,82	-2,88

Source: own study

**CHART 83.** Index value in the comparative system (V4 countries)



Source: own study

**The conclusion resulting from the value of our index is obvious: Poland's economic credibility have been declining dramatically, especially in the years 2021-2022.** A comparison within the peer V4 group does confirm this conclusion. Although the economic credibility of all the countries in the group has decreased after 2019, it has been clearly less so in the case of the Czech Republic and Slovakia than in Poland and Hungary. In the case of Poland, it has been even stronger than in Hungary.

**Nowadays, the key problem of the Polish economy lies maintaining economic growth based on structural competitiveness, i.e. without intensifying fiscal and monetary stimulation.** This requires a monetary policy conducted strictly by the bank: a policy of difficult money that is macroeconomically prudent and microeconomically mobilizing productivity.

**The growth rate of the Polish economy will be slower than in the years 2016-2023 (not to mention the previous years; and zero pace this year) for at least the following 7-8 years.** During this period, the effects of changes in institutions and economic policy introduced after 2015 will be more and more noticeable. We are going to experience this painfully in the years to come. The changes introduced after 2015 weakened each of the basic factors of long-term economic growth.

Long-term high economic growth depends chiefly on supply factors. Ours is a situation of dramatic reduction of labour resources, and only higher productivity of the use of own resources could overcome this deficit.

On the other hand, labour and energy costs are rising faster than in other European countries. **We are losing international competitiveness.** As a result, the tendency to set up companies in Poland remains low in comparison with the EU and the last decade has not seen much change in this respect. We are facing an entrepreneurial stagnation.

It is striking that Poles, considered to be quite entrepreneurial, are among the least willing to start a business in Europe. Research clearly indicates the reasons for this situation: instability

of tax and employment regulations, along with low efficiency of courts and rising labour costs are most often mentioned among the most important barriers to entrepreneurship.

**Inflation remains high, persistent, and structurally rooted.**

We should remember that two-thirds of Polish exports and imports are made within foreign companies, which weakens the impact of the exchange rate on inflation, but also the impact of monetary policy. Thanks to the EU membership, the zloty exchange rate is still relatively stable in relation to the euro and fluctuates along with the euro in relation to the dollar, even though, as a result of high inflation in Poland, the zloty has actually decreased in relation to both currencies. As Poland's economic credibility continues to deteriorate, the zloty may also begin to weaken more nominally against the euro and the dollar, which will adversely affect inflation.

**Fiscal imbalance contributes to the inflow of portfolio capital financing the growing public debt.** This periodically strengthens the zloty. That is why it is so important to observe the long-term trend of the equilibrium exchange rate. The risk of systematic weakening of the Polish zloty, especially in relation to the currencies of the countries with which we trade and compete, makes the prospect of entering the euro zone and facing economic competition more distant.

**The weakened institutional system of the state triggers a continuous increase in the state interventionism.** Among many examples, let us recall the reorientation of the banking system towards financial services for the state, which significantly weakened the deposit and credit services provided to households and enterprises. In practice, BGK serves the government, not the economy. It is a government bank.

**There is emerging a new architecture of the financial system, dominated by capital flows.**

As a result, the economic function of the state is also changing: it has the means and tools of expanding political and economic interventionism – discretionarily excluding or weakening

some components of the market mechanism and/or market segments, e.g. fuels.

**At the same time, the Polish banking system is economically shrinking (the ratio of bank credit to the private sector to GDP is around 50 percent, while in developed economies this ratio is at the level of 150 percent).** Financing modernization investments and maintaining high productivity dynamics will be a big problem. This applies specifically to small enterprises which are losing their ability to expand. The lack of funds for the National Recovery Plan is increasingly painful.

Of course, even the current banking system is able to provide long-term financing for national investment projects, but it will certainly not be relatively cheap, which in turn will exclude most small enterprises from it. This cuts off sources of financing for most small businesses which are competitive enough to sell abroad.

It is worth noting that, despite maintaining high growth dynamics, during the last four years of the rule of the Law and Justice party, the PMI index remained below 50 points in most months (39 out of 48). This indicates that we are dealing with a long-term trend of expiration of the growth's production and supply factors.

**However, Poland is not doomed to a permanent slowdown, much less to a crisis.** Whether, after the forthcoming lean years, there is improvement or further decline depends on changes to institutions and the economic policy introduced by the new government.

#### **Finally, a few key statements:**

- We are observing a growing deficit of our country's economic credibility, which results from degradation of numerous state institutions and progressive dysfunctionalization of the institutional system.
- Dynamics of the increase in state debt is bound to be worrying. Fiscal imbalance is structural and therefore poses a real threat.

- We finance consumption through deficits, not development, which leads to a reduction in the potential growth rate.
- We need relatively high and steady economic growth – an average annual GDP growth rate at over 3%.
- The environment of chronically elevated and volatile inflation is not conducive to achieving this goal. In our case, the basis of inflation is strongly and structurally rooted.
- The problem of monetary policy lies not in the instruments, but the institutional arrangement of its conduct and the quality and communication mechanisms.
- Political limitation of independence of the National Bank of Poland means for the monetary policy diminishing of a possibility of combining two analytical and decision-making perspectives is diminishing: a short-medium-term – strictly monetary one and a medium-long-term – general economic one.
- The latter is revealed only in communication and propaganda distorting reality.
- Strong internal prudential regulations are necessary – institutional coordination is failing.
- The Polish economy should remain on the convergence path with the eurozone countries: not only is there a need of nominal convergence, but also of structural one – leading to modernization of the sector structure of the economy. In this respect, we are observing divergence, which means undermining foundations of the growth of Poland's economic potential.
- A plan for Poland's entry into the euro zone is now necessary as a strategic tool for coordinating the economic policy.
- The state has a limited and clearly declining ability to modernize the economy. We observe exclusion and weakening of the market mechanism, as a result of the ever growing state interventionism, which weakens competition and, consequently, productivity orientation of enterprises and their tendency to invest productively.

**All this does not mean, however, that the process of erosion of Poland's economic credibility is to be reversed by repairing only the narrowly understood state institutions.**

The necessary step is to prevent the already decade-long process of departure from standards and values which are characteristic of democracy. Only when these norms are alive and widely accepted are we able to rely on state institutions to act pro publico bono, and not be guided by the short-term interests of the current government.

In fact, quality of the economic policy does not depend only on whether relatively more or less accurate decisions are made. The model of the state and the resulting scope of institutional independence exert at least a similar impact on the way the economic policy is conducted.

The simplest criterion for assessing the independence of key institutions conducting macroeconomic policy is its countercyclical nature and the lack of influence of the electoral cycle thereon. Until recently, this was the case. The monetary policy of the National Bank of Poland was countercyclical, and the recommendation issued in 2006 was the first example of the use of macroprudential policy for the purposes of stabilizing the financial system. Until recently, fiscal policy was also characterized by a constant pursuit to keep the economy on a path of sustainable and long-term growth, and it was not influenced by the electoral cycle.

All this was possible thanks to the fact that the key institutions deciding on the shape of the macroeconomic policy had sufficient decision-making autonomy, which resulted from the functioning model of the state.

