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POLAND: MACRO FISCAL ASSESSMENT
AN ANALYSIS OF THE FEBRUARY 2010 UPDATE OF THE CONVERGENCE
PROGRAMME

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 8 February 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 24 March 2010. 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 2009 forecast and February 2010 interim 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 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 24 March 2010. The ECOFIN Council is expected to discuss the opinion on the programme on 16 April 2010.

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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/sgp/index_en.htm

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1. INTRODUCTION

This document assesses the February 2010 update of the Poland's convergence programme, which was submitted on 8 February 2010 and covers the period 2009-2012. The programme builds on the policies included in the 2010 budget but it is based on new macroeconomic assumptions which are more optimistic than those in the budget. It was approved by the government and presented to the national parliament for a debate without a vote.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Poland. 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 forecasts¹. Section 4 analyses budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

¹ This assessment uses the Commission services' autumn 2009 forecast, as published on 3 November 2009, as a benchmark. However, more recent information that has become available has also been taken into account to assess the risks to the programme scenario.

Table 1. Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	CP Feb 2010	5.0	1.7	3.0	4.5	4.2
	COM Nov 2009	5.0	1.2	1.8	3.2	n.a.
	CP Dec 2008	5.1	3.7	4.0	4.5	n.a.
HICP inflation (%)	CP Feb 2010	4.2	4.0	2.1	2.7	3.2
	COM Nov 2009	4.2	3.9	1.9	2.0	n.a.
	CP Dec 2008	4.2	2.9	2.5	2.5	n.a.
Output gap ¹ (% of potential GDP)	CP Feb 2010	2.4	-0.4	-1.7	-1.5	-1.5
	COM Nov 2009 ²	2.6	-0.4	-2.2	-2.3	n.a.
	CP Dec 2008	1.0	-0.1	-0.6	-0.5	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	CP Feb 2010	-4.0	-0.1	-1.1	0.0	-0.8
	COM Nov 2009	-4.0	-0.2	-0.3	-0.7	n.a.
	CP Dec 2008	-4.0	-1.8	-1.3	-1.5	n.a.
General government revenue (% of GDP)	CP Feb 2010	39.6	37.4	39.6	40.3	40.3
	COM Nov 2009	39.6	37.6	38.6	38.3	n.a.
	CP Dec 2008	39.8	40.7	40.0	39.7	n.a.
General government expenditure (% of GDP)	CP Feb 2010	43.3	44.6	46.5	46.2	43.3
	COM Nov 2009	43.3	44.0	46.1	45.9	n.a.
	CP Dec 2008	42.6	43.2	42.4	41.7	n.a.
General government balance (% of GDP)	CP Feb 2010	-3.6	-7.2	-6.9	-5.9	-2.9
	COM Nov 2009	-3.6	-6.4	-7.5	-7.6	n.a.
	CP Dec 2008	-2.7	-2.5	-2.3	-1.9	n.a.
Primary balance (% of GDP)	CP Feb 2010	-1.4	-4.8	-4.2	-3.1	-0.2
	COM Nov 2009	-1.4	-3.8	-4.6	-4.6	n.a.
	CP Dec 2008	-0.3	0.1	0.2	0.5	n.a.
Cyclically-adjusted balance ¹ (% of GDP)	CP Feb 2010	-4.6	-7.0	-6.2	-5.3	-2.3
	COM Nov 2009	-4.7	-6.3	-6.6	-6.7	n.a.
	CP Dec 2008	-3.1	-2.5	-2.1	-1.7	n.a.
Structural balance ³ (% of GDP)	CP Feb 2010	-4.6	-7.0	-6.2	-5.3	-2.3
	COM Nov 2009	-4.7	-6.4	-6.6	-6.7	n.a.
	CP Dec 2008	-3.1	-2.5	-2.3	-1.7	n.a.
Government gross debt (% of GDP)	CP Feb 2010	47.2	50.7	53.1	56.3	55.8
	COM Nov 2009	47.2	51.7	57.0	61.3	n.a.
	CP Dec 2008	45.9	45.8	45.5	44.8	n.a.

Notes:

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

²Based on estimated potential growth of 5.0%, 4.2%, 3.7% and 3.3% respectively in the period 2008-2011

³Cyclically-adjusted balance excluding one-off and other temporary measures. There are no one-off measures according to the most recent programme and 0.1% of GDP in 2009, deficit-reducing, in the Commission services' autumn 2009 forecast.

Source:

Convergence programme (CP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

This section describes recent economic and budgetary developments for Poland, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

The economic boom of the years 2006-2008 (real GDP growth reached 6% on average over the period) was followed by a pronounced slow-down in 2009 caused by the global financial crisis, which affected Poland via three main channels: lower demand for exports, lower foreign direct investment, and a halt in credit growth (reflecting decline in supply and demand for credit). Nevertheless, with real GDP estimated to have increased by 1.7%, Poland was the only EU country to have recorded positive growth in 2009. This performance reflects a constellation of favourable factors including sound fundamentals at the outset of the crisis, a well capitalised and relatively sound financial sector, the relatively low degree of openness of the economy, a sizeable depreciation of the Polish currency (more than 30% against the euro over July 2008 – February 2009) as well as accommodative monetary policy (main interest rate was reduced from 6% in November 2008 to 3.5% in June 2009 and instruments were introduced to support bank liquidity), and expansionary fiscal policy starting from 2008.

Some of the factors that supported growth are of temporary nature and could hamper growth in the years to come. In particular, the margin for supportive fiscal policy has largely disappeared and the reversal of the exchange rate depreciation may weigh on growth in the coming quarters. At the same time, a number of factors will continue to support the economy. The effects of the crisis on potential growth should be less severe than in other countries of the region, especially because of the lower scale of capital destruction and Poland's flexible labour market. Moreover, Poland remains an attractive destination for foreign capital. In the medium term, growth will depend on the quality of fiscal consolidation and implementation of structural reforms that improve the functioning of labour and product markets. In particular, in view of Poland's low employment rate and the need for reforms in support of the ongoing catching up process, it will be important to take further measures that foster labour market participation, improve the business environment, stimulate private R&D spending and upgrade the export structure by continuing to focus it on capital-intensive and high-technology industries.

While Poland has overall sound macroeconomic fundamentals, key challenges for the years ahead will be to bring government finances back to a sustainable position and secure a sustained catching-up process without compromising fiscal and macroeconomic stability. Already ahead of the global crisis, Poland had a high government deficit (3.6% of GDP in 2008), showing that good times (2006-2008) were not used to consolidate public finances. Based on the April 2009 EDP notification by the Polish authorities of a government deficit above 3% of GDP in 2008, an excessive deficit procedure was opened and a recommendation to end the excessive deficit situation was issued by the Council on 7 July 2009 (see Box 1). Despite some consolidation measures, in 2009 the government deficit is estimated by the authorities to have widened to 7.2% of GDP, and the structural deficit to 7% of GDP.

3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

In the main macroeconomic scenario underlying the budgetary projections, the programme projects an acceleration of GDP growth from 1.7% in 2009 to 3% in 2010, and 4.5% in 2011. Real GDP growth would slightly decelerate to 4.2 % in 2012, due to a fall of public investment. According to the programme, over 2010-2012 the economy should be mainly driven by domestic demand. The contribution of external trade would

be slightly negative, reflecting an appreciating currency (14% against euro over February 2009-February 2010) and higher import dynamics driven by re-stocking and a gradual recovery in investments. The macroeconomic scenario is broadly consistent with monetary and exchange rate assumptions. However the external assumptions underpinning the programme scenario are more optimistic than those from the Commission services' autumn 2009 forecast.

The programme presents, although with little details, an alternative scenario with lower real GDP growth, at 2.7% in 2010, 3.7% in 2011 and 3.5% in 2012, amid lower external demand from the EU, a more limited increase in private investment and worse labour market developments leading to lower private consumption growth.

The output gap as recalculated by Commission services based on the information in the programme (baseline scenario) following the commonly agreed methodology is foreseen to get moderately more negative over the programme horizon. It is projected to decrease from -0.4% of potential output in 2009 to -1.7% of potential output in 2010 and stabilize around -1.5% thereafter.² The recalculated negative output gap in the programme is smaller than the one estimated in the Commission services' autumn 2009 forecast (of -2.2% and -2.3% of potential output in 2010 and 2011, respectively) due to a significantly higher real GDP growth forecast in the programme.

