EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

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# Assessment of the 2020 Convergence Programme for

# Poland

***(Note prepared by DG ECFIN staff)***

## CONTENTS

## Executive Summary

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the Covid-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- The Convergence Programme contains only short-term economic and budgetary projections (covering 2020). The Convergence Programme projects a real GDP contraction in 2020 of 3.4% triggered by the COVID-19 pandemic. This compares to a contraction of 4.3% projected in the Commission 2020 spring forecast.
- The Convergence Programme projects the headline general government deficit to rise strongly from 0.7% of GDP in 2019 to 8.4% of GDP in 2020. To fight the pandemic and to cushion its impact on the economy Poland has implemented several policy measures. According to the Convergence Programme they have a fiscal impact of 3.2% of GDP in 2020. They include amongst others allowances for self-employed, an exemption of self-employed and small companies from social contributions and subsidies to wages for companies employing people.
- The 2020 deficit projections included in the Convergence Programme are lower than those in the Commission 2020 spring forecast (deficit of 9.5% of GDP), however the Convergence Programme does not include in the 2020 deficit a measure related to planned conversion of loans into grants having a sizeable negative budget impact in the Commission forecast.
- The macroeconomic and fiscal outlooks are affected by high uncertainty due to the outbreak of the COVID-19 pandemic.

## 1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Convergence Programme of Poland covering the period 2020-2021[1] (hereafter called the Programme), which was submitted on 30 April 2020[2]. The note also assesses Poland's compliance with the preventive arm of the Stability and Growth Pact (SGP) in 2019. The government approved the Programme on 28 April 2020.

Poland is currently subject to the preventive arm of the Stability and Growth Pact (SGP).

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

The Programme indicates that the national escape clause to suspend budgetary constraints set by the national fiscal rules is planned to be triggered, as part of the effort to accommodate the budgetary implications of the outbreak.

## 2. MACROECONOMIC DEVELOPMENTS

Economic growth exceeded 4% in 2019, due to both a robust performance of domestic demand and strong export developments. However due to the COVID-19 pandemic, under the Programme scenario, real GDP will decrease by 3.4% in 2020, reflecting the disruption in economic activity. Private consumption is projected to be hit by an increase in unemployment, a drop in nominal wage growth and a decrease in employment. Investment is also set to fall strongly in 2020, in particular private investment. Output is set to drop in the first half of the year and then to gradually recover from the third quarter onwards, however the recovery is set to be smaller than the drop recorded in the first half of the year. In 2021, in the Programme real

[1] The Programme contains only short-term budgetary projections, in line with the guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak, provided by the Commission services on 6 April 2020.

[2] The English version of the Programme has been submitted on 14 May 2020.

GDP is assumed to bounce back and be stronger than the contraction in GDP recorded in 2020. However, no quantification for the 2021 macroeconomic outlook was provided in the Programme. The projection included in the Programme takes into account several measures implemented to cushion the impact of the crisis and to facilitate recovery. More details on those measures are provided in Section 3.2.

The above scenario is broadly in line with the Commission 2020 spring forecast (Commission forecast). While the Commission forecast expects a stronger contraction in private consumption than the Programme scenario, the drop in investment is bigger in the latter than in the Commission forecast. Overall, the difference between the real GDP decrease in 2020 projected in the Commission forecast and in the Programme is 0.9 percentage points of GDP.

In Poland, the macroeconomic forecasts underpinning the Convergence Programme are produced by the government without the involvement of independent institutions. However, external assessments take place in the case of the macroeconomic forecasts underpinning annual budgets. Ex ante this is carried out by the Monetary Policy Council and ex post by the Supreme Audit Office.

