

TRANSFORMATIONS OF BUDGET DEFICIT BETWEEN 1980 AND 2012 IN POLAND

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ABSTRACT. A budget deficit finds itself among the issues most often discussed in the field of the public finance. A budget deficit is influenced by factors of a varied character. It can result from excessive budgetary expenditure on the militarization of economy, on developed state administration, transfers, public investments, or from the domestic and foreign debts service.

In Poland a budget deficit appeared for the first time in 1980 and since then has been an inseparable element of the Polish public finance. Thus the deficits in those times were of apparent character. They resulted from most of all a redistribution activity, which manifested itself in high grants. In the studied period of time the amount of the budget deficit both in the nominal terms and in the relation to GDP was changeable. Nevertheless, every year the state budget was closed with a budget deficit, apart from 1990, when a budgetary surplus appeared. It should be emphasized that the deficits of the 1980s in the relation to GDP were considerably smaller than those in the 1990s or in the first decade of the 21st century.

The aim of this paper is to describe the reasons for the occurrence of a budget deficit in Poland since the beginning of the 1980s and its relation to GDP in Poland until 2012.

Key words: *balance of budget, budget deficit, budgetary surplus, excessive deficit procedure, public finance crisis, fiscal policy*

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1. Introduction

Ensuring a balance between public revenue and public expenses is a basic element of public finance in each market economy. Both public revenue and public expenses, two opposing “poles” of a state budget, are cash flows. A balance between them indicates some synchronization between revenue and expenses. The flows width and the intensity of the payments for the budget funds disposers on the revenue side may differ from the flows on the expenses side. It results from the fact that a major part of expenses is of a fixed character. The fixedness has its connections with financing of the key public sector fields, which determine effective functioning of the state and thus of the society.

A balance of the budget means the need for a current and mutual adjusting of budgetary revenue and budgetary expenditure in such a way that ensures financial liquidity of the budget sector. In practice a full synchronization between revenue and expenses is really difficult to achieve, therefore we may observe an imbalance between revenue and expenses in the form of budgetary surplus or budget deficit (Ciak, 1997, p.38). In most countries a budget deficit occurs most often.

A budget deficit appears when expenditure exceeds accumulated revenue. Both deficits themselves and their consequences for economy have been and still are the focus of attention of economists, politicians and public opinion. Deficits are a phenomenon inseparable from currently passed budgets and they appear in many even highly developed countries (Ciak, 2002a, p.22). Currently, the negative influence budget deficits exert on economy is being more and more often emphasized. The negative evaluation of deficits has a long tradition and it has been thought for a long period of time that avoiding deficits is a healthy budgetary policy.

The aim of this paper is to describe the reasons for the occurrence of a budget deficit in Poland since the beginning of the 1980s and its relation to GDP in Poland until 2012.

2. Literature review and research method used in the paper

The main area of interest in extensive literature of the research subject are reasons of long-term budgetary disequilibrium and its consequences for economies and financial markets of analyzed countries or group of countries (in particular for the level of GDP, public debt, interest

rates, and current account balance), and influence of long-run budget deficits in one country on economies of economically related countries.

In addition, popular among researchers are i.a. issues connected with:

- 1) influence of public finance austerity plans on economies of analyzed countries or group of countries;
- 2) conditions necessary for budget discipline implementation;
- 3) reasons why budget projections in developed countries are over-optimistic.

Apart from the Polish literature of the research subject used in the paper in the first group of publications can be mentioned e.g. papers of Buiter (1983), Roubini and Sachs (1989a and 1989b), Ball, Elmendorf and Mankiw (1998), Ball and Mankiw (1995) or Bohn and Inman (1996) as well as more recent works of Friedman (2006), Reinhart and Rogoff (2009), Kumhof and Laxton (2009), Clinton et al. (2010), Baldacci and Kumar (2010), Devries et al. (2011) or the most recent of Cottarelli and Jaramillo (2012), Mauro et al. (2013) or Wyplosz (2013).

The influence of public finance austerity plans on economy is analyzed e.g. by Perotti (2011) and Jorda and Taylor (2013). Among the newest publications analyzing what is necessary to implement the budget discipline by policymakers to avoid menace of long-term budget deficits can be mentioned e.g. works of Brender and Drazen (2005 and 2008), Fabrizio and Mody (2008), Diaz Roldan and Montero Soler (2011), Debrun (2011) and Alesina, Carloni and Lecce (2013). Reasons why budget projections are over-optimistic are analyzed e.g. in Frankel (2011) and Frankel and Schreger (2012).

Descriptive analysis of statistical data in relation to GDP was used in the paper as the basic research method.

3. The reasons and effects of budget deficits

The analysis of the occurrence of deficits and their effects on economy needs to be started with two opposing views that are the views of classics and those of keynesists. According to classics a government should limit its expenditure to its tax revenue aiming at balancing the expenditure and the tax revenue. A deficit in time of peace was treated as fiscal irresponsibility. This reasoning was supported by the assumption

that a government is like a household, thus constant deficits constitute a threat of going bankrupt (Kamerschen, McKenzie and Nardinelli, 1990, p.325).

