EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 6 June 2008
ECFIN/2008—EN-52601

POLAND: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE MARCH 2008 UPDATE OF THE CONVERGENCE PROGRAMME

(Note for the Economic and Financial Committee)

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not. The most recent update of Poland's convergence programme was submitted on 26 March 2008.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 19 June 2008. Comments should be sent to Piotr Bogumił (piotr.bogumil@ec.europa.eu) and Aleksander Rutkowski (aleksander.rutkowski@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' autumn 2007 forecast, (ii) the code of conduct ("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 11 October 2005) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying "methodological paper" prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 11 June 2008. The ECOFIN Council adopted its opinion on the programme on 8 July 2008.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

TABLE OF CONTENTS

SUMMARY AND CONCLUSIONS

As part of the preventive arm of the Stability and Growth Pact, each Member State that does not use the single currency, such as Poland, has to submit a convergence programme and annual updates thereof. The most recent programme, covering the period 2007-2010, was submitted on 26 March 2008.

Under the corrective arm of the Pact, Poland was placed in excessive deficit by the Council in July 2004. The deadline for correcting the excessive deficit was 2007.

Poland made recently progress in closing the gap with average EU income levels as real GDP growth picked up from around 4½% on average in 2003-2005 to above 6% in 2006-2007. The labour-intensive output growth improved considerably the situation in the labour market as unemployment dropped from nearly 20% in 2003 to 9½% in 2007. However, the fall in unemployment reflects, in addition to an extraordinary growth in employment, a shrinking labour force due to migration. Moreover, distortions of incentives to work enhanced by significant emigration increase the shortage of labour in some sectors. The tightening labour market puts pressure on wages impacting negatively on HICP inflation which, after a period of successful moderation from 2005 to the first half of 2007, picked up significantly at the end of 2007. Since peaking at 6¼% of GDP in 2003, the general government deficit declined on average by more than 1 percentage point annually to reach 2% of GDP in 2007. In recent years, outturns were generally better than the targets thanks to positive growth surprises resulting in windfall revenues as well as the incomplete execution of expenditure plans. Further budgetary consolidation will hinge crucially on the reform of the social transfer system (mainly early pensions and disability benefits) and the increase of labour participation.

The macroeconomic scenario underlying the programme envisages that real GDP growth will gradually decrease from 6.5% in 2007[1] to 5.2% on average over the rest of the programme period. Assessed against currently available information[2], this scenario appears to be based on plausible growth assumptions. The programme's projections for inflation appear to be on the low side reflecting slightly favourable assumptions on import prices and a relatively low increase in nominal compensation per employee. Overall, the economy seems to be in good economic times in the period 2007-2009.

The 2007 general government deficit outturn was 2.0% of GDP, compared to 3.4% projected in the November 2006 convergence programme. Much higher real and nominal GDP growth than assumed in November 2006 was the main reason, but expenditure was also restrained. In particular, high profitability of companies allowed for growth in subsidies to be contained, while the rapid fall in unemployment and the absence of indexation imposed by the Hausner plan[3] also curtailed growth in social transfers. In

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1 Real GDP in 2007 was revised by the Polish statistical office from 6.5% to 6.6% after the cut-off date for the preparation of this assessment. The composition of growth was also revised.

2 The assessment takes notably into account the Commission services spring 2008 forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

3 The most comprehensive and specific attempt at expenditure reform so far, proposed in 2003 and aimed at reducing public expenditure on social protection, public administration and state aids. Among

addition, compensation of public sector employees was lower than planned. Finally, government investment was lower than projected because of a slower absorption of EU funds than planned. Overall, the expenditure-to-GDP ratio was 1.5 percentage point lower than projected in November 2006. On the revenue side, revenue from indirect taxes and social contributions turned out better than envisaged in November 2006, mainly thanks to a much higher employment and wage growth. These positive surprises were offset by a lower performance of other revenue items (direct taxes due to an increase in tax brackets). Overall, this led to a revenue ratio slightly below the planned one. With an improvement in the structural balance ratio by about 1½ percentage point, budgetary implementation in the year 2007 more than fulfilled the invitation in the Council opinion of 27 February 2007 on the previous update of the convergence programme.[4]

The main goal of the budgetary strategy is a durable reduction of the structural general government deficit (cyclically-adjusted deficit net of one-off and other temporary measures) aimed at achieving the medium-term objective (MTO) for the budgetary position, which is a structural deficit of 1% of GDP, in 2011, i.e. one year after the programme period. This is consistent with the previous convergence programme, which envisaged achieving the MTO "after 2010". After deteriorating by 0.5 percentage point to 2.5% of GDP in 2008, the headline deficit is planned to improve to 1.5% by 2010. The primary balance follows a similar path and is projected to increase from −0.2% of GDP in 2008 to 0.8% in 2010. Against the backdrop of moderating output growth, the changes in the structural balance calculated according to the commonly agreed methodology are foreseen to be larger, with the structural deficit narrowing from about 2¾% of GDP in 2008 to slightly above 1% in 2010. The budgetary adjustment is expenditure-based and back-loaded to 2009 and 2010. In 2008, the deficit deterioration is mainly caused by the insufficient compensation of a sharp increase in the investment ratio as well as a large cut in social contributions. In 2009-2010, the consolidation is to be achieved mainly through restraint in compensation of employees, social transfers and intermediate consumption. The planned rate of deficit reduction between 2007 and 2009 is lower than in the previous update, however the starting point (2007) is much better and the new targets of the March 2008 update of the convergence programme are better each year than the targets in the November 2006 update thanks to a much-better-than expected 2007 outturn.

The risks to the budgetary projections in the programme appear broadly balanced in 2008, but the outcomes could be worse than projected in the programme afterwards. The 2008 deficit target in the programme is the same as in the spring 2008 forecast (2.5% of GDP). The 2008Q1 cash data for central budget point to a revenue performance above the budgetary projections, but the programme assumes slightly higher growth in 2008 than in the spring 2008 commission forecast and still mounting wage pressure in the public sector poses a risk for public finances. On the other hand, higher inflation than assumed in the programme will reduce the expenditure ratio in 2008, as expenditure is predominantly fixed in nominal terms. However, in 2009, the higher 2008 inflation could stimulate wage growth in the public sector and lead to higher pensions and social benefits than assumed in the programme, further exacerbated by a reform of the

other things, the Hausner plan replaced annual indexation with an indexation after cumulated inflation exceeds 5% or every three years (whatever comes first).

4 OJ C 72, 29.3.2007, p. 13.

indexation mechanism which links, as from 2008, social benefits not only to consumer prices but also partially to wages. While deficit-increasing measures have already been adopted by parliament (personal income tax rate reductions), offsetting measures are vague and their budgetary impact is uncertain (except for excise duty hikes related to EU harmonisation, which will not completely offset the personal income tax cut). If further high employment growth assumed by the government is not maintained, the continuation of the 2006-2007 job-rich-growth-based budgetary consolidation after 2008 may be difficult. On the other hand, the track record for the development of the general government balance is good: revenues have turned out frequently higher than projected while expenditure plans have been under-executed.

In view of this risk assessment, the budgetary stance in the programme seems consistent with a durable correction of the excessive deficit by 2007 as recommended by the Council. However, the safety margin against breaching the 3% of GDP deficit limit could not be ensured within the programme period. In addition, the budgetary stance in the programme may not be sufficient to ensure that the MTO is achieved by 2011, as envisaged in the programme. As the economy enjoys favourable growth conditions, the pace of adjustment towards the MTO implied by the programme is insufficient and needs to be strengthened in 2008 to be in line with the Stability and Growth Pact. Thereafter, it should be backed up with measures. In addition, should inflationary and wage pressures materialise, a tighter fiscal stance than foreseen in the programme would be required to avoid overheating.

Poland appears to be at low risk as regards the sustainability of public finances. According to the projections made in 2005 and based on the common methodology, the long-term budgetary impact of ageing is among the lowest in the EU. However, as from 2008, social benefits will be indexed not only to consumer prices but also partially to wages, which will raise expenditure in the long-term. The budgetary position in 2007 with a small structural primary deficit, despite being better than the starting position of the previous programme, constitutes a risk to sustainable public finances before considering the long-term budgetary impact of an ageing population. Further consolidation of public finances, including the reform of the early retirement (introduction of “bridge pensions” which limit early retirement to certain difficult professions) as intended in the convergence programme, would therefore contribute to both stimulating labour activity and employment and limiting risks to the sustainability of public finances.

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Poland’s national reform programme[5] and is summarised as follows. Poland’s national reform programme identified as key challenges the consolidation and better management of public finances, development of entrepreneurship, increased innovation by companies; upgrading and developing infrastructure, ensuring a competitive environment in networks sectors, creating and sustaining jobs and reducing unemployment; and improving the adaptability of workers and enterprises. The Commission’s assessment was that Poland has made limited progress in implementing its National Reform Programme over the 2005-2007 period.

[5] Communication from the Commission to the European Council, “Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)” - COM(2007) 803, 11.12.2007.

Against the background of strengths and weaknesses identified and the background of progress made, the Commission recommended that Poland was recommended to take action in the areas of: fiscal consolidation (mechanisms of expenditure control); competition in network industries; public research and support to private R&D; flexicurity, including active labour market policy, social benefits, lifelong learning and education. In addition, Poland is encouraged to also focus on the areas of: transport infrastructure; business registration process; e-government; transposition of internal market legislation; and childcare facilities. Based on the Commission Strategic Report, the Council adopted recommendations on the 2008 update of the broad guidelines for the economic policies for the Member States, including Poland, on 14 May 2008. The budgetary strategy in the convergence programme is partly consistent with the country-specific broad economic policy guidelines, included in the integrated guidelines, in the area of budgetary policies issued in the context of the Lisbon strategy. While the programme envisages continued fiscal consolidation, further mechanisms to enhance control expenditure are not mentioned. The Polish authorities seem to be aware of the weaknesses of public finances (such as excessive social transfers with effects for labour participation) identified in this assessment, but specific measures are not yet ready for implementation and the intentions do not appear very ambitious. The government intends to restrict early retirement and harmonise disability benefits with the reformed pensions as well as introduce private co-financing of medical services.

The overall conclusion is that, following the correction of the general government deficit in 2007, the programme envisages a deterioration of the general government balance by 0.5 percentage point of GDP in 2008 and a back-loaded progress towards the MTO in the following years in a context of favourable growth prospects. The general government deficit is likely to remain below 3% of GDP and the debt below 60% in 2008 and 2009, but the projected structural deterioration by almost ½ percentage point of GDP in 2008 (mainly due to higher public investment and a large reduction of social contributions) is not in line with the Stability and Growth Pact. Given the risks to the budgetary targets from 2009, mainly due to a lack of specified measures, the MTO may not be achieved by 2011 as planned in the programme. Moreover, should inflationary pressures emerge, a tighter fiscal stance than foreseen in the programme would be required. As regards the long-term sustainability of public finances, Poland appears to be at low risk, but the early retirement system is in need of reform.

Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	**CP Mar 2008**	**6.2**	**6.5**	**5.5**	**5.0**	**5.0**
	COM Apr 2008	6.2	6.5	5.3	5.0	n.a.
	CP Nov 2006	*5.4*	*5.1*	*5.1*	*5.6*	*n.a.*
HICP inflation (%)	**CP Mar 2008**	**1.3**	**2.6**	**3.5**	**2.9**	**2.5**
	COM Apr 2008	1.3	2.6	4.3	3.4	n.a.
	CP Nov 2006	*1.4*	*2.1*	*2.5*	*2.5*	*n.a.*
Output gap[1] (% of potential GDP)	**CP Mar 2008**	**0.5**	**1.1**	**0.7**	**-0.2**	**-0.9**
	COM Apr 2008[2]	0.6	1.2	0.5	-0.7	n.a.
	CP Nov 2006	*0.5*	*0.5*	*0.3*	*0.4*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**CP Mar 2008**	**-2.6**	**-2.6**	**-3.5**	**-4.2**	**-4.6**
	COM Apr 2008	-2.5	-2.6	-2.3	-3.6	n.a.
	CP Nov 2006	*-1.6*	*-1.8*	*-2.2*	*-2.7*	*n.a.*
General government balance (% of GDP)	**CP Mar 2008**	**-3.8**	**-2.0**	**-2.5**	**-2.0**	**-1.5**
	COM Apr 2008	-3.8	-2.0	-2.5	-2.6	n.a.
	CP Nov 2006	*-3.9*	*-3.4*	*-3.1*	*-2.9*	*n.a.*
Primary balance (% of GDP)	**CP Mar 2008**	**-1.1**	**0.2**	**-0.2**	**0.3**	**0.8**
	COM Apr 2008	-1.1	0.6	0.2	0.1	n.a.
	CP Nov 2006	*-1.5*	*-1.0*	*-0.7*	*-0.6*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**CP Mar 2008**	**-4.0**	**-2.4**	**-2.8**	**-1.9**	**-1.1**
	COM Apr 2008	-4.0	-2.5	-2.7	-2.3	n.a.
	CP Nov 2006	*-4.1*	*-3.6*	*-3.2*	*-3.0*	*n.a.*
Structural balance[3] (% of GDP)	**CP Mar 2008**	**-4.0**	**-2.4**	**-2.8**	**-1.9**	**-1.1**
	COM Apr 2008	-4.0	-2.5	-2.7	-2.3	n.a.
	CP Nov 2006	*-4.1*	*-3.6*	*-3.2*	*-3.0*	*n.a.*
Government gross debt (% of GDP)	**CP Mar 2008**	**47.6**	**44.9**	**44.2**	**43.3**	**42.3**
	COM Apr 2008	47.6	45.2	44.5	44.1	n.a.
	CP Nov 2006	*48.9*	*50.0*	*50.3*	*50.2*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 5.2%, 5.9%, 6.0% and 6.2% respectively in the period 2006-2009.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. There are no one-off and other temporary measures in the most recent programme and Commission services' spring forecast.

Source :
Convergence programme (CP); Commission services' spring 2008 economic forecasts (COM); Commission services' calculations

1. INTRODUCTION

The most recent update of the convergence programme was submitted on 26 March 2008[6]. The late delivery resulted from the October 2007 elections leading to the formation of a new government. The programme covers the period 2007-2010, with some indicators for the years beyond that period. It has been approved by government after the adoption of the 2008 budget by parliament.

This assessment is further structured as follows. Section 2 discusses the key challenges for public finances in Poland, with a particular focus on the quality of public finances and the labour market. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the convergence programme against the background of the Commission services' economic forecasts. Section 4 analyses budgetary implementation in the year 2007 and the medium-term budgetary strategy outlined in the new programme. Taking into account risks attached to the budgetary targets, it also assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses the quality of public finances and structural reforms, while Section 7 analyses the consistency of the budgetary strategy outlined in the programme with the national reform programme and its implementation reports and with the broad economic policy guidelines. The annexes provide a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme (Annex 1) and selected key economic indicators of past economic performance (Annex 2).

2. KEY CHALLENGES FOR PUBLIC FINANCES WITH A PARTICULAR FOCUS ON THE QUALITY OF PUBLIC FINANCES AND THE LABOUR MARKET IN POLAND

2.1. Introduction

The dismal functioning of the labour market was one of the main factors holding back a fast catching-up process identified by the Commission services in the assessment of the 2006 update of the Polish Convergence Programme. Furthermore, stabilisation and efficiency were identified as the key medium and long-term challenges for public finances.[7] In the process of catching-up to the living standards of the EU-15, restructuring of inefficient firms led to labour shedding and unemployment increased dramatically in Poland. Rather than analysing the sensitivity of the budget to labour market developments, this scene setter focuses on the influence of different elements of public expenditure and revenue on the situation in the labour market.

The overall spending on social protection reached about 17% of GDP in recent years – significantly above the average ratio for the recently acceded member states. Pecuniary social benefits (other than social transfers in kind) amounted to more than 15% of GDP, compared to about 11% in the other new member states on average. This high social

[6] The English version arrived on 17 April 2008.

[7] European Commission (2007), Economic Assessment of the 2006 Convergence Programme of Poland, ECFIN/G3 (2007) REP 50822 – EN, available at: http://ec.europa.eu/economy_finance/about/activities /sgp/country/commwd/pl/com_pl20062007.pdf

spending is not only a big burden for the budget, but also has a strong impact on the labour market in Poland, mainly through the incentives to work. It appears that easily available disability benefits and early pensions, heavily subsidised social security for farmers and the emphasis on passive labour market transfers rather than active labour market policy were not helpful in tackling high unemployment and low activity in Poland.

Currently planned reforms such as the “bridge pensions”, “task budgeting” and the “pro-family” subsidies and allowances are an opportunity to better target public transfers, improve the quantity and quality of labour supply and reduce the high tax wedge caused by excessive expenditure. Finally, as demonstrated in the last subsection, the tax wedge reduction will probably have some impact on the labour market but it would be less costly and more effective if narrowed down to the least-skilled.

2.2. The labour market in Poland

Over the past ten years, the unemployment rate in Poland rose continuously from 10% of the labour force in 1998 to a peak of 20% in 2002, owing to a combination of cyclical, demographic and structural factors. Since 2003, labour market conditions have been improving gradually and from mid-2005 at a more rapid pace. The unemployment rate has fallen by about 9 percentage points to around 9½% in 2007. However, at 57% of the working age population in 2007, the employment rate was second lowest in the EU-27.

The 2008 Commission services’ forecast projects the unemployment rate to fall around 7% in 2008 thanks to increased labour demand on the back of fast economic growth, but also thanks to a falling activity rate due to early retirements and emigration. The employment rate is projected to rise by about 1 percentage point in 2008, but it will still be far below the EU-27 average.

The impact of structural change during the transition from a centrally planned to a market economy on employment and unemployment levels in Poland has been far more challenging than in the other countries of the region, namely the Czech Republic, Hungary and Slovakia. Several factors explain Poland’s greater vulnerability:[8] the nature of the structural change (delays in large-scale privatisations), a different structure of its economy (a high share of employment in agriculture), a more severe impact of the Russian crisis in 1998, and the structure of public finances.

Polish unemployment is characterised by a large structural component (the NAIRU was estimated at 14.1% in 2006 and is expected to come down to 5.9% in 2009). Labour shortages which appear in certain segments of the market despite nearly 1.6 million people without a job, point to skill mismatches resulting from an unfavourable (although improving) structure of the economy (about 15% of all the employed work in the agricultural sector) and an unsatisfactory participation in life-long learning (about 5% of the population aged 25-64 in 2007). Low mobility across regions combined with a uniform minimum wage lead to considerable regional labour market disparities with unemployment rates ranging from 7½% to 11½%.

