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Challenges Towards Tax Policy in Poland

Both recession and bad condition of public finance extort changes in tax system. In Poland the process of tax system transformation has lasted for a dozen or so years, however, since a few years it has become a subject of serious political disputes. The most significant differences refer to redistribution and pro-efficiency aspects of taxation as well as to the ways of using fiscal policy in fighting against recession.

In presented paper tax policy dilemmas are considered in a context of effect of taxation on the structure of budget revenues, their economic (impact on investment, creation of new jobs, stimulating global demand) and social results, as well as from the viewpoint of accordance of the Polish tax system with the EU demands on harmonization of taxation.

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Changes that have taken place in Poland after 1989 have exerted an important influence on financial condition of public finance and have resulted in a crisis of the state budget (table 1). The following factors have been responsible for high budget deficit:

1) deep economic recession at the beginning of transformation process and in the end of nineties
2) low efficiency of the budget revenues' system measured as a relationship of budget revenues to GDP (resulting from low profitability of enterprises, wide range of tax reliefs and exemptions, high tendency in private firms to avoiding paying taxes, low effectiveness of tax collection administration)
3) increase in budget expenditures, especially social payments (unemployment benefits, growth in a number of pensioners) as well as expenditures connected with national debt.

Already at the beginning of transformation period all Central and East European countries faced a need of introduction the significant changes in their tax systems. In most countries there was not any common taxation of personal incomes, while turnover tax was as a rule very complicated and was subject to manipulations, used for often, current corrections in order to keep market equilibrium.

Table 1. Balance of the public sector finance (consolidated data) – in % of GDP

Specification	1993	1994	1995	1996	1997	1998	1999	2000	2001[a]
Total income	50,7	44,7	43,5	43,0	42,3	41,1	41,3	39,6	39,4
including tax revenues	.	28,1	27,2	26,7	25,9	25,0	22,1	20,8	20,0
Total expenditures	52,8	47,4	46,1	46,1	45,2	43,6	44,5	42,7	44,3
Including social expenditures	.	20,3	19,8	18,8	19,4	18,5	18,2	17,4	17,8
Budget deficit	-2,7	-2,8	-2,6	-3,1	-2,9	-2,6	-3,2	-3,1	-4,9

[a] estimations

Source: Pre-accession Economic Program, Warsaw, October 2001.

The process of tax changes was initiated in Hungary. On the 1st of January 1988, fundamental tax reform was introduced there, already before the beginning of transformation process. Hungarian reform to a large degree was based on the West European countries' experiences. The main aim of the reform was to make tax policy clear for foreign partners and to create suitable conditions for inflow of foreign capital. Other important goal of the reform was to create a system of participation of society in financing public expenditures, which would be correlated with the incomes of population. Change of redistribution system was of more and more importance, as together with widening of market mechanism and development of private entrepreneurship there appeared bigger and bigger differentiation of income amongst different social and professional groups. The new tax system was to adopt the main functions of redistribution of income, up till now realized by the price and wage policy. For such a reason progressive taxation of personal income as well as different rates of VAT were implemented.

Similar assumptions were accepted in Poland while introducing in 1992 common taxation of personal income (with three–degree tax rate: 20%, 30%, and 40%) and differentiated rates of VAT (with standard rate of 22%). In some Baltic countries very simple tax systems were introduced (for example linear tax in Estonia). This resulted to a more degree from lack of experiences and weakness of fiscal administration than from doctrinal reasons.

Taxation of personal income is one from the most significant tools of redistribution of income, enabling both realization of equity (social justice) idea and stimulation of demanded behaviors in the production and consumption spheres as well.

In theory of economics two kinds of equity are distinguished: horizontal equity, meaning identical treatment of identical persons and vertical equity, consisting in differential treatment of particular persons in order to reduce effects of natural differences[1]. While horizontal equity is commonly accepted, vertical equity, which essence resolves itself into taking away from the rich and giving the poor, is controversial and difficult for univocal defining. Controversial question is both the range and forms of redistribution. Equity rule is a subjective category, changing in time and needing social consensus.