It was the theory of Keynes that challenged the theory of a balanced budget. It turned out that budget deficits do not have to be treated explicitly as a sign of a bad financial situation of a state, and sometimes they can be accounted for by stabilizing budgetary policy (Keynes, 1985; Kosterna, 1995, p.5). J.M. Keynes showed the positive aspects of budget deficits within stabilization of economic fluctuations. According to his theory, we should neither fear a budget deficit nor aim at wiping it out. He claims it should be allowed, in certain conditions even wanted. The level of a balanced income derived by means of a deficit is higher than the level to which it could be lowered without a deficit. Moreover, an increase of a budget deficit financed by means of an issue of securities makes it possible to eliminate excess savings. Government expenditure is financed through the sources that in other case would not be used for consumption or investments. In this situation government expenditure supplements insufficient personal expenditure, thus supporting aggregate demand and increasing the usage of production potential, and enable the increase of the future consumption and investments.

With low demand and high unemployment, a budget deficit does not generate current or future costs. On the contrary, causing the increase of global expenses a deficit leads to employing more people, generating higher revenue and producing more goods. Resources like people or equipment could be unused (Ciak, 1997, p.40).

Currently the Keynesian views are advocated by some economists; still the belief that a budget deficit is not beneficial for economy is sustained. It concerns especially a long term budget deficit. Such a situation contributes to worsening the general economic climate, causes insecurity, risks and high inflationary expectations. Many decision-makers in the field of public finance voice the opinion that in the present-day conditions any increase in the budget deficit will accelerate inflation (price increase), when its financing leads to the increasing of the amount of money, or will cause the so-called "*crowding-out*". Thus it will decrease the amount of loan for economy and consequently will contribute to slowing down the growth of the economic activity or to declining in it.

The necessity to balance arithmetically the state budget revenue and expenditure or generally the individual units of the public finance sector when a deficit appears involves the need to search for the ways of its financing, thus balancing the budget.

It can be stated that the abilities to finance the financial resources shortage are of various effectiveness. Thus dilemmas concerning the choice of the correct way according to the situation appear. Basically there are three ways to balance a budget. The first one concern the expenditure side of a budget, the second one the income side, and the third one the revenue side.

In the first case analyses are made: whether expenditure saving exists and where it can be found. In the second case it is checked whether there are real possibilities that enable introducing new fiscal burden, placing a bigger number of entities under the existing tax system or introducing additional tax rates on goods and services that have not been taxed. On the other hand using the state budget revenue becomes necessary when it appears impossible to balance a budget with the usage of the above mentioned ways. It must be considered that the amount of the budgetary revenue results from specific obligations of the state, including the necessity to finance the budget deficit. It is beyond doubt that the above mentioned abilities to balance the state budget and cover a deficit are of different character and influence the economic processes differently.

4. Budget deficits in the 1980s – the beginnings of the state budget shortages

A deficit appeared in Poland for the first time in 1980. It resulted from the expanding of the state budget expenditure at the beginning of the 1980s. But the deficits in those times were of apparent character. They resulted from most of all a redistribution activity, which manifested itself in high grants. The most meaningful were the specific subsidies on official prices in consumption, which did not cover the manufacturing costs, and also the specified-user subsidies paying for unprofitable enterprises (Ciak, 2002b, p.78).

The deficit was also being created with the increasing costs of specialized government services (the army, the police) and subsidies on investment financing, which, due to delayed investment project completion

dates, did not earn any money. Sometimes they caused inflation. In order to prevent the above expenditure from causing inflation and to limit assuming obligations in the National Bank of Poland, the budget put a bigger tax pressure on enterprises. It made it possible to reduce the budget deficit, but the reduction was of apparent character. Enterprises, in order to pay taxes and continue their activities assumed obligations in the same bank as the budget. The National Bank of Poland then, playing the role of a bank both of the central and commercial characters, with a debt load for the budget, was itself accumulating a deficit since the deposits of the enterprises and the population were insufficient for an increased crediting. In such a situation, the financial resources shortage could be eliminated only by an additional issue of money (without coverage). The additional issue went to the budget in the form of taxes as its income thus covering a part of its deficit. Therefore we saw a kind of a vicious circle (Ciak, 2002a, pp.40-41).

The government budget balances in Poland in the period 1980-2016 in relation to GDP are shown in the table 1.

Table 1.

The government budget balances in Poland in 1980 – 2016 (in relation to GDP)

Specification- years/balance	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Balance:	-1.0	-4.0	-3.6	-0.3	-0.7	-0.1	-0.1	-0.1	-0.1	-3.0
Years	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Balance:	+0.4	-3.8	-6.0	-2.8	-2.7	-2.6	-2.5	-1.1	-2.4	-2.0
Years	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Balance:	-2.2	-4.5	-5.1	-4.5	-4.7	-3.9	-2.4	-1.4	-3.7	-5.0
Years:	2010	2011	2012	2013*	2014*	2015*	2016*	-	-	-
Balance:	-5.7	-4.3	-3.9	-3.5	-3.3	-2.7	-1.6	-	-	-

Source: Statistical Yearbooks of the Central Statistical Office in 1980 - 1999, Council of Ministers reports on budgetary performance in 2000-2012, in 2013 - 2016 Convergence Program; updates April 2013.

The budget deficits in the 1980s were relatively small. Taking into account their relation to GDP, then they amounted to 0.1 – 0.7% of GDP, except for the years 1981 – 1982, when the deficit was respectively 4.0% and 3.6% of GDP (Owsiak, 1994, p.31) and 1989, which was considered exceptional because of the scale of the lack of regulation of the Polish economy (Ciak, 2002b, p.78).

