

Poland and the Six Roles of Government

In a Market Economy

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ECON 2012 (online):

Principles of Macroeconomics

Term Paper / Fall 2007

17 November 2007

Foreword

With the fall of communism in 1989, Poland found itself thrust suddenly into the realm of liberal democracy. Transitioning from a communist economy, in which state planners tightly clutch the monetary reins, to one in which the market is (theoretically) free to steer most of those economic decisions, required swift and drastic action. Through the 1990s, Poland found itself on the receiving end of *shock therapy*, “the sudden release of price and currency controls, withdrawal of state subsidies, and immediate trade liberalization within a country” (definition courtesy of Wikipedia entry “Shock therapy [economics]”). Mark Kesselman, et. al., describe shock therapy as “the rapid application of neoliberalism... which involves the ending of price controls, a free hand for business elites, and a reduced role for government in managing the economy” (Kesselman, 2006; p.524). No longer was it dictated who would produce what, or for whom. Gone were price controls, monopolies, and employment guarantees. In their place came privatization, competition, and elitism. Follow this up with the country’s entrance into the European Union on 1 May 2004, and Poland steps onto the stage as a player in the world market.

But with that position come rules to be followed. One such tenet states that trade is essential to a healthy market economy. In order to have effective trade, there must be contracts, codes, methods, and regulations governing such – and the ability to enforce them. Thus, one cannot have a healthy market without an effective government to carry out said enforcement. David C. Colander outlines “six roles of government in a market

economy” (Colander, 2006; p.39). The question set forth in this paper is thus: *How does Poland in 2007 – a new member of the European Union (EU), clawing for its place in the globalized economy – rate in the context of Colander’s six roles of government?* If these six roles truly are representative of one’s ability to effectively participate in trade, and thus fuel one’s own economy, then gauging Poland’s progress in relation to such should provide insight into its future as a global player.

The Six Roles of Government in a Market Economy

Colander lays out the six roles of government as follows:

1.) “Provide a Stable Set of Institutions and Rules” (Colander, 2006; p.39).

Provides an “institutional framework” for the creating and enforcing of rules and consequences. This can frequently be a problem for countries in the developmental or transitional stages, as said economies can tend toward stagnancy, and their institutional frameworks may be hard to define while they are in flux.

2.) “Promote Effective and Workable Competition” (Colander, 2006; p.40).

Basically, gauging how effective a government is in playing the yo-yo game of promoting competition while not stepping on the feet of business. It involves the prevention of absolute monopolies, which crush competition and potentially drive up prices, which in turn can negatively effect the economy on a number of levels.

- 3.) **“Correct for Externalities”** (Colander, 2006; p.40). Whether or not a government can effectively adjust market results for externalities, which are “the effect[s] of a decision on a third party not taken into account by the decision maker.” To paraphrase one of Colander’s examples: A bloke who runs his air conditioner in the middle of summer does so to make himself cooler, but fails to take into account the damage he is doing to the ozone layer as a result; the harm to the ozone layer would be an externality. In the realm of economics, one could state that the EU signing and adhering to the Kyoto Protocol may be offset in many ways by the effects (externalities) of the United States – the largest producer of greenhouse emissions in the world – *not* signing on with the Protocol.
- 4.) **“Ensure Economic Stability and Growth”** (Colander, 2006; p.41). Focused on the macroeconomic externalities of unemployment, inflation, and economic growth, “government should prevent large fluctuations in the level of economic activity, maintain a relatively constant price level, and provide an economic environment conducive to economic growth.”
- 5.) **“Provide for Public Goods”** (Colander, 2006; p.41). Regarded by Colander as “goods that are most efficiently provided collectively rather than privately,” public goods are goods that, “if supplied to one person, must be supplied to all, and whose consumption by one individual does not prevent [their] consumption by another individual.” Providing for national defense falls under this category, as does infrastructure.
- 6.) **“Adjust for Undesirable Market Results”** (Colander, 2006; p.41). To quote Colander, “A controversial role for government is to adjust the results of the

market when those market results are seen as socially undesirable. Government redistributes income, taking it away from some individuals and giving it to others whom it sees as more deserving or more in need. In so doing, it attempts to see that the outcomes of trades are fair.” This leads to issues of progressive versus regressive versus proportional taxes; merit versus demerit activities; and market failures (“situations in which the market does not lead to a desired result,” p.42) versus government failures (“situations in which the government intervenes and makes things worse,” p.42) – and choosing “which failure... will be least problematic.”

