

# Greater Economic Freedom Will Aid Poland's Post-Virus Recovery

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## KEY TAKEAWAYS

Poland, a geopolitically significant and strategic member of NATO on Europe's border with Russia, is a close and important ally of the United States.

Although Poland ranks ahead of many other EU countries in economic freedom, there remains much room for improvement, which will require additional reforms.

To increase economic freedom after the outbreak, Poland should reduce government spending, focus on greater judicial effectiveness, and implement new labor laws.

Poland, a geopolitically significant and strategic member of the North Atlantic Treaty Organization (NATO) on Europe's border with Russia, is a close and important ally of the United States. Russian President Vladimir Putin, like his authoritarian counterparts in Communist China, has been exploiting the COVID-19 crisis to expand geopolitical influence. If Poland becomes economically unstable after the pandemic, it will be at a time when its alliance with NATO and the United States is of unparalleled importance to the West.

One sign of that importance is the high priority the U.S. government is assigning to the success of the Three Seas Initiative (3SI). As Heritage Foundation analysts have reported,<sup>1</sup> 3SI was launched in 2016 to facilitate the development of energy and infrastructure ties with Poland and 11 other nations in Eastern, Central, and Southern Europe. 3SI aims to strengthen

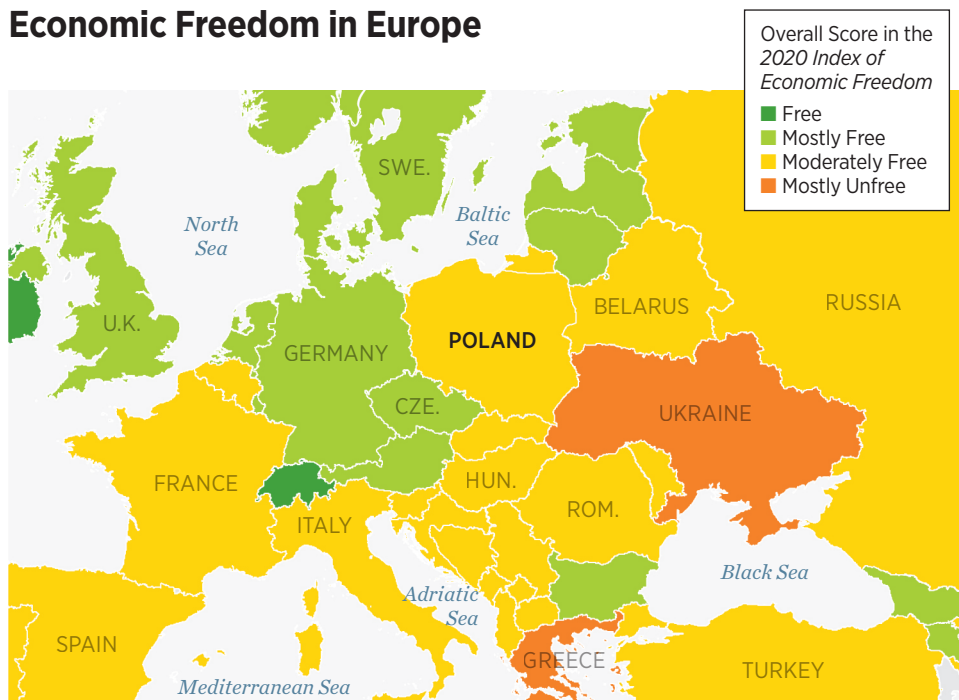
This paper, in its entirety, can be found at <http://report.heritage.org/ib5088>

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MAP 1

## Economic Freedom in Europe



**SOURCE:** Terry Miller, Anthony B. Kim, and James M. Roberts, *2020 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2020), <http://www.heritage.org/index>.

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trade, infrastructure, energy, and political cooperation among countries bordering the Adriatic Sea, the Baltic Sea, and the Black Sea. A strong, prosperous, and secure Eastern Europe is in the interest of the region, NATO countries in general, and the United States in particular. 3SI can play a role in making this happen.

Like many other countries, Poland has been facing a massive, sudden, and unprecedented economic crisis because of the coronavirus pandemic. To prevent complete economic collapse, the Polish government, following the lead of other nations in the European Union, of North America, and of Japan, hastily put into place measures to exercise much more state control over its economy—putting economic freedom at risk in the short term.

