

Polish Personal Income Tax Reforms in the Context of a Decade of Wage Growth in Central Europe

Kajetan Trzcinski and Michał Myck,

CenEA

Introduction

- Central European and Baltic countries have experienced the fastest rate of wage growth in the EU over the past decade
- Without a policy response wage growth causes fiscal drag, and in conjunction with inflation can result in additional pressure on household budgets
- None of the studied countries have implemented a consistent system for tax parameter adjustment to account for wage growth
- In most cases the costs of fiscal drag outweigh the benefits of tax policy reforms for household budgets
- I will present our methodology, outline the most recent Polish tax reforms, and run a comparison with other countries in the region

Methodology

This analysis was conducted using two distinct microsimulation models:

- Calculations of the current Polish tax reforms were done in SIMPL (Polish microsimulation model) with the use of the Household Budgets Survey Data (BBGD) from 2017 (updated to 2019).
- The EUROMOD (Tax-benefit microsimulation model for the European Union) was applied for cross country comparisons with the use of generated hypothetical households.

The cross country comparison was run on a family of four with one working parent and two children, aged 7 and 14.

Poland, Hungary, Czech Republic, Lithuania, Latvia, Estonia and Slovakia were selected for comparison.

Fiscal Drag

- Also known as “bracket creep”, it occurs when an increased proportion of wages are subject to taxation due to wage growth
- This puts downward pressure on household budgets
- The burden is even more significant in case of high inflation (when real wage growth is low)

- A. Paulus, H. Sutherland and I. Tasseva (2019) :
 - Distinction in tax-benefit analysis between structural reforms and the indexation effect
 - They found that between 2001 and 2011 in Belgium, Bulgaria, Estonia, Greece, Hungary, Italy and the United Kingdom indexation outpaced fiscal drag and tax reforms had a redistributive effect

- Immervol, H. (2000):
 - Fiscal drag can have a stabilising effect on the macro-economy level, preventing the economy from overheating during rapid growth and giving households some additional budgetary leeway when the economy is shrinking

Polish income tax reforms

Between 2009 and 2018 successive Polish governments froze the income tax system and its parameters, apart from a single reform in 2017 that raised the tax credit for low income earners and withdrew it for high income earners (a budget neutral reform)

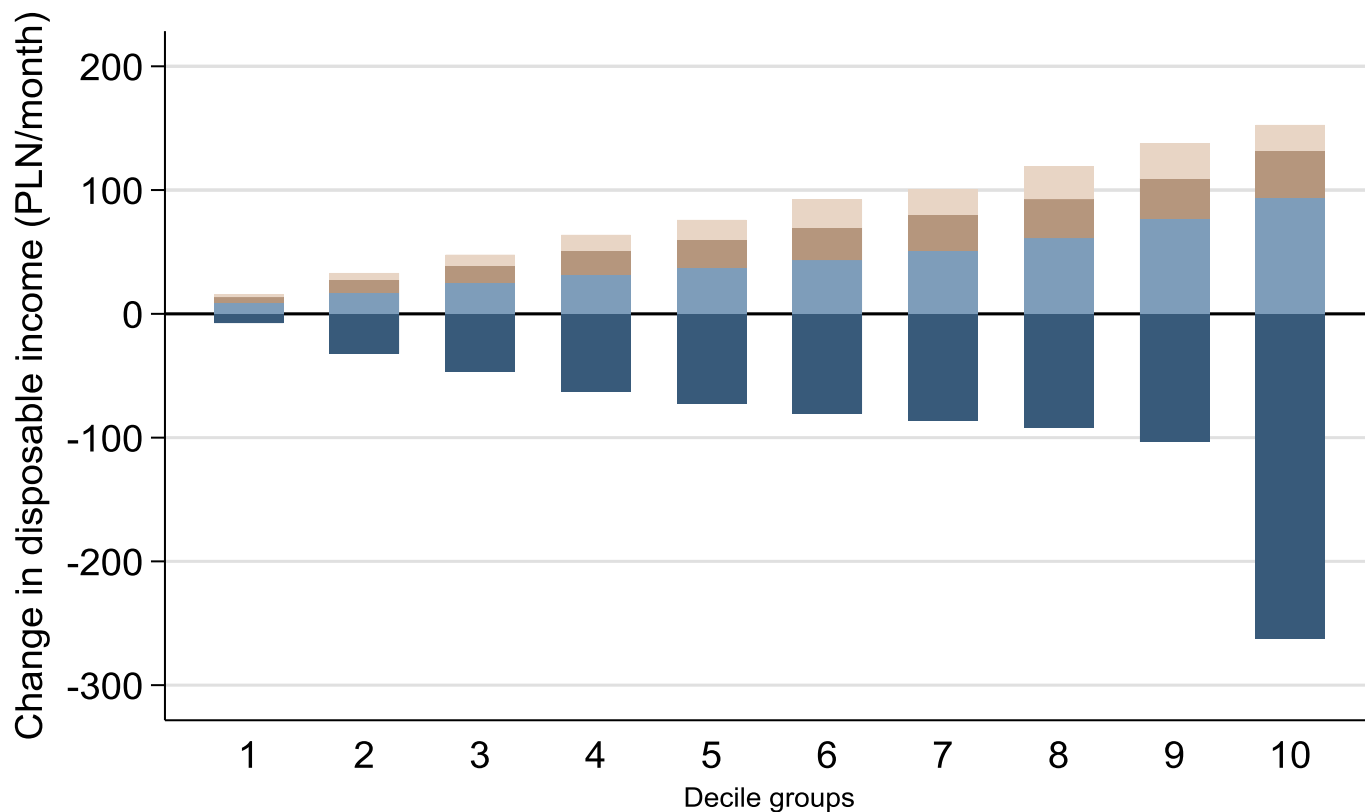
As of August of this year three significant reforms have been implemented by the government, two months in advance of the upcoming parliamentary elections:

- An increase of the tax free allowance from 1335 PLN to 3000 PLN
- A reduction of the lower income tax rate from 18% to 17%
- The elimination of the lower income tax band on employment income for anyone under the age of 26

These tax cuts are being implemented in conjunction with a drastic expansion of family benefits.