On the other hand there is an important workforce migration out of the country as the costs of domestic and international labour mobility are similar but potential gains in

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[8] European Commission (2006), Country Study: Growth and Competitiveness in the Polish Economy: The Road to Real Convergence, European Economy, Occasional Papers, No. 27, available from http://ec.europa.eu /economy_finance/publications/occasional_papers/2006 /ocp27en.pdf

salaries are much higher abroad giving a major incentive for young and educated people to leave the country.[9] In 2004-2006 the number of migrants doubled and reached almost 2 million people, of which about 1.5 million went to EU-25, mostly to United Kingdom and Ireland.

Significant international work migration together with generous early retirement schemes has led to an important decrease in the activity rate in 2000-2007 (from 65.8% in 2000 to 63.2% in 2007 when the activity rate was the fifth lowest in the EU-27). The latest Commission forecast projects a continuation of the trend, with the activity rate for people aged 15-64 projected to stabilise around 62½% in 2008 and 2009.

The situation of women and the young is particularly bad in Poland compared to the EU-27 averages: for women the employment rate is merely at about 48% and the unemployment rate reaches 10.3%. The unemployment rate of young people fell from more than 42% in 2002 to about 22% in 2007, but is still much higher than in other EU-27 countries. About 56% of the unemployed did not find any job for more than one year in 2006, which is 11 percentage points more than in the EU-25.

Table 1: Selected annual labour force survey indicators

		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Unemployment	'000	2788	3170	3431	3323	3230	3045	2344	1619	1202	1051
Unemployment rate	[%]	16.1	18.2	19.9	19.6	19.0	17.8	13.8	9.6	7.1	6.2
NAIRU	[%]	14.4	16.0	17.2	17.8	17.6	16.2	14.1	11.5	8.7	5.9
Unemployment rate females	[%]	18.1	19.8	20.9	20.4	19.9	19.1	14.9	10.3	n.a.	n.a.
Unemployment rate 15-24 years	[%]	35.2	39.5	42.5	41.9	39.5	36.9	29.8	21.7	n.a.	n.a.
Long-term unemployment	[%]	46.1	50.2	54.8	56.0	54.1	57.7	56.1	51.1	n.a.	n.a.
Employment	'000	14526	14206	13782	13617	13794	14116	14594	15240	15637	15842
Employment rate	[%]	47.5	46.1	44.4	44.0	44.3	45.2	46.5	48.6	49.7	50.3
Employment rate 15-64	[%]	55.0	53.4	51.5	51.2	51.7	52.8	54.5	57.0	58.1	58.8
Employment rate 15-64 Females	[%]	48.9	47.7	46.2	46.0	46.2	46.8	48.2	50.6	n.a.	n.a.
Life-long learning participation	[%]	n.a.	4.3	4.2	4.4	5.0*	4.9	4.7	5.1	n.a.	n.a.
Employment in agriculture	[%]	18.8	19.1	19.3	18.4	18.0	17.4	15.8	14.7	n.a.	n.a.
Employment in industry	[%]	30.8	30.5	28.6	28.6	28.8	29.2	30.0	30.7	n.a.	n.a.
Employment in services	[%]	50.4	50.4	52.0	53.0	53.2	53.4	54.2	54.5	n.a.	n.a.
Activity rate	[%]	56.6	56.5	55.5	54.7	54.7	54.9	54.0	53.7	53.6	53.7
Activity rate 15-64	[%]	65.8	65.5	64.6	64.0	64.0	64.4	63.4	63.2	62.7	62.8
Activity rate 15-64 Females	[%]	60.0	59.8	58.7	58.1	58.0	58.1	56.8	56.5	n.a.	n.a.
Work migration (end of period)	000	n.a.	n.a.	786	n.a.	1000	1450	1950	n.a.	n.a.	n.a.

Notes:
* Break in the series
Source:
Eurostat, Commission services' Spring 2008 forecast, GUS

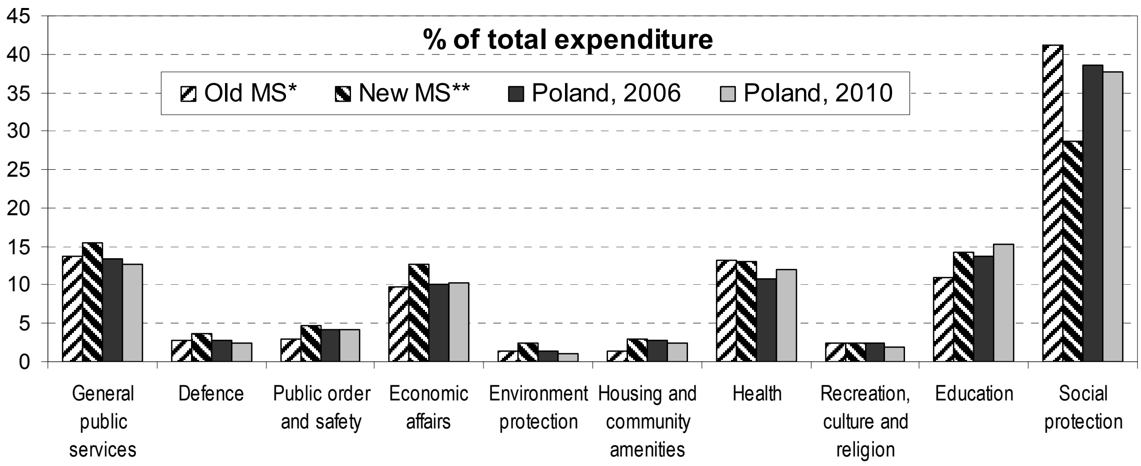
9 Ministerstwo Pracy i Polityki Społecznej and Instytut Badań Strukturalnych (2007), Zatrudnienie w Polsce 2006: Produktywność dla pracy, available from http://ibs.org.pl/site/index.php ?nr_dokumentu =0&nr_dzialu=2&PHPSESSID=7436de98a28992963006d2551b6d2fa0

2.3. The expenditure side of public finances

Poland has a relatively heavy government. In 2007, the general government expenditure ratio reached about 42½% of GDP, which was lower than a simple average for the EU-15 (45½% of GDP), but higher than for the other countries which joined the EU since 2004 (40% of GDP). If one looks at the functional composition of expenditure (Figure 1), Poland stands out as a country which spends a lot on social security (38½% of total expenditure, equivalent to almost 17% of GDP). In 2006, Poland allocated a slightly lower fraction of its public expenditure to social protection compared to the old Member States, whereas the average fraction in the new Member States was 10 percentage points lower. Consequently, spending on other government functions was crowded out. In particular, Poland spends relatively less on health, general public services, environment protection and defence.

It appears that the Polish authorities have recognised the need to reduce the bias in the composition of public expenditure. In the March 2008 convergence programme, they presented a target for 2010, according to which spending on social protection should be reduced by 2 percentage points to 15% of GDP compared to 2006, with little information on measures backing this target (see Section 4.2.2). However, this ratio will be still significantly higher than the 2006 average for many other new member states. It seems important to cut social spending in Poland even further because of two major reasons. Firstly, redirecting more public resources to growth-oriented public expenditure would support the absorption of EU funds and catching up. Secondly, too generous social protection systems are likely to create large distortions in the labour market. Excessive social spending may be partly responsible for both revealed and hidden unemployment in Poland and a low activity rate which hamper GDP growth.

Figure 1: The functional composition of general government expenditure

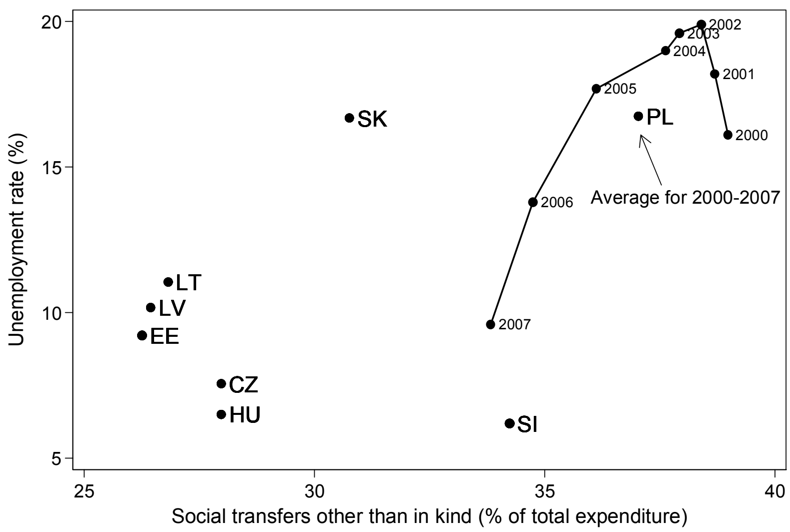


Notes:
* Austria, Denmark, Finland, Germany, Greece, Luxembourg, Spain in 2006 (data for other countries not available).
** Czech Republic, Cyprus, Lithuania, Malta in 2006 (data for other countries not available).
Source: Eurostat and the March 2008 convergence programme.

Despite a sharp increase in unemployment in 2000-2002, Poland slightly reduced the ratio of social benefits in total general government expenditure because of the sharp increase of the share of long-term unemployed in the total number of unemployed. Their rights to unemployment benefits expired and they could receive only relatively low social assistance benefits. A further reduction of this ratio was possible thanks to the improvement in the labour market in the following years. Nevertheless, the unemployment rate was still the highest among the countries of the region (Figure 2).

With comparable unemployment rates, Slovakia and Lithuania had much lower shares of social benefits in total expenditure (by about 10 percentage points), because of less generous social benefits systems. Both the experience of the Baltic states and Slovakia and cross-country time-series analyses point to a likely positive impact of lower social expenditure on long-term growth[10]. This seems possible thanks to stronger job-seeking and re-training incentives, which are hampered by high or broadly targeted social benefits for unemployed or inactive people. In view of the decline of unemployment occurring now and expected in the coming years, there is room for additional cuts in social spending in Poland which can strengthen the improvement in the labour market through reducing the incentives to become inactive as well as leaving more resources for public investment in human capital (active labour market policies) and thus allow for maintaining strong GDP growth.

Figure 2: Social benefits and unemployment in selected Eastern-European EU member states in 2000-2007



Source: Commission services.

2.3.1. A high inactivity rate: early pensions replace disability benefits

In the 1990s, inactivity was supported by both lenient disability benefits (approximately 3% of GDP) and generous early retirement schemes (which cost currently about 1.8% of GDP). According to another classification, about 4% of GDP is spent on different early inactivity transfers[11]. Besides ageing of the Polish society and migrations of active persons abroad, high spending on social benefits is among the main reasons for Poland's very low labour activity (one of the lowest activity rates in the EU-27: 63.2% compared to 70.5% for the EU-27 in 2007). Many of the inactive people appear to be de-facto unemployed receiving unconditional benefits which destroy motivation to look for registered jobs. Hidden unemployment was estimated at more than 5.5% of the labour

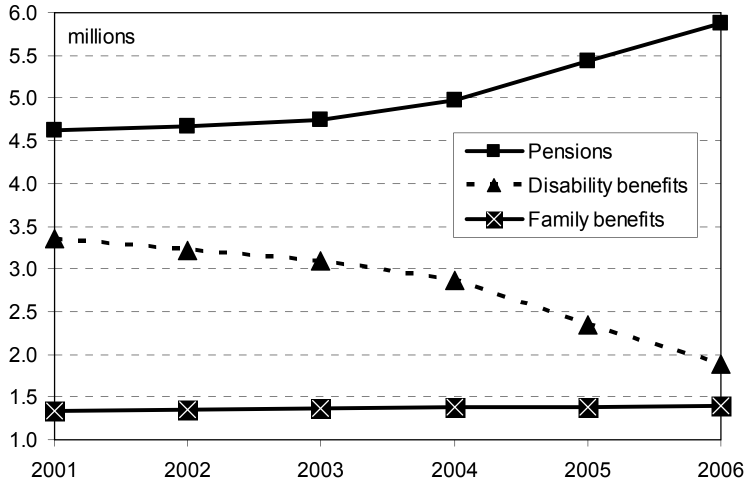
[10] European Commission (2006), Country Study: Growth and Competitiveness in the Polish Economy: The Road to Real Convergence, European Economy, Occasional Papers, No. 27, available from http://ec.europa.eu /economy_finance/publications/occasional_papers/2006 /ocp27en.pdf

[11] Wóycicka, I. (2007), "Czy Polska jest krajem solidarności społecznej?", *Rzeczpospolita*, No. 85, 11 April

force in recent years and it was the highest in rural areas[12]. Although rules on the access to disability benefits have been reinforced recently, the potential savings have been offset by increased retirement-related transfers (including early pensions and pre-retirement benefits), both in the general and in the farmers' social security system[13,14]. These trends appear to accelerate (Figure 3).

While introducing the pension reform in 1999, the policy-makers planned to replace traditional early pensions with less generous "bridge pensions" in 2007. This deadline has been postponed twice, first to 2008, and subsequently to 2009. There are delays due to political sensitivity and the concrete modalities of the reform are still to be specified. The "bridge" pensions are planned to be (i) paid only from early retirement until the standard retirement age, (ii) applicable only to people "working in difficult conditions", and (iii) at least partly financed through contributions, rather than fully paid from the budget. Nevertheless, the new system may be still fairly generous, covering large groups of public sector employees, such as teachers, and result in the persistency of strong incentives to retire early.

Figure 3: Pensions and social benefits in Poland



Notes:
Annual average number of total files (the general pay-as-you-go fund plus the farmers' social security fund, KRUS).
Source: Polish central statistical office (GUS).

2.3.2. Employment and social security in the agricultural sector

A subsidy to the farmers' social security fund (KRUS) constitutes a significant part of social protection expenditure (exceeding 1% of GDP annually). The net benefit from participation in the fund is very high and the eligibility rules are lenient. Farmers contribute less than 5% of gross wages to the KRUS on average, while the average contribution of a non-agricultural worker to the general social security fund is about 20%

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[12] Czamarski, J. and B. Slay (2006), "Poland's very difficult labour market", *Development & Transition* No. 05, available from http://www.developmentandtransition.net/uploads/issuesAttachments/15/DevTran5web.pdf

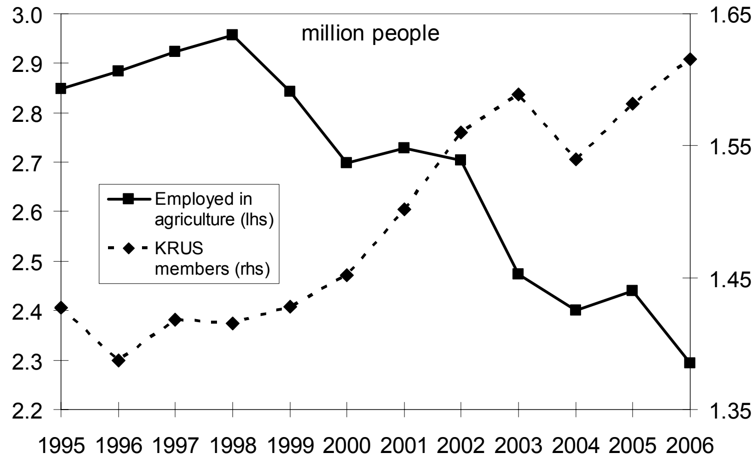
[13] European Commission (2006), Country Study: Growth and Competitiveness in the Polish Economy: The Road to Real Convergence, European Economy, Occasional Papers, No. 27, available from http://ec.europa.eu /economy_finance/publications/occasional_papers/2006 /ocp27en.pdf

[14] Organisation for Economic Co-operation and Development (2006), *Sickness, Disability and Work: Breaking the Barriers (Vol. 1): Norway, Poland and* Switzerland, No. 11

of gross wage . Moreover, owners of the smallest farms (below 2 hectares) do not have to pay contributions, but they are eligible for benefits. To qualify for membership in KRUS, one has to possess at least 1 hectare of land over a certain number of years of contribution, which allows many non-farmers to be KRUS beneficiaries. As a result, according to the 2007 budget, only 7.7% of KRUS expenditure is covered by contributions and the fund is heavily subsidised from the central budget.

It seems that KRUS has slowed down farm restructuring during transition, resulting in the persistence of a large number of low-productive farms of less than 2 hectares[15]. Despite many calls from different institutions to conduct a fundamental reform of KRUS,[16] the system has remained generally unchanged since 1990. The general pension reform establishing funded pension schemes did not cover the farmers' social security system. With no significant reforms, the number of people insured in KRUS has increased in recent years, despite a decline in the number of people employed in agriculture (Figure 4). These tendencies hamper the restructuring of agriculture and increase the implicit liabilities weighing on future government balances in Poland.

Figure 4: Employment in agriculture and farmers' social security fund (KRUS) membership



Source: Polish central statistical office (GUS, data until 1999) and Eurostat (from 2000) and the farmers' social security fund (KRUS).

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15 Latruffe, L. (2006), "Technical efficiency and indebtedness of Polish farms before accession to the European Union", *INRA Sciences Sociales*, No. 5/05, available from http://www.inra.fr/internet /Departements/ESR /publications/iss/pdf_eng/iss05-5_Eng.pdf

16 E.g.: European Parliament (1998), "The Social Dimension of Enlargement: Social Law and Policy in the Czech Republic, Estonia, Hungary, Poland and Slovenia", Directorate General for Research, Social Affairs Series Working Paper (SOCI 100 EN); World Bank (2001), "Poland's Labor Market: The Challenge of Job Creation", World Bank Country Study; Burns, A. and Yoo, K.-J. (2002), "Public expenditure management in Poland", Economics Department Working Papers No. 346 (ECO/WKP(2002)32), Organisation for Economic Co-operation and Development; Markiewicz M. and J. Siwinska (2003), "Wydatki sztywne budżetu państwa", Studies & Analyses, No. 249, Center for Social and Economic Research (CASE); European Commission (2006), *Country Study: Growth and Competitiveness in the Polish Economy: The Road to Real Convergence*, European Economy, Occasional Papers, No. 27.

2.3.3. *Labour market policy dominated by passive measures*

Labour market policy in Poland has been generally assessed as passive. Poland spends less than 0.2% of GDP on active labour market policies, compared to approximately 0.3% of GDP in the Czech Republic and Hungary[17,18]. Nevertheless, active labour market policies could have potentially significant effects in Poland, even when public administrators are relatively inexperienced in that area[19,20]. In spite of that, Polish labour offices have focused more on the registration of unemployed and the distribution of benefits rather than assisting in finding jobs or re-training. In the late 1990s, much of the responsibility for active labour market policies was delegated to local authorities. Insufficient funds were passed on from the central level and many local administrators still do not have the capacity to fulfil these duties effectively[21]. Therefore, only ca. 15% of the unemployed participated in active labour market programmes, but an initiative of the Polish Ministry of Labour to intensify effort and employing EU funds should increase the number of participants.

