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Reasons Why Poland Avoided the 2007-2009 Recession

Abstract

Poland was the only economy among the European Union members, which avoided the recession of 2007-09. Nevertheless, the impact of global recession was visible in many areas of the Polish economy. The paper analyzes some of the main reasons behind this outstanding performance. The analysis is based on data from business surveys, composite coincident and leading indexes and official statistics on Poland's economy. The reasons are divided into four groups:

(1) **General economic condition before the global crisis.** In this part the large inflow of direct investments and fast growing productivity throughout 2004-2007 are emphasized.

(2) **Structural factors related to the stage of Poland's economic development.** The main factors in this group are: low dependence on business and consumer credit; absence of high risk financial instruments (securities based on US subprime mortgages) in the banking sector; relatively small external ties of the Polish economy with relatively big domestic market.

(3) **Benefits of the EU membership.** Poland benefited from the large share of investments linked to EU transfers since May 2004. It boosted the activity in sectors such as building and construction and reduced the scale of layoffs.

(4) **Market forces.** Despite Poland's goal to join the euro area as soon as possible, its own currency and floating exchange rates helped to enhance Polish export during recession. Strong Polish currency during the period of high oil prices (2007-2008) prevented the economy from increasing costs of production and made imports cheaper. The later depreciation of the zloty (2008-2009) made export goods more competitive on the international markets which prevented Polish exports from declining. Another factor in this group is the absence of any special stimulus programs undertaken by the government.

Key Words: recession, composite leading indicator, business survey, business cycles

1. Introduction

The 2007-2009 crisis, that the whole world was grappling with did not spare the Polish economy. However, it was much milder than in many other countries, which allowed Poland to avoid a “technical recession” which is typically defined as a decline in real GDP for two or more consecutive quarters. Despite that, the annual GDP growth rate decreased significantly – from 6.8% in 2007 to 5.1% in 2008 and 1.8% in 2009.

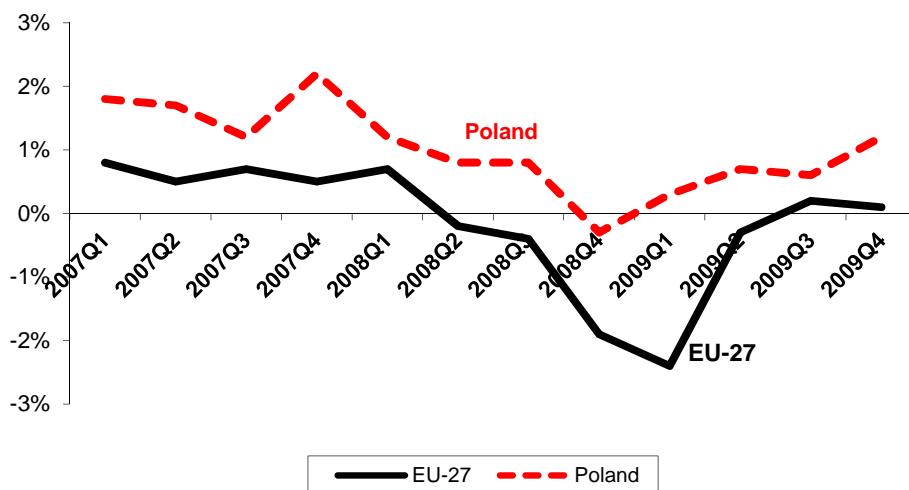


Figure 1. GDP growth rate Q/Q-1, Poland and EU-27

Source: CSO, Eurostat, data seasonally adjusted

In quarter-on-quarter terms, the Polish economy posted a negative GDP growth (-0.3%) only in the 4th quarter of 2008. The Polish financial system was not infected with soured assets, so financial institutions were not the source of turbulence in the economy. The real estate market admittedly showed symptoms of slight overheating, manifesting itself mainly in a dynamic growth of real estate prices. However, these transactions did not take the speculative character, and the credit granting criteria did not raise any serious doubts. The relatively good condition of the Polish economy during the worldwide recession of 2007-2009 was the result of many factors connected with the economic policy pursued for the last 20 years, the development stage of Polish economy and market mechanisms.

What follows is a discussion of those factors which I believe to have contributed significantly to restricting the negative effects of the 2007-09 worldwide crisis on the

Polish economy. I concentrate on those factors which stabilized the demand, in particular individual consumption and exports. It is these factors that contributed most significantly to sustaining the economic growth in Poland during the most violent economic turbulence in the world markets.

In the article I focus especially on the following issues:

- relatively low share of credit in financing business activity and consumption,
- swift improvement in the competitiveness of the Polish economy in the period preceding the crisis of 2007-2009,
- relatively low level of economic openness,
- flexible exchange rate,
- inflow of funds from the European Union,
- large share of shadow economy, and
- the government's cautiousness with regard to creating a special economic stimulus package and even greater reluctance to implement it.

These factors can be classified in three groups:

- **structural factors**, resulting from the characteristics of the economy, which is mainly the consequence of its development stage,
- **market mechanisms**, which regulate the capital flow and prices, and
- all kinds of **regulations**, i.e. measures taken by governments or non-governmental and supranational organisations with the purpose of providing funds to the economy or reallocating funds to areas in need of support.

Table 1. Factors stabilizing the economic situation in Poland during the worldwide crisis of 2007-2009 and their impact

Groups of factors	Structural factors			Market mechanisms		Regulations	
	Low share of credit in the economy	Low share of exports in the economy	Large share of shadow economy	Increased work efficiency	Flexible exchange rate	EU funds	Stimulus package
Impact							
Consumption	+/-	=	+	+	+	+	=
Exports	+/-	+	=	+	+	+	=

* “+” stands for positive influence (mitigating the effects of the crisis), “=” for neutral, and “-“ for restricting the growth in the given area.

The channels through which the above-mentioned factors stabilized the economy were mainly household incomes and costs of conducting business activity.

2. General economic outlook of Polish economy 2006-2009

In 2006 and 2007 the Polish economy was growing at the annual rate of over 6% despite clear indications of a crisis abroad. It even showed some symptoms of overheating which manifested itself mainly in a high rate of price increase (inflation in the middle of 2008 reached 4.8%), a high credit take-up rate and a moderate increase in real estate prices (Table 2). The first symptoms of economic slowdown appeared relatively early, i.e. in the second half of 2006. The Leading Index (LI) for Poland was one of the first to signal this.

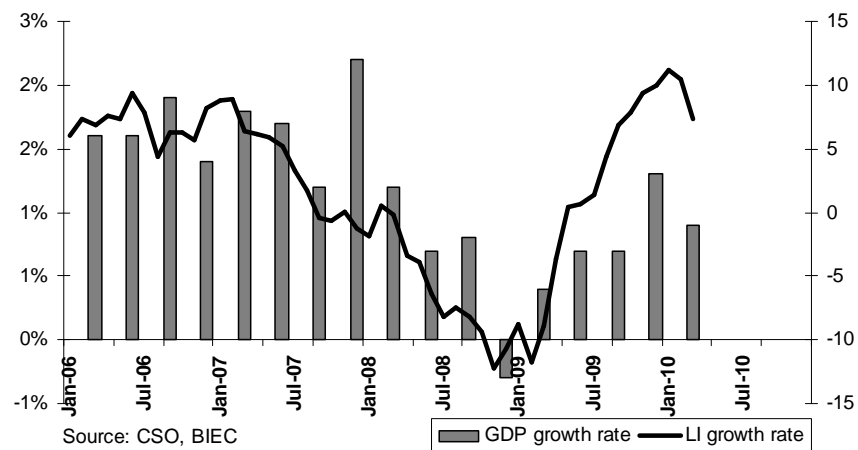


Figure 2. GDP and Leading Index growth rate, Poland, 2006-2009

Stock exchange indices collapsed, similarly to stock markets in the whole world. In real terms, export related difficulties appeared. The inflow rate of new export orders in the manufacturing sector went down. The main reason for this development was the decrease in the price competitiveness of the Polish exports resulting from the strengthening of the zloty. After Poland joined the European Union, the zloty consistently appreciated and by August 2008 it was almost 40% stronger than before the EU accession. In the initial stage, the strengthening of the zloty did not influence export due to the relatively large share of intra-corporate trade, which is generally more resistant to exchange rate changes and less to changes in the economic condition of the

investor's country of origin. The next set of symptoms of the approaching breakdown of economic activity appeared almost one year later. From February 2007 the Leading Index was falling consistently and sharply until February 2009. During these two years it lost 22% of its value and reached the lowest level since 1992⁸. This time the collapse of the inflow of new orders to companies was deep and long-lasting. The appreciation of the zloty went on and turbulences on financial markets were more and more visible and widespread, which resulted in deep investment aversion on all the world's financial markets. The Polish economy reached its peak of activity, measured by the Coincident Index (CI), in January 2008 (Figure 3).