Eventually, however, the virus will be defeated and the measures needed to realize greater economic freedom in Poland will be more important than ever. This *Issue Brief*, a collaboration between a Heritage Foundation analyst and the vice president of the Freedom and Entrepreneurship Foundation in Poland, offers recommendations to achieve that goal.

## A Deep Economic Shock from the Pandemic

Economic growth in Poland had begun to slow down even before the coronavirus crisis. According to official figures from Statistics Poland, while the annual rate of economic growth in the first quarter of 2019 was 4.8 percent, in the subsequent two quarters of that year, growth fell to 4.6 percent and 3.9 percent, respectively.<sup>2</sup>

More recently, the Purchasing Managers Index (PMI) for Poland dropped from 48.2 in February to 42.4 in March, and to 31.9 in April.<sup>3</sup> Entire economic sectors, such as housing, travel, and tourism, are already facing grave problems.<sup>4</sup> According to European Union data cited by the Polish Ministry of Labor, Family and Social Policy, unemployment in Poland, at 3.3 percent before the crisis, may rise to 7.5 percent at the end of 2020.<sup>5</sup> The European Commission estimates that, in 2020, Polish gross domestic product (GDP) will shrink by 4.3 percent.<sup>6</sup>

The government's first policy response to the pandemic, the "Anti-Crisis Shield" program,<sup>7</sup> was aimed at securing jobs, supporting private companies and public investments, and other actions. The estimated cost of the first "shield" may reach as much as 10 percent of GDP.

A second stimulus program was concentrated on tax deductions for entrepreneurs and financial help to farmers.<sup>8</sup> A third government package (Anti-Crisis Shield 3.0) contained a wide range of economic support and tax-deference measures, including for private-sector entrepreneurs and public sectors, such as railways, in addition to extra financial support for law enforcement and prioritization of the judiciary concerning which legal cases can be tried while most of the nation's courts are closed due to COVID-19.<sup>9</sup>

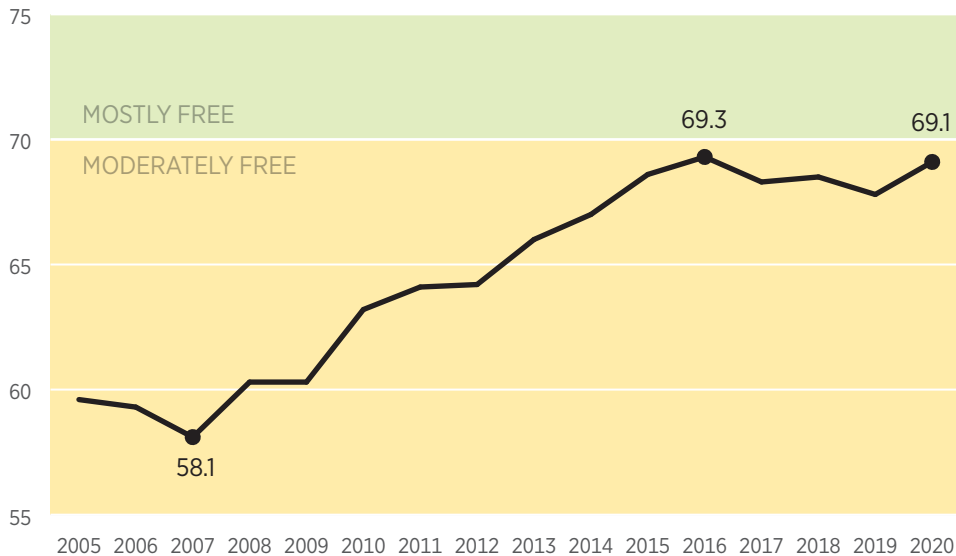
The fourth edition of the "shield" was adopted in June 2020. It is to be the last package of measures meant to counteract the negative impact of the pandemic on the economy. According to Dentons, a U.S.-based global law firm, Anti-Crisis Shield 4.0 includes "interest rate subsidies on bank loans to provide liquidity to entrepreneurs affected by COVID-19," and loosens certain other labor laws to permit telework.<sup>10</sup> In general, 4.0 adds flexibility to employer and employee rights and suspends provisions of collective agreements or remuneration regulations during the epidemic emergency.<sup>11</sup>