Table 2: Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012
	COM	CP	COM	CP	COM	CP	CP
Real GDP (% change)	1.2	1.7	1.8	3.0	3.2	4.5	4.2
Private consumption (% change)	2.1	2.3	1.3	0.8	3.3	3.0	4.8
Gross fixed capital formation (% change)	-1.9	-0.3	1.9	5.7	5.0	11.3	4.7
Exports of goods and services (% change)	-11.2	-9.4	2.9	5.5	5.7	7.0	8.0
Imports of goods and services (% change)	-14.1	-14.4	3.3	6.1	6.7	7.6	8.5
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	1.1	-1.0	1.4	3.4	3.4	4.8	4.5
- Change in inventories	-1.6	-2.5	0.6	0.9	0.3	0.5	0.5
- Net exports	1.7	2.7	-0.2	-0.3	-0.5	-0.3	-0.4
Output gap ¹	-0.4	-0.4	-2.2	-1.7	-2.3	-1.5	-1.5
Employment (% change)	-0.7	0.3	-1.1	0.3	0.1	1.0	1.4
Unemployment rate (%)	8.4	8.2	9.9	9.2	10.0	9.3	8.9
Labour productivity (% change)	1.9	1.4	2.9	2.7	3.1	3.5	2.8
HICP inflation (%)	3.9	4.0	1.9	2.1	2.0	2.7	3.2
GDP deflator (% change)	3.7	3.9	1.5	2.0	2.6	2.8	3.3
Comp. of employees (per head, % change)	4.5	3.9	1.5	3.5	3.1	5.4	6.8
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-0.2	-0.1	-0.3	-1.1	-0.7	0.0	-0.8
<u>Note:</u>							
¹ In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.							
<u>Source :</u>							
Commission services' autumn 2009 forecasts (COM); Convergence programme (CP).							

Real GDP growth assumptions in the programme seem to be slightly favourable in 2010 and favourable in 2011 and 2012, when real GDP growth is expected to be much higher

² The output gaps presented in the programme are significantly lower than the programme's recalculated output gaps, and amount to -0.9%, -0.2% and -0.2% of potential output in 2010, 2011 and 2012, respectively. This stems from lower potential output presented in the programme.

than projected in the Commission services' autumn 2009 forecast. This conclusion is based on the Commission services' February 2010 interim forecast which predicts a higher GDP growth path (1.7%, 2.6% and 3.3% in 2009, 2010 and 2011, respectively) compared to the autumn 2009 forecast.

The programme expects employment growth to stabilise at around 0.3% in 2010 and moderately accelerate to 1% in 2011, while the unemployment rate would increase from 8.2% in 2009 to around 9¼ over 2010-2011. The Commission services' autumn forecast assumes a fall in employment by 1.1% in 2010 and stabilisation in 2011 and an increase in the unemployment rate from 8.4% in 2009 to about 10% over 2010-2011. Taking into account recent information, the projection in the programme of a gradual recovery in employment over the period 2010-2012 is plausible, especially as the swift adjustment of real wages seems to be cushioning the effects of the downturn on employment. The programme's projections for inflation, showing a decline to around 2% in 2010 on the back of an appreciating currency and contained wage pressure followed by a moderate rebound to 2.7% in 2011 supported by improving economic situation, are broadly in line with Commission services' views. The February 2010 interim forecast projects inflation at 2.3% in 2010 and 2.5% in 2011.

Overall, the programme is based on favourable growth assumptions over the programme horizon. The real GDP growth assumptions outlined in the alternative scenario seem more plausible than those presented in the baseline scenario.

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

4.1. Budgetary implementation in 2009

The general government deficit increased from 3.6% of GDP in 2008 to 7.2% of GDP in 2009 according to the programme. This is more than expected in the spring or autumn 2009 Commission forecasts (6.6% and 6.4% respectively) and much more than projected in the December 2008 convergence programme (2.5%) which was based on an overly optimistic growth scenario and an underestimated 2008 general government deficit estimate (by 0.9 percentage point of GDP). The significant deterioration from a deficit of 3.6% of GDP in 2008 reflects to a large extent the impact of the crisis on government finances, but was also brought about by stimulus measures with an impact of about 2 percentage points of GDP which the government adopted in line with the European Economic Recovery Plan (EERP). A personal income tax cut (decided in 2006), an increase of public investment and an indexation of social transfers were the main elements of the stimulus.

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new convergence programme with the targets from the previous update of the programme. Differences between outcomes and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the 'denominator effect') are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme

update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates.³ The following messages emerge:

- The negative real GDP growth surprise in 2009 was high (2 percentage points) compared to the December 2008 convergence programme, but it was smaller in nominal terms (0.9 percentage point). In spite of that, the underperformance of revenue exceeded 3% of GDP, mainly due to a dramatic shift in growth composition, but also possibly to higher than expected costs of the personal income tax cuts.
- Over-spending contributed to the higher deficit: nominal expenditure growth was by 0.8 percentage points higher than planned in the December 2008 convergence programme. This higher than planned spending growth occurred despite the package of savings announced on 3 February 2009 and the supplementary budget of 17 July 2009. It was mainly due to higher than planned intermediate consumption, compensation of employees and social transfers other than in kind as well as interest expenditure and investment.

The comparison of the 2009 fiscal outturn, as estimated in the current convergence programme, against the spring 2009 Commission services' forecast on which the July 2009 104(7) EDP Council recommendations was based shows that nominal revenue growth turned out to be 1.6 percentage point lower than projected, and expenditure growth turned out to be by 1.4 percentage points higher than projected (reflecting higher social transfers and higher compensation of employees).

When comparing 2009 fiscal developments to 2008 figures, the following messages emerge:

- The increase of the deficit ratio in 2009 resulted both from a reduction of the revenue ratio (by 2.2 percentage points) and a rise of the expenditure ratio (by 1.3 percentage point). These developments reflected the work of automatic stabilisers as well as the impact of stimulus measures, which had been decided already ahead of the crisis but turned out to be in line with the European Economic Recovery Plan (EERP). The budgetary impact of discretionary stimulus measures amounted to about 2 percentage points of GDP and included mainly a cut in personal income tax (with a budgetary cost estimated now at about 0.8 percentage point) and an increase of investment in infrastructure (largely EU-funded, but requiring also domestic co-financing). Social transfers other than in kind increased by 0.7 percentage point of GDP in 2009 reflecting the operation of automatic stabilisers and generous indexation rules (on past high inflation and wage growth).
- On the other hand, it appears that the deficit outturn in 2009 would have been even worse if deficit-reducing measures (expenditure cuts announced on 3 February 2009 and extra high dividends extracted from state-owned enterprises estimated together at about 1½ percentage points of GDP) had not been

³ Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p} \Delta \rho_{-1}}_{\text{Base effect}} + \underbrace{\frac{\rho_{-1}^o}{(1+g^o)(1+g^p)} \Delta r}_{\text{Revenue growth effect}} - \underbrace{\frac{\rho_{-1}^o}{(1+g^o)(1+g^p)} \Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho_{-1}^o (r^o g^p - r^p g^o)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

implemented. Despite these measures, the structural balance deteriorated by more than 2 percentage points in 2009.

In summary, the significant deterioration from a deficit of 3.6% of GDP in 2008 to 7.2% estimated in the current programme reflects to a large extent the impact of the crisis on government finances, but was also brought about by stimulus measures adopted in line with the EERP.

Table 3: Budgetary implementation in 2009

	2008		2009	
	Planned	Outcome	Planned	Outcome
	CP Dec 2008	CP Feb 2010	CP Dec 2008	CP Feb 2010
Government balance (% of GDP)	-2.7	-3.6	-2.5	-7.2
Difference compared to target ¹	-0.9		-4.7	
Difference excluding denominator effect ^{1,2}			-4.7	
<i>Of which:</i> due to a different starting position end 2008			-0.9	
due to different revenue / expenditure growth in 2009			-3.5	
p.m. Residual ³			-0.2	
<i>p.m. Nominal GDP growth (planned and outcome)</i>			6.6	5.7
Revenue (% of GDP)	39.8	39.6	40.7	37.4
Revenue surprise compared to target ¹	-0.2		-3.3	
Revenue surprise excluding denominator effect ^{1,2}			-3.6	
<i>Of which:</i> due to a different starting position end 2008			-0.2	
due to different revenue growth in 2009			-3.2	
p.m. Residual ³			-0.2	
<i>p.m. Revenue growth rate (planned and outcome)</i>			9.0	-0.2
Expenditure (% of GDP)	42.6	43.3	43.2	44.6
Expenditure surprise compared to target ¹	-0.7		-1.4	
Expenditure surprise excluding denominator effect ^{1,2}			-1.1	
<i>Of which:</i> due to different starting position end 2008			-0.7	
due to different expenditure growth rate in 2009			-0.3	
p.m. Residual ³			0.0	
<i>p.m. Expenditure growth rate (planned and outcome)</i>			8.1	8.9
Notes:				
¹ A positive number implies that the outcome was better (in terms of government balance) than planned.				
² The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.				
³ The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.				
<i>Source: Commission services</i>				

Box 1: The excessive deficit procedure (EDP) for Poland

On 7 July 2009 the Council adopted a decision stating that Poland had an excessive deficit in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). At the same time, the Council addressed a recommendation under Article 104(7) TEC specifying that the excessive deficit had to be corrected by 2012. Specifically, the Council recommended the Polish authorities to (a) implement the fiscal stimulus measures in 2009 as planned, in particular the public investment plan, while structuring a supplementary budget in such a way to avoid any further deterioration in public finances; (b) ensure an average annual fiscal effort of at least 1¼ percentage points of GDP starting in 2010; (c) spell out the detailed measures that are necessary to bring the deficit below the reference value by 2012, and reforms to contain primary current expenditure over the coming years. The Council established the deadline of 7 January 2010 for the Polish government to take effective action to implement the fiscal measures in 2009 as planned, while avoiding any further deterioration of public finances, and to specify the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' spring 2009 forecast.