5. Public finance crisis – the deficit in 1991 – 1992

After a small surplus of 0.4% of GDP that appeared in 1990, in the years that followed the budget deficits returned. The surplus turned into a big deficit of 3.8% of GDP in 1991. The main reasons were the lack of execution of budgetary revenues, particularly on account of income tax and dividends. The reason for that situation was among other things financial difficulties of state enterprises, on which the budget mostly based its revenue² (Ciak, 2002b, p.101). Another, all-important reason was the mistakes made on the stage of estimating the revenue side of the budget, which caused irrationality in the policy of budgetary expenditure cuts made mostly under the pressure of the situation in the budget. It leads to generating excessive obligations of budget entities. As indicated in reference books, the budget deficit in that year was a cyclical deficit (recession) and a structural deficit, and most of all a transformation deficit.

The deficit in 1992 was particularly serious when considering its relation to GDP. It almost doubled and amounted to 6% of GDP. In connection with such a high index, a significant change in the fiscal strategy of the state occurred. It resulted from unfavourable real processes in the Polish economy. In 1991 it was noticeable that the budgetary expenditure adjusted passively to the budgetary revenue, characterized by a downward trend, whereas in 1992 it was agreed that it was not possible to balance the budget despite a balance assumed in the budget bill for 1992. From a time perspective it can be stated that it was a display of realism in interpreting the economic processes.

The financial deficit that appeared between the budgetary revenue and the budgetary expenditure limited the possibility to perform basic functions by the state. The crisis then became so deep that it started to threaten the system transformations having a destabilizing influence on the economic, social and political situation of the country (Kosek-Wojnar, 1995, p.199). The period of 1991 – 1992 is considered the time of public finance crisis.

² So-called payment backlogs appearing between individual enterprises prevented the state budget from collecting taxes due.

6. The years 1993 – 1997 – a positive tendency in the budget deficit

Disciplining the state budget by limiting the budgetary expenditure (mainly that for annuities, pensions, unemployment benefits, family allowances, endowment and subsidies) and also by increasing the revenue by means of continuing the tax system reform led in 1993 to a reduction of the budget deficit (-2.8% of GDP, see Table 1).

Further limiting of the budgetary expenditure with increased incomes mainly from indirect taxes³, tax threshold freezing in individual income tax and freezing of depreciation charges in relation to the investments made before 1990 and also earning considerable incomes from the privatization of the state-owned assets contributed to a further reduction of the budget deficit and its relation to GDP. It must be emphasized that the activities that disciplined the budgetary expenditure were connected with a reduction of pensions in relation to the average wage by 9%, a limitation of the real wage in the public sector and a reduction of the current non-payroll expenses in the public sector. The introduced activities brought expected results. The budget balance improved (the budget deficit amounted to 2.8% of GDP). The improvement was accompanied by an upward movement of the economy, since 1993 was another year in which the rate of GDP real growth was positive⁴.

A similar tendency in the improvement of the budget balance appeared in the following years as well, i.e. since 1995 to 1997, when the deficit was respectively 2.6% of GDP, 2.5% of GDP and 1.1% of GDP.

7. The deficits at the end of the 1990s

The end of the 1990s observed a different tendency both in the economic growth rate and in the budget deficit growth rate. At that time a slow down in the significant economic dynamics appeared. There was a real GDP growth by 4.8% with respect to almost 7% in 1997. The budget bill itself was based on very careful macroeconomic assumptions. A lower

³ A new goods and services tax VAT was introduced, the excise duty, the provisional import levy of 6%, so-called tax on importation.

⁴ For comparison in 1990 the real growth rate of GDP amounted to 11.6%, in 7.0% and in 1992 I 1993 respectively 2.6% and 3.8%. Cf. *A report on budgetary performance for the period from 1st January to 31st December 1994*, Council of Ministers, Warszawa 1995, p.9.

rate of economic growth was calculated (5.6%). The budgetary policy was neither of expansive (the expenses were to increase slower than GDP, the deficit was to become reduced) nor restrictive (assumed a smaller income from taxes) character (Wernik, 1999, p.149). The actual execution of the budget bill showed that the assumed amounts of the revenue or expenditure were not achieved. It was partly the effect of the introduced changes in the functioning tax system. The rate of company tax was lowered from 38% to 36%, in the individual income tax each tax threshold was changed respectively: from 20%, 32% and 44% to 19%, 30% and 40%. The goods and services tax VAT and the excise duty were increased. It did not exert a significant influence on the state budget revenue. A similar tendency was observed in the budgetary expenditure. The level assumed in the budget bill was not reached. The public debt service expenditure, the Labour Fund subsidy and the specific provision were all lower than planned. The treasuries service expenditure⁵ and credits and domestic credit guarantee service expenditure exerted the most decisive influence on the public debt service expenditure (Ciak, 2002b, p.142).

The accumulated deficit was smaller than planned, but in connection with the smaller rate of GDP growth, its relation to GDP was 2.4%. It must also be mentioned that a change was introduced in the methodology of the state budget revenue classification. From 1998 current incomes generated by the privatization, included in the state budget revenue, were changed into privatization revenue, becoming one of the sources of financing the financial resources shortage.

