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Where will Poland go?

Cues from the presidential election

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- The outcome of the Polish presidential election signals a change of direction of the political and possibly economic course in the years to come.
- The victory of the rightwing candidate could be followed by a radical shift in the general election this autumn, away from the liberal and EU-friendly governing Civic Platform towards socially conservative and eurosceptic Law and Justice, the party behind the new President-elect.
- Provided the governing party loses the election and the pledge given by the new President during his campaign is fulfilled, the years of economic progress and move to the political center could be put at risk.

How did the unexpected happen?

On the eve of the ballot on May 10, few expected that the relative unknown 43-year old lawyer Andrzej Duda would oust the incumbent candidate. According to a poll conducted by the Public Opinion Research Center (CBOS) in April 2015, Bronislaw Komorowski should have received the majority of votes already in the first round.

The final outcome seems to have been determined by three main factors. First, a part of the Polish society, especially young and economically active people, wanted to send a signal of rejection of the political inaction of Komorowski during his presidency and of the governing Civic Platform during the past several months. They were drawn in by a mix of a charismatic electoral campaign by Duda and a complacent attitude of Komorowski.[1] Second, the strong emphasis put on social issues by Duda mobilized voters who felt to have benefited little from prosperous growth during the last few years. Indeed, the regional distribution of electoral results broadly reflects an economic and social divide in Poland. Although disaggregated data show that large metropolitan cities across all Polish regions clearly benefited from the past economic growth, the inter-regional disparities persist and were put at the center of Duda's electoral campaign. As a consequence, rural and economically disadvantaged eastern areas delivered the decisive votes to Duda. The third group of his voters included traditional, conservative and faithful supporters of his rightwing party Law and Justice.

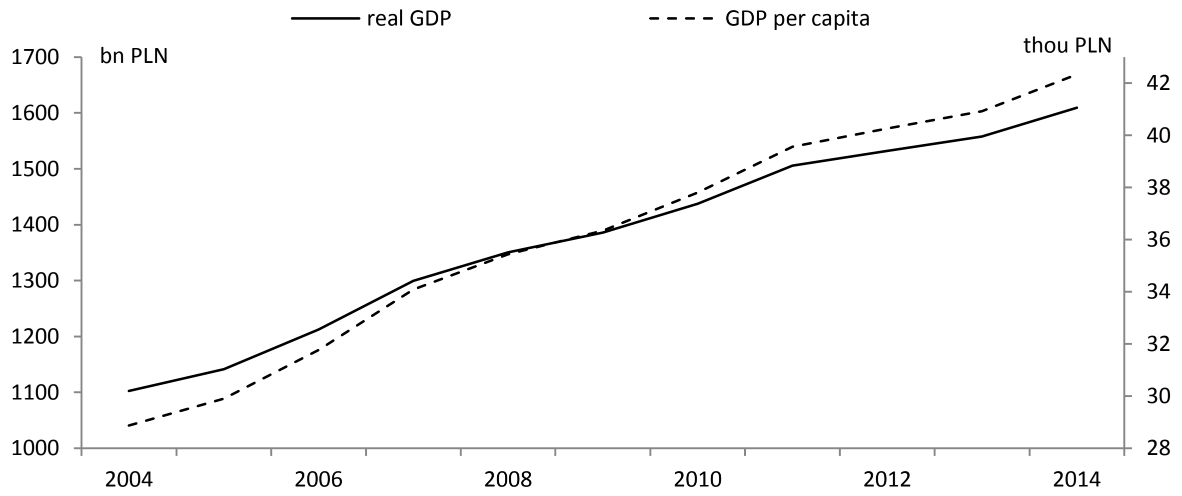
[1] Komorowski saw a dive of his public approval rating from 65% in February 2015 to 51% in April.

Poland's economic rise

Since Poland's EU accession in 2004, the economy has grown strongly (Fig. 1). Even the global financial crisis did not break the trend – Poland was the only EU country to avoid recession following the financial crisis of 2008. Between 2004 and 2014, growth of real GDP and GDP per capita amounted to 3.9% in the annual average. Since 2008 – the first year after the Civic Platform won the general elections in autumn 2007 – real GDP rose by 21.7% and real GDP per capita by 22.0%.