There is great controversy and great debate between political ideologies over how deeply a government – any government – should stick its hand into any one of these roles. But, Colander argues, to whatever extent, a government should be entrenched in each if it is to foster a healthy economy that can keep pace with trade and globalization.

With that, let’s have a look at how Poland presently fits into this scheme.

Poland and the First Rule: “Provide a Stable Set of Institutions and Rules”

Has Poland exhibited an adequate institutional framework within which to enforce rules and consequences in the economic realm? Truly, the very act of being accepted into the European Union requires that a country has fulfilled certain criteria in the implementation

of said institutions. The “Copenhagen Criteria,” on which all would-be member states are judged in the consideration for EU membership, are thus:

- 1.) “Stability of institutions guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities,”
- 2.) “Existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the EU,”
- 3.) Ability to take on the obligations of membership, including adherence to the aims of political, economic, and monetary union” (Dinan, 2005, p.148).

Thus, in order to have gained acceptance into the EU in the first place, Poland will have exhibited that it is a functioning democracy with a functioning market economy, etc. – that is, the aforementioned adequate institutional framework. Now, within the EU, they are part of a single market with the rest of Europe, and are considering the transition from Poland’s current form of currency, the zloty, to the EU’s euro.

Stable institutions inspire investment from around the world, and global investments stimulate growth. Marcin Klammer (Klammer, 2007) notes, “The recent political change is perceived positively by investors and entrepreneurs. Stable growth should be maintained by continuing investment by the government and EU.” The recent political change to which Klammer refers is the ousting of prime minister Juroslaw Kaczynski. As stated in *The Economist*, “Under the eccentric rule of Mr Kaczynski as prime minister and his twin brother, Lech, as president, Poland seemed to confirm the fears of those who said that enlarging the European Union to the east was a mistake. In the name of fighting corruption at home, the Polish authorities corroded independent institutions, undermined

the rule of law and misused the intelligence services.” Additionally, the Kaczynskis seriously damaged Poland’s reputation abroad, “making their country, once a respected ally, a laughing stock and a nuisance. They picked unnecessary fights with Germany, sourly cited past historical wrongs... in their bid for bigger voting weights within the EU, and put backs up all round” (The Economist [no byline] II, 2007). And the recent discovery that the outgoing prime minister issued, the day after losing his bid for re-election, an order for the destruction of Internal Security Agency documents has caused a stir in Polish politics (BBC Monitoring Europe, 2007). By law, and by practice, Kaczynski does not have to release to the public a justification for his order. This, combined with the murky ethical waters in which the entire issue treads, undermines transparency in government – which, in turn, raises suspicions and concerns, both within the country and further out into the global realm. For a country desperate for international aid in order to maintain their economic boom, lack of transparency in government can spell doom for international investors, and, in turn, for the country’s economy.

Poland and the Second Rule: “Promote Effective and Workable Competition”

How effective has Poland been at curbing monopoly and promoting economic competition? Part of acceptance into the EU requires the would-be member country to be making strides toward a “functioning market economy, competitive pressures, and market forces” (Dinan, 2005; p.149). Indeed, after ten years of negotiations and accession

conferences, Poland had proved itself to be heading in the right direction in these matters by the time it formally joined the EU in 2004.

A new EU law called MiFID (the Markets in Financial Instruments Directive), introduced in November 2007, effectively ends the monopoly of the national stock exchange in Poland (and, for that matter, those of national stock exchanges in every other EU state, as well). To this point, Poland had been holding tight to the requirement that trading take place via their national stock exchange; “the new rules end the monopoly (albeit a waning one) of national stock exchanges over share trading and throw open the field to newer electronic exchanges and even the big investment banks... [This] creates a common market for share, commodities and derivatives trading across thirty countries in Europe” (The Economist [no byline], 2007). Gone will be the practice of monopolizing exchanges charging tremendous fees for membership and absurd tariffs on trades. Per the Economist article, “Traders must now execute a buy or sell order on any exchange or trading system which they feel gives the best deal for their clients, though the exact definition of this has been left deliberately imprecise. The trades, rather than being reported to a national exchange, can now simply be made public. That represents a substantial business opportunity, as well as a potential cost saving, for the banks.” Thus, competition between stock trade options is promoted and encouraged, and transparency in the stock trading process is required.

Poland and the Third Rule: “Correct for Externalities”

Has Poland effectively adjusted its market for externalities? On the economic front, it certainly didn't take into account just how many workers would flee to other EU states before the ink had even finished drying in 2004. In joining the EU, expectations were high in Poland that new social and economic opportunities would lead to a stronger economy all around. However, mass emigration has left the country bereft of workers, who fled to countries like Britain and Ireland, who opened their labor markets to Polish workers immediately, when the state-run factories were shut down en masse without adequate employment options available to take their place – an externality the government had, foolishly, not fully anticipated or made provisions for.