The Polish authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the convergence programmes which will be prepared between 2009 and 2011.

On 3 February 2010 the Commission communicated to the Council that the Commission considered that no further steps in the excessive deficit procedure were needed. On 16 February 2010 the Council, following a recommendation by the Commission, considered that effective action had been taken in accordance with the recommendations.

4.2. The programme's budgetary strategy for 2010

The programme targets a 0.3 percentage point reduction of the deficit ratio to 6.9% of GDP in 2010. The small adjustment planned is justified in the programme by the need to avoid pro-cyclical fiscal policy which could jeopardise the recovery of the economy. It is to be achieved through a large increase in the revenue ratio (by 2.2 percentage point) which would more than offset the increase in the expenditure ratio (by 1.9 percentage point), which mainly reflects an increase in capital spending. There are three main sources for the expected revenue increase: (i) more EU funds to be absorbed, (ii) discretionary measures in the budget, and (iii) higher and more tax-rich GDP growth. Revenue and expenditure are projected to grow in parallel partly because of the planned increase in EU-funded public investment in infrastructure – in 2010 government gross fixed capital formation is projected to increase by 1.5 percentage point of GDP to 6.4% of GDP.

The budgetary projections in the programme are consistent with the 2010 budget, which was adopted by Parliament on 22 January 2010. The budget includes an increase in excise and quasi-excise duties (on cigarettes and fuel) with a deficit-reducing impact of about 0.2% of GDP. In addition, it imposes limits on wage and salary growth in the central government, leading to savings of about 0.3% of GDP (if nominal GDP growth turns out as projected in the programme). Following the adoption of the budget, on 29 January 2010, the Prime Minister and the Minister of Finance presented a package of reforms titled “The Plan for the Development and Consolidation of Finances”. However, the overall net impact of the package is small ($\frac{1}{2}\%$ of GDP⁴) and concentrated in 2012.

The current convergence programme foresees an improvement in the structural balance by about 0.8 percentage point of GDP in 2010 (Commission services' calculations based on information in the programme and according to the commonly agreed methodology). Part of the projected improvement results from a more favourable growth composition which is expected to raise tax revenues in comparison with 2009 (when growth was based mainly on net exports).

Overall, the budgetary target for 2010 taken at face value (i.e. before a risk assessment) is in line with the Council recommendations under Article 104(7) TEC, since the programme foresees the start of fiscal consolidation in 2010. The fiscal effort in 2010 implied by current plans is however smaller than the benchmark recommended by the Council in July 2009 (at least $1\frac{1}{4}$ percentage point of GDP annually on average) despite the worse starting position for the headline deficit (the 2009 deficit estimated in the programme is by 0.6 percentage points of GDP higher than assumed in the July 2009 recommendation) and the projected stronger recovery of the economy.

⁴ $\frac{1}{2}\%$ of GDP includes the impact of the expenditure rule as specified in the first package of reforms presented to the President.

Table 4. Main budgetary measures for 2010

Revenue measures ¹	Expenditure measures ²
Excise and similar duties (0.2% of GDP)	Wage growth constraint (-0.3% of GDP)
<p>Notes:</p> <p>¹ Estimated impact on general government revenue</p> <p>² Estimated impact on general government expenditure</p> <p><i>Source: Commission services</i></p>	

4.3. 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.

The main goal of the programme's medium-term budgetary strategy is to reduce the deficit below the 3% of GDP deficit reference value by 2012, in line with the Council recommendation under Article 104(7) TEC. Following the correction of the excessive deficit, the programme confirms the commitment to the medium term objective (MTO) of a government balance of -1% of GDP in structural terms. In view of the new methodology (see Box 2) and given the most recent projections and debt level, the MTO more than adequately reflects the objectives of the Pact. However, the programme does not envisage achieving it within the programme period.

Box 2: The medium-term objective (MTO) for Poland

As noted in the Code of Conduct⁵, the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

In particular, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the MTO of Poland is -1% of GDP. In view of the new methodology and given the most recent projections and debt level, the MTO more than adequately reflects the objectives of the Pact.

⁵ "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

The planned fiscal consolidation is considerably back-loaded: the headline balance is projected to improve by 1 percentage point of GDP in 2011 (following 0.3 percentage point of GDP in 2009) and by 3 percentage points in 2012. The structural balance would improve by 0.8-0.9 percentage point of GDP per year in 2010-2011, and by 3 percentage points of GDP in 2012. The average annual structural effort for the period 2010-2012 would be around 1½ percentage of GDP, slightly higher than recommended in the Council recommendation under the excessive deficit procedure, which would compensate for the worse starting position for the headline deficit in 2009 than assumed at the time of the Council recommendation. However, the planned structural improvement should be interpreted with caution because it is based on favourable macroeconomic assumptions which tend to inflate the potential growth estimates and structural effort estimates.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2008	2009		2010		2011		2012	Change: 2009-2012
	COM	COM	CP	COM	CP	COM ¹	CP	CP	CP
Revenue	39.6	37.6	37.4	38.6	39.6	38.3	40.3	40.3	2.9
<i>of which:</i>									
- Taxes on production and imports	14.2	13.3	13.0	13.5	13.8	13.3	13.6	13.5	0.5
- Current taxes on income, wealth, etc.	8.6	7.5	7.5	7.5	7.8	7.4	8.2	8.8	1.3
- Social contributions	11.4	11.2	11.3	10.9	11.1	10.6	11.1	11.3	0.0
- Other (residual)	5.5	5.6	5.6	6.8	6.9	7.1	7.4	6.7	1.1
Expenditure	43.3	44.0	44.6	46.1	46.5	45.9	46.2	43.3	-1.3
<i>of which:</i>									
- Primary expenditure	41.0	41.4	42.2	43.2	43.8	42.9	43.4	40.6	-1.6
<i>of which:</i>									
Compensation of employees	10.0	10.0	10.2	9.8	9.9	9.5	9.5	9.1	-1.1
Intermediate consumption	6.2	5.9	5.9	6.1	6.4	6.1	6.1	5.7	-0.2
Social payments	16.2	17.1	17.2	17.5	17.0	17.1	16.4	15.8	-1.4
Subsidies	0.7	0.7	0.7	0.7	0.8	0.8	0.8	0.7	0.0
Gross fixed capital formation	4.6	5.1	4.9	6.6	6.4	7.0	7.5	6.1	1.2
Other (residual)	3.4	2.5	3.3	2.5	3.4	2.5	3.2	3.1	-0.2
- Interest expenditure	2.2	2.7	2.4	3.0	2.7	3.0	2.8	2.7	0.3
General government balance (GGB)	-3.6	-6.4	-7.2	-7.5	-6.9	-7.6	-5.9	-2.9	4.3
Primary balance	-1.4	-3.8	-4.8	-4.6	-4.2	-4.6	-3.1	-0.2	4.6
One-off and other temporary measures	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	-3.6	-6.5	-7.2	-7.5	-6.9	-7.6	-5.9	-2.9	4.3
Output gap ²	2.6	-0.4	-0.4	-2.2	-1.7	-2.3	-1.5	-1.5	-1.1
Cyclically-adjusted balance ²	-4.7	-6.3	-7.0	-6.6	-6.2	-6.7	-5.3	-2.3	4.7
Structural balance³	-4.7	-6.4	-7.0	-6.6	-6.2	-6.7	-5.3	-2.3	4.7
<i>Change in structural balance</i>		-1.7	-2.3	-0.3	0.8	0.0	0.9	3.0	
Structural primary balance ³	-2.5	-3.7	-4.6	-3.7	-3.5	-3.7	-2.5	0.4	5.0
<i>Change in structural primary balance</i>		-1.3	-2.2	0.0	1.1	0.0	1.0	2.9	
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' autumn 2009 forecasts (COM); Commission services' calculations									

The consolidation foreseen after 2010 is mainly expenditure-based. Social transfers other than in kind are planned to fall by 1.3 percentage points in 2011-2012, the public wage bill by 0.8 percentage point and intermediate consumption by 0.7 percentage point.