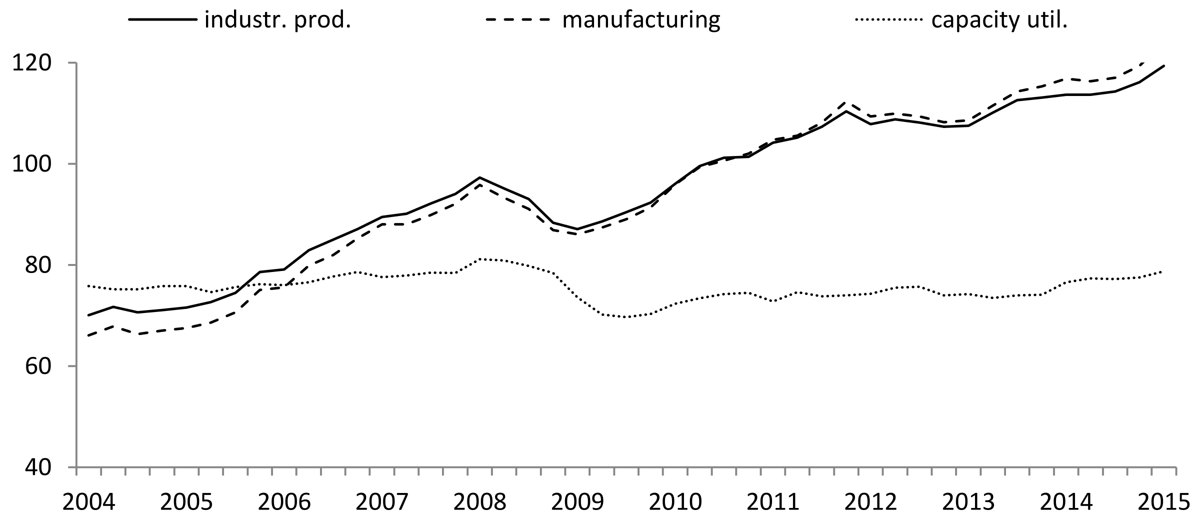
Other indicators, such as production and capacity utilization, support the Polish success

Figure 1. Real GDP in billions of chained 2010 zloty (left scale) and real GDP per capita in thousands of zloty.



Source: Haver.

Figure 2. Industrial production, manufacturing production, and capacity utilization.



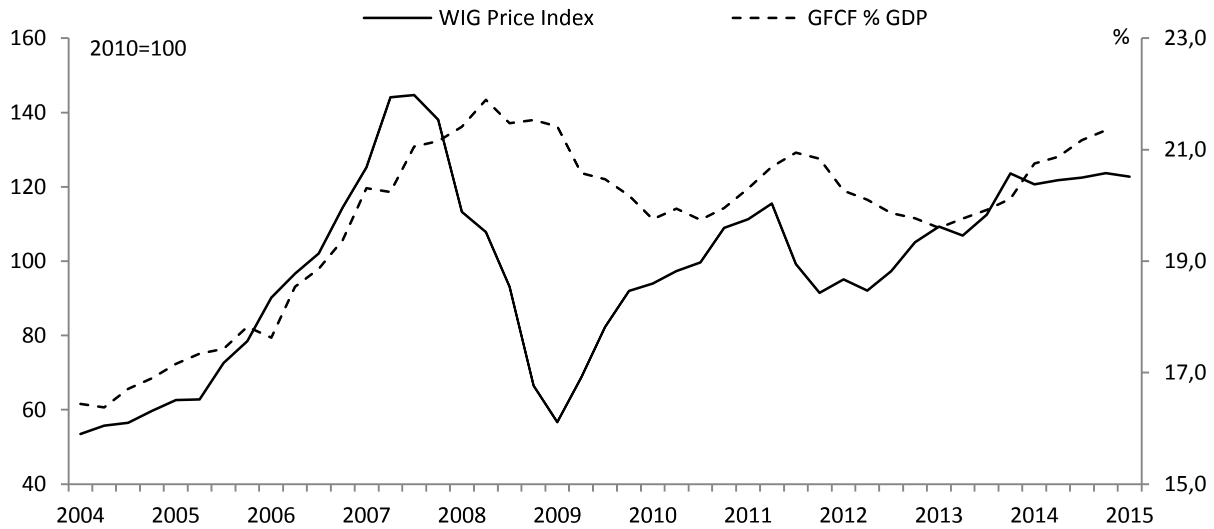
Source: Haver.

Note: Industrial production (excluding construction) and manufacturing activity are indexes with 2010=100; capacity utilization is expressed in percentage terms.

story (Fig. 2). There was only a slight dip around 2008, and the expansion continued in 2009 while rest of the EU was struggling against the slowdown in the aftermath of the global financial turbulences.