To sum up, the characteristic qualities of the state budgets then were a significant contribution of fixed charges, excessive burdening of the economy with premiums like taxes, subsidizing of inefficient sectors and a faulty structure of public expenditure. The substantial budget deficit was also a disadvantage, since when it exceeds 3% of GDP, when the economic growth is weak, the state financial requirements may increase. In the previous years the high level of the budgetary expenditure was caused by among other things a high level of social expenditure, high costs of the public debt service and the existence of an extensive public sector. Extensive budgetary expenses were closely connected with the increase of the burden of taxation, which in the long run threatens the economic growth

⁵ A report on budgetary performance for the period from 1st January to 31st December 1998, Council of Ministers, Warszawa 1999, p.131.

and can contribute to the development of the parallel economy⁶ (Ciak, 2005, p.367). A high contribution of the social expenditure and the public debt service expenditure limit the state's possibility to support other vital public tasks that include the justice financing, military modernization, financing of pro-developmental expenditure, i.e. education, scientific research, higher education, infrastructure development, etc. (Ciak, 2012, p.201).

Looking at 1999 it must be noticed that when compared with 1998, a smaller budget deficit was accumulated, 2.0% of GDP, despite many obstacles both internal and external. Most socio-economic phenomena in Poland were under the influence of unfavourable external circumstances, i.e. the effect of the financial crisis in Russia in August 1998 and a lower rate of economic growth in the European Union member countries at the end of 1998 and the beginning of 1999, and the circumstances resulted in a slower rate of economic growth in Poland, especially in the first half of 1999.

It is worth emphasizing that the financial situation of the country then was rather stable despite financial difficulties in connection with the introduction of a number of economic reforms. A reform of the public insurance scheme and of the territorial self-governments was started. The introduction of additional two levels of a territorial self-government (districts and provinces) caused a reduction in the state budget revenue in 1999 in connection with the transfer of some of the revenue to the province self-governments and the district self-governments together with the increase of the contribution of communes in the central taxes (i.e. individual income taxes and company taxes). At the same time the state budget revenue was partly reduced by the expenditure connected with the health service reform. The changes in the revenue were accompanied by the changes in the budgetary expenditure. The health

⁶ In the reference books the parallel economy is explained in many different ways. It is connected with its hidden and unofficial character. According to the SNA-93 (System of national Accounts), parallel economy includes two groups of production: **an illegal one** – manufacturing products or providing services prohibited by the law or manufacturing products or providing services by unauthorized people; and **a hidden one** – manufacturing products or providing services whose manufacturing or providing is not illegal but the volume of the activity is deliberately in full or partially hidden from the state administration bodies or unobserving law regulations and neglecting the duties they impose (tax, payments, duties or social security contributions avoidance).

protection expenditure was decreased, as was the expenditure on the tasks entrusted to the district and province self-governments as their own tasks. It considered mainly the education expenditure, administration expenditure and social assistance expenditure⁷. From a time perspective it can be claimed that the introduction of such significant reforms influenced the further increase of expenditure, especially those in the forms of endowment and subsidies, which now constitute a significant part of the general budgetary expenditure.

In 2000 the execution of economic processes differed greatly from the forecast made in 1999, on which the whole calculation of the state budget revenue and expenses based. The main differences concerned first and foremost the rate of the economic growth, the rate of inflation and the structure of the GDP distribution. The differences mentioned above influenced the level structure of the budgetary revenue and expenses and also the government budget balance itself. The budget increased when compare with the one in the previous year and amounted to 2.2% of GDP.

Both the budgetary revenue and expenditure amounted to a level lower than the budget bill had assumed. The revenue derived from the indirect taxation, the individual income tax and the profit of the National Bank of Poland was lower than forecast, whereas the revenue derived from the company tax, dividends, duties and foreign earnings was slightly higher. Undoubtedly, the worse than predicted budget performance resulted in the inability to execute the expenditure in its full amount as forecast in the budget bill. It resulted in the necessity for the Minister of Finance to present the Council of Ministers a scale of the budgetary expenditure limitation so that the budget deficit as planned in the budget bill would not be exceeded. Cutting of the budgetary expenses was done in the last quarter (at the end of November and the beginning of December) and it concerned all of them.

It should also be emphasized that in 2002 the real costs of the reforms started to manifest themselves, especially of the retirement reform started in 1999. There is no doubt that the burden of the reform did influence the conducted policy. In practice it was noticeable that a part of the reform costs was shifted to other segments of the public finance sector. The Social Security Fund became a special segment in this field. Undoubtedly, such activities artificially understated the state deficit.

⁷ A report on budgetary performance for the period from 1st January to 31st December 1999, Council of Ministers, Warszawa 2000, p.112.

Surely, such a policy could not be further conducted without any effect on the real situation in the state budget, and the first symptoms manifested themselves in the following year.

8. Further increase in the budget deficit in 2001 – 2004

The greatest widening of the deficit started from 2001. In this year the deficit increased more than two times. It resulted from first and foremost a small revenue dynamics and a significant and increasing expenditure dynamics, which consequently meant a difference in the dynamics index amounting to about 11 percentage points. The reference books also indicate other factors that caused the imbalance. Firstly, an increase of the budget deficit by 5 billion zloty planned in the budget bill, which resulted from the necessity to manage the pension liabilities from 2000 (in 2000 the pension adjustment index was understated). Secondly, the necessity to pay banks the outstanding commitments due to building society books and interest on mortgage guarantees. Thirdly, the mistakes made on the stage of planning, particularly the issue of conducting of deliberate budgetary policy allowing the increase of the budget deficit (Wernik, 2007, pp.207-209). Taking into account the data from table 1, the budget deficit in 2001 increased more than two times when compared with 2000.

