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Assessment of the 2016 Convergence Programme for

Poland

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

This document assesses Poland's April 2016 Convergence Programme (hereafter called Convergence Programme), which was submitted to the Commission on 28 April 2016 and covers the period 2016-2019. It was approved by the government and presented to the national parliament for a debate without a vote.

Poland is 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 26 February 2015 and updates it with the information included in the Convergence Programme.

Section 2 presents the macroeconomic outlook underpinning the Convergence Programme and provides an assessment based on the Commission 2016 spring forecast. The following section presents the recent and planned budgetary developments, according to the Convergence Programme. In particular, it includes an overview of the medium-term budgetary plans, an assessment of the measures underpinning the Convergence Programme and a risk analysis of the budgetary plans based on the 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 of long-term sustainability risks and Section 6 of recent developments and plans regarding the fiscal framework and the quality of public finances. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

The Convergence Programme presents a macroeconomic scenario where real GDP growth gradually increases from 3.8% in 2016 to 4.1% in 2019. The main driver of the projected growth path is domestic demand, in particular private consumption and investment. The projected solid growth rate of private consumption (3.8% – 4.1% per year over the programme horizon) reflects favourable developments in households' disposable income on the back of increasing employment (1% in 2016, slowing down to 0.5% in 2017 and 0.4% in 2018-2019), real compensation of employees (4.1% in 2016-2017 accelerating thereafter to exceed 5% in 2019) as well as an increase in social transfers due to the introduction of a new child benefit. As employment is expected to grow faster than the labour force, the unemployment rate is expected to fall from 7.5% in 2015 to 5.5% in 2019. Real unit labour costs are projected to increase by 1.3% in 2016 with more subdued growth in 2017-2018 as wage costs are set to exceed gains in labour productivity. The Convergence Programme expects private investment growth to gradually accelerate from 6% in 2016 to the average of 7.3% during 2017-2019, supported by favourable financial conditions and public policies supporting innovations in the economy. Public investment, following a slowdown in 2016 is projected to rise faster thereafter, helped by availability of funds from the EU's 2014-2020 Multi-annual Financial Framework. Export growth is projected to gradually decrease, from 6% in 2016 to 5% in 2019. Import dynamics is expected to exceed export dynamics over the projection period leading to a negative contribution to overall GDP growth of -0.2 pp. in 2016 and -0.4 pp. in the outer years.

Regarding the cyclical position of the economy, the output gap, as recalculated by the Commission, following the commonly agreed methodology, is slightly negative in 2016-2017

– when it is estimated to narrow from -0.3% to -0.1% of GDP – and moves into positive territory thereafter (0.2% in 2018 and 0.6% in 2019).

The 2016-2018 GDP growth path in the Convergence Programme is unchanged compared to the previous year edition. There is a small change in the growth composition with stronger private consumption growth and more negative contribution of net exports compared to the previous year.

The macroeconomic scenario underpinning the Convergence Programme is slightly more optimistic than the Commission 2016 spring forecast for 2016 and 2017. The programme forecasts marginally higher real GDP growth (by 0.1 pp.) in 2016 and by 0.3 pp. in 2017, mainly on account of more favourable assumptions for investment.

Overall, the macroeconomic assumptions of the Convergence Programme are plausible in 2016 and favourable thereafter.

Table 1: Comparison of macroeconomic developments and forecasts

	2015		2016		2017		2018	2019
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	3.6	3.6	3.7	3.8	3.6	3.9	4.0	4.1
Private consumption (% change)	3.0	3.0	4.1	4.0	4.0	4.1	3.8	3.8
Gross fixed capital formation (% change)	5.8	5.8	4.4	4.7	4.5	6.7	7.3	7.6
Exports of goods and services (% change)	6.8	6.8	6.2	6.0	6.6	5.5	5.2	5.1
Imports of goods and services (% change)	6.3	6.3	7.1	6.6	7.4	6.4	6.0	5.8
Contributions to real GDP growth:								
- Final domestic demand	3.6	3.3	4.0	3.9	3.8	4.3	4.3	4.5
- Change in inventories	-0.2	-0.2	0.0	-0.1	0.0	0.0	0.0	0.0
- Net exports	0.3	0.3	-0.3	-0.2	-0.2	-0.4	-0.4	-0.4
Output gap[1]	-0.5	-0.5	0.0	-0.3	0.4	-0.1	0.1	0.4
Employment (% change)	1.4	1.4	0.7	1.0	0.5	0.5	0.4	0.4
Unemployment rate (%)	7.5	7.5	6.8	6.6	6.3	6.2	5.8	5.5
Labour productivity (% change)	2.2	2.2	3.0	2.8	3.0	3.4	3.6	3.7
HICP inflation (%)	-0.7	-0.7	0.0	0.0	1.6	1.3	1.8	2.2
GDP deflator (% change)	0.4	0.4	0.2	0.4	1.3	1.6	1.9	2.3
Comp. of employees (per head, % change)	3.1	0.1	3.8	4.1	4.3	4.1	4.7	5.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.6	2.1	0.9	1.7	0.4	1.5	1.7	1.0

