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Assessment of the 2019 Convergence Programme for

Poland

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

Poland is subject to the preventive arm of the SGP. With a gross public debt of 48.9% of GDP, Poland is compliant with the debt criterion of the Pact (debt lower than 60% of GDP).

Strong domestic demand drove real GDP growth to 5.1% in 2018, the fastest pace in more than a decade. Growth was mainly driven by private consumption supported by favourable labour market developments and strong consumer confidence. Simultaneously, an increase in investment was observed, particularly public investment. Following the Commission 2019 spring forecast, GDP growth is expected to remain solid in 2019, at 4.2%, and to then to moderate to 3.6% in 2020.

In 2018, the headline general government deficit decreased to 0.4% of GDP, driven primarily by a strong rise in revenue from taxes on income and wealth and from social contributions, reflecting a favourable macroeconomic environment and a buoyant labour market. The Convergence Programme projects the headline general government deficit to rise significantly in 2019, mainly due to an increase in social transfers, following an extension of the child benefit to all children and an extraordinary payment of a lump sum pension benefit in 2019. In 2020, a surplus in the general government balance is expected under the Convergence Programme scenario thanks to a number of new measures to increase revenue. Many of these measures have not yet been legislated or worked out in detail. These measures were therefore not included in the Commission forecast, leading to some differences between the fiscal adjustment for 2020 in the Commission forecast and in the Convergence Programme.

Poland achieved the required adjustment towards the MTO in 2018. For 2017 and 2018 taken together, there was some deviation from the required adjustment towards the MTO. Based on the Commission 2019 spring forecast, Poland is at risk of a significant deviation from the adjustment path towards the MTO, both in 2019 and in 2020, mostly driven by the expansionary measures mentioned above.

1. INTRODUCTION

On 29 April 2019, Poland submitted its 2019 Convergence Programme (hereafter called Convergence Programme), covering the period 2019-2022. The government approved the Convergence Programme on 24 April 2019.

Poland is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its medium-term budgetary objective (MTO).

This document complements the Country Report published on 27 February 2019 and updates it with the information included in the Convergence Programme.

Section 2 presents the macroeconomic outlook underlying the Convergence Programme and provides an assessment based on the Commission 2019 spring forecast (hereafter called Commission forecast). The subsequent section presents the recent and planned budgetary developments, according to the Convergence Programme. It includes, in particular, an overview on the medium-term budgetary plans, an assessment of the measures underpinning the Convergence Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary of the assessment.

2. MACROECONOMIC DEVELOPMENTS

Real GDP increased by 5.1% in 2018, the fastest pace in more than a decade. Growth was mainly driven by private consumption, supported by favourable labour market developments and strong consumer confidence. In addition, an increase in investment was observed, particularly in public investment. Under the scenario presented in the Convergence Programme, GDP growth is set to gradually moderate to 4.0% in 2019, to 3.7% in 2020 and further to 3.3% in 2022 (Table 1). Private consumption and, in particular public, investment are expected to be the main driving factor. Private consumption growth is set to be supported by a strong labour market, rising household real income and a further fall in the unemployment rate, all leading to historically high consumer confidence levels. The unemployment rate is expected to fall from 3.9% in 2018 to 2.3% at the end of the Convergence Programme horizon. Investment growth is projected to slow down from 8.7% recorded in 2018 to 5.7% in 2019 and further to 5.4% in 2022. Export growth is expected to slow to 5.3% in 2019 from 6.3% in 2018 and remain constant at 4.8% thereafter. At the same time, import growth is set to reach 6% in 2019 and moderate to 5% in 2022. Consequently, under the scenario presented in the Convergence Programme, net exports are expected to have a slightly negative contribution to GDP growth (-0.1 percentage point) and remain neutral until the end of the Convergence Programme horizon.

For 2019, the macroeconomic scenario underpinning the Convergence Programme is more optimistic than the one presented in the 2018 edition of the Convergence Programme. It is broadly similar for 2020 and slightly more pessimistic for 2021. Under the Convergence Programme, GDP growth in 2019 is set to be stronger by 0.2 percentage points than in the last years' edition. Internal demand is expected to remain the primary driving growth factor, with a contribution higher by 0.3 percentage points than assumed in the last year's edition. For 2020, the expected stronger private consumption growth, as compared to the 2018 edition of the Programme, is expected to be compensated by slower growth in investment. For 2021, the expected slower GDP growth, as compared to the 2018 edition of the Programme, results from slower dynamics of all its major components.

According to the Commission forecast, GDP growth is expected to remain solid in 2019, at 4.2% to then slow to 3.6% in 2020. Private consumption growth will remain strong on the

back of strongly increasing wages and income boost from a new fiscal package. Real GDP growth in 2019 projected in the Convergence Programme is slightly more pessimistic than assumed in the Commission forecast, while real GDP growth in 2020 presented in the Convergence Programme is broadly in line with that in the Commission forecast. In both years, the Commission forecast assumes faster private consumption growth, while at the same time projecting slower investment growth than in the Convergence Programme. Under the Convergence Programme, the change in inventories will have a negative contribution to GDP growth in 2019, while this is assumed to be neutral in the Commission forecast.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	5.1	5.1	4.2	4.0	3.6	3.7	3.4	3.3
Private consumption (% change)	4.4	4.4	4.5	4.0	4.2	3.8	3.4	3.2
Gross fixed capital formation (% change)	8.7	8.7	4.9	5.7	4.1	5.6	5.5	5.4
Exports of goods and services (% change)	6.3	6.3	5.2	5.3	4.7	4.8	4.8	4.8
Imports of goods and services (% change)	7.1	7.1	5.7	6.0	5.3	5.1	5.1	5.0
Contributions to real GDP growth:								
- Final domestic demand	4.9	4.9	4.3	4.3	3.8	3.6	3.4	3.3
- Change in inventories	0.4	0.4	0.0	-0.2	0.0	0.0	0.0	0.0
- Net exports	-0.2	-0.2	-0.1	-0.1	-0.1	0.0	0.0	0.0
Output gap[1]	2.1	2.2	2.3	2.2	2.0	1.8	1.3	0.8
Employment (% change)	0.3	0.4	0.2	0.2	0.1	0.0	0.0	0.0
Unemployment rate (%)	3.9	3.9	3.8	3.6	3.5	3.3	2.8	2.3
Labour productivity (% change)	4.8	4.5	3.9	3.8	3.6	3.7	3.4	3.3
HICP inflation (%)	1.2	1.2	1.8	1.8	2.5	2.5	2.5	2.5
GDP deflator (% change)	1.1	1.7	1.8	1.7	2.4	2.4	2.5	2.5
Comp. of employees (per head, % change)	7.5	5.7	8.0	6.9	7.9	6.0	5.8	5.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.5	1.3	0.2	0.6	-0.1	0.6	0.5	0.1

Note:

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

[2]Figures may not add up due to rounding.