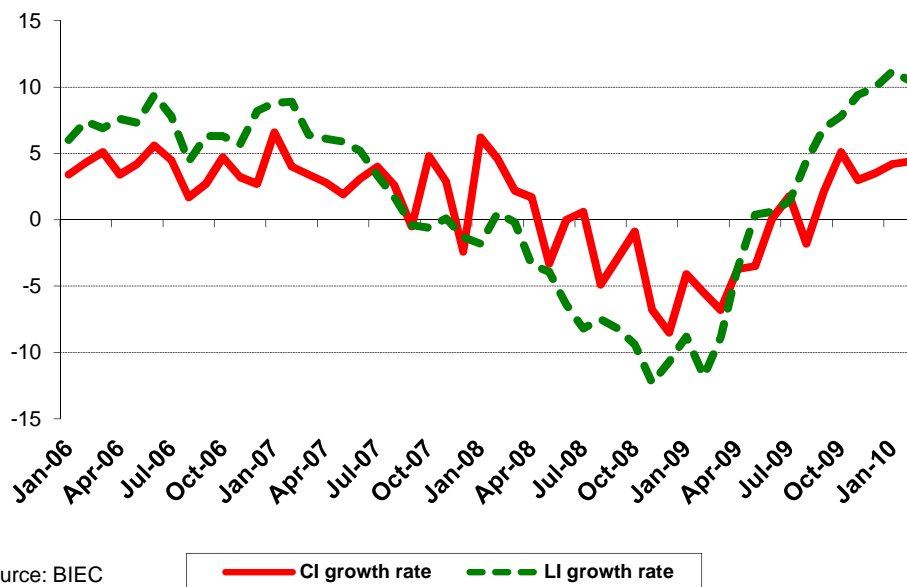


Figure 3. Coincident and Leading Indexes for Poland, growth rate (SMSAR), 2006-2007

In the subsequent months of the year 2008 orders were decreasing, production was consistently limited, and stocks of finished products in companies' warehouses were going up, which resulted in limiting production even further. In the period of the weakest industrial activity – from April to December 2008 – the real value of sales in

⁸ In 1992 the lower values of the Leading Index were connected with the recession of the Polish economy transformation started in 1990 and a worldwide recession.

industry shrank by almost 17%. Interestingly, retail sales did not collapse so sharply in the same period, only its growth rate was limited. Data on the real value of salaries and wages indicate that the domestic demand, and particularly individual consumption, did not decrease significantly. This resulted mainly from the fast growing real wages in the years 2007-2008 (over 6% annually) and higher household incomes being the consequence of a cut in the personal tax and a lower social security premium introduced from 2007. Consequently, the consumer sentiment remained good for a relatively long time. The Consumer Sentiment Index measured by IPSOS - based on surveys, as well as the Well-being Index by BIEC (Bureau for Investments and Economic Cycles) started deteriorating in July 2008.

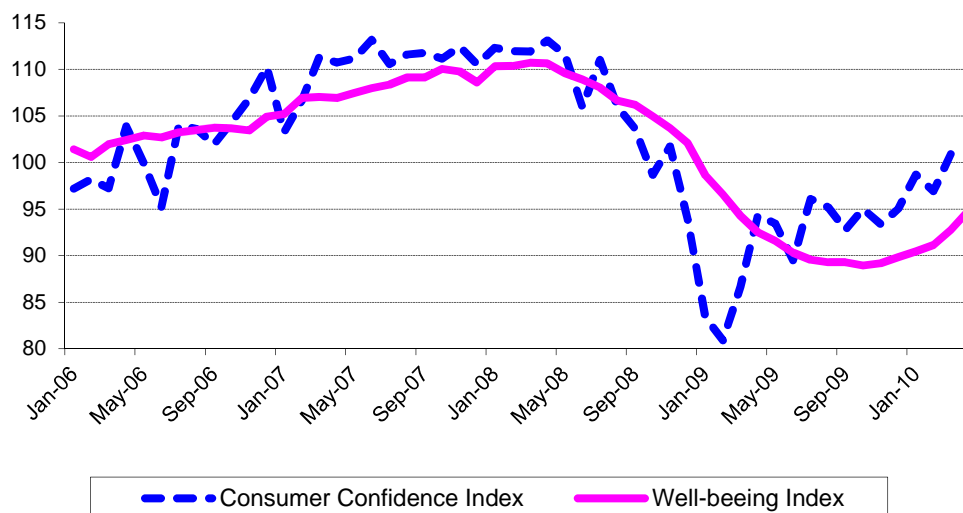


Figure 4. Consumer Sentiment Index, Well-being Index⁹, Poland 2006-2009
Source: BIEC, IPSOS

Consumer sentiment in the second half of 2008 deteriorated mainly due to the rise of prices, especially food prices. Therefore, deterioration of consumer sentiment in 2008, was not the direct result of threats connected with the imminent crisis – with the fear of losing one’s job, income, or going bankrupt. The unemployment rate started to rise later – in 2009. Throughout the whole period of the economic slowdown, the unemployment rate increased by 4.2 percentage points, from 8.8% in October 2008 to 13% in February 2010. This delay of the unemployment increase with regard to

⁹ The Well-being Index is a measurement based on the CSO quantitative statistics.

activity changes of the whole economy additionally contributed to stabilizing the internal demand at the time of the deepest downturn, i.e. from autumn 2007 to the end of 2008. From the second quarter of 2008 the financial condition of companies started to deteriorate, and the capacity utilization in industry went down to 64% (from 80% at the end of 2007, when the economic activity reached its peak). Although no symptoms of a financial crisis appeared in the Polish economy, banks limited considerably the scope of granting loans, especially for corporate clients, although banks' assets, solvency and financial standing was much better than in many other countries. The shrinking of the lending activity was mainly caused by the fear of excessive risk connected with the borrowers' possible financial difficulties or insolvencies, and not by the insufficient amount of funds held by the banks.

Table 2. Main Economic Indicators on GDP's Peak and Trough, Poland 2007-2009

Economic indicators Y/Y in %	Peak 2007/Q1	Trough 2009/Q1
GDP growth	7.5	0.8
Inflation	2	3.2
Unempl. Rate	14.7	10.8
Individual consumption	6.7	3.3
Industry	11.4	-5.9
Construction	34.8	3.6
Retail sales	7.2	2
Exports	11.2	-13.2
Imports	15.5	-11.4

Source: CSO

3. Factors moderating the influence of the worldwide 2007-2009 recession on the Polish economy

3.1. Factors resulting from the structure of the economy and its development stage

3.1.1. Low dependence on business and consumer credit

Despite the rapid development of financial institutions in Poland during the last 20 years, the dependence on bank credit for financing business activity and consumption

has never been high. The share of financing households and business by credit rose from 27% of GDP value in 1999 to about 53% in 2009. In the years 2005-09 the share of household credits increased particularly rapidly (about 22% of the GDP value from 2008), with mortgage credit claiming the largest share. In highly developed economies the household debt was much higher: in Germany – 74% of GDP, in Japan – 78%, in the USA – 100%, in the UK – 110% (Figure 5). The share of banks in financing business as percentage of GDP fluctuated in the years 1999-2009 from 12.5% in 2005 to 17.5% in 2008 (Figure 6).