Luckily for Poland – though not so luckily for the U.K. – the current burst of the housing market bubble in Britain means that soon there will be fewer jobs available in the U.K., and more reason for Polish workers to return to their homeland. And with the economic boom Poland is experiencing, employment opportunities and wage hikes may be enough of a lure to draw the Poles back.

Poland and the Fourth Rule: “Ensure Economic Stability and Growth”

Has the Polish government been effective in preventing large fluctuations in unemployment, inflation, and price levels, in order to harness an environment of economic growth? With such low inflation (1% in 2006), a booming economy, and

buoyant public finances, one's first inclination would be to bellow a merry, "Yes!"

According to Marcin Klammer (Klammer, 2007), Poland's gross domestic product (GDP) "rose 5.8% in 2006, compared with 3.5% in 2005, while inflation in 2006 was 2%. This is likely to pick up to about 3% in 2007, mainly owing to price rises in the construction industry." Klammer points to the increase in foreign capital following the 2004 accession into the EU as the stimulus for economic growth, particularly in the construction field. Klammer notes, "Foreign capital has affected all property sectors, particularly residential. This part of construction became a market of its own after decades of domination by the so-called housing co-operatives - entities established under the Communist regulations to develop residential projects." Thus, the government's elimination of state control, which is seen as a positive move by the majority of investors around the world, has led to increased investment from foreign entities, which in turn has led to successful market-driven growth. Per The Guardian (London)'s Ashley Seager, "It is to be hoped that the strong economic growth of recent years in the region will continue in spite of the global credit crunch, high oil prices and a fading property boom" (Seager, 2007).

That said, instabilities in government – particularly those under the reign of the outgoing Law and Justice Party Kaczynski brothers, president Lech and prime minister Jaroslaw – have created bumps in the road to attracting foreign investors. "In recent years Polish politics has regularly provided a troubling show of turbulence," writes Newsweek's William Underhill (Underhill, 2007). "Up to two million of its young have headed West to take jobs elsewhere in the bloc, while leaders have alienated their EU counterparts

with a macho disregard for diplomatic niceties, reviving decades-old grievances and blocking the tidy compromises the Union requires to function.” Namely, Underhill points to “cramming the civil service with cronies, overriding the Constitution and botching moves to strip jobs from those linked with the Soviet-era regime,” courtesy of the Kaczynski brothers. Yet to be seen is how the pro-European Civic Platform Party and its prime minister-to-be, Donald Tusk, just voted into power, will change the actions by and perceptions of Polish government.

While the market is recovering in some sectors, unemployment remains the dark horse of the Polish economy, as discussed in the Third Rule. The CIA World Factbook figures for 2006 place unemployment at 14.9% in Poland – one of the highest levels in the EU.

“While major economic growth has taken place in Poland since 2004, paradoxically, about two million young and qualified Poles have left to work in old EU countries,” Klammer writes. Indeed, states the aforementioned Underhill in an article co-written with Jessica Au, “In the three years since Poland joined the EU, millions of Poles have joined a westward exodus, with [Britain and Ireland] as clear favorites. By some reckonings, Ireland now plays host to 200,000 Polish ex-pats – equivalent to 5 percent of the population – while Britain accommodates at least 700,000” (Underhill and Au, 2007).

“However, many have started coming back, accepting lower salaries but benefiting from a lower cost of living,” states Klammer. With any luck, more Poles living abroad will follow this trend, returning home with new skills and new perspectives that will help shape the future of their homeland.

Poland and the Fifth Rule: “Provide for Public Goods”

How efficient has Poland been in providing public goods, namely infrastructure?

Poland has gone out of its way to project a positive image, in the hopes of attracting investment. To that end, the Euro 2012 Football Championship is to be held in Poland and Ukraine, and the preparations for such include a massive infrastructure overhaul to be enacted over the next five years. Focus at the moment is on fast-track approval for building out the cities, providing “hotels, conference centres, training and leisure centres, residential and other commercial investments... This is positive, as administrative restraints, claims, objections and lengthy approval processes have, in the past, been major obstacles to the successful execution of real estate projects” (Klammer, 2007).

Preparations for a football championship does not take the place of long-term government commitment to improvements in infrastructure, but they can be the launching place for such actions.