Source:

Commission 2019 spring forecast (COM); Convergence Programme (CP).

The output gap, as recalculated by the Commission based on the information in the Convergence Programme following the commonly agreed methodology (hereafter called recalculated output gap), amounted to 2.2% of potential GDP in 2018. The recalculated output gap remains stable in 2019 and then gradually decreases to 0.8% of potential GDP in 2022. It is higher by 0.2 – 0.6 percentage points of potential GDP than the output gap provided in the Convergence Programme, without recalculation.

Overall, the macroeconomic scenario underlying the Convergence Progamme is plausible.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2018 AND 2019

In 2018, the headline general government deficit decreased to a historically low level of 0.4% of GDP, strongly diverging from the deficit of 2.1% of GDP projected in the 2018 edition of the Convergence Programme. In relation to GDP, revenue was 1 percentage point higher than expected a year earlier. This was primarily driven by revenue from taxes on income and wealth and from social contributions, reflecting a strong macroeconomic environment and a buoyant labour market. In relation to GDP, expenditure turned out to be lower by 0.8 percentage points than expected in the 2018 Convergence Programme. This difference is explained mostly by social expenditure, subsidies and other expenditure items. In 2018, Poland did not implement any significant temporary or one-off measures to meet the fiscal targets.

The Convergence Programme projects the headline general government deficit to rise to 1.7% of GDP in 2019 (Table 2). This is close to the projected deficit of 1.5% of GDP assumed in the 2018 Convergence Programme. As a share of GDP, both 2019 revenue and expenditure are set to be higher than projected in the 2018 Convergence Programme, with the increase in expenditure (1.5 percentage points) projected to be stronger than the increase in revenue (1.4 percentage points)[1]. On the revenue side, current taxes on income and wealth as well as social contributions are now expected to be higher than in the 2018 Convergence Programme, driven by a better labour market outlook. Concurrently, the increase in expenditure is set to be driven to a major extent by an increase in social transfers, following an extension of the child benefit to all children and an extraordinary payment of a lump sum pension benefit in 2019, both of which were decided only in 2019. Simultaneously, compensation of employees is set to be higher than expected in the 2018 Convergence Programme, while other expenditure items remain, as a share of GDP, at broadly unchanged levels as compared to 2018 Convergence Programme. The Convergence Programme does not include any significant temporary or one-off measures that would help meeting the fiscal targets in 2019.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

As in previous years, the main objective stated in the Convergence Programme is to 'support inclusive growth'. In practical terms, several social policies will be maintained or extended. At the same time, the Convergence Programme commits to ensure relevant fiscal space that will help stabilise growth at a safe level, while ensuring long-term sustainability of public finances.

Poland has chosen a structural deficit of 1% of potential GDP as its MTO. This MTO is more stringent than required by the Pact. The structural balance reached 1.4% of potential GDP in 2018. According to the authorities, the scenario presented in the Convergence Programme would bring the structural balance to the MTO by 2021.

The structural balance cited in the Convergence Programme is expected to reach -2.5% of potential GDP in 2019 and then gradually improve to -1% of potential GDP in 2021. At the same time, the general government structural balance recalculated by the Commission on the

[1] Figues may not add up due to rounding.

basis of the information in the Convergence Programme according to the commonly agreed methodology (hereafter called recalculated structural balance) is set to reach -2.8% of potential GDP in 2019 and gradually improve to -1.1 % of GDP in 2021.

Concurently, the nominal headline balance is expected to deteriorate strongly to -1.7% of GDP in 2019, then record a small surplus in 2020, and reach -0.6% of GDP in 2022 (Table 2). This is a different path than the one assumed in the 2018 Convergence Programme which assumed a gradual improvement of the nominal headline balance to -0.7% of GDP in 2021. This is mainly driven by the fact that the Convergence Programme scenario includes an implementation of new tax and social policies that in turn are to be counterbalanced by a number of revenue increasing actions. Therefore, the budgetary targets in the Convergence Programme would require an implementation of several measures (Section 3.3). The measures are described in the Convergence Programme; however, many of them have not not yet been legislated.

The Convergence Programme assumes that revenue, as a share of GDP, will grow in 2019, reach a peak in 2020 and then decrease gradually to a level below the one recorded in 2018. The 2020 peak results from a number of measures planned to increase revenue from taxes and social contributions as well as from a recording of a one-off revenue from conversion fee following the planned transfer of assets of the current second pension pillar to the third pension pillar.

