Contents

Foreword 5
Summary 6
I. Economic outlook 7
I.1. Current prospects 7
I.2. Medium-term scenario 8
II. General government balance and debt 12
II.1. Policy strategy and medium-term objectives 12
II.2. Actual balances 12
II.3. Medium-term budgetary outlook 16
II.4. Structural balance 19
II.5. Government debt 22
III. Sensitivity analysis and comparison with the previous update 24
III.1. Risk factors 24
III.2. Sensitivity analysis 25
III.3. Comparison with the previous update 26
IV. Sustainability of public finances 28
IV.1. Long-term budgetary prospects, including the implications of ageing population 28
IV.2. Contingent liabilities 31
V. Quality of public finances 33
V.1. Composition, efficiency and effectiveness of expenditure 33
V.2. Structure and efficiency of revenue systems 33
VI. Institutional features of public finances 36
Table annex 37
Measures increasing tax compliance in the years 2018 and 2019 43

Convergence Programme, 2018 Update

3
Tables

Table 1. Structural general government balance * 20
Table 2. General government debt (end of the year) 23
Table 3. Divergence from the previous update 27
Table 4. Fiscal sustainability indicators 28
Table 5. Long-term sustainability of public finances 29
Table 6. Contingent liabilities 31
Table 7. Macroeconomic prospects 37
Table 8. Price developments 37
Table 9. Labour market developments 38
Table 10. Sectoral balances 38
Table 11. Basic assumptions 39
Table 12. General government budgetary prospects 39
Table 13. No-policy change projections 41
Table 14. Amounts to be excluded from the expenditure benchmark 41
Table 15. General government expenditure by function 42
Table 16. Budgetary impact of implemented and planned measures increasing tax compliance 44

Figures

Figure 1. The ratio of revenues from main taxes (State Budget revenues and local government units shares) to GDP (in %) and the structure of the loss divided into individual taxes 13
Figure 2. VAT gap (% of theoretical revenues) in the EU Member States in 2015 14
Figure 3. VAT gap (in %) and compliance effect (in PLN bn) 15
Figure 4. Nominal general government balance 19
Figure 5. Compliance with the expenditure benchmark in the years 2015-2017 21
Figure 6. EUR/PLN exchange rate (left chart) and its impact on the general government balance and gross debt (right chart) 25
Figure 7. Short-term interest rate (left chart) and its impact on the general government balance and gross debt (right chart) 26
Figure 8. Stochastic debt projection from 2018 29
Foreword

The European Union Member States submit annually the updates of stability or convergence programmes to the European Commission and the Ecofin Council. Based on the analysis of these documents, the Ecofin Council subsequently issues recommendations for the economic policies of the Member States, which shall be taken into account when designing budgets for the next year. The Ecofin Council in its opinion of 11 July 2017 on the last year’s update of the Convergence Programme recommended that Poland:

— pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive part of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of public finances,

— take steps to improve the efficiency of public spending and limit the use of reduced VAT rates.

This Convergence Programme (hereinafter referred to as the Programme) presents in Chapters II.4, and V the state of implementation of measures recommended by the Ecofin Council in its opinion on the Programme of 2017. Moreover, it presents the medium-term forecast of the Polish economy and public finances through 2021.

The Polish Programme is a part of the Multiannual Financial Plan of the State (MFPS), developed pursuant to the Public Finance Act of 27 August 2009. The MFPS shall provide the basis for the preparation of the draft Budget Act for 2019.

This document was developed in accordance with the Council Regulation No. 1466/97/EC of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies and the guidelines on stability and convergence programmes of EU Member States approved by the EU Economic and Financial Committee in May 2017. The cut-off date for taking new information into account in the macroeconomic scenario presented in the Programme is 3 April 2018.

The current Programme was prepared simultaneously with this year’s edition of the National Reform Programme (NRP), which contains, inter alia, an overview of structural reforms aimed at Poland meeting the objectives of the Europe 2020 strategy and implementing the Council policy guidance formulated based on an analysis of the 2017 NRP. Information on the Programme and the NRP was discussed at a joint meeting of parliamentary committees for EU affairs, public finances and the economy and development on 11 April this year. As in previous years, the opinion of the Council on this Programme and the Council recommendations concerning the 2018 NRP will be the subject of discussion of the Polish Parliament.

---

Summary

In 2017, the GDP growth accelerated to 4.6% and was the highest since 2011. Domestic demand was still the main growth driver. Outlook for the Polish economy remains positive. In 2018, investments will be an important growth factor, especially public ones. However, private consumption, supported by optimistic expectations of Polish consumers and a good situation on the labour market, will continue to be the main determinant of the economic growth. In 2018 and 2019 the GDP will increase in real terms by 3.8% y/y, and in 2020 and 2021 by 3.7% and 3.6%, respectively.

