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Numerical Fiscal Rules – The Experience of Poland

Abstract. *For years, fiscal rules have been considered to be one of the most important tools of disciplining public authorities in their fiscal policy execution. Over the past 20 years, the number of fiscal rules in the world, and particularly in Europe, has grown tenfold. The structure of fiscal rules is subject to constant evolution and changes. The article is a synthesis of the phenomena prompting the evolution of fiscal rules. They have been classified and characterised, and an analysis is done of the fiscal rules that are in force, specifically, in Poland.*

Keywords: *fiscal rules, public budget, fiscal policy, Poland*

Introduction

The departure from the classical rule of balancing the public budget resulted in the introduction of rules aimed at limiting public resource expenditures. As a consequence, the amount of planned deficit and public debt is legally limited.

The historical reason for the introduction of numerical fiscal rules was the departure from the traditional treasury rules to the Keynesian government intervention model. The fast evolution of fiscal rules began in the 1990's, following a period of the accumulation of public debt in many states with a free market economy. However, we ought to remember that the first fiscal rules emerged as early as right after World War II in countries such as Germany, Italy, Japan, or the United States.

Numerical fiscal rules, alongside budgetary procedures or independent fiscal institutions, became a part of the joint concept of institutional economics which points to solutions aimed at disciplining public authorities.

In the European Union, numerical fiscal rules have become one of the major criteria of the assessment of economic policies implemented by EU member states. The cohesion or convergence criteria are applied as the international assessment of a country's creditworthiness. Furthermore, not only the EU rules but also the national fiscal rules are becoming increasingly important. The European Commission data shows that by the end of 2014, the EU member states had introduced as many as nearly 120 fiscal rules.[1] That demonstrates the increasing significance of numerical fiscal rules in the verification of the, so called, "economic management."

Poland, too, has a broad range of numerical fiscal rules implemented both at thepublic sector level as a whole, and at the level of particular subsectors. The quantity, as well as, the quality of fiscal rules is constantly evolving from the rules determined, as constant annual relations to the rules are based on the multiannual perspective of historical data which show particular limits of nominal values.

The purpose of this article is to analyse the current fiscal rules in Poland, and to comment on the evolution of their structural changes.

1. The selected causes and effects of the introduction of fiscal rules

The findings of research conducted globally in the sphere of economic and political sciences justify, in many ways, the introduction of fiscal rules. The most important scientific phenomena include the issue of lags, the incoherence of fiscal policy over time, and the deficit bias.

Fiscal policy lags primarily concern the inability of public authorities to respond promptly to the changing market and economic conditions. The inability results mainly from procedural-institutional requirements (i.e. from failing to involve all decision-making bodies in the process, including Parliament). The lags phenomenon is not typical of fiscal policy as it derives from the identified problem of lags in monetary policy. However, as opposed to the fiscal policy, it is recognised that the response time of the market and the economy to the decisions of the central bank (e.g. in terms of interest rate changes) is relatively shorter. The lags issue is particularly important during an economic crisis, when it often takes too long between making a decision to apply a particular instrument and imple-

[1] http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/fiscal_rules/index_en.htm [access: 10.07.2016].

menting it. That results in the non-coordination of the authorities' response and the society's needs, i.e. an inconsistency in time [Fisher 1988]. What is more, in a dynamically unfolding crisis, not only might some decisions implemented "after due time" fail to be effective, but they can cause adverse effects outright. In such a case, the decision-making procedures before the implementation of a response, crucial to the transparency of policy-making, can hinder the countermeasures aimed at fighting the effects of the recession. To minimise the above-mentioned phenomena, it is accepted that the best solution is to implement a properly formulated fiscal rule which is to automatically adjust the budget to a country's changing economic situation [Marchewka-Bartkowiak 2010].

Overall, it must be acknowledged that the fiscal rule ought to induce the effect of anti-cyclicality, enabling the operation of automatic stabilisers of the economic cycle (which are part of the solution of some instruments, such as taxes, or unemployment benefits) without the active participation on the part of the authorities. That also means that the effect of the applied rule, during economic growth, ought to be the tightening of the fiscal policy (restrictiveness), and during a downturn – its loosening (expansiveness). The fiscal rule should also be a credible rule, i.e. deemed by the society as in line with the authorities' intentions, long-lasting, but primarily, one that delivers the desired results that are in line with social expectations. A credible rule is expected to create the basis for a predictable fiscal policy, which would enable businesses and the society to adjust their own individual behaviour to it. Thus, it should indirectly impact the rational of the society's decisions under conditions of its limited access to information.

