Forecasting GDP Values as Part of the Budgetary Procedure – De Lege Lata and De Lege Ferenda Conclusions[1]

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Abstract
The objective of the article is to verify the research hypothesis that the Polish rules of fiscal policy are susceptible to manipulation with the forecast GDP size adopted in the assumptions of the Budgetary Act. Such activities undertaken by the Council of Ministers lead to the creation of fiscal illusions and pose a threat to the financial order of the state. Therefore, they require the legislator to change the shape of the fiscal policy rules or to deprive the government of its competence to prepare macroeconomic forecasts for the budgetary procedure.

Keywords
public debt; fiscal rules; fiscal illusions

1 Introduction

In modern democratic societies there are many factors that cause the maximisation of the social utility to cease to be the objective of fiscal policy. The foreseeable result of the democratic choice process is the creation of a budgetary deficit whenever loan is

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the available means for substituting taxation (Buchanan, 1997: 133). The manifestation of this problem is the progressing accumulation of debt, which has become particularly visible since the 1970s (Alesina and Perotti, 1994: 3). It justifies the introduction of fiscal policy rules to the legal order of modern states. This notion covers institutional solutions that are meant to stop politicians from the excessive increase of the scale of public expenditure (Panfil, 2016: 17). In that sense, the rules of fiscal policy should be an impulse to start a real reform of public finances aiming at decreasing the scale of their imbalance. The reality is unfortunately quite different. Public authorities focus rather on the formal execution of obligations resulting from the fiscal policy rules. They resort to various "tricks" that generate the so-called fiscal illusions, which can be exemplified by creative accounting, discretionary actions or manipulations of the value of selected macroeconomic indicators.

The objective of the article is to verify the research hypothesis, according to which the Polish rules of the fiscal policy are susceptible to manipulation with the size of the forecast gross domestic product (hereinafter: GDP). A possible confirmation of this hypothesis justifies also the attempt to prepare the recommendations of legislative changes, which would make it impossible for the Council of Ministers to create fiscal illusions in the discussed scope. During the works on the article, a dogmatic and legal analysis was applied. Reference was also made to the binding normative material, secondary sources in the literature of the subject and documents developed by the Polish and EU institutions.

2 Method of Calculating the Gross Domestic Product

GDP is one of the most important macroeconomic indicators used for illustrating the economic situation. It can be defined as the value of all goods and final services manufacture in the economy of a given country within an assumed period, e.g. within one year, expressed in market prices. In Poland the methodology of calculating GDP was regulated in the Act of 26.10.2000 on the method of calculating the value of the annual gross domestic product (*Journal of Laws,* 2000, No. 114, item 1188) (hereinafter: ACGDP). In that way, the Polish legislator has fulfilled the obligation imposed on it by Art. 216 para. 5 of the Constitution of the Republic of Poland of 2 April 1997 (*Journal of Laws,* 1997, No. 78, item 483) (hereinafter: the Constitution), since this provision includes the method of calculating the annual gross domestic product in the statutory matter.

In accordance with Arts. 2 and 3 of the ACGDP, the method of calculating the annual GDP is based on the estimation of three macroeconomic categories equal in value, which define GDP through:

1. the size of production activity – GDP is calculated in market prices and is equal to the sum of added value of domestic production units increased by taxes on products and decreased by the subsidisation on products;

2. final result of production activity – GDP is calculated as a sum of final demand, i.e. consumption, accumulation and balance of exchange of products abroad;
3. the sum of primary income – GDP is calculated as a sum of primary income of domestic units obtained by institutional sectors operating in the territory of Poland and the net primary income of the foreign sector.

In compliance with Art. 5 of the ACGDP, the President of the Central Statistical Office (hereinafter: CSO) calculates the value of the annual GDP and announces the first estimate for a given year by 15 May of the following year. This announcement takes on the form of a notice published in the Official Journal of the Republic of Poland "Monitor Polski".