Expenditure, as a share of GDP, after its strong increase in 2019, is expected to gradually decrease towards the end of the Convergence Programme horizon, to below the level recorded in 2018. This will be driven primarily by the exptected fall, as a share of GDP, in social payments and compensation of employees.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**41.2**	**41.0**	**41.7**	**41.2**	**43.0**	**41.8**	**40.7**	**-0.5**
of which:								
- Taxes on production and imports	14.1	14.0	14.2	14.3	14.5	14.6	13.8	-0.3
- Current taxes on income, wealth, etc.	7.8	7.9	8.3	7.6	8.0	8.1	8.2	0.4
- Social contributions	14.1	14.3	14.5	14.3	15.0	15.1	15.0	0.9
- Other (residual)	5.2	4.8	4.7	5.0	5.5	4.0	3.7	-1.5
Expenditure	**41.5**	**42.6**	**43.3**	**42.6**	**42.8**	**42.1**	**41.3**	**-0.2**
of which:								
- Primary expenditure	40.1	41.3	41.9	41.3	41.4	40.8	40.1	0.0
of which:								
Compensation of employees	10.1	10.3	10.2	10.3	10.0	9.8	9.6	-0.5
Intermediate consumption	5.6	5.6	5.6	5.6	5.6	5.6	5.5	-0.1
Social payments	16.8	17.7	17.7	17.8	17.4	17.2	17.0	0.2
Subsidies	0.4	0.5	0.6	0.4	0.4	0.5	0.4	0.0
Gross fixed capital formation	4.7	4.7	4.7	4.6	4.8	4.4	4.3	-0.4
Other (residual)	2.5	2.5	3.0	2.5	3.1	3.3	3.1	0.6
- Interest expenditure	1.4	1.4	1.4	1.3	1.4	1.3	1.2	-0.2
General government balance (GGB)	**-0.4**	**-1.6**	**-1.7**	**-1.4**	**0.2**	**-0.3**	**-0.6**	**-0.2**
Primary balance	**1.1**	**-0.3**	**-0.3**	**-0.1**	**1.6**	**1.0**	**0.6**	**-0.5**
One-off and other temporary	0.0	0.0	0.0	0.6	1.1	0.2	0.1	0.1
GGB excl. one-offs	**-0.4**	**-1.6**	**-1.7**	**-2.0**	**-0.9**	**-0.5**	**-0.7**	**-0.3**
Output gap[1]	2.1	2.3	2.2	2.0	1.8	1.3	0.8	-1.4
Cyclically-adjusted balance[1]	-1.4	-2.8	-2.8	-2.4	-0.7	-0.9	-1.0	0.5
Structural balance[2]	**-1.4**	**-2.8**	**-2.8**	**-3.0**	**-1.8**	**-1.1**	**-1.1**	**0.4**
Structural primary balance[2]	0.0	-1.4	-1.4	-1.7	-0.4	0.2	0.1	0.1

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.

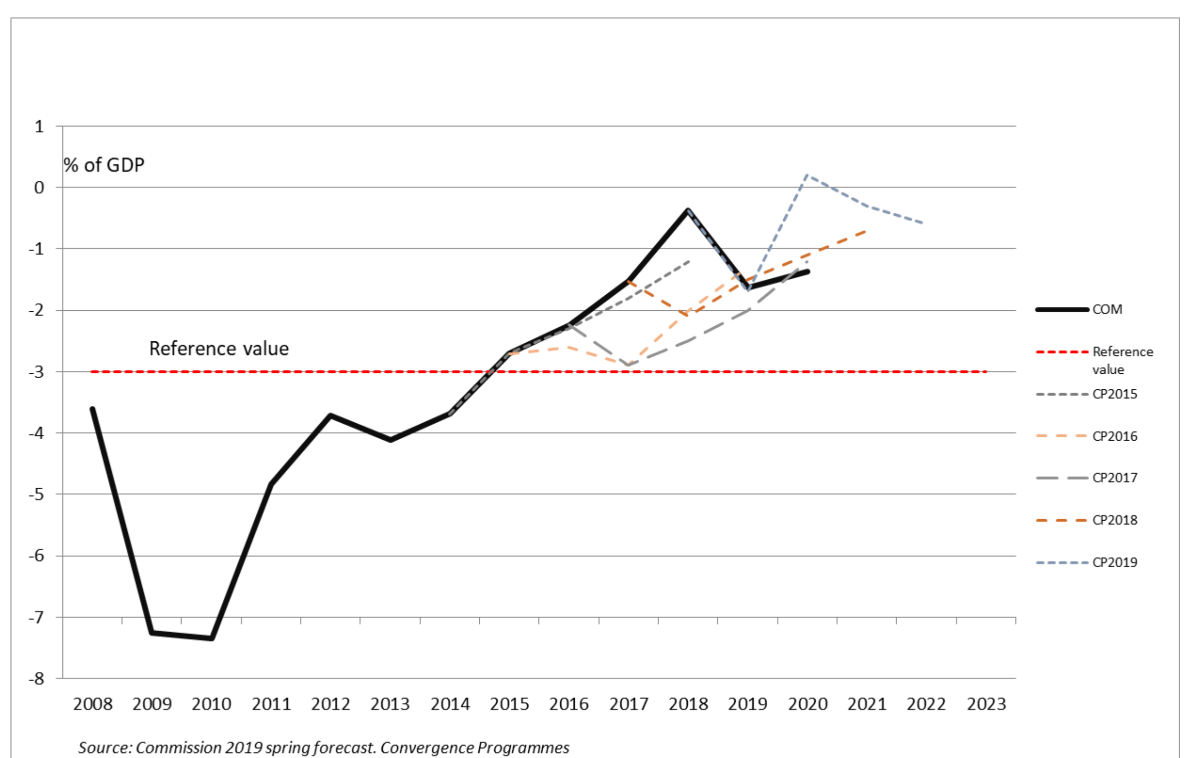
[3]Figures may not add up due to rounding.

Source:

Convergence Programme (CP); Commission 2019 spring forecasts (COM); Commission calculations.

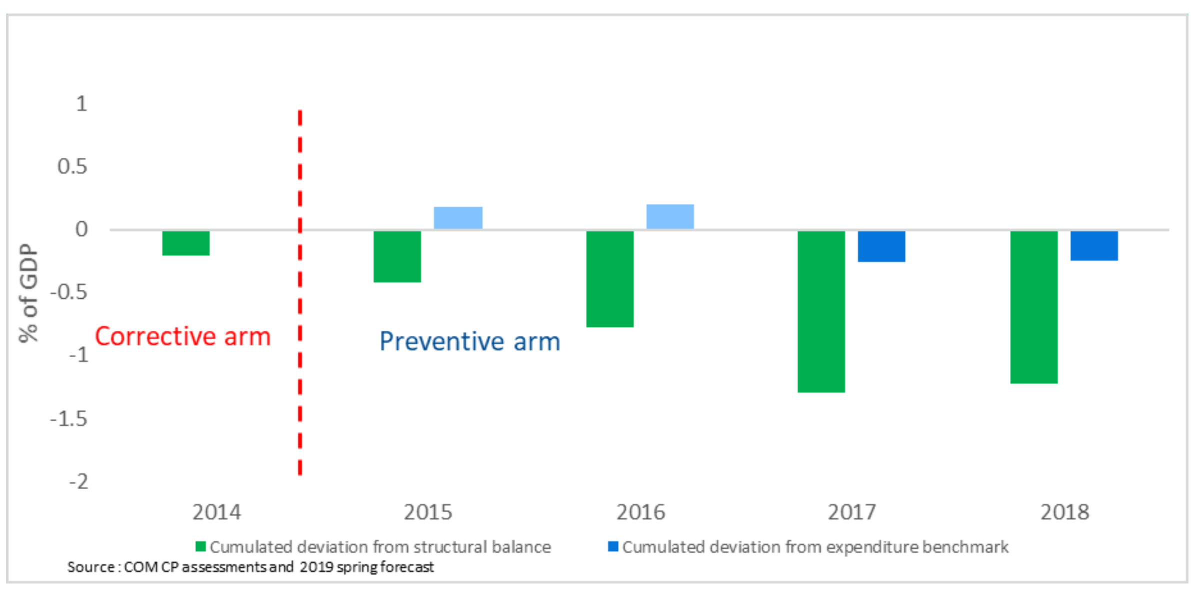
In the past, the fiscal adjustment path assumed by the Convergence Programme has been slower than the actual outcome (Figure 1). This has applied in particular to a horizon longer than a year. The Convergence Programme scenarios assume a full execution of expenditure allowed by the stabilising expenditure rule in Poland. Usually, there is a tendency not to spend the full limits set by the rule and allowed by the passed budget laws what could contribute to explaining this pattern.