Construction of personal income tax results from the fact that its task is to realize important social functions. The main elements of this construction are tax progression, amount free of tax dictated by social reasons, tax reliefs and exemptions influencing demanded directions of income expenditures. In principle, personal income tax introduced in 1992 includes all mentioned above elements. However, the Finance Ministry critically evaluated their practical functioning. The widest range of weaknesses concerning hitherto existing personal income tax system was presented in „White Book of Taxes", prepared and published by the Finance Ministry in August 1998. The following main disadvantages of personal income taxation system are pointed there[2]:

- The system is too complicated, mainly due to lots of different tax reliefs. In the framework of personal income tax there exist: 125 tax exemptions defined in the act and executory regulations, 13 kinds of income deductions and 16 kinds of tax deductions.
- Tax rules are unclear and complicated, which causes disputes and needs many interpretations. Tax offices issue tens of thousands of interpretations a year, sometimes contradictory to one another.
- Wide system of reliefs not only softens progression, but also causes that rich persons use reliefs more often than people with relatively low incomes. For example, in 1997 only 38.8% of taxpayers from the lowest tax bracket used tax deductions, 80.9% of taxpayers from the second bracket, and as much as 89.5% of those from the highest tax bracket. In previous years

[1] D. Begg, S. Fischer, R. Dornbush, *Economics*, vol. 1, PWE Warsaw 1993, p. 429 (in Polish).
[2] *White Book of Taxes*, Ministry of Finance, Warsaw 1998, pp. 51–53 (in Polish).

a scale of deductions was similar in particular brackets. Two main factors have impact on such distribution of persons using tax reliefs and deductions. Firstly, the poorest do not have enough money for expenditures covered by the reliefs (the so-called „big" building relief, modernization relief, education relief, health care expenditures' relief, etc.) Secondly, complicated system of accounts causes a lot of problems for many people who do not have enough information concerning different kinds of reliefs and have difficulties with fulfilling tax sheets.

- Tax system is unstable and is subject to many different changes. In „White Book of Taxes" one can read that in the years 1992–1998 the act on personal income tax was changed over 30 times. In principle, none regulation in the act – except from the first articles – does not resemble its preliminary version (for example the rules of flat reliefs were changed every year).

Construction of the Polish personal income tax system (tax brackets, widely developed range of reliefs and exemptions, possibility of joint account of married couples as well as persons who take care of children alone) caused that in 1997 (which in „White Book of Taxes" is treated as starting point for proposed tax reform) up to 94.57% of taxpayers found themselves in the first tax bracket, 4.42% in the second, and only 1.01 % in the third (table 2). Moreover, there existed big differentiation between nominal and effective burdens for taxpayers (table 3).

Critical analysis of personal incomes' taxation, as well as critical evaluation of the remaining taxes became the base for presentation by the Finance Ministry in the end of 1998 the assumptions of radical tax reform aiming at introduction of uniform taxation of physical and legal persons with flat rate of 22%. Taking into account the fact that standard VAT rate in Poland amounts to 22%, tax system would be very simple, as rates of three basic taxes: PIT, CIT, and VAT would be the same.

Table 2. Taxpayers, gained incomes, and tax burdens (in %)

Years	Tax brackets and rates	Percentage of taxpayers with incomes in the particular tax brackets	Percentage of taxpayers' incomes in particular tax brackets (before taxation)	Due tax (after deducting reliefs) in particular brackets
1995	I – 21%	92.70	71.99	63.78
	II – 33%	6.04	14.84	14.45
	III – 45%	1.26	13.17	21.77
1996	I – 21 %	93.34	75.25	69.78
	II – 33%	5.49	14.62	14.47
	III – 45%	1.17	10.13	15.75
1997	I – 20%	94.57	76.66	67.02
	II 32%	4.42	12.38	13.21
	III – 44%	1.01	10.96	19.77
1998	I – 19%	95.04	75.61	65.14
	II – 30%	3.77	11.10	11.80
	II – 40%	1.19	13.29	23.06
1999	I – 19%	94.93	76.27	54.50
	II – 30%	3.89	12.13	15.14
	III – 40%	1.18	11.60	30.36
2000	I – 19%	94.59	75.34	52.19
	II – 30%	4.09	12.56	15.75
	III – 40%	1.32	12.10	32.06

Source: The Finance Ministry data.