An additional problem is that individuals who need support most are not properly targeted, i.e. they do not receive sufficient transfers which are captured by those who are not necessarily in need but are able to exploit the weaknesses of the social security system. People from rural areas constitute only a small proportion of participants in active labour market policy programmes. In these areas, institutions providing vocational training are scarce[22]. Besides, Poland has a low participation rate of disabled people (below 20% of working age population disabled, which was one of the lowest ratios in Europe). The vocational rehabilitation is underdeveloped resulting in a declining employment rate of disabled people since the mid-1990s[23]. This can be attributed to a relatively low share of overall public spending on healthcare in total general government expenditure in Poland (by 3 percentage points compared to the mean for the old member

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[17] Ministerstwo Pracy i Polityki Społecznej and Instytut Badań Strukturalnych (2007), *Aktywne formy promocji zatrudnienia, łagodzenie skutków bezrobocia*, available from http://www.mpips.gov.pl /index.php?gid=704

[18] Organisation for Economic Co-operation and Development (2007), *Labour Force Statistics, Indicators, Labour Market Programmes, Public expenditure and participant stocks on LMP*, available from http://stats.oecd.org/wbos/default.aspx?DatasetCode=LMPEXP

[19] Kluve, J., Lehmann, H.F. and C.M. Schmidt (1999), "Active Labour Market Policies in Poland: Human Capital Enhancement, Stigmatization or Benefit Churning?", CEPR Working Paper No. 2059, available from http://ssrn.com/abstract=155089

[20] Puhani, P.A. (1999), "Estimating the Effects of Public Training on Polish Unemployment by Way of the Augmented Matching Function Approach", ZEW Discussion Paper No. 99-38, available from http://ssrn.com/abstract=376181

[21] Czamarski, J. and B. Slay (2006), "Poland's very difficult labour market", *Development & Transition* No. 05, available from http://www.developmentandtransition.net/uploads/issuesAttachments/15 /DevTran5web.pdf

[22] Kwiatkowski, E., P.Gajewski and T. Tokarski (2004), "Agricultural regions and regional policy in Poland", Research Project commissioned by Eouropean Commission, DG Employment (VC/2003/0367), available from http://ec.europa.eu/employment_social/employment_analysis /restruct/region_pol_case_en.pdf

[23] Organisation for Economic Co-operation and Development (2006), *Sickness, Disability and Work: Breaking the Barriers (Vol. 1): Norway, Poland and* Switzerland, No. 11

states and by 2 percentage points against the ratio for the new member states in 2005, Figure 1). Healthcare expenditure appears to be crowded out by social expenditure (including disability benefits and early pensions) which encourages being inactive, with perverse effects on both public finances and labour market dynamics.

2.3.4. Task budgeting: an opportunity to increase the efficiency of expenditure

The reforms in the composition and effectiveness of labour market policies can be linked to "task budgeting", the introduction of which is planned by the Polish government. "Task budgeting" entails the evaluation of the effectiveness of public expenditure in achieving some targeted improvement in specific indicators. Labour market indicators could be incorporated into this new budgetary system. "Task budgeting" with labour market indicators allows to examine the effectiveness of transfers, such as wage subsidies or child allowances, in terms of their employment-stimulating impact. In particular, the degree of generality and conditionality, associated with the social benefits, appear to play a role.

Carefully targeted wage subsidies seem to be much more effective in increasing living standards compared to transfers to which all inactive people have rights. In particular, a temporary subsidy may help solving the serious problem of high unemployment among young generations in Poland. The target group has initially low productivity and such subsidies may enhance their employability by increasing their productivity through experience and training opportunities when having a job. Nevertheless, these measures remain quite costly relative to their effects according to the UK experience[24].

To achieve the desired goals, targeting of transfers may require not only a precise delimitation of the recipients but also an appropriate and precise definition of the activity to be supported, e.g. subsidising a particular service. In Poland, general one-off child subsidies have been recently introduced and further pro-family transfers are discussed. Instead, more narrowly targeted child subsidies could be assigned to the purchases of certain services only such as childcare. Similarly to job subsidies, while targeting a desirable goal (such as raising the number of children and, thus, the neutralisation of ageing), childcare allowances are expensive in static terms. In dynamic terms, childcare subsidies may be partly self-financing as they are likely to increase the supply of labour, because a parent can return quickly to the labour market, as illustrated by the Dutch experience.[25] Thus, specific childcare allowances are more likely to have positive labour supply effects, in contrast to the more general child subsidies (or "pro-family" tax cuts).

Untargeted and unconditional social expenditure not only leave less resources for targeted and conditional social spending, but also for human and physical capital. Because of an underdeveloped transport network and housing infrastructure, Poland suffers from low domestic labour mobility restrained e.g. by long hours spent on commuting[26] and shortage of affordable accommodation. Increasing absorption of EU

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[24] Bell, B., R. Blundell and J. van Reenen (1999), "Getting the Unemployed Back to Work: The Role of Targeted Wage Subsidies", *International Tax and Public Finance*, Vol. 6, Issue 3, pp. 339-360

[25] Graafland, J. J. (2000), "Childcare subsidies, labour supply and public finance: an AGE approach", *Economic Modelling*, Vol. 17, pp. 209-246.

[26] Ministerstwo Pracy i Polityki Społecznej and Instytut Badań Strukturalnych (2007), Zatrudnienie w Polsce 2006: Produktywność dla pracy, available from http://ibs.org.pl/site/index.php?nr_dokumentu=0&nr_dzialu=2&PHPSESSID=7436de98a28992963006d2551b6d2fa0 – pp. 143, 157.

funds and cofinancing as well as the durable reduction of government deficits will require readjustments in public finances in favour of a larger share of public investment.

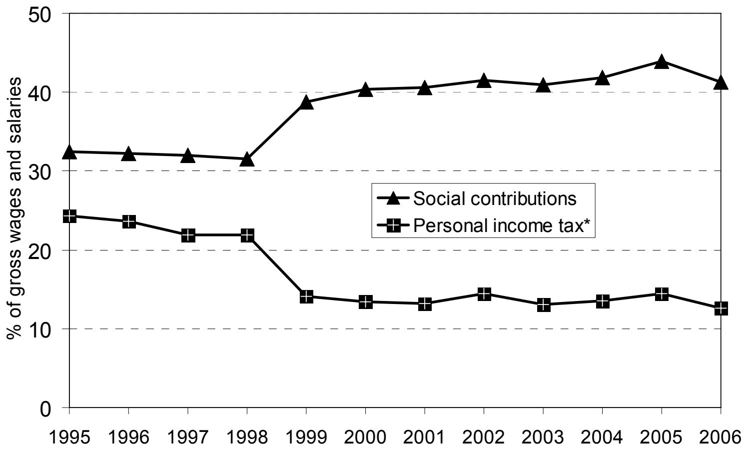
2.4. The revenue side of public finances

The composition of public revenues is also likely to have an impact on the labour market via the way wages are taxed. It has been argued that the "tax wedge"[27] is one of the factors contributing to high unemployment in Poland, especially the officially registered number.

The total tax wedge in Poland is above the average for the OECD countries, placing it in the 10th position among these countries, and around the EU-27 average. Most of that wedge consists of high social contributions resulting in a ratio of social contributions in Poland relative to labour costs which is the second highest after that in France.

In 1999, four reforms were implemented including the pension reform and healthcare reform. As a part of the healthcare reform, healthcare contribution was introduced (previously healthcare was fully financed by the budget only). The healthcare contribution was deducted from personal income tax, so it changed the composition of the tax wedge (Figure 5). Since then, there was a slight upward trend in social contributions resulting mainly from increasing healthcare contributions which were non-deductible, explaining the relatively flat share of taxes in gross wages. The drop in social contributions in 2006 resulted mainly from a more lenient social contribution regime for new entrepreneurs.

Figure 5: Evolution of observed tax wedge components in Poland



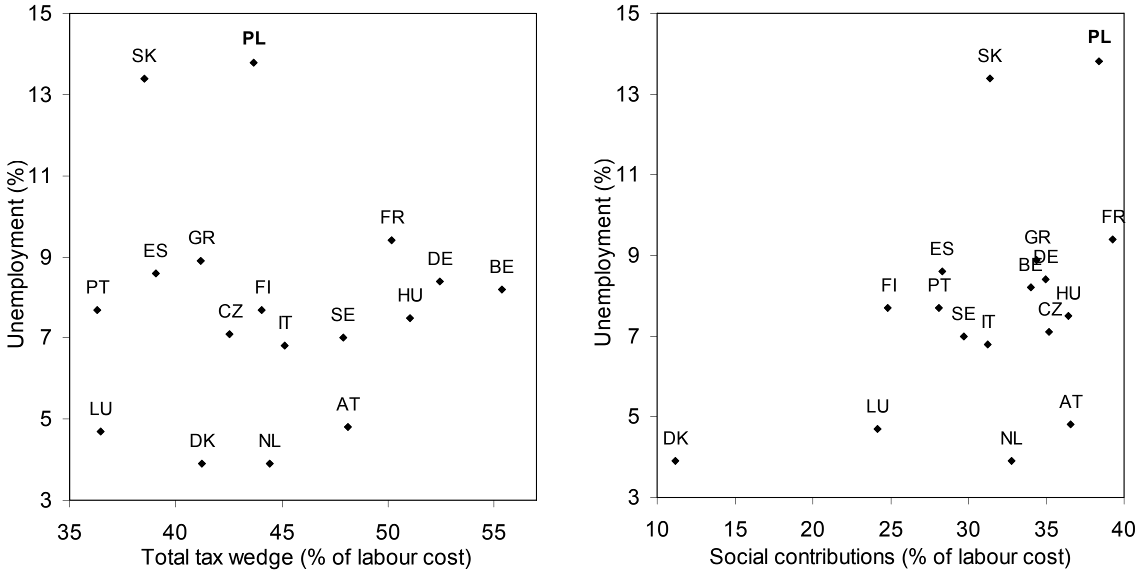
Notes:
* Current taxes on income and wealth paid by households and non profit institutions serving households.
Source: Commission services

There is no simple relationship between social contributions or the overall tax wedge and unemployment (Figure 6). The estimated short-run impact of social contributions on unemployment is quite strong in the EU-27 on average (about 0.2 percentage point decrease in unemployment two years after a 1 percentage point cut in the effective social contribution rate, see Box 1). The particularly strong short-run relationship in Poland (estimated coefficient at about 3.5) confirms the need for the Polish government to intervene in cutting social contributions. However, it seems that these effects wane over

27 Difference between the wage paid by employers and the take-home wage received by employees due to personal taxation and social contributions.

time. A simple cross-country long-run comparison for EU member states in 1990-2005 shows that a 1 percentage point reduction of the effective rate of social contributions decreases the unemployment rate by less than 0.08 percentage point on average.

Figure 6. Tax wedge in 2006



Notes:
For comparability, labour cost is defined as a gross wage of a single individual without children at the income level of an average worker.
Source: Eurostat and OECD, Organisation for Economic Co-operation and Development (2007), Taxing Wages, Special Feature: The Tax Treatment Of Minimum Wages, 2005/2006, 2006 Edition, p. 14.

Box 1: Regression analysis of a possible impact of social contribution cuts on unemployment

The government can directly set the nominal rate of social contributions, but what usually matters most is the effective rate, which is the variable used in the current econometric analysis. In order to explore the specificity of Poland, the analysis is conducted in a panel (cross-country time-series) regression. The Hausman test rejected (at 0.1%) the random (i.e. time-varying) effects and thus favoured fixed country effects (constant in time). Due to strong inertia in the labour market, one can expect autocorrelation in the residuals.[28] This can be dealt with by using a first-order autoregressive AR(1) error term.[29] To control for the impact of changes in both labour productivity and wages, real unit labour costs have been used and time dummies have been introduced to eliminate the impact from international business cycles which are common to all countries. A lag structure is included to find the best fit and to tackle the problem of possible endogeneity. The 2-year lags produced the most significant coefficients. In addition to taking account of labour market inertia, lagged independent variables help to overcome possible endogeneity i.e. the potential impact of unemployment on rates of social contributions (policy makers tend to reduce social contributions when unemployment is high).

It is found that a 1 p.p. reduction of the effective rate of social contributions may decrease the rate of unemployment by more than 0.2 p.p. on average. This short-run effect is 2.5-3

[28] Indeed, the Durbin-Watson *d* statistic is only 0.4-0.45 in the estimated regressions.

[29] $e_{it} = \rho \cdot e_{it-1} + \varepsilon_{it}$ where *e* is the auto-regressive error term, ε is an independent error term, *i* is a country, *t* is year, $|\rho| < 1$ and estimated as $\rho = 1 - d/2$ (*d* is the Durbin-Watson statistic).

times stronger than the long-run effect: The impact of 0.2 p.p. may be an underestimation of the relationships, to the extent that endogeneity is not fully eliminated, because governments can be expected to reduce social contributions in response to high unemployment. To inspect the uniqueness of Poland, one can employ interaction terms (effects). The relationship appears much stronger in Poland (unemployment rate lower by as much as 3.5 p.p. approximately, for social contributions reduced by 1 p.p.), but the coefficient is less significant (at about 10%).

The negative coefficient for the interaction term including the dummy for Poland and real unit labour costs is larger (in absolute terms) than the benchmark coefficient. The negative relationship between real unit labour costs and unemployment in Poland can be attributed to the process of restructuring involving large lay-offs. On the one hand, this process contributed to rising unemployment and a slow-down in wage growth, but on the other hand it was increasing productivity.

Table 2. Fixed-effects panel regression with AR(1) disturbance for 1990-2005

	No year dummies		With year dummies	
Effective rate of social contributions (% of compensation)	0.197* (0.097)	0.178 (0.123)	0.230** (0.049)	0.221* (0.052)
Real unit labour cost index (%)	0.196*** (0.000)	0.228*** (0.000)	0.157*** (0.000)	0.188*** (0.000)
Dummy for Poland × Effective rate of social contributions (% of compens.)		3.404* (0.094)		3.243 (0.113)
Dummy for Poland × Real unit labour cost index (%)		−0.355*** (0.004)		−0.340*** (0.005)
R-squared (within countries)	0.193	0.246	0.327	0.374
Number of countries	17	17	17	17
Number of observations	162	162	162	162

Notes:
Dependent variable: unemployment rate. Independent variables: 2-year lags.
p-values in parentheses: * p < 10%, ** p < 5%, *** p < 1%.
Data source: Ameco.

The consistency of the long-run and the short-run results is supported by the tests of the impact of social contributions on structural unemployment (with autocorrelation, fixed country effects, real unit labour costs and cycles controlled). In the long-run, the unemployment rate should fluctuate around its structural level (non-accelerating wage rate of unemployment, NAWRU). Indeed, regression analysis similar to the aforementioned shows that the impact of social contributions on structural unemployment is weaker. Consequently, cuts in social contributions seem to work considerably stronger in the short run (as a result of likely consumption booms thanks to hikes in disposable income), while other measures are needed to lower durably the unemployment rate.

Some reduction of social contributions may be reasonable, but it seems unlikely to contribute alone to a large durable drop in unemployment. Unemployment in Poland is also very much determined by other factors such as social benefits, industrial restructuring[30], relatively modest domestic labour mobility and a persistent skill mismatch between labour supply and demand[31] all leading to the jobless growth

[30] Newell, A. and F. Pastore (2006), "Regional Unemployment and Industrial Restructuring in Poland", *Eastern European Economics*, Vol. 44, Iss. 3, pp. 5-28

[31] Obadic, A. (2006), "Theoretical and Empirical Framework of Measuring Mismatch on a Labour Market", *Journal of Economics and Business*, Vol. 24, Iss. 1, pp. 55-80

observed in mid-1900s and around 2003-2005[32]. Growth seems to have become more job-rich since 2006, before the cuts in social contribution. On the other hand, the untargeted cuts are quite costly, with an expected budgetary impact in 2008 exceeding 1% of GDP. A targeted reduction of social contributions, directed only at the least-skilled workers, could have a stronger positive impact on registered employment.[33] Such cuts would be also less costly if not positive for the budget because many workers could leave the shadow economy and stop receiving unemployment benefits. Under the currently intended cuts which are proportional to wages, low-skilled workers gain very low amounts in absolute terms that are not likely to strongly influence their incentives.

2.5. Summary

Excessive expenditure, in particular on social benefits, constitutes a big burden for the budget which is financed with high government borrowing and a considerable tax wedge. It also negatively influences the situation in the labour market in Poland, through distortions of incentives to work. The high level of social spending results mainly form generous disability benefits and early pensions, heavily subsidised social security for farmers and the domination of passive labour market transfers over active labour market policy. This expenditure composition was not helpful in tackling the high unemployment and the low activity rate in Poland. Currently planned reforms such as the “bridge pensions”, “task budgeting” and the “pro-family” subsidies and allowances are an opportunity to better target public transfers and improve the quantity and quality of labour supply. More efficient government expenditure will permit to reduce the tax wedge and thus will further help improving the situation in the labour market. Therefore, fiscal adjustment can go hand-in-hand with structural reforms.

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[32] Wolnicki, M., E. Kwiatkowski, and R. Piasecki (2006), “Jobless Growth: A New Challenge for the Transition Economy of Poland”, *International Journal of Social Economics*, Vol. 33, Iss. 3-4, pp. 192-206

[33] Ministerstwo Pracy i Polityki Społecznej and Instytut Badań Strukturalnych (2007), Zatrudnienie w Polsce 2006: Produktywność dla pracy, available from http://ibs.org.pl/site/index.php?nr_dokumentu=0&nr_dzialu=2&PHPSESSID=7436de98a28992963006d2551b6d2fa0 – p. 171.

3. MACROECONOMIC OUTLOOK

This section assesses the plausibility of the macroeconomic scenario (economic activity, labour market, costs and prices) underpinning the public finance projections of the programme. It also examines whether good or bad economic times in the sense of the Stability and Growth Pact prevail. Finally, it describes macroeconomic challenges and how they are expected to develop according to the programme.

3.1. Economic activity

The programme expects a gradual decrease in GDP growth from 6.5% in 2007 to 5% in 2010. GDP growth should be driven by domestic demand with a negative external contribution over the whole programme period. The contribution of net exports which is likely to become less negative over 2009-2010 after a strong drop in 2008 is expected to be fuelled by a stabilising currency and lower import dynamics, as both import–intensive investments and private consumption will be decelerating.