Figure 1: Government balance projections in successive programmes (% of GDP)



Poland's structural adjustment fell short of the required adjustment towards the MTO until 2017 (0.5% of potential GDP per year). In 2018, an improvement in the structural balance higher than the required adjustment towards the MTO allowed Poland to reduce slightly the cumulative deviation generated between 2014 and 2017. At the same time, in 2015 and 2016 the expenditure benchmark pointed to an overachievement of the recommended effort by 0.2% of GDP in total. The difference between the signals sent by both indicators resulted from a number factors, including different deflators applied to both pillars, the impact of a sharp investment decline in 2016 and different estimates of potential growth used for both pillars. In 2017 and 2018, the evolution of both indicators was similar and their reading led to the same conclusions. The 2018 improvement was not, however, sufficient to attain the MTO.

Figure 2: Cumulative deviations of the preceding five years from the upper limit for net growth of government expenditure and from structural effort requirements (in % of GDP)



3.3. MEASURES UNDERPINNING THE PROGRAMME

As in previous years, the main objective stated in the Convergence Programme is to 'support inclusive growth'. In practical terms, several social policies will be maintained or extended. At the same time, the Convergence Programme reads that 'it is key to ensure a relevant fiscal space that will help stabilise growth at a safe level, while ensuring long-term sustainability of public finances.' To that end, the authorities plan to implement a number of revenue measures and to respect the national stabilising expenditure rule. The measures are enumerated in detail in the Convergence Programme (a summary of measures with the highest impact is provided in the table below). Overall, according to the Convergence Programme, the new discretionary measures would have a negative impact on the headline balance close to 1% of GDP in 2019 and a positive impact on the headline balance exceeding 1% of GDP in 2020.

On the revenue side, as in previous years, the Convergence Programme puts forward plans to further increase tax revenue and compliance. Indirect as well as direct taxes and social contributions are targeted, with the main focus – as compared to previous editions – shifting to the latter category. Also, a high one-off revenue from pension assets conversion fee is planned for 2020 (see below). In practical terms, in the case of VAT, the Convergence Programme projects new revenue mainly from the application or extension of already implemented measures – split payment and analysis of bank data to prevent fraud (0.3% of GDP in 2020). At the same time, the Convergence Programme lists new tools that are expected to generate additional revenue, though of a much smaller magnitude (in total less than 0.1% of GDP in 2020). Under the Convergence Programme, in 2022 the temporarily increased VAT rates may be lowered back to 22% and 7% which would correspondingly lower VAT revenue by some 0.4% of GDP as from 2022. In the area of direct taxes, the Convergence Programme assumes an additional revenue of below 0.2% of GDP, resulting from the application of a number of new measures, of which the highest impact is expected from a limitation of the use of a preferential tax regime for the self-employed and an introduction of a digital tax (cumulative impact of less than 0.1% of GDP). However, the

Convergence Programme does not provide any specific details of these measures. This would add to the impact of measures that are already in place, for instance the tax for high income earners, implemented in 2019.

Significant additional revenue is expected from social security contributions. The abolishing of the yearly cap of 30 average salaries that would make high-income earners pay their contributions on the totality of their revenue, and closing loopholes in the social contribution system, including by combating the use of non-standard labour contracts in cases where standard labour contract should be concluded, are expected to yield some 0.4% of GDP per year as from 2020. High one-off revenue is expected from a transfer of assets from the current second pension pillar to the third pension pillar in 2020. The authorities plan to change the pension saving in Poland by transferring the second pension pillar assets to the first pillar or to the current third pillar. Those who decide to have their assets moved to the third pension pillar will pay a conversion fee of 15% on the value of transferred assets. The government assumed that this would apply to four fifths of all insured and therefore the ensuing conversion fee would amount to 0.8% of GDP in 2020. In addition, this measure is expected to result in a permanent increase of revenue from social security contributions, since those currently paid to the second pension pillar will be shifted to the general system.

On the expenditure side, the Convergence Programme focuses on an important increase in social transfers. One main element is the extension, as from mid-2019, of the child benefit programme to all children, independently of households' income level. Currently, the allowance is paid as from the second child in a family (and for all children in low-income households). This extension of the programme is expected to cost some 0.4% of GDP in 2019 and have a full-year impact of some 0.8% of GDP as from 2020. In addition, a special payment of extraordinary lump sum pension benefits in the first half of 2019 will increase social expenditure by additional 0.5% of GDP. The Convergence Programme implies that this measure is not expected to be implemented from 2020 onwards.

A new tax expenditure in personal income tax is planned as from 2020. It is set to amount to 0.4% of GDP per year and results from an introduction of an additional lower tax threshold, an increase in tax free allowance and an exemption, up to a certain threshold, of young taxpayers from personal income tax.

The Convergence Progamme assumes that the currently binding stabilising expenditure rule will remain in force and will be respected. According to the Convergence Programme, the expenditure reaches the maximum expenditure level allowed by the rule.