The ideas of Professor Milton Friedman might become inspiration for replacement of progressive tax with flat tax. For the first time such a postulate Friedman formulated already at the beginning of sixties, proposing uniform tax rate of 23.5%[3]. With time he proposed even lower rate. Friedman's tax credo was presented in the book „Free to Choose". According to the author, low, flat tax rate – let's say 20% – referring to the incomes higher than level of exemptions (which results from tax regulations), without any deductions from the basic tax amount, except from strictly professional expenditures, would give more revenues than present, languid tax structure. Taxpayers would be better

[3] M. Friedman, *Capitalism and Freedom*, University of Chicago Press, Chicago 1962, pp. 174–176.

off, as they would not have to bear costs connected with hiding incomes in gray zone. The economy would be better off, too, as tax issues would play less important role in allocation of resources. Only lawyers, accountants, public administration officers and members of legislatures would be worse off, but instead they would have possibility to deal with something more productive than fulfilling tax sheets and revealing and liquidating gaps in existing legal regulations[4].

Table 3. Average tax burdens in particular tax brackets in the years 1994–2000

Years	Total		1 st bracket		2nd bracket		3rd bracket	
	Nominal tax burden	Effective tax burden	Nominal tax burden	Effective tax burden	Nominal tax burden	Effective tax burden	Nominal tax burden	Effective tax burden
1994	18.55	18.02	17.79	16.94	22.63	20.11	37.33	29.39
1995	18.42	17.97	17.68	15.84	22.56	16.88	38.11	29.29
1996	18.22	16.20	17.56	15.02	22.57	16.03	35.98	25.19
1997	19.24	17.13	16.40	14.97	21.59	18.26	36.47	30.89
1998	19.48	16.63	15.68	13.89	20.59	17.15	32.36	26.15
1999	17.94	15.54	15.09	13.55	20.64	17.23	32.78	26.12
2000	17.95	15.67	15.04	13.49	20.60	17.27	32.21	26.70

Source: Ministry of Finance data.

It is worth mentioning that also Leszek Balcerowicz gave very similar argumentation, additionally pointing at one more important factor in the Polish conditions: lowering of taxes will accelerate creation of new jobs. However, it should be underlined that M. Friedman, arguing for lowering of taxes, does not forget about adjustment of tax regulations to payment liabilities of the poorest part of society. From these premises (as well as from lack of belief in effectiveness of social policy) a concept of negative income tax is derived. This concept means that when income exceeds level of threshold value, one should pay a tax according to tax rates put on different amounts of incomes. However, when income is lower than threshold value, one receives donation dependent on donation rates attributed to different levels of not used threshold amounts[5].

[4] M. R. Friedman, *Free to Choose*, Panta, Sosnowiec 1994, p. 296 (in Polish).
[5] See as above, p. 116.

Radical lowering of taxes as well as their maximum simplification was important „supply" element of economic strategy of Ronald Reagan administration. The main role in propagation of the idea is assigned to representatives of „supply side of economics" as A. Laffer, G. Gidler, J. Wanniski, J. Kemp and I. Kristal.

Well-known Hungarian economist J. Kornai has similar view on tax reform. He is of opinion that tax system should not include any anti-incentives for increasing economic efficiency and investment growth. The system should not put progressive taxes on those, who are ready to devote a part of their free time for additional job. It should not force anybody to hide these activities and the same to cheat the state[6]. He clearly suggests one flat tax rate. One of his postulates is as follows: „There should be one, flat (non-progressive) wage tax. All employers that lead their activities legally, should pay flat tax on alt kinds of remuneration paid to their employees"[7].

