EUROPEAN
COMMISSION

Brussels, 29.5.2013
COM(2013) 393 final

Recommendation for a

COUNCIL RECOMMENDATION

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

{SWD(2013) 393 final}

Recommendation for a

COUNCIL RECOMMENDATION

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 on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 of the Treaty on the Functioning of the European Union (TFEU) 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) On 7 July 2009, the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC), that an excessive deficit existed in Poland and issued a recommendation to correct the excessive deficit by 2012 at the latest[1], in accordance with Article 104(7) TEC 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]. In order to bring the general government deficit below 3% of GDP in a credible and sustainable manner, the Polish authorities were recommended to implement the fiscal stimulus measures in 2009 as planned, ensure an average annual structural budgetary adjustment of at least 1¼% percentage points of GDP starting in 2010, spell out detailed measures that are necessary to bring the deficit below the reference value by 2012 and introduce reforms to contain primary current expenditure over the following years. The Council established a deadline of 7 January 2010 for effective action to be taken.

(4) On 3 February 2010, the Commission concluded that based on the Commission services' 2009 autumn forecast, Poland had taken necessary action in compliance with the Council recommendation of 7 July 2009 to bring its government deficit below the 3% of GDP reference value and considered that no additional step in the excessive deficit procedure was therefore necessary. On the basis of its 2011 autumn forecast, the Commission considered that Poland was not on track and asked for additional measures, which Poland provided. Thus, on 11 January 2012 the Commission

[1] All documents related to the excessive deficit procedure of Poland can be found at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/poland_en.htm

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

confirmed the Polish authorities had taken effective action towards a timely and sustainable correction of the excessive deficit and no further steps in the excessive deficit procedure of Poland were needed at the time[3].

(5) According to Article 3(5) of Regulation (EC) No 1467/97, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) TFEU, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation. The occurrence of unexpected adverse economic events with major unfavourable budgetary effects shall be assessed against the economic forecast underlying the Council recommendation.

(6) In accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97, the Council is required to make recommendations to the Member State concerned with a view to bringing the situation of an excessive deficit to an end within a given period. The recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0.5% of GDP as a benchmark.

(7) The Commission services' 2009 spring forecast, which was underlying the Council recommendation under Article 104(7) TEC of 7 July 2009, projected that the Polish economy would expand by 0.8% in 2010, while the years 2011 and 2012 were beyond that forecast's horizon. In 2009, real GDP increased by 1.6% and it was mainly driven by fiscal and monetary policy easing, inflows of EU funds financing infrastructure investments and a currency depreciation. The pick-up in exports and the rebound of domestic demand led to a recovery in 2010 and 2011, when real GDP grew by 3.9% and 4.5%, respectively, thus GDP growth in 2010 was well above the 0.8% of GDP expected in the Commission services' 2009 spring forecast. The Commission services' 2009 spring forecast, which expected the closure of the output gap beyond the forecast horizon, implicitly assumed a growth rate of the Polish economy around its potential one in outer years. However, the Polish economy slowed down sharply in 2012 with real GDP growth of 1.9%. Investment, especially construction, was held back by government consolidation, subdued credit growth and households refraining from real estate purchases. Overall, Poland has seen relatively resilient economic activity in 2009-2012, albeit with real GDP growth below potential in 2012, mainly resulting from the global economic and financial crisis.

(8) The Commission services' 2013 spring forecast projects an increase in real GDP of only 1.1% in 2013. Private consumption is forecast to grow by 0.8% due to falling employment, subdued wage growth and households rebuilding their savings. The trend in gross fixed capital formation, particularly in infrastructural construction, is set to remain negative with a decline of 2.6%, reflecting further fiscal consolidation, weak external demand and subdued credit growth. In 2014, some pick up of the economy

3 Communication from the Commission to the Council on assessment of budgetary implementation in the context of the ongoing Excessive Deficit Procedures after the Commission services' 2011 autumn forecast – COM(2012) 4 final, 11.1.2012.

with a real GDP growth of 2.2% is expected, although this is subject to risks in both directions depending on the speed of global recovery.

(9) The general government deficit had jumped to 7.4% of GDP in 2009 (from 3.7% of GDP in 2008) due to a sizeable fiscal stimulus and strong, in-built expenditure dynamics predicated on high growth. After the excessive deficit procedure was launched, consolidation measures in 2010 targeted the public sector wage bill, current spending and increased excise duties. Despite these consolidation measures of 0.6 % the headline deficit increased to 7.9% of GDP in 2010, driven by a sizeable increase in public investment (0.4% of GDP) and intermediate consumption (0.5% of GDP). Since 2011, the headline deficits have been influenced by continued consolidation effort, including cuts in social contributions transferred to open pension funds, increases in VAT rates and revenue-increasing changes in other taxes, the introduction of a temporary expenditure rule and cuts in spending on active labour market policies. Thus, the headline deficit decreased to 5% of GDP in 2011.

(10) The general government deficit, according to actual data reported in the Eurostat notification of April 2013, reached 3.9% of GDP in 2012. The 2012 deficit outturn is higher than the expected 3.5% of GDP publicly announced by the Polish authorities in September 2012. In particular, interest expenditure and social transfers were higher than projected. On the revenue side, indirect taxes, VAT in particular, were substantially lower than forecast. An even worse outcome was prevented by lower execution of public investments, partly counterbalanced by lower capital transfers received.