It is worth highlighting that in compliance with Art. 23 para. 1 of the Act of 29.08.1995 on public statistics (*Journal of Laws,* 2018, item 997) (hereinafter: APS), the President of CSO is the central body of the state administration competent in terms of statistics. The current regulations do not provide any guarantee of this body's personal independence. The President of the CSO can be removed from his/her office at any time by the Prime Minister, who exercises supervision over him/her. The lack of specified grounds for the appeal is clearly in contrast with the principles of the European Code of Statistical Practice, mentioned in Art. 11 of the European Parliament and Council (EC) Regulation No. 223/2009 of 11 March 2009 on the European statistics (EU Official Journal*,* 2009: 164). Nevertheless, the possibilities of influencing the GDP value announced by the President of the CSO by the Council of Ministers seem illusory. On the one hand, the methodology of calculating that macroeconomic category in Poland is in line with the EU regulations. Additionally, the data in that scope are presented to the European Commission and are subject to verification by Eurostat, which minimises the risk of manipulation. On the contrary, the situation with GDP forecasts is different.

In accordance with Art. 138 para. 1 of the Act of 27.08.2009 on public finances (*Journal of Laws,* 2017, item 2077) (hereinafter: APF), the Prime Minister presents the Council of Ministers with the assumptions of the draft state budget for the following year. And at the same time, they must take into account the arrangements and the directions of action contained in the Multiannual Financial Plan of the State. The assumptions of the draft state budget include, among others, the macroeconomic assumptions, including the forecasts concerning the GDP dynamics in the coming financial year. Also Art. 141 of the APF refers to the forecasts. In compliance with that regulation, the Council of Ministers adopts a draft budgetary act and together with justifications submits it to the Sejm by 30 September of the year preceding the financial year. Such justification contains in particular the macroeconomic assumptions for the following financial year and the three consecutive years including the forecasts concerning the GDP and its components.

In practice the state macroeconomic forecasts are developed by the Macroeconomic Policy Department, which is located in the structure of the Ministry of Finances. Most importantly, there are no instruments, which from a legal point of view, would allow the verification of the reality of such forecasts, and at the same time, the reality of budgetary assumptions. As a result, the Council of Ministers can instrumentally treat the values adopted at the stage of developing the draft budgetary act and adjust them to its needs, for example, in the scope of fulfilling obligations resulting from the rules of fiscal policy.

The comparison of forecasts concerning GDP developed by the Ministry of Finances, the National Bank of Poland (NBP) and the European Commission in the years 2008–2017 yields interesting conclusions (Table 1). The former is based on the budgetary assumptions made in June of the year preceding the financial year. The NBP forecasts were taken from the GDP projections, which in the years 2008–2010 were announced in June, and in the years 2011–2017 were announced in July.[3] Whereas, the estimates of the European Commission come from economic forecasts announced in May.

The data analysis indicates that for the most part of the adopted research period, the forecasts of the Ministry of Finances was characterised by optimism greater than that of the NBP and the European Commission. The Polish Central Bank proved to be the most effective in terms of its forecasts (seven out of nine cases). In the years 2009–2017 the average deviation of the forecasts developed by the NBP, the European Commission and the Ministry of Finances from the actual GDP growth was 0.88%, 1.18% and 1.22%, respectively.

Table 1. The forecasts concerning the dynamics of the Polish GDP in the years 2009–2018 developed by selected analytical centres and the actual GDP growth in the years presented above (%)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Forecast GDP growth										
The Ministry of Finance	5.0	0.5	3.5	4.0	2.9	2.5	3.8	3.8	3.9	3.8
NBP	4.8	1.4	4.6	3.6	2.1	3.4	3.6	3.4	3.5	3.5
European Commission	5.0	0.8	3.3	3.7	2.6	2.2	3.4	3.4	3.6	3.2
Real GDP growth	2.8	3.6	5.0	1.6	1.4	3.3	3.8	3.0	4.6	-

Source: Ministrów, 2018

3 The Polish Rules of the Fiscal Policy

The key element of the Polish rules of the fiscal policy is Art. 216 para. 5 of the Constitution. In accordance with that provision, the public debt in Poland cannot exceed the level of 60% of GDP. On the one hand, violating that limit would be tantamount to infringing the constitutional provision. Such situation should