The United States failed to introduce flat tax despite the fact that tax reform started in 1981 resulted in significant reduction of tax rates. Top rates were reduced from 70% to 50%. Successive lowering of tax rates took place in subsequent years. However, growing budget deficit caused increase of tax progression during presidencies of George Bush and Bill Clinton. At present in the USA personal incomes are taxed according to five rates: 15%, 28%; 31 %, 36%, and 39.6%. J. Kornai's arguments did not have impact on shaping the construction of Hungarian taxes, either.

Leszek Balcerowicz's trial to eliminate progressive tax raised categorical resistance amongst significant part of the society. This is clearly visible while analyzing the results of two surveys of public opinion conducted by the Center For Public Opinion Investigation (CPOI) in May and September 1998 on sample of 1000 people. My investigation completed in May 1999 on the base of 730 questionnaires gave similar results. it occurred that progression rule is accepted by 77% of investigated by CPOI (the same answers in both investigations[8]) and 76.3% of those investigated in May 1999. 17% of persons investigated by CPOI[9] and 23.7% respondents investigated a year later declared for flat tax.

In CPOI investigations persons with higher education and high social and economic status were most of all advocates of flat tax. In favor for this concept was 41 % of respondents with higher education, 42% representatives of

[6] J. Kornai, *Way to Market Economy*, Fundacja Polska Praca, Warsaw 1991, p. 81 (in Polish).

[7] See as above, p. 82.

[8] M. Falkowska, *Opinions on tax system*, CPOI Information Service, 1998, no 10 (in Polish).

[9] 6% of respondents investigated by CBOS had difficulties with precise formulation of their opinions.

management, administration officers and private entrepreneurs, 38% with highest incomes, and 33% of respondents evaluating their financial standing as good. For keeping existing status quo (i.e. for progression with three tax rates) most of all declared respondents paying taxes according to the first tax rate (44.3% versus 18.5% of persons paying according to the third rate), employees with lower level of education (40.7% of respondents with basic and vocational education and 43.9% with secondary and post-secondary education versus 32.3% of investigated with higher education) as well as employed in public sector (45.4%). Such attitude is fully justifiable, as for these groups of respondents tax progression is the most beneficial solution (as a rule they are taxed according to the lowest tax rate).

It is worth underlying that this common attitude towards tax progression points at sense of justice deeply rooted in the Polish society, according to which richer people should pay higher taxes while the poor should be subject to lower taxation. Opinions of respondents suggesting need of lowering the lowest tax rate are also an expression of egalitarian tendencies. The rate of 3%, 5%, and 7% was proposed. However, the most common opinion was to introduce the lowest rate amounting to 10%. These demands are not excessive taking into account fact that the lowest rate of 19% which is at present obligatory in Poland is high enough compared to European standards. On the other hand, there were not any suggestions of increasing the highest rate above 40%, although in some EU countries there exist higher tax rates (see tax rates in the European Union countries presented in table 4).

The Finance Ministry, proposing lowering of tax rates assumed simultaneously liquidation of nearly all of existing reliefs. However, empirical research points at very high attachment of taxpayers to the reliefs. The most of respondents (over 78%) vote for maintaining the reliefs connected with bad health situation (disability, chronic diseases). Almost 70% regard education reliefs for children as necessary. Over a half of investigated persons (61.5%) support house repair reliefs, reliefs connected with expenditures for cure (61.1 %), and professional reliefs (53.4%). Least of all are accepted reliefs connected with saving: for example purchase of bonds (17% of respondents) as well as private pensions and scholarships (18.4%). 37.9% of investigated persons supported reliefs for grants for social goals.

Significant majority of respondents (76.2%) declares for keeping tax-free amount, although the opinions on level of this amount are differentiated. Only 11.5% think that there should not be any tax-free amount, e.g. the whole income should be taxed, while 12.3% does not have any opinion on the issue.