**The following recommendations are formulated with a view to emphasising two things.**

**Firstly**, one should remember at all times that the economy is a complex mechanism, therefore the process of repairing its functioning requires making many different changes, which we write about in the Report. One may not delude oneself that some

simple recipes will be enough to bring immediate improvement – apart perhaps from changes in the judicial system which would release funds from the National Recovery Plan.

**Secondly**, our Report contains numerous warnings against the illusion of „agency” of state interventionism, which is created, among others, by ill-considered, large infrastructure projects intended, as in Turkey, to create the impression that Poland is becoming an economic power by means of applying shortcuts. Giving in to such an illusion is dangerous because economic interventionism dismantles two mechanisms which ensure optimal allocation of resources in the economy: the market mechanism and the system of institutions with appropriate autonomy, whose decisions are coordinated by their common pursuit of maintaining the economy on the path of long-term stable growth.





# Recommendations

In the second edition of the Poland's Economic Credibility Index, we included a total of **34** recommendations for all areas.

## The Rule of Law

**The first recommendation** is a mandatory assessment of effects of ex ante regulations for each draft law. It is necessary to prevent circumvention of the requirement to draw up a regulatory impact assessment (RIA). This is a reprehensible practice with a long tradition in Poland – government draft laws are submitted as parliamentary ones, because in this mode drawing up of an RIA is not required. In order to build credibility of the state, each draft law (MP, senator, presidential or government) should meet the same requirements in terms of consultation and presentation of an assessment of the effects of the regulation. This obligation should also include citizens' legislative initiatives. In the case of such initiatives, it should rest with the government so as not to hinder actions taken within the framework of direct democracy, which would have other negative effects – it would discourage citizens from engaging in public affairs.

The proposed solution will increase transparency of the legislative process and provide an opportunity to improve quality of the law. This should translate into a less frequent need to amend regulations.

**The second recommendation** is to limit the common courts to two levels. Currently, common courts in Poland include district, regional, and appellate courts. Despite the three-tier structure, the proceedings involve two instances. This results from the adopted principle that more complicated or serious cases in the first instance are to be referred to the regional court, which in other cases acts as the second-tier body. However, this is an unnecessary complication in the case of even workload distribution among judges working in different units.

A new project introducing a two-tier structure is really necessary since the one presented a few years ago by the Ministry of Justice was defective and involved a number of tasks which appeared incompatible with the principle of judicial independence. However, this does not eliminate the need for the reform itself, which, by simplifying the system, would contribute to improving the functioning of the justice system.

**The third recommendation** is increasing the remuneration of experts. Lengthiness of many cases is caused by difficulties in obtaining expert opinions. It is hardly surprising that specialists in even moderately lucrative professions are not interested in drawing up such opinions, and when they do undertake this duty, they do not prioritise it. An hourly rate for their work starts from PLN 22.90 net, which is close to the minimum wage. It is true that in some cases it is possible to award a higher remuneration – a maximum of PLN 105.49 net per hour for an expert holding the title of professor in particularly complex cases. It is therefore not surprising that respected specialists choose other, more lucrative and less stressful ways of earning money.

Introduction of higher rates, combined with streamlining of the process of ordering an opinion, its delivery, answering questions from the court and parties, as well as settling remuneration, could significantly speed up many cases and contribute to improving quality of issued judgments.

## Freedom of doing business

**The first recommendation** is to improve the work of courts, including shortening of the time of examining cases. The World Bank data indicate that this has not been achieved in the last decade, which may suggest that improvement is difficult to attain in many areas of state activity that are important for business without achieving a higher level of political stability.

**The second recommendation** is to increase stability of the legal environment, including, among others: extension of the *vacatio legis* period – in the last decade this period has decreased to 33 days for laws and 7 days for regulations. In the current institutional arrangement, there seem to be no appropriate mechanisms to induce the legislature to meet the need for stability in the economic environment.

**The third recommendation** is to strengthen representation of domestic business representatives in organizations representing entrepreneurs on the national and European forum, following the example of many European countries. Increasing prevalence of institutions representing interests of entrepreneurs would boost the automatic mechanism improving institutional conditions for conducting business activity. In 2018, only about 2 percent of Polish entrepreneurs were associated in institutions representing their interests, which not only causes the voice of entrepreneurs to be muffled in the legislative process, but also does not contribute to the abolition of bureaucratic barriers, which do the biggest harm to smaller entities.

## Credibility of public finances

**The first recommendation**, and the first immediate step to rebuild credibility in the area of public finances (because it does not involve any costs), is to restore their transparency: introducing the obligation to publish in the budget act the financial plans of all public finance sector units in accordance with

the scope of the EU methodology, introducing the obligation to publish detailed information on application of the expenditure rule in the budget act, changing the emphasis in the budget act on the deficit of the public finance sector, the deficit of the entire central budget (including funds, agencies, and other units) and the deficit of the social security subsector, creation of a public register of public finance sector units with information on financial matters, including on employment and remuneration, creation of a register of public levies. Ultimately, there exists a need for a comprehensive institutional and organizational reform of public finances, aimed at reducing funds and agencies, and redefining the „state budget” towards the „budget of the entire central sector”, so that the government receives a full and non-defective discharge.

**The second recommendation** concerns tightening and protecting against manipulation of fiscal rules: introducing into the constitution a definition of public debt consistent with the EU methodology, tightening the stabilizing expenditure rule so that it covers in principle all expenditure transactions within the meaning of the European methodology, including the practice of „giving away” treasury bonds within the scope of the rule, i.e. treating them as subsidies (expenditures); introducing a requirement for acceptance of changes in fiscal rules by 2/3 of the Parliament and an exit clause from fiscal rules in states of emergency specified in the constitution, also including the state of epidemic in the constitution.

**The third recommendation** is establishing a politically independent Fiscal Council, where the dominant role is played by experts with broad competences to assess and monitor all parameters and data within the field of public finances. Such institutional solution is obligatory for the eurozone countries. Establishment of a council should take place no later than upon taking a decision to introduce the Euro.

**The fourth recommendation** consists in ensuring openness and transparency of public finances at the micro level. In

this regard, the authors of the publication propose an urgent launch of a central register of contracts concluded by the public finance sector. Such register was deemed to be introduced in January 2024, but once again the Parliament postponed its implementation date, this time until 2026.

**The fifth recommendation** relates to taxes and assumes introduction by force of law of the code and principles of changes in the tax and contribution system, which would limit the frequency of changes in taxes (minimum *vacatio legis*) and enforce an appropriately long and reliable consultation process. Just as necessary is regular evaluation of the system in the context of transparency and complexity.

### **Stability of the financial system**

**The first recommendation**, which is also the first step that does not involve any costs, should be a change in the communication policy of the central bank. The 2022 „Poland’s Economic Credibility Index” observes that it should become either more restrained or closer to international standards. What is meant by restraint in communication is less frequent appearance of central bank representatives in the media. If public appearances do not build its credibility, they should be as rare as possible. By bringing communication closer to central banking standards, we mean focusing it on the mandate of the National Bank of Poland. The central bank should focus its communication on the issue of (restoring) a stable price level and factors influencing the prospects of the inflation returning to its target, and not getting involved in political disputes. Meanwhile, the National Bank of Poland increasingly often and openly takes one side of the political dispute. Its political involvement sometimes takes a grotesque form. An extreme example of this is plastering the NBP headquarters with slogans praising the policy of the government and the central bank while attacking the opposition.