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 2016 spring forecast (COM); Convergence Programme (CP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2015

The general government deficit amounted to 2.6% of GDP in 2015, its lowest level since 2007. This was in line with Poland's 2015 Convergence Programme, which projected a deficit of 2.7% of GDP in 2015. No temporary or one-off measures were taken in 2015 in order to meet the fiscal targets. The decrease in the budget deficit was driven by falling government expenditure. In particular, expenditure on compensation of employees increased much below the rate suggested by private sector wage dynamics, helped by a continued freeze of the wage bill for most central government institutions. In addition, public debt servicing costs continued to fall benefitting from low interest rates. On the revenue side, social contributions increased dynamically following acceleration of wage and employment growth, while both taxes on production and imports and current taxes on income and wealth stayed at the 2014 level in relation to nominal GDP.

3.2. Medium-term strategy and targets

The Convergence Programme targets a gradual reduction of the headline deficit to 1.3% of GDP in 2019 and to reduce the recalculated structural deficit[1] to 1.5% of GDP in 2019. It also envisages achieving the MTO of a structural deficit of 1% of GDP "shortly after" 2019, i.e. beyond the period covered by the Convergence Programme.

While the MTO of -1% of GDP is unchanged compared to the 2014 and the 2015 Convergence Programmes, Poland plans to achieve it later than in the programmes of 2014 and 2015. The MTO reflects the objectives of the Pact.

The programme targets are less stringent than those put forward by Poland in 2015 − by between 0.3% and 1.1% of GDP (Figure 1). As explained in the programme, this results from the implementation of the "priority objectives of government's policy", in particular the new child benefit programme costing some 0.9% of GDP in 2016 and 1.2% of GDP from 2017.

The planned fiscal adjustments concern both the expenditure and revenue side. The expenditure as a share of GDP is planned to increase up to 2017 and then to decrease until the end of the programme period, mainly in view of new social benefits. It should also be noted that the national expenditure rule (introduced to the Polish fiscal framework in 2013) was amended in December 2015 and – in the current economic environment (low inflation) – will allow higher expenditures than would be possible under the previous version of the rule.

Revenues as a share of GDP are expected to grow over the programme horizon. Poland plans to implement several measures with a view to increasing its tax revenues, mainly through enhanced VAT collection and fight against aggressive tax planning. At the same time, the VAT rates will decrease as from 2017.

In 2016, both the programme and the Commission 2016 spring forecast expect the headline deficit of 2.6% of GDP and the structural deficit of 3.0% of GDP. In 2017, the deficit target planned in the programme is 2.9% of GDP, which compares to a forecast of 3.1% of GDP in the Commission 2016 spring forecast. The difference is mostly due to higher expenditure expected by the Commission. Simultaneously, the (recalculated) structural 2017 deficit is

[1] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

forecast at 2.7% of GDP in the programme and at 3.3% of GDP in the Commission 2016 spring forecast. The difference results from the discrepancy in projected headline deficit figures and different output gap developments: a positive output gap in the Commission forecast for 2017 and a slightly negative (recalculated) gap based on the programme.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2015	2016		2017		2018	2019	Change: 2015-2019
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**38.9**	**39.1**	**39.0**	**39.1**	**39.0**	**39.4**	**39.4**	**0.5**
of which:								
- Taxes on production and imports	12.9	13.0	13.0	12.7	12.7	12.9	12.9	0.0
- Current taxes on income, wealth, etc.	6.9	7.1	7.0	7.2	7.3	7.4	7.5	0.6
- Social contributions	13.6	13.7	13.7	13.7	13.6	13.4	13.3	-0.3
- Other (residual)	5.5	5.4	5.3	5.6	5.4	5.7	5.7	0.2
Expenditure	**41.5**	**41.7**	**41.6**	**42.2**	**41.9**	**41.4**	**40.7**	**-0.8**
of which:								
- Primary expenditure	39.7	40.0	39.9	40.6	40.4	40.0	39.3	-0.4
of which:								
Compensation of employees	10.2	10.1	10.0	10.1	9.8	9.5	9.4	-0.8
Intermediate consumption	5.8	5.8	5.8	5.8	5.8	5.8	5.8	0.0
Social payments	16.3	17.1	17.3	17.2	17.2	16.8	16.4	0.1
Subsidies	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.0
Gross fixed capital formation	4.4	4.3	4.3	4.5	4.6	4.8	4.7	0.3
Other (residual)	2.6	2.1	2.1	2.6	2.5	2.5	2.5	-0.1
- Interest expenditure	1.8	1.7	1.7	1.5	1.5	1.4	1.4	-0.4
General government balance (GGB)	**-2.6**	**-2.6**	**-2.6**	**-3.1**	**-2.9**	**-2.0**	**-1.3**	**1.3**
Primary balance	**-0.8**	**-0.9**	**-0.9**	**-1.5**	**-1.4**	**-0.6**	**0.1**	**0.9**
One-off and other temporary	0.0	0.4	0.5	0.0	-0.1	0.0	0.0	0.0
GGB excl. one-offs	**-2.6**	**-3.0**	**-3.1**	**-3.1**	**-2.8**	**-2.0**	**-1.3**	**1.3**
Output gap[1]	-0.5	0.0	-0.3	0.4	-0.1	0.1	0.4	0.9
Cyclically-adjusted balance[1]	-2.4	-2.6	-2.5	-3.3	-2.8	-2.0	-1.5	0.8
Structural balance[2]	**-2.3**	**-3.0**	**-3.0**	**-3.3**	**-2.7**	**-2.0**	**-1.5**	**0.8**
Structural primary balance[2]	-0.5	-1.3	-1.3	-1.7	-1.2	-0.6	-0.1	0.4