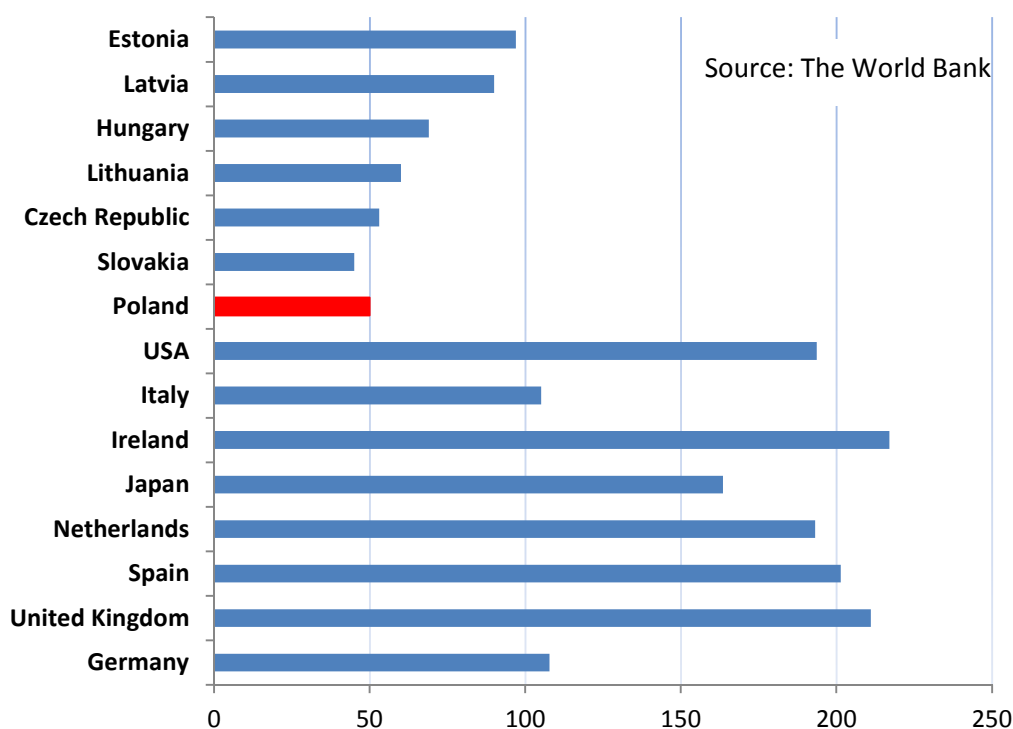


Figure 5. Domestic credit of the private sector in selected countries as percentage of GDP in 2008

The banks in relation to private sector, especially to small and medium enterprises, usually followed a very restrictive policy. The slowdown resulted in limiting the consumer and business credit activity only in 2009. However, while the volume of credits for business went down, the household credits grew at a slow rate (Figure 6). During the time of growing economy and favourable market conditions, the low share

of banks in financing business activity was perceived as a negative factor, limiting the growth rate of the whole economy. At the time of economic downturn a low credit commitment of entrepreneurs and households became an advantage. Borrowers were not exposed to a sudden cut of credit, which they got used to at the time of economic boom. In banks, on the other hand, the credit portfolio did not go down and they managed to stay in a good financial condition.

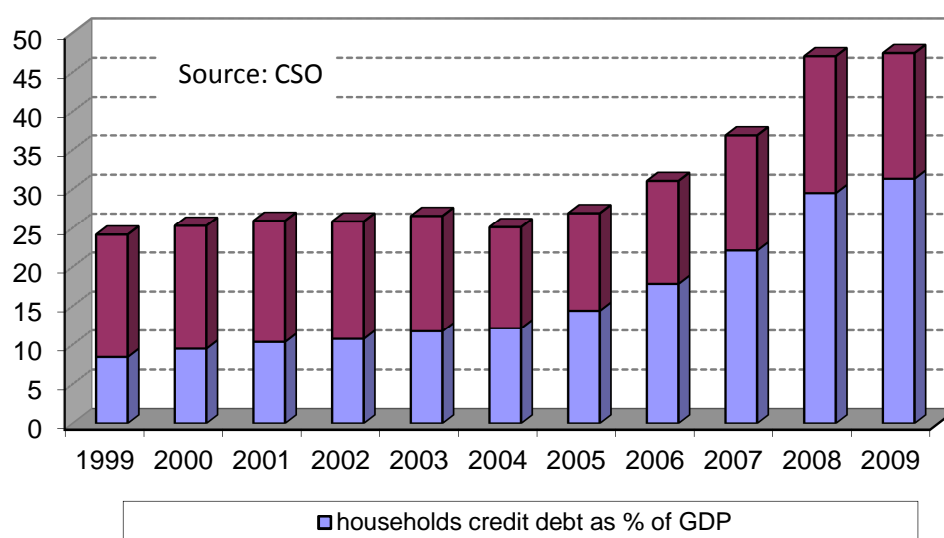
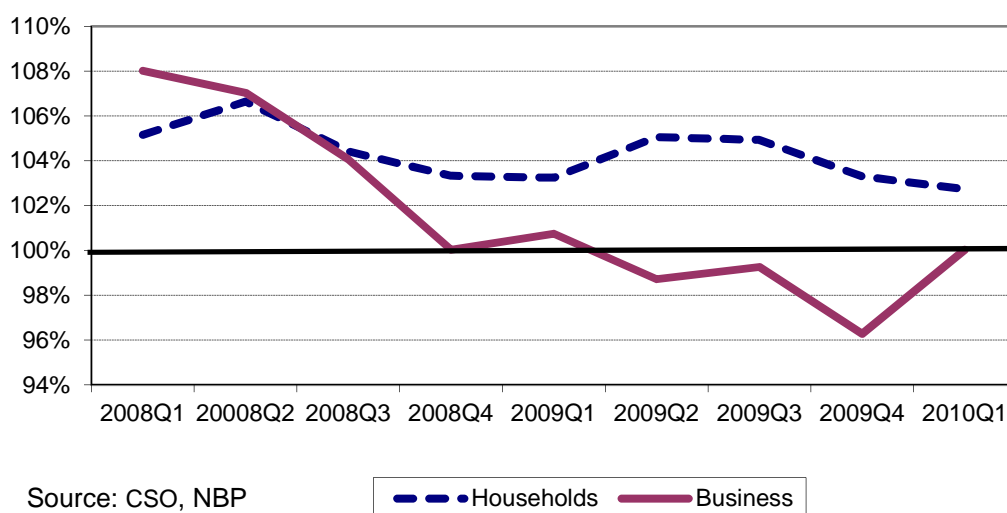


Figure 6. Credit liabilities in Poland as percentage of GDP, 1999 - 2009

In 2009 the value of credits granted to corporate clients decreased by 4.4% as compared with 2008. The greatest fall was observed in credits for current activity (10.5%), while the investment credit and mortgages even grew (investment - 0.9%, real mortgages - 2.8%). The share of all non-performing loans (NPL) in the bank sector was falling consistently from 7% in 2007 to 4.5% in 2008. Only in 2009 did the banks' credit portfolio deteriorate. As at the end of 2009, the share of NPL increased to 5.5%. For the enterprise sector this percentage rose from 6.1% in 2008 to 11.4% in 2009. The share of non-performing loans in all loans granted did not deviate in Poland from world standards. It is significantly lower than in the countries of the Central and Eastern Europe, where the historical backlog in financing consumption and business activity led to a credit boom after a few years of market economy and financial institutions development. As an example, I will cite NPL values for selected economies

in 2009: the USA – 5.4%, Italy – 6.2%, the UK – 3.3%, Spain – 5.1%, Lithuania – 16%, Hungary – 5.9%, Slovakia – 4.3%¹⁰.



Source: CSO, NBP

—•— Households — Business

Figure 7. Changes in households and business credit liabilities in Poland, 2008 – 2010 (Qt/Qt-1)

At the end of 2009 the consumer credit started to recover. The interest rate in mortgage credit rose again, stimulated by a fall in real estate prices during 2007-2008 period. Until the end of the 1st quarter of 2010, financing business activity by credit remained low, which is connected with the lack of recovery in investments.

It should be emphasised that the Polish banking sector at the time of the worldwide recession of 2007-09 was in a good condition. Banks' profits in 2008 were among the best ones in the last 20 years, and in 2009 they fell by only 30% as compared to the previous year. The Polish banking sector did not suffer from poor liquidity; many foreign banks received additional financial support from its parent institutions. The banks' reluctance to grant credits was, mostly caused by the uncertainty of the economic situation development; in other words, it was determined mainly by psychological factors. The banks' own assets rose consistently and were invested in financial instruments other than credits, mainly in government securities. In the years 2007-2009 consumer confidence in financial market institutions did not decrease.

¹⁰ Meeting New Challenges to Stability and Building a Safer System, Global Financial Stability Report, IMF, April, 2010.

Maintaining the confidence of individual clients was influenced by the decision to raise government guarantees for individual customer deposits from EUR 10 thousand to EUR 50 thousand. The Polish banking sector was not involved in risky sub-prime securities. Some economists classify this as underdevelopment of the financial system failing to keep up with instruments and institutions of highly developed countries. In my opinion, the Polish financial system in the last twenty years has been developing at a rate corresponding to the development of the whole economy and responded to the needs of market participants. Consequently, it was strictly adapted to the economy development stage, and the lack of some instruments on the market turned out to be a positive phenomenon in this case.

3.1.2. Small external ties, big domestic market

Poland is a medium-sized economy with a large domestic market. It is less dependent on exports than other countries of the region. Exports comprise ca. 30%-40% of the GDP value, and individual consumption is equal to ca. 60% of the gross domestic product (Figure 8).