**The second recommendation** is abandoning both the banking tax and the exemption of interest on deposits from capital gains tax (i.e. the so-called Belka tax), even though each of these activities would involve costs for public finances in the case of deep imbalance. The authors of the publication consider waiving the banking tax to be more important. In order to limit fiscal costs of this solution, it could be narrowed down to newly granted loans. The argument for abandoning this tax, at least partially, is not only the much higher tax burden on banks in Poland than elsewhere in Europe, in a situation where they incur high costs of legal disputes regarding Swiss franc loans and the so-called credit holidays.

First of all, this solution would weaken incentives of banks to replace loans with treasury bonds, which are exempt from this tax and additionally do not require banks to commit their own capital, as the regulator allows such bonds to be assigned zero risk. This would contribute to reducing the still very high sensitivity of the banking sector to possible turmoil in public finances, as well as dependence of the public finance sector on the banking sector. In turn, the second solution should increase the effective (i.e. after tax) interest rate on deposits, which in real terms remains deeply negative, despite significant increases in the National Bank of Poland's interest rates last year and a decline in inflation this year. As a result, this would further reduce the risk that households would replace bank deposits with riskier assets.

### **Employment protection and security**

The area of employment protection and security stands out positively in comparison with other areas included in the „Poland's Economic Credibility Index”. However, it should be emphasized that demographic conditions favour creating good conditions on the labour market, which is increasingly an „employee” market. Yet, while this situation appears favourable, there still exist

challenges related to segmentation of the labour market on the one hand, and to development of competences related to the changing requirements on the labour market on the other.

The growing share of foreigners, especially from outside the European Union (Ukraine, Belarus, or India), favours segmentation and limiting social protection of employment. **The first recommendation** is to develop and implement an appropriate migration policy, which is crucial to ensuring proper protection and job security for both migrants and current workers.

Platform work or forced self-employment often result in less employee protection. **The second recommendation** concerns informing in an appropriate manner about applicable regulations and working conditions, especially in the case of persons coming to work from outside Poland, as well as proper control and monitoring of compliance with the law.

Another significant challenge for the labour market is creating and maintaining high-quality jobs, which often require appropriate competences, including digital ones.

**The third recommendation** is to create solutions supporting development of competences and lifelong learning. This applies primarily to employees from the small and medium-sized enterprise sector, as well as persons with low education, i.e. those groups whose participation in various forms of learning is the lowest.

## Quality of public services

In recent years, the relative value of public spending on education in Poland has declined. In 2014, it was approximately 4.3 percent. Currently in Poland the share of public expenditure on education in GDP has fallen below 4%. **The first recommendation** is therefore to increase the financing of education at all levels so that adequate funds will be allocated for infrastructure, modern teaching materials, and competitive salaries for teachers (by introducing, for example, a rule for determining



teachers' remuneration in relation to the minimum wage, e.g. the minimum remuneration of an assistant is 150% of the salary minimum). **The second recommendation** concerns increasing availability of teaching staff, which can be achieved by means of using various incentives to take up the teaching profession and thus increasing the prestige of this profession. **The third recommendation** is to strengthen training and professional development programmes for teachers allowing for adapting skills to changing educational needs.

**The fourth recommendation** concerns improving the quality of health services, where it is necessary to strengthen the patient's first contact with the health care system by increasing access to general practitioners, community nurses, and primary care specialists. This can be achieved by introducing longer opening hours of facilities or the use of telemedicine and remote treatment, which became popular during the COVID-19 pandemic, and may significantly improve availability of medical services.

**The fifth recommendation**, related to preventive medicine, is to increase the level of support for educational campaigns on a healthy lifestyle, promoting and offering regular preventive examinations, especially among risk groups, which may reduce the incidence of chronic diseases.

A great challenge for the health service in Poland is ensuring adequate access to psychiatric services. Children and young persons are increasingly struggling with this type of problems. **The sixth recommendation** concerns the need to develop a system of access to psychiatric services, psychotherapy, and preventive activities in the area of mental health, especially for younger patients.

**The seventh recommendation**, which concerns reducing the number of crimes against family and care in Poland, requires a multi-dimensional approach and involvement of numerous institutions and communities. Firstly, of great importance are education and public awareness. Solutions should be based on

elements such as: (1) appropriate campaigns aimed at raising society's awareness of domestic violence and its consequences, (2) educational programmes in schools to educate children and young people about healthy interpersonal relationships and resolving conflicts without violence, as well as (3) helping victims by creating specialized support centres for victims of domestic violence, where they can receive psychological, legal, and social support. A faster response of the police services to reports of domestic violence cases is also very important.

Compared to other systems in our everyday use (e.g. electronic banking), the ePUAP platform seems to be totally outdated. It has a number of disadvantages: it is difficult to use, lacks intuitiveness and uniformity, and does not provide any technical support for users. **The eighth recommendation** is to create a new version of the platform which, thanks to access via mobile devices (smartphone, tablet), will be an easy and accessible tool for citizens.

### Climate and environment

It should be emphasized that, as evidenced by long-term data, economic and social development is not linearly related to the increase in greenhouse gas emissions, water and resource consumption. On the contrary, resource efficiency and sustainable consumption and production support stronger economic growth in the long term. Responsible and credible activities of the state, including creating sector-dedicated policies, must take into account such dependencies. This means that, for example, limiting resource and energy intensity in industrial policy and the emission intensity of the energy sector may lead to a speedy economic growth. However, it is impossible to obtain such change in the economy without releasing local potential.

**The first recommendation** is the need for regulatory changes enabling activities of citizen energy communities (in accordance with the RED II directive), equalizing landfill biogas and

biogas from sewage treatment plants with agricultural biogas, and introducing energy cooperatives to the Polish cities. Moreover, Poland is left with no other choice if it intends to maintain competitiveness of its export-based economy. Customer preferences, strategies of financial institutions, as well as regulations in a growing number of countries, especially the highly developed ones, where Polish companies have the strongest position, mean that the lack of care for the environment limits sales opportunities and access to financing.

According to **the second recommendation**, Poland needs to take actions related to, for example, water protection by means of investing in wastewater treatment infrastructure and strengthening monitoring of tightness of the system. **The third recommendation** concerns waste management, which requires significant investment outlays, and its infrastructure such as processing and recycling plants. The EU funds may be a good source of financing in this case. **The fourth recommendation** covers improving the quality of air, that is an area in which consistent and long-term public interventions are necessary, e.g. replacing boilers and improving energy efficiency of buildings and better correlating activities at the level of central and local governments. All funds from the sale of CO<sup>2</sup> emission rights should be allocated for financing the energy transformation, including half for activities undertaken by local governments.