The imbalance in the state budget increased again in 2002; the increase was not that dramatic as in the previous year, but it indicated a continuing tendency for the deficit to widen. The increase was not significant, but it can be stated that the index in relation to GDP was second largest taking into account the started process of the system transformation in Poland. Surely, the enormous imbalance did not come as a surprise. As early as during planning the budget it was said that the deficit can grow till about 90 billion zloty, which could amount to 10% of GDP. It was colloquially called "Bauc's gap"⁸ (Jankowiak, 2003).

⁸ The concept was named after the contemporary Minister of Finance Jarosław Bauc, who in the summer of 2001 presented the assumptions of the draft budget for 2002. They proved shocking because of the shortage of financial resources and the suggested recovery plan. The problems with interpreting the budgetary assumptions project resulted from the fact that it was not in the strict sense a plan of state revenue and expenditure, but rather variant scenarios of the fiscal policy development. Thus the amount of the official central budget deficit oscillated between 35 and 88 billion zloty.

Another solution was then so-called “Belka’s rule”⁹ (Jankowiak, 2003). It was to discipline the budgetary expenditure by determining an indicator of maximum growth of expenditure on the level if inflation increased by 1 percentage point. It could only slow down the fast speed of the deficit increase. In practice the rule was not basically followed (Józefiak, Krajewski and Mackiewicz, 2006, pp.60-62).

2003 brought a temporary decrease of the budget deficit, which amounted to 37 billion zloty, and was limited to 2.4 billion zloty only and a decrease in relation to GDP by 0.6 percentage point. An economic recovery started and it contributed to a small increase of the budgetary revenue with a steady increase in the budgetary expenditure.

In 2004 a growth of the real budgetary deficit to the level of 41.4 billion zloty was noticed. In relation to GDP it amounted to 4.7%, thus a small increase appeared here as well. In this year a change in the way the budget expenditure was recorded was introduced for the first time, which consequently influenced the showed real state budget deficit. It can be claimed that the accounting records in the state budget that showed some of the outgoings from the state budget as outflows and not budgetary expenditure made it difficult to estimate the actual situation of the state budget. The accounting records take place even today. An example can be the supplementary financing of the Social Security Fund, the biggest of all the systematic funds in Poland¹⁰ (Piotrowska-Marczak, 2006, pp.24-25). Since 2004 the endowment for the Social Security Fund for the reimbursement of contributions to Open End Pension Funds have

⁹ The concept was named after the contemporary undersecretary of finance, who in 2002 presented an independent project of the budget bill. Belka prepared an emergency budget, which was to protect us from falling into the above mentioned Bauc’s gap, but it was not a budget of the public finance sector reform. It was mainly about waiting a year avoiding a fiscal catastrophe. The first decision of the new government was blocking expenditure on the level of 8.6 billion zloty. The savings proved insufficient. The most pessimistic scenario of the loss of revenue prepared by Bauc was increased by 3 billion zloty. Predicting the revenue amounting to 141.4 billion, the government decided to increase the deficit by about 4 billion. The catastrophic budget in 2001 had to be amended again. It was assumed that a part of the resources from the amendment would be used to pay the budgetary commitments (as items of among other things warrant premium refunds, additional payments to mortgages interest, health insurance for the unemployed contributions). As many works show, it was only bluffing. Belka’s rule was to be introduced in 2003, but its author gave up on the changes he had put forward at the moment he became the Ministry of Finance.

¹⁰ The Social Security Fund is a fund whose resources are in part (26%) an aid from the national budget.

been excluded from the budgetary expenses, which resulted in just formal decrease of the state budget deficit. For example, if it had not been for the above measure, the total amount of the state budget deficit with the amount of the reimbursement of contributions to Open End Pension Funds would have amounted to 52 billion zloty, which in relation to GDP would have been the amount similar to that in the recessionary 1992. In practice it amounted to 4.7% GDP.

Lowering subsidies in 2004 and in the years that followed resulted from the change in the way the public insurance scheme reform was financed. From that year the financial resources for that reform were recorded as outgoings and not the state budget expenditure. Although in fact the expenses were borne, they did not increase the real state budget deficit. The effect of the state of affairs was a debit balance in the privatization revenue disposition, which required financing with the treasuries issue, which in turn generated another loan requirement of the state, thus creating a government debt.

To sum up the above points, it can be stated that in the 2001 – 2004 the deficit was of a typically transformational character. The reference books list the factors that exerted the biggest influence: the beginning of the system reforms, which revealed and caused a rise in the costs of their implementation; the issues connected with the settlement of liabilities in connection with insufficient endowment from the state budget; an economic slowdown (1.2% in 2001 and 1.4% in 2002) together with a succeeding process of disinflation. Moreover, Poland joining the European Union on 1st May, 2004 had a significant influence, as it on one hand meant significant revenue from the EU budget for the state budget as an item of resources from the structural funds, and on the other hand it was a security of the national part of the contribution to the projects and programs executed with the help the union resources. Additionally, the necessity to spend some money from the state budget in the form of the membership fee for the EU budget meant a significant burden of the state budget. The reform of the territorial self-government revenue, particularly the bigger contribution of the self-government's levels in the central taxes (i.e. individual income taxes and company taxes) constituted a similar burden. Despite the increase of the contribution, the expenditure resulting from the cash flow for the territorial self-government on account of endowment and subsidies was not limited (Owsiak, 2006, pp.699-703).