Table 4. Personal income tax rates in the European Union countries in 2000

Country	Number of rates	Level of tax rates (in %)
Austria	5	10; 22; 32; 42; 50
Belgium	7	25; 30; 40; 45; 50; 52.5; 55
Denmark	4	6; 15; 25; 40
Finland	6	5.5; 15.5; 19.5; 25.5; 31.5; 38
France	6	9.5; 23; 33; 43; 48; 54
Germany		25 to 51
Great Britain	3	10; 23; 40
Greece	5	5; 15; 30; 40; 45
Ireland	2	24; 46
Italy	2	18.5; 25.5
Luxembourg	17	6; 16; 18; 20; 22; 24; 26; 28; 30; 32; 34; 36; 38; 40; 42; 44; 46
The Netherlands	4	33.9; 37.9; 50; 60
Portugal	4	14; 25; 35; 40
Spain	6	15; 20.17; 23.57; 31.48; 38.07; 39.6
Sweden		20 to 50 (including local tax)

Source: Own calculations based on: European Tax Handbook 2000, P. S. Andersen (ed.), *International Bureau of Fiscal Documentation*, Amsterdam 2000.

Relatively low number of respondents are of opinion that tax-free amount of income should be connected with the level of minimum wage (19.8%) and the level of unemployment benefit (6.3%). This manifests relatively moderate claim attitudes and at the same time points to the fact that financial situation of groups of society with the lowest incomes is not taken into account. It is worth mentioning that in tax systems in many countries tax-free amount is established on the base of taxpayers' payment liability. Level of tax-free amount is a result of political compromise that takes into consideration civilization, cultural, and social factors, as well as level of social benefits covered by the state budget. In some countries, for example in Portugal, tax-free amount is established in relation to minimum wage (in 1996 it amounted to 71% of minimum wage). However, more often it is established as lump-sum tax (for example, in 1996 it amounted to 4049 USD in Greece, 8428 USD in France, and 9259 USD in Finland). In Hungary incomes lower than 100.000 forints

(606 USD) were not taxed[10]. At the same time in Poland due tax was decreased by 218.4 PLN, which means that tax-free amount reached a level of 1040 PLN (361 USD). It is also worth to mention that in Poland a tax-free amount of income has been subject to significant decrease. Only in 2000 it slightly exceeded a monthly gross salary (table 5).

There exist some premises that Polish society has clearly visible redistribution-egalitarian expectations towards domestic tax system. The following views predominate: need of taking into consideration a difficult financial situation of taxpayers with the lowest incomes (underlined by over 40.7% of respondents), need of redistribution of income (21.5%), collection of revenues for budget expenditures (20.0%), care for social peace (19.2%). Pro-effectiveness reasons (28.1 %) and simplification of tax account procedures (38.4%) are of less importance.

It is obvious that redistribution reasons are most clearly pointed by respondents with the lowest income, while taxpayers from the second and the third tax brackets prefer pro-efficiency aspects.

Such social expectations towards tax system are not individual phenomenon. Even in Sweden, a country with high level of fiscal stringency, it occurred that lowering of taxes causing reduction of the level of social benefits is not accepted by the society. When in 1991 conservative coalition threw away the power and started to lower taxes and to reduce range of „social state", it did not meet with common applause. Investigations proved that two thirds of Swedes are inclined to pay higher taxes rather than resign hitherto existing benefits. Victory of social democrats in the next election confirmed that society does not accept rapid changes of social policy[11].

Also American experiences are worth closer analysis. It occurred that lowering of taxes in 1981 did not cause demanded supply effects, but it resulted in drop in income in the poorest families. It was a kind of warning for politicians and was reflected in corrections of tax system, aiming at reduction of tax burdens for the poorest groups of population.

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[10] Own calculations based on European Tax Handbook 1996, P. S. Andersen (ed.), *International Bureau of Fiscal Documentation*, Amsterdam, 1997.

