



ShowCASE

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Editorial

In this issue of showCASE, we address the problem of the rule of law, which has been undergoing a clear erosion in Poland since 2015. In a most recent exhibition of a misalignment of the rule of law priorities throughout the European Union Member States, Poland, alongside Hungary, engaged in a debate over the rule of law conditionality for the disbursement of the EU funds and subsequently vetoed the recovery plan and the EU long-term budget of about EUR 1.8 trillion.

The article, while timely, is not an immediate reaction to the recent events, however, but rather tackles the issue of the rule of law in broader terms, looking at it and its social reception as determinants of economic development. It is based on a *study* prepared by CASE (Krzysztof Głowacki, Christopher Hartwell, Kateryna Karunska, Jacek Kurczewski, with contributions from Maria Krell) and European Academy Berlin (Elisabeth Botsch, Tom Göhring, and Weronika Priesmeyer-Tkocz) within the project *'Norma praworządności i jej oddziaływanie społeczne jako czynniki rozwoju gospodarczego Analiza porównawcza Niemiec i Polski'/'Das Prinzip der Rechtsstaatlichkeit und ihre soziale Wirkung als Determinante des ökonomischen Wachstums Eine vergleichende Analyse Deutschlands und Polens'* supported by the Polish-German Foundation for Sciences (No. 2018-26).

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CASE Analysis

The Rule of Law in the Economic Life. Does It Matter?

The article is based on a study prepared by CASE - Center for Social and Economic Research and European Academy Berlin within the project entitled 'Norma praworządności i jej oddziaływanie społeczne jako czynniki rozwoju gospodarczego Analiza porównawcza Niemiec i Polski' / 'Das Prinzip der Rechtsstaatlichkeit und ihre soziale Wirkung als Determinante des ökonomischen Wachstums Eine vergleichende Analyse Deutschlands und Polens' (No. 2018-26).

The rule of law is, as a matter of course, a *sine qua non* for a modern democratic society. It is also a necessary condition for existence of a stable, effective, and sustainable market economy. The connection between the rule of law and the economy has increasingly been the focus of much scientific and analytical work. According to the new institutional economics stream of research, the rule of law – and particularly inclusiveness and the transaction reducing properties of well-functioning institutions – are among the main determinants of the economic growth. The applicability and effectiveness of the relevant norms depends, however, on their social reception and validation. In the long term, insufficient understanding of the rule of law in a society can prompt the government to abandon or undermine the rule of law, which in turn threatens socio-economic wellbeing of a given population.

Understanding the Rule of Law in Poland and Germany

The current state and perception of the rule of law and public institutions in Poland and Germany have been shaped by historical and economic factors. While both countries benefit from rich constitutional traditions, there are clear divergences in terms of the role and level of the rule of law across the old lines of division that used to cut both

countries in two (Germany) and three (Poland).

Germany

Performance of Germany in terms of the available rule of law indicators has remained high and historically stable. In the latest [World Justice Project Rule of Law Index](#), in particular, Germany ranked 6th globally (score of 0.84) with the government accountability, freedom from corruption, and accessibility and efficiency of the court system [praised as particularly strong](#). Similarly, according to the [World Bank Doing Business ranking](#), Germany remains among the 25 top global performers.

As suggested by the results of the [national surveys](#), however, a certain degree of divergence in terms of trust in public institutions can be found across the country. Subject to the economic downturn, missing identification of the newly built institutions, and a legacy of the former authoritarian state, the distrust in media, government, police, and administration have been found to be more common in the East Germany than in the [Western part of the country](#). Thus, even if the absolute trust in public institutions continues to rise, the intra-country gap persists and remains one of the major challenges of the Federal Republic of Germany.

Poland

Despite being a historical vanguard of constitutional development in Europe, Poland underperforms relative to Germany and other EU countries in terms of the rule of law.

More importantly, in the recent years, Poland experienced a significant downturn across all main rule of law indicators. Following a strong performance in the **World Justice Project Rule of Law Index** and recognition as a successful reformer in the 2010 and 2011 editions of the report, Poland recorded a **25% drop in the constraints on government power indicator** between 2015 and 2019, the largest decrease among the 126 countries included in the study. According to the **Heritage Foundation's Index of Economic Freedom**, a significant decline was also recorded in the **judicial effectiveness components (by 24% since 2018)**.

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That erosion of the rule of law in Poland has taken form of both detrimental changes in the legal rules and in the approach of the ruling class to law or legal culture. Indeed, in the recent years the situation has been **raising numerous concerns** across both European and international actors.

Social Reception of the Rule of Law in Poland and Germany

The findings of the surveys and in-depth interviews¹ with business representatives in both countries underline intrinsic divergences in terms of the understanding and reception of the rule of law in Poland and Germany.

