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Description and Application of Fiscal Rules as Instruments of Ensuring the Sustainability of Public Finances in Poland

Abstract. *The purpose of this article is to describe and evaluate fiscal rules aimed at maintaining the sustainability of public finances in Poland. Fiscal stability is defined as the government's ability to regulate its obligations. In the following section the author systematizes fiscal rules and provides their brief characterization. These rules constitute permanent budgetary constraints, which are reflected by the budgetary indicators that are used to monitor the implementation of this policy. The final part of the article is devoted to the analysis of the sustainability of public finances in Poland in the years 2007-2016, with particular emphasis on the fiscal rules. The author answers the question whether fiscal policy in the reference period was characterized by stability.*

Keywords: *public finance, fiscal stability, fiscal rules, budget policy*

Introduction

Fiscal policy is currently playing an extremely important role in all types of operations in the public finance sector. It deals with the development of state revenue and expenditure and processes of managing public funds. It is one of the fundamental forms of stimulating economic development and it is an important instrument for correcting the market mechanism. There is no doubt that a responsible fiscal policy aimed at maintaining stability in the public finance sector requires the establishment of and compliance with strict standards and rules.

The purpose of this paper is to present the fiscal rules that are currently in force in Poland and to describe the role they play in preserving the sustainability of public finances. The main idea of fiscal stability is presented based on the literature on economics and finance. Given widespread budget deficits and growing public debt, it is extremely important to have a proper understanding of this concept. The second part of the article contains a systematic description of the existing fiscal rules, taking into account various classification criteria and their concise characteristics. Each fiscal rule is a permanent limitation of political discretion in fiscal policy and is reflected by the budgetary indicators used to monitor its implementation. The final part of this paper is devoted to the analysis of the sustainability of public finances in Poland in the years 2007-2016. The author's attention focuses on the impact of the current fiscal rules on the condition of the public finance sector in order to evaluate the stability of fiscal policy in Poland in the reference period.

1. The main idea of fiscal stability

In the literature on economics and finance, there are numerous approaches to fiscal sustainability. Despite the growing interest in the concept, one cannot fail to note a certain degree of ambiguity in the definition of this term. No consistent and accepted definition of fiscal sustainability has been formulated to date. For this reason, only selected formulations will be cited, which refer to the main idea of the concept.

According to one definition, fiscal sustainability is understood as a feature of fiscal policy that enables the government of a country to regulate its obligations in a timely manner without making important adjustments in the balance of public revenue and expenditure [Jajko 2008: 43]. The above formulation highlights the concept of solvency and essentially refers to the state's ability to fulfil its obligations, while respecting all agreements and deadlines involved.

Fiscal stability is also defined as the ability of the public finance sector to continue its existing policies without undermining the budgetary constraints of the sector [Mackiewicz 2010: 88]. It is important to pay special attention to the condition that must be met in order to respect the interim budgetary constraints of the public finance sector. The condition is met when public debt in the initial period is equal to the discounted debt in the final period and the sum of the discounted differences between the projected public revenue and the expected public expenditure [Pączek-Jarmulska 2016: 49]. The above-mentioned differences between public revenue and public expenditure are respectively the budget surplus (in the case of a positive difference) or the budget deficit (in the case of a negative difference).

While discussing the essence of fiscal sustainability, one cannot forget about the problem of public debt, which is emphasized in the next definition. According to this view, fiscal sustainability is preserved by maintaining the level of public debt within reasonable limits, i.e. such that minimize negative consequences of budget deficits and debt and enable the state to effectively achieve its tasks aimed at stabilizing the economy [Włodarczyk 2013: 314]. The permissible level of debt is determined by functioning prudential thresholds. When the level of public debt exceeds 55% of GDP and 60% of GDP, the government is required to take a strict action to reduce the level of debt.

There is no shortage of practical approaches to defining fiscal stability. According to J. Blanchard, a stable fiscal policy occurs when the ratio of public debt to GDP strives to reach the baseline level. Stability is preserved when real debt in real terms does not increase faster than the interest rate, and the ratio of public debt to GDP should not rise more than the difference between the rate of growth and the interest rate [Blanchard 1990: 13]. In view of this, stable fiscal policy allows expansionary fiscal policy during periods of recession, bearing in mind the need for stabilization or, if possible, limiting the ratio of public debt to GDP after a period of increased budget expenditure.