The government's priority goal is to maintain sustainable public finances while supporting the inclusive economic growth. This means the need for conducting budgetary policy which takes into account constraints imposed by fiscal rules that ensure the sustainability of public finances. Growth-friendly fiscal policy, supporting the economic recovery, but without risks to the sustainability of public finances is also recommended by the European Council.

The general government deficit was reduced in 2017 to 1.5% of GDP, which is the lowest level since the Polish accession to the European Union. The debt of the general government in relation to GDP decreased to 50.6%. In the baseline scenario of the Programme the general government deficit is expected to be reduced to 0.7% of GDP in 2021.

The process of sealing the tax system will be continued. It will be oriented mainly on increase in VAT revenues and combating related frauds. At the same time, an automatic correction mechanism of the stabilizing expenditure rule defined in the Polish law will enforce limiting the expenditure growth rate so that it is consistent with requirements to reach the MTO, which - based on the Stability and Growth Pact – is a structural deficit of 1% of GDP.

The continuation of fiscal consolidation focused on achieving the MTO and the economic recovery will lead to a reduction of the risk to the sustainability of public finances in Poland in the medium and long term despite costs related to the aging of the population. Planned introduction of Employee Capital Plans (PPK) – a system of voluntary savings, which will consist of contributions paid by an employee and employer supported with financial incentives by the state – should lead to an increase in the long-term savings rate of Poles and accelerate the potential GDP growth rate.

Poland will continue to participate in the process of deepening the Economic and Monetary Union. The scale and strength of political and economic ties between Poland and the common currency area Member States mean that condition of the euro area significantly affects the processes taking place in Poland. Increase in the degree of economic convergence with the euro area requires implementation of structural reforms that strengthen the potential and performance of the Polish economy, including those indicated in the Strategy for Responsible Development by the year 2020 (with the perspective to 2030) and the National Reform Programme. At the current similarity level of the Polish economy with the euro area – in particular in terms of development, measured for example by GDP per capita – Polish membership in the euro area could be a source of turbulences in the economy. In addition, completion of the institutional reform in order to ensure the euro area stability still seems distant and unclear, which constitutes a necessary prerequisite for potential Poland’s accession to the common currency area.
I. Economic outlook

I.1. Current prospects

The average quarterly GDP growth rate in 2017 amounted to approx. 1.1% (qoq, sa) and was higher than in 2016 (approx. 0.8%) and close to the long-term average. Throughout the year, the dynamics of GDP in this approach was characterised by very low volatility. In the entire 2017, the GDP growth accelerated to 4.6% (from 3.0% in 2016), which means that it was the highest since 2011. Domestic demand remained the main growth driver and its dynamics was clearly higher than a year before. Net exports had a slightly positive contribution to GDP growth.

In 2017, the economic situation in the EU countries continued to improve. The GDP growth rate in this area was clearly higher than a year earlier and amounted to 2.4% against 2.0%. Domestic demand, in particular private consumption, remained the main source of economic growth, with the positive contribution of investment. At the same time, the rate of growth in the volume of EU imports, the main indicator of the demand for Polish products and services, stabilised at close to last year's (4.6%), while export growth accelerated (5.0%) supported by the recovery in world trade. In the favourable international economic situation, the growth rate of the volume of Polish exports of goods and services in general has nevertheless slightly decelerated (8.2%), which could have been driven by some strengthening of the real effective exchange rate.

The improvement in the dynamics of economic activity in 2017 was accompanied by further improvement of the situation on the labour market. The number of employed persons increased by 1.4%, i.e. at a rate higher than the one recorded a year earlier (0.7%). This growth resulted from an increase in the number of employees (as a result of the increase of people employed on permanent contracts) with a small decrease in the number of employers and the self-employed. The increase in the number of employed mainly resulted from growth in the number of workers in the service sector, and to a lesser extent in the industrial sector (including industry and construction), with the decline in the agricultural sector. The increase in labour demand contributed to a further decline in unemployment. The unemployment rate fell to 4.9% from 6.2% a year earlier and was lower than the EU average (7.6%). The participation rate - after two years of stabilization - increased by 0.2 percentage points to 56.4%. Mainly inactive people decided to retire in the reduced retirement age from October 1, 2017.

The improved situation on the labour market, implementation of the Family 500 plus programme combined with buoyant consumer sentiment were reflected in the higher dynamics of private consumption. The rate of private consumption growth in 2017 was 4.7% (against 3.9% in 2016) and was the highest since 2008. Investments - in contrast to the situation in 2016 – also had a positive contribution to growth. Strong investments dynamics was recorded mainly in the general government.