**The fifth recommendation** concerns biodiversity. Providing it has become an essential and necessary environmental protection activity. Since it is horizontal in nature, it must be taken into account, for example, in the agricultural policy or state energy policy. Expanding naturally valuable protection areas, although necessary, cannot be a sufficient measure in this respect. The first step, however, is exclusion of 20% of forest areas from economic use. Such action is feasible, desirable, and possible to carry out within a short period of time.

Natural capital and ecosystem services are of particular importance for the future, since there is currently no full understanding

of what we are losing, and this loss is influenced by the various sector-based policies mentioned above. One important step to raise awareness and reduce degradation of natural capital is to implement natural capital accounting (**the sixth recommendation**) with a view to strengthening the knowledge base for future activities at the national and European levels. Including natural capital in national accounts systems, initially on a pilot and experimental basis, may help to appreciate the importance of biodiversity.

### Respecting international obligations

**The first recommendation**, which is also a key condition for Poland to improve its credibility in respecting international obligations, is a radical change to the current policy of the Polish government, which consists in dismantling the rule of law and, as a result, undermining the *acquis communautaire*. This change should take an immediate effect by means of Poland's implementing all judgments of the CJEU and ECtHR.

These activities will provide Poland with access to financial resources from the EU financial perspective for the years 2021–2027. **The second recommendation** concerns the need for the Sejm to pass an act implementing Poland's obligations under the National Recovery Plan, which will enable the use of these financial resources as well as fulfillment of milestones agreed with the European Commission.

In both cases, fulfillment by Poland of its obligations arising from the EU membership will require the Polish government to withdraw from the changes made so far in the justice system and to abandon plans for further judicial reform. **The third recommendation** includes the need to withdraw from the „deform” of the justice system carried out in the years 2015–2023, which must be accompanied by a thorough and comprehensive reform of the justice system. The latter should be carried out in cooperation with Polish and EU judicial institutions. **The fourth**

**recommendation**, which is the main goal of changes in the judiciary, puts forward a need to guarantee greater efficiency and actual independence of the judiciary and, most importantly, ensuring its full compatibility with the EU legal system.



Stanisław Kluza  
Andrzej Sławiński

## Economic policy in countries ruled by populists

“Populism is not an ideology. It is a strategy for gaining and maintaining power” (Moisés Naím 2017)

“In Latin America, populist economic policy was characterized by the subordination of monetary policy to fiscal policy goals” (Sebastian Edwards 2019b)

“The process of erosion of the quality of institutions begins immediately when populists take over” (Manuel Funke, Moritz Schularick and Christoph Trebesch, 2020)

„Contemporary populism, with its ruthless application of the principle of majority rule, pushing for a plebiscite model of politics and the approach that the winner can do anything, undermines institutional solutions designed to ensure equal participation in political life” (Wojciech Sadurski 2020)

## 1. Introduction

Until recently, publications on the impact of populist governments on the economy concerned mainly Latin American countries. In recent years, however, as populists have been increasingly taking over governments in a number of other countries, publications on the economic effects of populism are growing in popularity once again. We have selected four quotes from such category of publications speaking about basic features of the economic policy pursued by populist governments.

The first quote, selected from one of the publications of Moisés Naím (2017), shows that the interventionist economic policy, aimed at maximizing the current rate of economic growth, without taking into account its impact on the state budget and inflation, is only one of the many instruments employed by populists to maintain popularity of their governments. Populists need it to make institutional changes so as to ensure their permanent power. Other ways of gaining and maintaining power used by populists include: creating and deepening social divisions, seeking to delegitimise the opposition, and limiting the ability of civil society organizations to operate (Naím 2022, Acemoglu, Robinson 2022, Boeri et al. 2018).

The second quote, taken from Sebastian Edwards (2019b), highlights the fact that in countries ruled by populists, monetary policy is subordinated to fiscal policy. Initially, when inflation effects of fiscal and monetary expansion do not yet appear, the interventionist economic policy is intended to demonstrate the ability of populists to perform economic „miracles”, even if it is known in advance that they are achieved „on credit”, at the expense of subsequent economic imbalances (Velasco and Yeyati 2022, Edwards 2010, Dornbusch and Edwards 1991).

The third quote, sourced from an extensive report presenting results of research on the effects of the economic policies of populist governments in over 60 countries over the last 120



years, highlights that a common feature of such governments is elimination of the separation of powers (parliamentary, executive, and judiciary), which allows to deprive of autonomy institutions which under ordinary conditions are responsible for maintaining balance in the economy and increasing its efficiency. Depriving many institutions of their previous autonomy paves the way to a highly centralized interventionist economic policy (Funke, Schularick and Trebesch 2020).

The fourth quote, taken from the publication of Wojciech Sadurski (2020), highlights that populists equate majority rule with democracy in order to introduce the primacy of executive power over the parliamentary power and thus be able to conduct a strongly interventionist economic policy without regard to the parliament or the position of opposition parties.

## 2. Economic costs of populism

The general conclusion seen in publications on economic effects of populism is that the objective of the economic policy of populist governments is not to maintain balance the economy or increase its efficiency, but to maintain the government's popularity and to gain time for institutional changes allowing populists to remain permanently in power (Åslund 2019). Such intention is clearly illustrated by the fact that achieving the objective of reducing income inequality, as declared by populists, does not require replacing democracy with a façade democracy, which populists covertly call illiberal democracy. It is exactly the opposite. Only democracy provides a long-term guarantee that income inequality will be corrected (Iversen and Soskice 2019, Acemoglu, Naidu, Restrepo and Robinson 2014, Acemoglu and Robinson 2012).

It has been already stated that, as the number of countries ruled by populists increases, so does the number of publications talking about the economic costs of populism (Guriev and Papaioannou 2022, Scheiring 2021, Funke et al. 2020, Åslund

2019, Edwards 2019a, 2019b). These costs result mainly from the decreasing efficiency of the economy under the populist rule. The reason is that, in order to gain control over the economy, populists reduce the scope of operation of market mechanisms and strive to nationalize enterprises, and above all, banks. Over time, the balance in the economy and its efficiency are becoming more and more secondary, as „state capitalism”, as populists initially call their rule, becomes the less hidden power of the oligarchy associated with the government (Åslund 2019).

A key change for the economic policy is removing the decision-making autonomy from institutions which, under ordinary conditions, care about keeping the economy in balance and increasing its efficiency. Their autonomy is taken away so as to allow the government to conduct a highly interventionist economic policy in a centralized manner, the aim of which is to gain social support for increasingly less democratic governments (Stiglitz 2023).

Ultimately, however, the inevitable effect of economic interventionism, which is tantamount to turning off market mechanisms, is the decreasing efficiency of the economy's production and the decreasing growth rate. Over time, there appears, as Joseph Stiglitz (2017) calls it, illiberal economic stagnation, accompanied by increased inflation. Chronically elevated inflation is an inevitable result of the continued use of fiscal and monetary expansion in an economy which is becoming less and less productive and is characterized by persistently low pace of productivity growth.