3 The only exclusion in that scope concerns the year 2011, when the budgetary assumptions for the year 2012 were published in March. As a result, the GDP projections announced by the NBP in March 2011 were exceptionally adopted for the purpose of the analysis.

give rise to the liability of the Prime Minister and the Minister of Finances before the State Tribunal. On the other hand, it is unacceptable to adopt a budgetary act, the implementation of which would lead to the state public debt exceeding the level of 60% of GDP. The potential risk of such a situation could be evidenced by a simple summary of data contained in the justification for the draft act. Thus, with a high level of state public debt, the Council of Ministers may be interested in increasing the forecasts concerning the GDP vales in the coming financial year. In that way it would gain greater freedom in terms of shaping the primary budgetary amounts, including the public expenditures. On the surface, this solution is seemingly absurd. It exposes the Council of Ministers to the risk of violating the constitutional limit on debt in the coming financial year. From the point of view of the members of that body, the issue ceases to matter, if parliamentary elections are to take place in the coming year and the change of the current ruling camp is highly probable. In such a case, another government will be held liable for the implementation of the budgetary act and possible violation of the constitutional provision.

The constitutional limit on debt is additionally strengthened by two rules of the fiscal policy, regulated in Art. 112aa and Art. 86 of the Act of 27.08.2009 on public finances. The first of the aforementioned editorial units prescribes the so-called stabilising expenditure rule, whereas, the second – the prudential and remedial procedures.

In general, the stabilising expenditure rule makes the growth rate of the expenditures of various institutions and bodies[4] dependent on the medium-term GDP growth. The limit on expenditure for the coming financial year is, at the same time, defined on the basis of a complex algorithm (Panfil, 2014: 129), the crucial element of which is the formula contained in Art. 112aa para. 1 of the APF. After introducing some simplifications, it can be presented in the following way:

Amount of expenditures for the financial year (year x)
=
amount of expenditures from the previous year (x-1) adjusted
in accordance with the update of the average annual inflation rate forecasts
x
the level of the medium-term inflation objective determined
the Monetary Policy Council
x
(the medium-term GDP values dynamics factor
in constant prices + expenditure amount adjustment value)
+
forecast value of the discretionary actions

[4] What is meant here are the selected units of the public finances sector, and also the Bank Guarantee Fund and the funds established, entrusted or transferred to the Bank Gospodarstwa Krajowego.

The medium-term GDP values dynamics factor in constant prices is dependent on:

1. total GDP value dynamics from the last six years preceding the year x-1 (announced by the President of the Central Statistical Office on the basis of Art. 38b para. 2 of the APF);
2. the annual dynamics of GDP values in constant prices in year x-1 and in year x, forecast in the draft budgetary act for year x.

Thus, the medium-term GDP values dynamics factor encompasses the period of 8 years. As stems from the explanatory memorandum of the Act of 08.11.2013 on the change of the Act on public finances and some other acts, this is the average duration of a business cycle in Poland determined on the basis of empirical studies (Sejm Papers, 2013: 27).

The prudential and remedial procedures are a collection of quantitative and qualitative rules of the fiscal policy. Their objective is the protection of the public finances sector, and indirectly also the Polish economy against the consequences of violating the constitutional limit on debt (Panfil, 2011: 235–236). The prudential and remedial policies are initiated when the relation of the state public debt to GDP in year x-2 exceeds 55%. In such a case, the Council of Ministers adopts in year x-1 the draft budgetary act for year x, in which deficit is assumed to be absent or its level is such that ensures the decrease of State Treasury debt to GDP ratio in relation to year x-2. The prudential and remedial policies also contain a series of additional solutions, which make it easier for the government to execute the above mentioned obligation through limiting the growth of some public expenditures.