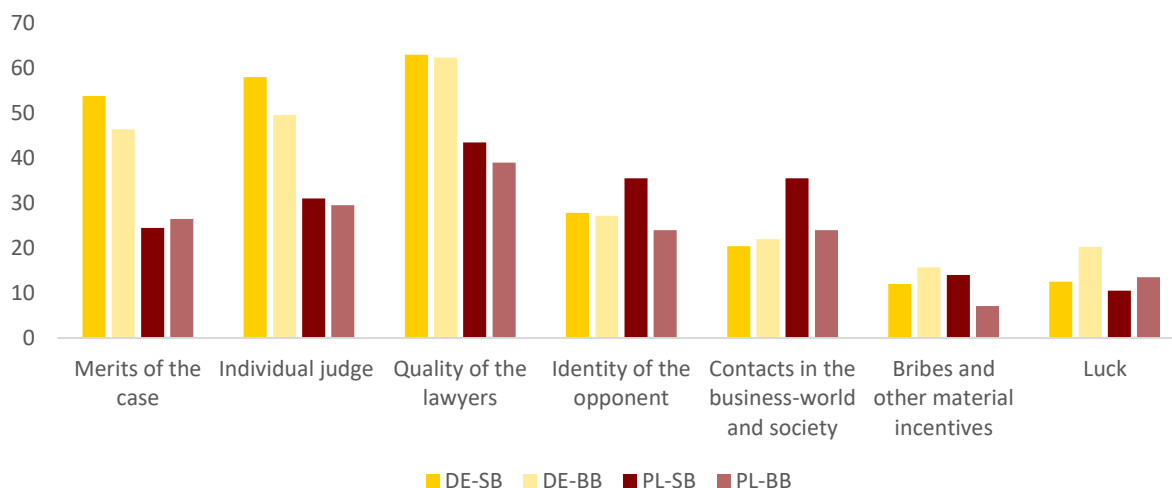
Polish companies tend to share a higher level of insecurity and have a restrictive vision of the rule of law as simple rule-obedience. For instance, one of the Polish respondents described the situation with regard to the rule of law in the country as a *'dishonest application of the law that may apply in all spheres of living, including economic life. This foments the great anxiety [...] which may be more felt in some areas. [...] in reality, there is a risk that at some moment one wakes up to the totally new order, where there is no room for an activity or the business is taken over or nationalised.'*

This, in turn, is contrasted by the perception of the state actions in Germany: *'[...] the state should also [...] try to bridge or compensate for structural or temporary deficits with support so that the economy in our country can keep pace with the economies of competing countries. The framework is important, the rules are important [...].'* Thus, in Germany, firms view the rule of law more as an instrument at their disposal, to be used *vis-à-vis* business partners and the state. This perception is not devoid of critique, however, with about one-third of small and big business representatives in Germany stating that *'none'* of the rule of law elements are being adequately fulfilled in the country.

The difference in the levels of trust is particularly evident from the responses to the questions related to the impartiality of justice. As Figure 1 shows, *'quality of the lawyers'* – most frequently perceived as the main condition of success in the court in both countries – is followed in Poland by the social connections of the opposing party rather than merits of the case itself.

¹ For a detailed discussion of methodology, survey results, and insights from the in-depth interviews see CASE & EAB (2020). *Rule of Law and its Social Reception as Determinants of Economic Development. A Comparative Analysis of Poland and Germany.*

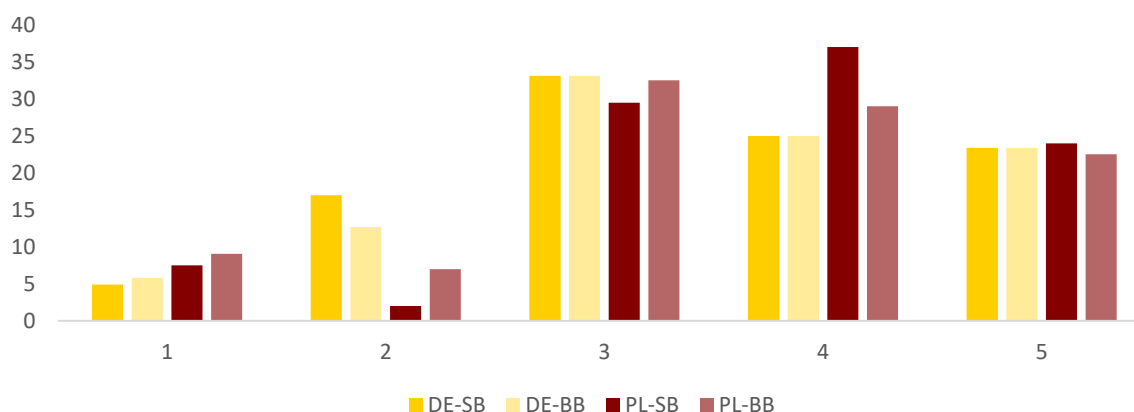
Figure 1. Distribution of answers to Question 3: 'Imagine that your company has a legal case against another company in a court. In your opinion, which factors have an impact on who wins a case in court?' (in %)



Source: CASE & EAB (2020). Rule of Law and its Social Reception as Determinants of Economic Development. A Comparative Analysis of Poland and Germany.