Another premise to apply a fiscal rule is also the politicians' excessive deficit bias due to their short-term political interest. Research shows that this phenomenon depends, among other things, on the electoral cycle phase, i.e. the closer the election the more need there is for rapid and often unexpected modifications to the budget (an increase in expenditure, or tax cuts) resulting in excessive deficit. Additionally, the so called "common pool problem" may occur, i.e. the pursuit to increase spending and deficit by particular interest groups, notably in multi-party governing coalitions, which may result in the intensification of the deficit increase. The inclination to go into deficit impairs the appropriate adjustments of the budget towards cyclical changes through the adverse impact of politics [Alesina & Perotti 1994]. That is because during economic growth politicians are inclined to increase budget expenditures and loosen their policies so as to allow the consumption of the "fruits of economic growth." In turn, during a recession, they are increasingly focused on maximising the public intervention so as to rescue the economy. Furthermore, it must be stressed that the phenomenon in question triggers the political assent to implement the policy of running into debt. The overlapping of the two effects often causes the so called debt ratcheting, which means that during prosperity the surplus generated does not go towards its repayment, while during a downturn the debt increases rapidly. In this way, the country falls into a trap or the debt spiral, which may ultimately lead to declaring insolvency.

We ought to remember though that fiscal rules can bring undesirable results through attempts to evade their restrictive construction. An example of that can be the process of debt transfer. It is recognised that the strict rules of borrowing imposed on the central or state authorities result in increased debt locally. This phenomenon also works the other way around, which means that if local authorities are forbidden to seek finance externally, they will exert pressure on the central authorities to go into debt with the intention of transferring resources to the local government. Additionally, what can also occur are the phenomena of creative accounting and fiscal illusion [Easterly 1999]. They consist of computational and statistical manipulation of data or the construction of performance indicators (such as budget deficits, budget expenditures, and public debt). Such actions are also of legal character. Typically, they concern the use of public guarantees which are a form of contingent liabilities rather than, for example, direct subsidies or a budget loan. In this way, public authorities do not increase the current budget deficit or the public debt; instead, they can postpone the possible financial consequences (i.e. the payouts under the guarantees provided) until later years. Another example is that of manipulation in terms of the rules of accounting financial operations executed by public authorities. The examples include recording privatisation proceeds as income rather than budget revenues so as to reduce deficit, the proposal to include social insurance contributions in pension schemes as budget revenues, or the more sophisticated solutions such as excluding the securitisation operations from the debt indicator which result in its reduction or stabilization. Obviously, those actions impair the transparency of the fiscal policy and the creditworthiness of the fiscal rule. Therefore, common views now are that the rules that enable *ex ante* control are becoming an increasingly less effective tool, notably so, over the long-term.

3. The types of numerical fiscal rules

According to the definition by G. Kopits and S. Symansky [1998], the fiscal rule is "a permanent limit of fiscal policy reflected in budget indicators identifying its progress.". Based on the above statement and on the solutions postulated in the literature, the most important rules of establishing the fiscal rule include as follows:

– determining precisely the budget indicator which the rule comprises (e.g. budget or structural deficit, the primary deficit or the total budget expenditures, the current expenditure or the total budget revenues, tax revenues or gross debt, net debt, etc.),

– introducing a high rank legal rule by setting it out in the constitution or an act (e.g. the Public Finance Act) to confirm its long-term character,

– formulating the rule in a simple and explicit way for the general public to have a good understanding of it as well,

– defining the sanctions for failing to obey the set out rule and the principles of executing them by a body independent of the state authorities,

– selecting a rule consistent with the adopted medium- and long-term financial and economic strategy of the state [Marchewka-Bartkowiak 2010].

The above stated principles mark the level of reference to the optimal fiscal rule formula, which ought to be pursued.