Public investment is planned to increase significantly in 2010 and 2011 to a large extent because of the increasing absorption of EU funds and preparation of infrastructure for the 2012 European football championship. It would then drop considerably (1.4 percentage point) in 2012. On the revenue side, direct taxes are expected to yield 1 percentage point of GDP more in 2011-2012.

The consolidation towards the programme deficit targets in 2011 and 2012 is not supported by well-specified measures. The known measures (i.e. those included in “The Plan for the Development and Consolidation of Finances”) do not explain the large improvements in the structural balance projected in the programme. The net impact of the known measures and the planned expenditure rule (assuming that it becomes fully effective from 2011) explains only about 15% of the improvement in the structural balance in 2011-2012, calculated according to the commonly agreed methodology using the economic and fiscal projections in the programme. The Plan foresees significant measures for the long-term sustainability of public finances, but their positive impact on the deficit will not materialise within the programme horizon.

4.4. Risk assessment

This section discusses the plausibility of the programme’s budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services’ autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated programme. However, although the assessment uses the Commission services’ forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

The fiscal targets in the programme are subject to the following risks: (i) real GDP growth could turn out to be less favourable than expected, which would translate into lower than expected tax revenue; (ii) the forecast for non-tax revenue appears to be on the optimistic side (especially in 2010 and 2012); (iii) the fiscal targets for 2011 and 2012 are not supported by concrete measures, and the heavy electoral calendar for the coming two years raises questions on when these measures will be specified and implemented (presidential and local elections in autumn 2010, parliamentary elections in autumn 2011); and (iv) Poland has a mixed track record in achieving its general government expenditure targets specified in the subsequent Convergence Programmes updates. New initiatives to strengthen the fiscal framework may not be sufficient to change this pattern in the time span covered by the programme. These elements are discussed in more detail below.

- While the assumption for real GDP growth in 2010 appears only moderately optimistic, the growth assumptions for 2011 and 2012 are on the optimistic side. If the alternative, more cautious and plausible scenario (implying cumulated real GDP growth in 2010-2012 lower by 1.9 percentage point, but the same policy measures as in the main scenario) presented in the programme would materialise, the deficit in 2012 would be significantly higher than in the main scenario – by about 1.8 percentage point of GDP according to the programme. The excessive deficit would then not be corrected within the deadline set by the Council.
- It is unclear how the stabilisation of the property income ratio (at 1.4% of GDP) in the general government will be achieved in 2010. Indeed, the budget includes a projected reduction of dividends by more than 40%. This results from (i) very high dividends in 2009 made possible by high past profits, no longer possible after the crisis, and very high extraction share, no longer possible without damaging state enterprises’ financial position; and (ii) the planned reduction of state ownership

(acceleration of privatisation). Apparently, a very high profit of the central bank is assumed, which was not included in the budget. Furthermore, the very high increase of property income (0.6% of GDP) planned in 2012 is not supported by measures.

- The programme does not provide sufficient information about the fiscal consolidation measures to reach the 2011 and 2012 deficit targets. This concerns in particular items such as social transfers other than in kind (planned to decrease by 1.2 percentage point in 2011-2012) or direct taxes (expected to increase by 1 percentage point in the same period). The disaggregated budgetary impact of different measures is spelled out in the document to which the programme extensively refers (“The Plan for the Development and Consolidation of Finances” of 29 January 2010) but numbers do not add up. The measures in the Plan mentioned above would yield consolidation in net terms (the Plan also includes expenditure-increasing measures) of about ¼% of GDP. Moreover, its implementation is not guaranteed, because (i) it has not been endorsed by the whole government and (ii) some measures are at a very early stage.
- The consolidation partly relies on the future introduction of new expenditure rules. First a "temporary" expenditure rule, which would set a 1% ceiling on the real growth of some expenditure categories, would be implemented. However, the rule has not yet been agreed within the government – experience with a previous attempt to introduce an expenditure rule in 2001 suggests that the political risk is high. Besides, the recently announced rule is supposed to cover only the non-mandatory part of the central state budget which is currently less than 15% of general government expenditure (mainly investment).⁶ Finally, by reducing the share of non-mandatory expenditure, the rule will decrease the fraction of expenditure which the government can use for a timely and discretionary counter-cyclical policy. The proposed rule may also impact on public investment and, thus, negatively affect potential growth. This rule would be in force until the structural general government deficit reaches the MTO (deficit of 1% of GDP). Then, the authorities plan to introduce a "target" expenditure rule (the objective would be to keep the structural deficit at 1% of GDP), which would cover a larger share of government expenditure.
- The track record of Poland, when it comes to respecting its fiscal targets, was positive in 2004-2007 (Figure 1). This resulted from reform efforts in the beginning of the period (partial implementation of the “Hausner plan”), strong growth and windfall revenues as well as an under-execution of expenditure (mainly investment) due to administrative bottlenecks. However, there were significant deviations from plans in the more recent period. While the negative surprise in 2009 can be mainly attributed to the effects of the crisis on the revenue side, slippages in expenditure appear to be another reason, especially in 2008, when real GDP growth was high (5%) and as expected in the March 2008 convergence programme. The slippages in current primary expenditure increased in the recent years (Table 6) suggesting mounting problems in expenditure control.

The overall assessment of the balance of risks is negative, especially in the outer years of the programme.

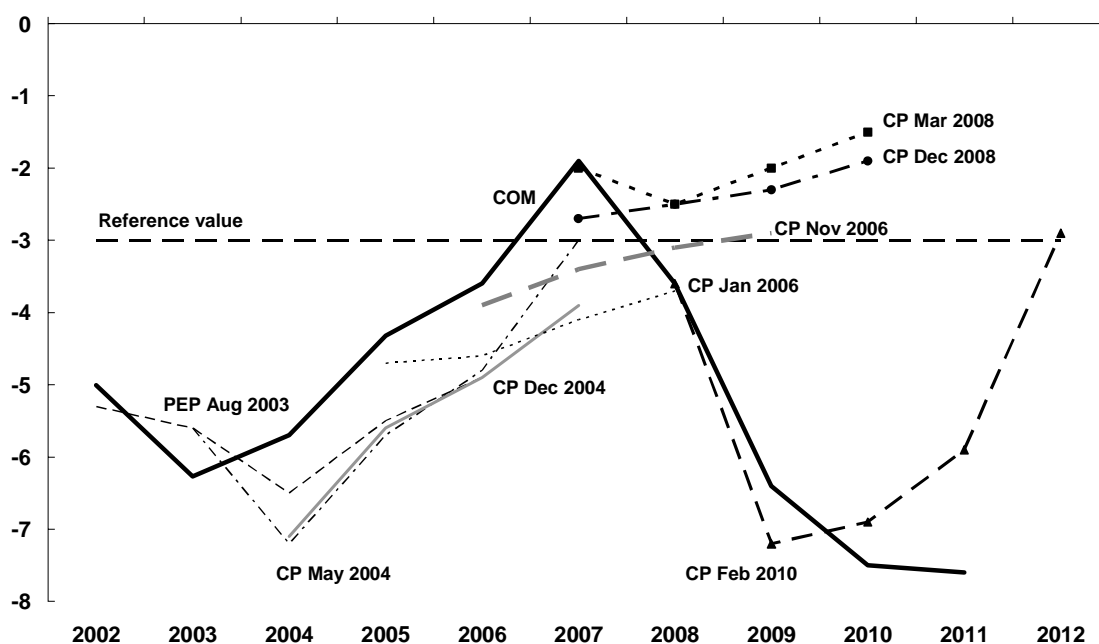
⁶ If the consolidation was based just on that measure, the correction of the excessive general government deficit from 7.2% of GDP in 2009 to 3% would be accomplished only after the year 2040, with an annual improvement by about 0.1 percentage point on average (somewhat higher in the beginning and lower towards the end of the period). The simulation assumes that the rule is implemented already in 2010. Until 2012 the real GDP growth is taken from the programme. Beyond 2012, the long-term real GDP growth (after 2012) is (optimistically) assumed as constant at 4%.