The output gap as recalculated by Commission services based on the information in the programme is foreseen to decline both in 2008, however still remaining positive at 0.7% of potential output. It is projected to turn negative in 2009 to 0.2% of potential output and further to 0.9% of potential output in 2010. The average growth projection for the whole programme period is broadly in line with the average growth performance of the past five years.

Table 3: Comparison of macroeconomic developments and forecasts

	2007		2008		2009		2010
	COM	**CP**	**COM**	**CP**	**COM**	**CP**	**CP**
Real GDP (% change)	6.5	6.5	5.3	5.5	5.0	5.0	5.0
Private consumption (% change)	5.2	5.2	5.6	6.0	4.7	5.4	4.5
Gross fixed capital formation (% change)	20.4	20.4	15.3	14.5	12.0	10.0	10.0
Exports of goods and services (% change)	9.1	9.0	6.9	6.0	6.6	6.2	6.2
Imports of goods and services (% change)	10.9	10.9	10.5	9.6	8.7	7.8	7.0
Contributions to real GDP growth:							
- Final domestic demand	7.4	7.4	7.0	7.2	6.0	6.0	5.6
- Change in inventories	0.0	0.0	0.0	-0.1	0.0	0.0	0.0
- Net exports	-0.9	-0.9	-1.7	-1.7	-1.0	-1.0	-0.6
Output gap[1]	1.2	1.1	0.5	0.7	-0.7	-0.2	-0.9
Employment (% change)	4.5	4.3	2.6	1.6	1.3	1.2	1.1
Unemployment rate (%)	9.6	9.4	7.1	7.2	6.1	5.8	4.5
Labour productivity (% change)	1.9	2.1	2.6	3.9	3.6	3.8	3.8
HICP inflation (%)	2.6	2.6	4.3	3.5	3.4	2.9	2.5
GDP deflator (% change)	3.0	3.2	4.9	3.4	3.1	3.0	2.5
Comp. of employees (per head, % change)	8.1	6.2	8.0	6.8	7.0	7.0	6.8
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.6	-2.6	-2.3	-3.5	-3.6	-4.2	-4.6

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source :

Commission services' spring 2008 economic forecasts (COM); Convergence programme (CP)

The external assumptions underpinning the macroeconomic scenario in the programme diverge slightly from the Commission services' spring 2008 forecast. The programme assumes a slightly weaker exchange rate of PLN against EUR in 2008, lower oil prices (in USD terms) over the whole programme horizon and a slightly lower short–term interest rates in 2008.

The GDP growth decrease from 6.5% in 2007 to 5.5% in 2008 and 5% in 2009 projected by the programme is broadly in line with the Commission services' spring 2008 forecast of a drop from 6.5% in 2007 to 5.3% in 2008 and 5% in 2009. The programme's growth projection for 2010 remains below the estimate of potential growth in the spring 2008 forecast for the period 2007-2009 of 6%.

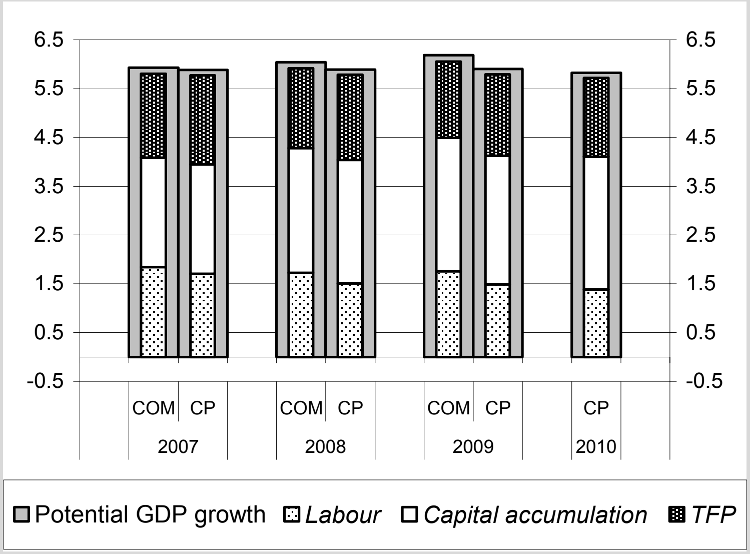
Private consumption and compensation of employees are according to the programme expected to grow on average by 5.5% and 6.7% respectively in years 2007-2009. The programme's private consumption growth projection is thus slightly above the Commission services' spring 2008 average forecast of 5.2% while its projection for growth in compensation of employees is below the Commission services' forecast of 7.7%. The pattern in private consumption growth is slightly favourable. The programme plausibly assumes strong growth of investment spending, amounting on average to 15% in years 2007-2009, backed by high level of utilisation of production capacity, increasingly better utilisation of EU funds and the high profitability of enterprises (compared to the Commission services' forecast of an increase in investment by 15.9% on average for years 2007-2009).

Overall, the programme's macroeconomic outlook seems to be based on plausible growth assumptions for 2007-2009 and cautious assumptions for 2010.

Box 2: Potential growth and its determinants

Potential growth as recalculated by the Commission services using the commonly agreed methodology based on the information in the programme is estimated to remain stable at 5.9% over the years 2007-2009 and then decline slightly to 5.8% in 2010.

Potential growth and its determinants



Average potential growth over the whole programme period is above average growth in the past ten years as it benefits from both strong investment and labour utilisation growth, albeit lower TFP growth. The difference between potential growth estimates as recalculated by the commission services using the commonly agreed methodology on the basis of the programme's macroeconomic scenario and the Commission services' spring 2008 forecast is mainly driven by higher labour utilisation assumed by the Commission services in the years 2008-2009.

The programme mentions structural reforms in the labour market that should increase the participation rate and the employment rate, especially among people aged 50 and more. However their impact on potential growth is not explicitly modelled given the limitations of the methodology used to derive potential output in the programme.[34]

The positive output gap for 2008 as recalculated by the Commission services on the basis of the data provided in the programme using the commonly agreed method is around ¼ percentage point higher than the output gap indicated in the Commission services' spring 2008 forecast. The negative output gap for 2009 is around ½ percentage point smaller than the output gap indicated in the Commission services' spring 2008 forecast. [35]

Although estimates for the years 2006-2008 varied considerably in successive Commission services' forecasts and convergence programmes (as recalculated according to the commonly agreed method), a positive output gap has been consistently indicated for the year 2007 and with one exception for the year 2008.

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[34] The Polish Ministry of Finance uses the Hodrick-Prescott filter for estimating output gaps, not the production function approach.

[35] Output gaps presented in the programme are different: 0.6% of potential output in 2007, 0.5% in 2008, 0.1% in 2009 and −0.1% in 2010.

Table 4: Output gap estimates in successive Commission services' forecast and convergence programme updates (% of potential GDP)

	2006		2007		2008		2009	
	COM	CP	COM	CP	COM	CP	COM	CP
Spring 2008	0.59		1.15		0.45		-0.69	
CP Mar 2008		**0.5**		**1.1**		**0.7**		**-0.2**
Autumn 2007	0.29		0.86		0.36		-0.64	
Spring 2007	0.14		0.37		-0.20		n.a.	
CP Nov 2006		**0.5**		**0.5**		**0.3**		**0.4**
Autumn 2006	0.39		0.28		0.11		n.a.	
Spring 2006	0.79		1.12		n.a.		n.a.	
CP Jan 2006		**0.3**		**0.3**		**0.6**		**n.a.**
Autumn 2005	0.42		0.60		n.a.		n.a.	
Spring 2005	1.46		n.a.		n.a.		n.a.	
CP Dec 2004		**1.2**		**2.1**		**n.a.**		**n.a.**
Minimum value	0.14	0.30	0.28	0.30	-0.20	0.30	-0.69	-0.20
Maximum value	1.46	1.20	1.15	2.10	0.45	0.70	-0.64	0.40
Average output gap revision (1)	0.01	-0.17	0.50	0.13	0.37	0.25	-0.06	-0.60
Standard deviation of revision (2)	0.48	0.39	0.35	0.81	0.28	0.21		
Percentage cases of change of sign w.r.t. latest estimate (3)	0%	0%	0%	0%	33%	0%	0%	100%

Source:
Commission services' forecasts and convergence programme updates
Notes:
(1) average of the difference between the latest available estimate (Spring 2008) and the previous vintages figures.
(2) Standard deviation of the difference between the latest available estimate (Spring 2008) and the previous vintages figures
(3) Frequency of the change in the sign of output gap figures in different vintages compared to the sign of the latest estimate (Spring 2008).

3.2. Labour market and cost and price developments

The programme projects employment growth to decrease gradually from 4.3% in 2007 to 1.1% in 2010 while the unemployment rate should fall from 9.4% in 2007 to 4.5% in 2010. This is in line with the substantial drop in employable labour in Poland in recent years due to migration and the inactivity of the older workers. The programme assumes that lowering of the tax wedge will have a favourable impact on labour supply and will contribute to an increase in labour demand. It also assumes that the rising wages and salaries will pull some unemployed and inactive into employment.

The decline in employment growth is more profound than the anticipated deceleration in GDP growth due to persistent labour market rigidities (described in Section 2). Further gradual improvement in the labour market conditions is not fully in line with negative output gap estimates for 2009 and 2010 (as recalculated by Commission services), but could be explained by the lagged response of the labour market to the strong GDP and investment growth of the previous years.

According to the programme, HICP inflation is expected to increase from 2.6% in 2007 to 3.5% in 2008 and gradually decrease afterwards to 2.5% in 2010. For 2008 and 2009, the Commission services' inflation projections are 0.8 and 0.5 p.p. higher than the programme projections. This can only partly be explained by differences in forecast assumptions: While the programme assumes slightly more favourable oil price developments (expressed in USD), it also assumes a weaker PLN/euro exchange rate and slightly lower interest rates than the Commission services' spring forecast, which would tend to yield a higher inflation forecast. Against this background, in particular HICP inflation for 2008 seems to be underestimated in the programme.

The inflation projection is subject to non-negligible upside risks related to possible higher-than-expected wage increases and growth in food and oil prices. Also, prices of gas and electricity are set to increase significantly in the course of the second quarter 2008, which may add to inflation dynamics for much of 2008 and in the first months of 2009. Further appreciation of the currency would on the other hand dampen inflationary pressures. In order to contain inflation, there is a need for further structural reforms, especially in the labour market. They could not only exert a positive impact on the inflation outlook but improve the competitiveness of the economy as well.

3.3. Macroeconomic challenges

With the tightening labour markets impacting on wages and unfavourable supply side developments, it will be crucial to address the issue of price stability, if Poland is to maintain on its convergence path towards the euro area.

Fuelled by strong wage increases, credit growth, hikes in administered prices and surging food and energy prices, HICP inflation picked up significantly in the second half of 2007 and in the first quarter of 2008 (from 2.6% in June 2007 to 4.4% in March 2008). The Commission services foresee a peak in HICP inflation in Q3 of 2008 and some easing throughout 2009 under the assumption of stabilising food and fuel prices. However, the strong wage growth and sectoral labour shortages will likely remain the driving force behind the inflation dynamics. Gradually appreciating PLN will play an inflation stabilising role over the forecast horizon, but will also exert negative pressure on the external competitiveness of the economy and current account developments.

Although the programme describes several structural policy measures to ease the situation in the labour market and improve the business environment, these are mainly only non-binding intentions at this stage. Among the measures, the largest potential in terms of preserving long-term price stability is seen in those aiming at reducing the tax wedge and increasing activity rates among 50+ old. On the former, the enacted reduction in social contributions should increase labour participation across all labour groups. In view of a tightening labour market with a high share of inactive people aged 50 or more, tax policy should be accompanied by government policies supporting active participation of older workers in the labour market. At the same time, incentives to find and provide employment should be strengthened, especially for low-skilled workers.

Structural policies aiming at a stronger competitive environment would be welcome. In the energy sector, diversification of energy import possibilities and increased domestic energy production capacities are crucial in generating effective competition necessary to enable favourable energy price developments on a sustainable basis. At the same time, increased energy efficiency would decrease the high role of energy prices in households' consumption. Finally, a prudent fiscal stance will also be essential to contain inflationary pressures.

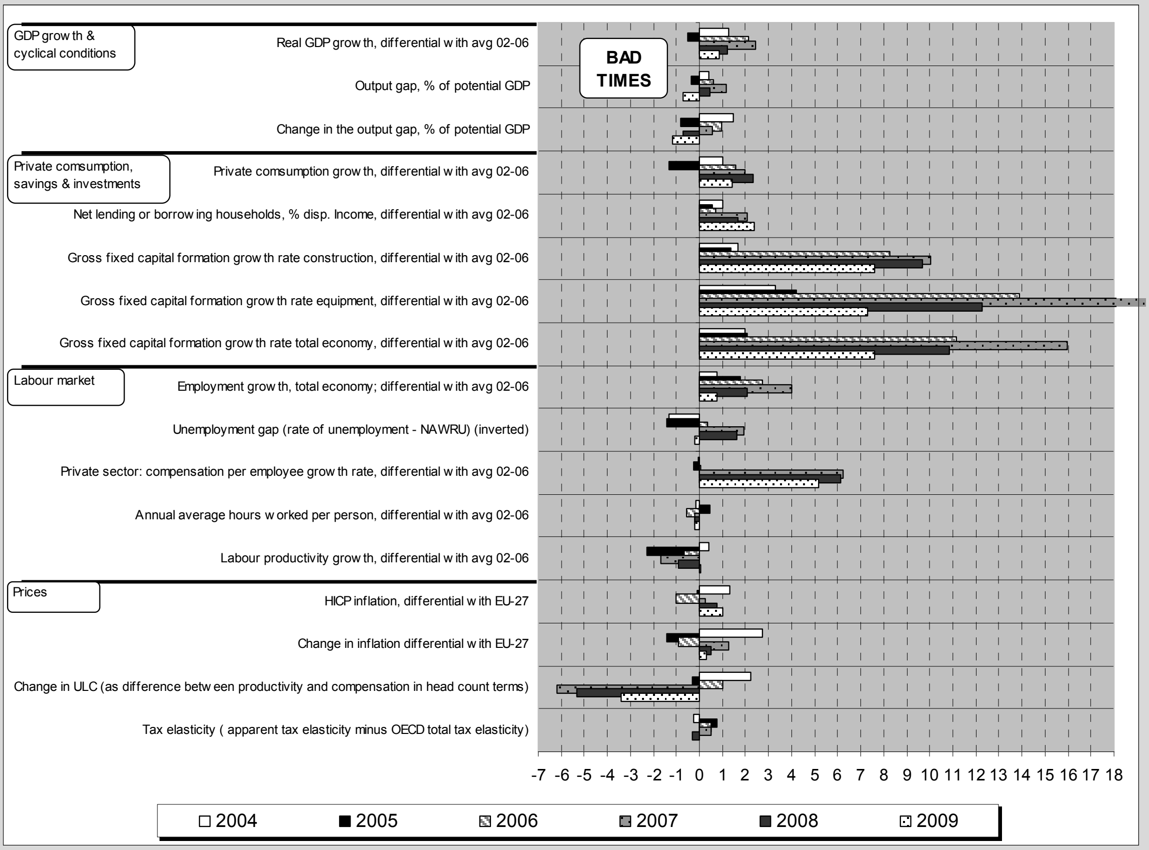
Box 3: Good or bad economic times?

According to the code of conduct, the assessment of whether the economy is experiencing good or bad economic times starts from the output gap, but draws on an overall economic assessment, which should also take into account tax elasticities. The figure below presents a set of macroeconomic indicators drawn from the Commission services' spring 2008 forecast. Overall, the economy seems to be in good economic times taking into account tax elasticities in the period 2007-2009.

The Commission services project that the positive output gap will decrease over the forecast horizon and reach negative values in 2009. However, both private consumption and investment are foreseen to grow strongly. The slowing employment growth and still high dynamics of compensation in the private sector are indicating further labour market tightening. On the other hand, the unemployment gap is projected to turn out positive in 2009 pointing towards some easing in the labour market. Inflation is foreseen to remain above average for the EU in both 2008 and 2009 indicating existing demand pressures stemming from the labour market (eg strong wage growth). Skill shortages are becoming more prevalent and are driving up wages above productivity developments, indicating that the international price competitiveness of the country is deteriorating, albeit at a slower pace than in 2007.

Tax elasticities point towards good times in 2007, in particular for direct and indirect taxes, driven by changes in the composition of consumption (larger share of higher-end heavier taxed goods) and high wage bill growth under still progressive income tax system. This better tax performance was partly offset by the first cut in social contribution which turned out slightly more costly than expected by the Commission services. The apparent tax elasticity for 2008 is lower than the one calculated by the OECD. However this is due to the second, even more costly cut in social contribution. The composition component indicates good times. The overall 2009 tax elasticity is in line with the OECD elasticity. The personal income tax cuts will be offset by still favourable growth composition pointing to still good times.

Good versus bad times



4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first part discusses budgetary implementation in the year 2007 and the second presents the medium-term budgetary strategy in the new update. The third analyses the risks attached to the budgetary targets in the programme. The final part assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact.

4.1. Budgetary implementation in 2007

Table 5 compares the 2007 revenue and expenditure targets (as a percentage of GDP) from the previous update of the convergence programme with the results of the Commission services' spring 2008 forecast The difference between the revenue and expenditure targets for 2007 and the outcome is decomposed into a base effect, a GDP growth effect and a revenue / expenditure growth effect[36]:

- The base effect captures the part of the difference that is due to the actual outcome for 2006 being different from what was projected in the previous update in the programme (either because the actual revenue or expenditure level in 2006 was different from the estimated outturn in the previous programme or because GDP turned out to be different from the scenario in the previous update of the programme). The base effect therefore also captures the effect of revisions to the GDP series.
- The GDP growth effect on the denominator captures the part of the difference that is related to current GDP growth projections turning out higher or lower than anticipated in the previous update of the programme (therefore reducing / increasing the denominator of the revenue and expenditure ratio).
- The revenue or expenditure growth effect captures the part of the difference related to the revenue or expenditure growth rate in 2007 turning out to be higher or lower than targeted in the previous update of the programme. This would typically be due to GDP developments different from those expected in the previous update of the programme or as a result of apparent tax elasticities different from the ex ante tax elasticities (or both)

[36] A fourth, residual component is usually small, except if there are very large differences between the autumn forecast and the target (the full mathematical decomposition is in the methodological paper mentioned above).