Aggregate budgetary impact on households resulting from:	
Income Tax Reforms	Fiscal Drag
12.37 bn PLN	-13.17 bn PLN
Net effect: -0.8 bn PLN	

Absolute effect of 2019 reforms and fiscal drag on household budgets

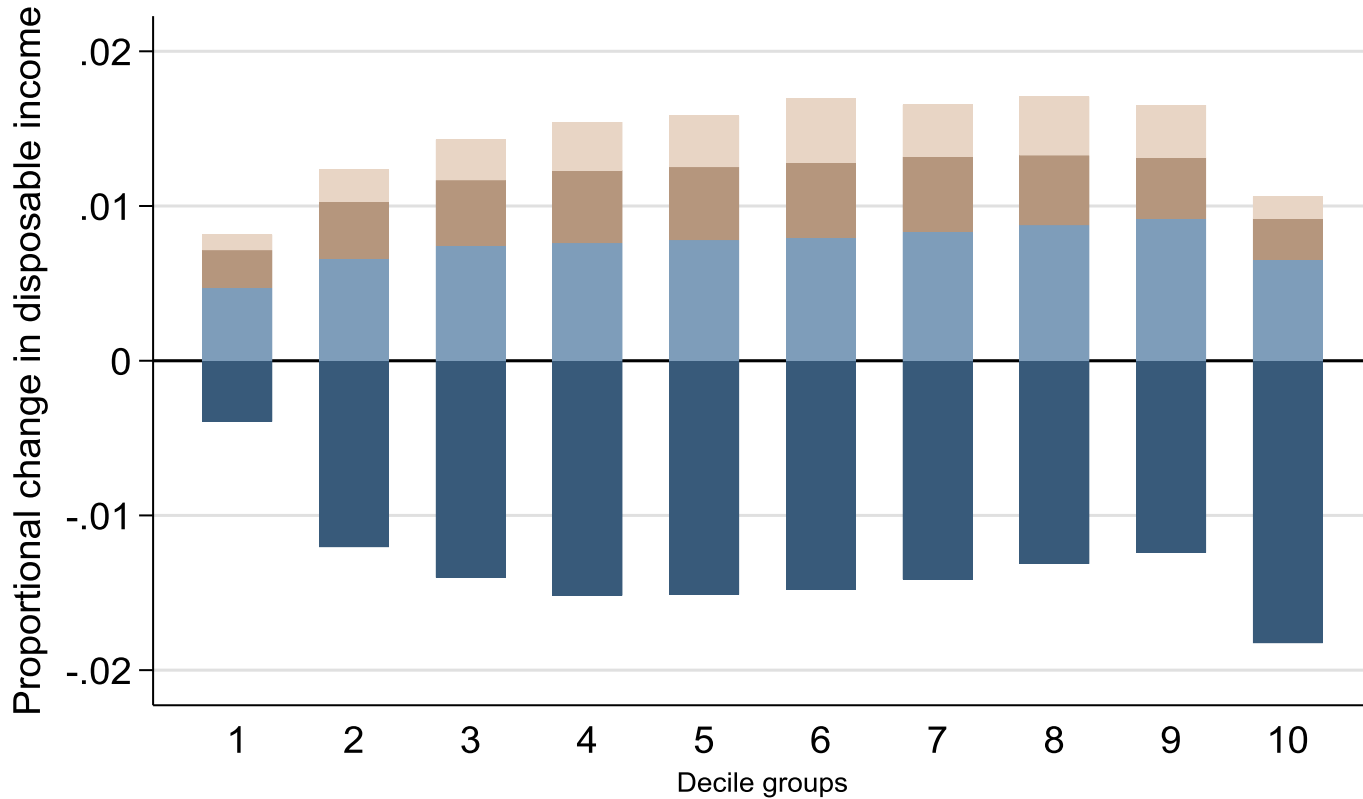


- Fiscal drag
- Lowered tax rate from 18% to 17%
- Increased tax allowance
- Waived tax for workers <26

Decile groups	1	2	3	4	5	6	7	8	9	10
Fiscal drag	-7.45	-32.13	-46.89	-62.79	-72.45	-80.49	-86.19	-91.70	-103.40	-262.47
Total reforms	15.44	33.03	47.78	63.83	75.91	92.31	100.86	119.26	137.69	152.64
Lowered tax rate from 18% to 17%	8.91	17.54	24.93	31.47	37.38	43.41	50.97	61.20	76.70	93.62
Increased tax allowance	4.62	9.83	14.10	19.45	22.61	26.22	29.36	31.46	32.61	38.37
Waived tax for workers <26	1.91	5.65	8.76	12.91	15.91	22.67	20.52	26.60	28.37	20.64