The stabilising expenditure rule and the prudential and remedial procedures relate both to the real GDP value for the previous financial years, as well as the forecasts relating to the future. In this first instance, the Council of Ministers assumes, for the purposes of both rules of the fiscal policy, the amounts provided by the CSO President. As results from the previous analysis, it can be assumed that they are in line with reality. The forecasts relating to the shaping of GDP values in the future turn out to be a significant problem. The higher the value the smaller the restrictions imposed on the Council of Ministers by the rules of the fiscal policy. This creates a certain incentive for the "optimistic" forecasting of GDP changes by the Ministry of Finances. It is worth highlighting here that the stabilising expenditure rule and the prudential and remedial procedures are connected only *ex ante,* that is at the stage of developing the draft budgetary act and its adoption. However, there are no verification mechanisms of the extent to which the objective, which the implementation of such rules was supposed to serve, is executed. Therefore, the Council of Ministers does not have to fear the consequences of overestimating the forecast GDP value at the stage of budgetary act implementation. In this respect, we can only talk about political responsibility borne within the framework of the democratic choice. Considering the scale of complexity of the discussed matter, possible manipulations of the Council of Ministers, however, are not perceived by an average voter.

4 *De Lege Ferenda* Postulates

The current shape of the Polish legislative solutions encourages the Council of Ministers to manipulate the forecast GDP value, thus contributing to the creation of fiscal illusions. Two directions of action can be indicated that would allow the limitation or elimination of this phenomenon. The first one would be an appropriate modification of the Polish rules of fiscal policy. The second one – entrusting the responsibility of developing macroeconomic forecasts to an analytical centre independent from the Council of Ministers.

By modifying the shape of the fiscal policy rules, the Polish legislator could in particular extend their binding force to the stage of budgetary act implementation or resign from referring to macroeconomic forecasts in their structure. Both solutions, however, give rise to conceptual problems that are difficult to overcome. In the literature of the subject many postulates have been developed the execution of which should contribute to increasing the effectiveness of the fiscal policy rules (Kopits and Symansky 1998: 18–19). One of them is the simplicity of the implemented solutions. This would make it easier to present to the society the motives behind the undertaken decisions and gain its support for the policies maintained by the fiscal authorities. Simplicity facilitates also the improvement of control efficiency in terms of observance of the introduced limitations. It is a truism to say that the stabilising expenditure rules and prudential and remedial procedures are characterised by a far reaching level of complexity. It seems that currently they are understandable only to the limited group of experts. De facto, the only Polish rule of fiscal policy of simple construction is the constitutional limit on debt, which in itself is not useful for operational application. The attempt to extend the binding force of the stabilising expenditure rule and the prudential and remedial procedures to the stage of budgetary act implementation would further complicate the current legal situation. This state of affairs would give the Council of Ministers further opportunities to resort to creative accounting and concealing the true state of the public finances. On the other hand, failure to execute the objective that lies at the basis of a particular fiscal policy rule is not always the effect of actions or omissions of the Council of Ministers. For example, the decreasing of the ratio of state public debt to GDP assumed in the prudential and remedial procedures may turn out to be impossible due to strong devaluation of the domestic currency and the related surge of external debt.

The concept of detaching the structure of Polish rules of fiscal policy from the macroeconomic forecasts also seems defective. In such a case, the resultant limitations would pose a serious challenge to the execution of public finances stabilising function. The reduction of public expenditures or increasing taxes in times of recession would result in further decrease of aggregated demand and increase the scale of economic downturn fluctuations. In extreme cases, a phenomenon called the “trap of structural deficit” could occur. This term describes the state of economy, in which the public authorities undertake actions that aim at decreasing the excessive deficit, which further deepens the recession (Petru, 2015: 154). The associated decrease of economic activity and tax base leads – through the feedback loop – to the secondary increase in deficit. As a result, the public authorities not only fail to achieve their objective, but also through their actions increase the problem scale.