The Commission forecast was prepared under the no-policy-change assumption. As a result, it does not include the expected effects of any non-legislated fiscal measures which have not yet been specified in sufficient detail at the forecast cut-off date. More concretely, the Commission forecast for 2019 includes the additional pension benefit paid in 2019 and the extension of the child benefit scheme as of mid-2019. For 2020, it includes announced changes to the personal income tax, and revenue from conversion of the second pension pillar assets, under a technical assumption that 50% of these assets would be transferred to the general pension system. It does not include other new revenue measures described above as they were not legislated or sufficiently detailed at the forecast cut-off date. This is the main reason for a significant difference between the general government balance path assumed in the Commission forecast and the one assumed in the Convergence Programme.

Main budgetary measures included in the Programme

Revenue	Expenditure
2019	
• Measures to increase VAT revenue and compliance, including split payment and analysis of bank data to prevent tax fraud (0.2% of GDP) • Measures to increase direct taxes revenue and compliance, including a modification of the general tax anti-avoidance rule, implementation of mandatory disclosure rules or changes in the witholding tax (0.1% of GDP)	• Extension of the child benefit scheme to all children (0.4% of GDP) • Extraordinary pension benefit (0.5% of GDP)
2020	
• Second pension pillar assets' transfer: conversion fee (0.8% of GDP) – one-off • Tax expenditure in personal income tax: new threshold, increased tax free allowance, exemption for young taxpayers (-0.4% of GDP) • Increase in revenue from social contributions: abolishing of the yearly cap of 30 average salaries, closing loopholes in the social contribution system (0.4% of GDP) • Measures to increase VAT revenue and compliance, including continued impact of split payment and analysis of bank data to prevent tax fraud and a number of new changes (0.3% of GDP) • Measures to increase direct taxes revenue and compliance, including a limitation of use of a preferential self-employed tax regime, an introduction of a digital tax and changes in monitoring of goods' transport (0.1% of GDP) • Second pension pillar assets' transfer: increase in revenue from social contributions (0.1% of GDP)	• Full-year impact of an extension of the universal child benefit scheme (0.4% of GDP)
2022	
• End to an application of increased VAT	

rates (-0.4% of GDP)	
Note: The table refers to the main measures included in the 2019 Convergence Programme that have an incremental budgetary impact over the programme period. The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.	

3.4. DEBT DEVELOPMENTS

In 2018, the general government debt fell below 50% of GDP and reached 48.9% of GDP. Under the scenario presented in the Convergence Programme, it is set to further steadily decline to 40.6% of GDP in 2022 (Table 3). This is expected to be driven by relatively low nominal general government deficits (and a surplus in 2020) and strong nominal GDP growth.

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**52.4**	**48.9**	**48.2**	**47.9**	**47.4**	**46.0**	**42.9**	**40.6**
Change in the ratio	-0.6	-1.7	-0.7	-1.0	-0.8	-1.9	-3.1	-2.3
Contributions[2] *:*								
1. Primary balance	**1.0**	**-1.1**	**0.3**	**0.3**	**0.1**	**-1.6**	**-1.0**	**-0.6**
2. "Snow-ball" effect	**-0.2**	**-1.6**	**-1.4**	**-1.2**	**-1.4**	**-1.3**	**-1.3**	**-1.2**
Of which:								
Interest expenditure	1.9	1.4	1.4	1.4	1.3	1.4	1.3	1.2
Growth effect	-1.7	-2.4	-1.9	-1.9	-1.7	-1.7	-1.5	-1.3
Inflation effect	-0.4	-0.5	-0.8	-0.8	-1.1	-1.0	-1.1	-1.0
3. Stock-flow adjustment	**-1.4**	**1.0**	**0.5**	**-0.1**	**0.6**	**1.1**	**-0.8**	**-0.5**
Of which:								
Cash/accruals diff.				0.2		1.2	0.5	0.6
Acc. financial assets				-0.2		-0.3	-1.3	-1.0
Privatisation				-2.6		-2.8	-2.6	-2.4
Val. effect & residual				0.0		0.0	0.0	0.0

Notes:

[1] End of period.

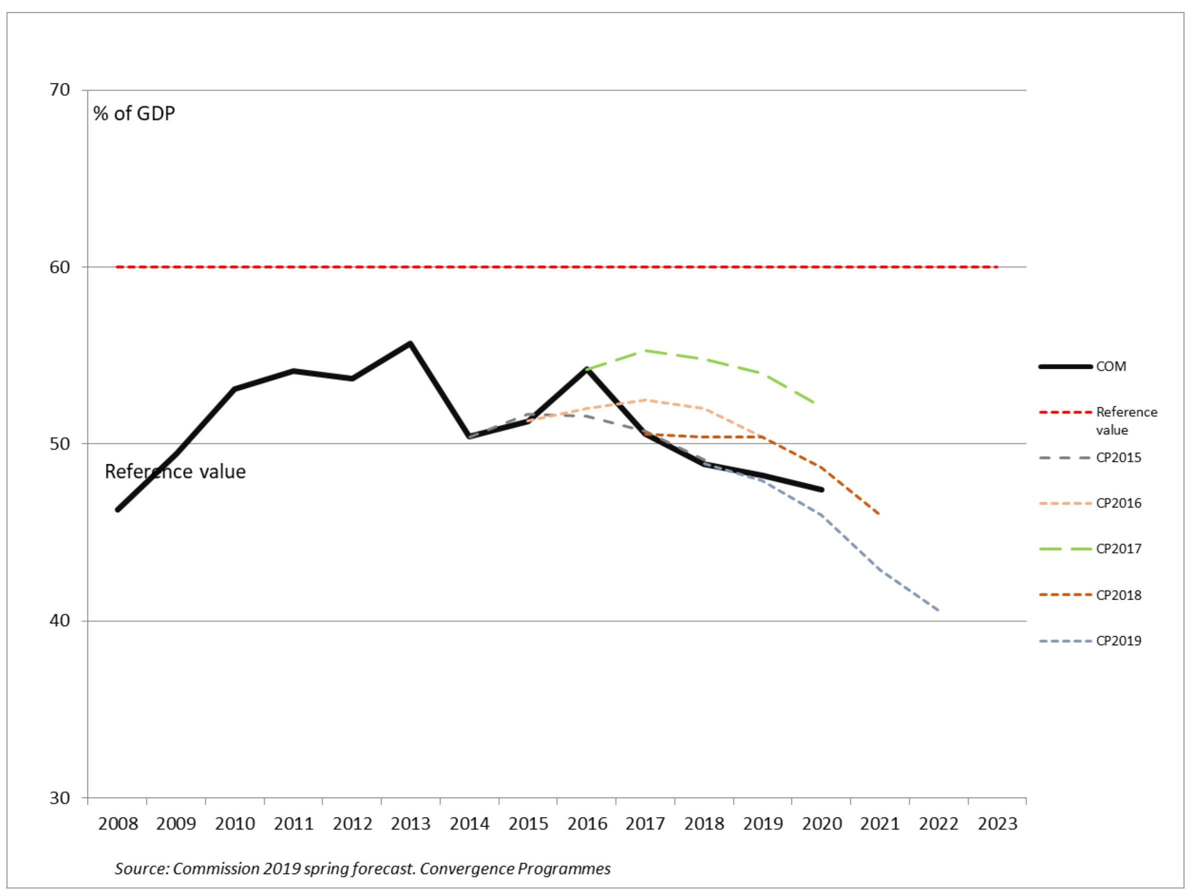
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2019 spring forecast (COM); Convergence Programme (CP), Commission calculations.