Calculations done in SIMPL on BBGD

Proportional effect of 2019 reforms and fiscal drag on household budgets

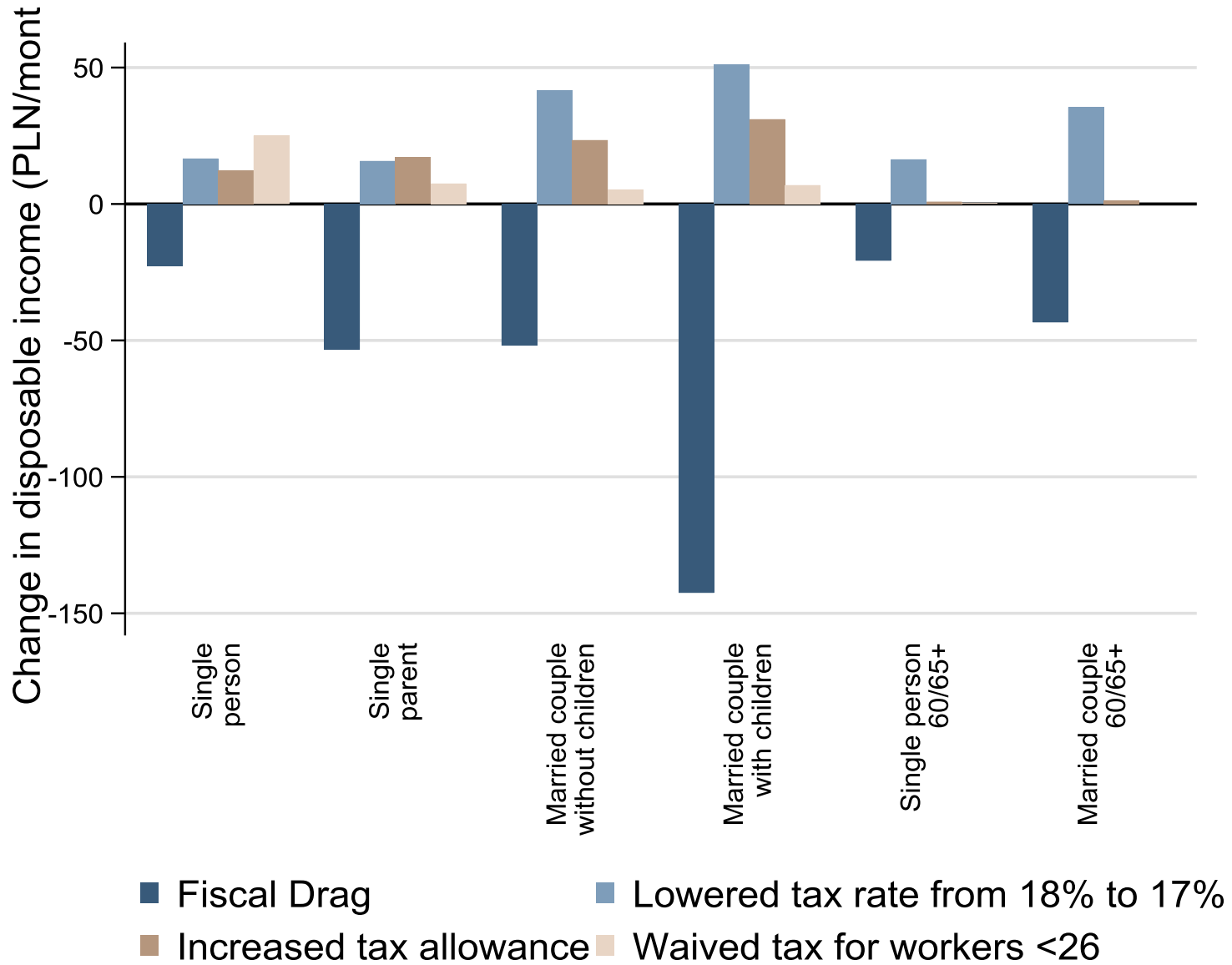


- Fiscal drag
- Lowered tax rate from 18% to 17%
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Decile groups	1	2	3	4	5	6	7	8	9	10
Fiscal drag	-0.39%	-1.21%	-1.40%	-1.52%	-1.51%	-1.48%	-1.41%	-1.31%	-1.24%	-1.83%
Total reforms	0.82%	1.24%	1.43%	1.54%	1.58%	1.69%	1.65%	1.71%	1.65%	1.06%
<i>Lowered tax rate from 18% to 17%</i>	0.47%	0.66%	0.75%	0.76%	0.78%	0.80%	0.84%	0.88%	0.92%	0.65%
<i>Increased tax allowance</i>	0.24%	0.37%	0.42%	0.47%	0.47%	0.48%	0.48%	0.45%	0.39%	0.27%
<i>Waived tax for workers <26</i>	0.10%	0.21%	0.26%	0.31%	0.33%	0.42%	0.34%	0.38%	0.34%	0.14%

