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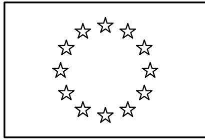

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of the action taken by Poland in response to the Council Recommendation to Poland with a view to bringing an end to the situation of excessive government deficit

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty on the Functioning of the European Union (TFEU). The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 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, and thereby ensuring long-term sustainability of public finances.

2. THE EXCESSIVE DEFICIT PROCEDURE FOR POLAND

On the basis of the data notified by the Polish authorities in April 2009[1] and subsequently validated by Eurostat[2] and taking into account the Commission services' spring 2009 forecast, the Commission adopted a report under Article 104(3) of the Treaty establishing the European Community (TEC) for Poland on 13 May 2009[3]. Subsequently, and in accordance with Article 104(4) TEC, the Economic and Financial Committee formulated an opinion on the Commission report on 28 May 2009.

On 24 June 2009 the Commission, having taken into account its report under Article 104(3) TEC and the opinion of the Economic and Financial Committee under Article 104(4) TEC, addressed to the Council, in accordance with Article 104(5) TEC, its opinion that an excessive deficit existed in Poland. Subsequently, acting upon a recommendation by the Commission, the Council decided on 7 July 2009 that an excessive deficit existed in Poland in accordance with Article 104(6) TEC, and, also on a recommendation by the Commission, it addressed

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[1] According to Council Regulation (EC) No 3605/93, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Poland can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

[2] Eurostat news release No 56/2009 of 22 April 2009.

[3] All EDP-related documents for Poland can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/poland_en.htm.

recommendations to Poland in accordance with Article 104(7) TEC with a view to bringing an end to the situation of an excessive government deficit by 2012. In its recommendations, the Council established a deadline of 7 January 2010 for effective action to be taken.

3. ASSESSMENT OF EFFECTIVE ACTION TAKEN

According to Regulation (EC) No 1467/97[4] and the revised Code of Conduct[5] a Member State should be considered to have taken effective action if it has acted in compliance with the Article 126(7) recommendation. The Code of Conduct states that the assessment of effective action should in particular take into account whether the Member State concerned has achieved the annual improvement of its cyclically adjusted balance, net of one-off and other temporary measures, initially recommended by the Council. In case the observed adjustment proves to be lower than recommended, a careful analysis of the reasons for the shortfall should be made. In case of a multi-annual adjustment, the Code of Conduct specifies that the assessment should mainly focus on the measures taken in order to ensure an adequate fiscal adjustment in the year following the identification of the excessive deficit.

In its recommendation under Article 104(7) TEC of 7 July 2009, the Council recommended that Poland put an end to the situation of an excessive deficit by 2012, in a credible and sustainable manner. Specifically, the Council recommended the Polish authorities to (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 to avoid any further deterioration in public finances; (b) ensure an average annual fiscal effort of at least 1¼ percentage points of GDP starting in 2010; (c) spell out the detailed measures that are necessary to bring the deficit below the reference value by 2012, and reforms to contain primary current expenditure over the coming years. To limit risks to the adjustment, the Council further recommended a strengthening of the medium-term budgetary framework, for example by introducing a legal ceiling on the growth of primary current expenditure, as well as improving the monitoring of budget implementation throughout the year. The Council established a deadline of 7 January 2010 for Poland to take effective action and to specify the measures that will be necessary to progress towards the correction of the excessive deficit.

Poland is the only EU country to have recorded positive economic growth in 2009. Real GDP is estimated to have increased by 1.7%, while in spring 2009 the Commission services projected a decline by 1.4%. This positive performance reflects a constellation of favourable factors including sound fundamentals at the outset of the crisis, a well capitalised and not vulnerable financial sector, the closeness of the Polish economy and the early depreciation of the currency. Regarding fiscal policy, the authorities allowed a full operation of automatic stabilizers, and rapidly designed an investment-focused recovery plan. The size of the overall fiscal stimulus in 2009 – measured as the change in the structural balance – is estimated at about 2 percent of GDP. At the same time, the authorities took measures to contain the increase in the government deficit. In January 2009, six months before the Council issued its recommendation in accordance with 104(7), they adopted a consolidation package with an estimated impact of ¾% of GDP consisting, inter alia, of reductions in administrative expenditure and increases in dividends from state-owned enterprises. Subsequently, on

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4 OJ L 209, 2.8.1997, p. 6.

5 "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009.

17 July 2009, immediately after adoption by the Council of a Recommendation to Poland with a view to bringing an end to the situation of excessive deficit, the authorities adopted a supplementary budget including additional expenditure cuts of 0.2% of GDP and higher dividends from state-owned companies of 0.4% of GDP. Despite these consolidation measures and significantly better economic developments than expected at the time of the Council Recommendation, the government deficit is estimated by the authorities to have reached 7.2% of GDP in 2009, slightly higher than the 6.6% of GDP projected in the spring by the Commission services. Although available data does not allow a precise assessment of the reasons for the higher deficit, there is evidence that it partly reflects higher co-financing of EU-funded projects and the fact that higher GDP growth did not fully translate into higher revenue due to an unfavourable shift in growth composition and structural changes in the tax system before the crisis.

In parallel, the authorities took important actions in 2009 to strengthen the fiscal framework. They made the existing debt rule more restrictive, by introducing additional specific provisions on the type of measures to be implemented once public debt exceeds 55% of GDP. The fiscal planning horizon for the central state budget was extended from 3 to 4 years. Some reorganisation of the general government took place, aimed at increasing the transparency of public accounts. The gradual introduction of a performance budgeting system continued. Finally, the authorities are contemplating the introduction of expenditure rules in the course of 2010, which would facilitate future consolidation.