Complementing limitation of autonomy of institutions responsible under ordinary conditions for maintaining balance in the economy is replacing experts in the authorities of these institutions with persons determined to uncritically implement the government's economic policy (Bellodi et al. 2021, Adam 2018). The natural consequence of such situation is not only the decreasing efficiency of the economy as a result of market mechanisms' being switched off, but also a significant increase

in the risk of committing serious mistakes in the economic policy, since the mechanisms for verifying rationality of decisions made by the government are disappearing.

In recent decades, populism has emerged partially from criticism of neoliberal economic policy, which in the 1980s was largely a reaction to the growing economic interventionism of the 1960s and 1970s (Glyn 2006). Criticism of neoliberalism was to some extent right, as it brought about increased oligopolization of the economies of highly developed countries and increased income inequality. Over time, however, this criticism of neoliberalism became quite doctrinal. An example of this was the criticism of the so-called The Washington Consensus, i.e. a set of pro-market structural reforms intended to increase efficiency of the economies of developing countries (Williamson 2000).

In reality, as it became obvious over time, structural reforms often work with considerable delay – especially in less affluent economies. It so happens that only after a longer period of time, as confirmed by an increasing number of empirical studies, when it comes to developing countries, higher economic growth is recorded in those that avoided excessively interventionist economic policy and implemented structural reforms with a view to improving quality and independence of institutions (Spence 2021, Grier, Grier 2021, Goldfajn et al. 2021, Chari et al. 2020).

When analyzing causes of emergence of populism in the countries of Central and Eastern Europe, often pointed out are social and political consequences of deindustrialization which took place in the initial period of systemic transformation (Scheiring 2021). In Poland, the importance of this factor was emphasised, among others, by Karol Modzelewski (2013). Nevertheless, Poland was a country where the economic transformation turned out to be exceptionally effective, as it brought about 30 years of uninterrupted economic growth (Gradzewicz et al. 2018).

The economic success of the Polish transformation had three main reasons.

Firstly, thanks to the restoration of democracy, it was possible to create a system of institutions ensuring balance in the economy, which were given a sufficiently large scope of autonomy for this purpose. And it was not just about an independent central bank. The positions of ministers of finance and ministers of economy were often held by persons, whose professional position (including often also academic position) predisposed them to make independent decisions that were consistent with the requirement to maintain balance in the economy.

Secondly, effective stabilization of the Polish economy and its opening to exchange – combined with the prospect of our accession to the EU – attracted a large inflow of direct investments to Poland (as well as to other countries in the region). Thanks to this, technological competitiveness of the Polish economy was constantly improving. Within a relatively short period of time, we became an economy with export surpluses, which eliminated the need to borrow abroad. Poland is among the countries which account for half of the total volume of European exports. This group consists of Germany, Austria, Switzerland, Poland, the Czech Republic, Slovakia, Hungary, and Slovenia (Landesman and Stöllinger 2018).

One should add, which is rarely emphasized, that exports have become the main driver of our economic growth (Muck and Hagemajer 2019). From a historical point of view, the inflow of direct investment into Central and Eastern Europe played a role analogous to the inflow of American direct investment into Western Europe after the end of World War II, when it enabled European economies to quickly reduce the technological and managerial gap that separated them at that time from the American economy (Bergeaud, Cette and Lecat 2014).

Thirdly, liberalization of the economy carried out as part of the Balcerowicz Plan enabled mass establishment of new companies, created by entrepreneurs across all social groups (Gardawski et al. 2013). New jobs were mushrooming chiefly in the service sector. Thanks to this, the large number of jobs created

in services today contributes to low unemployment even in periods of weaker economic conditions.

The success of the economic transformation brought Poland closer to joining the euro zone. And it was not only about meeting the Maastricht criteria. The point was that the previous dilemmas, mainly related to the exchange rate policy, lost their importance. In a situation where, since our accession to the EU, half of Polish exports have consisted of sales abroad of goods and services produced in enterprises that are part of global value chains, it is not changes in the zloty exchange rate that have a much greater impact on our exports, but changes in the volume of foreign direct investments flowing into Poland (Sławiński 2020). In this situation, the National Bank of Poland analyses with regard to Poland's entry into the euro zone began to focus mainly on identifying additional institutional and structural reforms which would strengthen our economy prior to adoption of the common European currency (Kosior and Rubaszek 2016).

The institutional changes which have been made in Poland for several years could have permanently pushed the Polish economy off the path of economic growth that was sustainable until only recently. An example of a country where this has already happened is Turkey, whose experiences are in some respects similar to those of Poland.

The similarity results from the fact that changes in Turkey's economic policy were the result of institutional changes. The sequence of introducing the changes was similar to ours. First, the changes were made in response to the deep financial and economic crisis, and later as a result of negotiations with regard to Turkey's accession to the European Union. The introduced institutional changes meant that the Turkish economy entered the path of rapid and sustainable growth at that time. Later, however, when negotiations on entering the EU were unsuccessful, the populist AKP party ruling Turkey withdrew

from previous structural reforms – abolishing the autonomy of institutions responsible for the economic policy (Özel 2015).

This caused to Turkey serious economic problems, which are widely known today. Their spectacular manifestations in recent years have been the almost complete loss of foreign exchange reserves by the Bank of Turkey, very high inflation, and an exceptionally long period of strong depreciation of the Turkish lira (Acemoglu and Úcer 2020). The result was a loss of credibility of the Turkish state not only in the eyes of domestic business, but also in the eyes of foreign investors, a symptom of which was a significant deterioration of the rating of Turkish government bonds (Flug, Portal and Hirsh 2023).

### **3. Impact of interventionist economic policy on the condition of the budget and inflation**

Sebastian Edwards points out that the manner in which fiscal and monetary policy is conducted in a number of Latin American countries is disturbingly similar to the recommendations of the so-called Modern Monetary Theory (MMT), which explicitly recommends financing the budget deficit by issuing money (Edwards 2019a).

Why does the MMT assume a small impact of monetary financing of the budget deficit on inflation (Kelton 2020)? The reason is that the MMT is derived from the theory of functional finance, which was formulated by Abba Lerner in the 1940s, when economists still feared that the mass unemployment that characterized the Great Depression of the 1930s would return following the end of World War II (Lerner 1943). They also remembered that the 1930's strong fiscal expansion did not generally result in high inflation because there was a lot of spare capacity as a result of the Great Depression, not to mention that the goal of the economic policy was to overcome strong deflation (Romer 1992).

However, many things have changed since then. Today, central banks and governments are trying, with more or less success, to maintain the balance in economies, and there is no longer nearly as much spare production capacity as there was in the 1930s. This raises the risk that strong fiscal expansion may lead to high inflation, as illustrated by its increase as a result of governments using monetary fiscal expansion in response to the need to reduce the economic effects of the COVID-19 epidemic.

The reason for the emergence of the MMT was that after the 2007–2008 financial crisis, relatively large budget deficits did not cause inflation. The reason for the persistence of low inflation in highly developed countries – despite the occurrence of relatively large budget deficits in their economies – was not only the weak nature of the economic recovery at that time, raising concerns that the economies of highly developed countries were entering secular stagnation (Summers 2016). An important reason that large budget deficits did not cause inflation was largely the fact that in Japan since the mid-1990s, and in other highly developed countries since the beginning of the 21st century, there has been a large and chronic excess of savings in enterprises (Rachel and Summers 2019, Chen et al. 2017, Gruber and Kamin 2015, Fukao et al. 2014).