Previous editions of the Convergence Programme have had a tendency to be more conservative in terms of general government debt developments, in particular in timeframes longer than one year (Figure 3). Around one third of the Polish sovereign debt is denominated in foreign currencies. As a consequence, the long-term forecasts of the debt level are subject to related uncertainty.

Figure 3: Government debt projections in successive programmes (% of GDP)



3.5. RISK ASSESSMENT

For 2019 and 2020, the Convergence Programme assumes a plausible macroeconomic scenario.

For 2019, the macroeconomic and fiscal scenarios presented in the Convergence Programme are broadly in line with the Commission forecast. Potentially lower than assumed tax revenue growth constitutes a risk to the nominal general government balance targets.

For 2020, a key downside risk for the the general government balance path projected in the Convergence Programme comes from the fact that it assumes new revenue generated by a number of already implemented or newly planned revenue measures. Many of these measures have not yet been decided in detail or legislated. The assumed impact on general government revenue depends on whether they are actually legislated and on their actual effectiveness. Finally, the forecast of revenue from the conversion fee is based on an assumption of the number of insured whose assets will be transferred to the third pension pillar, which remains uncertain. On the expenditure side, the Convergence Programme assumes a full execution of

the central government expenditure allowed under the stabilising expenditure rule. In the past, there was a tendency not to spend the full limits set by the rule and allowed by the passed budget laws. This constitutes an upside risk for the Convergence Programme general government balance path.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council Recommendations addressed to Poland

On 13 July 2018, the Council addressed recommendations to Poland in the context of the European Semester. In particular, in the area of public finances the Council recommended to Poland to 'ensure that the nominal growth rate of net primary government expenditure does not exceed 4,2 % in 2019, corresponding to an annual structural adjustment of 0,6 % of GDP.'

Poland is subject to the preventive arm of the Pact.

For 2018, Poland was recommended to achieve an annual fiscal adjustment towards the MTO. It translated into a requirement of a nominal growth rate of net primary government expenditure[2] that does not exceed 3.7%[3]. This corresponds to a structural adjustment of 0.5% of GDP. In 2018, based on outturn data, the nominal growth rate of net primary government expenditure was marginally lower than the expenditure benchmark. This pointed to compliance with the requirement. At the same time, the structural balance improved by more than 0.5% of potential GDP compared to 2017. Therefore, the reading of the structural balance also points to compliance with the recommended adjustment path towards the MTO. In the 2019 Convergence Programme, the Polish authorities highlight significant exceptional expenditure in 2018 related to a period of drought and provided evidence of the scope and nature of these additional budgetary costs. Based on outturn data, the 2019 Convergence Programme confirms that the expenditure incurred in 2018 amounted to 0.07% of GDP and the Commission assessed that Poland can benefit from an overall temporary deviation of the same magnitude. When taking this into account, Poland overachieved the required adjustment to the MTO by nearly 0.1% of GDP. Overall, there is no material difference in the reading between both indicators. Over 2017 and 2018 taken together, considering the above temporary expenditure of 0.07% of GDP, there is some deviation from the required adjustment towards the MTO based on both the expenditure benchmark and structural balance pillars driven by the 2017 outcome. Thus, based on the outturn data and the Commission forecast, the ex-post assessment suggests that there was some deviation from the adjustment path towards the MTO in 2018.

For 2019, Poland was recommended to achieve an annual fiscal adjustment of 0.6% of GDP towards the MTO, corresponding to a nominal growth rate of net primary government expenditure that does not exceed 4.2%. Based on the information provided in the Convergence Programme,

[2] Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

[3] As part of the agreement on the EFC Opinion on "*Improving the predictability and transparency the SGP: a stronger focus on the expenditure benchmark in the preventive arm*", which was adopted by the Economic and Financial Committee on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

the nominal growth rate of net primary government expenditure is expected to exceed in 2019 the applicable expenditure benchmark, leading to a negative impact of 2.2% of GDP on the underlying fiscal position. In addition, according to the Convergence Programme, the recalculated structural balance is set to worsen by 1.3% of GDP. This would lead to a deviation of 1.9% of GDP from the required adjustment path. Simultaneously, based on the Commission forecast, the nominal growth rate of net primary government expenditure is set to exceed the expenditure benchmark, leading to a deviation of 1.7% of GDP from the recommended adjustment path, pointing to a risk of significant deviation. The structural balance also points to a risk of a significant deviation (2.0% of GDP). There are no major differences in the reading between both indicators according to the Commission forecast – the difference is slighlty above 0.2% of GDP[4] and results mainly from slight differences in potential growth rates underlying the two indicators. The difference between the indicators calculated based on the Commission forecast and based on the Convergence Programme results mainly from an assumption of higher expenditure made in the Convergence Programme. Considering the two-year averages for 2018 and 2019, both the expenditure benchmark and the structural balance point to a risk of a significant deviation based on the Commission forecast. Thus, following an overall assessment, a significant deviation from the adjustment path towards the MTO is to be expected in 2019, putting at risk compliance with the requirements of the preventive arm of the Pact.