**Table 1: Comparison of macroeconomic developments and forecasts**

| | 2019 | | 2020 | | 2021 | | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|
| | COM | CP | COM | CP | COM | CP | CP | CP |
| Real GDP (% change) | 4.1 | 4.1 | -4.3 | -3.4 | 4.1 | | | |
| Private consumption (% change) | 3.8 | 3.8 | -4.9 | -3.0 | 3.8 | | | |
| Gross fixed capital formation (% change) | 7.2 | 7.2 | -8.4 | -11.4 | 5.9 | | | |
| Exports of goods and services (% change) | 4.7 | 4.7 | -9.8 | -7.0 | 8.6 | | | |
| Imports of goods and services (% change) | 2.7 | 2.7 | -10.6 | -9.7 | 8.9 | n.a. | n.a. | n.a. |
| *Contributions to real GDP growth:* | | | | | | | | |
| - Final domestic demand | 4.4 | 4.4 | -3.9 | -3.3 | 3.6 | | | |
| - Change in inventories | -1.4 | -1.4 | -0.3 | -1.1 | 0.1 | | | |
| - Net exports | 1.2 | 1.2 | -0.1 | 1.1 | 0.3 | | | |
| Output gap[1] | 4.0 | 4.0 | -2.5 | -1.4 | -1.8 | n.a. | n.a. | n.a. |
| Employment (% change) | -0.2 | n.a. | -4.5 | n.a. | 2.2 | | | |
| Unemployment rate (%) | 3.3 | n.a. | 7.5 | n.a. | 5.3 | n.a. | n.a. | n.a. |
| Labour productivity (% change) | 4.4 | n.a. | 0.3 | n.a. | 1.8 | | | |
| HICP inflation (%) | 2.1 | 2.1 | 2.5 | 2.6 | 2.8 | | | |
| GDP deflator (% change) | 2.9 | 2.9 | 2.4 | 3.2 | 2.5 | n.a. | n.a. | n.a. |
| Comp. of employees (per head, % change) | 7.3 | n.a. | 3.8 | n.a. | 2.6 | | | |
| Net lending/borrowing vis-à-vis the rest of the world (% of GDP) | 1.9 | n.a. | 1.3 | n.a. | 1.7 | n.a. | n.a. | n.a. |

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

*Source :*

*Commission 2020 spring forecast (COM); Convergence Programme (CP).*

## 3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

### 3.1. DEFICIT AND DEBT DEVELOPMENTS AND MEDIUM-TERM STRATEGY AND TARGETS

In 2019, the headline general government deficit increased to 0.7% of GDP, after having reached a historical low of 0.2% of GDP in 2018. This outcome strongly diverged from the deficit of 1.7% of GDP projected in the 2019 edition of the Programme. In relation to GDP, revenue was 0.4 percentage points lower than expected a year earlier. One of the main reasons are changes in the personal income tax (PIT) decided only in 2019 that negatively impacted revenue from taxes on income and wealth. By contrast, in relation to GDP, expenditure turned out to be 1.3 percentage points lower than expected in the 2019 Programme, driven mostly by lower than expected investment and social expenditure, as well as stronger than expected nominal GDP growth.

The Programme projects the headline general government deficit to rise to 8.4% of GDP in 2020 (Table 2), driven by the pandemic impact on economic activity and the related fiscal measures aiming at cushioning its effects on households, workers and firms. The revenue is planned to be lower by 1.3 percentage points of GDP as compared to 2019, driven primarily by a drop in revenue from taxes on income and wealth. This revenue stream is hit not only by the economic slowdown and ensuing cyclical factors but also by the 2019 changes in PIT that have an incremental negative impact in 2020. The expenditure is planned to increase significantly by 6.4 percentage points of GDP as compared to 2019, reflecting GDP developments much lower than potential growth and the impact of automatic stabilisers but also discretionary measures to cushion the economic impact of the pandemic (as well as a full year impact of an increase in social transfers that started in 2019, mainly to middle- and high income households). Measures aimed at containing the impact of the pandemic included in the Programme lift the 2020 expenditure by 3.2% of GDP (for details see section 3.2). The main difference in deficit developments between the Programme and the Commission forecast result from the planned conversion of loans into grants explained in section 3.2 (having an impact of around 2¾ percentage points of GDP in the Commission forecast), while the Commission forecast is more optimistic about revenue developments. According to the Programme, the debt-to-GDP ratio will increase substantially, reflecting the deficit and nominal GDP developments. However, it is projected in the Programme as well as in the Commission forecast to remain below 60%.