(11) The Commission services' 2013 spring forecast projects the general government deficit at 3.9% of GDP in 2013 (against Poland's deficit target for 2013 of 3.5% of GDP) and, under a no-policy-change assumption, at 4.1% of GDP in 2014. Taking into account additional measures contained in the 2013 update of the Polish Convergence Programme (CP), which was published after the cut-off date of the Commission services' 2013 spring forecast hardly change the assessment. For 2013 the CP does not incorporate new discretionary measures. Although the CP envisages keeping VAT rates at their current level instead of lowering them, the inclusion of this measure would, according to Commission estimates, reduce the 2014 deficit to 3.7% of GDP. Therefore, the Commission service’s spring forecast has been updated with the measures included in the CP in order to have an accurate baseline scenario for the new recommendation.

(12) The main downside risk to budgetary targets in 2013 and beyond is – based on past evidence –strong procyclicality of indirect and direct tax revenues, below standard revenue elasticities used in the forecast. In particular, it was experienced in 2012 when, despite an increase in the tax base, indirect tax revenues fell driven by an increase in VAT refunds and VAT arrears.

(13) The structural deficit decreased from 8.3% of GDP in 2010 to 5.4% in 2011 and 3.8% in 2012. Consolidation measures implemented over this period targeted in particular indirect taxes, disability contributions, contributions to open pension funds, public sector (excluding local government) wage bill and intermediate consumption. These measures were sizeable and covered both, revenue and expenditure side. Cumulatively they amounted to 2.1 % of GDP in 2011 and to 1.6% of GDP in 2012.

(14) The average annual apparent fiscal effort over the period 2010-2012 is estimated at 1.5% of GDP. When adjusted for the significant upward revision in potential output growth since the time when the recommendation was issued (-0.3pp) and because of

revenue unexpectedly growing at a lower rate than would have been implied by the GDP growth based on standard elasticities (+0.4pp), the average annual adjusted structural effort (1.6% of GDP) exceeds the recommended average annual fiscal effort (1¼% of GDP) over 2010 - 2012. The bottom-up approach estimates the cumulative size of consolidation measures at some 4.3% of GDP over 2010-2012. Thus, Poland has taken effective action.

(15) The European Commission Fiscal Sustainability Report 2012 shows that Poland does not face a risk of fiscal stress in the short run. The country is at medium sustainability risk in a medium term and at a low risk in a long-term perspective, providing the plans for fiscal consolidation are fully implemented. The 2012 Ageing Report indicates a limited projected increase in total age-related public expenditure over the years 2010-60. Nevertheless, Poland still needs to implement long-term sustainability-enhancing policies, but this effort is below the average improvement required for the EU as a whole.

(16) Public debt declined to 55.6% of GDP in 2012 from 56.2% of GDP in 2011, on the back of sizeable stock-flow adjustment. The Commission services' 2013 spring forecast projects its increase to 57 ½% of GDP in 2013 and, based on a no-policy-change assumption, to almost 59% of GDP in 2014.

(17) In order to reduce the deficit below the 3% of GDP threshold by 2013, thus extending the deadline by one year, the required structural effort would amount to at least 1.4% of GDP. Such a yearly effort would be higher than requested in the Council Recommendation of 7 July 2009 (1¼ % of GDP), despite the fact that fiscal risk has fallen since 2009 as the headline deficit is at a much lower level and debt remains below the 60% threshold. As a consequence, a more gradual pace of consolidation is affordable as it would also reduce output costs, which would be sizeable if a correction had to be done in 2013. In particular, because the time available after the recommendation to enact the required measures would be limited. Therefore, they have to be scaled up to be able to achieve an impact of about 1% of GDP over the entire year.

(18) In view of the above and consistent with the rules of the Stability and Growth Pact, an extension of the deadline to correct the excessive deficit by two years is warranted.

(19) Correcting the excessive deficit by 2014 would be commensurate with intermediate headline deficit targets of 3.6% of GDP for 2013 and 3.0% of GDP for 2014. The underlying improvement in the structural budget balance implied by these targets are 0.8% of GDP in 2013 and 1.3% of GDP in 2014. This implies a need of additional measures of 0.4% of GDP in 2013 and 0.4% of GDP in 2014, on top of those already included in the spring forecast and in the update of the Convergence Programme with an estimated budgetary impact of 0.25% in 2013 and 0.4% of GDP in 2014.

(20) Poland fulfils the conditions for the extension of the deadline for correcting the excessive general government deficit as laid out in Article 3(5) of Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure,

HAS ADOPTED THIS RECOMMENDATION:

(1) Poland should bring an end to the excessive deficit situation by 2014 at the latest.

(2) Poland should reach a headline deficit target of 3.6% of GDP in 2013 and 3.0% of GDP in 2014, which is consistent with an annual improvement of the structural

balance of at least 0.8% and 1.3% of GDP respectively, based on the updated Commission services' 2013 spring forecast.

(3) Poland should rigorously implement the measures already adopted , while complementing them with additional measures sufficient to achieve a correction of the excessive deficit in 2014 at the latest.

(4) The Council establishes the deadline of [01 October 2013] for Poland to take effective action and, in accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets.

Furthermore, Polish authorities should (i) improve the quality of public finances, in particular through minimising cuts in growth-enhancing infrastructure investments, a careful review of social expenditures and their efficiency; (ii) improve tax compliance and increase the efficiency of tax administration and (iii) make the institutional framework of public finances more binding and transparent, including through prompt adoption of a permanent expenditure rule on the general government budget. Finally, to ensure the success of the fiscal consolidation strategy, it will be important to back the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to Poland in the context of the European Semester. Beyond the report foreseen in recommendation (4), the Polish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the convergence programmes, until full correction of the excessive deficit has taken place.

This recommendation is addressed to the Republic of Poland.

Done at Brussels,

For the Council
The President