Table 6: Experience with expenditure targets (excluding investment and interest expenditure)

(in bn PLN)	2005	2006	2007	2008	2009
Target	396.5	389.4	408.9	445.3	482.1
Outcome	366.2	395.4	420.2	463.8	501.8
Deviation (outcome minus ceiling, % of target)	-7.7	1.5	2.8	4.2	4.1

Source:
Successive convergence programmes; Commission services' calculations

Figure 1: Government balance projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive convergence programmes

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

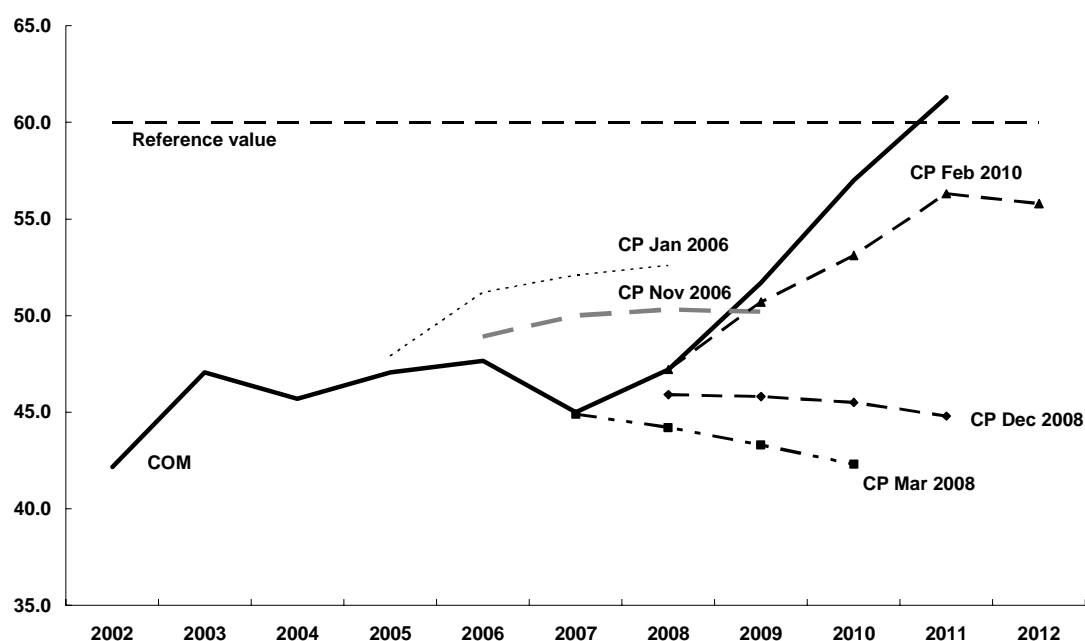
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

The general government debt of Poland is expected to increase from 50.7% of GDP in 2009 to 55.8% in 2012 according to the programme, remaining below the Treaty value. The 2009 debt ratio estimated in the programme is 1 percentage point lower than the Commission services' autumn 2009 forecast, notwithstanding the higher 2009 deficit outturn. This results from a positive stock-flow adjustment, despite the rather neutral impact of the exchange rate (depreciation of the Zloty followed by appreciation in 2009). The programme stresses that the stock-flow adjustment was due to debt-reducing cash-to-accrual adjustments and accumulation of financial assets other than through privatisation. Privatisation receipts are expected to play a much more significant role in reducing debt in 2010, leading to an even larger debt-decreasing stock-flow adjustment.

Figure 2: Debt projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive convergence programmes

Table 7: Debt dynamics

(% of GDP)	average 2003-07	2008	2009		2010		2011		2012
			COM	CP	COM	CP	COM	CP	CP
Gross debt ratio¹	46.5	47.2	51.7	50.7	57.0	53.1	61.3	56.3	55.8
Change in the ratio	0.6	2.2	4.5	3.5	5.3	2.4	4.3	3.2	-0.5
<i>Contributions²:</i>									
1. Primary balance	1.6	1.4	3.8	4.8	4.6	4.2	4.6	3.1	0.2
2. "Snow-ball" effect	-0.6	-1.1	0.5	-0.1	1.3	0.3	-0.1	-0.8	-1.2
<i>Of which:</i>									
Interest expenditure	2.7	2.2	2.7	2.4	3.0	2.7	3.0	2.8	2.7
Growth effect	-2.2	-2.1	-0.5	-0.8	-0.9	-1.4	-1.7	-2.2	-2.2
Inflation effect	-1.1	-1.3	-1.6	-1.8	-0.7	-1.0	-1.4	-1.4	-1.7
3. Stock-flow adjustment	-0.4	2.0	0.2	-1.2	-0.5	-2.0	-0.1	1.0	0.6
<i>Of which:</i>									
Cash/accruals diff.	-0.2	-0.3		-0.6		-0.1		-0.2	0.1
Acc. financial assets	0.3	0.3		-0.5		-2.4		0.3	0.5
<i>Privatisation</i>	-0.4	-0.2		0.0		-0.9		-0.3	-0.1
Val. effect & residual	-0.5	2.0		-0.1		0.5		0.9	0.0

Notes:

¹End of period.

²The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). 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' autumn 2009 forecasts (COM); Commission services' calculations

5.1.2. Assessment

The programme projects the debt ratio to increase but to remain under the Treaty reference value throughout the programme period. Under a different real GDP and inflation scenario as well as a different deficit path (no policy change assumption for 2011), the Commission services foresaw in their autumn 2009 forecast the debt ratio breaching the 60% of GDP threshold in 2011. Higher-than-targeted primary deficits seem to pose the highest risk to the debt projection presented in the programme (see Section 4.4). Besides, lower-than-projected real GDP growth may imply less favourable “snow-ball” effect (slower increase in the denominator of the ratio). The programme foresees large privatisation in 2010 (about 1% of GDP). In light of still weak market conditions and underperformance of past privatisation plans, there is a risk that receipts will be lower than expected. This risk seems however to be taken into consideration in the programme (about half of the officially planned privatisation receipts of about 2% of GDP seem to be included). Finally, as indicated in the programme, a 6 percentage point increase in state guarantees to 10% of GDP by 2012 is planned, mainly to support the EU-funded infrastructure projects. All in all, the debt projections seem to be subject to upside risks reflecting the risk of worse government deficit outcomes, the risk of lower stock-flow adjustments, and the risk that real GDP growth turns out to be lower than projected in the programme.

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

5.2.1. Sustainability indicators and long-term debt projections

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology⁷.

The projected increase in age-related spending is much below the EU average (4.6 pps.), falling by 1.1 percentage points of GDP between 2010 and 2060. This is due to a projected decrease by 2.1 pp in public pension expenditure owing to an increasing share of pensions in funded schemes. Sustainability indicators for two scenarios are presented in Table 9. 'The 2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting year, while 'the programme scenario' takes into account the consolidation planned in the programme up to 2012 and is based on the projected 2012 structural primary balance as a starting position. Assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2)⁸ would amount to 5.6% of GDP; nearly 6 percentage points higher than in last year's assessment, which is mainly due to deterioration in the estimated structural primary balance in the starting year. Additionally the age-related expenditure decrease less in the 2009 projections compared to the previous ones. The starting budgetary position is not sufficient to stabilize the debt ratio over the long-term and entails a risk of unsustainable public finances.

⁷ Economic Policy Committee and the European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009. European Commission (2009), 'Sustainability Report 2009', *European Economy* No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008..

⁸ The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

The "programme scenario", which is based on the end-of-programme structural primary balance, would reduce the gap substantially. If the budgetary consolidation planned in the programme was achieved, risks to long-term sustainability of public finances would be markedly mitigated.

Table 8: Long-term age-related expenditure: main projections

(% of GDP)	2007	2010	2020	2030	2040	2060	Change 2010- 60
Total age-related spending	20.5	19.1	17.8	17.9	17.7	18.1	-1.1
- Pensions	11.6	10.8	9.7	9.4	9.2	8.8	-2.1
- Healthcare	4.0	4.1	4.4	4.6	4.8	5.0	0.8
- Long-term care	0.4	0.4	0.5	0.6	0.7	1.1	0.7
- Education and unemployment benefits	4.5	3.8	3.3	3.2	3.0	3.2	-0.6
Property income received	1.3	1.2	1.0	0.9	0.8	0.8	-0.4

Source: Economic Policy Committee and Commission services.

