EMERGING EUROPE ECONOMICS UPDATE

EC triggers Article 7 against Poland: what next?

- The decision by the European Commission to trigger an Article 7 procedure against Poland is unlikely to have a major impact on the economy in the short-term. Poland’s structural fund inflows can’t be removed as part of the Article 7 procedure and the most extreme sanction that could result – a removal of voting rights – is unlikely to be imposed. But Poland’s constant run-ins with the EU do risk souring the country’s image among foreign investors, which could weigh on economic growth in the medium-term.

- Article 7 is designed to ensure that member states comply with the EU’s fundamental values, including democracy and the rule of law. The Article 7 procedure has never before been invoked and so we are, to a large extent, in unchartered territory. Nonetheless, this could ultimately be the first step in the European Commission (EC) imposing sanctions on Poland. Any such measure could take several forms. On the most extreme end of the scale, Poland could be stripped of its voting rights in the EU. But importantly, Article 7 can’t lead to a reversal of EU structural fund inflows, which would have a damaging economic impact.

- The triggering of Article 7 is the result of an infringement procedure that began in July, when the ruling Law and Justice party (or PiS as it is known locally) proposed three bills to reform the judiciary. We looked at these in a Watch in August, but the short point is that the reforms may result in more political influence in the Supreme Court and the lower courts. (See “Taking stock of Poland’s controversial judicial reforms”, 3rd August.) Since then, it had been widely expected that the EC would trigger an Article 7 procedure. The decision to do so today has therefore had little impact on local markets.

- There is still a long way to go before the triggering of Article 7 leads to Poland facing sanctions. Indeed, given the strategic importance of Poland, we suspect that the various EU bodies involved will remain reluctant to impose sanctions.

- The next step is that the European Council (comprised of heads of states of member governments) will now hold a hearing with the PiS government and propose recommendations. It’s only after this point – and assuming the Polish government doesn’t heed the recommendations – that the Council (acting with an 80% majority) will be able to vote to continue the Article 7 procedure. Following that, the final stage would then be for the Council, acting by a qualified majority (16 out of 28 member states, accounting for 65% of the EU population), to vote to impose sanctions on Poland.

- In the short-run, Article 7 is likely to have little economic impact. For one thing, it’s unlikely that Poland will face the most extreme sanction which can be imposed under the Article 7 procedure – a loss of voting rights. It would require a unanimous vote among EU member states and Hungary has continuously stated that it will side with the Polish government.

- More fundamentally, the experience of Hungary itself, which has been at loggerheads with Brussels for a much longer period than Poland, suggests that recurrent run-ins with the EC do not tend to have much impact on growth in the short-run.

- However, we are concerned about the potential impact on Poland’s growth prospects over the medium-term. The judicial reforms, together with a more general erosion of institutions under PiS, have soured Poland’s image among foreign investors. The country’s investment rate is already among the lowest of any major emerging market and the economy is now at the stage of the cycle where labour market constraints are starting to build and investment is critical to sustaining growth. From the perspective of growth over a 2-5 year horizon, a protracted dispute with the EU is the last thing that Poland’s economy needs.
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