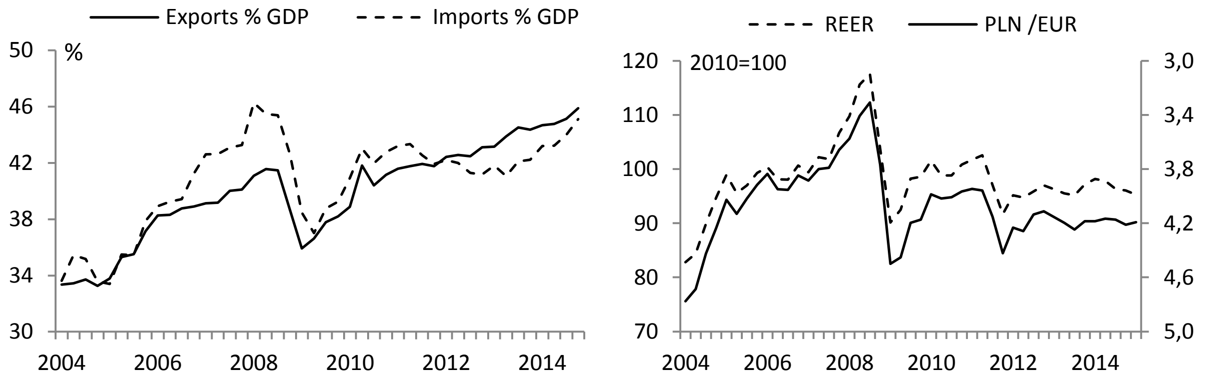
Due to the strong linkages with international capital markets, the Warsaw Stock Exchange Price Index could not escape the global downturn of 2007/2008, but it rallied again soon thereafter (Fig. 3). The collapse of the international financial system weakened investment performance between 2008 and 2010, but since then the share of gross fixed capital formation in GDP has held up while it has declined on average in the rest of the EU (Fig. 3).[2]

Figure 3. Warsaw Stock Exchange Index (WIG; left scale) and gross fixed capital formation in percentage of GDP.



Source: Haver.

Figure 4. Exports and imports of goods and services in percentage of GDP (left graph) and zloty exchange rates (right graph): nominal to the euro (right scale) and real effective (REER).



Source: Haver and Eurostat.

[2] In the EU-28, the share of GFCF in percentage of GDP collapsed from 22.8% in the first quarter of 2008 to 19.3% in the fourth quarter of 2014.

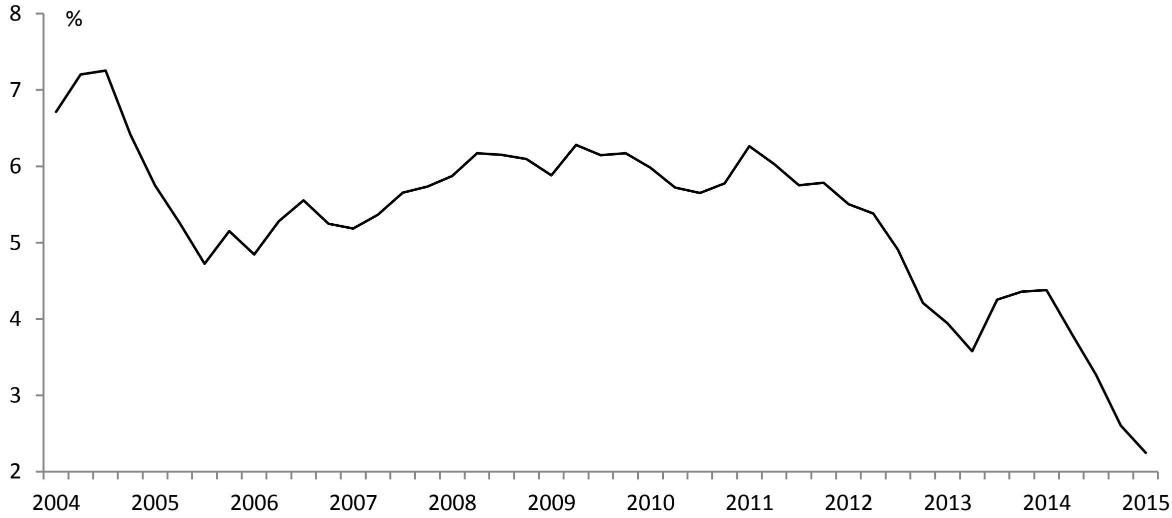
Table 1. General government deficit and debt in percentage of GDP.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Deficit ratio	-5.4	-4.0	-4.0	-2.1	-3.6	-7.2	-7.6	-4.9	-3.7	-4.0	-3.5
Debt ratio	45.6	47.0	47.5	44.6	47.0	50.3	53.6	54.8	54.4	55.7	48.8*

Source: Haver

Note: The sharp reduction of the debt ratio in 2014 was a one-shot accounting effect due to the fact that the Polish Social Insurance Institution (ZUS) took over a part of the liabilities of the Open Pension Fund. In this way, pension obligations were moved to the "hidden debt", which – according to the new ESA 2010 rules – has to be included in the debt accounts starting in 2015.

Figure 5. 10-year Government Bond Yields (% per annum).



Source: Haver.

A similar temporary dip can be seen in the trade data around 2008, but both imports and exports recovered fast in the subsequent period (Fig. 4, left graph). The positive performance of exports was accompanied by a stable currency both in real effective terms and against the euro (Fig. 4, right graph).