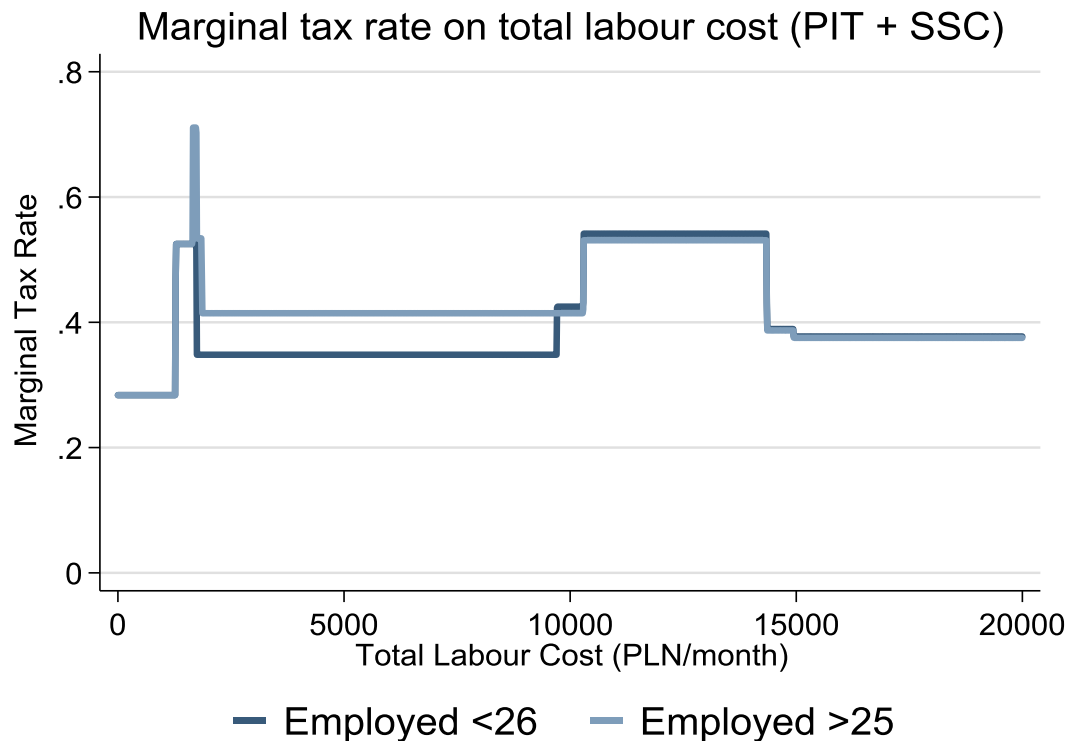
Calculations done in SIMPL on BBGD

Absolute impact by family type



Marginal tax rates for young workers

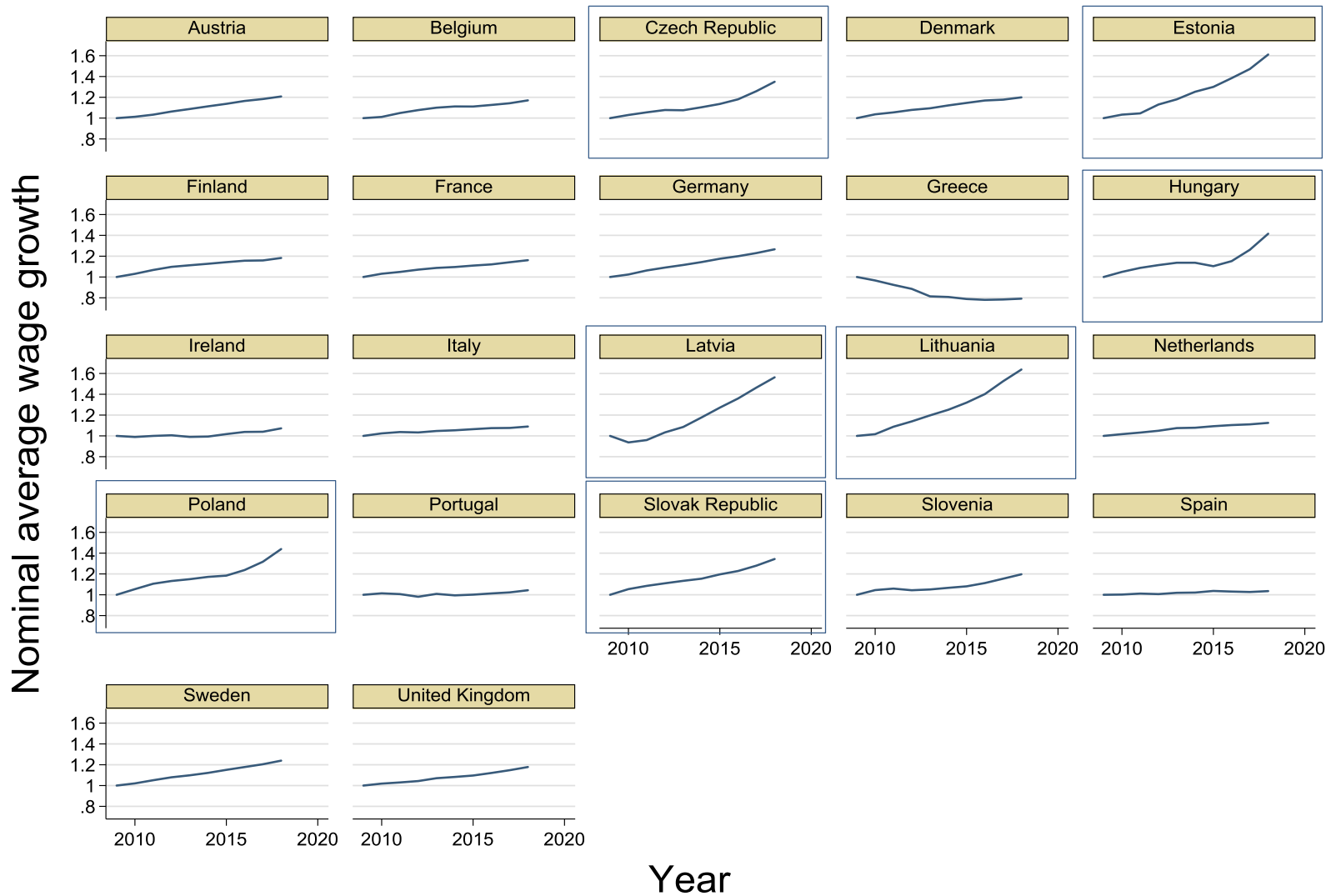
- The tax cut for young workers is an especially interesting reform for two reasons:
 - Political motivations
 - Evidence from previous experiments is mixed
- E. Saez, B. Schoefer and D. Seim (2019):
 - Tax cut from 31% to 15% for workers under 26 in Sweden found that the savings were passed over to the firms (which was distributed among all workers in firms with well established rent sharing), but has positive employment effect on young workers of 2% - 3%
- The effective tax cut in for young workers in Poland amounts to 10.25% (from 18% to 7.75%)