Table 9: Sustainability indicators and the required primary balance

Value	2009 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
Value	5.4	5.6	1.4	0.2	0.5	1.3
<i>of which:</i>						
Initial budgetary position (IBP)	5.8	6.0	-	0.6	0.8	-
Debt requirement in 2060 (DR)	0.0	-	-	-0.1	-	-
Long-term change in the primary balance (LTC)	-0.4	-0.4	-	-0.4	-0.4	-

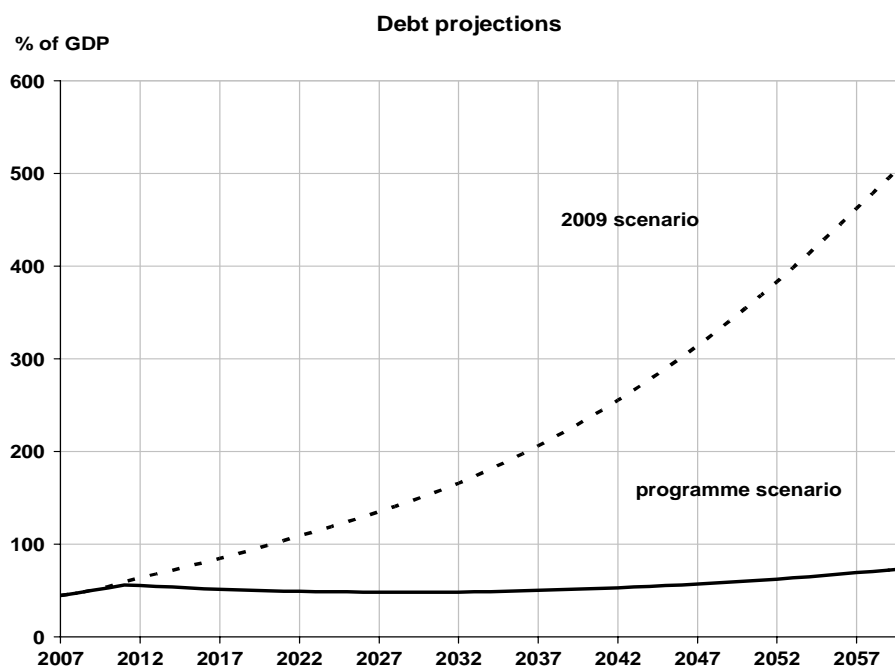
Source: Commission services.

Based on the assumptions used in the projection of age-related expenditure and the calculation of the sustainability indicators, Figure 3 displays the projected debt-to-GDP ratio over the long-term.

Based on the alternative assumptions of economic developments presented in the Commission services' autumn 2009 forecast publication⁹, Figure 4 shows the projected medium-term trajectory of the debt-to-GDP ratio. The two scenarios are in broad terms similar, though taking into account the latest economic development (below) debt is decreasing more rapidly than in the baseline (above).

⁹ Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009. This economic scenario assumes that the output gap caused by the crisis will be closed by 2017.

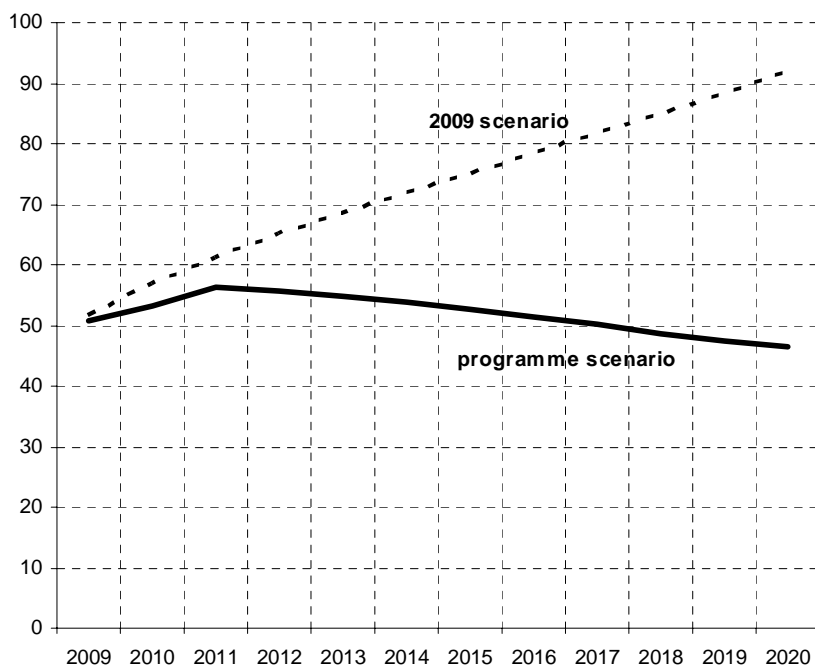
Figure 3: Long-term projections for the government debt ratio



Note: 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.

Source: Commission services calculations

Figure 4: Medium-term projections for the government debt ratio



Source: Commission services' calculations

5.2.2. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account, as shown in Table 10. The strong decline in the pension benefit ratio is assessed to increase risks to long-term sustainability of public finances.

The programme foresees important positive reforms supporting the long-term sustainability of public finances: a gradual inclusion of uniformed professions (newly-recruited policemen or soldiers) in the reformed general pension system and, in a less committing way, “an initiation of the debates” on (i) the increase and harmonisation of the retirement age for women and men as well as (ii) reform of the farmers’ social security fund which was not covered by the 1999 pension reform and is still heavily subsidised. Indirectly, through a reference to the reform Plan of 29 January 2010 (Sections 4.2 and 4.4), the programme includes a reduction of disability benefits. While very important for the long-term sustainability of government finances and labour market developments, these measures are intended to be implemented gradually and, thus, will not have significant effects on the government balance in the period covered by the programme.

Table 10: Additional factors for the assessment of long-term sustainability risks

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	na
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	-
High tax burden	na
Difference between S1 and S2	na
<p><i>Note: '-' : factor tends to increase the risk to sustainability, '+' : factor tends to decrease the risk to sustainability.</i> <i>'na' : not applicable.</i></p> <p><i>Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".</i></p> <p><i>An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.</i></p> <p><i>Source: Commission services.</i></p>	

5.2.3. Assessment

The long-term budgetary impact of ageing is the lowest in the EU, thanks to the projected decrease in public pension spending. However, the budgetary position in 2009 is significantly worse than in the previous programme and causes a marked sustainability gap over the long term. Ensuring higher primary surpluses over the medium term, as already foreseen in the programme, would contribute to reducing the medium risks to the sustainability of public finances.

Medium-term debt projections until 2020 that take account of more recent economic developments and projections on the potential growth show that the budgetary development envisaged in the programme, taken at face value, is more than enough to stabilise the debt ratio in the medium term and to reduce it below 50% of GDP by 2020.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

This section is subdivided into two elements: the fiscal framework and the quality of public finances in a broader sense.

6.1. Fiscal framework

There is scope to improve Poland's fiscal framework.¹⁰ Poland does not have any independent fiscal institution (fiscal council). It has only one type of fiscal rule, based on three debt thresholds (50% and 55% of GDP, both included in the Public Finance Act, and 60% in the Constitution; these ratios are based on the national public debt definition which is more narrow and implies lower debt than ESA95), the breach of which should trigger increasingly large fiscal consolidation measures. Its highly pro-cyclical nature has recently resulted in pressure to reverse the 1999 pension reform (see Section 5.2.2). On the expenditure side, the institutional framework is relatively weak, does not ensure sufficient expenditure control and results in recurring expenditure slippages. Finally, when assessed against cross-country indices measuring the strength of medium-term budgetary frameworks, Poland ranks only 20th among EU countries.

The authorities modified the fiscal framework in 2009. They made the existing debt rule more restrictive, by introducing additional specific provisions on the type of measures to be implemented once public debt exceeds 55% of GDP (non-ESA95): a nominal freeze in central budget wages, restriction of pension indexation to CPI inflation only, and reduction of spending programs financed by foreign credits as well as multi-year investment programs. The last element should be actually avoided because it is harmful for potential GDP growth, especially in Poland which suffers from substantial deficiencies in the quantity and quality of public infrastructure.¹¹

Another modification introduced in the 2009 revised fiscal framework was to extend the fiscal planning horizon for the central state budget from 3 to 4 years. Some reorganisation of the general government took place, aimed at increasing the transparency of public accounts. Finally, the authorities are planning the strengthening of the fiscal framework, including by introducing "temporary" and "target" expenditure rules. The "temporary" rule would somewhat support future consolidation but again risking to affect public investment (see Section 4.4).

6.2. Quality of public finances

Looking at the composition of public expenditure, Poland has a relatively large share of public expenditure allocated to social protection at the cost of underspending in growth-enhancing categories (innovation, R&D) and healthcare. Moreover, there seems to be scope to improve efficiency of public expenditure in areas such as healthcare and education. As far as the revenue side is concerned, the level of taxation is around the EU average, but the complex system of taxation and tax collection would benefit from further simplification.

Since 2005, the Polish authorities have gradually designed and implemented performance budgeting. It is intended to improve both the cost efficiency (i.e. efficient use of inputs)

¹⁰ The fiscal governance database is available at http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/index_en.htm.