2. Classification and characterization of fiscal rules

Fiscal stability discussed above is closely related to fiscal rules. They are an essential element contributing to the quality of public finance, which can be seen in the dimensions of the scope of public finances, the scale of budget imbalances and the structure of public revenue and expenditure and their effectiveness. Fiscal rules are factors which support the process of ensuring the quality of public finances, apart from institutional and operational solutions [Franek 2010: 66].

Fiscal rules can be defined as a type of permanent restriction of political discretion in fiscal policy, which is expressed by numerical limits imposed on fiscal aggregates [Kopits & Symansky 1998: 2]. They are seen as promising tools in the fight against the public finance crisis in individual states. The main impetus for the implementation of fiscal rules for public finance systems has been the tendency of governments to face a widening budget deficit, which in turn leads to a steady increase in public debt and budgetary expenditures related to the servicing and repayment of debt [Spychała 2015: 228].

There are many reasons for introducing fiscal rules into the public finance system. One of them is to guarantee macroeconomic stability in the economy. Fiscal rules also designed to preserve the shape of fiscal policy in the long run. They are meant to reduce negative externalities of autonomous fiscal policies adopted by the countries of the European Union. Undoubtedly, the most important reason for the implementation of fiscal rules is the improved credibility of fiscal policy and a reduced risk of excessive government deficits [Działo 2012: 220].

In the European Union, there is a two-tier mechanism for the functioning of fiscal rules – the national and the EU level. The task of the EU level is to effectively discredit the fiscal policies of the Member States. This is because fiscal policy is shaped by individual Member States. Accordingly, each country's budget is based on the country's regulations. There are certain differences between individual country regulations but they part of a general framework agreement and comply with international treaties and agreements, i.e. the Maastricht Treaty and the Stability and Growth Pact [Próchnicki 2012: 30].

After presenting the main idea and importance of fiscal rules, it is necessary to systematize them, taking into account different classification criteria. In the literature, fiscal rules are often classified with respect to budget indexes. According to this approach, four types of fiscal rules are distinguished:

– budget balance rules,
– public debt rules,
– revenue rules,
– expenditure rules.

Budget balance rules can refer to the actual balance, i.e. the difference between revenue and expenditure in a financial year, a structural balance – a hypothetical figure arising under conditions of full utilization of the manufacturing capacity of the economy and the rate of unemployment corresponding to full employment or to a cyclical balance, which takes into account the impact of the business cycle on the level of budget revenue and expenditure [Wójtowicz 2011: 139]. Two specific rules are worth mentioning at this point: the balanced budget rule and the golden budget rule. The first one is the clearest and is considered to be the most rational rule, although numerous analyses suggest that it has procyclical effects (not anticipating changes in the business cycle). It should be noted that the above rule may not apply continuously. On the other hand, the main idea of the golden rule is to balance the current budget. As a result, the government is allowed to increase budget expenditure to finance investments; current revenue can only be used to cover public current expenditure, while capital expenditure can be covered by debt. At present, the budget balance rules usually cover the limit of the acceptable level of deficit in relation to GDP [Marchewka-Bartkowiak 2012: 49-50].

Public debt rules are quite uniform and in principle are not subject to significant modifications. They involve imposing a limit on the level of public debt in the form of debt to GDP ratio [Działo 2012: 222]. The most common debt rule is contained in the Treaty of Maastricht. According to this rule, the public debt of EU Member States must not exceed 60% of GDP. It should be noted that an analogous rule is included in the Polish Constitution, which stipulates that the ratio of public debt to GDP must not exceed 3/5 of GDP. The debt rules generally take into account the gross debt of the sector as a whole, but they can also refer to the debt of individual segments, i.e. government debt, local government or insurance [Wójtowicz 2011: 140].

Revenue rules are introduced to achieve three main objectives. The first is the implementation of the goal of maintaining stable taxes and minimizing drastic actions in this area (primarily tax increases). Another goal is to determine the allocation norms for a revenue surplus that has been achieved in the current year. It should be noted that the available funds should be used to repay the existing debt. The last goal of revenue rules is to specify what percentage of the budget revenue is to be transferred to state stabilization funds [Marchewka-Bartkowiak 2012: 51].