Undoubtedly, the beginning of the four system reforms, among them the pension reform and the self-government reform, solidified the structural character of the budget deficit. As it is often indicated in the financial literature, the reforms were often unfinished in all details with regard to the concept and unsecured financially. Additionally, apart from a badly conducted policy of “cooling down the economy”, the issue of periodicity of economic processes, which influence the financial possibilities of the state, was overlooked on the stage of shaping and then implementing the above reforms. One might venture an opinion that Poland was not prepared to introduce four such significant reforms at the same time, as they meant significant financial costs (Owsiak, 2006, p.700).

At the same time *Program naprawy finansów Rzeczypospolitej*¹¹ (Kołodko, 2004) was drafted, whose author was the contemporary deputy prime minister and the Minister of Economy and Labour Grzegorz Kołodko. The program was executed to only a small extent unfortunately.

The difficult situation of the state budget forced the official authority to try to limit the budget deficit. Unfortunately, the majority of the planned activities did not bring the expected results or were not put into practice. For instance, from *Program naprawy finansów Rzeczypospolitej*¹² (Kołodko, 2004), only the plan concerning the reduction of direct taxes was implemented, and many of the suggested solutions aiming at a reduction of the budgetary expenditure were not applied.

¹¹ The plan had three parts.

- The first part considered the economy, first of all the restructuring of the Polish National Railways (400 million zloty), the restructuring of the coal mining (380 million zloty a year), the financial restructuring of the public health care centres (250 million zloty), the liquidation of inefficient systems of additional payments (70 million zloty) and the change in the rules of financing the military needs of Poland (1.26 billion zloty in 2005).
- The second part concerned activities in the administration and also expenditure and revenue of the state budget. The savings were to concern among other things a reduction of workplaces in the administration (54.6 million zloty) and limitations in using company cars (5 million zloty). Those two areas were to bring savings of 20 billion zloty by the end of 2007.
- The third part was a reform of the state social expenses, mainly in the employee social insurance fund and agricultural social insurance fund (KRUS) and also in the system of aid for disabled people. The savings in this area were to amount in 2007 to 12 billion zloty (in the years 2004 – 2007 they were to amount to 30 billion zloty).

¹² The program aimed at reforming the financial system in Poland and improving Poland's economic situation. The maintaining of the high rate of economic growth for a longer period of time was the priority.

9. The deficit stabilization in 2005 – 2007

In 2005 – 2007 the growth processes in the budgetary deficit slowed down. Undoubtedly, a good economic trend was of a significant meaning in this aspect. Additionally, steps were taken in the tax system, particularly in the goods and services tax (VAT) and in the excise duty and small changes in the income tax (PITa and CITs) were introduced.

In the budget of those years a high budgetary dynamics on the level of 110% a year could be observed. At the same time, the budgetary expenditure grew at a reasonable speed, which ensured a favourable balance between those two figures. The budgetary deficit in 2005 amounted to 28.4 billion zloty, which with a favourable economic trend resulted in the deficit amounting to 3.9% of GDP. The situation was similar in the following 2006 year.

A good situation of the state budget in 2007 resulted mainly from suitable conditions, including a good economic trend. Favourable trends in the budgetary revenue as well as a significant decrease in the expenditure dynamics became an indispensable condition for the budgetary deficit to decrease¹³. The decrease in the expenditure dynamics, and thus in the relation to GDP, did not result from the system reforms, but rather from the occurrence of factors that could be assumed to be incidental. Moreover, an important role here was played by the decrease mainly in the social expenses dynamics (they grew only by 4.9% in 2007 compared to 6.6% in 2006) but it resulted mainly from the lack of the pension adjustment. Undoubtedly, the adjustment is inevitable and its lack in 2007 influenced the expenditure dynamics in 2008. Thus, notwithstanding the cause of the expenditure level, the public finance deficit decreased considerably to 1.9% of GDP (the budgetary deficit itself amounted to 1.4% of GDP). It was the first significant limitation of the deficit since Poland had joined the European Union¹⁴ (Wernik, 2009, pp.61-62).

¹³ In 2007 the budgetary expenditure grew by only 6.7% when compared with 2006, whereas in 2006 when compared with 2005 it grew by 8.9%. Cf. *Council of Ministers reports on budgetary performance in 2006 – 2007*.

¹⁴ In connection with the relation of the deficit amounting to below 3% of GDP, the Council of European Union on 8th July, 2009 decided to finish the excessive deficit procedure for Poland, which was introduced on 5th July, 2004.

10. The trends of the budgetary deficits after 2007 and the budgetary deficit in the time of crisis

The second half of the first decade of the 21st century started to be considered the time of crisis. It was clearly seen in the second half of 2008, whereas the beginning of 2009 brought its reinforcement. The Polish economy started to feel the effects of the world crisis, especially when its fundamental symptoms are taken into account:

- 1) a decline in the industrial production
- 2) a reduction of employment in enterprises
- 3) decreasing wage development
- 4) a decrease in the state budget revenue
- 5) a growth in the deficit of the whole public finance sector, generated by the state budget deficit

But despite the crisis, in the first quarter of 2008 Poland reached the growth level of 1.9%, the calculations of the European Union were slightly lower and amounted to 1.3%¹⁵. It was smaller than the economic growth from the previous years. Zloty was still very weak, which also influenced the situation of the whole financial system, the budgetary system including.