Estimates of the potential growth rate of the Polish economy, prepared in accordance with the methodology of the European Commission, indicate that one of consequences of the global financial crisis was the slowdown in the potential economic growth in Poland, which since 2013 has been accompanied by a negative output gap. The tendency in the dynamics of the potential GDP was not compensated even by the strong decline trend in the equilibrium unemployment rate (NAWRU) observed since 2002 and continued at present. As the persistent, continuous large labour demand, the gradual increase in the rate of growth of productivity of the factors of production is observed. In effect, it is estimated that in 2017 the potential growth rate in Poland increased by 0.2 percentage point to approx. 3.2% yoy. The increasing dynamics potential of Polish economy in 2017 onwards was, however, significantly lower than the rate of growth of real GDP (4.6% yoy), which resulted in the opening of a positive output gap of around 1% of GDP.

The increase in prices on the commodity market, in particular in oil prices at the turn of 2016/2017 caused a rapid increase in the growth rate of energy prices in Poland. As a result, inflation in the first quarter of 2017 increased to 2.0% (against 0.2% a quarter earlier). In the following quarters of 2017, it remained relatively stable. As a result, after two years of deflation, in 2017 the average increase in the

---

2 Information on labour market based on LFS data (aged 15 years and over).
prices of consumer goods and services amounted to 2.0% (HICP 1.6%). For five years, inflation in Poland has been below the inflation target of the National Bank of Poland (NBP). Despite the good situation on the labour market and high growth rate of private consumption core inflation (i.e. CPI excluding food and energy prices) remained moderate, from April 2017 in narrow range 0.7–1.0% (average in the year 0.7%). Fluctuations in commodities prices also influenced the dynamics of producer prices (PPI), which after reaching the maximum level in the first quarter of 2017 (4.4%), in the fourth quarter decreased to 1.7%, and on average in the entire year amounted to 2.9%.

In view of the limited risk of inflation persistently exceeding the target in the medium term, the Monetary Policy Council (MPC) did not change the NBP interest rates in 2017. The main interest rate – the reference rate remained at the level of 1.5%.

In 2017, current account recorded a small surplus at 0.3% of GDP, which was the first such situation since the middle of the nineties. The main negative impact on the external balance of the economy still had the primary income deficit (3.8% of GDP), which is a consequence of the high negative net international investment position. The balance also worsened the increase in transfers related to seasonal labour migration of non-residents, mainly Ukrainian citizens. On the other hand, surplus of services has reached the record level, which was caused, among others, by development of the business services sector. The inflow of long-term capital was maintained, although in the case of capital account it was still influenced by the transitional period between the financial perspectives of European funds.

On average, in 2017, the euro-zloty exchange rate (EUR/PLN) amounted to 4.26 and the dollar-zloty rate (USD/PLN) to 3.78 and was by 2.4% and 4.2% respectively lower than a year before. In the first half of the year, the downward trend of the EUR/PLN exchange rate dominated. The Polish currency strengthened under the influence of domestic factors, mainly the good growth prospects of the Polish economy, as well as global factors. Among the latter, the growing chances for a more cautious approach of U.S. monetary authorities to further normalization of monetary policy, the dovish rhetoric accompanying the ECB’S meeting in April and election results in Western European countries favouring the appetite for risk were of crucial importance. At the end of May, the appreciation of the zloty slowed down and in the following months the Polish currency weakened. Upward trend in the EUR/PLN exchange rate reversed in October, when the improvement in investment sentiment resulting from the decline in political risks in Europe contributed to the sharp strengthening of the Polish currency. The appreciation of the zloty grew stronger at the end of the year and the EUR/PLN exchange rate fell below the level of 4.17 in December.

I.2. Medium-term scenario

Winter forecasts of the European Commission regarding the increase in aggregate economic activity of the main trading partner of Poland, which is the European Union, are slightly more optimistic than the expectations presented in the autumn last year. The European Commission raised the GDP growth path for EU economies in 2017 to 2.4% yoy and in the forecast years 2018 and 2019 by 0.2% and 0.1% respectively. Therefore, it is expected that the GDP growth in the EU in 2018 and 2019 will be on average higher than the potential and will amount to 2.3% and 2.0% yoy respectively. For the euro area, the forecast of economic growth was raised to 2.1%, and 1.9% in 2018 and 2019 respectively. Winter forecast of the European Commission concerning import include the period up to 2019, for the macroeconomic scenario presented in the Programme, it is assumed that in the following years, the real EU GDP growth rate will gradually converge to the long-term average (1.7%).