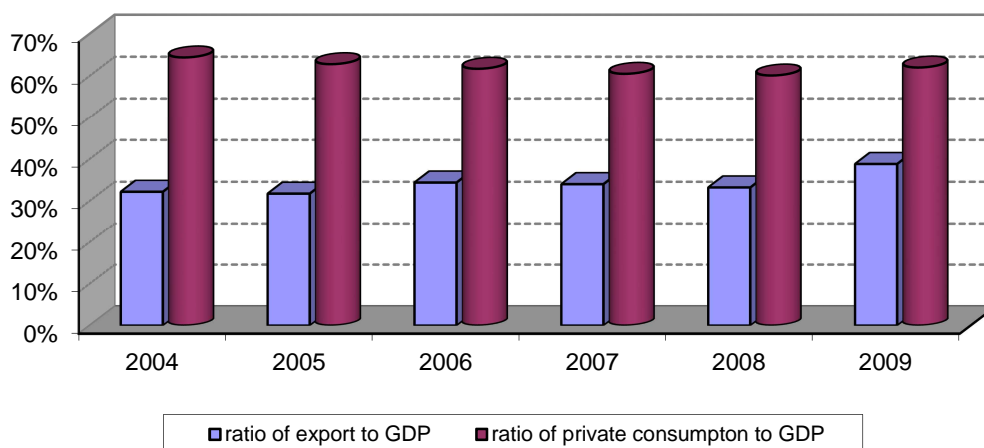


Figure 8. Export and private consumption as % of GDP, Poland 2004-2009

Source: CSO, NBP

This means that Poland is less exposed to the external factors than such economies as, for example, Hungary, where exports account for 80% of GDP, Slovakia – 86%, the Czech Republic – 76% or Lithuania – 55% of GDP (Figure 9). The main channels

through which the worldwide crisis came to the Central and Eastern Europe was foreign trade and financial markets.

The relatively low dependence of the Polish economy on exports moderated the influence of the world economic slump through the smaller impact of the international commodity exchange channel. An additional, significant factor stabilizing exports was the flexible exchange rate, which will be discussed in more detail in 3.2.2.

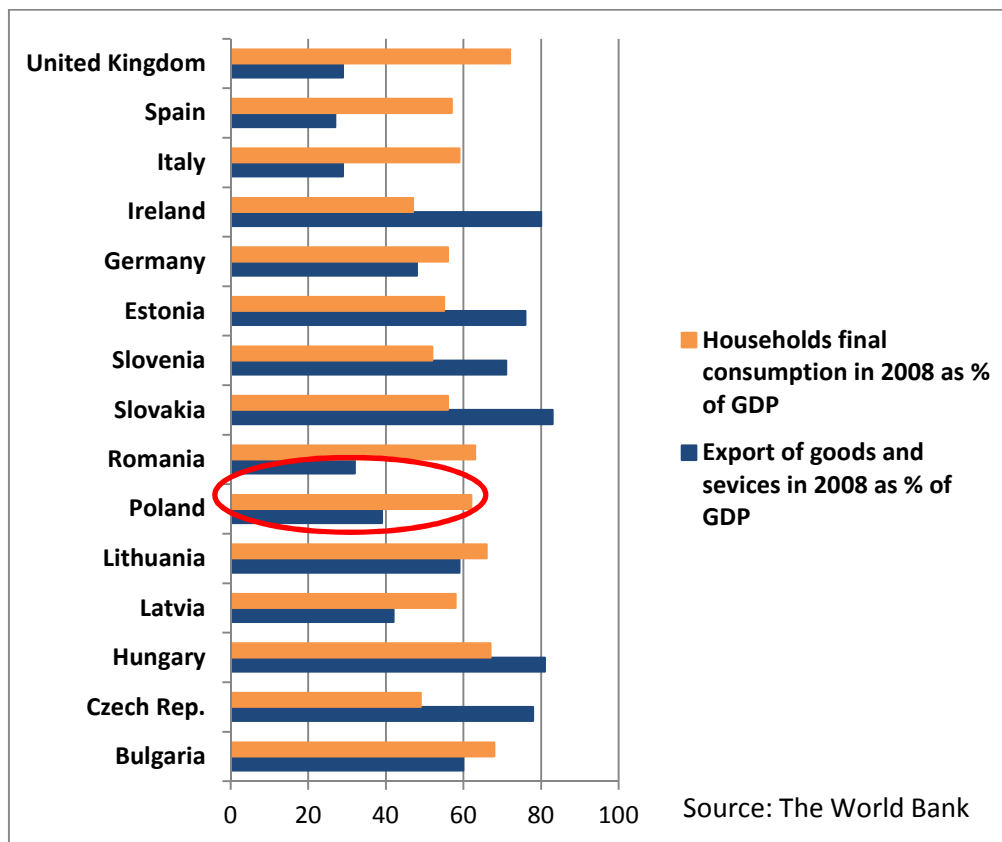


Figure 9. Final consumption and exports as % of GDP in selected countries in 2008

3.1.3. Shadow economy

The size of the shadow economy, expressed in the value of goods produced within its framework in relation to GDP, shows anti-cyclical behaviour in the business cycle. There are two main reasons for this:

- (1) **The flexibility of the shadow economy in business cycle stages.** People try to defend their income, which usually decreases during recession, by transferring their

activity to shadow economy. Employers, for whom cost cutting becomes top priority during recession, are more eager to employ people “off the book” or even close down their officially registered companies and conduct activity in shadow economy. Moving activity of companies from the official to the shadow economy is particularly popular with micro-enterprises employing up to 9 people. It can be assumed, therefore, that the greater the share of the smallest companies in the economy, the more the shadow economy increases at the time of recession.

- (2) **Decrease in real GDP at the time of recession.** Even if it is assumed that the size of the shadow economy, expressed by the volume of value produced by it, does not change throughout the business cycle, the mere fact that the real value of the registered product shrinks increases the percentage share of shadow economy in relation to GDP.

The European System of Accounts (ESA 95) adjusts the GDP value upwards by taking into account legal and illegal non-registered activity. Polish national accounts take into account only the legal part of the hidden economy. The following elements of hidden production are taken into account in the national accounts: understating the results of activity of registered entities and the activity of non-registered entities. The share of the shadow economy in the Polish economy officially estimated by the Central Statistical Office fluctuated between 15.9% in the years 2005 and 2006 and 14.7% in 2007¹¹. Many economists point out that the official calculations are underestimated.

This is confirmed by the research of Friedrich Schneider¹², an eminent expert in this area and the author of many reports on shadow economy in the economies around the world. According to F. Schneider’s estimations, the share of the shadow economy in the Polish economy fluctuated in the years 1999-2007 between 26.5% in the years of economic boom (e.g. 2007) and 29.3% at the time of economic downturn. Although the official Polish statistics show a different scale of the phenomenon, they confirm the thesis that the share of shadow economy decreases in the periods of economic boom and increases during economic slowdown; it can be assumed, however, that the change in the size of shadow economy follows with a lag in relation to GDP changes.

¹¹ National Accounts By Institutional Sectors and Sub-Sectors 2005-2007, Statistical Analyses and Studies, Central Statistical Office Warsaw, July 2009, appending 4.

¹² Friedrich Schneider, The Size of the Shadow Economy for 25 Transition Countries over 1999/00 to 2006/07: What do we know”, September 2009.

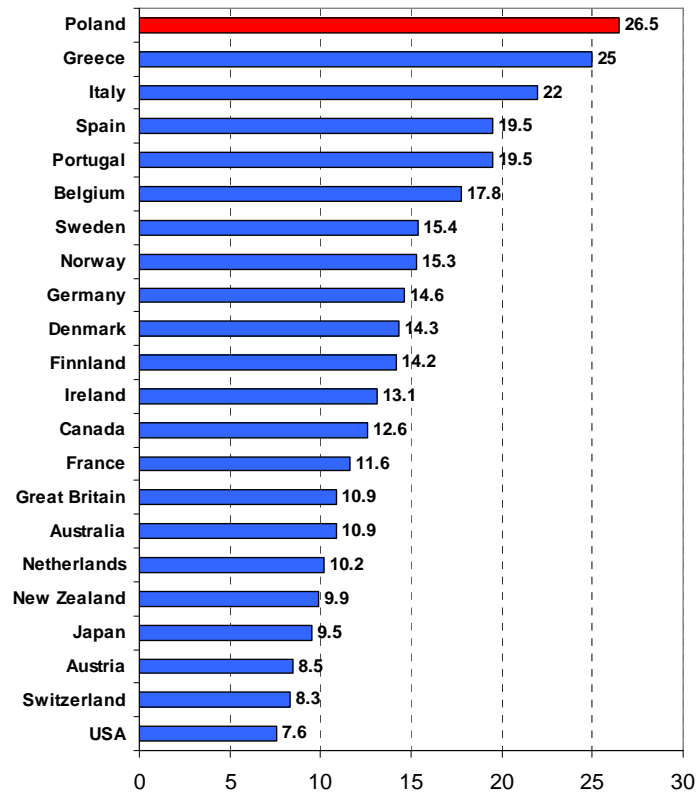


Figure 10. Shadow economy in 2009 as % of GDP, selected OECD countries

Source: Friedrich Schneider, *The Size of the Shadow Economy for 25 Transition Countries over 1999/00 to 2006/07: What do we know?*, September 2009.