As the Programme was submitted in a streamlined form, it does not contain any projections of fiscal developments beyond 2020. Yet, it mentions that the ratio of tax revenue to GDP is expected to be higher in 2021 than a year earlier, driven by economic growth and the pro-cyclicality of tax revenue, as well as partially specified measures to increase tax compliance.[3]

[3] In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

## Table 2: General government budgetary position

| (% of GDP) | 2019 | 2020 | | 2021 | | 2022 | 2023 | Change: 2019-2023 |
|---|---|---|---|---|---|---|---|---|
| | COM | COM | CP | COM | CP | CP | CP | CP |
| **Revenue** | **41.3** | **40.8** | **40.0** | **40.3** | n.a. | n.a. | n.a. | n.a. |
| *of which:* | | | | | | | | |
| - Taxes on production and imports | 13.9 | 13.8 | 13.4 | 13.6 | | | | |
| - Current taxes on income, wealth, etc. | 8.0 | 7.3 | 7.4 | 7.5 | | | | |
| - Social contributions | 14.3 | 14.2 | 14.4 | 14.1 | | | | |
| - Other (residual) | 5.1 | 5.4 | 4.8 | 5.0 | | | | |
| **Expenditure** | **42.0** | **50.3** | **48.4** | **44.1** | n.a. | n.a. | n.a. | n.a. |
| *of which:* | | | | | | | | |
| - Primary expenditure | 40.6 | 48.9 | 47.1 | 42.8 | | | | |
| *of which:* | | | | | | | | |
| Compensation of employees+Intermediate consumption | 15.8 | 17.1 | 16.6 | | | | | |
| Compensation of employees | 10.2 | 11.1 | 10.9 | 10.8 | | | | |
| Intermediate consumption | 5.6 | 6.0 | 5.7 | 5.7 | | | | |
| Social payments | 17.5 | 19.0 | 19.4 | 18.3 | | | | |
| Subsidies | 0.5 | 2.0 | 2.0 | 0.6 | | | | |
| Gross fixed capital formation | 4.3 | 4.3 | 4.3 | 4.2 | | | | |
| Other (residual) | 2.6 | 6.4 | 4.8 | 3.1 | | | | |
| - Interest expenditure | 1.4 | 1.4 | 1.3 | 1.4 | | | | |
| **General government balance (GGB)** | **-0.7** | **-9.5** | **-8.4** | **-3.8** | n.a. | n.a. | n.a. | n.a. |
| **Primary balance** | **0.6** | **-8.1** | **-7.0** | **-2.4** | | | | |
| One-off and other temporary measures | 0.0 | 0.3 | 0.2 | 0.2 | n.a. | n.a. | n.a. | n.a. |
| **GGB excl. one-offs** | **-0.7** | **-9.8** | **-8.6** | **-4.0** | | | | |
| Output gap[1] | 4.0 | -2.5 | -1.4 | -1.8 | n.a. | n.a. | n.a. | n.a. |
| Cyclically-adjusted balance[1] | -2.7 | -8.3 | -7.7 | -2.9 | | | | |
| **Structural balance[2]** | **-2.7** | **-8.5** | **-7.9** | **-3.1** | n.a. | n.a. | n.a. | n.a. |
| Structural primary balance[2] | -1.4 | -7.1 | -6.6 | -1.7 | | | | |
| **Gross debt ratio** | **46.0** | **58.5** | **55.2** | **58.3** | n.a. | n.a. | n.a. | n.a. |

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

*Source* :

*Convergence Programme (CP); Commission 2020 spring forecasts (COM); Commission calculations.*