Poland belongs to those EU countries where the phenomenon of population aging will intensify. Forecasts indicate that over the next fifty years the demographic load in Poland measured as a ratio of people over 64 to the population aged 15-64 will almost triple. Demographic determinants of the forecast presented in Programme are based on the assumption of demographic changes planned in the EUROPOP2015 scenario adjusted for CSO data available until March 2018. Until 2021, a minimum increase in population (on average 0.05%) is expected in Poland against a slight drop expected a year ago by approx. 0.1%. The relative improvement in the scope of demographic trends is associated with
better than estimated results in 2017, which is a good starting point for subsequent years. This improvement may be associated with the positive effects of the structural reform introduced by the government - the Family 500 plus programme - and the observed higher than expected number of births\(^3\), however, the full evaluation of the reasons of this phenomenon will only be possible from a longer-term perspective. Despite a relative improvement in the scope the total level of population, the population aged 15 – 74 in the period till 2021 will decrease by approx. 0.8%. While it is assumed that the factors delaying the number of exits from the labour market: low rate of replacement, the increasing share of services in the economy and the activation of people aged 21-24 years will affect positively on the rate of occupational activity.

It is anticipated that in 2018 the number of employed persons in the Polish economy will increase on average by 0.7%. In the next two years, the rate of growth will fall to approx. 0.2%, and in the last year of the forecast employment will remain unchanged. Changes in total number of employed include the assumption adopted the Programme concerning the stabilisation of the number of employed in the general government by 2021. Considering the expectations related to the developments in the participation rate over the Programme period, a further systematic reduction in the unemployment rate is expected. It is estimated that in 2018 the unemployment rate will fall to 4.2% from 4.9% recorded in the previous year, and in 2019 it will reach the level of 3.9%. It is assumed that while maintaining the assumed trends in the labour market, in the long-term forecast, the unemployment rate may even decrease to 3.3%.

The continuation of the improvement in the situation on the labour market will be conducive to the increase in wages in the market sector. Taking into account the changes in wages and salaries in general government units (see Chapter II), it is expected that in 2018 the nominal growth rate of the average wage in the national economy will amount to 5.7%. In the subsequent years, it will reach 5.6% in 2019, 5.5% in 2020, and 5.5% in 2021 respectively. The real growth in wages in the subsequent years will be close to expected changes in the long-term trend on labour productivity and will remain on average at 3.1%.

It is expected that real incomes will continue to grow faster than in 2010-2015 due to the very good situation in the labour market and only a slight slowing of inflation. Ease of finding work and a low probability of loss of work translate to record upbeat consumer sentiment. As a result, private consumption will remain the main driver of the economic growth and will grow in real terms by 3.8% yoy in 2018. In subsequent years covered by the forecast real consumption growth will be on average 3.5%.

Real growth in public consumption will be determined by the actions of the government aimed at compliance with applicable fiscal rules and towards the MTO. It is estimated that the real growth rate in this economic category in 2018 shall amount to 3%, to stabilise in 2019-2021 at a level of approximately 1.8–2.2%.

In the coming years, a good economic situation in major trading partners of Poland and the relatively high demand for Polish products exporters is forecast. The continuing high price competitiveness of Polish products allows companies to achieve relatively high rates of sales profitability. Considering additionally a high level of production capacity use and investment financing structure observed in the recent period, the conditions for acceleration of enterprises’ investment action should be recognised as favourable. The factors supporting the growth in investment demand of the private sector will also include: the cost of capital remaining on a relatively low level due to low interest rates and effective implementation of measures stipulated in the Strategy adopted by the government aimed at increasing the investment rate and productivity of Polish economy. Therefore, it is expected that during the period of the forecast the share of investment in GDP will grow.

It is projected that in 2018 the share of gross fixed capital formation of the private sector in GDP will amount to 14.1% in order to, over the Programme period, increase by 2.3 percentage points. Thus, the contribution to the GDP growth of private investment will reach nearly 1.5 percentage points. In the long-term perspective, the total gross fixed capital formation in the entire economy will increase from

---

\(^3\) Statistical data indicate that the number of births increased from 369 thousand in 2015 to 403 thousand in 2017.
1. Economic outlook

18.6% of GDP in 2018 to 20.3% of GDP in the last year of the forecast. The status of inventories is linked with the level of demand in the domestic market and in foreign markets. It is estimated that in the period covered by the Programme, the contribution of changes in inventories to GDP growth will be close to neutral.

Since the accession of Poland to the EU a systematic opening of the Polish economy to foreign markets has been observed. As a result, the share of exports in GDP has been growing rapidly, and in 2017 it reached a record level of 54%. One of the factors explaining such a dynamic change in the structure of the Polish GDP has been a high competitiveness of Polish enterprises. In addition, periods of relatively weak domestic demand, especially in 2012 and 2013, forced domestic entrepreneurs to look for new markets. Over the Programme period the exports of goods from the Poland will be supported by a good economic climate in major trading partners, as a consequence, real export growth will remain above the average growth rate of export markets and will be 6.2% in 2018. In the years 2019-2021 the export growth stabilizes on average 5.3% yoy.