In addition to infrastructure, Poland has had to overhaul its power plants. The vast majority of power is still driven by coal, a method known for being both inefficient and horribly polluting. By joining the EU, Poland has agreed to meet the emissions standards set forth by the Kyoto Protocol; the current system of power falls woefully short of those standards. In fairness, the modernization and overhaul of Poland’s energy plants has been underway since the 1990s, but with Kyoto requirements looming overhead, the

pressure for power plant rehabilitation has become more intense and immediate. And the rewards of such are two-fold for Poland: 1) Fulfilling the requirements of the new standard puts them in good standing in the global community, and 2) the new infrastructure will prove more efficient and more cleanly for the people of Poland – “the public good” at its best.

Poland and the Sixth Rule: “Adjust for Undesirable Market Results”

How effective is Poland in adjusting for undesirable market results, particularly in the realm of redistributing income through taxes? That is a difficult question, mired in the quagmire that is the Polish tax system. On the basic level of tax interpretation, individuals are taxed at a progressive rate, but the top income shelf is hit comparatively early at PLZ 85,528 (“early” compared to other economies), with a 40% tax. Tax types consist of, among others, personal income tax, corporate income tax, and VAT (value added tax). Mandatory social security tax did not exist in Poland until its accession into the EU in 2004, at which point it was implemented as an expense divided between employer and employee. Social security in Poland covers maternity costs, pensions for widows and orphans, regular personal pensions, sickness costs, disability insurance, unemployment, and death. Taxes are withheld from paychecks on a monthly basis, and tax returns are to be filed by 30 April every year. This is all basic information relating to personal taxes, and they seem quite similar to taxation practices elsewhere in the world.

And that is as far as this researcher's tax knowledge goes. But, apparently, taxation rules in Poland – particularly those relating to business – are not nearly as clear-cut as these seem.

The Polish tax system is reportedly bogged down by complications and confusion. "The taxpayers are frustrated not with the fact that they have to share their money with the revenue office, but by the fact that the rules are unclear," said Arkadiusz Michaliszyn, lawyer at CMS Cameron McKenna, as quoted in an article by the Polish paper *Gazeta Prawna* (translated by the Polish News Bulletin [no byline] I, 2006).

PricewaterhouseCoopers and World Bank experts state, "While the nominal CIT [corporate income tax] rate in Poland is relatively low (19 percent), after taking into account all the additional tax-related payments the total tax rate contributed by businesses operating in the country rises to 38.4 percent" and that the tax regulations are "unclear and frequently-changing" (Polish News Bulletin [no byline] III, 2007; PricewaterhouseCoopers, 2007). The situation is described most succinctly by Polish economist Leszek Balcerowicz, in an interview with the Polish-language *Wall Street Journal Polska* (translated by the Polish News Bulletin):

"Polish tax burdens, calculated as percentage of the GDP [gross domestic product], are on average twice as high as in Asia's tigers, which, of course, is the result of inflated budget spending. The large spending is not the consequence of assigning huge sums of money to the construction of motorways, but badly addressed social transfers. The maintenance of the social sphere in Poland costs six times as much as the total costs of the whole public administration. Furthermore, the spending does not reach the most needing, who really find it

troublesome to get a living. Experience shows that a social state often is a great mystification, especially in the Third World, in the most underdeveloped countries, in which it simply is one of the reasons for their economic backwardness. We have many mystifications in Poland connected with the state's social mission. It does not help to pull people out of poverty, but hampers this great task harming development" (Polish News Bulletin [no byline], V).

Balcerowicz goes on to point to public spending outpacing economic development and the fact that there are still companies that have not been released from state control as further factors in economic inefficiency and frustration in Poland.

Adds Janusz Fiszer, partner with the firm White & Case in Warsaw: "The biggest challenges faced by the Polish tax market in 2007 are the lack of a coherent and consequent tax reform, the defective VAT law, and increased taxation of shareholder loans or unrelated-party loans (increase from 0 to 0.5% or even 2% respectively)" (International Tax Review, 2007).

Conclusion

Poland seems well on its way to full integration in Europe as a democratic state engaging in the globalized economy. But, while it has been a quick transition, it has not been an easy one, and it is very much a state – and an economy – in flux. Poland possesses the institutions needed for a full transition, but it needs to learn how to utilize them efficiently; it is making strides toward workable competition, but it is not completely there, yet; it is still reeling from the flight of its workers to other European countries, but

in trying to woo them back they are striving toward a correction for that externality; economic growth is its strong suit at this point – now it is simply a question of how long the boom will last, and how they’ll handle the plateau when it inevitably comes; the need for public goods like infrastructure has been acknowledged and is in the process of being addressed; and the tax system, while in need of an overhaul, possesses potential. Overall, Poland appears to be on the right track.

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