Calculations done in SIMPL on BBGD

Wage growth in Europe (2009 – 2018)

Figure 1: Nominal wage growth in Europe based on OECD data

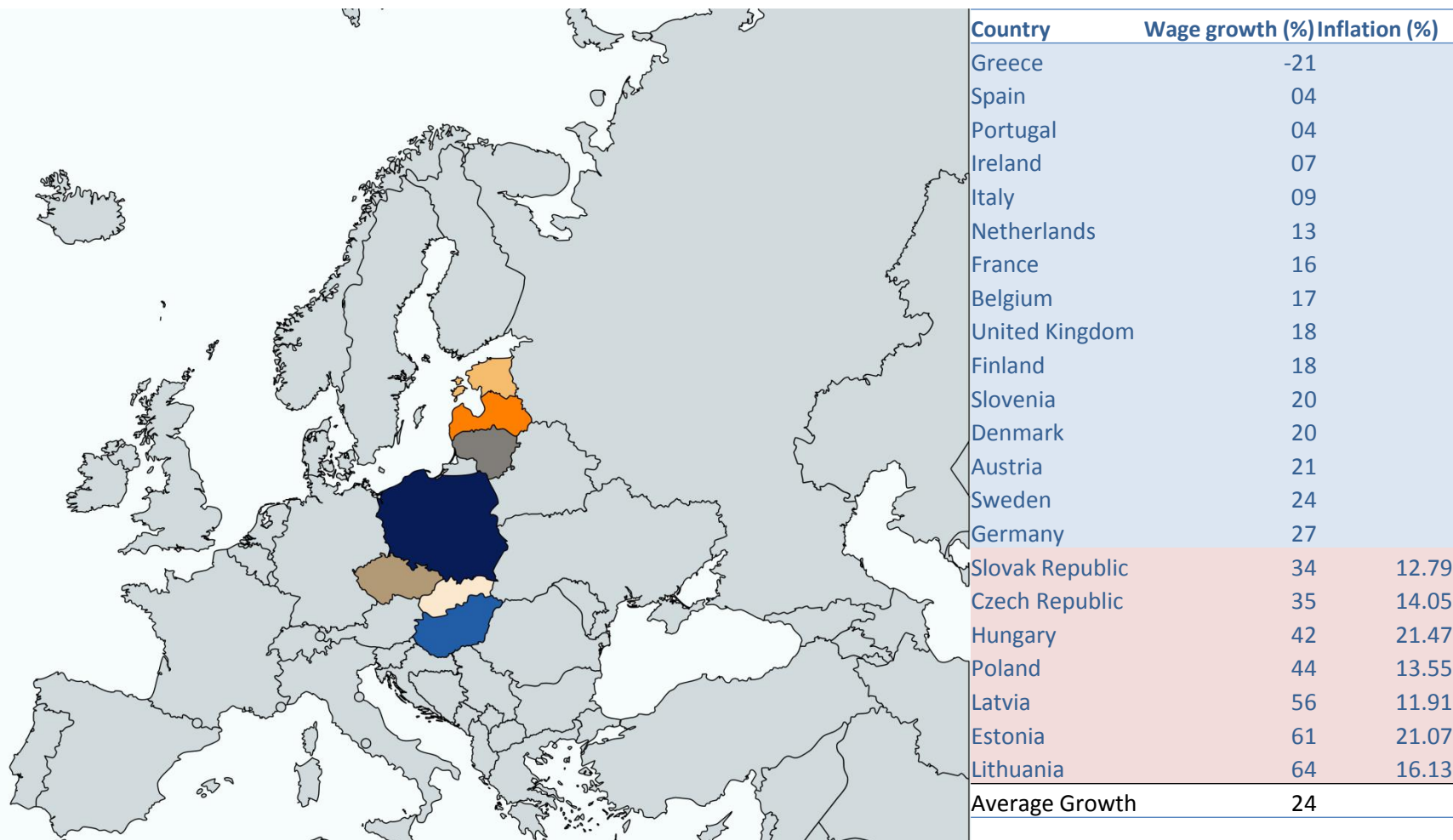


Graphs by country

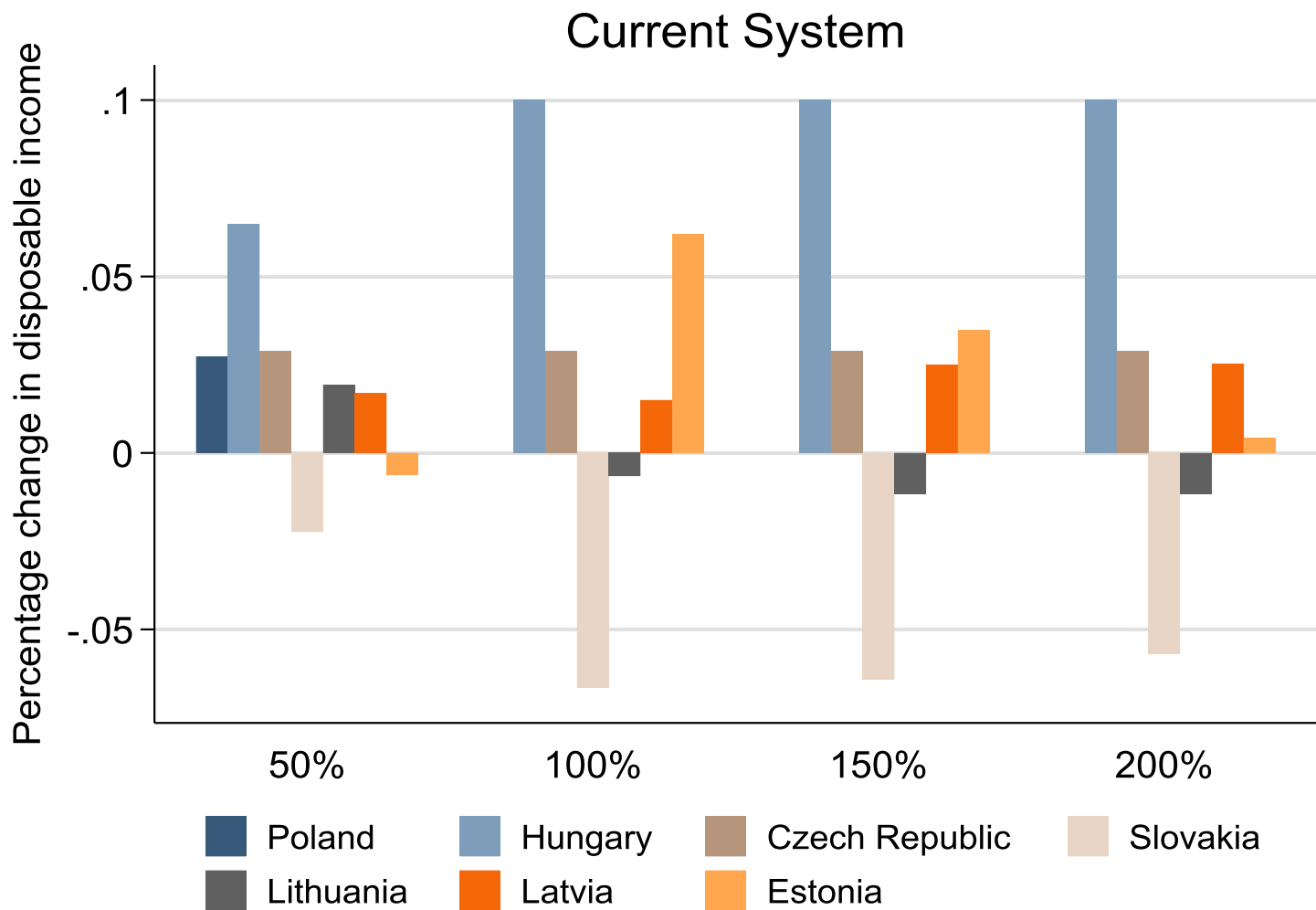
Wage Growth and Inflation in Central Europe

Rapid wage growth in the region can be attributed to a wide range of factors

- Accession to the EU in 2004
- Convergence with Western European countries and recovery from the financial crisis
- Wage growth has been stimulated by overall economic expansion