The governing Civic Platform managed to reduce public budget deficits after the increase in the years following the financial turmoil. Yet the public debt ratio continued to rise between 2007 and 2013, approaching the constitutionally established upper bound of 55-60% (Tab. 1).[3] The rise would have continued, if debt had not been reduced by an accounting maneuver (see note to Table 1).

Due to the relatively low debt ratio by international comparison and to the strong commitment of the Polish government to reduce deficits, yields on the 10-year government bond have fallen since 2009. It seems that markets believed in the sound performance of the Polish economy (Fig. 5).

[3] In Art. 216, the Polish Constitution establishes the so called 'security thresholds' for the debt ratio. Most importantly, it states that in case the debt ratio lies between 55% and 60%, the budget projections for the following year should not show a deficit or they should at least assure that the debt ratio falls again.

The strong growth performance of the economy as a whole translated into an improvement of the economic and social situation of the population. Indeed, income inequality, measured in terms of the Gini coefficient, fell significantly before the crisis and continued to do so after 2008, when Civic Platform came into power.[4] Economic and social conditions improved at the regional level as well. Metropolitan cities across all Polish regions saw their GDP per capita increase and the unemployment rates decline. Although growth benefited all Polish cities, this was concealed during the presidential campaign and, instead, the persistence of inter-regional disparities became one of the focus points in the electoral program of the President-elect.

The meaning of Duda's election pledge

The electoral campaign of the challenger was led by an 'electoral agreement' with the voters.[5] The central idea of the agreement was the construction of the "common Polish home", based on a strong fundament and stabile pillars. These pillars were: family, work, dialog and security. Specifically, the "family pillar" included a promise of 500 zloty (EUR 120) child benefits as of the second child; cost-free kindergarten for every child; radical reform to the health and early educational system; and the return to a pension entry age of 65 for men and 60 for women (from 67 at present). The annual cost of the latter – assuming additionally that at least 50% of men and women reaching the pension entry age would remain in the labor market – has been estimated at about EUR 3.6bn. The "work pillar" includes support to investment, accompanied by a reduction of barriers to the ease of doing business. It further promises an increase in wages and support to exports, which is to be achieved through the maintenance of a favorable exchange rate of the Polish currency. The "dialog pillar" foresees the establishment of a National Development Committee (with business and industry representatives, experts and scientists), with the main task to make suggestions for the development of existing and the creation of new companies. The final pillar "security" should be built by establishing a strong international political standing in conjunction with a strong economy.

On different occasions during the campaign, these pillars were more and more clarified. In terms of foreign policy, a 'recalibration' of the relations with Germany would take place, with the aim of diminishing Germany's influence over Poland in questions such as climate change and relations with Russia. At the same time, tighter diplomatic collaboration with the US is seen as a key in the endeavor to establish a permanent Nato base on Polish territory. Finally, powers from Brussels should be shifted back to member states.

As a member of a party with a nationalist orientation, Duda's aim is to protect more fiercely Polish entrepreneurship. One of the proposals includes the introduction of additional taxes on large supermarket chains – a sector strongly dominated by foreign retailers. Another proposal aims at the renationalization of the banking sector, where two-thirds are currently controlled by foreign players.

It remains questionable whether and how the new President-elect is going to realize his promises. He must rely on the success of his party in the general election this autumn.

[4] Gini coefficient measures the degree to which income distribution within an economy deviates from a perfectly equal distribution. The lower the coefficient, the nearer the distribution of income is to the perfectly equal one. In Poland, the coefficient diminished from 35.6 in 2005 to 32.0 in 2008 and further to 30.7 in 2013.

[5] For details, see the official website of Andrzej Duda at http://andrzejduda.pl/umowa-programowa.

Should this indeed happen, the question will become pertinent how to finance these promises. Although any estimate can only be guesswork at present, it is indisputable that implementation of the promises would put a heavy burden on the government budget. The past fiscal consolidation efforts would probably be wiped out, creating tensions for public finances as the debt ratio would rise towards the critical boundary. Also, growth would probably suffer, particularly if the pension-entry age was reduced, and wages and tax allowances were increased.

Recent political achievements would almost certainly be threatened. Instead of being perceived as a rising political power in Europe and close ally of Germany, Poland would be regarded as peripheral member of the EU with little influence on EU policy.

Where will Poland go eventually?

After years of economic prosperity and political stability, the future now seems uncertain. The electoral results of the Polish presidential election signal a radical change in the years to come. The victory of the rightwing, conservative candidate reflects a deep dissatisfaction of a large part of the electorate with the current government and could therefore be followed by a further shift in power in the general election this autumn, away from the liberal and EU-friendly Civic Platform towards the socially conservative and eurosceptic Law and Justice Party. If the new President's election pledge is implemented by a new government after the parliamentary elections in autumn, the years of economic progress and international political rise of the country would be at risk.

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