Expenditure rules, the last category in the above classification, can take on various forms because there are various categories of public expenditure. Most of these rules refer to aggregate expenditure. The most common spending limit is expressed in the form of spending growth rules. The idea of the limit is that government spending should grow at a fixed rate, regardless of changes on the revenue side of the budget. Expenditure rules can also apply to separate categories of expenditure. Generally, they take the form of multi-year limits imposed on individual categories of expenditure [Działo 2012: 222].

As already mentioned, the EU utilizes a two-way mechanism for the implementation of fiscal rules. Therefore, depending on their territorial coverage, fiscal rules can be classified into the **transnational rules** (the budget criteria contained in the Treaty of Maastricht, subsequently extended in the Stability and Growth Pact) and the **national rules** contained in national legislation.

Another classification takes into account the specific type of institutional arrangements, which can be divided into **quantitative rules** (also called numerical rules), expressed as quantified limits for certain budget categories, and **qualitative rules** (also referred to as procedural rules), which refer to official guidelines for the construction and implementation of the budgetary law and to solutions that ensure their transparency [Wójtowicz 2011: 138].

The last extremely important classification criterion for fiscal rules is their application scope: namely, some rules apply to the whole public sector, while others only refer to the government and local government sector (regional and local). There are also fiscal rules for social security [Marchewka-Bartkowiak 2012: 49].

3. Analysis of the sustainability of public finances in the light of fiscal rules in the period 2007-2016

The main fiscal rule that governs fiscal policy in Poland is the **rule of public debt**. As mentioned earlier, it is included in the Constitution of the Republic of Poland and defines the acceptable limit of public debt. Specifically, it is prohibited for the government to borrow or grant financial guarantees that will cause public debt to exceed 3/5 of the value of annual GDP. The above provision is complemented by regulations set out in the Public Finance Act, which includes precautionary and sanctioning procedures to be followed when public debt levels exceed 55% and 60% of GDP, respectively. It is important to briefly discuss the sanctions and restrictions that are imposed when individual prudential thresholds are exceeded.

Prudential procedures are triggered when **the debt to GDP ratio is greater than 55% and less than 60%**. In this situation, the level of budget deficit in the draft budget for the next year is reduced so that the ratio of Treasury debt to GDP projected at the end of the budget year should be lower than in the current year. In addition, the Council of Ministers reviews budget expenditures, which are financed by foreign loans and the review of multiannual programs. The Council is also obliged to submit a sanitation program to the Parliament, which aims to reduce the debt to GDP ratio. There are also restrictions on the financial management of local governments. The expenditures of the local government specified in the budget resolution for the following year can exceed the revenues, plus surplus and free funds only by the amount related to the implementation of strictly defined statutory tasks.[1]

The strictest restrictions apply when **the public debt to GDP ratio is equal to or greater than 60%**. Then in the draft budget law for the next year and in budget resolutions of local governments, the amount of expenditure must be equal or lower than the amount of expected revenue. The Council of Ministers is obliged to present to the Parliament a sanitation program aimed at reducing the debt to GDP ratio to less than 60%. It is also prohibited to issue new sureties and guarantees by units of the public finance sector.[2]

It should also be mentioned here that by 2013 there was another (lowest) prudential threshold – the ratio of public debt to GDP higher than 50% but not exceeding 55%. In this case, the ratio of the budget deficit to the budget revenue for the following year must not exceed the corresponding ratio for the current year. The first prudential threshold was waived under the Law on the Amendment of the Public Finance Act and some other statutes.[3]

Strictly linked to the rule of public debt is the **rule of the budget balance**. In Poland this rule is implemented as the **budget deficit limit**. The main idea of budget deficit limits is that in a given period (usually fiscal year) the deficit cannot

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[1] Public Finance Act, Journal of Laws no. 157, item 1240 as amended (ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych, Dz.U. nr 157, poz. 1240 z późn. zm.).

[2] Ibidem.