Table 5: Budgetary implementation in 2007

	2006		2007	
	Planned CP Nov 2006	Outcome COM	Planned CP Nov 2006	Outcome COM
Revenue (% of GDP)	39.9	40.0	40.5	40.4
Expenditure (% of GDP)	43.8	43.8	43.9	42.4
Government balance (% of GDP)	-3.9	-3.8	-3.4	-2.0
Nominal GDP growth (%)			6.9	10.0
Nominal revenue growth (%)			8.5	11.2
Nominal expenditure growth (%)			7.1	6.7
Revenue surprise compared to target (% of GDP)			**-0.1**	
Of which [1]: 1. Base effect			0.1	
2. GDP growth effect on the denominator			-1.1	
3. Revenue growth effect			0.9	
Of which: due to a marginal elasticity of total revenue w.r.t. GDP larger than 1 [2]			*-0.2*	
Expenditure surprise compared to target (% of GDP)			**-1.5**	
Of which [1]: 1. Base effect			0.0	
2. GDP growth effect on the denominator			-1.2	
3. Expenditure growth effect			-0.2	
Government balance surprise compared to target (% of GDP)			**1.4**	
Of which: 1. Base effect			0.1	
2. GDP growth effect on the denominator			0.1	
3. Revenue / expenditure growth effect			1.1	

Notes:

[1]A positive base effect points to a higher-than-anticipated outcome of the revenue / expenditure ratio in 2006. A positive denominator effect indicates lower-than-anticipated economic growth in 2007. A positive revenue / expenditure growth effect points to higher-than-anticipated revenue / expenditure growth in 2007. The three components may not add up to the total because of a residual component, which is generally small.

[2]Equal to (2)+(3). A positive sign means that the marginal elasticity of revenue with respect to GDP exceeds one.

Source :
Commission services

As indicated in Table 5, the 2007 general government deficit outturn of 2% of GDP is significantly better than the official target of 3.4% of GDP set in the November 2006 convergence programme and the 3% outturn expected in the 2008 budget.

Much higher real GDP growth (6.5%) and inflation (GDP deflator of 3%) than assumed in November 2006 (5.1% and 1.7% respectively) were the main reasons. While the revenue ratio was broadly at the planned level, the expenditure ratio turned out significantly lower, mainly as a result of the denominator effect in combination with some expenditure restraint (for the experience with expenditure execution see Table 10).

High profitability of companies allowed for subsidies ratio to be contained compared to the November 2006 convergence programme. The positive situation in the labour market and the ceiling imposed by the Hausner plan (last year of its operation) also curtailed growth in social transfers (other than in kind). Government investment was lower because of slower absorption of EU funds. Compensation of public sector employees was also lower than planned. The growth in other spending items was higher than projected. Overall, total expenditure in 2007 turned out 1.5 percentage point lower compared to the projections in the November 2006 programme.

At the revenue side, revenue from indirect taxes turned out by 0.6 percentage point higher than expected. Social contributions were by about ½ percentage point better thanks to much higher employment and wage growth than projected in November 2006. These positive surprises were offset by a worse performance of other revenue items and by tax cuts (reduction in social contributions and a large increase in personal income tax brackets), leading to the revenue ratio close to the planned one.

The just described disaggregated comparison between the 2007 outturn and the adjusted figures from the November 2006 convergence programme is approximate because of the reclassification of pension funds.

In its latest opinion of 27 February 2007 on the previous update of the convergence programme, the Council invited Poland to ensure the correction of the excessive deficit by 2007 in line with the new recommendation under Article 104(7). According to the Council recommendation of the same day, Poland should have (i) put an end to the present excessive deficit situation by 2007 at the latest and (ii) reduced the general government deficit in a credible and sustainable manner and, to this end, ensured an improvement of the structural balance by at least 0.5 percentage points of GDP between 2006 and 2007. As regards the 2007 outturn, this recommendation has been fulfilled since the excessive deficit was corrected and the improvement in the structural balance reached about 1½ percentage point.

4.2. The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme – and how it compares with the one in the previous update – as well as the composition of the budgetary adjustment, including the broad measures envisaged.

4.2.1. The main goal of the programme's budgetary strategy

A durable reduction of the fiscal deficit in order to achieve the MTO of −1% of GDP in 2011, i.e. beyond the programme period, is the main goal of the medium-term budgetary strategy. According to the programme, this should allow for a continuous reduction of the debt ratio.

Box 4: The excessive deficit procedure (EDP) for Poland

On 5 July 2004 the Council adopted a decision stating, in accordance with Article 104(6), that Poland had an excessive deficit, based on a general government deficit of 4.1% of GDP in 2003. At the same time, the Council issued recommendations, under Article 104(7), to correct the excessive deficit. In particular, Poland was recommended to 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 line with the Council opinion on the May 2004 convergence programme. In November 2006, the Council decided that action taken until then by the Polish authorities was inadequate. In February 2007, the Council issued new recommendations confirming the 2007 deadline for the correction. The Polish authorities were recommended to ensure an improvement of the structural balance by at least 0.5 percentage point of GDP between 2006 and 2007. In November 2007, the Commission addressed a communication to the Council, in which the action taken by Poland in response to the Council recommendation was found consistent with the recommendation. However, as far as 2008 and 2009 were concerned, the Commission expressed concerns about the durability of the correction of the excessive deficit without which the excessive deficit procedure cannot be abrogated.

Table 6: Evolution of budgetary targets in successive programmes

		2006	2007	2008	2009	2010
General government balance (% of GDP)	**CP Mar 2008**	**-3.8**	**-2.0**	**-2.5**	**-2.0**	**-1.5**
	CP Nov 2006	*-3.9*	*-3.4*	*-3.1*	*-2.9*	*n.a.*
	COM Apr 2008	-3.8	-2.0	-2.5	-2.6	n.a.
General government expenditure (% of GDP)	**CP Mar 2008**	**43.8**	**42.0**	**42.5**	**41.2**	**40.1**
	CP Nov 2006	*43.8*	*43.9*	*42.7*	*40.7*	*n.a.*
	COM Apr 2008	43.8	42.4	42.6	42.3	n.a.
General government revenue (% of GDP)	**CP Mar 2008**	**40.0**	**40.0**	**40.0**	**39.2**	**38.7**
	CP Nov 2006	*39.9*	*40.5*	*39.6*	*37.8*	*n.a.*
	COM Apr 2008	40.0	40.4	40.1	39.7	n.a.
Structural balance[1] (% of GDP)	**CP Mar 2008**	**-4.0**	**-2.4**	**-2.8**	**-1.9**	**-1.1**
	CP Nov 2006	*-4.1*	*-3.6*	*-3.2*	*-3.0*	*n.a.*
	COM Apr 2008	-4.0	-2.5	-2.7	-2.3	n.a.
Real GDP (% change)	**CP Mar 2008**	**6.2**	**6.5**	**5.5**	**5.0**	**5.0**
	CP Nov 2006	*5.4*	*5.1*	*5.1*	*5.6*	*n.a.*
	COM Apr 2008	6.2	6.5	5.3	5.0	n.a.

Note:

[1]Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. There are no one-off and other temporary measures in the most recent programme and Commission services' autumn forecast.

Source :
Convergence programmes (CP); Commission services' spring 2008 economic forecasts (COM)

As shown in Table 6, the headline general government balance deteriorates in 2008 and the budgetary consolidation is back-loaded to 2009 and 2010. The primary surplus is expected to evolve in a similar way: from 0.2% of GDP in 2007 to 0.8% in 2010, with a transient drop to −0.2% in 2008.

In structural terms, the Commission services' calculations on the basis of the information in the programme according to the commonly agreed methodology indicate that the structural balance of around −1% of GDP is to be reached already in 2010. In order to achieve this, the planned fiscal stance is restrictive and an adjustment effort exceeding 0.8 percentage point annually in 2009 and 2010 is foreseen, which appears ambitious and should require significant reforms. In light of mounting aggregate demand pressures linked to an expected increase in the absorption of EU funds, especially in 2008 (when two financial perspectives overlap), such restrictive fiscal policy is appropriate.

On the back of the much better-than-anticipated outcome of 2007, the new targets for the general government deficit in the current update of the convergence programme, submitted by the new government, are clearly lower than in the previous update, especially for 2009. Against the better 2007 outturn (by 1.4 percentage point) and slightly more favourable macroeconomic scenario, the 2008 general government balance target is only by 0.6 percentage point better than the target ratio in the November 2006 convergence programme. The 2009 target improved by almost 1 percentage point, but appears less credible because the GDP growth forecast has been revised downwards. Targets for the structural balance have been adjusted in a similar way. As for the planned rate of deficit reduction (both in nominal and structural terms) the current update foresees a significant deterioration in 2008 (compared to a slight improvement in the previous update), whereas for 2009 the adjustment is planned to be higher.

Table 7: Composition of the budgetary adjustment

(% of GDP)	2006	2007	2008	2009	2010	Change: 2010-2007
Revenue	**40.0**	**40.0**	**40.0**	**39.2**	**38.7**	**-1.3**
of which:						
- Taxes on production and imports	14.2	14.4	14.7	14.8	14.5	**0.1**
- Current taxes on income, wealth, etc.	7.5	8.4	8.2	8.0	7.9	**-0.5**
- Social contributions	12.2	11.9	10.9	10.7	10.6	**-1.3**
- Other (residual)	6.1	5.3	6.2	5.7	5.7	**0.4**
Expenditure	**43.8**	**42.0**	**42.5**	**41.2**	**40.1**	**-1.9**
of which:						
- Primary expenditure	41.1	39.8	40.2	38.9	37.8	**-2.0**
of which:						
Compensation of employees	9.8	9.6	9.2	8.9	8.5	**-1.1**
Intermediate consumption	6.0	5.6	5.3	5.1	4.9	**-0.7**
Social payments	17.3	16.6	16.5	16.2	15.8	**-0.8**
Subsidies	0.6	0.7	0.8	0.9	0.8	**0.1**
Gross fixed capital formation	3.9	4.6	5.2	5.0	5.0	**0.4**
Other (residual)	3.5	2.8	3.2	2.8	2.8	**0.0**
- Interest expenditure	2.7	2.2	2.3	2.3	2.3	**0.1**
General government balance (GGB)	**-3.8**	**-2.0**	**-2.5**	**-2.0**	**-1.5**	**0.5**
Primary balance	**-1.1**	**0.2**	**-0.2**	**0.3**	**0.8**	**0.6**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	**0.0**
GGB excl. one-offs	**-3.8**	**-2.0**	**-2.5**	**-2.0**	**-1.5**	**0.5**
Output gap[1]	0.5	1.1	0.7	-0.2	-0.9	**-2.0**
Cyclically-adjusted balance[1]	-4.0	-2.4	-2.8	-1.9	-1.1	**1.3**
Structural balance[2]	**-4.0**	**-2.4**	**-2.8**	**-1.9**	**-1.1**	**1.3**
Change in structural balance		*1.6*	*-0.4*	*0.8*	*0.8*	
Structural primary balance[2]	-1.3	-0.2	-0.5	0.4	1.2	**1.4**
Change in structural primary balance		*1.1*	*-0.3*	*0.8*	*0.8*	

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance as recalculated by Commission services on the basis of the information in the programme.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :
Convergence programme; Commission services' calculations

4.2.2. The composition of the budgetary adjustment

Both the revenue and the expenditure ratios are planned to decrease on average, by about 0.4 and 0.6 percentage point per year respectively in 2008-2010 (Table 7). The Polish authorities intend that, after a temporary hike to 42.5% of GDP in 2008 (primarily because of higher public investment), to reduce the expenditure ratio to 40.1% of GDP in 2010. This implies a nominal growth of total general government expenditure below 5% annually in 2009-2010 (and about 2% in real terms). The decline of the revenue ratio, following a stabilisation in 2008, is expected to be twice as small.

The fiscal adjustment on the expenditure side is to be achieved mainly through a low nominal growth of compensation of employees (declining from about 4⅔% in 2008 to about 4¾% in 2010), as well as social transfers other than in kind (declining from about 8½% in 2008 to about 4½% in 2010). These plans could be considered plausible if they were supported by a timetable of specific expenditure cuts. Indeed, the fiscal projections are not based on the no-policy-change assumption. As in previous programmes, the envisaged consolidation (e.g. reduction of administrative costs) is not sufficiently supported by specific measures and seems to rely only on broad policy intentions. To the extent that measures are presented, they are not expenditure-reducing in the programme period ("bridge pensions", task budgeting, new public finance act, new budgetary procedure), but may have some impact afterwards, or they imply additional spending (new indexation rules for social transfers, active labour market policies, innovation support). For most of the intended actions, there is no implementation schedule or disaggregated estimation of budgetary effects. The slower growth of social benefits appears to be based mainly on the expected further improvement in the labour market (decrease of unemployment and unregistered employment as well as increase in labour activity) rather than intended cuts in social benefits (replacing early pensions with less generous "bridge pensions"). The envisaged decrease in the cost of debt servicing mentioned in the programme is not reflected in the projections of interest expenditure (broadly stable ratio after 2007).

On the revenue side, there are no significant deficit-decreasing measures. There will be only excise duty hikes related to the EU tax harmonisation (+0.2% of GDP in 2008 and 0.1% in 2009). After the reduction in 2007, a second deep cut of social contributions in the beginning of 2008 was undertaken (budgetary cost exceeding 1% of GDP). It will lead to a deterioration in the surplus in the social security sector. The 2009 personal tax reform, comprising a reduction of the effective tax rate for almost all taxpayers, seems optimistic with respect to revenue projections.

With respect to the subsectors, the worsening of the general government balance in 2008 is envisaged to be partly cushioned by an increase in the surplus of the local government subsector. The higher surplus in this subsector is envisaged despite the costly personal income tax relief (a support to families based on number of children) which have to be financed by local budgets to a large extent. The burden of the adjustment in the following years is to be carried almost entirely by the central government. The factors behind these patterns are not explicitly explained in the programme.[37]

Box 5: The budget for 2008

The 2008 budget was adopted by the previous Polish government on 25 September 2007. The new parliament elected in October 2007 slightly modified the budget, with wage increases in the public sector (mainly for teachers) offset by administrative expenditure cuts, resulting in an improvement of the central government balance by about 0.2% of GDP. The 2008 budget was finally adopted by the new parliament on 23 January 2008. The budget includes significant revenue-decreasing measures: the second cut of social contributions to the disability fund (the first one took place on 1 July 2007) estimated at about 1% of GDP and a pro-family relief (related to the number of children) on the personal income tax, estimated at ½% of GDP. These revenue cuts are only partly offset by excise duty hikes for cigarettes (most of them required under EU tax harmonisation) estimated at 0.1% of GDP. The government projects that the budgeted changes would be neutral for the deficit ratio thanks to continuing favourable labour market conditions (steep wage and employment growth) additionally stimulated by the tax wedge cut. On the expenditure side, the 2008 budget reintroduces the annual indexation of pensions and disability benefits, which had been abandoned as part of the Hausner plan. The indexation will be extended with a link to wage growth (i.e. inflation plus 20% of wage growth). In addition, the 2008 indexation will be based

[37] Arguably, the improvement in the local government balance ratio in 2008 can be linked to the overlap of two EU financial perspectives. Thanks to the large inflow of EU funds and an increase in EU-funded expenditure some domestic expenditure can be reduced.

on cumulated inflation for 2006-2007, with an overall budgetary cost in 2008 estimated at almost ½% of GDP.

Main measures in the budget for 2008

Revenue measures*	Expenditure measures**
o Social contribution cut (−1% of GDP)	o Special indexation of transfers (0.5% of GDP)
o Income tax relief for families (−0.5% of GDP)	
o Excise duty hike (+0.2% of GDP)	

* Estimated impact on general government revenues.
** Estimated impact on general government expenditure.
Sources: Commission services.

4.3. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2009, Table 8 compares the detailed revenue and expenditure projections in the Commission services' autumn 2007 forecast, which are derived under a no-policy change scenario, with those in the updated programme.

Table 8: Comparison of budgetary developments and projections

(% of GDP)	2006	2007		2008		2009		2010
	COM	COM	CP	COM	CP	COM[1]	CP	CP
Revenue	**40.0**	**40.4**	**40.0**	**40.1**	**40.0**	**39.7**	**39.2**	**38.7**
of which:								
- Taxes on production and imports	14.2	14.2	14.4	14.5	14.7	14.8	14.8	14.5
- Current taxes on income, wealth, etc.	7.5	8.6	8.4	8.3	8.2	7.9	8.0	7.9
- Social contributions	12.2	12.1	11.9	10.9	10.9	10.8	10.7	10.6
- Other (residual)	6.2	5.5	5.3	6.4	6.2	6.2	5.7	5.7
Expenditure	**43.8**	**42.4**	**42.0**	**42.6**	**42.5**	**42.3**	**41.2**	**40.1**
of which:								
- Primary expenditure	41.1	39.9	39.8	40.0	40.2	39.6	38.9	37.8
of which:								
Compensation of employees	9.8	9.6	9.6	9.3	9.2	8.9	8.9	8.5
Intermediate consumption	6.0	5.9	5.6	5.7	5.3	5.5	5.1	4.9
Social payments	17.3	16.5	16.6	16.3	16.5	16.2	16.2	15.8
Subsidies	0.6	0.6	0.7	0.8	0.8	0.9	0.9	0.8
Gross fixed capital formation	3.9	4.1	4.6	4.5	5.2	4.8	5.0	5.0
Other (residual)	3.5	3.2	2.8	3.4	3.2	3.4	2.8	2.8
- Interest expenditure	2.7	2.6	2.2	2.7	2.3	2.7	2.3	2.3
General government balance (GGB)	**-3.8**	**-2.0**	**-2.0**	**-2.5**	**-2.5**	**-2.6**	**-2.0**	**-1.5**
Primary balance	**-1.1**	**0.6**	**0.2**	**0.2**	**-0.2**	**0.1**	**0.3**	**0.8**
One-off and other temporary measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-3.8**	**-2.0**	**-2.0**	**-2.5**	**-2.5**	**-2.6**	**-2.0**	**-1.5**
Output gap[2]	0.6	1.2	1.1	0.5	0.7	-0.7	-0.2	-0.9
Cyclically-adjusted balance[2]	-4.0	-2.5	-2.4	-2.7	-2.8	-2.3	-1.9	-1.1
Structural balance[3]	**-4.0**	**-2.5**	**-2.4**	**-2.7**	**-2.8**	**-2.3**	**-1.9**	**-1.1**
Change in structural balance		*1.5*	*1.6*	*-0.2*	*-0.4*	*0.4*	*0.8*	*0.8*
Structural primary balance[3]	-1.3	0.1	-0.2	0.0	-0.5	0.3	0.4	1.2
Change in structural primary balance		*1.4*	*1.1*	*-0.1*	*-0.3*	*0.3*	*0.8*	*0.8*

Notes:

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence programme (CP); Commission services' spring 2008 economic forecasts (COM); Commission services' calculations

Overall, the programme's macroeconomic outlook seems to be based on plausible growth assumptions for 2007-2009 and cautious assumptions for 2010 (see Section 3). As far as significant differences are concerned, the Commission services' inflation projections for 2008 and 2009 are by 0.8 and 0.5 percentage point higher, respectively, compared to the programme projections.