[11] D. Mibank, *Swedes are resistant*, „The Wall Street Journal Europe" (Gazeta Wyborcza, 6.02.1995) (in Polish).

Table 5. Tax rates and brackets in the years 1992, 1995, and 2000

Tax rates obligatory in 1992

Tax base in zl		Amount of tax:
over	to	
	6480	20% of the tax base minus 86.4 zl
6480	12960	1209.6 zl plus 30% of surplus above 6480 zl
12960		3153.6 zl plus 40% of surplus above 12960 zl

Tax-free amount: 432 zl
Average monthly gross salary: 289.73 zl

Tax rates obligatory in 1995

Tax base in zl		Amount of tax:
over	to	
	12.400	21% of the tax base minus 165.6 zl
12.400	24.800	2438.4 zl plus 30% of surplus above 12400 zl
24.800		6530 zl plus 45% of surplus above 24800 zl

Tax-free amount: 788.57 zl
Average monthly gross salary: 690.92 zl

Tax rates obligatory in 2000

Tax base in zl		Amount of tax:
over	to	
	32736	19% of the tax base minus 436.2 zl
32736	65472	5783.64 zl plus 30% of surplus above 32736 zl
65472		15604.44 zl plus 40% of surplus above 65472 zl

Tax-free amount: 2295.78 zl
Average monthly gross salary: 2040.82 zl

The government project of lowering the second and third tax rates, keeping level of the first one unchanged[12], awoke serious social resistance, supported by veto of the President of Republic of Poland. Resistance of different political parties towards this proposition arose from similar premises.

[12] In the Budgetary Act for the year 2000 it was assumed that 19% will not change, 30% rate will be lowered to 29%, and 40% tax rate will be reduced to 36%.

Advantages for the economy due to diminishing tax burdens were not questioned. Politicians were seriously alarmed by the fact, that lowering of taxes can shake budgetary balance and cause shortage of financial sources for realization of important social goals. On the other hand, one can not be sure that lowering of taxes for social groups with the highest incomes will lead to growth in savings. Maybe – as opponents maintain – it would cause increase of luxury consumption and consumption import? Moreover, suggested changes would result in deepening of – already high – social differentiation. Elimination of mentioned anxieties and gaining of acceptance for tax reform in shape proposed by L. Balcerowicz needs fundamental analysis of presented objections.

During discussions on changes in tax system, need of regarding demands of the European Union is often pointed at. This mainly refers to VAT and excise tax. Some changes in corporate income tax are also necessary. However, need of harmonization of taxes in the framework of the EU does not refer to personal income tax. It was assumed that its unification is not necessary condition for free flow of products, services, capital, and labor within common internal market. Particular countries have full self-dependence in shaping the rules of taxation of population and in taking into consideration domestic specificity, traditions, feeling of social justice, economic situation, and the range of social benefits. The only limitation of particular countries' independence is the so-called European Social Card included into Maastricht Treaty, guarantying defined packet of social benefits for different social groups as well as consideration of the „social justice" rules in budget policy. This can raise pressure for use of taxation of personal incomes as a tool for softening excessive social differentiation (for example through tax progression, tax-free amount, reliefs and exemptions taking into account personal situation of a taxpayer and his/her family).

In a context of mentioned about facts it is clearly visible that proposition of changes in tax rates in 2000 (placed by the Finance Ministry in „White Book of Taxes" in August 1998, and discussed in the Parliament at the end of 1999), as well as project of two-degree personal income tax with final rates of 17% and 34% in 2005 presented by former Minister of Finance or project of linear tax with rates of 15% or 18% suggested by liberal political parties, do not arise from need of harmonization of the Polish tax system towards demands of the European Union and are not convergent with actual solutions adapted in West European countries.