## 3.2. MEASURES UNDERPINNING THE PROGRAMME

The Programme lists several measures to contain the pandemic and cushion its economic impact. They are listed in the tables 3 and 4 below. While the additional 2020 healthcare expenditure (both current expenditure and investment) is estimated at around 0.3% of GDP, the measures to support the economy have the highest budgetary impact, estimated at around 2.9% of GDP in 2020. On top, the authorities estimate the currently decided and quantified liquidity measures at close to 6% of GDP. The Programme focuses on measures (to be) implemented in 2020, without providing information on possible measures in 2021. Overall, the measures taken by Poland are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak[4]. Overall, the measures appear timely, temporary and targeted at cushioning the shock induced by COVID-19. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term. The measures set out in the Programme were available in time and were sufficiently detailed to be included in the Commission forecast.

Allowances for self-employed and those working on non-standard labour contracts who recorded a decrease in revenue, as well as an exemption of self-employed and small companies from (a part of) social contributions for 3 months are the biggest measures in terms of their fiscal impact (1.4% of GDP in total in 2020). Subsidies to wages for companies employing people and subsidies for self-employed with no employees are another key measures, having a cost exceeding 0.5% of GDP in 2020.

Liquidity measures listed in the Programme are close to 6% of GDP. However, the list provided in the Programme includes state guarantees for bonds issued by the Polish Development Fund of PLN 115 billion. In fact, a significant part of these bonds is linked to a scheme of loans provided to companies by the Polish Development Fund (worth some PLN 100 billion). The authorities announced that it is expected that around 60% of them will be disbursed in the form of grants. Consequently, the expected grant part is included in the Commission forecast as an expenditure item having a negative impact of some 2¾% of GDP on the 2020 deficit. The Programme considers the whole envelope of PLN 100 billion as a liquidity measure with no direct impact on the deficit in 2020.

### Table 3: Discretionary measures adopted/announced in response to COVID-19 outbreak

| List of measures | Description | ESA Code (Expenditure / Revenue component) | Adoption Status | Budgetary impact (% of GDP - change from previous year) | |
|---|---|---|---|---|---|
| | | | | 2020 | 2021 |
| 1 | Allowance for self-employed and those working on non-standard labour contracts | D.39 | Adopted | 0.71 | n.a. |

[4] https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf

| | | | | | | |
|---|---|---|---|---|---|---|
| **2** | Exemption of self-employed and companies employing up to 49 people from (a part of) social contributions for 3 months | D.75/D.39 | Adopted | | 0.65 | n.a. |
| **3** | Subsidies to wages and subsidies for self-employed with no employees | D.39 | Adopted | | 0.56 | n.a. |
| **4** | Loans for micro-companies | D.75 | Adopted | | 0.38 | n.a. |
| **5** | Healthcare expenditure | D.63/P.51/D.1 | Adopted | | 0.31 | n.a. |
| **6** | Capital injection to the Polish Development Fund | D.9 | Adopted | | 0.22 | n.a. |
| **7** | Allowance for careers of young children and for farmers | D.62 | Adopted | | 0.19 | n.a. |
| **8** | Programme to support the accounts receivable insurance market | D.99 | Announced | | 0.10 | n.a. |
| **9** | Re-guarantees of lease contracts | D.9 | Adopted | | 0.08 | Expected impact lower than in 2020 |
| | | | | **Total** | **3.20** | **-** |

Source: Convergence Programme

### Table 4: Guarantees adopted/announced in response to COVID-19 outbreak

| **List of measures** | **Description** | **Adoption Status** | **Maximum amount of contingent liability*** **(% of GDP)** | |
|---|---|---|---|---|
| **1** | State guarantees resulting from bonds issued by the Polish Development Fund | Adopted | | **5.1** |
| **2** | State guarantees resulting from bonds issued by the development bank in relation to a new anti-COVID fund | Adopted | | Data unavailable |
| **3** | State guarantees resulting from bonds issued by the development bank in relation to the guarantee fund | Adopted | | n.a. |
| **4** | State guarantees resulting from bonds issued by the development bank in relation to a new liquidity fund | Adopted | | 0.7 |
| | | | **Total** | **5.8** |

***** Any possible budgetary impact related to the call of those guarantees should be provided in Table 1

Source: Convergence Programme

### 3.3. Risk assessment

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact. An additional risk stems from the considerable size of public guarantees issued in response to the crisis.