In 2020, in view of Poland's projected output gap of 2.0% of GDP, the nominal growth rate of net primary government expenditure should not exceed 4.4%, in line with the structural adjustment of 0.6% of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact. Under the Convergence Programme scenario, the nominal growth rate of net primary government expenditure would exceed the applicable expenditure benchmark in 2020, leading to a negative impact of 1.0% of GDP on the underlying fiscal position. The structural balance would improve by 1.0% of GDP, exceeding the required adjustment by 0.4% of GDP. Following the no-policy-change assumption, based on the Commission forecast, in 2020, both indicators point to a risk of a significant deviation. The deviation from the recommended path towards the MTO as measured by the expenditure benchmark is of 1.3% of GDP, while the deviation as measured by the structural balance amounts to 0.8% of GDP. The difference in the reading between both indicators results mainly from other treatment of interest expenditure and investment expenditure underlying the two indicators. The difference between the calculations based on the Commission forecast and the Convergence Programme results from the fact that the Commission forecast for 2020 is based on the no-policy-change assumption. At the same time, the Convergence Programme projects a significant improvement of the general government balance between 2019 and 2020 (see section 3.3 on measures planned in the Convergence Programme that have not been factored in in the Commission forecast). Considering the two-year averages, both the expenditure benchmark and the structural balance point to a risk of a significant deviation based on the Commission forecast. Overall, following an overall assessment, a significant deviation from the adjustment path towards the MTO is to be expected in 2020 putting at risk compliance with the requirements of the preventive arm of the Pact.

[4] Figues may not add up due to rounding.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019		2020	
Background budgetary indicators[1]					
Medium-term budgetary objective (MTO)	-1.0	-1.0		-1.0	
Structural balance[2] (COM)	-1.4	-2.8		-3.0	
Setting the required adjustment to the MTO					
Structural balance based on freezing (COM)	-2.0	-2.8		-	
Position vis-à-vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
Required adjustment[4]	0.5	0.6		0.6	
Required adjustment corrected[5]	0.4	0.6		0.6	
Corresponding expenditure benchmark[6]	3.9	4.2		4.4	
Compliance with the required adjustment to the MTO					
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Change in structural balance[7]	0.5	-1.3	-1.4	1.0	-0.2
One-year deviation from the required adjustment[8]	0.1	-1.9	-2.0	0.4	-0.8
Two-year average deviation from the required adjustment[8]	-0.2	-0.9	-1.0	-0.7	-1.4
Expenditure benchmark pillar					
Net public expenditure annual growth corrected for one-offs[9]	3.8	10.3	9.0	7.1	8.0
One-year deviation adjusted for one-offs[10]	0.0	-2.2	-1.7	-1.0	-1.3
Two-year deviation adjusted for one-offs[10]	-0.2	-1.1	-0.9	-1.6	-1.5
Finding of the overall assessment	**Some deviation**	**Significant deviation**	**Significant deviation**	**Significant deviation**	**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 point 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, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

[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 2018) is carried out on the basis of Commission 2019 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 2019 spring forecast (COM); Commission calculations.

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Poland does not appear to face fiscal sustainability risks in the short run.[5]

Based on Commission forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 48.2% of GDP in 2019, is expected to rise to 58.1% in 2029, thus remaining below the 60% of GDP Treaty threshold. Over this period, government debt is projected to peak in 2029. Sensitivity analysis shows similar risks.[6] Overall, this highlights medium risks for the country from debt sustainability analysis in the medium term. The full implementation of the Convergence Programme would nonetheless put debt on a clearly decreasing path by 2029.

The medium-term fiscal sustainability risk indicator S1[7] is at 0.7 percentage points of GDP, primarily related to the initial budgetary position and the projected ageing costs, which contribute together 1.7 percentage points of GDP. This indicator signals medium risks in the medium term. The full implementation of the Convergence Programme would put the sustainability risk indicator S1 at -2.1 percentage points of GDP. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are, therefore, medium. Fully implementing the fiscal plans in the Convergence Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 is at 3.5 percentage points of GDP. In the long term, Poland therefore appears to face medium fiscal sustainability risks, primarily related to the initial budgetary position and the projected ageing costs. Full implementation of the programme would nonetheless put the S2 indicator at 1.7 percentage points of GDP, leading to a lower long-term risk.[8] The debt sustainability analysis discussed above points to medium risks. Hence, overall, long-term fiscal sustainability risks are assessed as medium for Poland.

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[5] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

[6] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[7] See the note to Table 5 for a definition of the indicator.

[8] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 5: Debt sustainability analysis and sustainability indicators

Time horizon			Commission Scenario		Convergence Programme Scenario	
Short-term			**LOW risk**			
S0 indicator [1]			0.2			
Fiscal subindex			0.0	LOW risk		
Financial & competitiveness subindex			0.3	LOW risk		
Medium-term			**MEDIUM risk**			
DSA [2]			MEDIUM risk			
S1 indicator [3]			0.7	MEDIUM risk	-2.1	LOW risk
of which	Initial Budgetary Position		1.4		-0.6	
	Debt Requirement		-1.0		-1.8	
	Cost of Ageing		0.3		0.3	
	of which	Pensions	0.0		-0.1	
		Health care	0.1		0.2	
		Long-term care	0.1		0.1	
		Other	0.1		0.1	
Long-term			**MEDIUM risk**			
DSA [2]			MEDIUM risk			
S2 indicator [4]			3.5	MEDIUM risk	1.7	LOW risk
of which	Initial Budgetary Position		2.4		0.6	
	Cost of Ageing		1.1		1.1	
	of which	Pensions	-0.4		-0.5	
		Health care	0.6		0.7	
		Long-term care	0.5		0.5	
		Other	0.4		0.4	

Source: Commission services; 2019 Convergence Programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. The 'convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2018.

6. FISCAL FRAMEWORK

In Poland, a stabilising expenditure rule, covering nearly the entire general government sector, applies to budget laws. This was also the case for the 2018 budget. The Public Finance Act requires an ex-post compliance assessment to be included in the government report on the budget execution to be submitted to the parliament and to the Supreme Audit Office by 31 May. This assessment will be discussed in the budget implementation report by the Supreme Audit Office. There is no assessment of the ex-post compliance with the expenditure rule in the Convergence Programme. As the expenditure rule does not cover the entire general government sector (while its coverage is close to this aggregate), it is not possible to provide an assessment for 2018 without the information to be published by the end of May.