According to the Commission services' autumn 2009 forecast, the budget for 2010 is consistent with a slight deterioration of the structural balance in 2010. The budget foresees a sizeable increase in public investment and the continued full play of automatic stabilisers which, given the generous indexation rules, will imply a large increase in social transfers. At the same time, it includes a nominal freeze in public wages – total compensation of employees in the general government sector would increase by less than 1% in 2010 – nominal reductions in other current spending, and increases in taxes on cigarettes and fuel oil. Importantly, the budget was based on cautious macroeconomic assumptions. Real growth was assumed to be 1.2%, while recent information suggests that a rate above 2% seems likely, and inflation was projected at 1%. This might lead to positive revenue surprises in 2010.

In a letter from 7 January 2010 to Commissioner Almunia, Finance Minister Rostowski presented a fiscal consolidation plan for 2010-2012. The main measures announced included a gradual increase and equalisation of the retirement age for men and women at 67 years, the inclusion of uniformed services personnel in the general security system, and a broadening of the tax base (some specific professions will have to use fiscal cash registers) and additionally, an acceleration of privatisations starting from 2010. [6]

Overall, while not negligible, the fiscal effort implied by current policies for the period 2010-2012 is significantly smaller than that recommended by the Council in July 2009 (3¾ percentage point of GDP over the period). Although the improvement of the economic outlook since the Commission services' spring 2009 forecast implies that a smaller structural fiscal effort may be sufficient to correct the excessive deficit by 2012, reducing the government deficit below 3% of GDP in 2012 will require an intensification of the fiscal

[6] On 29 January 2010 the Prime Minister unveiled a "Plan for development and consolidation of finances". The main measures include a reform of disability benefits, the inclusion of uniformed services personnel in the general security system, reduction of VAT refunds (on corporate cars and fuel) and a broadening of the tax base (some specific professions will have to use fiscal cash registers).

effort in 2011 and 2012. The success of the authorities' strategy therefore requires a very rigorous implementation of the budget in 2010 – to ensure strict respect of expenditure targets and that any windfall revenue is allocated to deficit reduction – and consolidation efforts in the 2011 and 2012 budgets which go well beyond those currently planned.

4. CONCLUSIONS

On current information it appears that Poland has taken action towards the correction of the excessive deficit within the time limits set by the Council. In particular the Polish authorities:

- implemented the fiscal stimulus measures in 2009 as planned, including the public investment plan, while taking measures to avoid an excessive increase in the general government deficit;

- introduced a 2010 budget based on cautious macroeconomic assumptions and including measures to contain the deficit, and announced the first elements of a fiscal consolidation programme for the period 2010-2012;

- strengthened the fiscal framework, and initiated work to introduce expenditure rules, which is expected to facilitate consolidation in the years ahead.

There are, however, considerable risks attached to the fiscal strategy of the Polish authorities. Even taking into account the better than anticipated growth prospects, further sizeable consolidation measures will be needed to bring the deficit below 3% in 2012. Against this background, new stimulus measures should be avoided, the 2010 budget be strictly implemented, windfall revenue be allocated to deficit reduction, and additional consolidation measures be prepared for the following years.

In view of the above assessment, the Commission considers that no further steps in the excessive deficit procedure of Poland are needed at present. Calling for a prompt implementation of the planned measures, the Commission will continue to closely monitor budgetary developments in Poland in accordance with the Treaty and the SGP.

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011
Real GDP (% change)	COM autumn 2009 forecast	6.8	5.0	1.2	1.8	3.2
	COM spring 2009 forecast	6.6	4.8	−1.4	0.8	n.a.
	National forecast	6.8	5.0	1.7	2.6[2]	n.a
Output gap (% of potential GDP)	COM autumn 2009 forecast	2.6	2.6	−0.4	−2.2	−2.3
	COM spring 2009 forecast	3.4	3.5	−1.5	−3.8	n.a.
	National forecast	n.a.	n.a.	n.a.	n.a.	n.a.
General government balance (% of GDP)	COM autumn 2009 forecast	−1.9	−3.6	−6.4	−7.5	−7.6
	COM spring 2009 forecast	−1.9	−3.9	−6.6	−7.3	n.a.
	National forecast	−1.9	−3.6	−7.2[3]	n.a.	n.a.
Primary balance (% of GDP)	COM autumn 2009 forecast	0.4	−1.4	−3.8	−4.6	−4.6
	COM spring 2009 forecast	0.4	−1.7	−3.7	−4.3	n.a.
	National forecast	0.4	−1.4	n.a	n.a.	n.a.
Cyclically-adjusted balance (% of GDP)	COM autumn 2009 forecast	−2.9	−4.7	−6.3	−6.6	−6.7
	COM spring 2009 forecast	−3.2	−5.3	−6.0	−5.8	n.a.
	National forecast	n.a.	n.a.	n.a.	n.a.	n.a.
Structural balance[1] (% of GDP)	COM autumn 2009 forecast	−2.9	−4.7	−6.4	−6.6	−6.7
	COM spring 2009 forecast	−3.2	−5.3	−6.0	−5.6	n.a.
	National forecast	n.a.	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	COM autumn 2009 forecast	45.0	47.2	51.7	57.0	61.3
	COM spring 2009 forecast	44.9	47.1	53.6	59.7	n.a.
	National forecast	45.0	47.2	n.a	n.a.	n.a.

[1] Cyclically-adjusted balance excluding one-off and other temporary measures.
[2] The latest available information in the letter from Finance Minister Mr Rostowski to Commissioner Mr Almunia of 7 January 2010.
[3] "Plan for development and consolidation of finances" of 29 January 2010.
Sources: Commission services' autumn 2009 forecast; Draft Budget for 2010 (September 2009); October 2010 fiscal notification; Letter from Finance Minister Mr Rostowski to Commissioner Mr Almunia of 7 January 2010.