Notes:

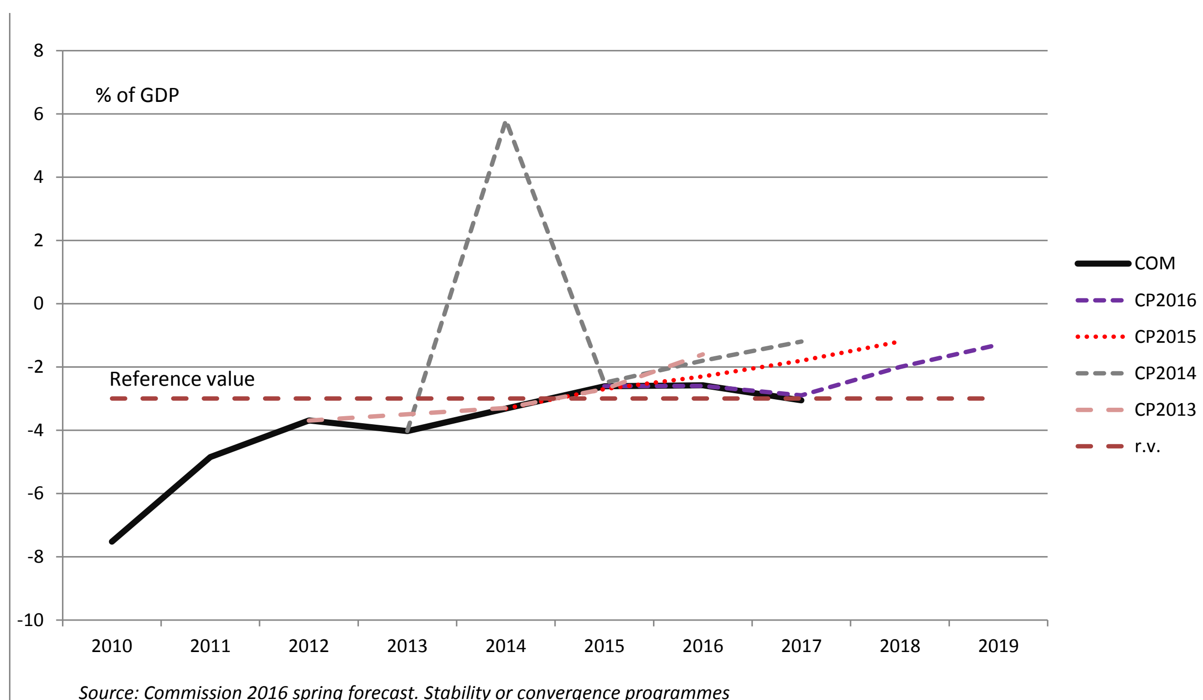
[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

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

Source:

Convergence Programme (CP); Commission 2016 spring forecasts (COM); Commission calculations.

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



3.3. Measures underpinning the programme

The programme contains a list of measures taken or planned until 2019, in some cases without providing estimates of their budgetary impact. Most of them concern the period 2018-2019.

According to the programme, the main measure underpinning an increase in government revenue is an improvement of fiscal efficiency (amongst others: implementation of the General Anti-Avoidance Rule, decrease of the cash transactions' limit, restructuring and modernisation of the tax and custom authorities). Its objective is to improve tax revenue collection, mainly through enhanced VAT collection and fight against aggressive tax planning. Poland plans to implement the changes gradually as – according to the programme – a sharp adjustment could have a detrimental effect on government's social and economic policy and increase the level of social exclusion. Simultaneously, new taxes (on assets of financial institutions and not yet legislated retail sales tax) are listed without quantification of their fiscal impact.

On the expenditure side, the stabilising expenditure rule introduced in 2013 will be maintained. The expenditure rule was for the first time applied to the 2015 budget law, with the objective of limiting the growth of public expenditure. The rule was amended in 2015 and – in the current economic environment (low inflation) – will allow higher expenditures than initially planned[2]. The programme also mentions new expenditures, including the child benefit (fiscal impact not specifically quantified in the document but estimated by the Commission at 0.9% of GDP in 2016).