Enterprises invested their excess savings either directly in treasury bonds or in banks, which used them (given weak demand for credit) as a source of financing for the purchase of government debt securities. In such circumstances, in highly developed countries, the source of financing budget deficits were savings, thanks to which these deficits did not cause significant inflation pressure.

In developing countries, the main problem of fiscal policy is different. Economies of these countries generate relatively less savings available to finance budget deficits. For this reason, the economic policy in a number of Latin American countries is characterized not only by fiscal dominance, but also by monetary financing of the budget deficit (Edwards 2019b).

In recent years, there could be found elements of MMT in Poland's economic policy i.e. a combination of a highly expansionary fiscal policy with financing the budget deficit in a way that may transform into monetary financing. A hidden form of strong fiscal expansion in recent years has been the transfer of a very large part of public expenditure to dedicated funds, outside the democratic control of the Sejm, which meant that the officially published budget deficit constituted a relatively small percentage of its actual size (Benecki, Dudek and Kotecki 2023).

The source of financing for these expenses was the issue of bonds of Bank Gospodarstwa Krajowego (BGK) and the Polish Development Fund (PFR). Both institutions sell their bonds chiefly to domestic banks. The problem is that the source of financing for the assets of commercial banks only in small part is savings, which is typical in relatively low-income countries such as Poland. In such situation, the funds spent by domestic commercial banks to purchase treasury bonds may come from three sources.

Firstly, such source may be liquid reserves of banks, and domestic commercial banks hold a large surplus of them. When commercial banks pay PBK and PFR with their liquid reserves, these funds ultimately go to the accounts of, for example, enterprises (financed by special purpose funds invested in BGK and PFR), where they become money spent on purchases of goods and services.

Secondly, even if commercial banks use cash deposits paid to them to purchase PBK and PFR bonds, which does not have a direct impact on inflation, it is worth recalling that purchasing bonds is tantamount to granting a loan. This means that the large-scale transactions in question can trigger a credit multiplier, leading to an increase in the money supply and inflation.

Thirdly, commercial banks, if they intend to buy PBK and PFR bonds, can create new money deposits themselves, which inherently increases the money supply (Armeliuś et al. 2020, Borio



2021, Deutsche Bundesbank 2017, McLeay et al. 2014, Goodhart 2009, Holmes 1969, Tobin 1963).

Fourthly, if the NBP returned to interventions on the bond market, such as those conducted from the end of February 2020 to the end of June 2021 (Lindquist 2021), this would again create the opportunity for commercial banks to make back-to-bank transactions, i.e. purchase bonds, including those issued by BGK and PFR, combined with their simultaneous resale to the NBP, which would be a form of monetary financing of the budget deficit by the central bank (Sławiński 2023).

All these relationships contradict the widespread view that, since bonds are long-term securities, then their source of financing must be savings, thanks to which inflation pressure caused by the increasing budget deficit is at best moderate. In reality this is not the case. Poland is not a country with excess savings.

In addition, if there have been institutional changes conducted for a number of years, which by their nature lead to a decrease in efficiency of the economy, continuation of such state of affairs would lead to a relative decrease in the supply of savings. In such situation, inflation threats from budget deficits would increase. This, in turn, would escalate the pressure to use various forms of monetary financing of government expenditure, such as, for example, state banks granting increasing amounts of loans to inefficient state behemoths (Edwards 2019b).

#### 4. Inflation tax

„Although it has become common international practice to provide central banks with legal powers to stabilize inflation, this does not always mean their actual independence from governments” (Cristina Bodea and Ana Carolina Garriga 2022)

Central banks became independent from governments so that their monetary policy was subordinated to the need of maintaining

balance in the economy, and not to the government's political goals. If seen from this perspective, the National Bank of Poland did not use its formal independence after 2016. The tightening of the monetary policy took place with a significant delay, and the pretext for premature withdrawal from interest rate increases was the non-existent risk of a strong increase in unemployment – in a situation where for a decade now the aging population has been reducing the pace of supply growth on the labour market, and new jobs are being created mainly in the service sector, which is relatively less susceptible to economic fluctuations than the industry sector (Filar 2022). Overly accommodative monetary policy led to much higher inflation than there could have been, had the National Bank of Poland reacted as an independent central bank should. As a result, the costs of inflation – including the loss of purchasing power of the monetary resources of people and enterprises – were much greater than commonly believed.

We have decided to define the loss of purchasing power of the monetary resources of people and enterprises as an inflation tax. Although not all the loss of monetary resources of the population and enterprises was translated entirely into government revenues, still, it was largely the result of irresponsible fiscal and monetary policy pursued by the Polish authorities. Therefore, the use of the term inflation tax is justified.

In the case of cash resources, these provide no protection against inflation. In the case of cash and savings deposits, their interest rates should protect their real value, but this did not happen in Poland as a result of interest rates being reduced to almost zero in 2020. This decision not only increased the inflation-induced decline in the real value of bank deposits. It also prompted many households to seek protection from inflation by investing in the stock and real property markets. In Poland, a country with a relatively low average household income, this meant that many households took risks that they should not have taken due to their low level of wealth.

In order to estimate the scale of the inflation tax imposed on households and businesses in Poland, we constructed a simple model taking into account the volume of our economy, public debt, and government tax revenues. There was used a conservative estimation method, allowing to obtain the lowest possible estimate.

We used CPI as a measure of inflation, and not the cost of living measure, which would be more accurate, since it is not regularly published in our country. We made three assumptions while estimating the amount of inflation tax imposed on the economy.

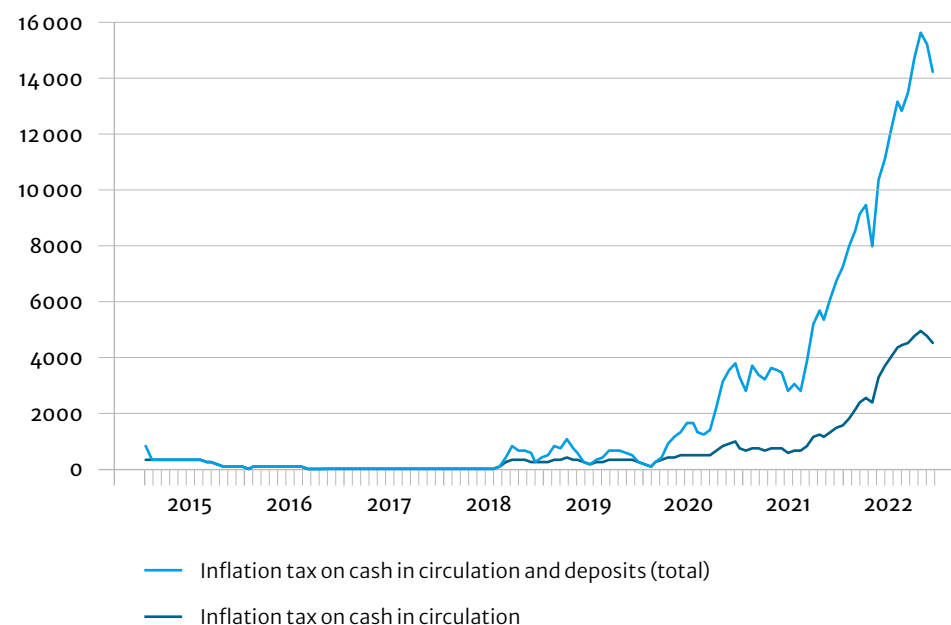
The amount of the inflation tax is estimated only for households and enterprises. This assumption is justified because – with the exclusion of cash resources – deposits from households and enterprises constitute 90 percent of M3 in Poland.