In 2008 the deficit grew significantly and reached the level of 3.9% of GDP. It cannot be considered to be a result of a weak market, since the GDP dynamics was still high. Many studies indicate that the main reason was an irresponsible fiscal policy of the previous government, which as early as in 2006 made a few decisions that resulted in a reduction of the public revenue. The decisions concerned the following issues:

- Firstly, as an item of the individual income tax, family reliefs were introduced, thus reducing the budgetary revenue by 5.4 billion zloty;
- Secondly, the pension insurance contribution was reduced (from 13% to 6%), which in 2008 brought about a reduction of the revenue by over 20 billion zloty;
- Thirdly, changes were introduced in the tax progression, in the individual income tax. Instead of the three tax thresholds of 19%, 30% and 40%, two were introduced: 18% and 32% (they started to be applicable in 2009). Simultaneously, as conducted research and simulations indicate,

¹⁵ *With such a deficit we will not let you into the Euro area*, an interview with J. Almunia, the Union Commissioner for the economic and currency affairs, *Rzeczpospolita*, 133 (8339), 8th June, 2009, pp.28-29.

only 1% of taxable persons were taxed with the tax of 32%. In connection with the above, the negative profit on this ground was estimated as about 8 billion zloty¹⁶.

The budget deficit amounting to 5.0% of GDP in 2009 and to 5.7% of GDP in 2010 showed that the situation of the Polish public finance had deteriorated. It meant that both the budgetary revenue and expenditure were determined and will be in the coming years by factors of macroeconomic character and by introduced system changes. At the same time in 2009 the Economic and Financial Affairs Council (Ecofin) stated that the deficit in Poland is alarming and recommended its wiping out till 2012 the latest¹⁷.

In connection with the above, consolidating actions were undertaken and they contributed to a slow improvement of the government budget balance. The Budgetary deficit in relation to GDP was getting reduced (in 2011 it amounted to 4.3% of GDP, and in 2012 to 3.9% of GDP). Among the expenditure actions that influenced the limitation of the expenditure by 2.3% of GDP the following must be mentioned:

- introduced in 2011 a disciplinary rule¹⁸ whose role was to limit the rate of increase of the discretionary expenses (flexible ones) and the new fixed expenses to 1% realistically annually;
- the reduction of the early retirement privileges;
- a limitation from 2011 of wages funds in the state budgetary units by means of a general rule of its freeze on the nominal level from the previous year;
- current (modified in 2009) rules for the territorial self-government units, i.e.
 - a rule of at least balanced current result as described in article 242 of the Law on Public Finance (since 2011);
 - individual debt limit – described in article 243 of the Law on Public Finance (from 2014 – the limit will be calculated according to a three-year moving average, for the first time for the years 2011 – 2013);

¹⁶ Cf. Council of Ministers reports on budgetary performance in 2008 – 2009.

¹⁷ Among other things by a reduction of the structural deficit (so-called fiscal effort) by at least 1 and ¼ percentage points of GDP on average in 2010 – 2012. More: *Convergence Program. Update 2013*, The Republic of Poland, Warszawa, April 2013, p.4.

¹⁸ Article 112c of the law on *Public Finance* passed on 27th August, 2009, the Official Journal of Law 157, item 1240.

- a periodic (at the time when Poland is liable to the excessive deficit procedure) ban on introducing by the government bills that could result in the reduction of the public finance sector units revenue in relation to the amounts arising from the binding regulations and projects causing increasing expenditure (article 112c of the law on Public Finance);
- a limitation in 2011 of the funeral receipt to 4000 zloty.

The most important actions for the budgetary revenue were the following:

- a limitation of a part of the pension insurance contribution transferred to Open End Pension Funds (OFE). The part transferred was reduced in May 2011 from 7.3% of basis of assessment to 2.3%;
- an increase of VAT from 22% to 23% and from 7% to 8% and a simultaneous decrease from 7% to 5% on basic foodstuff (since January 2011);
- an increase in the disability pension contribution chargeable to the employer by 2 percentage points (since February 2012);
- a limitation of the possibility to deduct VAT calculated on purchasing passenger cars with the type approval for goods vehicles and petrol for their driving (since the beginning of 2011);
- freezing of the scale in the individual income tax (on the nominal rate from 2009);
- the abolition of the allowance for the excise tax on bio components;
- an increase in the excise tax on cigarettes (every year since 2010);
- an increase in the excise tax on diesel oil and in the petrol fee (since January 2012);
- changes in the bank deposits profits tax limiting the possibility to avoid the tax (introduced in 2012);
- introducing a fee for using some of the natural resources (tax on the exploitation of some mineral resources¹⁹: copper and silver since April 2012)²⁰.

¹⁹ Cf. the law passed on 2nd March, 2012 *on the tax on the exploitation of some mineral resources*, the Official Journal of Law 2012, item 362.

²⁰ *Convergence Program. Update 2013*, The Republic of Poland, Warszawa, April 2013, pp. 13-14.