Considering the above observations, the withdrawal of the right of the Council of Ministers to develop macroeconomic forecasts for the purposes of the budgetary procedure should be postulated. Such a decision should be accompanied by the indication of an entity that would take over such competences. In that scope, adopting various solutions is possible. The simplest would be to transfer the aforementioned competences to the NBP. This entity develops macroeconomic forecasts for the purposes of the conducted monetary policy. They could also be used for the purposes of budgetary procedure and adopt as the basis for budgetary assumptions. A big advantage of this solution would be to base the fiscal policy and the monetary policy on the same macroeconomic forecasts. At the same time, the systemic independence of the NBP would be the best guarantee for the independence of these forecasts from the influence of the Council of Ministers. However, this solution is not free of certain flaws. In the first instance, it would create a point of contention in the relations of the NBP and the Council of Ministers. In that sense, it would become another factor inhibiting the effective coordination of the fiscal and monetary policy. Additionally, there is no certainty that in a specific situation, in order to fulfil its constitutional obligations, the NBP would not start using macroeconomic forecasts in an instrumental way.

Another statutory body obliged to develop economic and social forecasts is, pursuant to Art. 25 para. 1 of the APS, the CSO President. Those forecasts, as well, could be potentially used as part of the budgetary procedure. This would, however, require a significant increase of the personal independence of the CSO President and separating him/her from the influence of the Council of Ministers. A certain model example, in that respect, could be the independence of the President of the NBP. Its basic elements include the six-year term procedure for the appointment (the Sejm at the request of the President of the Republic of Poland) and clearly defined grounds for dismissal. The change of role of the Scientific Statistical Council that support the CSO President. Currently, it plays the role of an advisory and opinion-making body. The legislator could enhance the significance of the Scientific Statistical Council by determining its composition, working procedures and competences. The latter could include approving the macroeconomic forecasts developed by the CSO President and binding as part of the budgetary procedure. The above changes would, however, require a far reaching intervention by the legislator. The model of the systemic situation of the CSO President should be changed in particular and, with the extended competences, who should function outside the framework of government administration.

Another solution could involve the establishing of an independent fiscal institution in Poland. It can be defined as a permanent agency with a statutory or executive mandate to assess publicly and independently from partisan influence the government's fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short-medium-term macroeconomic stability, and other official objectives (Debrun et al., 2013: 8). This solution is applied in many countries around the world. For example, fiscal institutions operate in Belgium, Holland, Japan, Germany, the USA, Great Britain and Italy. The responsibilities of such entities include, among others, developing macroeconomic forecasts (Calmfors, Wren-Lewis, 2011: 652). Usually, they are used in assessing the reality of the government's budgetary assumptions. In some countries, however, the forecasts prepared by fiscal institutions are of binding character for the Council of Ministers at the stage of developing the draft budgetary act. It seems that this solution could be successfully transferred to the Polish legal order.

By the way, it should be mentioned that developing a draft budgetary act belongs in Poland to the constitutional prerogatives of the Council of Ministers. Its seems, however, that imposing on the government the macroeconomic forecasts developed by an independent and specialist analytical centre does not violate the constitutional provisions. The role of such forecasts would be similar to data prepared by the CSO President, which are used as part of the budgetary procedure as a source of information on the previous years. Their aim would be only to make the estimates behind the basis of the draft budgetary act more realistic, and not to influence the shape of the fiscal policy maintained by the Council of Ministers.

5 Conclusion

The analysis of the rules of fiscal policy in force in Poland confirm that their shape "encourages" the Council of Ministers to generate fiscal illusions through manipulating the macroeconomic forecasts. In this way, that body can reduce the rigor of restrictions that bind it. Moreover, the analysis of statistical data shows that government macroeconomic forecasts concerning GDP are in general more optimistic than the forecasts of other analytical centres. This situation justifies the intervention of the Polish legislator. At the same time, it is highly unlikely to solve the diagnosed problem by modifying the shape of the fiscal policy rules. Thus, the withdrawal of the right of the Council of Ministers to develop macroeconomic forecasts for the purposes of the budgetary procedure should be postulated. Such competences could be transferred to an independent analytical centre. The role could be taken on, for example, by the NBP or the CSO President. It seems, however, that the best solution would be to establish an independent fiscal institution, which would exercise a constant supervision over the methods of fiscal policy in Poland. The competences of this entity would include, among others, developing macroeconomic forecasts, which would be adopted as one of the elements of the budgetary assumptions.

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