We assume that the average interest rate on deposits of households and enterprises (current and term-based) was not higher than the reference rate of the National Bank of Poland. The adoption of such an assumption is justified because, in practice, interest rates on current deposits and deposits with different maturities were often significantly lower than the NBP reference rate.

We assume that the share of deposits in foreign currencies was 15%. In reality it was smaller, but we assumed its value at 15% due to the fact that the increase in uncertainty in recent years (triggered, among others, by high inflation and the weakening exchange rate of the Polish zloty) led to a gradual increase in the share of foreign currency deposits.

The result of our calculations is an estimate of the smallest possible amounts of inflation tax imposed on households and enterprises in the years 2012–2022. As shown in Chart 1, in 2022 its value amounted to PLN 150 billion. In order to show the scale of the loss of real purchasing power of monetary resources of households and enterprises, one may compare them with the amount of budget tax revenues, which amounted to PLN 466 billion in 2022. Let us recall that this included VAT revenues in the amount of PLN 234 billion (50.3%), excise tax revenues in the amount of PLN 80 billion (17.1%), and PIT and CIT revenues in the amount of PLN 68 billion (14.6%) and PLN 70 billion (15.1%) respectively, as well as PLN 6 billion (1.3%) from taxation of financial institutions.

**CHART 84.** Amount of inflation tax in Poland in the years 2012–2022 (millions of zlotys per month)



**Tabela 31.** Inflation tax in Poland in 2012–2022 (in millions of zlotys per year)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Cash in circulation (PLN million)	3696	975	262	0	116	3475	3197	4949	9064	16470	48307
Deposits (PLN million)	0	0	0	0	0	3863	2073	8614	31079	55100	102373
Cash and deposits (total) (PLN million)	3696	975	262	0	116	7338	5269	13563	40143	71571	150681
Cash and deposits (total) (mIn euro)	883	232	62	0	27	1724	1236	3156	9032	15670	32149
Share of deposits in inflation tax (%)	0	0	0	-	0	52,6	39,3	63,5	77,4	77	67,9
Inflation tax/GDP (%)	0,2	0,1	0	0	0	0,4	0,2	0,6	1,7	2,7	4,9
EUR/PLN (annual average)	4,185	4,1975	4,1852	4,2615	4,3625	4,2623	4,2623	4,298	4,4448	4,5674	4,6869

In order to assess the scale of inflation tax imposed on households and enterprises, one should also take into account the fact that in Poland cash and bank deposits constitute 50% of total financial assets of households, while in the European Union this share is at the average level of 32–33%. It is also worth recalling that the lower the income of households, the greater the share of cash and bank deposits in the value of their assets. This relationship illustrates the degressive nature of the inflation tax imposed on the economy.

## 5. Final remarks

„The new system, defined by its creator Viktor Orban himself as illiberal democracy, is at best a façade democracy and shows more and more attributes of a downright authoritarian system”  
(Bogdan Góralczyk 2019)

The course of events in the economies under the populist rule raises a question why in many countries political and institutional changes continued, which led almost inevitably to imbalances in the economy and its decreasing efficiency. The reason was the pursuit of populist governments to gain as much control over the economy as possible and their doctrinal belief in effectiveness of the interventionist economic policy. Of importance is also the fact that the longer the system of facade democracy lasts, the more social groups there are to benefit from this system, as is the case with the oligarchy associated with the government. To make matters worse, the society, having no access to free media, is less and less aware of the long-term costs of the interventionist economic policy. Meanwhile, populists continuously proclaim its „agency”, even though – by limiting operation of market mechanisms – it is a factor which reduces efficiency of the economy and, in the long term, pushes it onto the path of stagnant growth.

Since the political and institutional changes which took place in Poland are similar to those in Turkey, this raises the question why our economic situation has not deteriorated as radically as that of Turkey, when that country – having resigned from meeting the entry conditions to the European Union – withdrew from the previously made political and institutional changes. The reason for this difference is largely our membership in the European Union. It has helped to sustain a belief of foreign investors that Poland would not apply an economic policy leading to economic imbalances as large as in Turkey.

Such perception of Poland by foreign investors is manifested by, among others, the fact that despite imprudent fiscal policy, the rating of Polish treasury bonds has not yet been lowered, and the Polish zloty has not weakened significantly in relation to the euro, although inflation in Poland has been much higher than in the euro zone, and thus the zloty was losing real value against the euro (Flug et al. 2023).

If Polesit were to take place, the process of pushing the Polish economy off the path of sustainable growth would radically accelerate also as a result of significant deterioration in the assessment of our credibility by foreign investors. The inflow of foreign investments would quickly decline. Investors would lose the certainty of maintaining fully open access to the large European market. They would also no longer be protected by the European law and courts. Due to the decline in the inflow of foreign investments, the chances for development of modern industries, which by their nature constitute part of global production networks, would decrease. The risk premium contained in the prices of Polish treasury bonds would increase dramatically, which would translate into an increase in long-term interest rates with all the ensuing consequences.

However, it is also obvious that the quality of the economic policy could be permanently degraded even without a formal exit from the European Union. An example of this is the economic situation in Hungary, permanent deterioration of which

is the result of the end of the process of transforming democracy into a façade democracy in the country. (Góralczyk 2019).



# Impact of the systemic change in the monetary policy on exchange rates

A sharp decline in the Turkish lira exchange rate in recent years was a result of growing imbalances in the Turkish economy, resulting from its departure from pro-market institutional reforms (Flug et al. 2023). In the case of the forint and zloty, changes in their exchange rates were less spectacular, even though in Hungary and Poland the process of withdrawing from the pro-market institutional reforms implemented in the 1990s was ongoing. An important reason for this difference was that the economic credibility of Poland and Hungary was still maintained by the strong integration of both countries with the euro zone and their membership in the European Union.

After the successful economic transformation in our region's countries, currency dealers believed that the Czech Republic, Poland, and Hungary were so strongly economically integrated with the euro zone that they could adopt the common currency if they decided to do so. At the same time, long-term investors assumed that the Czech Republic, Poland, and Hungary would pursue economic policies consistent with the requirements of

the European Union, and therefore no large and lasting imbalances would occur in their economies.