Note: 'DE' stands for Germany and 'PL' for Poland. 'SB' and 'BB' correspond to small and big business representatives, respectively.

Figure 2. Distribution of answers to Question 5: 'According to your knowledge and experience, how likely is it that in adjudicating a dispute between a company like yours and the public administration, the court would act biased and pass the verdict in favour of the administration?' (in %)

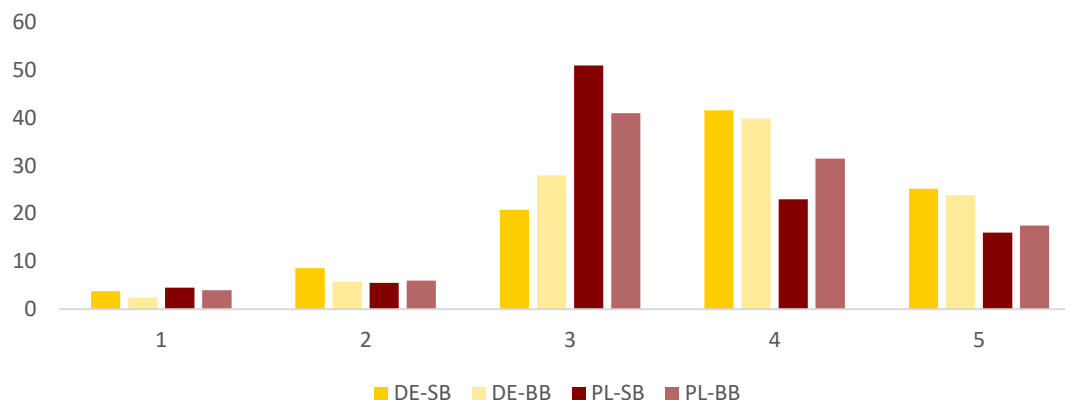


Source: CASE & EAB (2020). Rule of Law and its Social Reception as Determinants of Economic Development. A Comparative Analysis of Poland and Germany.

Note 1: 'DE' stands for Germany and 'PL' for Poland. 'SB' and 'BB' correspond to small and big business representatives, respectively.

Note 2: range from 1 (unlikely) to 5 (certain).

Figure 3. Distribution of answers to Question 4: 'Let's assume your company has won a case of this kind in court. How likely, according to your knowledge and experience, is the court verdict to be implemented in practice?' (in %)



Source: CASE & EAB (2020). Rule of Law and its Social Reception as Determinants of Economic Development. A Comparative Analysis of Poland and Germany.

Note 1: 'DE' stands for Germany and 'PL' for Poland. 'SB' and 'BB' correspond to small and big business representatives, respectively.

Note 2: range from 1 (unlikely) to 5 (certain).

When the cases against the administration are concerned, Polish business representatives (regardless of their size) tend to be more inclined to expect that the court will favour public administration (Figure 2). Similarly, Polish business representatives have been found to be more sceptical of the chances of a favourable verdict being implemented in practice (Figure 3).

» Crucially, as lower levels of the rule of law translate into lower investment, in the long term they adversely affect the socio-economic well-being of workers and pace of development of a country as a whole.

Rule of Law and Investment

The sociological findings of the study suggest that the rule of law is not perceived as the main determinant of the investment decisions by companies neither in Germany nor in Poland. It is rather seen as a mean for securing a stable economic and institutional environment for running a business.

Based on the empirical results², however, the rule of law has been proven to have a positive and substantial impact on investment.

The shift from the current level of rule of law³ in Poland to its historical maximum (i.e. 0.964 in 2009-2010) would thus result in an increase

² For a detailed discussion of methodology and econometric results see CASE & EAB (2020). Rule of Law and its Social Reception as Determinants of Economic Development. A Comparative Analysis of Poland and Germany.

³ As measured by the Varieties of Democracy (V-Dem) dataset, available at: <https://www.v-dem.net/en/>.

in its income-based capital per worker⁴ of an additional USD 3,216 (in 1990 constant USD). Similarly, if rule of law in Germany was to increase from its current level (i.e. 0.989 in 2018) to its 2012 maximum, the country would see a gain in capital of about USD 1,190 per worker after some time. Conversely, if Poland and Germany were to suffer lower levels of rule of law (i.e. shift for Poland from its current level to those witnessed in 1986, and for Germany – from its current level to the level in the present day Poland), their workers would lose USD 11,240 and USD 7,911 in capital, respectively.