While these "Shield" measures are targeted to stabilize the economy in the short term, the government must also focus on adopting reforms that are more sweeping in the medium term as the virus recovery proceeds. In this context, many helpful recommendations can be found in the 2020 edition of The Heritage Foundation's annual *Index of Economic Freedom*.<sup>12</sup>

CHART 1

## Economic Freedom in Poland

OVERALL SCORE IN THE *INDEX OF ECONOMIC FREEDOM*



**SOURCE:** Terry Miller, Anthony B. Kim, and James M. Roberts, *2020 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2020), <http://www.heritage.org/index>.

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## Restoring Economic Freedom and Growth in Post-Virus Poland

Poland’s economic freedom score is 69.1 (of 100), making its economy the 46th-freest in the 2020 *Index* out of 180 countries measured. Its overall score has increased by 1.3 points, primarily because of a higher government integrity score. Poland is ranked 25th among 45 countries in the Europe region, and its overall score is approximately equal to the regional average, and well above the world average.

The Polish economy has been climbing the ranks of the “moderately free” economies (overall score above 60) for more than a decade. That progress has been matched by steady GDP growth over the past five years, driven by booming private consumption and investment.

To make it over the hurdle into the ranks of the “mostly free” economies (overall score above 70), the government will have to confront its most problematic *Index* indicator—government spending. Cognizant of

that imperative, the newly re-elected government has tabled a draft 2020 budget that targets a balanced central government budget and a general government shortfall of just 0.3 percent of GDP.

Some analysts in Poland have criticized the budget as unrealistic, partially because it was based on one-off receipts, and because it pushed off some expenses to the Solidarity Fund, the Local Government Road Fund, and local governments.

The 2020 edition of the *Index*, published pre-pandemic, found that Poland's government spending has amounted to 41.3 percent of GDP over the past three years, and budget deficits have averaged 1.4 percent of GDP. Public debt is equivalent to 48.4 percent of GDP.

This deceleration of economic growth, combined with the black swan event of the pandemic, forced the compulsory freezing of the economy. That had two major effects. First, the lockdown hit Polish businesses very hard. That further weakened a country that has had a very low level of innovation<sup>13</sup> and has depended on consumer-led economic growth. In recent years, that consumption has been fueled by infusions of taxpayer money.<sup>14</sup>

Second, there is a risk that the government will be tempted to blame the coronavirus for the poor condition of the country's economy, thereby understating the impact of other factors contributing to economic stagnation. The pandemic countermeasures deployed so far by the government have not always been focused on solving the long-range problems, but instead on responding to real-time needs.

The truth is, however, that even without the coronavirus crisis, the Polish economy would eventually run into significant problems. Additionally, the government control over the economy and the special circumstances currently are delaying the real and necessary reforms that could help to maintain the healthy GDP growth rate that has been generated by hard-working Poles.

## Recommendations for the Polish Government

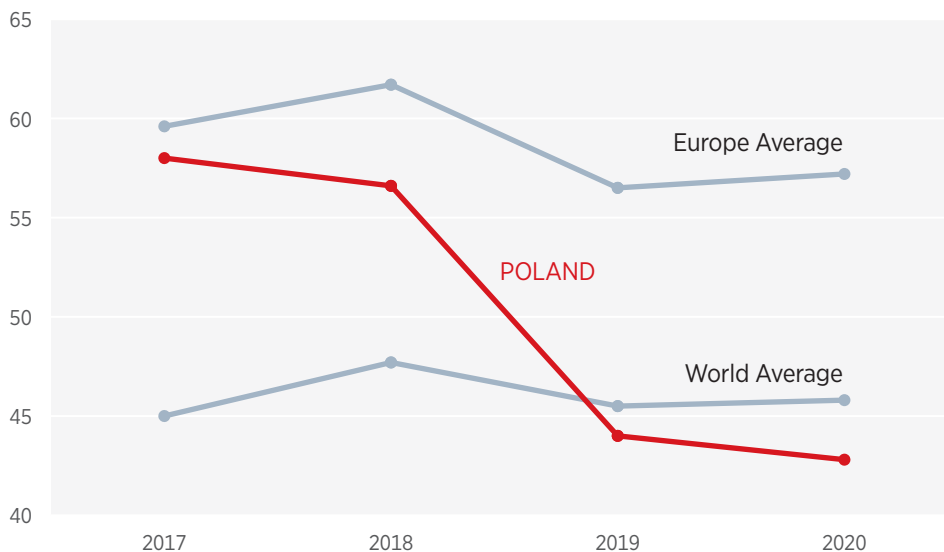
The best advice for the Polish government is to extend economic freedom by focusing on reforms that are measured by the three indicators in the 2020 *Index* for which Poland received the lowest scores—judicial effectiveness, government spending, and labor freedom.