The Convergence Programme also describes and quantifies additional possible planned measures that have not yet been legislated and where the final decision has not yet been taken by the government. These measures are not taken into consideration in the basic programme

[2] This is because the amendment inter alia changed the formula replacing actual inflation with the inflation target followed by the National Bank of Poland (2.5%).

scenario. The three concerned measures are: (i) lowering of the statutory retirement age, (ii) increasing the tax-free allowance in personal income tax, and (iii) maintaining higher VAT rates after 2016. The programme assesses the potential impact of lowering the statutory retirement age to 60/65 years of age (in line with the draft law submitted to the Parliament by the President) as equivalent to 0.4% of GDP in 2017 and 0.5% of GDP per year in 2018-2019[3]. The gradual increase of the tax-free allowance in personal income tax would lower tax revenues by 0.2% of GDP in 2017 and more in subsequent years (0.5% of GDP in 2019). In contrast, maintaining higher VAT rates after 2016 would generate higher tax revenue of 0.4% of GDP per year in 2017-2019.

In its 2016 spring forecast, the Commission followed the usual no-policy-change assumption for 2017 (as this is a year for which no budget has been adopted yet). Therefore, the Commission did not take into account the assumed effects of planned but not yet legislated and implemented fiscal measures.

Main budgetary measures

Revenue	**Expenditure**
2015	
	• Expenditure of the Fund for Protection of Guaranteed Assets related to a bankruptcy of a bank (0.1% of GDP) – one-off measure
2016	
• Sale of a mobile internet frequencies (0.5% of GDP) – one-off measure	
2017	
• Expiry of past temporary increase of VAT rates (-0.4% GDP)	
2018-2019	
• Efficiency gains in tax collection (0.8% GDP)	• Public administration – limited increase of wages, purchase of goods and services (-0.4% of GDP) • Slow increase of pension and disability allowances' expenditures (-0.5% of GDP)[4] • Improvement of the household revenues and resulting decrease of social security allowances (-0.2% of GDP)

Note: 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] The reported figure is only an increase of expenditure of the Social Insurance Fund. No overall assessment is provided in the programme.

[4] Main reasons listed in the programme are the decrease of the number of disability pension beneficiaries and the functioning of the defined contribution pension system.

3.4. Debt developments

In the 2016 Convergence Programme, the government debt-to-GDP ratio is projected to peak at 52.5% in 2017 (as compared to 51.3% recorded in 2015), before declining to 50.4% in 2019 (Figure 2). This will be mainly driven by the above described envisaged improvements in the general government deficit and nominal GDP growth.

Table 3: Debt developments

(% of GDP)	Average 2010-2014	2015	2016		2017		2018	2019
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**53.6**	**51.3**	**52.0**	**52.0**	**52.7**	**52.5**	**52.0**	**50.4**
Change in the ratio	0.1	0.8	0.8	0.7	0.6	0.5	-0.5	-1.6
Contributions[2] :								
1. Primary balance	**2.3**	**0.8**	**0.9**	**0.9**	**1.5**	**1.4**	**0.6**	**-0.1**
2. "Snow-ball" effect	**0.0**	**-0.2**	**-0.3**	**-0.3**	**-0.9**	**-1.2**	**-1.5**	**-1.7**
Of which:								
Interest expenditure	2.4	1.8	1.7	1.7	1.5	1.5	1.4	1.4
Growth effect	-1.5	-1.8	-1.8	-1.9	-1.8	-1.9	-2.0	-2.0
Inflation effect	-0.9	-0.2	-0.1	-0.1	-0.7	-0.8	-1.0	-1.1
3. Stock-flow adjustment	**-2.1**	**0.2**	**0.2**	**0.1**	**0.0**	**0.4**	**0.5**	**0.3**
Of which:								
Cash/accruals diff.				0.6		-0.1	0.0	0.0
Acc. financial assets				-0.1		0.7	0.9	0.5
Privatisation				0.0		-0.1	0.0	0.0
Val. effect & residual				-2.3		-3.0	-3.4	-3.5

Notes:

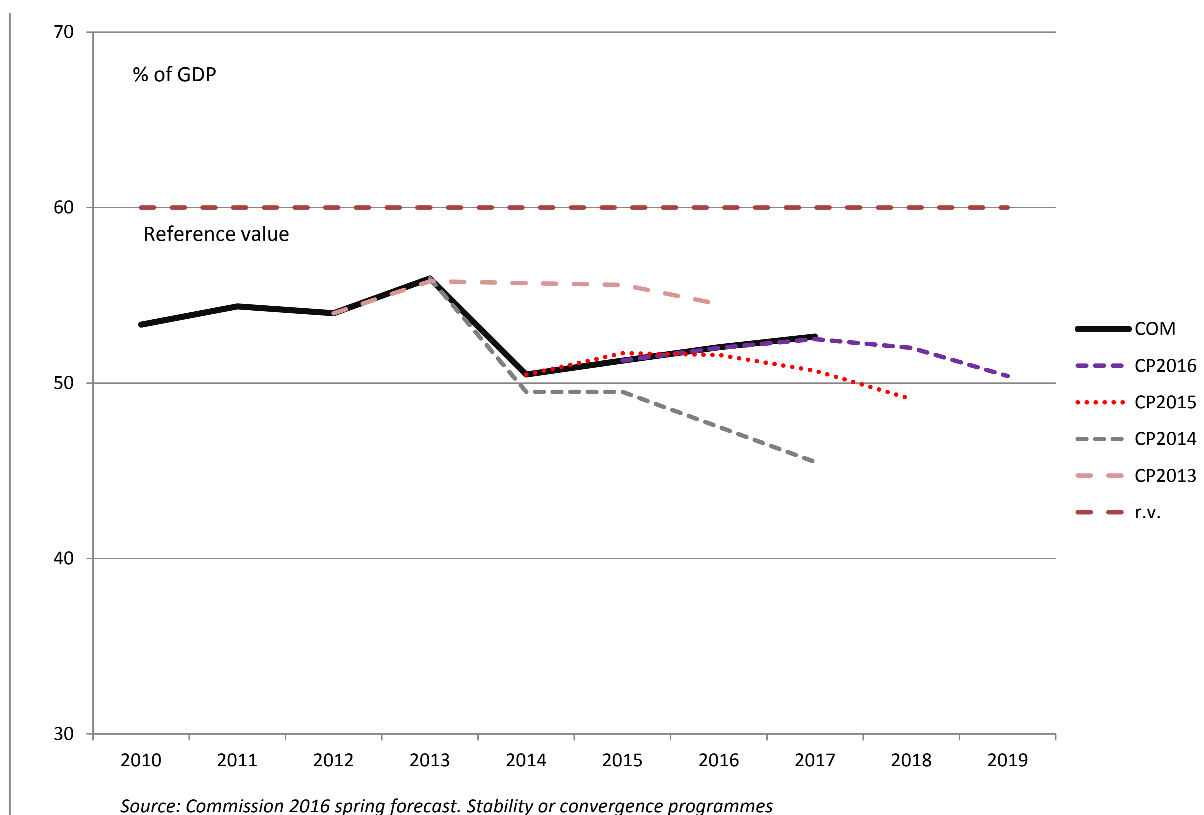
[1] End of period.

[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 2016 spring forecast (COM); Convergence Programme (CP), Comission calculations.

Figure 2: Government debt projections in successive programmes (% of GDP)



3.5. Risk assessment

As the macroeconomic projections in the Convergence Programme are favourable in 2017 and beyond, lower overall economic growth constitutes a downside risk to the general government targets as laid down in the programme. This risk is limited to the extent that one factor potentially slowing overall growth could be lower public investment if the implementation of projects financed from the EU's 2014-2020 Multi-annual Financial Framework takes longer than envisaged. The programme's central scenario does not incorporate some deficit-increasing policy measures that are still being discussed. This applies especially to the possible lowering of the statutory retirement age and the increase of the tax-free allowance in personal income tax. At the same time, the programme's central scenario does not incorporate an option of prolongation of the use of higher VAT rates that has also been publicly debated and that would have a deficit-reducing effect. Another risk factor is related to potential changes in the market assessment of these macroeconomic and fiscal risks, which could translate into higher interest rates and weaker PLN exchange rate with ensuing negative implications for public finances. Finally, the improved outlook for tax collection presented in the programme hinges on the effective implementation of several measures outlined in the programme. The details of some of the specific solutions are yet to be worked out and their real impact on tax collection remains uncertain.

The risks to the budgetary deficit targets previously mentioned would also have an impact on the public debt.

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

In 2015, the estimated improvement of the structural balance (0.3% of GDP) falls short by 0.2% of GDP from the 0.5% of GDP recommended by the Council. At the same time, the growth rate of government expenditure, net of discretionary revenue measures, was lower than the applicable expenditure benchmark rate (2.5%). This lower increase in government expenditure alone has contributed to the improvement of the underlying fiscal position by 0.3% of GDP. This calls for an overall assessment. The difference between the two indicators stems from several factors. First, the estimate of potential GDP growth underlying the improvement of the structural balance is lower than the medium-term average used in the expenditure benchmark. The former seems to provide a more adequate estimate of Poland's medium-term potential growth rate at the current juncture, as potential output growth for Poland consistently decreased since the Commission 2013 winter forecast (the vintage currently used to assess compliance with the expenditure benchmark in 2015). The observed decrease is natural for catching-up countries as their per-capita income increases. Second, the difference between the two indicators also captures the effects of lower-than-expected inflation. Whereas the expenditure benchmark uses the GDP deflator from earlier vintages of the forecast, the structural balance reflects actual inflation which, due to international price developments, turned out lower than previously forecast with ensuing negative impact on the change in the structural balance. Finally, one-off transactions have a positive, but limited, effect on compliance with the expenditure benchmark (0.2% of GDP). Taking all these factors into consideration in the overall assessment, the adjustment path towards the MTO appears to have been in line with the requirements of the preventive arm of the SGP in 2015.

Box 1. Council recommendations addressed to Poland

On 14 July 2015, the Council addressed recommendations to Poland in the context of the European Semester. In particular, following the correction of the excessive deficit, in the area of public finances the Council recommended to achieve a fiscal adjustment of 0.5% of GDP towards the MTO in both 2015 and 2016, to establish an independent fiscal council and to broaden the tax base, in particular by limiting the use of the extensive system of reduced VAT rates.