Propositions of radical lowering of personal income taxes are most often articulated by advocates of significant reduction of role of the state in the economy. In official forecasts presented by liberally-oriented government it was predicted that share of public expenditures in GDP, which in Poland in 2000 amounted to about 43% (less than an average in the EU), would decrease to 39% in 2003 and to 35% in 2010[13]. This would be possible mainly due to lowering of corporate taxes and taxation of groups of taxpayers with the highest incomes (in order to stimulate entrepreneurship) on one hand, and thanks to reduction of widely understood social benefits on the other. This is a clear appearance of direction of the state role evolution, which would cause important consequences for the whole society, although this issue is not exposed in official statements and discussions. In my opinion such changes must not be introduced in secret, under a cover of improvement of the existing tax regulations' efficiency, and taking advantage from lack of knowledge amongst the population concerning tax systems in the world.

A question of reduction of public expenditures is controversial and difficult for implementation. But where to look for possibilities of lowering these expenditures? Already nowadays a level of expenditures for health care, education, research and development, and wide range of social benefits is alarmingly low. It is worth to underline that in Poland a share of taxes in GDP in recent years has been diminishing at a high rate (from 52.8% in 1993 to 42.75 in 2000, e.g. by 11.1%). Within those seven years also in the EU countries public expenditures have been dropping, however, at a lower rate (by 7.5%)[14], but in Poland in those years a number of persons needing social aid has increased significantly (due to early retirements and skyrocketing unemployment).

Rather unrealistic, and besides economically and socially groundless, is also significant reduction of personal income tax. The following arguments speak for this opinion:

- From the beginning of transformation period state budget revenues have been lower than budget expenditures. State budget deficit has reached permanently a level of 2–4% of GDP. Lowering of taxes for the group with highest incomes can significantly reduce budget revenues from personal income tax. Although in 2000 only 1.32% of taxpayers paid taxes according to the highest 40% tax rate, however this gave the state budget as much as 32.06% of revenues from personal income tax. Taxpayers from the second tax bracket (burdened with rate of 30%) constituted 4% of all taxpayers, but they supported the budget with over 15% of revenues from PIT. On the other hand, the most numerous group of taxpayers (95%), who pay taxes according to 19% rate, provided the budget with the rest (52.19%) of revenues from

[13] Strategy of Public Finance and Economic Growth – Poland 2000-2010, Council of Ministers, Ministry of Finance, Warsaw 1999, p. 46 (in Polish).

[14] OECD Data Basis.

PIT. In the previous years situation was similar (see table 2). Reduction of tax burdens without exact analysis of impact of such a decision on budget revenues can cause a threat of shaking budget equilibrium.

- The main argument of advocates of lowering of taxes for the richest, a few percent group of the society, is not convincing, either. Lower taxes are to increase savings that will be assigned for growth in investments and creation of new jobs. However, only small part of taxpayers from the highest tax bracket they are entrepreneurs who run their own businesses. In this group representatives of free professions, members of parliament, high public administration officers, managers and board members of large firms, especially with foreign capital, as well as specialists from consulting firms predominate. Results of analysis of the budgets of households, conducted on base of the Main Statistical Office data, point at the fact that increase of income in Poland is clearly connected with growth, and most of all with change in the structure of consumption[15]. Lowering of taxes for physical persons does not cause direct increase of savings with all its consequences for creation (through investments) of the new jobs. Increase of luxury consumption can result in subsequent growth of imports and worsening of trade account balance (for many years negative in Poland).
- Tax reforms, consisting in lowering of tax rates on personal incomes, assuming stimulation of pro-effective activities (increase of incentives for growth in incomes and growth in investment sources) as a rule at the same time assume increase of burdens connected with indirect taxes (in order to keep budget equilibrium). It is clearly visible that Polish reformers have also such an idea. Share of indirect taxes in state budget revenues has been increasing very quickly: from 38.7% in 1993[16] to 58.8% in 2000[17]. At the same time it is commonly known that indirect taxes are of digressive character, e.g. they burden poor households in greater degree than rich ones. This leads to further pauperization of the Polish society.
- Reliefs and exemptions connected with the ways of earning income and its spending are important pro-effective instruments of tax policy. Thanks to these reliefs it is possible to influence taxpayers' behaviors in many important areas, for example via stimulating propensity to save, purchase of bonds, increase of expenditures for flat building, health care, education, etc.