[3] Law on the Amendment of the Public Finance Act and some other statutes, Journal of Laws item 1646 (ustawa z dnia 8 listopada 2013 r. o zmianie ustawy o finansach publicznych oraz niektórych innych ustaw, Dz.U. poz. 1646).

exceed a specified limit, expressed as a percentage of GDP. In line with the Maastricht Treaty, budget deficits in member states **should not exceed 3% of GDP** [Działo 2012: 221].

In order to assess the effectiveness of the above-mentioned fiscal rules, the development of the budget deficit and public debt should be analyzed in the reference period. Table 1 presents the budget deficit in relation to GDP and public debt in relation to GDP in the period 2007-2016.

Table 1. Budget deficit and public debt (% of GDP) in 2007-2016

Year	Budget deficit	Public debt
2007	1.9	44.2
2008	3.6	46.3
2009	7.3	49.4
2010	7.3	53.1
2011	4.8	54.1
2012	3.7	53.7
2013	4.1	55.7
2014	3.5	50.2
2015	2.6	51.1
2016	2.4	54.4

Source: based on data from *Raport roczny. Dług publiczny* 2017: 87, 91.

One particularly noteworthy fact about the data shown in the table above is the substantial increase in the budget deficit in 2009. This was due to the major economic downturn at that time. In the same year, Poland was included in the excessive deficit procedure. In practice, this meant that Poland was obliged to comply with certain recommendations made by the Council of the European Union. In 2015 the Council decided to close the excessive deficit procedure for Poland because the budget deficit had been reduced to less than 3% of GDP.[4]

In recent years, public debt in Poland has been on an upward trend. The only exception is 2014, when public debt fell (by 9% of GDP)[5] due to the transfer of some of the assets from Open Pension Funds to the Social Insurance Institution.

Existing fiscal rules designed to control the budget balance and public debt undoubtedly have a very significant impact on the sustainability of public finances in Poland. The obligation to comply with these rules, which are stipulated both in international and national laws, helps to avoid excessive, uncontrolled increases

[4] www.forbes.pl/wiadomosci/rada-ue-zdjela-z-polski-procedure-nadmiernego-deficytu/0szjv7d [access: 1.09.2017].

[5] www.forbes.pl/wiadomosci/polski-dlug-publiczny-spadl-o-9-proc-pkb-dzieki-ofe/cstpn2v [access: 2.09.2017].

in the budget deficit and public debt. In the light of the above analysis, the size of the budget deficit and public debt in the period under review was under control thanks to the application of these fiscal rules.

It is now time to discuss another fiscal rule which is in force in Poland – the expenditure rule. The current **stabilizing expenditure rule** was incorporated into the Polish legal system in early 2014 [Ustawa o zmianie ustawy 2013]. It replaced the disciplinary spending rule, which was implemented only for a temporary period [Budzyński 2016: 21].

The purpose of the stabilizing spending rule is **to set a limit on the general government expenditure** at a level that ensures the sustainability of public finances. It sets a maximum cap for spending across the sector, so expenditures of some entities can grow faster along with a slower increase or decrease in expenditures of other entities subject to this limit. This symmetric correction mechanism has been incorporated into the rule with an operational objective closely linked to the medium-term budgetary objective. The control account cumulates the deviations of the nominal value of the general government from this medium-term budgetary objective. In cases where the level of deviations is disturbed, an additional adjustment of the expenditure limit dynamics is triggered. However, if the situation does not need to be adjusted, spending limits increase at a medium-term GDP plus expected inflation [MF 2013: 1-3].

Estimates of expenditure for 2016 were made in accordance with the binding stabilizing spending rule. Estimates were made taking into account the amount of expenditure for 2015 (PLN 696.7 bn) and forecasted macroeconomic indicators, such as the medium-term GDP growth rate and the projected CPI for 2016. The correction resulted from the update of the inflation estimates for 2014-15, the correction due to the public finance imbalance and the projected value of significant discretionary measures for 2016. As a result, the estimated expenditure for 2016 was 712.8 billion PLN and was 2.31% higher than the amount of expenditure for 2015, which was equivalent to a decrease in the expenditure to GDP ratio by 1 percentage point compared to 2015 [MF 2015: 11].