Shadow economy absorbs the negative shocks of economic slowdown by smoothing consumption. Research of the Central Statistical Office show that in Poland, work in shadow economy generates 4-5% of additional GDP and about 60% of the product produced in shadow economy is used for individual consumption in households. 18%-20% of the product produced in the shadow economy is used for fixed capital formation, with the share of this kind of expenditure rising consistently during the years covered by the research (2005-2007)¹³.

¹³ National Accounts by Institutional Sectors... op.cit.

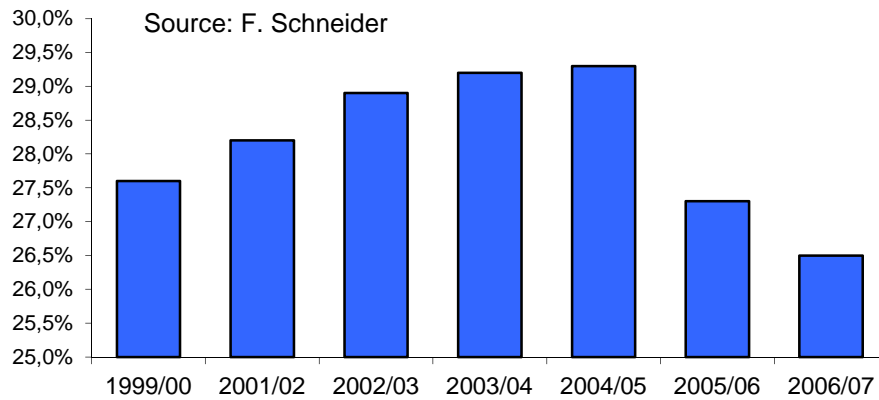


Figure 11. Shadow economy in Poland as % of GDP, 1999-2007

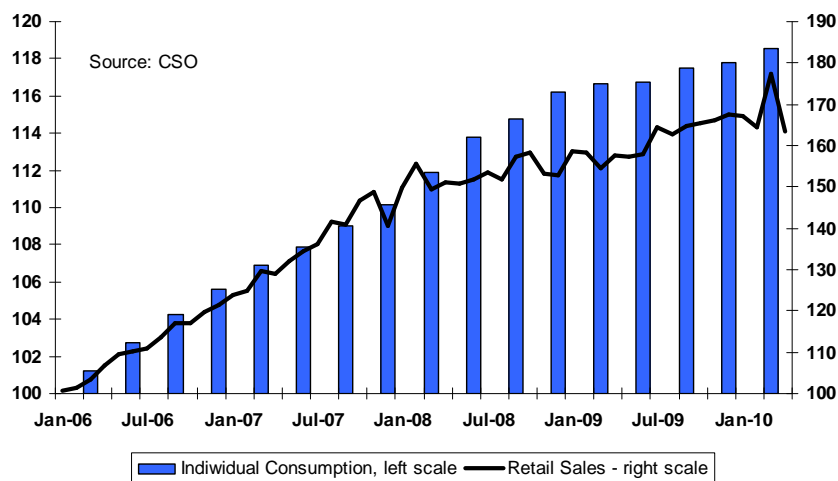


Figure 12. Changes in consumption and retail sales, Poland 2006-2009, real terms 01/2005=100

A thesis could be put forward, then, that the shadow economy uses periods of prosperous market conditions to prepare for entering the registered economy if the circumstances are favourable. On the other hand, during economic slump the shadow economy finances mainly consumption. Financing consumption at the time of economic downturn may help sustain economic activity. This is what happened in Poland. The high share of shadow economy, inflow of EU funds and direct foreign

investment provided work places to people. Retaining a legal or illegal job helped to maintain the previously achieved income level, which in turn sustained consumption. This is indicated by data on the value of retail sales and individual consumption. These values did not collapse in the years 2006-2009; only in the years 2008-2009 their growth rate was reduced.

3.2. Market conditions

3.2.1. Productivity and competitiveness of the Polish economy

An important factor moderating the effects of the worldwide crisis was the consistent growth of the competitiveness of the Polish economy, which was expressed mainly by the improvement in the labour productivity. According to a report by the Conference Board¹⁴, in the years 1990-2009 the productivity calculated as the GDP value per one hour of work increased in Poland every year by nearly 4%. In highly developed countries this increase was smaller by over a half (Figure 13). According to my calculations, productivity in the manufacturing enterprises sector rose every year by over 7% on average, fluctuating between 3.5% to nearly 16%. In comparison with 1990, work efficiency increased 2.5 times for the whole economy (according to the methodology of the Conference Board), and 3.6 times for the industry alone (own calculations). The productivity growth slowed down only in 2007, when the labour market had to cope with a shortage of labour force, which brought about a sudden growth in real wages by over 10% year-on-year. Market situation research indicated that in 2007 as many as 60% of large enterprises experienced staff shortages and regarded this as the most important factor hindering further development of the company¹⁵.

After the Polish accession to the European Union, an additional factor increasing productivity in the years 2005-2007 was the growth in fixed capital formation. In the years 2000-2004 fixed capital formation per one employee increased by slightly over 2% a year on average. In the years 2004-2006 the annual rate of growth of this kind of

¹⁴ Recent Productivity Developments in the World Economy, The Conference Board Database, New York, January 2010,

http://www.conferenceboard.org/economics/downloads/Summary_Statistics_2010.pdf

¹⁵ Informacja o kondycji sektora przedsiębiorstw ze szczególnym uwzględnieniem stanu koniunktury w I kwartale 2008 roku (Information on the condition of the enterprise sector with particular attention paid to the condition of the economy in Q1 of 2008), Narodowy Bank Polski, Instytut Ekonomiczny, Warsaw 2008.

expenditure exceeded 10%, and in 2007 and 2008 it jumped to over 16% a year. The factor which contributed to such a rapid growth of fixed capital formation was the inflow of EU funds, accelerating the development of Polish companies and the inflow of direct foreign investment. 2007 was the record year with the value of direct investment reaching EUR 17.2 billion, while for 2008 and 2009 the respective values were EUR 10 billion and EUR 8.4 billion (despite the crisis). In 2008 Poland moved up in the Foreign Direct Investment (FDI) Confidence Index created by AT Kearney¹⁶ from the 22nd to the 6th rank and was overtaken only by China, the USA, India, Brazil and Germany.

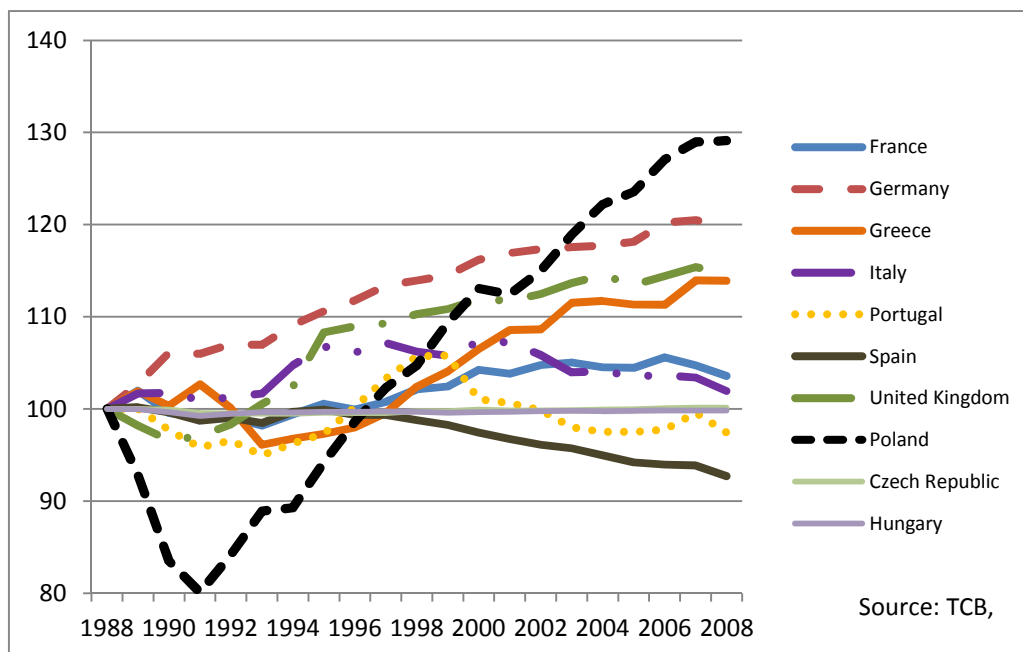


Figure 13. Changes in the productivity in selected countries, 1988=100, cumulative

From the point of view of sustaining growth, in the period of economic downturn, it was also important that most profits of foreign companies were not transferred abroad but reinvested in Poland.

