COUNCIL OF
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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 **COMMON GUIDELINES** **Consultation deadline for Croatia: 18.6.2013**

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 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 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 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[1] ("the Council Recommendation of 7 July 2009"), 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 Treaty 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.

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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.

(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 general government deficit below the 3 % GDP Treaty reference value and considered that no additional step in the excessive deficit procedure (EDP) 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 confirmed in its Communication to the Council on assessment of budgetary implementation in the context of the ongoing excessive deficit procedures that the Polish authorities had taken effective action towards a timely and sustainable correction of the excessive deficit and that no further steps in the EDP of Poland were needed at the time.

(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 the original Council Recommendation. Under Article 3(5) of that Regulation the occurrence of unexpected adverse economic events with major unfavourable budgetary effects shall be assessed against the economic forecast underlying the original Council Recommendation.

(6) In accordance with Article 126(7) TFEU and Article 3 of 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 requests 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, that is, 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 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 Union 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 as 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 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 EDP 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 value added tax (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 Poland's Convergence Programme for 2012 to 2016, which was published after the cut-off date of the Commission services 2013 spring forecast hardly change the assessment. For 2013 the Convergence Programme does not incorporate new discretionary measures. Although the Convergence Programme 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 services 2013 spring forecast has been updated with the measures included in the Convergence Programme in order to have an accurate baseline scenario for the new Council 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 increased to 8,3 % of GDP in 2010 and decreased to 5,4 % of GDP in 2011 and 3,8 % of GDP 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 those measures 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 Council Recommendation of 7 July 2009 was issued (-0,3 percentage points) and because of revenue unexpectedly growing at a lower rate than would have been implied by the GDP growth based on standard elasticities (+0.4 percentage points), the average annual adjusted structural effort (1,6 % of GDP) exceeds the recommended average annual structural effort (1¼ % of GDP) over the period 2010-2012. The bottom-up approach estimates the cumulative size of consolidation measures at some 4,3 % of GDP over the period 2010-2012. Thus, Poland has taken effective action.

(15) The Commission Fiscal Sustainability Report 2012 shows that Poland does not face a risk of fiscal stress in the short run. Poland 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 2010-2060. Nevertheless, Poland still needs to implement long-term sustainability-enhancing policies, but this effort is below the average improvement required for the Union as a whole.

(16) Public debt declined from 56,2 % of GDP in 2011 to 55,6 % of GDP in 2012, on the back of sizeable stock-flow adjustment. The Commission services 2013 spring forecast projects its increase to 57½ % 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 % GDP threshold by 2013, thus extending the deadline by one year as the Stability and Growth Pact foresees as a rule, 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 this Recommendation to enact the required measures would be limited. Therefore, those measures 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 justified.

(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 Commission services 2013 spring forecast and in the Convergence Programme for 2012 to 2016 with an estimated budgetary impact of 0,25 % of GDP 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 down in Article 3(5) of Regulation (EC) No 1467/97,

HAS ADOPTED THIS RECOMMENDATION:

(1) Poland should put an end to the excessive deficit situation by 2014.

(2) Poland should reach a headline general government 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 budget balance of at least 0,8 % of GDP and 1,3 % of GDP in 2013 and 2014, respectively, based on the Commission services updated 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 by 2014. Poland should use all windfall gains for deficit reduction.

(4) The Council establishes the deadline of 1 October 2013 for Poland to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets set out in recommendation (2).

Furthermore, the Polish authorities should:

(a) 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;

(b) improve tax compliance and increase the efficiency of tax administration; and

(c) 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 also 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