COUNCIL OF
THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit in Poland

COUNCIL RECOMMENDATION

of

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

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 are to 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) On 5 July 2004, the Council decided, in accordance with Article 104(6) of the Treaty, that an excessive deficit existed in Poland[1].

(4) Having decided on the existence of an excessive deficit in Poland, the Council recommended on 5 July 2004, in accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[2] that the Polish authorities take action in a medium-term framework in order to bring the deficit below 3 % of GDP by 2007 in a credible and sustainable manner, in accordance with the path for deficit reduction as specified in the Council opinion of the same day on the convergence programme submitted in May 2004[3].

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[1] OJ L 62, 9.3.2005, p. 18.

[2] OJ L 209, 2.8.1997, p. 6. Regulation as amended by Regulation (EC) No 1056/2005 (OJ L 174, 7.7.2005, p. 5).

[3] OJ C 320, 24.12.2004, p. 15.

(5) The Council recommendation under Article 104(7) of the Treaty referred to figures that did not include the deficit-increasing impact of the Eurostat decision of 2 March 2004 on the classification of defined-contribution pension schemes outside general government. However, the recommendation under Article 104(7) and the Council opinions on the May 2004 convergence programme and its subsequent updates (of November 2004 and January 2006) took explicitly into account the risks for the correction of the excessive deficit from the implementation of this Eurostat decision, which, as was decided by Eurostat in September 2004, has to be implemented by 1 April 2007 (deadline for the first notification of actual debt and deficit data for the year 2006 and preceding years). At the time of the Council recommendation under Article 104(7), the deficit-increasing impact of implementing the Eurostat decision (i.e. the annual cost of the 1999 Polish pension reform) was estimated at around 1½ % of GDP.

(6) On 28 November 2006, the Council adopted a decision in accordance with Article 104(8) of the Treaty stating that the action taken by Poland in response to the Council recommendation of 5 July 2004 under Article 104(7) of the Treaty was proving to be inadequate to correct the excessive deficit by 2007[1]. The decision was based on (i) the upward revision of the deficit target for 2007 in the budget for 2007 compared to the recommendation (in spite of much better-than-expected budgetary outturns for the period 2004-2006); (ii) risks of a higher-than-targeted deficit for 2007 as identified in the Commission services' autumn 2006 forecast; and (iii) the implementation of the abovementioned Eurostat decision as of spring 2007, estimated to result in an increase in the 2007 deficit by around 2 % of GDP.

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[1] OJ L 414, 30.12.2006, p. 81.

(7) Poland is currently a Member State with a derogation within the meaning of Article 122(1) of the Treaty, which means that it is to avoid excessive deficits but that Articles 104(9) and Article 104(11) of the Treaty do not apply to it; further recommendations can be addressed to Poland only on the basis of Article 104(7).

(8) According to Article 3(4) of Regulation (EC) No 1467/97, a recommendation made in accordance with Article 104(7) of the Treaty has to specify that effective action is to be taken by the Member State concerned within six months at most and that the correction of the excessive deficit, should be completed in the year following its identification, unless there are special circumstances. Article 3(4) also specifies that in a recommendation to a Member State to correct an excessive deficit, the Council should request the achievement of a minimum annual improvement in the structural balance of at least 0,5 % of GDP as a benchmark.

(9) Special circumstances – namely, the size of the deficit and the ongoing structural shift in the economy – were considered to exist when the Council issued its recommendation to Poland under Article 104(7) of the Treaty, which allowed for a correction in a medium-term framework, namely by 2007. Given that the deficit outturns in the period 2004-2006 were well below the targets underlying the Council recommendation under Article 104(7) and economic growth expected for 2007 is broadly confirmed, there is no reason to extend the deadline for the correction of the excessive deficit.

(10) The November 2006 update of the convergence programme, covering the period 2006-2009, also envisages the correction of the excessive deficit by 2007, the same as in the previous programmes. Building on a better-than-expected outturn for 2006 as estimated in the programme (1,9 % of GDP), the deficit target for 2007 is set at 1,4 % of GDP. Thereafter, the deficit is planned to be reduced to 1,0 % of GDP in 2008 and 0,6 % in 2009. These targets do not include the impact on the deficit of the abovementioned Eurostat decision. Including this impact, the deficit series becomes: 3,9 % in 2006, 3,4 % in 2007, 3,1 % in 2008 and 2,9 % in 2009. In structural terms (i.e. in cyclically-adjusted terms net of one-off and other temporary measures), the deficit is planned to improve by around ½ % of GDP annually in 2007-2009.

(11) The programme assumes that, for the purpose of abrogating the decision on the existence of an excessive deficit under Article 104(12), the Commission and the Council could, as foreseen in Article 2(7) of Regulation (EC) No 1467/97, consider the cost to the budget of the 1999 pension reform according to a linear degressive scale amounting to 60 % in 2007. The Council recalls that for Poland to benefit from this provision, the deficit should have declined substantially and continuously and have reached a level that comes close to the reference value. As the deficit has declined substantially and continuously over the period 2004-2006, the outcome for the 2007 deficit and the outlook thereafter will determine whether this provision can be applied to Poland.

(12) The Commission services' autumn 2006 forecast showed that there are risks attached to the deficit target for 2007. Taking into account more recent information that has become available since the completion of the autumn forecast, especially the better-than-expected outturn for 2006 (now estimated at 1,9 % of GDP), the 2007 deficit is likely to be around 3,7 % of GDP (including the cost of pension reform), that is, somewhat better than projected in the autumn forecast (around 4 % of GDP) but worse than the most recent official target (3,4 % of GDP).

(13) In its opinion of 27 February 2007 on the November 2006 update of the convergence programme, the Council reviews the medium-term budgetary plans of the Polish authorities. The overall conclusion is that the programme envisages a correction of the excessive deficit by 2007 but that the action taken so far is not sufficient and the planned measures should be strengthened to achieve that result. However, while in subsequent years the programme envisages making appropriate progress towards the medium-term objective in a context of strong growth prospects, there are important risks to the achievement of the budgetary targets, and the durability of the adjustment. The risks to the budgetary targets stem notably from (i) a favourable macroeconomic scenario for the period 2008-2009; (ii) significant uncertainties surrounding the effective implementation of planned reforms; and (iii) a lack of information on the measures supporting the envisaged expenditure restraint, which appear to be in an early conceptual phase.

(14) In general, 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 THAT:

1. The Polish authorities put an end to the present excessive deficit situation by 2007 at the latest.

2. The Polish authorities reduce the general government deficit in a credible and sustainable manner and to this end ensure an improvement of the structural balance by at least 0,5 percentage points of GDP between 2006 and 2007.

The Council establishes the deadline of 27 August 2007 for the Polish authorities to take effective action to this end.

In addition, the Council invites Poland to ensure that budgetary consolidation towards its medium-term objective of a structural deficit of 1 % of GDP is sustained after the excessive deficit has been corrected.

This Recommendation is addressed to the Republic of Poland.

Done at Brussels, 27 February 2007.

For the Council
The President