Fiscal rules are broken down by different criteria (Table 1). There are quantity rules (also known as numerical, based on the determined limits of budgetary indicators) and quality rules (which determine the limits introduced in a descriptive or procedural way), rules referring to a short term (e.g. to a one-year budget), multiannual rules (based on historic data or setting the direction of financial limits), and national and international rules (including those which refer mainly to the EU rules comprising uniform rules for all member states). There are also rules concerning a government budget, some other public entities (the local government or the pension system units, separately), or the public sector as a whole. It is also noteworthy to point out the division in terms of the legal framework which deter-

Table 1. The selected criteria for the division of the numerical fiscal rules

Criteria	Rule type
Geographic	International (supranational) National
Subject	Balance (deficit) Expenditures (total, current, capital) Debt (liabilities) Revenues
Subjective	Concerning the whole public sector (according to the adopted sector rule) Concerning government budget Concerning local government budget Concerning selected sector units
Legal	Of the international (including EU) legal basis Of the constitutional basis Of the statutory basis Of other legal basis
Structural	Concerning the nominal values of the indicated budget items Concerning the relation of the selected budget items to items overall Concerning the relation to GDP Concerning the relation to other macroeconomic and budget quantities

Source: own elaboration.

mines the possibilities of political intervention (the higher the rule's legal rank, the more possible it usually is to change it over a short time).

However, the most important division of fiscal rules is based on their construction. In this case, the possibilities of creating fiscal rules seem limitless. Nonetheless, bearing in mind the above criteria, we must point to four basic groups of rules. The first and simplest rule is based on setting annual nominal limits of the determined budget volumes (e.g. offsetting the budget at 0, the public sector debt limit in the USA, the possibilities to boost spending by some specific nominal values). Another often used construction is limiting the specific relation of budget items to the GDP generated in a given year (that concerns, for instance, the budget criteria established in Maastricht). In addition, it is also possible to limit some selected budget items in relation to overall revenues or expenditures of a sector or a unit, to be achieved within a specified time (such a solution is often used in regards to the limits set for the local government or pension sectors). Moreover, there are also limits that are based on the corrections of budget data that are based on some other macroeconomic and fiscal variables (e.g. inflation, potential GDP, or non-recurring expenditures).

The plethora of fiscal rules in force around the world today makes it easy to select a rule to meet some specific need. According to the International Monetary Fund, in 2013 fiscal rules were enforced in 97 countries, of which 47 countries had national rules only, while 48 countries also depended on international rules. This figure shows a very rapid evolution towards tightening fiscal budgetary discipline using those measures. It is worth adding that according to the IMF, in 1990 as few as seven countries had fiscal rules defined in the classical way [IMF 2015].

Thus, basically, the right selection of a rule in a given country must entail that it is efficient, and ought to be assessed by independent institutions on the basis of an impartial financial analysis of a long-term character.

4. Fiscal rules in force in Poland

Taking account of provisions in acts of both national and international character, we should assume that in Poland during the year 2016 there are ten fiscal rules concerning four budget lines, i.e. balance, expenditures, debt, and revenues (Table 2).

Within those rules, the most numerous group is **the balance rules**. They are mostly EU rules setting quantity limits concerning the balance of the general government, i.e. calculated under EU methodology. The sector type, to which the three EU rules in question are subject, is one of the two crucial common elements of those rules. Basically, the most important goal of their gradual implementation was meeting the deficit criterion of 3% GDP calculated on the basis of the fiscal year that was imposed on all EU member states in 1992. The justification of such a level of this criterion is to be found at the then level of budget expenditures linked to the costs of servicing the public debt of Western Europe's states, standing on average between 2 and 2.5% GDP. Thus, it may mean that effectively the criterion ought to be the goal to offset the primary balance. However, while constructing the criterion, the overall balance was regarded as the base volume, rather than the primary balance of the sector. Poland, as an EU member state since 2004, has been subject to the fiscal criterion of deficit. Failing to observe the criterion results in imposing the EU excessive deficit procedure on the given member state. Poland has twice been subject to this sanction procedure.

Since 2005 the assessment of the capability to meet the budget deficit criterion has been closely linked to the implementation of the balance rule based on the formula of structural balance. Thus, the rule is included in the prevention arm of the Stability and Growth Pact. The rule itself was dubbed *medium term objective* (MTO), as it sets out an objective measured over a medium-term (rather than fiscal or annual). The structural balance, in crude terms, is the sector balance adjusted for cyclical factors, as well as, non-recurring and temporary actions. MTO is set individually for particular states, having considered their economic and fiscal situation, as well as, the potential threats to their public finance stability. In the case of Poland, it is set at the level of anegative sector balance (i.e. deficit) of 1% GDP. It should be added that since the Stability and Growth Pact reform in 2011, more elements have been launched aimed at disciplining the authorities in their implementation of the rule in question , including, among other things, the following ones: if the MTO has not been achieved, the correction of the structural outcome should be 0.5% of GDP (assuming that the output gap in Poland will be in the range of ±1.5%, and debt will remain at or below 60% of GDP).