Taking into account the very short period of the functioning of the stabilizing spending rule, it is extremely difficult to assess its impact on the level of state budget expenditures, as well as the general government sector and the size of the budget deficit. Nevertheless, one can assess reliable forecasts for 2018. With strict adherence to the spending rule, the expenditure to GDP ratio and a medium-term budgetary objective (structural deficit of –1% of GDP) are expected to keep falling in 2018 [MF 2014: 8, 14]. The rule was the motivating factor and a kind of guarantee behind the decision to close the excessive deficit procedure for Poland despite the fact that the sector deficit at the end of 2014 exceeded 3% of GDP [Budzyński 2016: 27].

The last category of fiscal rules that apply in Poland are **revenue rules**. One particular revenue rule is the obligation to transfer some proceeds from privatization to the Demographic Reserve Fund [Działo 2012: 210]. According to the Act on the Social Security System, the Demographic Reserve Fund is financed, among other things, from the privatization of State Treasury assets in the amount of 40% of total gross proceeds from all privatization processes in a given year, less the sum of the obligatory write-offs for obligatory special purpose funds.[6] It should be noted that of all applicable rules described above revenue rules have the least impact on maintaining the sustainability of public finances in Poland.

Conclusion

The objective of this paper was to present and evaluate the existing fiscal rules in Poland. The analysis was based on the most commonly used classification of fiscal rules, which distinguishes between rules designed to control the budget balance, public debt, expenditure and revenue. The analysis focused on the impact of particular fiscal rules on the sustainability of the public finance sector in Poland.

The analysis of the sustainability of public finances in Poland in the period 2007-2016 shows that the fiscal rules fulfill their expected role. The imposition of the excessive deficit procedure in 2009 undoubtedly contributed to a faster reduction of the alarmingly high budget deficit. The procedure was applied as a result of observing the budget balance rule (and more precisely the deficit rule) and the closely related public debt rule. These rules are clear and have a high legal status. Their disadvantage is that they can lead to the implementation of the pro-cyclical fiscal policy (this is the case when the relevant indicators are not corrected for fluctuations in the business cycle).

The condition of the public finance sector is also affected by the stabilizing expenditure rule, which sets a limit on the general government expenditure at a level that ensures the sustainability of public finances. The advantage of this rule is undoubtedly the fact that it limits the discretion of fiscal policy by precisely setting acceptable spending limits. Poland also applies the revenue rule, but its impact on financial stability is by far the smallest.

It can therefore be concluded that the fiscal rules helped to maintain the relative stability of public finances in Poland in the reference period. In addition to playing an extremely important role in maintaining the fiscal discipline of the public finance sector, the fiscal rules have a significant impact on limiting the level of government spending, the budget deficit and public debt.

[6] Act on the Social Security System, the Demographic Reserve Fund, Journal of Laws no. 137, item 887 (ustawa z dnia 13 października 1998 r. o systemie ubezpieczeń społecznych, Dz.U. nr 137, poz. 887).

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Charakterystyka i zastosowanie reguł fiskalnych jako instrumentów utrzymania stabilności finansów publicznych w Polsce

Streszczenie. *Celem artykułu jest charakterystyka i ocena reguł fiskalnych służących utrzymaniu stabilności finansów publicznych w Polsce. Przedstawiono w nim definicyjne ujęcie oraz istotę stabilności fiskalnej, która rozumiana jest jako zdolność rządu do regulowania swoich zobowiązań. Następnie usystematyzowano występujące reguły fiskalne oraz dokonano ich krótkiej charakterystyki. Reguły te stanowią permanentne ograniczenia polityki budżetowej, znajdujące odzwierciedlenia we wskaźnikach budżetowych, wskazujących na postępy tej polityki. W ostatniej części dokonano analizy stabilności finansów publicznych w Polsce w latach 2007-2016, ze szczególnym uwzględnieniem omówionych wcześniej reguł fiskalnych. Tym samym zweryfikowano, czy polityka fiskalna w Polsce cechowała się stabilnością w badanym okresie.*

Słowa kluczowe: *finanse publiczne, stabilność fiskalna, reguły fiskalne, polityka budżetowa*