## 4. Compliance with the provisions of the Stability and Growth Pact

### 4.1. Compliance with the deficit criterion

According to the Programme, Poland's general government deficit is expected to reach 8.4% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. This provides *prima facie* evidence of the existence of an excessive deficit in Poland for the purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU, which analyses Poland's compliance with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

### 4.2. Compliance with the required adjustment path towards the MTO

Poland is subject to the preventive arm of the Pact.

Poland was recommended to ensure that the nominal growth rate of nominal primary government expenditure, net of discretionary revenue measures and one-offs, does not exceed 4.2% in 2019, corresponding to a structural adjustment of 0.6% of GDP. The growth of primary government expenditure, net of discretionary revenue measures and one-offs, exceeded that benchmark. This led to a deviation of 2.0% of GDP in the underlying fiscal position, thus pointing to significant deviation from the recommended adjustment path towards the MTO in 2019. The conclusion is also confirmed for 2018-2019 taken together. In turn, the structural balance worsened by 0.8 percentage points of potential GDP in 2019, also pointing to significant deviation by 1.4% of GDP from the recommended structural adjustment of 0.6% of GDP towards the MTO in 2019. This is also confirmed for 2018-2019 taken together. The overall assessment points to a significant deviation from the recommended adjustment path towards the MTO in 2019 and over 2018-2019 taken together.[5]

[5] The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

## Table 5: Compliance with the requirements under the preventive arm

| | (% of GDP) | 2019 | 2020 | | 2021 | |
|---|---|---|---|---|---|---|
| | **Background budgetary indicators**[1] | | | | | |
| (1) | Medium-term objective (MTO) | -1.0 | -1.0 | | -1.0 | |
| (2) | Structural balance[2] (COM) | -2.7 | -8.5 | | -3.1 | |
| | ***Setting the required adjustment to the MTO*** | | | | | |
| (3) | Structural balance based on freezing (COM) | -2.2 | | | | |
| (4) = (1) - (3) | Position vis-a -vis the MTO[3] | Not at MTO | | | | |
| (5) | Required adjustment[4] | 0.6 | | | | |
| (6) | Required adjustment corrected[5] | 0.6 | | | | |
| (8) | Corresponding expenditure benchmark[6] | 4.2 | | | | |
| | ***Compliance with the required adjustment to the MTO*** | | | | | |
| | | **COM** | **COM** | **CP** | **COM** | **CP** |
| | *Structural balance pillar* | | | | | |
| (8) = Δ (2) | Change in structural balance[7] | -0.8 | | | | |
| (9) = (8) - (6) | *One-year deviation from the required adjustment*[8] | -1.4 | | | | |
| | *Two-year average deviation from the required adjustment*[8] | -0.7 | | | | |
| | *Expenditure benchmark pillar* | | | | | |
| (10) | Net public expenditure annual growth corrected for one-offs[9] | 9.8 | | | | - |
| (11) = (10) - (8) | One-year deviation adjusted for one-offs[10] | -2.0 | | | | - |
| | Two-year deviation adjusted for one-offs[10] | -1.0 | | | | |
| | ***Finding of the overall assessment*** | **Significant deviation** | | | | |

***Legend***

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

***Notes***

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 2019) is carried out on the basis of Commission 2020 spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

*Source*:

*Convergence Programme (CP); Commission 2020 spring forecast (COM); Commission calculations.*