It is worth emphasizing that the worsening economic conditions around Poland contributed to the lower rate of economic growth of the country, which caused a significant change of the macroeconomic conditions. The lower rate of economic growth manifested itself clearly in the slower rate of the increase of the budgetary revenue, particularly the tax revenue (influenced by of the automatic stabilizers). Moreover, the slowdown was so significant that in view of significant budgetary expenditure the budget deficit could not be lower than 3% of GDP in 2012. The amount was a condition Poland had to meet so that the excessive deficit procedure was no longer applied from 2013²¹. In such a state of affairs Poland was given another two years to improve the budget balance (and first of all the general government balance).

Taking into account the forecasts for the budget deficit in the following years (2013 – 2016), it can be noticed that its considerable limitation is planned, so that in 2016 it will not be higher than 1.6% of GDP (see table 1). Time will tell whether the plan is realistic, especially that this year the situation in the state budget is not satisfactory. The first months of 2013 indicated some mistakes made on the stage of planning the state budget and thus the revenue amount was assumed too optimistically. More and more often the necessity to introduce a budget amendment is indicated. It is estimated that there will be a shortage of additional 24 billion zloty in the state budget²² (Sofuł, 2013).

In order to achieve the planned limitation of the budget balance in the following years, significant changes in the tax system are necessary, namely in the indirect taxes – the goods and services tax (VAT) and the excise tax, which constitute the basis of the state budget revenue (about 60%); abolition of some allowances both in the VAT and in the direct taxes. In the case of the individual income tax (PIT) – from 2014 on the

²¹ The procedure was included in the item 126 of the Treaty on the European Union. According to its rules, *'The member countries avoid an excessive deficit'* (item 126.1). The European Commission was granted the rights to control the budget situation and the level of the government debt in the member countries in order to discover possible mistakes when executing the budgetary Policy (item 126.2 TFUE). The procedure is used in a member country if the *general government* deficit (i.e. of the government and self-government bodies) exceeds 3% of GDP.

²² The Polish government to suspend the Law on Public Finance in order to increase the deficit in this year's budget. As economists indicate it is not the best solution but the government did not have much freedom for maneuver in this issue.

Internet allowance is to be limited, and in the case of the company tax (CIT) – from 2014 on limited joint-stock partnerships, and from 2015 on also limited partnerships, are to be taxed. Additionally, exclusion of the right to get a tax exemption on dividend payments and other income (revenue) from profit sharing of legal persons that are deducted in the company paying the dividend.

It is worth noting that thanks to the good results achieved by enterprises with the participation of the State Treasury the increase of the income from the dividends from companies and payments from single member State Treasury companies profits is planned. From 2014 on a system of auction sales of the rights to CO2 emission introduced in 2013 will become a constant source of the budgetary revenue. Nevertheless, the actions indicated above are only forecasts and if they bring the expected results, they will contribute to improving of the situation in the state budget and the public finance in Poland.

11. Conclusions

Deficits and the characteristics of their effects are nothing new in the reference books, it can even be said that the deficit issues have been discussed for many years. Yet it is difficult to find an unambiguous assessment of the occurrence of deficits in economy. Simultaneously the evaluation of the impact of deficits depends on the economy functioning and also on the market efficiency.

A budget deficit is inseparable with the situation in which current revenue are insufficient to cover current expenses. It constitutes a revenue gap with planned expenditure, which must be covered by assuming different kinds of obligations. The appearance of such a gap results from the inability to collect sufficient income in the conditions of the existing economic system or it is the effect of a conscious decision about financing a part of expenditure with loans (an issue of treasuries) and credits. It is vital though that a deficit influences the amount needed for loans. A deficit in the *ex ante* approach is an expected inflow of money, whereas in the *ex post* approach it is a realized inflow of money.

It is worth emphasizing that deficits have become an immanent quality of economies of a market character. They appear not only in developing countries but also cause problems for numerous countries with well developed economies. Burdens of the necessity to repay earlier assumed obligations of different character bring about profound effects

for the budget itself and the whole economy of a given country. When we take into consideration communities, like for example the European Union, the imbalance of the budgets in individual countries may cause a so-called snowball effect.

The problem of a budgetary imbalance in Poland started in the 1980s. The deficits at that time in relation to GDP were considerably smaller than those in the 1990s or in the first decade of the 21st century. Unfortunately, both then and now the main reasons for the imbalance concerned excessive expenditure. 1990 was an exception, when a budgetary surplus of 0.4% of GDP appeared. Discussing the inability to cover expenditure with revenue, it can be stated that on average the budgetary revenue covered the expenses only in 88%.

In the following years the only balance in Poland was a budgetary deficit. In the individual periods of time the deficit was characterized by an upward movement in real terms. In the relation to GDP the trend was changeable. It should be mentioned that the deficit was small in relation to GDP in 1997 or 2007. Nevertheless, in the last few years it has increased greatly in this aspect. In connection to this it required and still requires more additional financial resources to be covered. This in turn means burdening the budgets in the following years.

As it was indicated above, a budget deficit has become an immanent quality of the state budget. Its reasons varied in different years, but it has always resulted from excessive public expenditure, which was not covered by the current revenue. Despite many activities done by the official authorities, so far Poland has not been able to regain a balanced budget. Hopefully, the planned actions indicated in the paper will be effective enough to bring about a significant improvement in the public finance. A long term imbalance in the state budget results in a substantial increase of the government debt, and this in turn has a harmful influence on the expenditure aspect – the debt service costs rise.

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