Import growth will, in turn, be a derivative from the shape of the final demand. The estimated real growth of imports in the years 2018-2021 will reach 7.6%, 6.9%, 5.2% and 5.2%, respectively. As a result, the contribution of net exports to GDP growth in 2018 will amount to -0.5 percentage point. Then, along with the slightly decreasing dynamics of internal demand, it will coincide with the neutral one, and will remain so until the end of the forecast horizon.

The development of net exports is, in turn, reflected in the balance of trade in goods and is an important factor affecting the current account balance of payments. In 2018, the deficit of the current account will remain low, below 1% of GDP. The main source of external imbalances will be still a deficit of primary incomes, which reflects the negative net international investment position of the Polish economy. Over the Programme period, a slight increase in the deficit of the current account balance of payments should be expected. However, it is expected that this deficit will be financed from the inflow of long-term capital with a surplus, i.e. funds classified in the capital account (mainly European structural funds) and foreign direct investments.

In conclusion, it is expected that real GDP growth in the years 2018 and 2019 shall remain at the level of 3.8% yoy and will slightly decrease over the Programme period. At the same time share of investments in GDP is expected to increase, among others in connection with the use of funds from the EU’s financial perspective for 2014-2020. Nevertheless, private consumption supported by optimistic expectations of the Polish consumers and a good situation on the labour market will remain the most important component of economic growth. In the years 2020 and 2021, the real GDP growth rate will be at 3.7% and 3.6% yoy, respectively.

The growth rate of potential output will accelerate over the Programme period and exceed 3.5% yoy. The main factors contributing to the increasing dynamics of the potential of the economy will be accumulation of productive capital and total factor productivity growth. A significant increase in public investments supported by EU funds and private investments, supported by programmes aimed at increasing innovation, translates into faster accumulation of capital in the economy. On the other hand, the increasing level of human capital, associated with the influx of a better educated young workforce to the labour market, contributes significantly to the growing pace of the efficiency of production factors observed since 2014. A smaller positive impact on the potential of the Polish economy will have a constantly decreasing NAWRU equilibrium rate reflecting positive structural changes on the Polish labour market. The product gap will remain open at above 1% of GDP in 2018-2021.

Due to the balanced risks in the external environment the Polish economy (chapter III.1) for the purposes of the macroeconomic scenario presented in the Programme it was assumed that in the whole forecasted period the złoty exchange rate will remain on average at the level from 30 January, 2018 (i.e. 4.15 EUR/PLN and 3.34 USD/EUR). This is a technical assumption, and the date is related to the beginning of forecasting works on the Programme. Due to the cost of operating the external debt and the level of debt in relation to GDP over the medium term, the adopted assumption of the constancy of the course seems to be relatively conservative. The foundations of the Polish economy, in the absence of external shocks, should promote the strengthening of the Polish currency in the following years.
The beginning of 2018 brought a drop in the annual CPI to 1.4% in February, resulting from lower dynamics of food and energy prices. Assuming no supply-side shocks, food and energy prices are expected to stabilise over the Programme period. However, core inflation growth mainly driven by base high growth rate of wages, large enough to increase productivity will be observed. As a result, it is expected that the base inflation shall reach 1.6% in 2018 and slowly approach the inflation target. On the other hand, the pace of increase in the prices of consumer goods and services in 2018 will amount to 2.3% and with decreasing contribution to inflation in energy and food prices it will reach 2.5% between 2020 and 2021.
II. General government balance and debt

II.1. Policy strategy and medium-term objectives

Maintaining the sustainability of public finances while supporting inclusive growth remains the goal of fiscal policy. Measures in the area of the economic and social policy – including those aimed at implementing the Strategy for Responsible Development up to 2020 (with the outlook up to 2030) will be implemented without prejudice to the sustainability of public finances. At the same time, the EU reference values for the nominal deficit and the general government debt as well as regulations laid down in national legislation will be respected. They envisage, among others, constraints arising from the stabilising expenditure rule which defines the limit for majority of general government expenditure (cf. Chapter II.4).

II.2. Actual balances

In 2017, the major goal of fiscal policy was accomplished - maintaining the sustainability of public finances taking into account the limitations contained in the provisions of the national and EU law. In 2017, preliminary estimates show that the general government deficit (according to ESA2010) amounted to 1.5% of GDP, showing a significant improvement by approx. 0.8 percentage point comparing to 2016. The decrease in the general government deficit resulted from a growth of general government revenues and decrease of the expenditure. In the last year, the ratio of domestic revenues\(^4\) to GDP reached the level of 38.5%, i.e. 0.5 percentage point higher than in 2016, and domestic expenditure – the level of 40%, i.e. 0.3 percentage point lower than in 2016.