The applicable debt ceilings defined in the Constitution and in the Public Finance Act have been respected in 2018. In addition, the 2018 central government deficit was lower than the limit defined in the 2018 budget law. Both the 2018 headline and the structural general government deficits (0.4% of GDP and 1.4% of potential GDP respectively) were also lower than projected in the 2018 edition of the Convergence Programme.

According to the Convergence Programme, the 2019 fiscal plans and the targets for the outer years are consistent with the limits defined by the expenditure rule. The expenditure rule was also respected in the 2019 budget law. The evolution of the debt-to-GDP ratio in the Convergence Programme also respects the debt ceilings defined in the Polish law.

Based on the information provided in the Convergence Programme, the past and planned fiscal performance in Poland appear to comply with the requirements of the applicable national numerical fiscal rules.

Poland is the only EU Member State without an independent fiscal council. While some functions typically assigned to fiscal councils are performed by several other institutions, this scattered approach may undermine their impact. Tasks usually assigned to fiscal councils include the preparation or endorsement of macroeconomic forecasts and the analysis of the long-term sustainability of public finances. Currently, the macroeconomic forecasts underpinning the Convergence Programme are produced by the government without the involvement of independent stakeholders. Also, there is no independent analysis of the long-term sustainability of public finances. 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.

7. SUMMARY

In 2018, an improvement of the structural balance of more than 0.5% of GDP, which exceeds the required adjustment towards the MTO, was recorded. Poland, however, did not achieve the MTO. Simultaneously, the growth rate of government expenditure, net of discretionary revenue measures, did not exceed the applicable expenditure benchmark rate. Over 2017 and 2018 taken together, there was some deviation from the required adjustment. This points to some deviation from the requirement of the preventive arm of the Pact in 2018.

Poland plans a growth rate of government expenditure, net of discretionary revenue measures, which exceeds the applicable expenditure benchmark rate in both 2019 and 2020. Poland plans a deterioration of the structural balance by 1.3% of GDP in 2019 and an improvement of the structural balance of 1.0% of GDP in 2020. Poland plans to reach the MTO in 2021. This path implies a risk of a significant deviation from the required adjustment in both, 2019 and 2020.

8. ANNEXES

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	3.1	4.8	3.0	3.1	4.8	5.1	4.2	3.6
Output gap [1]	-4.0	1.2	-0.4	-0.7	0.8	2.1	2.3	2.0
HICP (annual % change)	2.8	2.9	1.6	-0.2	1.6	1.2	1.8	2.5
Domestic demand (annual % change) [2]	2.3	5.2	2.3	2.3	4.9	5.5	4.4	3.9
Unemployment rate (% of labour force) [3]	19.0	9.7	9.3	6.2	4.9	3.9	3.8	3.5
Gross fixed capital formation (% of GDP)	18.9	21.5	19.8	18.0	17.5	18.2	18.4	18.5
Gross national saving (% of GDP)	16.4	17.6	18.7	19.6	20.0	20.1	19.8	19.4
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-4.9	-4.7	-3.8	-2.2	-1.5	-0.4	-1.6	-1.4
Gross debt	43.4	48.0	53.0	54.2	50.6	48.9	48.2	47.4
Net financial assets	-22.6	-20.0	-37.6	-43.2	-40.3	n.a	n.a	n.a
Total revenue	39.9	39.9	38.9	38.9	39.7	41.2	41.0	41.2
Total expenditure	44.8	44.6	42.7	41.1	41.2	41.5	42.6	42.6
of which: Interest	2.8	2.3	2.3	1.7	1.6	1.4	1.4	1.3
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-0.1	2.9	7.2	5.3	5.2	4.9	4.8	4.3
Net financial assets; non-financial corporations	-74.8	-83.8	-79.6	-84.8	-82.4	n.a	n.a	n.a
Net financial assets; financial corporations	5.3	-7.7	-2.5	1.5	-4.7	n.a	n.a	n.a
Gross capital formation	11.6	12.2	11.1	11.6	11.7	11.6	11.7	11.9
Gross operating surplus	19.0	23.1	25.0	24.5	24.0	23.7	23.6	23.2
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	2.0	-2.2	-3.2	-1.9	-2.8	-4.3	-3.3	-3.4
Net financial assets	51.4	52.7	54.5	65.2	66.7	n.a	n.a	n.a
Gross wages and salaries	33.5	32.7	31.6	31.9	31.9	32.4	33.2	33.8
Net property income	5.1	3.4	3.0	2.5	2.4	2.3	2.2	2.1
Current transfers received	19.9	17.3	16.8	17.4	17.2	17.0	17.8	17.9
Gross saving	6.8	3.1	1.2	2.5	1.2	0.4	1.0	1.2
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-3.1	-4.0	0.1	1.2	1.1	0.5	0.2	-0.1
Net financial assets	41.2	59.6	66.1	62.2	61.4	n.a	n.a	n.a
Net exports of goods and services	-2.7	-2.7	0.8	4.0	4.2	3.4	2.9	2.4
Net primary income from the rest of the world	-1.3	-2.8	-3.6	-3.9	-4.1	-4.1	-3.9	-3.9
Net capital transactions	0.1	1.1	2.1	1.2	0.9	1.0	1.2	1.2
Tradable sector	51.0	50.6	51.3	51.6	51.2	51.3	n.a	n.a
Non tradable sector	37.3	37.2	37.2	36.7	36.6	36.3	n.a	n.a
of which: Building and construction sector	6.6	7.2	7.1	6.2	6.2	7.0	n.a	n.a
Real effective exchange rate (index, 2000=100)	98.9	101.3	94.4	89.5	93.6	94.7	95.0	96.9
Terms of trade goods and services (index, 2000=100)	95.9	99.6	99.3	103.0	103.5	102.6	102.0	101.7
Market performance of exports (index, 2000=100)	78.0	92.4	109.1	120.0	124.9	128.7	131.4	133.1

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :
AMECO data, Commission 2019 spring forecast

Mandatory variables not included in the Convergence Programme

The data on inflation and GDP growth and levels in 2018, as well as data on certain basic assumptions (world growth excluding EU beyond 2020 and world import volumes excluding EU beyond 2020) were not included in the Convergence Programme. These not included mandatory variables do not impede the Commission's ability to assess the Convergence Programme on the basis of the Programme's assumptions.