Poland's score for the *Index*'s judicial effectiveness indicator was the lowest of its 12 indicator scores. It has fallen from 58.0 in 2017 to just 42.8 in 2020. The decline of this metric indicates that the judicial-sector reforms since 2017 have fallen short. The continuing weakness of the judiciary in

CHART 2

## Judicial Effectiveness Plummeting in Poland

JUDICIAL EFFECTIVENESS SCORE IN THE *INDEX OF ECONOMIC FREEDOM*



**SOURCE:** Terry Miller, Anthony B. Kim, and James M. Roberts, *2020 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2020), <http://www.heritage.org/index>.

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Poland has had the aggregate effect of undermining the tripartite separation of powers, which in turn is beginning to be reflected in the economic stability of the country.

The Polish government, headed by the Law and Justice Party, is trying to use the appointment process for judges to shift the reigning judicial philosophy in Poland to one that aligns more closely with its long-term, conservative-nationalist goals. In seeking to attain these goals, the Polish government should:

- **Focus on greater judicial effectiveness** and implement a new labor law that gives greater flexibility to private-sector employers and employees, and
- **Avoid heavy-handed and unpredictable interference in the routine procedures and processes of the courts**, which could weaken the rule of law and make Poland less attractive to foreign investors.

As noted above, the score for Poland's government spending indicator (48.8) is the lowest of the country's 12 indicator scores in the 2020 *Index*. Given the added burden of additional spending to respond to the pandemic, getting control of government spending poses an especially heavy challenge to the government. In addition to necessary emergency expenses to meet the threat of the pandemic, generous spending on social welfare programs has been a trademark of the governing party. To address these shortcomings, the Polish government should:

- **Consider streamlining its family benefit programs** where possible, while maintaining their effectiveness and continuing to use them to promote the goal of stronger traditional families in Poland, which are the backbone of any successful society.
- **Reduce the cost of public administration.** The pandemic situation and social distancing have shown that the administration can perform many of its tasks online. Polish authorities should think about how, thanks to the deployment of technology, it would be possible to reduce the burden that taxpayers pay for unnecessary bureaucracy.

The 2020 *Index* reports that labor policy changes are sometimes fast-tracked without input from businesses or labor unions, which negatively affected Poland's low score (62) on the labor freedom indicator. The costs of the pandemic must be borne by everyone, however, and it would be irresponsible to put that burden only on the backs of wage earners. The Polish government should:

- **Implement a more flexible policy** for the reduction of the fixed costs related to hiring workers. The minimum wage should be diversified and adjusted to regional economic conditions in each *województwo*,<sup>15</sup> as the big cities, especially Warsaw, are strikingly better off economically. This would mean the end of the one-size-fits-all uniform minimum-wage policy and the creation of a scale of minimum wages based on location.

A strong, prosperous, and secure Eastern Europe is in the interest of Poland, the region, NATO countries in general, and the United States in particular. 3SI can play a role in making this happen. The Polish government should:

- **Make the success of 3SI a priority.** 3SI will strengthen trade, infrastructure, energy, and political cooperation among countries bordering the Adriatic, Baltic, and Black Seas.

So far, the COVID-19 pandemic has not had a catastrophic impact on Poland. As of this writing, the number of deaths due to illness caused by the virus has been less than 1,500 people. That low figure reflects the success of the entire society, which jointly followed the health restrictions that made it difficult for the disease to spread. However, the effects of the virus on the economy are much more serious.

Although Poland ranks ahead of many other EU members in the *2020 Index of Economic Freedom*, there remains much room for improvement. To achieve this improvement will require implementation of the additional reforms outlined in the *Index*.

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## Endnotes

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