¹⁶ www.paiiz.gov.pl, *FDI Confidence Index*, AT Kearney 2009

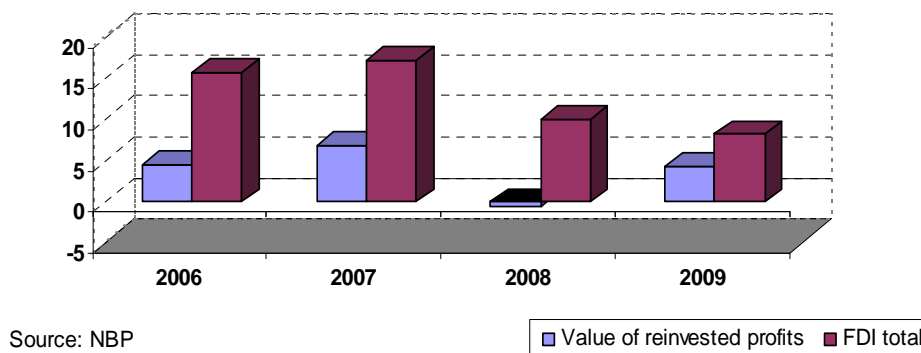


Figure 14. FDI in Poland, billion EUR, 2006-2009

3.2.2. Floating exchange rate of the zloty

The exchange rate of the zloty had a stabilizing effect on the Polish economy in the last years, and contributed to sustaining its growth twice: first in the period directly preceding the 2007-2009 crisis, and then in the middle stage of the crisis – in the second half of 2008.

From May 2004 to June 2008 the Polish zloty was strengthening in relation to the most important world currencies. At the same time, oil prices on commodity markets in the world were increasing from 2002, with the most rapid growth (almost twofold) having occurred in the period from January 2007 to June 2008. The strengthening zloty cushioned the increase in import prices, including oil prices, which lowered the costs borne by the private sector and households. This strengthened them financially and allowed them to enter the crisis stage in a better condition. It would not have been possible if zloty had not been appreciated and costs of imports had been higher.

The second time when the zloty had a cushioning effect was in the period from July 2008 to February 2009, when the trend in the exchange rate of the zloty reversed and its depreciation started. The Polish currency was therefore losing value at the time of the deepest economic downturn in the world economy.

The flexible rate of the zloty and its depreciation had a stabilizing effect on the Polish exports at that time. The Polish industrial goods and services started to be more competitive on the world markets. During recession both, consumers and enterprises seek cheaper products which are comparable with respect to value. The Polish exports met these criteria. Consequently, there was no collapse of exports, but only a decrease

in their growth rate. At the same time the weaker the zloty had a limiting effect on imports, creating more space for Polish products on the domestic market. The fall in imports and the slower growth rate of exports resulted in a positive foreign trade balance. Consequently, the contribution of the net exports to GDP was positive throughout 2009.

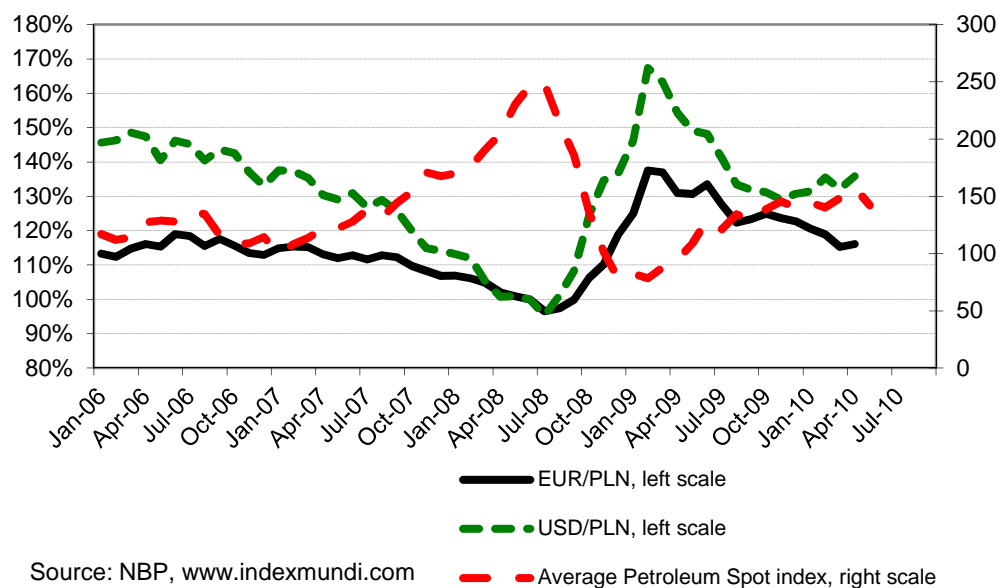


Figure 15. Index of exchange rate USD and EUR to PLN, 2006-2010, 01/2007=100 and index of oil prices

Particularly, the automotive industry found itself in favourable situation. Over 83% of the Polish automotive production is directed to the EU market with Germany being the largest buyer. In 2009 most EU member states implemented programmes aimed at encouraging consumers to purchase cars. In Germany alone the value of the new car purchase subsidy programme was worth USD 7 billion. This benefited Polish manufacturers, who produced cars which were cheaper and whose standard was more adjusted to the tastes and expectations of customers, who at the time of recession were looking for smaller and more economical cars.

A sudden collapse of the exchange rate of the zloty at the turn of 2008 and 2009, however, caused disruptions which created much turmoil, especially in the media, but did not influence significantly the economy as a whole. This was the problem of

currency options used by some companies as a way of hedging against sudden changes of the exchange rate. The steady strengthening trend of the zloty from mid 2004 to August 2008 encouraged entrepreneurs to enter into such transactions without a security in income from foreign trade, which indicated a speculative nature of these transactions. The problem of currency options received extensive coverage in the media, but in practice they constituted not more than 15% of all transactions in the banks' portfolios¹⁷.

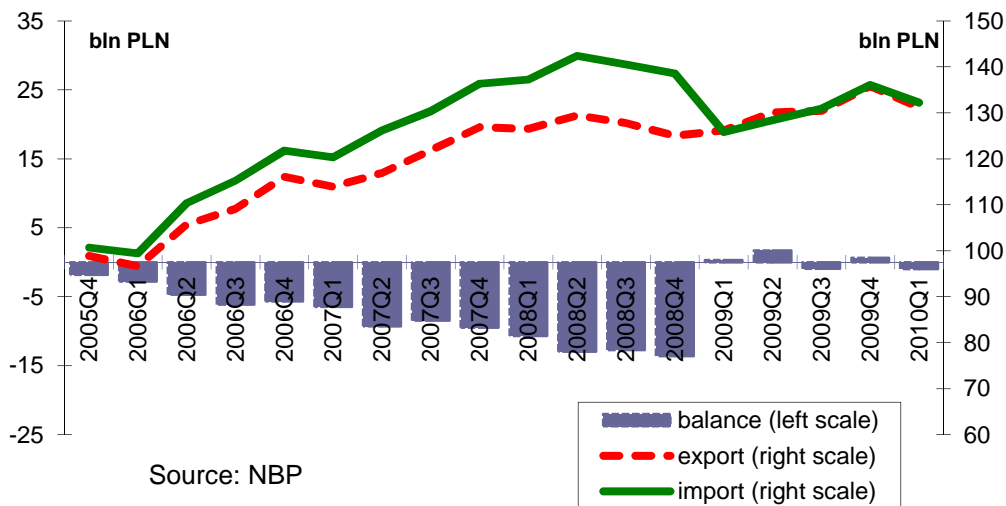


Figure 16. Exports, Imports, Poland 2005-2009

3.3. Regulatory factors

3.3.1. Inflow of EU funds

Poland as a member of the European Union has been a net beneficiary of EU funds since 2004. It is estimated that in the years 2004-2013 as much as EUR 81.3 billion will come to Poland, with an additional own contribution of Poland in the amount of EUR 17.7 billion. In the years 2004-2010 the amount of funds coming to Poland was not evenly distributed in time. The largest inflow occurred in the years 2007-2009. About 61% of these funds were earmarked for expenditure on infrastructure in its broad sense, i.e. on transport, communications and municipal infrastructure. About

¹⁷ Komisja Nadzoru Finansowego (Polish Financial Supervision Authority), Activity Report for 2009, Warsaw 2010

22% of the EU subsidies were earmarked for the development of human resources, and about 17% for direct support of the manufacturing sector. It is estimated that the impact of increased expenditure on the economic growth was also diversified¹⁸.