¹¹ See http://ec.europa.eu/economy_finance/publications/publication_summary16455_en.htm.

and the effectiveness of government expenditure (i.e. effectiveness in achieving the desired outcomes). The 2010 budget has extended the scope of performance budgeting: (i) additional parts of the general government sector are covered (autonomous general government agencies, funds and other legal entities), (ii) additional expenditure categories to be included (multi-annual investment programmes). A number of less important methodological developments took place in 2009. The first central budget to be fully covered by performance budgeting is supposed to be implemented in 2013. The current implementation roadmap extends to 2014 and 2015 when comprehensive ex-post performance assessment is planned to be done. Only this assessment is likely to result in the elimination of unnecessary expenditure.

7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the Council Recommendations under Article 104(7) of 7 July 2009 with a view to correcting the excessive deficit and the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

Overall, in 2010 the budgetary strategy set out in the programme is broadly consistent with the Council recommendations under Art. 104(7) TEC of 7 July 2009. However, taking into account the risks, the budgetary strategy, from 2011, may not be consistent with the Council's recommendations. The average annual structural effort planned for the period 2010-2012 is 1½ percentage of GDP, slightly higher than recommended in the Council recommendation under the excessive deficit procedure. The Polish authorities intend to start fiscal consolidation in 2010 and to complete the correction of the excessive deficit by 2012. However, most of the adjustment is considerably backloaded, planned to take place in 2012 when the deficit would fall by 3% of GDP. In view of Poland's good economic performance during the crisis, the recovery projected by the authorities from 2010, the large structural government deficit, and the authorities' objective to correct the excessive deficit by 2012, a more frontloaded fiscal consolidation strategy would be appropriate. Consequently, the authorities should implement the 2010 budget rigorously, under-executing primary current expenditure plans wherever possible and allocating windfall revenue to deficit reduction.

The fiscal targets in the programme are subject to several downside risks: (i) real GDP growth could turn out to be less favourable than expected in 2011 and 2012, which would translate into lower than expected tax revenue; (ii) the forecast for non-tax revenue appears to be on the optimistic side (especially in 2010 and 2012); (iii) the fiscal targets for 2011 and 2012 are not supported by concrete measures, and the lack of consensus in favour of consolidation in the ruling coalition as well as the heavy electoral calendar for the coming two years raises doubts on when they will be designed and implemented; and (iv) Poland has a poor track record in respecting its current spending plans at general government level, and new initiatives to strengthen the fiscal framework may not be sufficient to change this pattern. In view of these risks, the fiscal targets in the programme need to be backed up by concrete and substantial consolidation measures in 2011 and 2012.

The programme announces further gradual consolidation towards the medium term objective (MTO) following the correction of the excessive deficit by 2012, but does not

mention a target year for reaching it.¹² The MTO is set as a structural balance of –1% of GDP which is more demanding than required by the Pact according to the updated estimations.

Intentions to strengthen the fiscal framework, in particular through the introduction of new expenditure rules, are welcome. However, while making fiscal institutions somewhat stronger, they are not sufficient to ensure the correction of the excessive deficit by 2012 and cannot be considered as a substitute to measures reducing mandatory expenditure, which require legislative amendments. In addition, the amended or proposed fiscal rules could affect potential growth through pressure to reduce public investment. In Poland, this would be particularly undesirable in view of deficiencies in terms of both quantity and quality of public infrastructure.

* * *

¹² 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.

ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

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. It also assesses to what extent Country followed up on the Council's recommendation to report on progress made in the correction of the excessive deficit, in a separate chapter of the programme.

(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 refers to different years than the standard table (2007, 2015, 2060, rather than 2005, 2010, 2050) and it does not contain projections for total expenditure, age-related expenditure, other age-related expenditure, occupational pensions in general government, total revenue, property income, and consolidated public pension fund assets (assets other than government liabilities). The table with sectoral balances does not include the projected statistical discrepancy.

The tables on the following pages show the data presented in the February 2010 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) Separate chapter on progress made in the correction of the excessive deficit

In its recommendations under Article 104(7) of 7 July 2009 with a view to bring the excessive deficit situation to an end, the Council also invited Poland to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the convergence programmes. Poland partly complied with this recommendation. In particular, the detailed and sufficiently large measures that are necessary to bring the deficit below the reference value by 2012 and reforms to contain primary current expenditure over the coming years have not been sufficiently spelled out.

(iv) 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
<i>a. Involvement of parliament</i>			
... mentions status vis-à-vis national parliament.	X		
... indicates whether Council opinion on previous programme has been presented to national parliament.		X	
<i>b. Economic outlook</i>			

The SCP...	Yes	No	Comments
... (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		X	
... 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	
<i>c. Monetary/exchange rate policy</i>			
... (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.		X	
<i>d. Budgetary strategy</i>			
... 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).	X		
... backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.		X	
... specifies state of implementation of measures.		X	
<i>e. “Major structural reforms”</i>			
... (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	
<i>f. Sensitivity analysis</i>			
... 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		partly
... (in case of “major structural reforms”) analyses how changes in assumptions would affect budget and potential growth.		X	
<i>g. Broad economic policy guidelines</i>			
... provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.		X	
<i>h. Quality of public finances</i>			
... describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
<i>i. Long-term sustainability</i>			
... outlines strategies to ensure sustainability.	X		
... includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
<i>j. Other information (optional)</i>			
... includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		
<u>Notes:</u> SCP = stability/convergence programme; CP = convergence programme			
<u>Source:</u> <i>Commission services</i>			

Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1* ^g	1235.6	5.0	1.7	3.0	4.5	4.2
2. Nominal GDP	B1* ^g	1272.8	8.2	5.7	5.1	7.4	7.6
Components of real GDP							
3. Private consumption expenditure	P.3	753.9	5.9	2.3	0.8	3.0	4.8
4. Government consumption expenditure	P.3	226.9	7.5	1.1	3.8	0.0	0.0
5. Gross fixed capital formation	P.51	274.6	8.2	-0.3	5.7	11.3	4.7
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	21.4	1.6	-0.9	0.0	0.5	1.0
7. Exports of goods and services	P.6	513.4	7.1	-9.4	5.5	7.0	8.0
8. Imports of goods and services	P.7	554.7	8.0	-14.4	6.1	7.6	8.5
Contributions to real GDP growth							
9. Final domestic demand		-	5.7	-1.0	3.4	4.8	4.5
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-1.1	-2.5	0.9	0.5	0.5
11. External balance of goods and services	B.11	-	-0.7	2.7	-0.3	-0.3	-0.4

Table 1b. Price developments

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		<i>n.a.</i>	3.0	3.9	2.0	2.8	3.3
2. Private consumption deflator		<i>n.a.</i>	4.2	3.0	2.1	2.7	3.2
3. HICP¹		<i>n.a.</i>	4.2	4.0	2.1	2.7	3.2
4. Public consumption deflator		<i>n.a.</i>	4.1	3.0	2.1	2.7	3.2
5. Investment deflator		<i>n.a.</i>	2.3	2.0	3.3	3.3	3.5
6. Export price deflator (goods and services)		<i>n.a.</i>	-0.9	13.8	-2.1	2.0	2.0
7. Import price deflator (goods and services)		<i>n.a.</i>	0.9	10.0	-1.1	2.1	2.0

¹ Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons¹		15800	3.7	0.3	0.3	1.0	1.4	n.a.
2. Employment, hours worked ²		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)³		7.1	7.1	8.2	9.2	9.3	8.9	n.a.
4. Labour productivity, persons⁴		80.6	1.3	1.4	2.7	3.5	2.8	n.a.
5. Labour productivity, hours worked ⁵		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees	D.1	472.5	13.0	3.7	3.4	6.7	8.5	n.a.
7. Compensation per employee		38.8	8.2	3.9	3.5	5.4	6.8	optional

¹Occupied population, domestic concept national accounts definition.

²National accounts definition.

³Harmonised definition, Eurostat; levels.

⁴Real GDP per person employed.