For 2016, the programme envisages a worsening of the (recalculated) structural balance by 0.7% of GDP in 2016. This implies a deviation of 1.2% of GDP from the recommended adjustment path towards the MTO in 2016. The programme also projects growth of government expenditure, net of discretionary revenue measures, to be slightly lower than the applicable expenditure benchmark rate in 2016 (2.5%). This would improve the underlying fiscal position by 0.1% of GDP. The difference between the two indicators partly owes to the fact that one-off transactions (especially sale of a mobile frequencies) have a positive and significant (above 0.4% of GDP) effect on compliance with the expenditure benchmark, but given their intrinsically non-recurrent and temporary nature they are excluded from the structural balance. The Commission 2016 spring forecast implies similar though slightly less positive developments. The structural balance is projected to fall short by 1.2% of GDP from the recommended adjustment towards the MTO, while the gap on the basis of expenditure benchmark is projected at -0.1% of GDP. Again, the difference in the two indicators reflects in particular the fact that one-off transactions have a positive and significant (above 0.4% of GDP) effect on compliance with the expenditure benchmark. Accordingly, on the basis of the Commission 2016 spring forecast, there is a risk of a significant deviation from the recommended adjustment path towards the MTO in 2016, following an overall assessment.

For 2017 the programme envisages an improvement of the (recalculated) structural balance by 0.2% of GDP. This implies some deviation from the recommended adjustment path towards the MTO (gap of -0.3% of GDP). The programme also projects the growth of government expenditure, net of discretionary revenue measures, to be higher than the applicable expenditure benchmark rate in 2017 (1.8%). This projected deviation from the expenditure benchmark would translate into a deterioration of the underlying fiscal position by 1.0% of GDP, also pointing to a significant deviation from the requirement. According to the Commission 2016 spring forecast, which was less optimistic than the programme as regards GDP growth and projected somewhat higher government expenditure, the projected deterioration of the structural balance of 0.3% of GDP results in a significant deviation from the recommended adjustment towards the MTO (gap of -0.8% of GDP). The expenditure benchmark pillar also points to significant deviation (gap of -1.4% of GDP). Therefore, on the basis of the Commission 2016 spring forecast, there is a risk of a significant deviation from the required adjustment path towards the MTO in 2017.

In 2018 and 2019, the (recalculated) annual structural adjustments planned in the programme (0.7% of GDP in 2018 and 0.5% of GDP in 2019) meet the minimum annual adjustment of 0.5% of GDP per year.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2015	2016		2017	
Initial position[1]					
Medium-term objective (MTO)	-1.0	-1.0		-1.0	
Structural balance[2] (COM)	-2.3	-3.0		-3.3	
Structural balance based on freezing (COM)	-2.3	-3.0		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2015**	**2016**		**2017**	
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.5	0.5		0.5	
Required adjustment corrected[5]	0.5	0.5		0.5	
Change in structural balance[6]	0.3	-0.7	-0.7	0.2	-0.3
One-year deviation from the required adjustment [7]	-0.2	-1.2	-1.2	-0.3	-0.8
Two-year average deviation from the required adjustment [7]	0.3	-0.7	-0.7	-0.7	-1.0
Expenditure benchmark pillar					
Applicable reference rate[8]	2.5	2.5		1.8	
One-year deviation [9]	0.3	0.1	-0.1	-1.0	-1.4
Two-year average deviation [9]	-	0.2	0.1	-0.4	-0.8
Conclusion					
Conclusion over one year	Overall assessment	Overall assessment	Overall assessment	Overall assessment	Significant deviation
Conclusion over two years	-	Overall assessment	Overall assessment	Significant deviation	Significant deviation

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] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

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

[8] 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.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law 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 2016 spring forecast (COM); Commission calculations.

5. FISCAL SUSTAINABILITY

General government gross debt stood at 51.3% of GDP in 2015. The Convergence Programme scenario would imply the general government debt to remain broadly stable, reaching 50.8% of GDP in 2026. In contrast, under a no-policy-change assumption (based on the Commission 2016 spring forecast), general government debt is expected to rise to 64.9% in 2026, remaining above the 60% of GDP Treaty threshold.

Overall, in the short run, Poland does not appear to face fiscal sustainability risks, although some indicators (such as the current primary balance) point to potential short-term challenges. In the medium-term, however, fiscal risks appear to be high from a debt sustainability analysis perspective due to the increasing and relatively high stock of debt at the end of the projection period (2026). The fiscal sustainability risk indicator S1 is at 1.3 pps. of GDP, mainly related to the unfavourable initial budgetary position (1.7 pps. of GDP) mitigated by the debt requirement (-0.6 pps. of GDP), thus indicating medium risks in the medium term. The implementation of the Convergence Programme would put the sustainability risk indicator S1 at -0.7 pp. of GDP, leading to a low medium-term risk.