Before delving into the differences between the convergence programme budgetary projections and the spring 2008 Commission forecast for public finances, it should be highlighted that the latter is based on more recent information for 2007. The March 2008 convergence programme was still founded on the estimated 2007 outturn for revenue and expenditure items (with February 2008 as cut-off date). The spring 2008 forecast is based on the 2007 outturn data reported by the Polish statistical office to Eurostat in the April 2008 fiscal notification. In consequence, there are differences between the Commission spring 2008 forecast and the latest Polish convergence programme revenue and expenditure composition (but not in government balances) which produce base effects in the following years.

Considering the better than expected 2007 revenue performance of direct taxes and social contributions, the tax revenue projections in the programme embody plausible assumptions about the tax intensity of economic activity. The Commission services envisage slightly higher revenue (and, symmetrically, expenditure) in 2009 because of more optimistic projections for the absorption of EU funds, partly channelled via the general government. On the contrary, the Commission services foresee a slightly larger drop (by 0.4 percentage point rather than 0.2, but from a higher base in 2008) in direct tax revenue ratio due to the personal income tax reform in 2009 (switching from three marginal rates, 19%, 30% and 40% to 18% and 32%, with almost all tax payers covered by the lower rate).

Table 9: Assessment of tax projections

	2008			2009			2010
	CP	COM	OECD[3]	CP	COM[1]	OECD[3]	CP
Change in tax-to-GDP ratio (total taxes)	-1.0	-1.3	-0.2	-0.3	-0.3	-0.2	-0.5
Difference (CP – COM)	0.3		/	-0.1		/	/
of which [2]*:*							
- discretionary and elasticity component	*0.1*		*/*	*-0.2*		*/*	*/*
- composition component	*0.1*		*/*	*0.2*		*/*	*/*
Difference (COM - OECD)	/	-1.0		/	-0.1		/
of which [2]*:*							
- discretionary and elasticity component	*/*	*-1.0*		*/*	*-0.3*		*/*
- composition component	*/*	*0.7*		*/*	*0.4*		*/*
p.m.: Elasticity to GDP	0.7	0.6	0.9	0.9	0.9	0.9	0.8

Notes:

[1]On a no-policy change basis.

[2]The composition component captures the effect of differences in the composition of aggregate demand (more tax rich or more tax poor components). The discretionary and elasticity component captures the effect of discretionary fiscal policy measures as well as variations of the yield of the tax system that may result from factors such as time lags and variations of taxable income that do not necessarily move in line with GDP, e.g. capital gains. The two components may not add up to the total difference because of a residual component, which is generally small.

[3]OECD ex-ante elasticity relative to GDP.

Source:
Commission services' spring 2008 economic forecasts (COM); Convergence programme (CP); Commission services' calculations; OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434).

On the expenditure side, interest spending in 2007 turned out higher than estimated in the convergence programme (2.6% in the fiscal notification compared to 2.2% of GDP in the programme), weighing on the projections for the following years, with interest expenditure likely to be underestimated.

The 2008 deficit target in the programme is the same as in the spring 2008 forecast (2.5% of GDP). In addition, the January-April 2008 cash data for central budget indicate that the realised deficits were significantly below the planned ones. With respect to the macroeconomic outlook, the programme assumes slightly higher growth in 2008 but also much lower inflation than in the spring 2008 commission forecast. This may have positive effects for government expenditure in 2008, most of which was fixed in nominal terms under lower inflation assumption and thus the GDP ratio and real expenditure growth may turn out lower than budgeted. Consequently, the balance of risks to the general government balance in 2008 looks neutral. However, higher 2008 inflation will result in larger indexation of pensions and social benefits than assumed in the programme and is likely to increase wage pressure in the public sector, thus unfavourably impacting on budgetary expenditure in 2009 compared to the predictions in the programme.

Besides, there is disagreement about the likely nominal growth rates of specific expenditure items in 2009. In particular, the Commission services are not convinced that the nominal growth of public investment, which was at about 20% in 2006 and 2007 (with a similar planned growth in 2008), will sharply drop to less than 4% in 2009 as foreseen by the authorities, especially in view of the ambitious road construction programme and the preparation to the European football championship in 2012. The Commission projects a smaller decrease (to 16%). Besides, the Commission services forecast also a higher increase of social transfers in 2009 due to indexation to a higher inflation rate in 2008 than assumed in the convergence programme.

The Commission forecast is made under the no-policy-change-assumption (it considers measures which are adopted or very likely to be adopted), whereas the Polish authorities assume the introduction of some deficit-decreasing measures which are still at an early conceptual phase (an extensive reform of the social security system and labour market policies). As already indicated in Section 4.2.2 above, the programme does not provide sufficient information (such as the expected budgetary impact and the state of implementation) in contrast with the deficit-increasing measures. In addition, presidential vetoes may delay or even stop the implementation. Consequently, the programme seems to rely on some informal expenditure ceiling, which is however not enacted as a law, which makes it less credible. On the other hand, Poland has recently spent less than planned (Table 10).

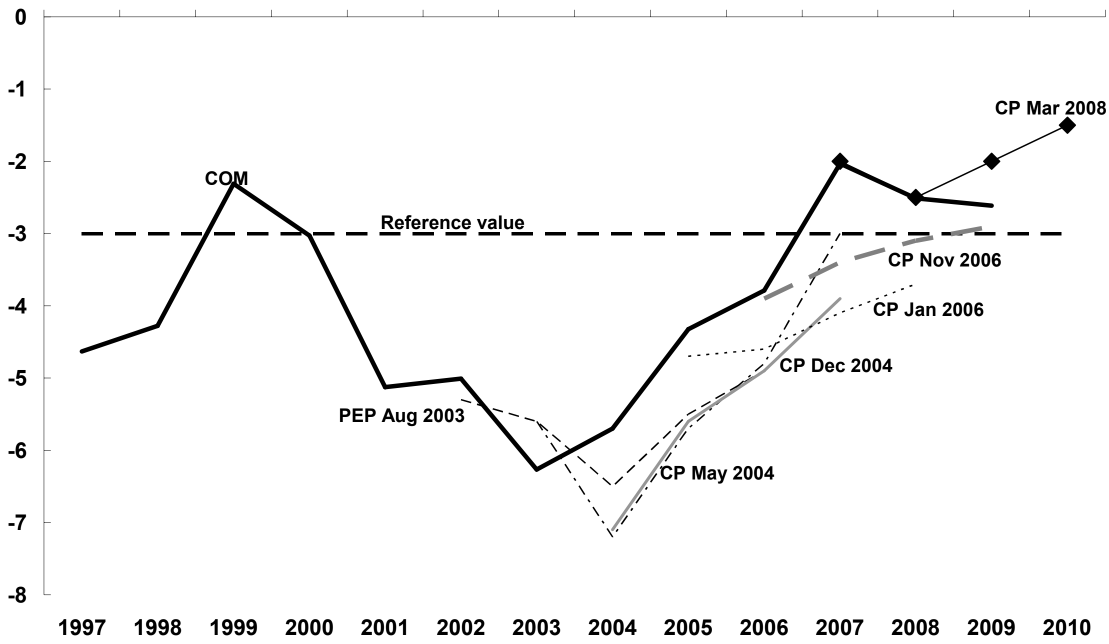
Table 10: Experience with expenditure execution

(in % of GDP)	**2004**	**2005**	**2006**	**2007**
Target	47.9	48.4	44.8	43.9
Outcome	42.6	43.3	43.8	42.4
Deviation (outcome minus target)	−5.3	−5.1	−1.0	−1.5

Note:
Target for year n *is taken from a programme which was due in December of the year* n−1, *except for target for 2004 taken from PEP Aug 2003. Expenditure includes pension reform cost approximated by Commission services.*
Source:
Successive convergence programmes ; Commission services' calculations

Also the overall track record, when it comes to respecting its fiscal targets, is positive (Figure 6). However, meeting the targets in recent years was facilitated by some statistical reclassifications in 2005 and revenue overshoots resulting from positive growth surprises in 2006 (real GDP growth turned out 6.2% compared to 4.3% expected in January 2006) and 2007 (6.5% rather than 5.1% projected in November 2006).

Figure 6: Government balance projections in successive programmes (% of GDP)



Notes:
For comparability, the ex ante pension reform cost projections are included. For PEP Aug 2003 and CP May 2004, the implicit annual rough estimate of 1.5% of GDP is assumed. For other programme updates, the explicit projections are included.
Source: Commission services' spring 2008 forecast (COM) and successive convergence programmes

The balance of risks surrounding the fiscal strategy appears neutral for 2008 and negative for the following years, mainly on account of the lack of specific information on the deficit-decreasing measures in contrast with the deficit-increasing measures and an underestimated acceleration of inflation.

4.4. Assessment of the fiscal stance and budgetary strategy

The table below offers a summary assessment of the country's position relative to the budgetary requirements laid down in the Stability and Growth Pact. In order to highlight the role of the preceding analysis of the risks that are attached to the budgetary targets presented in the programme, this assessment is done in two stages: first, a preliminary assessment on the basis of the targets taken at face value and, second, the final assessment also taking into account risks.

Table 11: Overview of compliance with the Stability and Growth Pact

	Based on programme[3] (with the targets taken at face value)	**Assessment** (taking into account risks to the targets)
a. Consistency with correction of excessive deficit by 2007 deadline	yes	yes
b. Safety margin against breaching 3% of GDP deficit limit[1]	from 2010 onwards	not within programme period
c. Achievement of the MTO	beyond the programme's horizon (from 2011 onwards)	not within programme period
d. Adjustment towards MTO in line with the Pact[2]?	not in 2008	not in 2008, should be backed up with measures thereafter

Notes:

[1] The risk of breaching the 3% of GDP deficit threshold with normal cyclical fluctuations, i.e. the existence of a safety margin, is assessed by comparing the cyclically-adjusted balance with the above mentioned minimum benchmark (estimated as a deficit of around 1.5% of GDP for Poland). These benchmarks represent estimates and as such need to be interpreted with caution. NB: A decreasing fraction of pension reform costs (which are about 2% of GDP annually) can be deducted from a headline deficit if a headline deficit exceeds 3% of GDP but is close to the threshold: 40% in 2008 or 0.8% of GDP, 20% in 2009 or 0.4% of GDP, 0% in 2010.

[2] The Stability and Growth Pact requires Member States to make progress towards their MTO (for countries in the euro area or in ERM II, this has been quantified as an annual improvement in the structural balance of at least 0.5% of GDP as a benchmark). In addition, the structural adjustment should be higher in good times, whereas it may be more limited in bad times.

[3] Targets in structural terms as recalculated by Commission services on the basis of the information in the programme.

Source:
Commission services

Poland did satisfy the recommendation to correct the general government deficit by 2007. At 2% of GDP, the 2007 deficit outturn was significantly below the 3% reference value. The structural adjustment reached about 1½ percentage point.

The safety margin against breaching the 3% of GDP deficit limit is ensured by 2010 only if the programme projections are taken at face value, but not taking into account the risks to the targets. The cyclically-adjusted balance is not likely to reach the minimum benchmark (estimated as a deficit of around 1½% of GDP for Poland) according to the spring 2008 Commission forecast based on the no-policy change assumption.[38] Hence, further structural deficit reduction is required.

For 2008, the Polish authorities foresee a temporary departure from the deficit reduction path which is the budgetary cost of the cut in the tax wedge, being one of the measures aimed at stimulating labour activity in Poland (see section 2 for an analysis of the link between public finances and labour market problems). However, there is no risk that Poland will breach the 3% of GDP deficit limit both according to the programme and the spring 2008 Commission forecast.

The programme envisages that the MTO will be achieved in 2011, i.e. beyond the programme period. The structural deficit, as recalculated by the Commission services using the commonly agreed methodology based on the information in the programme,

[38] There is no Commission forecast for 2010, but one can reasonably assume that a structural adjustment by about 0.8 percentage point (from −2.3% of GDP envisaged for 2009 to the minimum benchmark of −1.5% of GDP the year after) is difficult without measures.

will be close to 1% of GDP already in 2010. According to the spring 2008 Commission forecast, the structural deficit will reach about 2.3% of GDP in 2009. It implies that, to achieve the MTO in 2011, a structural deficit reduction by more than 0.6 percentage point annually will be necessary in 2010-2011. This is achievable provided that appropriate measures are implemented.

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

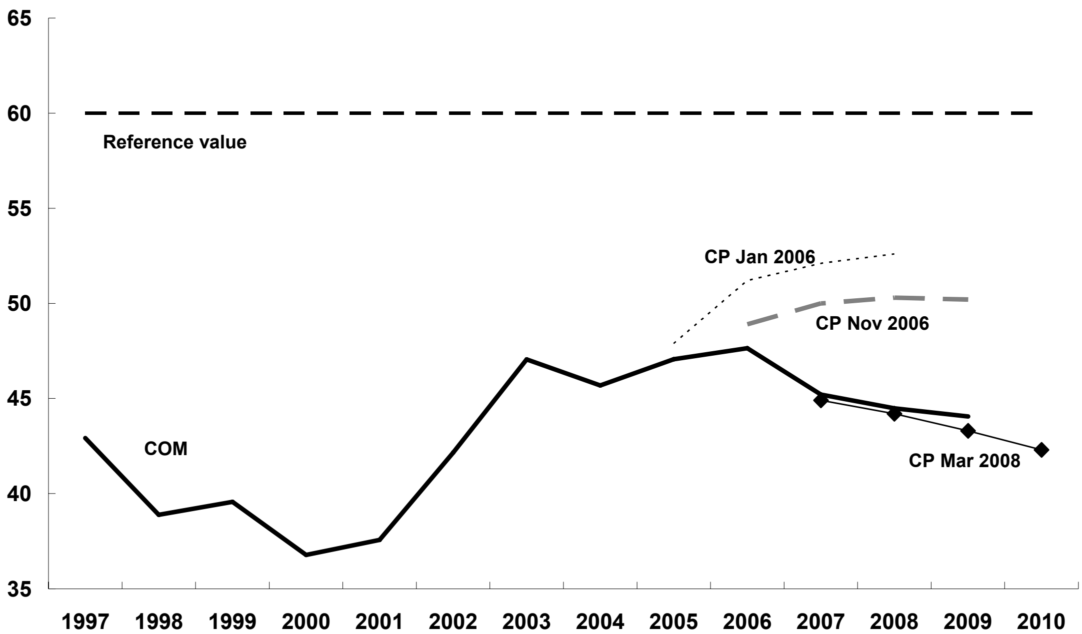
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

After having reached a peak of 47.6% of GDP in 2006, the debt ratio appears to be on a declining path. A significant debt reduction was achieved in 2007, when the ratio decreased by almost 2½ percentage points to 45.2% of GDP (compared to 50% of GDP projected in the November 2006 convergence programme), mainly thanks to high nominal GDP growth but also appreciation of the Złoty, which reduced the domestic currency value of foreign debt. Consistent with a positive deficit track record (Figure 6), the debt ratios have also been better (Figure 7) than projected in the consecutive programmes.

Figure 7: Debt projections in successive programmes (% of GDP)



Notes:
For comparability, the programmes prior to January 2006 are not included because of lack of data on the pension reform cost accumulated in government debt.
Source: Commission services' spring 2008 forecast (COM) and successive stability/convergence programmes

Table 12: Debt dynamics

(% of GDP)	average 2002-05	2006	2007		2008		2009		2010
			COM	CP	COM	CP	COM	CP	CP
Gross debt ratio[1]	**45.5**	**47.6**	**45.2**	**44.9**	**44.5**	**44.2**	**44.1**	**43.3**	**42.3**
Change in the ratio	2.4	0.6	-2.4	-2.7	-0.7	-0.7	-0.4	-0.9	-1.0
Contributions [2] :									
Primary balance	**2.5**	**1.1**	**-0.6**	**-0.2**	**-0.2**	**0.2**	**-0.1**	**-0.3**	**-0.8**
"Snow-ball" effect	**0.4**	**-0.7**	**-1.7**	**-2.0**	**-1.4**	**-1.4**	**-0.7**	**-1.0**	**-0.7**
Of which:									
Interest expenditure	2.9	2.7	2.6	2.2	2.7	2.3	2.7	2.3	2.3
Growth effect	-1.5	-2.7	-2.8	-2.8	-2.2	-2.3	-2.0	-2.0	-2.0
Inflation effect	-1.0	-0.6	-1.4	-1.4	-1.9	-1.4	-1.3	-1.2	-1.0
Stock-flow adjustment	**-0.5**	**0.2**	**-0.1**	**-0.5**	**0.9**	**0.6**	**0.4**	**0.4**	**0.6**
Of which:									
Cash/accruals diff.	-0.1	0.0	0.4	0.0		0.1		0.2	0.3
Acc. financial assets	-0.3	0.6	0.5	0.4		0.3		0.3	0.5
Privatisation	*-0.6*	*-0.1*	*n.a.*	*-0.1*		*-0.3*		*-0.3*	*-0.3*
Val. effect & residual	-0.1	-0.4	-0.9	-0.9		0.2		-0.1	-0.2

Notes:

[1]End of period.

[2]The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; *D, PD, Y* and *SF* are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth (in the table, the latter is decomposed into the growth effect, capturing real GDP growth, and the inflation effect, measured by the GDP deflator). The term in parentheses represents the "snow-ball" effect. The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :
Convergence programme (CP); Commission services' spring 2008 economic forecasts (COM); Commission services' calculations

5.1.2. Assessment

The March 2006 convergence programme envisages slightly lower ratios than the Commission services' spring 2008 forecast, but the debt ratio should be on a declining path according to both projections. The differences stem mainly from a base effect from 2007 (for which the Commission services' forecast uses more recent data reported by the statistical office), especially for interest expenditure as well as the stock-flow adjustment. In 2009, there are also different government deficit forecasts.

The debt ratio may decline faster if privatisation is reactivated. On the negative side, possibly high reprivatisation claims (demands to restore properties seized by a government before 1990 to their former owners or to compensate them) are an unresolved problem. Finally, as indicated in the sensitivity analysis section of the convergence programme, if real GDP growth slows down by 1 percentage point, the decrease in the debt ratio is likely to stop.