General government revenues

Taxes

In 2017, tax revenues amounted to 21.0% of GDP, which translates into a growth by 0.4 percentage points as compared to 2016, including a growth by 0.2 percentage point in revenues from taxes on production and imports, and similarly to the rise in revenues from taxes on income and wealth. A strong increase in tax revenues has been noticed since the introduction of a number of reforms in the tax system, and the foundation of the National Revenue Administration (March 2017). Tax revenues increased by approx. 61 billion PLN in the period 2016-2017, and in relation to GDP by 1.2 percentage point.

A significant improvement in VAT revenue positively influenced the execution of the state budget in 2017. The state budget collected in 2017, due to measures aimed at improving tax compliance, PLN 30 billion more, on a cash basis, compared to 2016. In a period of two years VAT revenues increased and reached, on a cash basis, a total of PLN 33.7 billion.

Apart from positive effects regarding VAT revenues an improvement in the field of excise tax on motor fuels was also observed. Revenue on motor fuels in 2017, on a cash basis, increased by 6.9% yoy, i.e. PLN 2.0 billion. Analysing developments in historic trends of legal consumption of excise goods, in particular motor fuels, it can be assessed that the high increase of tax revenues in 2017, apart from positive market developments, was also the result of measures aimed at improving tax compliance.

Strong increase in CIT revenues was also observed in 2017. It significantly exceeded the nominal economic growth rate. The revenues from CIT increased by 13% in 2017, raising the profits by PLN 4.6 billion in comparison with 2016 and exceeding the expected results of implemented anti-avoidance rule.

---

\(^4\) Domestic expenditure/revenues means the expenditure/revenue adjusted by expenditure financed from the EU funds for which the final beneficiaries are the general government units. According to the EU methodology ESA2010, the EU funds absorption by the general government units are neutral to the balance. In 2017, the total level of all domestic expenditure and expenditure financed from the EU funds for which the final beneficiaries are the general government units, in relation to GDP, was on the same level as in 2016 (41.1%)
Rapid increase in tax revenues in 2017 was a result of series of measures introduced in 2016 aimed at improving tax compliance. However, despite the improvement observed in the last 2 years (by 1.2 percentage point of GDP) the ratio of tax revenues to GDP is still significantly lower as compared with the situation prior to the global economic crisis. In 2007, general government tax revenues amounted to 22.7% of GDP, while in 2017 revenues amounted to 21.0% of GDP.

In 2017, revenues from four main central taxes (i.e. taxes being the revenues of the central budget, together with shares of local government units in PIT and CIT) were by 2.0 percentage points of GDP lower, on accrual basis, than in 2007. In the conditions of 2017 this corresponds to approx. PLN 40 billion, which implies a potential for further improvement in tax compliance.

Analyses indicate a reasonably large space for increasing the revenue flow from VAT. According to the European Commission in 2015 Poland belonged to the EU Member States with the highest VAT gaps. Only five counties recorded a bigger tax gap and those include: Italy, Greece, Slovakia, Lithuania and Romania.

For comparison, the most recent data from the European Commission (September 2017) covering the EU countries was used. Estimates of the VAT gap relate to 2015. For comparative purposes the percentage index is applied - i.e., the percentage of the VAT gap share in the theoretical proceeds (VTTL). This ratio indicates the percentage of potential tax revenue lost by state budget.

II. General government balance and debt

Figure 2. VAT gap (% of theoretical revenues) in the EU Member States in 2015

Source: Ministry of Finance estimates on the basis of the European Commission data, for 2017 and Ministry of Finance data.

For the purpose of estimating the VAT gap in 2017 a top-down method was applied, as in the previous Programme update. It uses macroeconomic data on VAT base (private consumption, net purchases and general government investments). The estimates of VAT gap obtained by applying method used at the Ministry of Finance are very close to the European Commission’s estimates. According to preliminary estimates of the Ministry of Finance⁷, a noticeable reduction of the tax gap was recorded in 2017 (by 6.0 percentage points, i.e. by approx. PLN 2.5 billion), although it still amounted to approx. PLN 25 billion, i.e. approx. 14.0% of potential revenues (cf. Chart 3).

Based on the European Commission’s methodology for assessing the VAT gap the improvement in VAT revenues resulting from taxpayers better complying with actual regulations (the so-called compliance effect) may be estimated at PLN 10.8 billion (with PLN 17.4 billion reached in the period of 2016 and 2017). It confirms the effectiveness of measures implemented to counteract VAT criminal practices, and other measures aimed at improving tax compliance.