In the long run, Poland faces medium risks to fiscal sustainability due to the sizeable value of the long-term sustainability gap indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) at 3.7 pps. of GDP. These risks are also largely connected to the unfavourable initial budgetary position (contribution of 2.6 pps. of GDP to the required fiscal adjustment) and to the necessity to meet future increases in the costs of ageing (1.1 pps. of GDP), notably in the healthcare and long-term care areas. Therefore, over the long-term, reducing the projected age-related expenditure increases remains a key challenge to improving fiscal sustainability. Implementation of the Convergence Programme would put the S2 indicator at 2.2 pps. of GDP, leading to a qualitatively similar long-term risk assessment.

It is worth underscoring that the above conclusions are based on the projections for the age-related expenditure taken from the 2015 Ageing report. Fully implementing past enacted pension reforms introduced in the past and taken into account in these projections, is key in supporting long-term fiscal sustainability, as the country is expected to experience one of the strongest increase in the old-age dependency ratio in the EU.

Table 5: Sustainability indicators

Time horizon				No-policy Change Scenario		Stability / Convergence Programme Scenario	
Short Term				**LOW risk**			
S0 indicator [1]				0.3			
	Fiscal subindex (2015)			0.2	LOW risk		
	Financial & competitiveness subindex (2015)			0.3	LOW risk		
Medium Term				**HIGH risk**			
DSA [2]				HIGH risk			
S1 indicator [3]				1.3	MEDIUM risk	-0.7	LOW risk
of which							
	IBP			1.7		-0.1	
	Debt Requirement			-0.6		-0.9	
	CoA			0.2		0.3	
Long Term				**MEDIUM risk**		**MEDIUM risk**	
S2 indicator [4]				3.7		2.2	
of which							
	IBP			2.6		1.0	
	CoA			1.1		1.2	
		of which					
			Pensions	-0.2		-0.1	
			HC	0.8		0.8	
			LTC	0.6		0.6	
			Other	-0.1		0.0	

Source: Commission services; 2016 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2016 forecast until 2017. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period coveerd by the programme. Age-related expenditure as given in the 2015 Ageing Report.

[1] The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.35 and 0.45.

[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. See Fiscal Susstainability Report 2015.

[3] The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the foercast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2017) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

[4] The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

6. FISCAL FRAMEWORK

The expenditure rule, covering nearly the entire general government sector, was applied for the first time in the 2015 budget. The Public Finance Act (Article 182) requires an ex-post assessment of compliance to be included in the report on the execution of the budget law that is to be submitted by the Government to the Parliament and the Supreme Audit Office by May 31st. This will then in particular be discussed in the Supreme Audit Office report on budget implementation. There is no assessment of the ex-post compliance with the expenditure rule in the Convergence Programme. Given that its coverage is close but not identical to the general government, it is not possible to provide an assessment for 2015 without the information to be published by end-May.

The applicable debt ceilings defined in the Constitution and in the Public Finance Act have not been breached in 2015. The 2015 central government deficit was lower than the limit defined in the 2015 budget law. Both the 2015 headline and the structural general government deficits (2.6% of GDP and 2.3% of GDP respectively) were also lower than projected in the previous year Convergence Programme.

According to the Convergence Programme the 2016 fiscal plans and the targets for the outer years are consistent with the limits defined by the expenditure rule. For 2016 the expenditure rule was also respected in the 2016 budget law. The evolution of the debt-to-GDP ratio prescribed in the Convergence Programme is also consistent with respecting the debt ceilings defined in the Constitution and in the Public Finance Act.

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

The macroeconomic forecasts underpinning the Convergence Programme are produced without an involvement of independent stakeholders. Also, there is no ex-ante independent assessment of the programme's macroeconomic scenario and of an analysis of the long-term sustainability of public finances. Poland has not established an independent fiscal council that could fulfil such a role. However, an external assessment takes place in the case of 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. CONCLUSIONS

In 2015, Poland achieved a general government deficit of 2.6% of GDP and a structural deficit of 2.3% of GDP. The general government debt amounted to 51.3% of GDP. In 2015, Poland improved its structural balance by 0.3% of GDP, what is below the recommended adjustment towards the MTO. On the other hand, the growth rate of government expenditure, net of discretionary revenue measures, was below the applicable expenditure benchmark rate. Following an overall assessment, the adjustment path towards the MTO appears to be in line with the requirements of the preventive arm of the SGP in 2015.

Poland's general government gross debt-to-GDP ratio is expected to remain below the Treaty reference value of 60% over the programme horizon. Poland plans to achieve compliance with the MTO after 2019, i.e. beyond the period covered by the programme. The programme envisages the worsening of the structural balance by 0.7% of GDP in 2016, followed by an improvement by 0.2% of GDP in 2017. This path implies a deviation of 1.2% of GDP from the recommended adjustment path towards the MTO in 2016 and a deviation of 0.3% in 2017. The programme also envisages the growth of government expenditure, net of discretionary revenue measures, to be slightly lower than the applicable expenditure benchmark rate in 2016 (overachievement by 0.1% of GDP) and significantly higher in 2017 (gap of -1% of GDP). According to the Commission 2016 spring forecast, the projected deterioration of the structural balance of 0.7% of GDP in 2016 results in a significant deviation from the recommended adjustment towards the MTO (gap of -1.2% of GDP). At the same time, the expenditure benchmark pillar points to some deviation (gap of -0.1% of GDP) in 2016. In 2017, the projected deterioration of the structural balance of 0.3% of GDP results in a significant deviation from the recommended adjustment towards the MTO (gap of -0.8% of GDP). The expenditure benchmark pillar also points to a significant deviation (gap of -1.4% of GDP) in 2017. Therefore, on the basis of the Commission 2016 spring forecast, there is a risk of significant deviation both in 2016 and 2017 following an overall assessment.

