COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL RECOMMENDATION TO POLAND

with a view to bringing an end to the situation of an excessive government deficit

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission;

Whereas:

(1) According to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(4) The Council has decided on [7 July 2009], in accordance with Article 104(6), that an excessive deficit exists in Poland.

(5) In accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1] (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances, and request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of 0.5 percentage point of GDP as a benchmark. In deciding

[1] OJ L 209, 2.8.1997, p. 6.

whether special circumstances exist, “relevant factors” as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account.

(6) Special circumstances, which are relevant for the greater flexibility in the application of the EDP introduced with the 2005 reform of the Stability and Growth Pact, are deemed to exist in the case of Poland. In particular, the deficit is expected to reach 6.6% of GDP also because of an unfavourable global environment. The collapse of exports, the sharp tightening of mortgage loans and corporate loans and a correction in the domestic housing market are all factors likely to entail a recession this year. In addition, the ongoing structural shift in the economy, which will have to be speeded up because of the global crisis, contributes to quickly rising unemployment rates. The Commission Spring forecast expects real GDP to contract by 1.4% in 2009, recovering to positive growth of 0.8% in 2010. The Polish authorities have revised downwards substantially their convergence programme update growth forecast of 3.7% in 2009 on two occasions; the first time in January, to 1.7% for 2009, and more recently on 22 June to "close to zero, but positive" in 2009 and 0.5% in 2010[2]. On 22 June the Minister of Finance also announced that the general government deficit may significantly exceed the 4.6% of GDP planned for the current year in the Spring 2009 EDP notification.[3]

(7) The existence of special circumstances authorises the Council to allow the correction of the excessive deficit in a medium-term framework. Considering the Commission services’ spring 2009 forecast which projects the structural balance to reach 6% of GDP in 2009 and, on a no-policy-change basis, 5.6% in 2010, and the special circumstances, Poland is recommended to correct the excessive deficit by 2012. This would imply a structural fiscal effort of 1¼-1½ percentage point of GDP annually.

(8) In a context of expansionary fiscal policy in 2008, when the structural balance deteriorated by around 2 percentage points of GDP, the Polish Monetary Policy Council adopted a restrictive stance and the reference interest rate reached 6% in the first half of the year. However, with the growth slowdown and falling inflation pressures, the reference interest rate was progressively cut down to 3.75% in March 2009. Moreover, the Polish currency, which has been steadily appreciating since the beginning of 2004, underwent a rapid depreciation in the autumn of 2008. The stimulating impact of the depreciation is however partly offset by the negative balance-sheet effect on households indebted in foreign currency.

(9) The excess over the 3% of GDP threshold from 2008 also reflects the fact that the recent good times were not fully used as an opportunity to consolidate public finances and undertake deep reforms on the expenditure side. In particular, the farmers’ social fund (KRUS) is only marginally financed by contributions and is almost fully subsidised by the central budget (about 1¼% of GDP annually). This is not changed by the now planned reform of KRUS which will have a negligible budgetary impact. A reform of the disability benefits system is in needed in order to avoid that disability benefits may be higher than pensions. Moreover, a review of entitlements of a large number of disability benefit recipients with permanent eligibility (rather than

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[2] Letter from Finance Minister Mr Rostowski to Commissioner Almunia.

[3] See footnote 2.

eligibility subject to periodical review), accumulated under old lenient eligibility criteria would also be needed. The reform of the costly early pensions, with a positive budgetary impact materialising only in the long term, excludes some professional groups and it does not fully address the issue of financing the early pensions.

(10) The negative deficit surprise in 2008 appears to be related to problems with expenditure planning and implementation control. Higher than planned public consumption was the main reason for the general government deficit slippage. Significant overspending on intermediate consumption (including administrative and military expenditure) by 0.8 percentage point compared to the estimate in the December 2008 convergence programme points to some problems in planning and execution of the budget. There was a high discrepancy between the outturn of the cash budget and the ESA95 accounts: the provisional outturn for the cash central state budget deficit (non ESA95) was 1.9% of GDP, better than planned in the 2008 budget (by 0.2 percentage point), whereas the ESA95 central government deficit was 4.2% of GDP (0.6 percentage point higher than estimated in the December 2008 convergence programme). The absence of appropriate rules and enforcement mechanisms to impose spending discipline appear to be at the origin of this discrepancy, since the cash spending limits did not prevent general government entities from incurring liabilities on an accrual basis. In addition, a lack of up-to-date information from different spending entities played a role.

(11) General government gross debt remains below the 60% of GDP reference value and stood at 47.1% of GDP in 2008. However, due to high expected deficits, the general government debt is likely to reach almost 60% in 2010 according to the Commission services' spring 2009 forecast.

(12) Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy. In this context, a separate chapter in the updates of Poland's convergence programme which will be prepared between 2009 and 2011 could usefully be devoted to this issue.

(13) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.

HEREBY RECOMMENDS:

(1) On the basis of the macroeconomic outlook of the Commission services' spring 2009 forecast, the Polish authorities should put an end to the present excessive deficit situation as rapidly as possible and at the latest by 2012.

(2) The Polish authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Polish authorities should:

(a) implement the fiscal stimulus measures in 2009 as planned, in particular the public investment plan, while structuring a supplementary budget in such a way that any further deterioration in public finances is avoided;

(b) ensure an average annual fiscal effort of around 1¼-1½ percentage point of GDP starting in 2010;

(c) rapidly spell out the detailed measures that are necessary to bring the deficit below the reference value by 2012, by containing primary current expenditure over the coming years.

(3) To limit risks to the adjustment, Poland should strengthen its medium-term budgetary framework, for example by introducing a legal ceiling on the growth of primary current expenditure, as well as improve the monitoring of the budget implementation throughout the year.

(4) The Council establishes the deadline of [7 January 2010] for the Polish government to take effective action to implement the fiscal measures in 2009 as planned, while avoiding any further deterioration of public finances, and to specify the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' spring 2009 forecast.

(5) The Polish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the convergence programmes which will be prepared between 2009 and 2011.

(6) In addition, the Council highlights the importance of the medium-term objective (MTO) for appropriate budgetary management in economic downturns. It therefore invites the Polish authorities to ensure that budgetary consolidation towards the medium-term objective, a general government structural deficit of 1% of GDP, is sustained after the excessive deficit will have been corrected. The quality of public finances can be improved by a prompt implementation of performance-based review and budgeting of expenditure.

This recommendation is addressed to the Republic of Poland.

Done at Brussels,

For the Council
The President