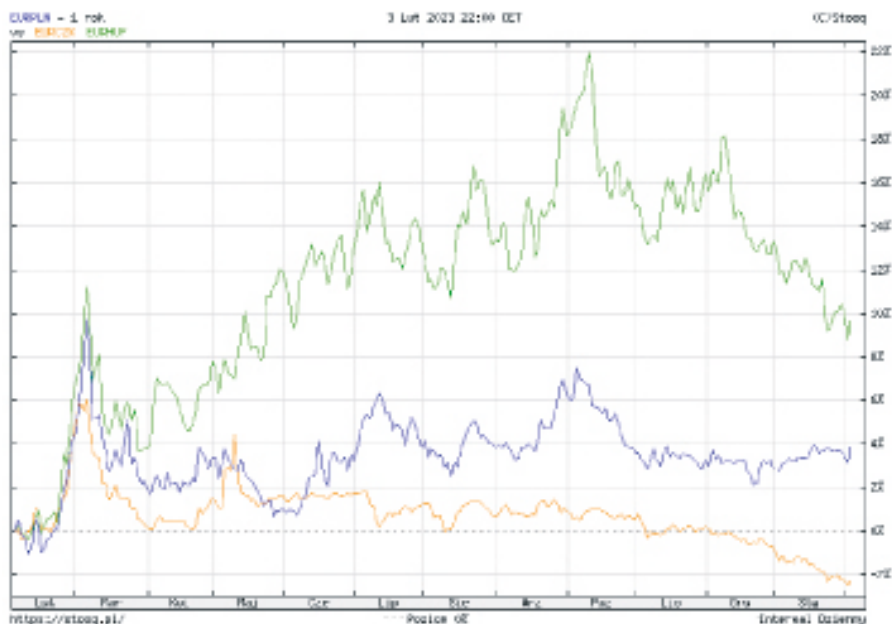
Finding this type of approach to the economies of our region, currency dealers saw no reason to gamble on, for example, a strong decline in the exchange rate of the koruna, zloty, or forint in relation to the euro. This resulted in exchange rates of all three currencies being, on average, very stable in relation to the euro for a number of years – as was the case (for analogous reasons) with the pound sterling and the Swedish krona.

However, in recent years, long-term exchange rate trends have begun to reflect the growing differentiation in credibility of the economies of our region as a result of changes which have taken place in the state model and the method of conducting economic policy in Poland and Hungary. The charts below clearly reflect that at the same time as the appreciation of the Czech crown against the euro continued in 2021–2022, the currencies of Poland and Hungary began to weaken in relation to the European currency, and in the case of the forint, the scale of its depreciation was significantly greater.

Marked depreciation of the forint against the euro began in 2017, when Fidesz completed the process of transforming Hungarian democracy into a façade democracy (Góralczyk 2019). It is difficult to rule out that the perception of the forint and the zloty by foreign investors was also influenced by the fact that the scale of the QE programmes undertaken by Poland and Hungary was larger than in other emerging economies, and the Polish central bank resorted to the classic helicopter drop of money by purchasing bonds from BGK and PFR, i.e. from institutions that directly finance government expenses (Arena et al. 2021).

In the first half of 2023, the Polish zloty and the forint strengthened in relation to the euro. However, this was due, among others, to the earlier increase in interest rates in Poland and Hungary, which caused the zloty and forint to strengthen against the euro, despite the fact that inflation in recent years in both economies was much higher than in the euro zone.





# **TABLE 31. Public debt and inflation tax in Poland in the years 2012-2022**

	2012	2013	2014*	2015	2016	2017	2018	2019	2020**	2021	2022
	(mln zł)										
State Treasury Debt	793 853,7	838 025,4	779 938,4	834 550,6	928 666,2	928 473,0	954 269,3	973 338,2	1 097 480,0	1 138 034,2	1 238 466,0
State public dept	840 476,8	882 293,0	826 774,7	877 282,4	965 199,0	961 841,5	984 313,5	990 948,4	1 111 806,3	1 148 579,0	1 209 594,1
General Government sector debt	883 523,7	931 060,6	873 908,8	923 416,5	1 010 021,9	1 007 199,6	1 035 798,3	1 046 022,3	1 336 557,6	1 410 499,5	1 512 226,8
State Treasury Debt / GDP	49,2	51,4	45,9	46,4	50,1	46,8	44,9	42,5	46,9	43,2	40,2
State public dept / GDP	52,1	54,1	48,6	48,8	52,1	48,5	46,3	43,3	47,6	43,7	39,3
General Government sector debt / GDP	54,8	57,1	51,4	51,3	54,5	50,8	48,7	45,7	57,2	53,6	49,1
GDP	1 612 739	1 630 126	1 700 552	1 798 471	1 853 205	1 982 794	2 126 507	2 288 492	2 337 672	2 631 302	3 078 325
<b>Nominal growth</b> (mln zł rocznie)											
State Treasury Debt	22 726,2	44 171,7	-58 087,0	54 612,2	94 115,6	-193,2	25 796,3	19 068,9	124 141,8	40 554,1	100 431,9
State public dept	25 130,6	41 816,2	-55 518,3	50 507,7	87 916,6	-3 357,4	22 471,9	6 634,9	120 857,9	36 772,6	61 015,1
General Government sector debt	26 943,5	47 536,9	-57 151,8	49 507,7	86 605,4	-2 822,3	28 598,7	10 224,0	290 535,4	73 941,9	101 727,3
<b>Relative growth</b> (proc. rocznie)											
State Treasury Debt	2,9	5,6	-6,9	7,0	11,3	0,0	2,8	2,0	12,8	3,7	8,8
State public dept	3,1	5,0	-6,3	6,1	10,0	-0,3	2,3	0,7	12,2	3,3	5,3
General Government sector debt	3,1	5,4	-6,1	5,7	9,4	-0,3	2,8	1,0	27,8	5,5	7,2
<b>Inflation tax</b>											
Cash in circulation (PLN million)	3 696	975	262	0	116	3 475	3 197	4 949	9 064	16 470	48 307
Deposits (PLN million)	0	0	0	0	0	3 863	2 073	8 614	31 079	55 100	102 373
Cash and deposits (total) (PLN million)	3 696	975	262	0	116	7 338	5 269	13 563	40 143	71 571	150 681
Cash and deposits (total) (EUR million)	883	232	62	0	27	1 724	1 236	3 156	9 032	15 670	32 149
Share of deposits in inflation tax (%)	0,0	0,0	0,0	-	0,0	52,6	39,3	63,5	77,4	77,0	67,9
Inflation tax/GDP (%)	0,2	0,1	0,0	0,0	0,0	0,4	0,2	0,6	1,7	2,7	4,9
EUR / PLN (annual average)	4,1850	4,1975	4,1852	4,2615	4,3625	4,2576	4,2623	4,2980	4,4448	4,5674	4,6869

- In 2014, Open Pension Funds (OFE) lost the opportunity to invest in treasury bonds. As a consequence, 51.5 percent their assets were transferred to the Social Insurance Institution (ZUS) (PLN 134 billion) and to the Demographic Reserve Fund (PLN 19 billion)
- In 2020, as a result of government spending to mitigate the economic effects of the COVID-19 epidemic, there was a significant increase in public debt.

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