8. ANNEX

Table I. Macroeconomic indicators

	1998-2002	2003-2007	2008-2012	2013	2014	2015	2016	2017
Core indicators								
GDP growth rate	3.4	5.1	3.4	1.3	3.3	3.6	3.7	3.6
Output gap [1]	-0.7	-1.3	1.7	-1.2	-1.0	-0.5	0.0	0.4
HICP (annual % change)	7.3	2.1	3.7	0.8	0.1	-0.7	0.0	1.6
Domestic demand (annual % change) [2]	3.0	5.6	2.5	-0.7	4.9	3.4	4.1	3.9
Unemployment rate (% of labour force) [3]	15.6	16.1	8.9	10.3	9.0	7.5	6.8	6.3
Gross fixed capital formation (% of GDP)	22.2	19.3	20.9	18.8	19.7	20.1	20.3	20.5
Gross national saving (% of GDP)	19.2	16.8	17.3	18.5	19.1	20.6	20.3	19.9
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.8**	**-4.1**	**-5.4**	**-4.0**	**-3.3**	**-2.6**	**-2.6**	**-3.1**
Gross debt	**38.6**	**46.0**	**51.6**	**56.0**	**50.5**	**51.3**	**52.0**	**52.7**
Net financial assets	**n.a**	**-21.1**	**-25.2**	**-35.3**	**-38.2**	**-39.4**	**n.a**	**n.a**
Total revenue	40.3	40.3	38.9	38.4	38.9	38.9	39.1	39.1
Total expenditure	44.1	44.4	44.3	42.4	42.2	41.5	41.7	42.2
of which: Interest	3.2	2.5	2.5	2.5	1.9	1.8	1.7	1.5
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-5.4**	**0.7**	**4.9**	**8.1**	**6.6**	**7.2**	**5.7**	**6.6**
Net financial assets; non-financial corporations	**n.a**	**-83.1**	**-80.0**	**-82.0**	**-82.0**	**-80.7**	**n.a**	**n.a**
Net financial assets; financial corporations	**n.a**	**-6.0**	**-2.7**	**-7.2**	**-3.9**	**1.1**	**n.a**	**n.a**
Gross capital formation	15.3	12.4	11.6	10.4	11.4	11.4	11.5	11.5
Gross operating surplus	16.2	21.6	23.8	25.0	25.6	25.4	24.8	25.3
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**5.5**	**-0.3**	**-2.5**	**-2.6**	**-3.0**	**-2.7**	**-2.1**	**-3.1**
Net financial assets	**n.a**	**60.9**	**46.9**	**57.8**	**59.6**	**60.3**	**n.a**	**n.a**
Gross wages and salaries	35.0	32.2	32.4	31.7	31.7	32.0	32.4	32.5
Net property income	5.6	4.3	3.2	3.2	3.1	2.5	2.4	2.1
Current transfers received	20.1	18.1	16.7	16.7	16.5	16.3	17.0	17.0
Gross saving	10.1	4.5	2.2	1.6	1.2	1.7	2.4	1.5
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.7**	**-3.7**	**-3.0**	**1.5**	**0.4**	**1.6**	**0.9**	**0.4**
Net financial assets	**n.a**	**49.8**	**61.9**	**67.4**	**65.3**	**59.5**	**n.a**	**n.a**
Net exports of goods and services	-4.8	-2.3	-2.0	1.9	1.3	2.8	2.6	2.1
Net primary income from the rest of the world	-0.4	-2.3	-3.1	-3.3	-3.5	-3.8	-3.8	-3.9
Net capital transactions	0.0	0.5	1.5	2.0	1.6	1.5	1.2	1.3
Tradable sector	50.7	51.4	50.9	51.8	51.3	51.7	n.a	n.a
Non tradable sector	37.5	36.4	37.3	37.0	37.4	37.2	n.a	n.a
of which: Building and construction sector	7.6	6.1	7.3	6.6	6.6	7.0	n.a	n.a
Real effective exchange rate (index, 2000=100)	104.1	93.4	99.2	94.4	94.2	92.3	89.7	89.7
Terms of trade goods and services (index, 2000=100)	97.8	97.9	99.3	98.3	100.1	102.8	103.2	102.7
Market performance of exports (index, 2000=100)	71.6	83.0	99.9	110.5	112.9	114.2	116.2	117.8

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 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 2016 spring forecast