For the years 2015–2017 data is of preliminary character, due to lack of statistical data in required detail, which would allow to make the complete estimate.
In addition, an econometric analysis of the VAT revenues in 2017 was conducted. A combination of two methodologies was applied: the method of estimating discrepancies between real and theoretical revenues, and the method of estimating the flexibility of the tax base by using the cointegration analysis. The results of estimation confirm a structural increase (i.e. not resulting from cyclical conditions) in VAT revenues in 2016 and 2017, which is consistent with estimates based on the European Commission’s methodology.

The comparison of tax revenue-to-GDP ratios for years 2007 and 2017, and the level of VAT gap imply a potential for further improvement in tax collection. Implemented and planned measures aimed at improving tax compliance are presented in Chapter V.2 and more thoroughly in the Annex.

**Social security contributions**

Apart from the growth in tax revenues, the increase in general government revenues in 2017 was brought about by the increase – by approx. 0.2 percentage points (approx. 7.9% yoy in nominal terms) – in social security contributions registered in the social security subsector. This growth mainly resulted from a solid situation in the labour market (high increase of employment and increase of wages), thus the dynamics of the wage fund was the highest since 2008.

**General government expenditure**

The ratio of domestic expenditure of the general government to GDP in 2017, despite a much higher nominal growth rate than in the previous year (5.8% against 3.6%), decreased by 0.3 percentage points and amounted to 40.0%. The ratio of expenditure, including EU resources, amounted to 41.1% of GDP.

The main factors determining the level of expenditure in 2017 were expenditure on social and educational benefits and a significant acceleration of public investment. The increase in spending on social and educational benefits resulted from:
II. General government balance and debt

— continuation of the *Family 500 Plus* programme (increase of spending from 17.3 billion PLN in 2016, to 23.4 billion PLN in 2017, caused by the implementation of the programme for a period of full 12 months),

— the increase in expenditure on retirement benefits, as under regulations introduced on 1 October 2017 the retirement age was lowered to 60 years for women and 65 years for men. As a result of this change, the Social Security Institution accepted 313.000 retirement benefit applications.

2017 saw a significant acceleration of general government investment, which increased in nominal terms by 21.9% yoy (or by 0.4 percentage points of GDP) after a decrease by 23.6% yoy in 2016. Strong bounce of capital expenditure of local government units was the main factor – nominal increase in the local government subsector amounted to 33.7% yoy. The bounce was caused, first and foremost, by acceleration of use of the funds from the EU’s financial perspective for the years 2014-2020. An increase in investment was also recorded in the central government subsector, nominally by 15.1% yoy (after a drop by 12.2% yoy in 2016). The increase in investment spending of the central government subsector in 2017 was mainly due to increased investment in railway infrastructure carried out by the Polish Railway Lines [*PKP PLK SA*].

In 2017, an increase in public consumption by 5.5% yoy was also noticed. As a result, the consumption in relation to GDP dropped to 17.7% from 17.9% in the previous year, which was affected i.a. by a reduction of labour costs – by 0.1 percentage point of GDP.

II.3. Medium-term budgetary outlook

The baseline scenario of the *Programme*, i.e. assuming full use of the expenditure limit, foresees that the general government deficit in 2018 will reach 2.1% of GDP and in subsequent years 1.5% of GDP, 1.1% of GDP and 0.7% of GDP, respectively.

A significant fiscal adjustment has been assumed over the *Programme* period. It results from a faster growth of general government revenues than expenditure growth determined by the stabilising expenditure rule.

**Factors determining the general government revenues**

According to the projections, the ratio of general government's domestics revenue\(^8\) to GDP in 2018, will reach 38.7%, and in subsequent years is expected to attain 38.7%, 38.5% and 38.4%.

*Social insurance contributions*

The most important source of general government revenues will be inflows from social security contributions. Revenues from those contributions depend on the basis for their calculation, where the main component is the wage fund in the national economy. However, they are also determined by systemic changes. Nominal growth rate of the wage fund, after an increase in 2017 by approx. 9.1% yoy, and expected high growth in 2018 (approx.7.4% yoy), should remain high in subsequent years, but below the nominal GDP growth rate.

Good situation in the labour market, translating into higher revenues from contributions has brought about a decrease of transfers from the state budget to the Social Security Institution [*ZUS*]. Actions undertaken by ZUS in the area of IT and accounting infrastructure also have a positive impact on the revenue level. Since 1 January this year taxpayers have been contributing to one individual account instead of making separate transfers to specific funds managed by the Social Security Institution (see Chapter V.2). The implemented solution reduces the costs of error verification, increases the transparency and efficiency of the payment system.

\(^8\) Domestic expenditure/revenues means the expenditure /revenues adjusted by expenditure financed from the EU funds for which the final beneficiaries are the general government units. According to the EU methodology ESA2010, absorption of the EU funds by the general government units is neutral to the balance.
II. General government balance and debt

**Taxes**

Tax revenues are determined by their base, mostly by private consumption, income from work, retirement and disability pension benefits and corporate profits. Over the Programme period, no changes in basic tax rates have been assumed. At the same time, systemic changes will continue to play a significant role, as their effects are expected to sealing the tax system. Actions in this area will focus on the increased collection of the tax on goods and services and the counteract against fraud associated with it. Implemented and planned measures are presented in Chapter V.2 and more thoroughly in the Annex.