5.2. Long-term debt projections and the sustainability of public finances

This section analyses the long-term sustainability of public finances. It uses long-term projections of age-related expenditures to calculate sustainability gap indicators and make long-term government debt projections so as to assess the sustainability challenge the country concerned is facing.

5.2.1. Sustainability indicators and long-term debt projections

Table 13 shows the evolution of government spending on pensions, healthcare, long-term care for the elderly, education and unemployment benefits according to the EPC's projections and property income received by general government according to an agreed methodology.[39] Non age-related primary expenditure and primary revenue is assumed to remain constant as a share of GDP.

Table 13: Long-term age-related expenditure: main projections

(% of GDP)	2004	2010	2020	2030	2040	2050	Change up to 50
Total age-related spending	23.7	20.2	17.9	17.6	17.3	17.0	-6.7
- Pensions	13.9	11.3	9.7	9.2	8.6	8.0	-5.9
- Healthcare	4.1	4.4	4.8	5.1	5.3	5.5	1.4
- Long-term care	0.1	0.1	0.1	0.1	0.2	0.2	0.1
- Education	5.0	3.9	3.0	3.0	3.0	3.1	-1.9
- Unemployment benefits	0.5	0.4	0.3	0.2	0.2	0.2	-0.4
Property income received	1.9	1.6	1.3	1.1	1.0	1.0	-1.0

Source: Economic Policy Committee and Commission services.

The projected dynamics in age-related spending in Poland is well below the EU average; falling by 6.7 percentage points of GDP between 2004 and 2050. This is mainly due to the projected decline in pension expenditures falling by almost 6 percentage points of GDP over the projection period due to the pension reform enacted in 1999, featuring a significant reduction in public pensions as a share of GDP. The increase in health-care expenditure is projected to be 1.4 percentage point of GDP, slightly above the EU average. For long-term care spending, the projected increase of 0.1 percentage point of GDP up to 2050 is below the EU average. Property income received by the general government should decrease over the long-term by 1 percentage point of GDP. As common assumptions, the face value of bonds is kept fixed over time and the accruing interest used for debt reduction, which implies that Poland's relatively high current interest income will decline over time as a share of GDP.

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39 See the accompanying "methodological paper" for a description of the property income projections.

Table 14: Sustainability indicators and the required primary balance

	2007 scenario			Programme scenario		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	-1.7	-1.3	-0.2	-3.2	-2.8	-0.2
of which:						
Initial budgetary position (IBP)	1.1	1.5	-	-0.4	0.0	-
Debt requirement in 2050 (DR)	-0.3	-	-	-0.3	-	-
Long-term change in the primary balance (LTC)	-2.5	-2.8	-	-2.5	-2.8	-

Source: Commission services.

On the basis of the current budgetary position and the projected budgetary changes over the long-term, Poland has no sustainability gap in the baseline scenario (S2 is negative, at −1.3% of GDP).[40] This has remained unchanged compared with the results of last year's assessment. However, the structural primary deficit in 2007 is estimated at −0.2% of GDP, which is far lower than that of 2006 estimated in last year's assessment (−1.3% of GDP).[41] On the other hand, the negative change is more contained than in last year's assessment (−3.4 percentage points of GDP).[42]

The initial budgetary position is not sufficiently high to stabilize the debt ratio over the long-term and entails a risk of unsustainable public finances before considering the long-term budgetary impact of ageing. According to both sustainability gaps, the long-term budgetary impact of ageing is negative. The programme plans a structural primary budgetary consolidation of 1.4% of GDP between 2007 and 2010; no sustainability gap emerges in the programme scenario either.

The required primary balance (RPB) is slightly negative, due to the negative cost of ageing.

Another way to look at the prospects for long-term public finance sustainability is to project the debt-to-GDP ratio over the long-term using the same assumptions as for the calculations of the sustainability indicators. The long-term projections for government debt under the two scenarios are shown in Figure 8.[43] The gross debt ratio is currently below the 60% of GDP reference value, amounting to 44.9% of GDP in 2007. In both the "2007 scenario" and the "programme scenario", the debt ratio is projected to decrease over the projection period.

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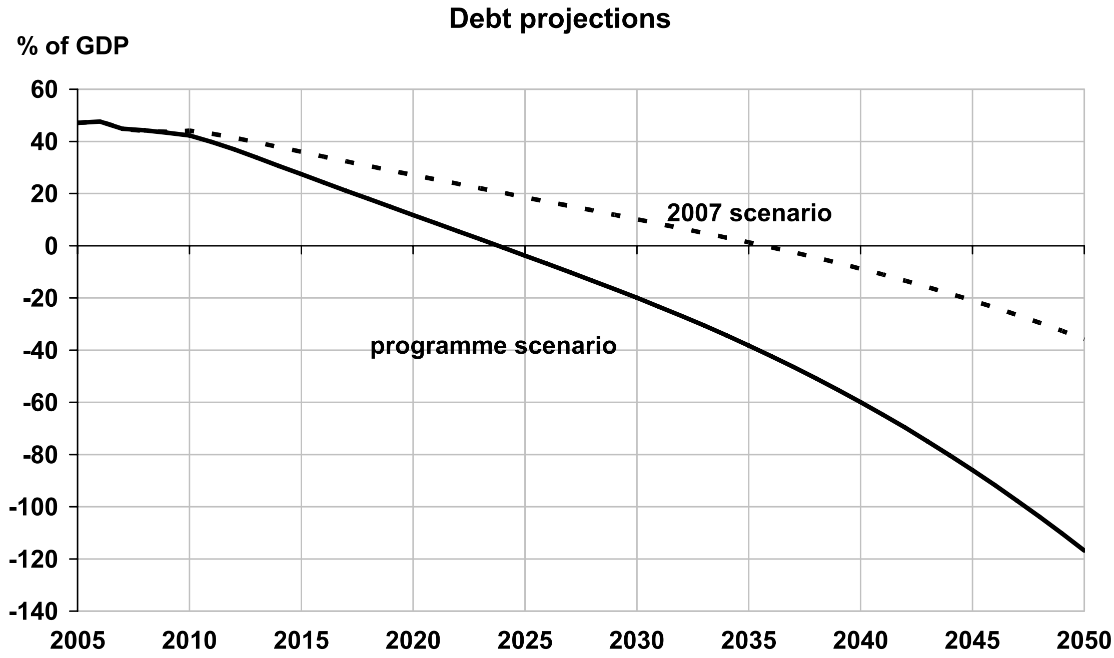
[40] The sustainability gap (S1) that assures the debt ratio reaching 60% of GDP by 2050 would be −1.7% of GDP.

[41] Both figures include the revenue-reducing and deficit-increasing impact of classifying funded defined contribution pension schemes outside the general government sector.

[42] Last year, the programme period ended in 2009, this year it ends in 2010. Age-related expenditure as a share of GDP is projected to fall between 2009 and 2010 as a result of relatively high nominal (and real) GDP growth and pensions being indexed to inflation in the common projections.

[43] It should be recalled, however, that being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.

Figure 8: Long-term projections for the government debt ratio



Source: *Commission services*

5.2.2. Additional factors

To reach an overall assessment of the sustainability of public finances, other relevant factors are taken into account, which in addition allow to better appreciate where the main risks to sustainability are likely to stem from.

First, the long-term projections in the programme update do not include the change in the indexation rule of pension benefits, although the programme states that it will affect expenditure. In particular, as from 1 January 2008 pension benefits are indexed to CPI plus 20% of real wage growth. This is more generous than the common projections in the Ageing Report, which are based on benefit indexation to CPI (in force at the time). On the other hand, the programme mentions plans to end early retirement schemes and to introduce less costly “bridge pensions” for persons “who work in special conditions or whose work is of special nature” as well as to gradually equalise the retirement age for men and women to 65 years of age. However, some groups, such as miners or uniformed public employees, will be excluded from these reforms and will enjoy special early pensions financed fully by the budget and unrelated to their contributions.

Second, the benefit ratio – that is the average pension divided by the GDP per worker – in Poland is projected by the Ageing Report to decrease markedly, by around 40% until 2050, which is the largest projected fall among EU Member States. The above-mentioned change in the indexation rule would result in a less marked decrease. Employment rates of older workers in Poland are currently considerably below the EU average (40%), but are projected to increase slightly more than on average in the EU, though remaining below the EU average in 2050 (at 49% compared with the EU25 of 59%). A greater increase in the employment rate of older workers than that underlying the projections would imply that the decrease in the benefit ratio would be less marked than projected, as it would foster GDP growth and ensure that workers can accumulate more pension rights.

5.2.3. Assessment

Poland appears to be at low risk as regards the sustainability of public finances.

According to the projections made in 2005 and based on the common methodology, the long-term budgetary impact of ageing is among the lowest in the EU. However, as from 2008, social benefits will be indexed not only to consumer prices but also partially to wages, which will raise expenditure in the long-term.

The budgetary position in 2007 with a small structural primary deficit, despite being better than the starting position of the previous programme, constitutes a risk to sustainable public finances before considering the long-term budgetary impact of an ageing population. Further consolidation of public finances, as planned in the convergence programme, would therefore contribute to limiting risks to the sustainability of public finances.

6. STRUCTURAL REFORM, THE QUALITY OF PUBLIC FINANCES AND INSTITUTIONAL FEATURES

The analysis is related with Section 2 but it focuses on the quality of the planned reforms presented in the March 2008 update of the convergence programme and on their impact on the structural public finance position.

The Polish authorities seem to be aware of the weaknesses of public finances (such as excessive social transfers with effects for labour participation) identified in Section 2, but specific measures are not yet ready for implementation and the intentions do not appear very ambitious. As regards potentially direct deficit-decreasing but still discussed measures, the government intends to (i) restrict early retirement and harmonise disability benefits with the reformed pensions[44] (both of which are not a new measure but it has been postponed by previous governments) and (ii) introduce private co-financing of medical services. The lack of other specific reform plans makes the COFOG projections for 2010 not sufficiently substantiated. Some intentions do not seem ambitious enough, e.g. the reform of the farmers' social fund (KRUS) is planned as raising contributions only for the large land owners (which is a very small group in Poland compared to the overall number of farmers) rather than including KRUS in the general social security system.

Gradual implementation of task budgeting (together with a multiannual planning), started with the 2008 budget which includes task descriptions for selected central government areas, is to be continued. Another attempt to reorganise public finances (including decentralisation), after several unsuccessful tries by the previous government, will be undertaken. This is expected to contribute to a better accomplishment of policy targets through systematic ex-post reviews and to improve the efficiency of administrative expenditure. However, their direct deficit-decreasing impact is uncertain and is likely to be small. The effects concern principally non-fixed expenditure (about 30% in the 2008 central state budget, non-ESA95), and thus would not fundamentally improve the composition of government expenditure. More fundamentally, they reorganise public tasks but do not eliminate them. Hence, resources are foreseen to be allocated differently within the general government but total spending is not expected to change dramatically.

The recent declarations by members of the Polish government concerning a possible introduction of some expenditure rule (ceiling on expenditure growth) is not reflected in the March 2008 convergence programme. The fiscal rules in Poland remain unchanged. It should be pointed out that the main constitutional rule referring to the government deficit quoted in the programme[45] (its Annex 2) is in practical terms non-binding. While expenditure is increased above the levels set in the draft budget presented by government, the members of the Polish parliament often keep the state budget deficit unchanged by artificially projecting an increase in government revenue, above the government projections, without introducing any revenue-increasing measures (e.g. by assuming better tax compliance). Moreover this constitutional rule concerns the central state budget only, implying that parliament can increase the central budget expenditure by reducing the transfers to the social security or local government subsectors and, thus,

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[44] The level of disability benefits is to be linked with the accumulated capital in pension funds.

[45] "The Sejm [the lower chamber of the Polish parliament] while increasing expenditure or limiting revenues cannot increase the level of the State budget deficit approved by the Council of Ministers in the annual draft budget (on cash basis)."

increasing their and the general government deficit. Other fiscal rules, such as the restraints imposed on local government, the expenditure overruns controlled by the Finance Minister and a restriction on reallocating unspent funds, appear more effective and could have contributed to the underexecution of expenditure plans resulting in lower-than-foreseen government deficits.

On the revenue side, almost all already adopted or planned reforms are directly deficit-increasing: social contribution cuts, personal income tax reductions and exemption on biofuels (in excise duty and income tax). These revenue-diminishing measures are only to a small degree offset by excise duty hikes on tobacco products (about 0.2% of GDP more revenues in 2008 and 0.1% in 2009).

Recent cuts of social contributions to the disability fund (by 3 percentage points of gross wage in the middle of 2007 and by 4 percentage points in the beginning of 2008) are aimed at stimulating employment through decreasing the relatively high tax wedge in Poland. These cuts are very costly for the budget (about 2% of GDP less revenue in 2007-2008) as they apply to all tax payers – also high-skilled who do not have problems finding jobs and who provide relatively much more to the disability fund. For the low - skilled, the cut may be too small and not effective enough in stimulating employment (or moving people from unregistered to registered employment) as they gain little in absolute terms. Moreover, in the current cyclical position, with quickly declining unemployment and high capacity utilisation and where labour demand seems quite rigid and labour supply more elastic, the cuts are likely to increase disposable income and consumption rather than lower labour costs for employers.

The already adopted personal income tax reform will from 2009 replace the three existing marginal rates (19%, 30% and 40%) with two reduced ones (18% and 32%). It will also introduce a threshold for high income earners which implies that about 98-99% of all tax payers will pay only by the lower rate. Similarly to the social contribution cuts discussed above, this quasi-flat income tax may further stimulate consumption while having relatively small impact on the registered employment of the least-skilled and being costly for the public finances (about ½% of GDP less revenue). Importantly, local government may be particularly hit by this change as revenue from the personal income tax is a relatively important source and as they have limited opportunities to increase other revenues. Consequently, public investment and absorption of EU funds, for which local authorities have the principal responsibility, may be restrained.

Beyond the reforms having a direct influence on expenditure or revenue, the recently adopted governmental privatisation plan for 2008-2011 (estimated at more than 2% of GDP) promises debt-decreasing impact, which may lead to the reduction of interest expenditure.

Finally, the Polish authorities have to conclude the pension reform implemented in 1999, when the saving in the new funds started. The law on the method of estimating individual pension benefits has not yet been adopted though the first pensions according to the new system are to be paid in 2009. Safeguarding a direct link between the personal accumulated capital and the amount of individual pension paid to beneficiaries, which was assumed when the reform was implemented, is essential for the old-age saving incentives and the long-run sustainability of Polish public finances. Furthermore, as agreed at the implementation of the reform, early pensions have to be replaced by "bridge pensions",[46] otherwise the new funded-pension system will be incomplete as it will not cover many privileged groups who currently have unfunded pensions.

46 See section 2.3.1 for the description of the main features of the "bridge pensions".

7. Consistency with the National Reform Programme and with the broad economic policy guidelines

The March 2008 convergence programme was prepared by the new government formed after the autumn 2007 elections, whereas the 2005 national reform programme (NRP) and its October 2007 implementation report were submitted by the previous government. Therefore, there is little continuity between the two programmes as regards the implementation schedule. The implementation of most of the reforms seem to be lagging. Nevertheless, the general list of reforms intended for implementation and presented in the convergence programme is consistent with the 2005 NRP and its implementation report. It includes: reform of early retirement and disability benefits, reform of the farmers' social fund (KRUS), healthcare reform, reorganisation and decentralisation of public finances, multiannual task budgeting.

The March 2008 convergence programme does not contain a qualitative assessment of the overall impact of the NRP within the medium term fiscal strategy, including via its effect on growth (potential) and employment, or on the overall policy-mix. Moreover, the programme does not explicitly mention to what extent the budgetary projections in the programme take into account the public finance implications of the reforms envisaged in the implementation of the NRP. However, the convergence programme includes a table with information on the direct budgetary costs (or savings) associated with the main reforms envisaged in the NRP. It is declared in the convergence programme that both the existing and the upcoming NRP (which is now being prepared by the Polish authorities) will not have any significant effect on the assumed path for the reduction of the general government deficit.

On the whole, the convergence programme and the NRP (together with its implementation report) seem to be integrated to some extent. The degree of integration could be increased if (i) the convergence programme included a clear qualitative assessment of the overall impact of the NRP within the programme horizon on the public finance position at large and (ii) convergence programme were based on the same implementation schedule as the NRP.

Box 6: The Commission assessment of the October 2007 implementation report of the national reform programme

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Poland's national reform programme[47] and is summarised as follows.

Poland's national reform programme identifies as key challenges the consolidation and better management of public finances, development of entrepreneurship, increased innovation by companies; upgrading and developing infrastructure, ensuring a competitive environment in networks sectors, creating and sustaining jobs and reducing unemployment; and improving the adaptability of workers and enterprises.

The Commission's assessment is that Poland has made limited progress in implementing its National Reform Programme over the 2005-2007 period and has shown limited progress in fulfilling the commitments agreed by the 2006 Spring European Council in the four priority action areas.

[47] Communication from the Commission to the European Council, "Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)", 11.12.2007, COM(2007)803.

Against the background of strengths and weaknesses identified, the Commission recommends that Poland is recommended to take action in the areas of: fiscal consolidation (mechanisms of expenditure control); competition in network industries; public research and support to private R&D; flexicurity, including active labour market policy, social benefits, lifelong learning and education.

Against the background of progress made, the Commission recommends that Poland is encouraged to also focus on the areas of: transport infrastructure; business registration process; e-government; transposition of internal market legislation; and childcare facilities.

The tables below provide an overview of whether the strategy and policy measures in the convergence programme are consistent with the broad economic policy guidelines in the area of public finances issued in the context of the Lisbon strategy for growth and jobs. The first table makes the assessment against the integrated guidelines for the period 2005-2008, adopted by the Council in July 2005. The second table makes the assessment against the country-specific recommendations, adopted by the Council in March 2007. The budgetary strategy in the convergence programme is partly consistent with the country-specific broad economic policy guidelines in the area of budgetary policies issued in the context of the Lisbon strategy. While the programme envisages continued fiscal consolidation, further mechanisms to enhance the control over expenditure are not mentioned.

Table 15: Consistency with the broad economic policy guidelines (integrated guidelines)

Broad economic policy guidelines (integrated guidelines)	Yes	Steps in right direction	No	Not applicable
1. To secure economic stability				
– Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it[1].		X		
– Member States should avoid pro-cyclical fiscal policies[2].				X
– Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits[3].	X			
– Member States posting current account deficits that risk being unsustainable should work towards (…), where appropriate, contributing to their correction via fiscal policies.				X
2. To safeguard economic and fiscal sustainability In view of the projected costs of ageing populations,				
– Member States should undertake a satisfactory pace of government debt reduction to strengthen public finances.				X
– Member States should reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible (…)		X		
3. To promote a growth- and employment-orientated and efficient allocation of resources				
Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives and ensure the overall coherence of reform packages.		X		

Notes:
[1]As further specified in the Stability and Growth Pact and the code of conduct, i.e. with an annual 0.5% of GDP minimum adjustment in structural terms for euro area and ERM II Member States.
[2]As further specified in the Stability and Growth Pact and the code of conduct, i.e. Member States that have already achieved the medium-term objective should avoid pro-cyclical fiscal policies in "good times".
[3]As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.