Formally, Poland is also subject to the third balance rule of general government, introduced in 2012 under the so called "Fiscal Compact" which was ratified by national public authorities in 2013. Under this solution, all countries ought to pursue offsetting the balance or to aim for a higher budgetary surplus. It is the most radical approach of all of the EU rules on public finance. This rule has also been linked to MTO as it is considered to be only fulfilled if the annual structural balance of the general government corresponds to the medium-term objective of the given country, where the bottom of the structural deficit stands at 0.5% of GDP in market prices. This rule may be considered to be of low-level binding character, and it is not subject to formal assessment as stated in the update of the Convergence Programme.

The final rule of the above-mentioned balance rules in force in Poland is not linked directly to EU rules, and it concerns the local government directly. It takes the form of a restriction imposed on particular annual local budgets, which assumes that the current budget of the local government must be offset. This rule is

Table 2. Numerical fiscal rules in force in Poland

Rule Subject	Structure	Rule Formula	Subject	Legal Entity
The Balance Rule	Deficit criterion	3% of GDP	General government sector	EU
	Structural balance rule (MTO)	The medium-term fiscal objective, i.e. target structural outcome of the general government sector stands at -1% GDP	General government sector	EU
	Balance offsetting rule	The general government's balance must be offset or in surplus	General government sector	EU
	Local government's current budget offsetting rule	The planned current expenditures must not exceed the planned current revenues plus the budget surplus of the previous years and free resources	Local government sector	National
The Debt Rule	EU debt criterion	60% of PKB	General government sector	EU
	Relation of public debt to GDP	It is prohibitted to take out loans or provide financial guarantees resulting in government public debt exceeding 3/5 of annual GDP	Public finance sector	National
	Prudential thresholds of public debt	Limiting the maximum level of public debt in relation to GDP to between 55% and 60%; Introducing remedial processes; The thresholds of 48% and 43% GDP are linked to corrective measures in the stabilising expenditure rule.	Public finance sector	National
	Restrictions in debt-serviced by local government authorities (JST)	The individual debt ratio of JST determined so that the ratio of debt and interest payment to total revenues in a given year must not exceed the arithmetic mean of the three successive years prior to a given year, based on the current budget and the proceeds from the sale of property to total revenues	Local government sector	National
The Expenditure Rule	Stabilising expenditure rule	Basically, the sector's expenditure can rise over a medium-term GDP real growth rate multiplied by the CPI inflation forecast	General government sector	National
The Revenue Rule	Obligation to transfer part of the proceeds from privatisation to the Demographic Reserve Fund	DRF receives financing from, among others, the transferred funds from the privatisation of State Treasury property amounting to 40% of the revenue from the overall gross amount, minus obligatory write-offs towards obligatory earmarked funds, obtained from all privatisation processes conducted in a given year	Public finance sector	National

Source: own elaboration based on relevant acts.

linked to the local government debt rule (and furthermore, to the debt of the whole sector) indicating that the only area of providing finance through going into debt, can be property (i.e. investment) expenditures.

Another group of rules, often applied in Poland, are the **debt rules**. At present, there are four restrictions in force, in that regard. Much like in the case of the balance rule, the EU fiscal rule has been top-down imposed on Poland as well. It aims to limit the level of going into debt by the general government to 60% of GDP. Despite the findings of numerous scientific studies questioning the validity of the level of the above-mentioned relationship, it should be assumed that the figure of 60% GDP results from the relationship average typical of the 1980's, i.e. prior to the creation of the Maastricht Treaty.

The 60% GDP debt level was inscribed into the Constitution of the Republic of Poland in 1997, and into the "Public Finance Act" in 1998 as the highest statutory safety threshold, the exceeding of which results in some specified sanctions imposed on public authorities. The difference consists in the sector approach to this indicator. The EU criterion refers to the sector structure formulated by Eurostat, while the constitutional provision and prudential thresholds concern the public finance sector. As a result of the above, there are, in fact two performance indicators which refer to separate debt rules.