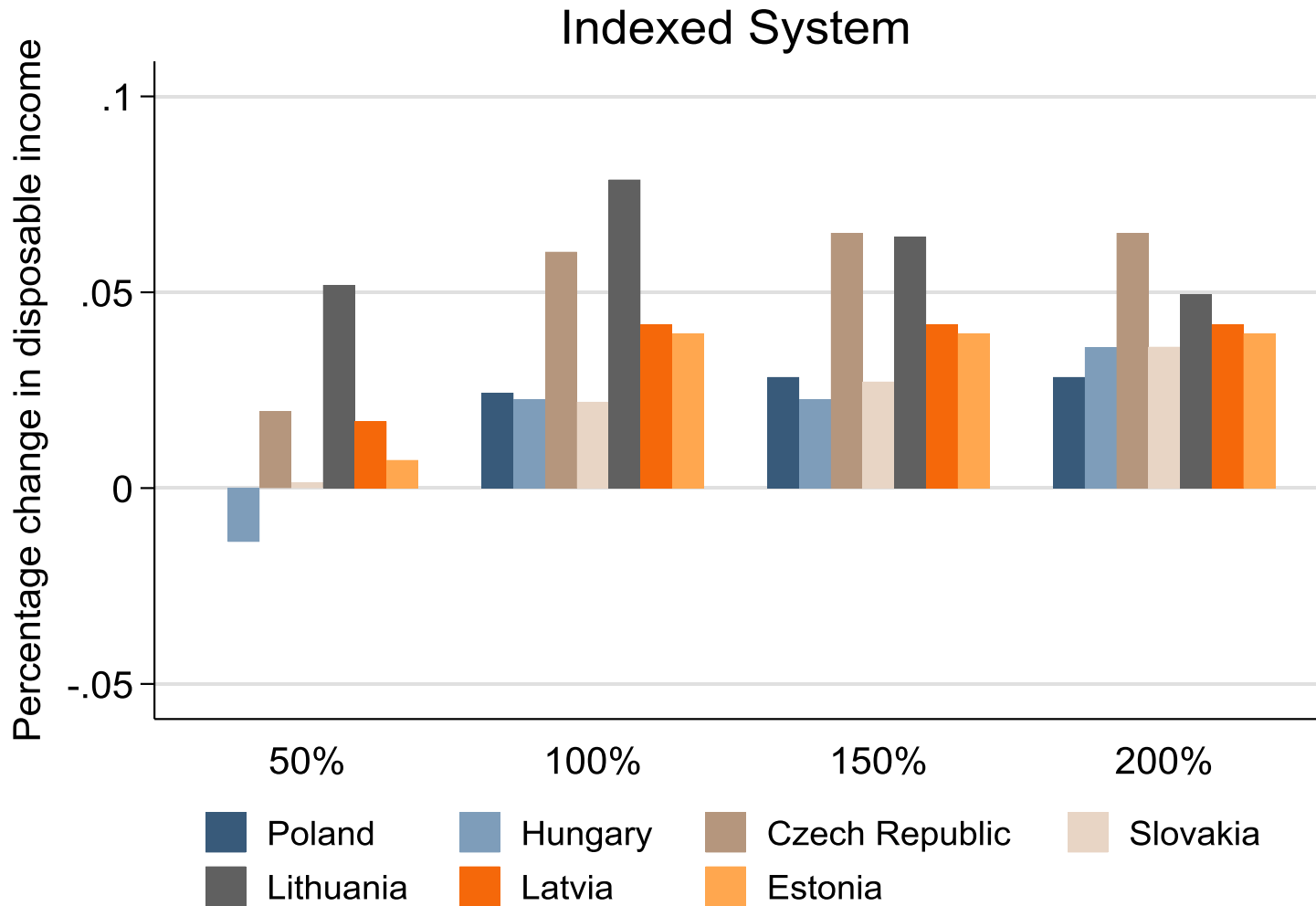


Cross country impact of tax policy reforms (2009 – 2018)



Calculations done in EUROMOD on hypothetical hh

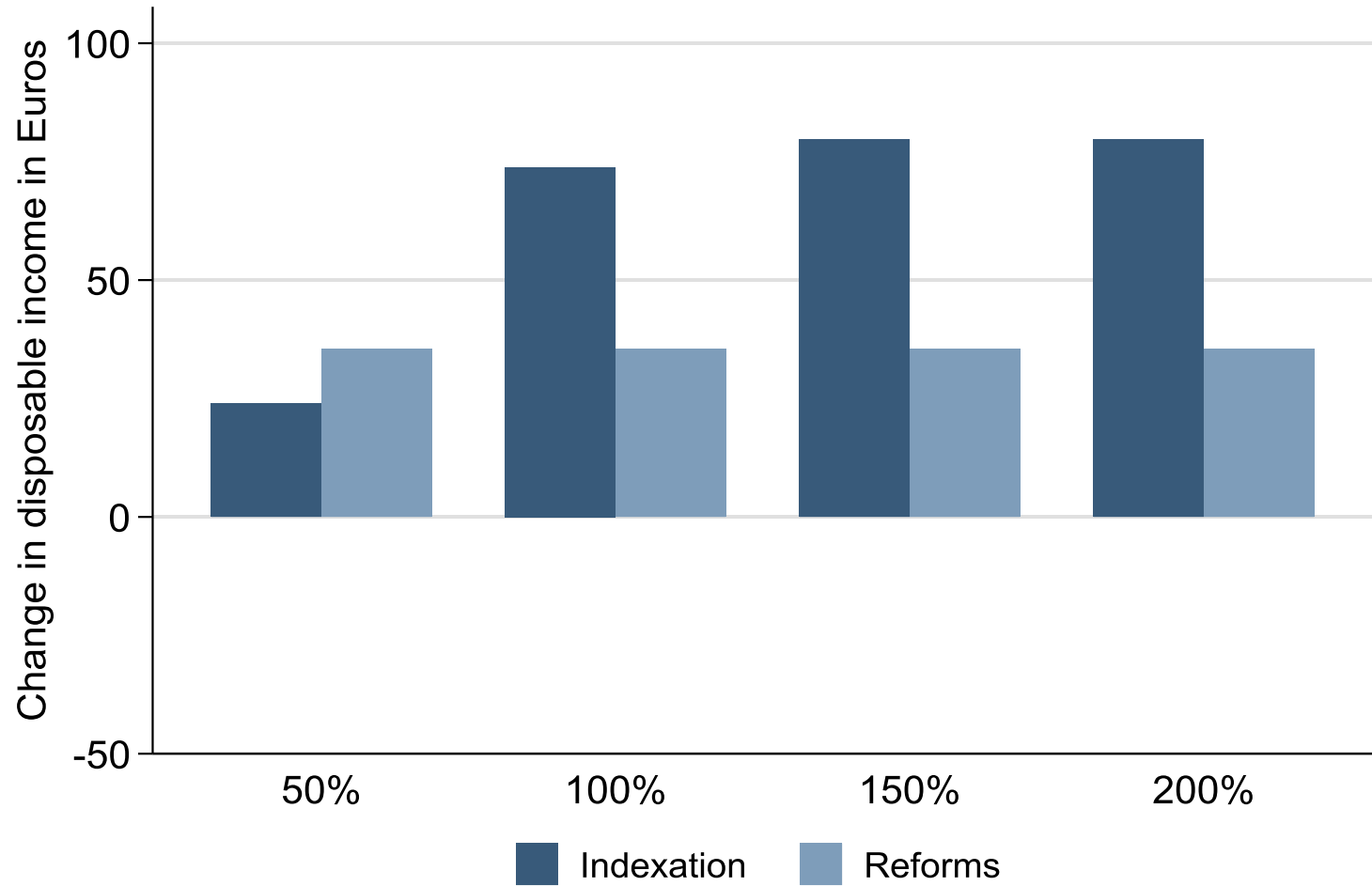
Cross country impact of fiscal drag (2009 – 2018)