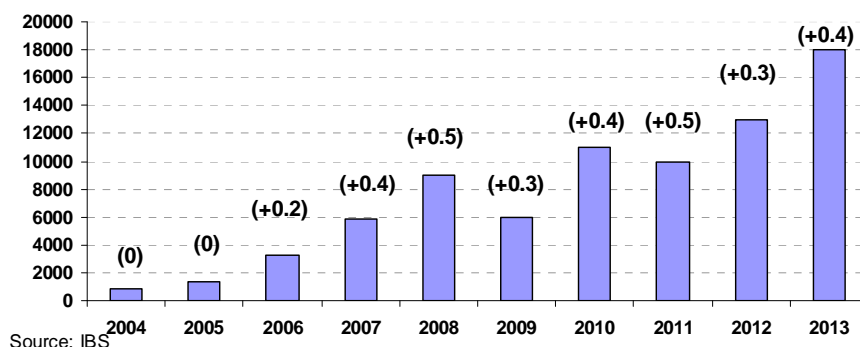


Figure 17. The inflow of EU funds in EUR million and its impact on GDP in percentage points (in parenthesis)

In the initial period the incoming funds did not result in increasing the economy's growth rate. The strongest effect could be observed in the years 2008-2010. Individual research centres differ on the assessment of the impact of these funds on the GDP growth rate. The estimated influence of the incoming EU funds on the additional GDP growth does not usually exceed 1 percentage point per annum. There can be no doubts, however, that the accumulation of expenditure in the years 2007-2009, i.e. in the third year after Poland's accession to the EU and the gradual increase of EU help in the subsequent years had a synergistic effect and stimulated economic growth. The impact channels of funds expended for individual goals were also diversified. Funds earmarked for transport infrastructure increased the reserve of public capital, which was used by the private sector, thus increasing its productivity. Funds earmarked for the development of human resources, mainly for education and trainings, contributed to the increase labour productivity, though on the other hand they also increased costs of work in the private sector. Funds for subsidizing manufacturing activity increased the economy growth rate most directly. All kinds of EU funds had a stabilizing effect on the labour market and stimulated private consumption.

¹⁸ M. Bukowski, D. Pelle, W. M. Saj, Wpływ funduszy unijnych na gospodarkę Polski w latach 2004-2020 (Impact of EU funds on the Polish economy in the years 2004-2020), IBS, Warsaw, 2008

A question arises: Why did other economies, which also benefited from EU funds, fail to avoid recession? Firstly, Poland received the largest amount of these funds. Taking into account only the tranche for the years 2007-2013, Poland received EUR 67 billion, Spain – EUR 35 billion, Italy – EUR 28 billion, the Czech Republic – EUR 26 billion, Portugal – EUR 21 billion. But the amount of funds and their effective use were not the only important factors here. More significant from the point of view of sustaining economic growth was the mutual support of all factors discussed here, such as the flexible exchange rate, the inflow of foreign direct investment or the good condition of financial institutions.

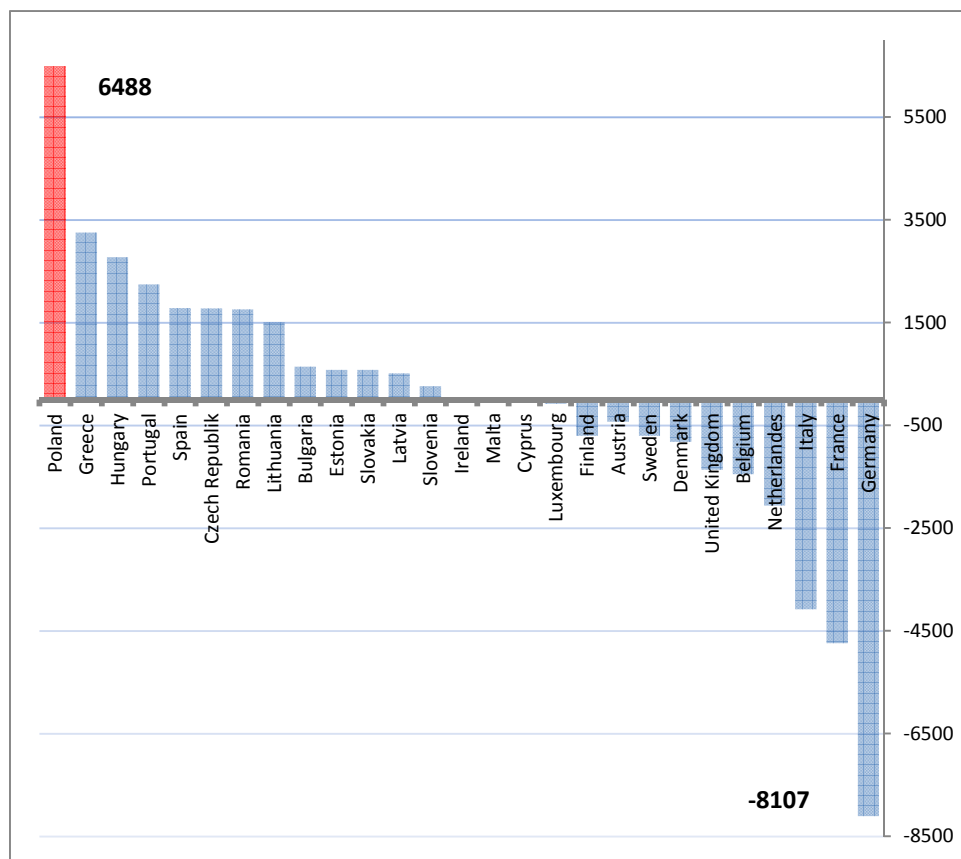


Figure 18. The net inflow of EU funds in euro million in 2009

Source: European Commission

3.3.2. The stimulus package in Poland

During a recession, participants' expectations concerning the governments', central banks' and international organisations' intervention usually grow stronger and fade gradually as the economy starts to recover. While at the time of economic boom the ideas of free market are extolled, recession gives rise to other views, such as state interventionism, socialism or often even nationalism. The belief in the effectiveness of actions taken by government agencies and the social pressure, force them to introduce stimulus packages which are usually very costly. Economists have varied opinions on the effectiveness of plans stimulating economic growth and varied opinions on that kind of stimulus taken so far in history. Economists point out to the short- and long-term effects of such programmes and varied responses of large, highly developed and small, developing economies, among which Poland is included. Blanchard and Perotti¹⁹ as well as Christiansen²⁰ point out that the economic effect of fiscal stimulus plans is different for the US economy and for the leading European economies. In their opinion, the multiplier effect of the active fiscal policy brings better results in the USA (it increases the economy growth rate more significantly) than a fiscal plan of the same value used in highly developed European economies. Moreover, some suggest that in the case of small open economies rescue plans may limit the growth rate through increased inflation, which weakens the economic growth rate in the recovery period, a too rapid accumulation of public debt limiting the application of an active fiscal policy, and high costs of creating the debt (high risk premium) and its service later on. Countries which are dependent on imports, inflow of direct and capital foreign investment, are less susceptible to the effects of stimulus plans. Some economists show that fiscal rescue plans are of marginal significance at least for some economies, and that a successful monetary policy brings much better results²¹. Some economists are sceptical about using any rescue plans, pointing out that it is against the nature of free market, which cleanses itself of ineffective entities during recession.

¹⁹ O. Blanchard, R. Perotti: „An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Taxes on Output”, *Quarterly Journal of Economics*, Vol.117, 2002, pp. 132-68.

²⁰ L. Christiansen: *Fiscal Multipliers – A Review of the Literature*”, Appendix II to “IMF Staff Position, Note 08/01, Fiscal Policy for the Crisis”, IMF, Washington, 2008.

²¹ Ch. Romer, D. Romer: „What End Recession?”, NBER, *Macroeconomic Annual 1994*, Cambridge, Massachusetts, 1994, pp. 13-79.

