# After years of above-average growth, Poland now faces the spectre of recession.

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*In comparison to the rest of Europe, Poland has experienced stand-out economic performance since the beginning of the economic crisis in 2008. However,* **Gavin Rae** *warns that this performance is largely based on the Polish government's ability to leverage funding from the EU. With a declining EU budget that now focuses on innovation over infrastructure, as well as increased budgetary pressures, Poland may now face the real possibility of recession.*

Although the global economic crisis severely affected Central-Eastern Europe, Poland is the only EU member state not to have undergone a recession in recent years. Poland's GDP rose on average by 3.5 per cent between 2008 and 2012, down from 5.5 per cent in the years after joining the EU. Now, declining investment in infrastructure from the EU may mean such growth rates will be a thing of the past.

Poland was able to avoid an economic recession due to a unique combination of internal and external factors. Firstly, the country suffered no significant collapse in its banking and financial sectors. Personal debt in Poland remained low and the banking sector relatively well regulated. Secondly, Poland was not as dependent on the inflow of private credit and capital as some other small economies in the region, nor so heavily reliant upon exports. Thirdly, Poland had not joined or tied its currency to the euro and therefore could retain some competitiveness through devaluation. Finally, throughout the crisis, the Polish government continued to increase spending, particularly by raising public investment through utilising the money gained from an inflow of EU structural and cohesion funds.

PGE Arena Gdańsk under construction in 2010 Credit: Adam Kuśmierz (Creative Commons BY ND)

This last point is of particular importance when understanding Poland's on-going growth. Government expenditures continued to increase in Poland throughout the crisis, rising from €15.1billion in 2008 to €16.5billion in the first quarter of 2012. One of the most important actions of the government was to increase public investment, through utilising available EU funds. Poland was the single largest recipient of EU funds from the 2007-13 budget, as it was liable to receive up to €67billion in structural and cohesion funds. This helped the government to instigate large investments in the country's infrastructure, particularly in preparation for the Euro2012 football championships. As a share of overall investment, public investment increased from 35 per cent to 43 per cent between 2005 and 2010 and as a share of GDP from 4.2 per cent to 5.7 per cent from 2007 to 2011. The biggest increase in investment has been in the area of buildings and infrastructure, which increased from €1.8billion in 2005 to €3.1billion in 2010.

Despite Poland's comparatively impressive growth throughout the period of the economic crisis, this began to significantly slow in 2012. After expanding by more than 4 per cent in the fourth quarter of 2011, GDP growth dropped to 1.1 per cent in the fourth quarter of 2012 and then to just 0.5 per cent in the first quarter of 2013.

This slowdown in economic growth has been driven primarily by a decrease in the rate of investment. After peaking at 10 per cent growth in the fourth quarter of 2011, the rate of investment began to decline and from the third quarter of 2012 it has fallen for three successive quarters. This sharp fall in the rate of investment has primarily been due to a decline in public investment, as the large construction projects connected to preparations for the Euro2012 football championships have come to an end. Public investment as a share of GDP fell from 5.6 per cent in 2011 to 4.6 per cent in 2012.

Another important contributory factor to Poland's slowdown has been the drop in personal consumption. The rate of increase in personal consumption slowed steadily throughout 2011 and 2012, before actually falling in the fourth quarter of last year. The labour market situation is worsening, with unemployment rising above 14 per cent in 2013, and real salaries being 1.4 per cent below the level they had been a year earlier. This is the first time that real salaries have declined in Poland since the early 1990s.

The main question facing the Polish economy is whether its present downward trend will continue and lead towards its first economic recession since the implementation of the shock-therapy reforms at the beginning of the 1990s. With funds from the EU's present budget (2007-13) coming to an end, the government has found it difficult to sustain its previous policy of raising public investment. The ability of the Polish government to maintain large public investments is heavily dependent upon the amount of funds it receives from the EU's 2014-20 budget. Although for the first time in its history the EU's budget was actually reduced in size, Poland has managed to increase the absolute amount of money it will receive from this budget (equalling around €1,890 per head, €82 more than that received out of the 2007-13 budget).

The relative success of the Polish government in negotiating an increase in EU funds potentially provides the means for the government to increase its level of investment in the economy. However, a number of factors could hinder this aim. The government's commitment to bringing down its deficit and debts could mean that there are fewer resources available for new investment projects. The Polish constitution states that public debt cannot cross 60 per cent of GDP and the government has voluntarily signed up to the Eurozone's fiscal pact that demands increased fiscal discipline and a reduction in deficits. Also, while the structural and cohesion funds from the 2007-13 budget were focused upon infrastructure projects, in the 2014-20 budget the priority has shifted to raising innovation. It remains to be seen what impact this will have on the rate of investment and whether it can continue to boost economic growth.

The Polish economy presently stands at a crossroads. After being the EU's best performing economy, in the initial years following the outbreak of the global economic crisis, its economy has begun to slow, which is having an increased negative impact on the labour market and living standards. Although exports remain strong, these are heavily dependent upon continual growth in the major Western European economies; and as a large diversified economy these cannot fully compensate for declines in other parts of its economy. The major issue now is whether the Polish government will be able to repeat its public investment led growth strategy that helped its economy to expand whilst all other European economies were declining.

*of the London School of Economics.*

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**About the author**


**Gavin Rae-** *Kozminski University, Warsaw*

Gavin Rae is an Associate Professor at Kozminski University in Warsaw; he is author of the book 'Poland's Return to Capitalism' and runs the blog Beyond the Transition.


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