[15] I. Bolkowiak, *Effects of proposed reform of tax system for the Polish economy* Expertise for the Ministry of Economy, Warsaw 1999, p. 12 (in Polish).

[16] *Polish Statistical Yearbook* 1995, GUS, Warsaw 1995, p. 497.

[17] *Statistical Bulletin*, GUS, Warsaw 2001, p. 61.

Advocates of lowering of tax rates at the same time postulate liquidation of almost all reliefs. There are not any reasonable reasons for resigning these rather effective, reliable, and commonly used instruments of exerting influence on taxpayers' behaviors only in order to decrease taxes for narrow group of the richest taxpayers (not knowing their further behaviors).

- One of the basic assumptions of lowering of taxes for the richest population was a conviction that in present conditions low propensity to invest is the main barrier of economic growth and that the rich have the highest propensity to save. Empirical research proves that for many entrepreneurs insufficient demand is a factor that more and more limits their development possibilities[18]. Lowering of taxes is in fact the best stimulator of the global demand growth, but in the groups of population with the lowest income (e.g. where the propensity to save is the lowest). In conditions of recession and lack of demand savings coming from lowering of taxes do not have to be transformed into investments and new jobs. Who will develop production capacities having difficulties with selling already manufactured products? On the other hand, lowering of taxes for people with the lowest income could undoubtedly cause significant growth of demand.
- Belief that one should choose between effectiveness and equity is a popular argument for postulating or accepting growth in differentiation of incomes. A view predominates that higher national income is better („national cake"), even if it is unequally divided. Is such an attitude reasonable? Experiences of Asian countries are convincing examples that one can act more effectively and divide more equally. Fast speed of growth in „Asian tigers" is not connected with significant increase of social differences[19].
- Experiences from countries with relatively low level of development, that were admitted to the European Union in subsequent phases of widening (Ireland, Greece, Spain, and Portugal) should serve as source for reflections on possibilities of significant lowering of tax revenues in Poland in following years. In mentioned countries after entering the European Union budget expenditures have been increasing, due to need of adjustment to union standards, support of restructuring processes, and improvement of competitiveness of the economy (table 6). There are not any reasons for thinking that in Poland adjustment processes after entering the European

[18] E. Mączyńska (ed.), *Restructuring of enterprises in the process of transformation of the Polish economy*, Vol. 1, DiG, Warsaw 2001, p. 332 (in Polish).

[19] The East Asian Miracle. Economic Growth and Public Policy, A World Bank Policy Research Report, Oxford University Press, 1993, pp. 81–87.

Union will need lower financial sources (taking into consideration situation in agriculture, environment protection, education, and technical infrastructure).

Table 6. Share of budget expenditures in Ireland, Greece, Spain and Portugal before and after integration (as % of GDP in current prices)

Country	A year before accession to the UE	A year after accession to the UE	Within first five years after integration				
Ireland	37,0	36,8	42,5	46,3	45,5	43,1	44,0
Greece	30,6	39,9	39,7	41,5	44,3	48,1	47,9
Spain	42,1	41,7	40,6	40,9	41,8	42,7	43,5
Portugal	43,5	44,6	43,0	43,0	42,9	44,0	45,3

Source: Own calculations based on: European Economy. Annual Economic Report 1991–1992, no 50 ECSC-EEC-EAEC, Brussels, December 1991, s. 265.

Summing up my reflections concerning radical tax reform in Poland, I think that both economic and social arguments do not justify necessity of introduction of tax reform in a shape proposed by the former liberally oriented government. Since autumn 2001 the new social-democratic coalition has been ruling and has declared a new attitude towards taxes. Increase of tax-free amount of income as well as introduction of additional (lower) PIT rate for taxpayers with the lowest incomes in planned.

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