⁵Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-4.0	-0.1	-1.1	0.0	-0.8	n.a.
<i>of which :</i>							
- Balance on goods and services		3.9	0.2	0.8	1.1	1.2	n.a.
- Balance of primary incomes and transfers		1.1	1.4	1.6	1.5	1.6	n.a.
- Capital account		-1.1	-1.5	-1.3	-2.6	-2.1	n.a.
2. Net lending/borrowing of the private sector	B.9	0.8	4.4	5.8	5.9	2.1	n.a.
3. Net lending/borrowing of general government	EDP B.9	-3.6	-7.2	-6.9	-5.9	-2.9	n.a.
4. Statistical discrepancy		0.4	2.7	optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-46.4	-3.6	-7.2	-6.9	-5.9	-2.9
2. Central government	S.1311	-49.4	-3.9	-5.6	-5.7	-6.1	-3.6
3. State government	S.1312	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>
4. Local government	S.1313	-2.3	-0.2	-0.5	-0.5	-0.1	0.0
5. Social security funds	S.1314	5.2	0.4	-1.1	-0.7	0.4	0.7
General government (S13)							
6. Total revenue	TR	504.2	39.6	37.4	39.6	40.3	40.3
7. Total expenditure	TE ¹	550.6	43.3	44.6	46.5	46.2	43.3
8. Net lending/borrowing	EDP B.9	-46.4	-3.6	-7.2	-6.9	-5.9	-2.9
9. Interest expenditure	EDP D.41	28.3	2.2	2.4	2.7	2.8	2.7
10. Primary balance²		-18.1	-1.4	-4.8	-4.2	-3.1	-0.2
11. One-off and other temporary measures³		0	0.0	0.0	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		290.3	22.8	20.5	21.7	21.8	22.4
12a. Taxes on production and imports	D.2	180.2	14.2	13.0	13.8	13.6	13.5
12b. Current taxes on income, wealth, etc	D.5	109.7	8.6	7.5	7.8	8.2	8.8
12c. Capital taxes	D.91	0.3	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	144.6	11.4	11.3	11.1	11.1	11.3
14. Property income	D.4	17.5	1.4	1.4	1.4	1.2	1.8
15. Other⁴		51.8	4.1	4.2	5.5	6.2	5.0
16=6. Total revenue	TR	504.2	39.6	37.4	39.6	40.3	40.3
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)⁵		433.6	34.1	31.7	32.7	32.8	33.5
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	206	16.2	16.1	16.3	15.5	14.8
17a. Compensation of employees	D.1	127.3	10.0	10.2	9.9	9.5	9.1
17b. Intermediate consumption	P.2	78.7	6.2	5.9	6.4	6.1	5.7
18. Social payments (18=18a+18b)		205.8	16.2	17.2	17.0	16.4	15.8
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	26.6	2.1	2.4	2.4	2.3	2.4
18b. Social transfers other than in kind	D.62	179.1	14.1	14.8	14.7	14.0	13.4
19=9. Interest expenditure	EDP D.41	28.3	2.2	2.4	2.7	2.8	2.7
20. Subsidies	D.3	8.3	0.7	0.7	0.8	0.8	0.7
21. Gross fixed capital formation	P.51	58.5	4.6	4.9	6.4	7.5	6.1
22. Other⁶		43.7	3.4	3.3	3.4	3.2	3.1
23=7. Total expenditure	TE ¹	550.6	43.3	44.6	46.5	46.2	43.3
p.m.: Government consumption (nominal)	P.3	236.3	18.6	18.8	19.0	18.2	17.4

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

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

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

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

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

⁶D.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	2007	2012
1. General public services	1	5.6	5.9
2. Defence	2	1.4	1.4
3. Public order and safety	3	1.8	1.8
4. Economic affairs	4	4.7	5.4
5. Environmental protection	5	0.6	0.7
6. Housing and community amenities	6	1.1	1.2
7. Health	7	4.6	4.7
8. Recreation, culture and religion	8	1.1	1.1
9. Education	9	5.7	5.8
10. Social protection	10	15.6	15.2
11. Total expenditure (=item 7=23 in Table 2)	TE ¹	42.2	43.3

¹Adjusted 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	2008	2009	2010	2011	2012
1. Gross debt¹		47.2	50.7	53.1	56.3	55.8
2. Change in gross debt ratio		2.2	3.5	2.4	3.3	-0.5
Contributions to changes in gross debt						
3. Primary balance²		1.4	4.8	4.2	3.1	0.2
4. Interest expenditure³	EDP D.41	2.2	2.4	2.7	2.8	2.7
5. Stock-flow adjustment		-1.4	-3.8	-4.5	-2.6	-3.5
<i>of which:</i>						
- Differences between cash and accruals ⁴		-0.2	-0.6	-0.1	-0.2	0.1
- Net accumulation of financial assets ⁵		-0.1	-0.5	-2.4	0.3	0.5
<i>of which:</i>						
- privatisation proceeds		-0.1	0.0	-0.9	-0.3	-0.1
- Valuation effects and other ⁶		2.0	-0.1	0.5	0.9	0.0
p.m.: Implicit interest rate on debt⁷		5.0	5.1	5.3	5.3	5.1
Other relevant variables						
6. Liquid financial assets ⁸		1.9	1.9	1.6	1.5	1.4
7. Net financial debt (7=1-6)		45.3	48.7	51.5	54.9	54.4

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

²Cf. item 10 in Table 2.

³Cf. item 9 in Table 2.

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

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

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

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

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

Table 5. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Real GDP growth (%)		5.0	1.7	3.0	4.5	4.2
2. Net lending of general government	EDP B.9	-3.6	-7.2	-6.9	-5.9	-2.9
3. Interest expenditure	EDP D.41	2.2	2.4	2.7	2.8	2.7
4. One-off and other temporary measures¹		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		4.5	4.0	3.7	3.6	3.6
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		2.0	-0.2	-0.9	-0.2	-0.2
7. Cyclical budgetary component		0.8	-0.1	-0.3	-0.1	-0.1
8. Cyclically-adjusted balance (2 - 7)		-4.4	-7.1	-6.6	-5.8	-2.9
9. Cyclically-adjusted primary balance (8 + 3)		-2.2	-4.6	-3.9	-3.0	-0.2
10. Structural balance (8 - 4)		-4.4	-7.1	-6.6	-5.8	-2.9

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

Table 6. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012
Real GDP growth (%)						
Previous update		5.1	3.7	4.0	4.5	n.a.
Current update		5.0	1.7	3.0	4.5	4.2
Difference		-0.1	-2.0	-1.0	0.0	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-2.7	-2.5	-2.3	-1.9	n.a.
Current update		-3.6	-7.2	-6.9	-5.9	-2.9
Difference		-0.9	-4.7	-4.6	-4.0	n.a.
General government gross debt (% of GDP)						
Previous update		45.9	45.8	45.5	44.8	n.a.
Current update		47.2	50.7	53.1	56.3	55.8
Difference		1.3	4.9	7.6	11.5	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2000	2007	2015	2020	2030	2060
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension expenditure	13.2	11.6	9.6	9.7	9.4	8.8
Social security pension	13.2	11.6	9.6	9.7	9.4	8.8
Old-age and early pensions	10.3	9.8	8.4	8.7	8.4	7.9
Other pensions (disability, survivors)	2.9	1.7	1.2	1.0	1.0	0.9
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	n.a.	4.0	4.3	4.4	4.6	5.0
Long-term care (<i>this was earlier included in the health care</i>)	n.a.	0.4	0.4	0.5	0.6	1.1
Education expenditure	n.a.	4.4	3.3	3.2	3.2	3.2
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	0.0	0.0	0.0	0.0	0.0	0.0
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.
<i>Of which</i> : from pensions contributions (or social contributions if appropriate)	7.9	6.9	5.6	5.4	5.1	5.1
Pension reserve fund assets	0.0	0.3	0.4	0.4	0.4	0.8
<i>Of which</i> : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	n.a.	3.0	3.4	3.1	2.7	1.7
Real GDP growth	n.a.	5.9	3.1	2.5	2.0	0.5
Participation rate males (aged 20-64)	79.3	77.4	76.8	76.9	78.6	77.1
Participation rates females (aged 20-64)	66.0	62.2	63.0	64.3	67.1	65.6
Total participation rates (aged 20-64)	72.5	69.7	69.8	70.5	72.8	71.4
Unemployment rate	16.1	9.8	5.9	5.9	5.9	5.9
Population aged 65+ over total population	n.a.	13.4	15.3	18.2	23.0	36.2

Table 8. Basic assumptions

	2008	2009	2010	2011	2012
Short-term interest rate¹ (annual average)	5.7	3.8	3.7	4.8	5.6
Long-term interest rate (annual average)	6.1	6.1	6.2	6.3	6.4
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	-8.4	24.5	-9.4	-6.2	-3.3
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	3.5	4.3	4.0	3.7	3.6
World excluding EU, GDP growth	3.0	-0.8	3.8	4.1	4.1
EU GDP growth	0.8	-4.0	1.2	2.2	2.2
Growth of relevant foreign markets	3.1	-13.3	4.1	6.3	6.3
World import volumes, excluding EU	3.4	-12.3	5.6	6.8	6.8
Oil prices (Brent, USD/barrel)	97.7	61.9	76.0	80.0	80.0

¹If necessary, purely technical assumptions.