Conclusions

The findings of the study showcased underlying divergences in terms of understanding and execution of the rule of law in both countries. The rule of law, by securing civil and economic rights, can contribute substantially to enhancing trust and reducing transaction costs in relations between companies and administration. On the other hand, if not properly adopted, the rule of law can contribute to insecurity in the economic life.

More importantly, we find substantial and immediate adverse domino effects of poor rule of law. Crucially, as lower levels of the rule of law translate into lower investment, in the long term they adversely affect the socio-economic well-being of workers and pace of development of a country as a whole.

⁴ Understood as the capital accrued over the lifespan of a worker whose income increases over time. Income-based capital per worker is used as a measure of productive investment in the econometric model based on Van Leeuwen and Földvári (2013), where the base of the empirical data comes from.

Highlights

Trade, Innovation, and Productivity

Joe Biden's replacing of Donald Trump as president of the United States of America may be a chance for a new start in the trade relations between the US and the EU. Trade tensions between the two partners have been significant during Trump's term. In 2018, the US imposed tariffs of 25% and 10% respectively on steel and aluminium imports from the EU and other US trading partners including Canada, Japan, Turkey, and China. These trade tariffs have been shown to have a negative impact on the EU trade with a 1.2% decrease in the exports of steel and aluminium products one year after their implementation with a resulting decrease in value-added and employment in European steel and aluminium sectors of **0.76% and 1.02% respectively**. The retaliatory response by the EU involved extra duties on US-originating goods (mainly steel, aluminium, and agricultural products). Another ongoing trade conflict involves the subsidies to Boeing and Airbus that already resulted in Washington's imposing **25% tariffs** on multiple European agri-food products. The EU, in turn, secured an approval from the World Trade Organization to impose tariffs on USD 4 billion worth of US goods. Brussels has not, however, levied these tariffs until now and may not apply them if parties agree to renegotiate. Lastly, Biden's administration may resume the negotiations of the EU-US preferential trade agreement that has been halted during Donald Trump's term in the office.

Labour Market and Environment

As much as **EUR 108,000 million** was invested in Social Impact Investments (the SII) in 2017 – twelve times more than in 2011. SII is aimed at generating societal and financial returns, at the same time offering innovative alternatives to help social organisations to access funding and increase their ability to make an impact. Despite a significant progress of this market at the EU level, the maturity of the SII in most EU Member States remains low – 75% of the EU MS are at the inception phase, when implementing the concept. The three main challenges identified by the EP study (2020), when it comes to the development of the SII market are: 1) national governments being insufficiently involved in the development of SII, 2) most of the existing initiatives targeting the supply side of the market and neglecting the demand one, 3) the EU funds being distributed predominantly as general funding mechanisms, not tailored to the specific needs of the SII market stakeholders (social enterprises included). On the top of that, the COVID-19 pandemic has negatively affected the SII market actors, similarly to that of other economic stakeholders. Combating the existing challenges at the EU and national level might be possible by virtue of promoting the concept of SII, closing the knowledge gap and raising awareness about the SII, and facilitating the capacity building of the market.

Macro and Fiscal

The latest tax collection figures from the Ministry of Finance point to fast increase in VAT revenue in Poland in the third quarter of 2020. Over the last four consecutive months, VAT revenue increased by more than 12% y/y. Thanks to such a good performance, the VAT revenues during the first 10 months of this year have been at a practically unchanged compared to the last year. This happened in spite of the policy changes (new "rate matrix", simplification of VAT treatment of imports), which reduced somewhat the effective rate. The reason for that might be an increase in the volume of electronic payments in Q2 compared to Q1 (by 4%). As Christmas expenditure this year will also most likely take an electronic form, the VAT revenues may remain relatively satisfactory despite the decline in the economic activity. Against all odds, the VAT Gap could also be lower than it was forecasted earlier this year.

Other CASE Products

The Weekly Online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly. For more information on our weekly online CASE CPI, please visit: <http://case-research.eu/en/online-case-cpi>.

The latest Online CASE CPI read-out shows that price stabilisation, which started around August, continues. It seems that the second wave of the COVID-19 pandemic has put on hold any substantial retail price adjustments, albeit the situation might change rapidly and it appears difficult to predict the scale of those adjustments. The biggest observed change happened in “Education” category where prices on average grew by 1.1%. Prices in “Restaurants and Hotels” category went up by 0.5%, while “Transportation” observed a drop of about 0.2%.

Our Weekly Online CASE CPI



Monthly CASE Forecast for the Polish Economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, investments, industrial production, growth of nominal wages, and the CPI.

CASE economic forecasts for the Polish economy						
<i>(average % change on previous calendar year, unless otherwise indicated)</i>						
	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices	Nominal monthly wages
2020	-4.0	-4.4	-8.3	-4.6	3.2	3.6
2021	3.8	4.0	3.4	2.8	2.6	3.2

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