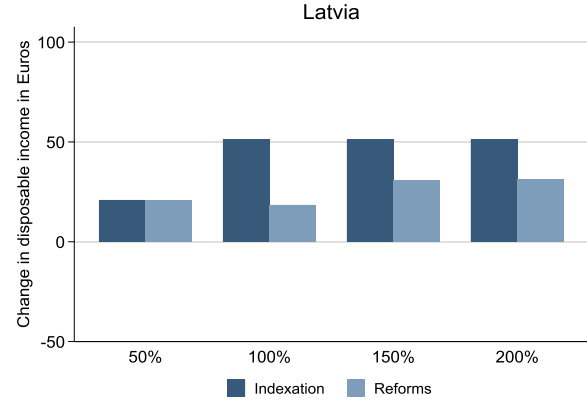
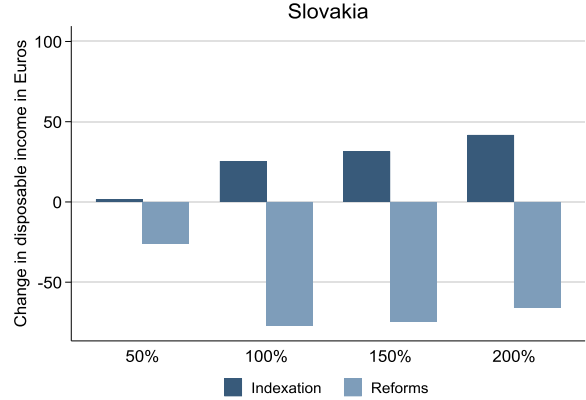
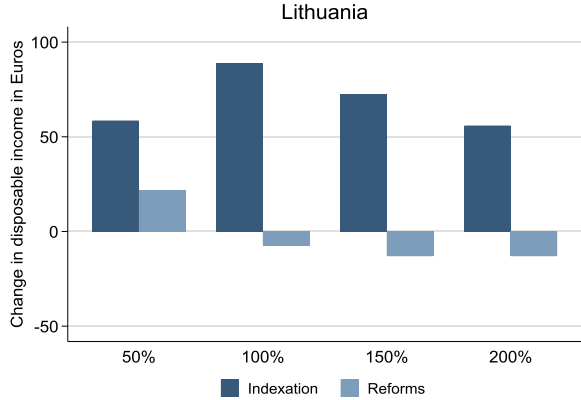
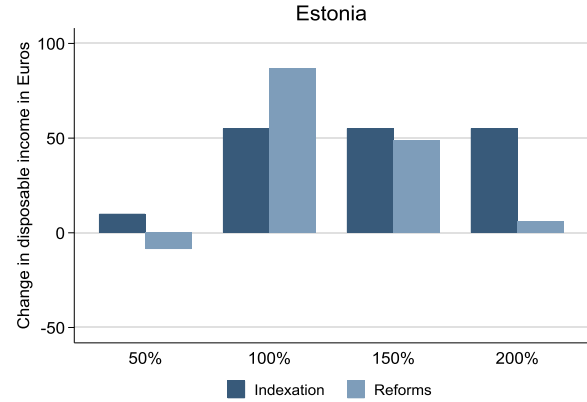
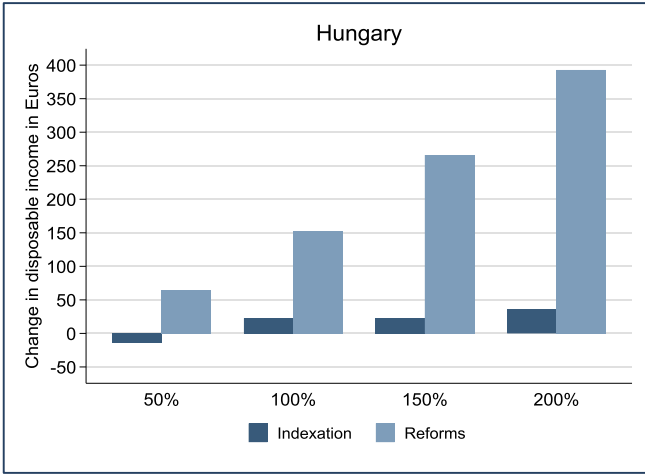
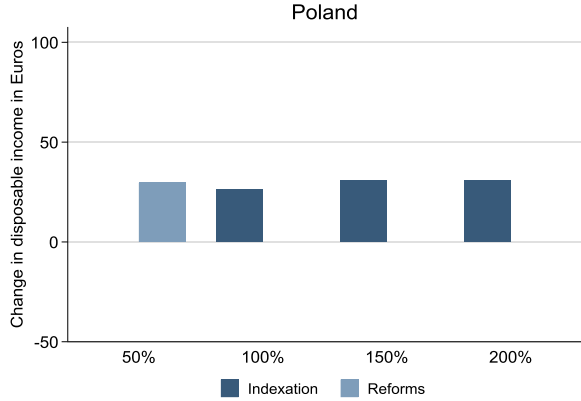
Calculations done in EUROMOD on hypothetical hh

Reforms vs Indexation

Czech Republic



System comparisons by country



Conclusions

- Poland is not unique in its approach to the income tax system – using fiscal drag to widen the budgetary margins allowing for politically louder tax cuts is common in the region
- At first glance the implemented reforms seem to play a redistributive role, more so than hypothetical indexation (apart from the case of Hungary)
- However – it is important to note that this does not take into account benefit erosion – further research is needed to understand the general impact of structural changes and tax-benefit indexation in high-growth Central European and Baltic countries

Thank you