Source:
Commission services

Table 16: Consistency with the broad economic policy guidelines (country-specific recommendations and points to watch)

Broad economic policy guidelines (country-specific recommendations and points to watch)	Yes	Steps in right direction	No	Not applicable
1. Country-specific recommendations				
Pursue its action to continue fiscal consolidation and supplement the nominal State budget deficit "anchor" (deficit ceiling) with further mechanisms to enhance control over expenditure.		X		
2. Points to watch				
none				X

Source:
Commission services

* * *

Annex 1: Compliance with the code of conduct

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned.

(i) Model structure

The update adheres to the code of conduct as far as its table of contents is concerned.

(ii) Data requirements

The update presents all the compulsory data. However, there are some gaps in the optional data . The table on labour market developments provides no information on employment in hours worked or labour productivity in hours worked. The table on cyclical developments does not include a split in the contributions from labour, capital and total factor productivity to potential growth. This gap results from the national method used for estimating potential GDP (HP filter rather than production function). The table on long-term sustainability of public finances does not contain projections for total expenditure, occupational pensions in general government, total revenue, property income, and pension reserve fund assets. The table with sectoral balances does not include the statistical discrepancy. Besides, the presented non-compulsory estimation of the pension reform cost is not consistent with the difference between the general government deficit as reported until March 2007 (when the funded pension schemes were included in the general government) and after that date (when the funded pension funds were excluded from the general government). The cost reported in the current programme appears overestimated due to the inclusion of foregone revenues and extra expenditure not directly related to the pension reform.

The following tables show the data presented in the March 2008 update of convergence programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.	X		
… indicates whether Council opinion on previous programme has been presented to national parliament.		X	
b. Economic outlook			
… (for euro area and ERM II Member States) uses "common external assumptions" on main extra-EU variables.			not applicable
… explains significant divergences with Commission services' forecasts[1].		X	Commission spring forecast published after CP was received
… bears out possible upside/downside risks to economic outlook.	X		
… analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.		X	
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.	X		
d. Budgetary strategy			
… presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.	X		
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).			not applicable

The SCP…	Yes	No	Comments
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.		X	insufficient information
… specifies state of implementation of measures.		X	
e. "Major structural reforms"			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.			not applicable
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.		X	
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X		
… (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			not applicable
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.	X		
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	X		very general description
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	X		
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		with some gaps or inconsistencies
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		

Notes: SCP = stability/convergence programme; CP = convergence programme
[1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.

Source:
Commission services

Table 1a. Macroeconomic prospects

	ESA Code	2006 Level	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Real GDP	B1*g	*1 044.7*	6.2	6.5	5.5	5.0	5.0
2. Nominal GDP	B1*g	*1 060.2*	7.8	9.9	9.2	8.2	7.6
Components of real GDP							
3. Private consumption expenditure	P.3	*649.4*	4.8	5.2	6.0	5.4	4.5
4. Government consumption expenditure	P.3	*188.1*	5.8	1.0	2.0	1.5	1.6
5. Gross fixed capital formation	P.51	*207.1*	15.6	20.4	14.5	10.0	10.0
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*14.1*	1.4	1.3	1.1	1.1	1.0
7. Exports of goods and services	P.6	*418*	14.6	9.0	6.0	6.2	6.2
8. Imports of goods and services	P.7	*432*	17.4	10.9	9.6	7.8	7.0
Contributions to real GDP growth							
9. Final domestic demand		-	7.3	7.4	7.2	6.0	5.6
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.4	0.0	-0.1	0.0	0.0
11. External balance of goods and services	B.11	-	-1.1	-0.9	-1.7	-1.0	-0.6

Table 1b. Price developments

	ESA Code	2006 Level	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. GDP deflator		*n.a.*	1.5	3.2	3.4	3.0	2.5
2. Private consumption deflator		*n.a.*	1.2	2.6	3.5	2.9	2.5
3. HICP[1]		*n.a.*	1.3	2.6	3.5	2.9	2.5
4. Public consumption deflator		*n.a.*	3.0	2.4	3.5	2.9	2.5
5. Investment deflator		*n.a.*	0.9	3.0	3.0	3.0	2.5
6. Export price deflator (goods and services)		*n.a.*	2.3	3.4	0.0	1.5	1.5
7. Import price deflator (goods and services)		*n.a.*	2.4	2.3	0.0	1.5	1.5

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2006 Level	2006 rate of change	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change
1. Employment, persons[1]		*14 594*	3.4	4.3	1.6	1.2	1.1
2. Employment, hours worked[2]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)[3]		*13.8*	13.8	9.4	7.2	5.8	4.5
4. Labour productivity, persons[4]		*72.6*	2.8	2.1	3.9	3.8	3.8
5. Labour productivity, hours worked[5]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees	D.1	*377*	7.1	12.2	9.5	9.0	8.5
7. Compensation per employee		*34.2*	1.7	6.2	6.8	7.0	6.8

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-2.6	-2.6	-3.5	-4.2	-4.6
of which :						
- Balance on goods and services		-1.4	-1.7	-3.1	-3.6	-4.0
- Balance of primary incomes and transfers		-1.8	-2.0	-1.7	-1.8	-1.8
- Capital account		0.6	1.1	1.3	1.2	1.2
2. Net lending/borrowing of the private sector	B.9	1.2	-0.6	-1.0	-2.2	-3.1
3. Net lending/borrowing of general government	EDP B.9	-3.8	-2.0	-2.5	-2.0	-1.5
4. Statistical discrepancy		n.a.	optional	optional	optional	optional

Note: Polish Labour Force Survey (BAEL) data as verified by Eurostat is a data source for Table 1c.

Table 2. General government budgetary prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*-40.2*	-3.8	-2.0	-2.5	-2.0	-1.5
2. Central government	S.1311	*-44.1*	-4.2	-3.2	-3.2	-2.5	-2.0
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-3.5*	-0.3	0.2	0.6	0.3	0.3
5. Social security funds	S.1314	*7.4*	0.7	1.0	0.1	0.2	0.2
General government (S13)							
6. Total revenue	TR	*424.2*	40.0	40.0	40.0	39.2	38.7
7. Total expenditure	TE[1]	*464.3*	43.8	42.0	42.5	41.2	40.1
8. Net lending/borrowing	EDP B.9	*-40.2*	-3.8	-2.0	-2.5	-2.0	-1.5
9. Interest expenditure	EDP D.41	*28.7*	2.7	2.2	2.3	2.3	2.3
10. Primary balance[2]		*-11.5*	-1.1	0.2	-0.2	0.3	0.8
11. One-off and other temporary measures[3]		*0*	0.0	0.0	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*229.8*	21.7	22.8	22.9	22.8	22.4
12a. Taxes on production and imports	D.2	*150.5*	14.2	14.4	14.7	14.8	14.5
12b. Current taxes on income, wealth, etc	D.5	*79.3*	7.5	8.4	8.2	8.0	7.9
12c. Capital taxes	D.91	*0.3*	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	*129.1*	12.2	11.9	10.9	10.7	10.6
14. Property income	D.4	*17.1*	1.6	1.2	0.9	0.9	0.8
15. Other[4]		*47.9*	4.5	4.1	5.2	4.8	4.9
16=6. Total revenue	TR	*424.2*	40.0	40.0	40.0	39.2	38.7
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			33.5	35.1	34.2	33.8	33.3
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*167.6*	15.8	15.1	14.5	14.0	13.4
17a. Compensation of employees	D.1	*104.1*	9.8	9.6	9.2	8.9	8.5
17b. Intermediate consumption	P.2	*63.6*	6.0	5.6	5.3	5.1	4.9
18. Social payments (18=18a+18b)		*183.9*	17.3	16.6	16.5	16.2	15.8
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*22.6*	2.1	2.0	2.0	2.0	2.0
18b. Social transfers other than in kind	D.62	*161.3*	15.2	14.6	14.5	14.2	13.8
19=9. Interest expenditure	EDP D.41	*28.7*	2.7	2.2	2.3	2.3	2.3
20. Subsidies	D.3	*6.1*	0.6	0.7	0.8	0.9	0.8
21. Gross fixed capital formation	P.51	*40.8*	3.9	4.6	5.2	5.0	5.0
22. Other[6]		*36.7*	3.5	2.8	3.2	2.8	2.8
23=7. Total expenditure	TE[1]	*464.3*	43.8	42.0	42.5	41.2	40.1
p.m.: Government consumption (nominal)	P.3	*193.7*	18.3	17.1	16.4	15.8	15.2

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	**2005**	**2010**
1. General public services	1	6.1	5.1
2. Defence	2	1.1	1.0
3. Public order and safety	3	1.7	1.7
4. Economic affairs	4	3.8	4.1
5. Environmental protection	5	0.6	0.4
6. Housing and community amenities	6	1.4	1.0
7. Health	7	4.5	4.8
8. Recreation, culture and religion	8	1.0	0.8
9. Education	9	6.2	6.1
10. Social protection	10	17.0	15.1
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	43.4	40.1

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	**2006**	**2007**	**2008**	**2009**	**2010**
1. Gross debt[1]		47.6	44.9	44.2	43.3	42.3
2. Change in gross debt ratio		0.6	-2.7	-0.7	-0.9	-1.0
Contributions to changes in gross debt						
3. Primary balance[2]		-1.1	0.2	-0.2	0.3	0.8
4. Interest expenditure[3]	EDP D.41	2.7	2.2	2.3	2.3	2.3
5. Stock-flow adjustment		-3.2	-4.7	-3.2	-3.0	-2.5
of which:						
- Differences between cash and accruals[4]		0.2	0.0	0.1	0.2	0.3
- Net accumulation of financial assets[5]		0.5	0.4	0.3	0.3	0.5
of which:						
- privatisation proceeds		0.0	-0.1	-0.3	-0.3	-0.3
- Valuation effects and other[6]		-3.9	-5.1	-3.6	-3.5	-3.2
p.m.: Implicit interest rate on debt[7]		6.0	5.1	5.5	5.5	5.5
Other relevant variables						
6. Liquid financial assets[8]		0.9	0.8	0.6	0.6	0.5
7. Net financial debt (7=1-6)		46.8	44.1	43.6	42.7	41.8

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Real GDP growth (%)		6.2	6.5	5.5	5.0	5.0
2. Net lending of general government	EDP B.9	-3.8	-2.0	-2.5	-2.0	-1.5
3. Interest expenditure	EDP D.41	2.7	2.2	2.3	2.3	2.3
4. One-off and other temporary measures[1]		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		5.3	5.5	5.5	5.4	5.2
contributions:						
- labour		n.a.	n.a.	n.a.	n.a.	n.a.
- capital		n.a.	n.a.	n.a.	n.a.	n.a.
- total factor productivity		n.a.	n.a.	n.a.	n.a.	n.a.
6. Output gap		-0.3	0.6	0.5	0.1	-0.1
7. Cyclical budgetary component		-0.1	0.2	0.2	0.0	0.0
8. Cyclically-adjusted balance (2 - 7)		-3.7	-2.2	-2.7	-2.1	-1.4
9. Cyclically-adjusted primary balance (8 + 3)		-1.0	0.1	-0.4	0.2	0.8
10. Structural balance (8 - 4)		-3.7	-2.2	-2.7	-2.1	-1.4

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2006	2007	2008	2009	2010
Real GDP growth (%)						
Previous update		5.4	5.1	5.1	5.6	n.a.
Current update		6.2	6.5	5.5	5.0	5.0
Difference		0.8	1.4	0.4	-0.6	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-3.9	-3.4	-3.1	-2.9	n.a.
Current update		-3.8	-2.0	-2.5	-2.0	-1.5
Difference		0.1	1.4	0.6	0.9	n.a.
General government gross debt (% of GDP)						
Previous update		48.9	50.0	50.3	50.2	n.a.
Current update		47.6	44.9	44.2	43.3	42.3
Difference		-1.3	-5.1	-6.1	-6.9	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	18.6	15.2	12.8	12.4	12.4	n.a.
Pension expenditure	13.7	11.3	9.8	9.4	9.3	n.a.
Social security pension	13.7	11.3	9.7	9.2	8.0	n.a.
Old-age and early pensions	11.1	9.4	8.4	7.9	6.6	n.a.
Other pensions (disability, survivors)	2.6	2.0	1.3	1.3	1.4	n.a.
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	4.1	4.3	4.7	5.0	5.4	n.a.
Long-term care *(this was earlier included in the health care)*	0.1	0.1	0.1	0.1	0.2	n.a.
Education expenditure	4.9	3.9	3.0	3.0	3.1	n.a.
Other age-related expenditures	0.0	0.0	0.0	0.0	0.0	n.a.
Interest expenditure	0.0	0.0	0.0	0.0	0.0	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : from pensions contributions (or social contributions if appropriate)	9.2	9.7	10.1	10.0	10.0	n.a.
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : consolidated public pension fund assets (assets other than government liabilities)	8.3	15.5	33.1	50.7	84.5	n.a.
Assumptions						
Labour productivity growth	4.2	3.6	3.1	2.7	1.7	n.a.
Real GDP growth	3.3	5.0	3.2	2.2	0.4	n.a.
Participation rate males (aged 20-64)	77.8	79.9	82.1	84.0	81.7	n.a.
Participation rates females (aged 20-64)	65.1	67.0	71.3	74.4	70.3	n.a.
Total participation rates (aged 20-64)	71.4	73.4	76.7	79.2	76.1	n.a.
Unemployment rate	18.2	15.8	9.9	7.0	7.0	n.a.
Population aged 65+ over total population	13.1	13.5	18.2	22.6	29.4	n.a.

Table 8. Basic assumptions

	2006	2007	2008	2009	2010
Short-term interest rate[1] (annual average)	4.1	4.4	5.5	5.8	5.5
Long-term interest rate (annual average)	5.3	5.5	5.9	5.9	5.9
USD/€ exchange rate (annual average) (euro area and ERM II countries)	n.a.	n.a.	n.a.	n.a.	n.a.
Nominal effective exchange rate	-3.5	-4.9	-7.0	-1.1	-0.5
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	3.9	3.8	3.6	3.5	3.4
World excluding EU, GDP growth	5.0	4.8	3.8	3.8	3.8
EU GDP growth	3.0	2.9	2.0	2.0	2.0
Growth of relevant foreign markets	11.4	8.7	7.0	7.0	7.0
World import volumes, excluding EU	8.3	7.2	7.0	7.0	7.0
Oil prices (Brent, USD/barrel)	65.4	72.7	90.0	90.0	90.0

[1]If necessary, purely technical assumptions.

Annex 2: Key indicators of past economic performance

This annex displays key economic indicators that summarise the past economic performance of Poland. To put the country's performance into perspective, right-hand side of the table displays the same set of indicators for the recently acceded Member States (EU12).

Table: Key economic indicators

	Poland						Recently acceded Member States					
	Averages			2005	2006	2007	Averages			2005	2006	2007
	'96 - '05	'96 - '00	'01 - '05				'96 - '05	'96 - '00	'01 - '05			
Economic activity												
Real GDP (% change)	4.3	5.4	3.1	3.6	6.2	6.5	3.8	3.6	4.1	4.9	6.4	6.1
Contributions to real GDP growth:												
Domestic demand	*4.5*	*6.9*	*2.2*	*2.5*	*7.3*	*7.4*	*4.4*	*4.6*	*4.1*	*4.0*	*7.6*	*7.5*
Net exports	*-0.3*	*-1.4*	*0.9*	*1.1*	*-1.1*	*-0.9*	*-0.5*	*-1.0*	*0.0*	*0.9*	*-1.1*	*-1.3*
Real GDP per capita (PPS; EU27 = 100)	49	47	50	53	55	57	47	45	49	52	54	56
Real GDP per capita (% change)	4.3	5.4	3.1	3.7	6.3	6.6	4.0	3.8	4.3	5.0	6.5	6.2
Prices, costs and labour market												
HICP inflation (%)	6.4	11.0	2.7	2.2	1.3	2.6	7.8	12.9	5.7	3.8	3.4	4.2
Labour productivity (% change)	4.7	5.8	3.7	1.3	2.9	1.9	4.1	4.0	4.2	3.5	3.8	3.4
Real unit labour costs (% change)	-1.5	-0.4	-2.7	-2.3	-2.4	3.0	-1.3	-1.2	-1.3	-0.2	-0.7	1.8
Employment (% change)	-0.4	-0.3	-0.6	2.3	3.3	4.5	-0.4	-0.7	-0.2	1.0	2.7	2.6
Unemployment rate (% of labour force)	15.7	12.5	18.9	17.7	13.8	9.6	11.3	9.8	12.9	11.9	9.9	7.6
Competitiveness and external position												
Real effective exchange rate (% change)	1.4	3.6	-0.7	11.0	1.0	7.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Export performance (% change)[1]	3.6	3.2	3.9	1.1	4.4	2.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-2.8	-3.0	-2.5	-1.2	-2.5	-2.6	-4.4	-4.5	-4.4	-4.3	-5.6	n.a.
Public finances												
General government balance (% of GDP)	-4.6	-3.8	-5.3	-4.3	-3.8	-2.0	-4.2	-3.8	-4.4	-3.5	-3.4	-1.9
General government gross debt (% of GDP)	42.1	40.3	43.9	47.1	47.6	45.2	38.0	35.6	39.4	39.5	38.7	36.6
Structural balance (% of GDP)[2]	n.a.	n.a.	-5.3	-4.2	-4.0	-2.5	n.a.	n.a.	-3.9	-3.5	-3.7	-2.4
Financial indicators												
Short-term real interest rate (%)[3]	6.8	7.8	5.7	2.6	2.7	1.7	3.9	6.3	2.9	1.4	0.9	0.3
Long-term real interest rate (%)[3]	4.3	3.8	4.5	2.5	3.7	2.4	n.a.	n.a.	n.a.	n.a.	1.5	0.5

Notes:

[1]Market performance of exports of goods and services on export-weighted imports of goods and services of 35 industrial markets.

[2]Cyclically-adjusted balance net of one-off and other temporary measures; available since 2003.

[3]Using GDP deflator.

Source :
Commission services