At present, the statutory debt rules, known as safety thresholds, comprise two groups of limits. One (i.e. the 55% and 60% GDP thresholds), are linked to some specific remedial procedures, which are launched on exceeding the above-mentioned thresholds. This solution is of *ex post* assessment character, after obtaining the ultimate debt nominal values as announced by the Ministry of Finance and the GDP nominal values as provided by the GUS (Central Statistical Office of Poland). The other group of limits are the 43% and 48% GDP thresholds.Defaulting on these means an obligation for relevant disciplinary corrective action in order to determine the sector's expenditure value, subjected to the stabilising expenditure rule.

The final type of debt rules applies to the local government sector within individually imposed restrictions based on the historically (within three years) developed figures in the local government's budget, such as, current revenues and expenditures, property revenues, and total revenues. This rule directly concerns the limit imposed on the servicing of local debt, including the principal and interest on the debt incurred. This rule, first applied in 2014, replaced two numerical rules which set, in a uniform manner, the restriction for both the total debt and the servicing of the debt of all types of units. As mentioned before, the recently introduced local debt rule has been augmented by the current budget offsetting rule. It has also allowed a broader coordination of actions aimed at asset and liabilities management on the part of the particular units.

The stabilising **expenditure rule** introduced in Poland in 2014 is a peculiar solution. First, it is linked to the MTO rule which means that it concerns achieving a particular value of structural balance over a medium-term. Second, it is only correlated to MTO, as it does not comply with all the provisions of an EU rule (it concerns the expenditure aspect only and some other assumptions of the historical data period, plus being provided in nominal values). Third, despite being a national rule, it is based on the sector calculated under EU methodology. Fourth, it is based on the econometric model determined by the MF, which, when entered into the Public Finance Act, set new standards for the fiscal rules legal provisions. We must also add that the assessment of the expenditure rule implementation was vested in the Supreme Audit Office (Najwyższa Izba Kontroli) (however, as for now, no assessment has been made in this respect yet). This rule replaced the before-introduced 'temporary' rule which encompassed the state budget only and allowed the raising of annual expenditure by 1%, plus CPI inflation.

The last of the discussed rule types is **the revenue rule,** concerning the provisions of financing the Demographic Reserve Fund. Highlighting this rule results from the fact that it is linked to the safeguarding of society's ageing process. Thus, it refers to a phenomenon which is mentioned explicitly in the "Stability and Growth Pact". It provides that all fiscal rules, including balance, debt, and revenue rules ought to take account of the above-mentioned demographic processes. The revenue rule, which defines part of the privatisation revenues as the source of financing the special security fund, is an immediate execution of the Pact's provision.

Conclusions

In recent years, fiscal rules have been one of the most important instruments of disciplining public authorities engaged in fiscal policies. The international rules enforced in the EU have gained importance. As shown by the above-presented data, the number of rules has increased by as many as several dozen in relation to the time the Maastricht Treaty was developed.

Over the span of a few years, new fiscal rules were introduced in Poland, and some of the old rules have changed their character. Those changes can be summarised as follows:

– over the past 25 years the number of fiscal rules in use has been growing steadily,

– the national fiscal rules are increasingly aimed at supporting the execution of EU rules,

– the construction of many national fiscal rules is not, however, fully adjusted to the construction of EU rules, which results in an additional lack of transparency in their execution assessment and in the duality of solutions,

– most of the currently applied fiscal rules concern the whole sector, while Poland is still lacking in the planning and execution of the public budget, i.e. the budget of the whole sector,

– the fiscal rules in force in Poland are increasingly complex as they are based on legally binding mathematic and econometric formulas,

– there are no detailed assessments made of the fiscal rule execution efficiency in the execution reports of state and local government budgets.

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Numeryczne reguły fiskalne – doświadczenia polskie

Streszczenie. *Reguły fiskalne zostały uznane za jedno z najważniejszych narzędzi dyscyplinowania organów publicznych w realizacji ich polityki fiskalnej. W ciągu ostatnich 20 lat liczba reguł fiskalnych na świecie, a szczególnie w Europie, wzrosła dziesięciokrotnie. Struktura reguł fiskalnych podlega ciągłej ewolucji. W artykule zaprezentowano syntezą zjawisk wpływających na ewolucję reguł fiskalnych. Zostały one także sklasyfikowane i scharakteryzowane. Szczegółowa analiza reguł fiskalnych dotyczyła doświadczeń polskich.*

Słowa kluczowe: *reguły fiskalne, budżet publiczny, polityka fiskalna, Polska*