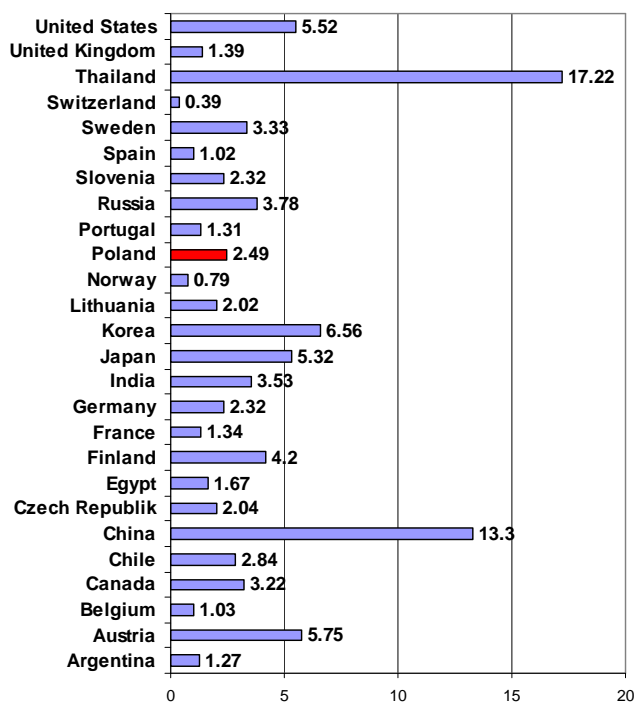


Figure 19. The value of officially declared stimulus package as % of 2008 GDP in selected countries

Source: Y. Zhang, N. Thelen, A. Rao, Social Protection in Fiscal Stimulus Packages: Some Evidence, UNDP/ODS Working Paper, New York, March 2010, and „Fiscal Packages across OECD Countries: Overview and Country Details”, OECD, Economic Department, 31 March 2009.

Irrespective of the attitude of economists and politicians to monetary and fiscal instruments for market regulation, stimulus packages in the years 2007-2010 became a fact. Individual tools used for counteracting the recession have been known in the economic history of the world for many years and were applied many times during the previous recessions. The uniqueness of the 2009-09 crisis lies above all in the enormous, supranational involvement of governments, international organisations and central banks in rescuing the world economy from the economic collapse. OECD experts assess that the value of the implemented stimulus packages exceeds 3.4% of the value of GDP generated by the member states of this organisation in 2008, though the size of stimulus programmes and structure of expenditure vary significantly between individual countries. Some economies chose to reduce taxes more drastically, but refrained from increasing expenditure significantly. Most tax cuts related to

personal taxes (Australia, Finland, Korea, Luxembourg, New Zealand, Spain, Sweden and the USA), where the tax cut exceeded 1% of GDP of these countries. Only the UK cut a consumption tax – VAT – and the value of this decrease is estimated to be slightly over 0.5% of the British GDP of 2008. Figure 19 shows the sizes of stimulus packages officially declared by the governments of selected countries. This does not mean that all planned spending has been realised. This is exactly what happened in case of Poland.

In order to stimulate economic activity, the Polish government accepted a strategy different from those used by most developed countries. Due to the deepening of the fiscal imbalance in 2008 and 2009, expressed by a significant increase in the budget deficit, the Polish government decided not to introduce a broad fiscal package stimulating demand despite very strong political pressure and social expectations. The first steps aimed at stabilizing the Polish economy were taken by the government in August 2009, i.e. after the main wave of the crisis was over, and the Leading Indicator and business survey showed first symptoms of recovery. The full package of anti-crisis measures was presented in November 2009 in the “Stability and Development Plan” with economy stabilizing activities amounting to PLN 94 billion (ca. USD 30 billion). Regulations and anti-crisis measures were to be in force until the end of 2011. They related to the following issues: a scheme of government subsidies and guarantees for enterprises, support for defense industry companies, subsidies for people losing their jobs, increasing the flexibility of the labor market and increasing the pace of expending funds from the European Union. Many of the proposed solutions were never or only to a very limited extent put into practice. For example, the government assumed in the anti-crisis package that the subsidies for enterprises which refrain from dismissing employees would be used by ca. 60 thousand companies and ca. 250 thousand employees. In practice, by the end of March 2010 only slightly over 110 companies used this form of assistance, covering by it about 10 thousand people. A significant part of the government’s anti-crisis package were guarantees and sureties granted to companies by the Treasury (ca. USD 13 billion). Only about 50% of the amount planned in the package was realized. This kind of aid covered mostly the largest enterprises, often owned by the state (e.g. Bank Gospodarstwa Krajowego, PKP Polskie Linie Kolejowe – Polish Railways). The assumptions of the anti-crisis package included also: increase in the limit of sureties and guarantees for the economy and the financial market to the value of USD 13 billion, creating additional, safe loans for small and medium enterprises to the value of USD 6.5 billion, as well as subsidies for companies who refrain from reducing staff. Entrepreneurs pointed out the very

restricted criteria for awarding the aid (e.g. a fall in turnover by 25% during three consecutive months and preparing a recovery programme) as well as tiresome bureaucratic procedures. By April 2010 only USD 1.4 million were expended from the fund earmarked for companies refraining from dismissing employees. From the planned amount of USD 30 billion just slightly over USD 6.5 billion were spent.

Generally, it can be stated that the anti-crisis measures did not contribute much to sustaining the economy growth rate. Firstly, this is due to the fact that they were taken relatively late; most solutions were implemented when the economy had already started the recovery. Secondly, the structure of the economy and some market mechanisms as well as the inflow of EU funds increased its resistance to the worldwide collapse. Implementing the package would only have increased the budget imbalance, made it necessary to increase the debt and intensified fears among market participants that the situation of the economy was at that time worse than officially presented. This in turn could lead to the loss of credibility of the Polish economy in the world and a fall in the prices of government debt securities.

4. Conclusion

The relatively good situation of the Polish economy during the worldwide recession of 2007-2009 resulted from a coincidence of many factors. The reasons presented above reflect just one view and do not exhaust the list of all strengths and weaknesses of the Polish economy as well as the activities taken with the purpose of stabilizing it. The article did not cover, among others, the issue of the monetary policy of the central bank. I emphasised those factors which I considered characteristic of the Polish economy at that time and essential for sustaining growth at the time of strong turbulence in the world. Some of the discussed factors are in fact negative and show the weakness of the Polish economic system. This group includes the large share of shadow economy, the low level of openness of the Polish economy and the relatively small share of bank credits in financing economic activity. These are features typical of post-Communist, young and developing economies trying to catch up with the developed countries. At the time of recession, however, these features decreased Poland's susceptibility to an external shock in the form of the last worldwide crisis and had a stabilizing effect on the economic growth.

The unquestionable assets of the Polish economy include the dynamic increase of its competitiveness and work efficiency, although if it were not for external sources of financing in the form of funds coming from the European Union and for direct foreign investment, the improvement of competitiveness would probably be much more

moderate. The price competitiveness was also influenced by the flexible exchange rate of the Polish currency.

None of the discussed factors would have been able to stabilize the economic situation on its own. Many of them supported each other, giving in effect a positive impetus sustaining growth.

The significant share of shadow economy had a stabilizing effect on the incomes of households, providing families with non-taxed income and stabilizing consumption. The increase in household incomes was also helped by the inflow of EU funds, which created additional demand for work and stabilized the employment. The growth of competitiveness, and particularly of work efficiency, contributed to a remuneration growth, while the exchange rate made it possible for households to spend less at the time of growing commodity prices and to save more, which stabilized consumption during the period of economic downturn and decrease in real income.

Similarly, many factors contributed to reducing the costs of company functioning. The floating exchange rate made it possible to import goods at lower prices thanks to the appreciation of zloty and to offer competitive prices on the world markets at the time of its depreciation. The increase of productivity worked up to lower costs of production. Higher efficiency was related to the inflow of direct foreign investment and EU funds. The infrastructural investments realised, with the support of EU funds decreased the costs of transport and communications.

A whole group of factors helped to enhance the resistance of the economy to external shocks. Thanks to its small degree of openness to international trade, the sudden collapse of demand in the environment of the economy was less severe than in the case of economies relying strongly on exports. The relatively low share of credit in financing business activity did not deteriorate the condition of the banking sector. The membership in the EU increased the credibility of the Polish economy, while the government's reluctance to construct anti-crisis packages prevented induced fears among market participants about the actual condition of the economy and forced companies to take efficiency improvement measures moderating the results of the world economic collapse.

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