**Factors determining general government expenditure**

The level of general government expenditure is determined by stabilising expenditure rule the imposed by the Public Finance Act (cf. Chapter II.4) which sets up the maximum level of expenditure of the state budget that can be planned in the budget act. In turn, other regulations of the Public Finance Act indicate that the amount of expenditure included in the budget act represents the absolute limit and thus determines the upper limit for the administrators of budgetary parts.

According to the projections, the ratio of domestic expenditure of the general government to GDP will amount to 40.7% in 2018. In the subsequent years, it is expected to reach 40.2%, 39.6% and 39%, respectively. In the presented scenario, the level of expenditure since 2018 has been assumed in line with maximum limits resulting from the stabilising expenditure rule.

At the same time, the administrators, when implementing the budget act, are bound to comply with the rules of financial management defined in Article 162 of the Public Finance Act, including the principle of rational management of public funds in a purposeful and cost-effective way, aiming to obtain best results from specific outlays. The above conditions and other operational factors cause that funds actually spent are regularly lower than the expenditure limit specified in the budget act.

The average level of under-execution of the budget expenditure in the medium term is approx. 3% of the total amount of expenditure planned in the budget act. In 2017, the state budget expenditure amounted to 97.7% of the plan, i.e. was by 8.9 billion PLN lower than planned (0.4% of GDP). In 2011-2017 budget expenditure was by an approx.10.2 billion PLN (0.6% of GDP) lower than planned.

**Social transfers**

Total social transfers in 2018 in relation to GDP will amount to 17.1% and will remain at a similar level as in 2017, and through 2021 it will decrease to 16.2%.

In the expenditure group categorised as social transfers the largest categories are:

- expenditure on regular and classified pensions in the social security subsector. In 2018, they will amount to 10.4% in relation to GDP, which in comparison to 2017 means an increase by 0.3 percentage point, while over the Programme period they are expected to fall to 10.2%. The forecast takes into account the effects of reducing the retirement, since 1 October 2017, to the age of 60 years for women and 65 years for men (Act of 16 November 2016 amending the act on retirement and disability benefits from the Social Insurance Fund and other acts) and indexation of pensions dependent on inflation and real wage growth in the previous year (indexation in 2018 was included in the Budget Act for 2018),

- expenditure on health services determined by the rule set up in the Act of 24 November 2017 amending the act on health care services financed from public funds,

- expenses related to the continuation of measures aimed at active pro-family policy and in the area of social policy. Changes aimed at improving compliance of the system regarding the child-support benefits under the Family 500 plus programme, and a significant improvement in the households’ incomes, resulting from a good situation on the labour market, will cause a decrease, as a ratio to GDP, of transfers connected with the programme as well as from other benefits in the area of social security.
**Public investment**

Public investments, after a significant decline in 2016 to 3.3% of GDP and a bounce in 2017 to 3.7% of GDP, will accelerate, remaining in relation to GDP at approx. 4.3%. In 2018, the increase in public investment as a ratio to GDP will amount to 0.8 percentage points GDP, of which 0.4 percentage points are investments financed with EU funds.

The level of general government investments will be determined by multiannual governmental programmes, particularly in the area of infrastructure and by the implementation of the EU financial perspective for 2014-2020. Investment tasks in the central subsector will be implemented particularly as part of:

- the **National Road Construction Programme for 2014-2023 (with perspective until 2025)** adopted by the resolution of the Council of Ministers. It involves investment related to the construction and reconstruction of national roads and motorways financed from the National Road Fund sources [KFD], the state budget and the funds from the EU financial perspective for 2014-2020,

- the **National Railway Programme until 2023**, including investment expenditure on construction and modernisation of railway lines carried out by the Polish Railway Lines [PKP PLK SA]. Investments in railway infrastructure are financed from the Rail Fund, the state budget, EU funds and from PKP PLK SA own resources.

It is assumed that investment of the local government subsector will have a significant impact on the level of total general government investment over the Programme period. After the acceleration in 2017 a high absorption rate of EU funds is expected to be maintained by local government units, which will also require their own contribution. It is expected that the implementation of investment of local government units from the EU funds will take place in such areas as urban transport, low-carbon economy, revitalisation, environmental protection (with particular emphasis on water protection).

**Other current expenditure**

Wage fund in state budget units will be executed in accordance with the expenditure limit provided by the stabilising expenditure rule, with the assumption that the fund will grow in line with inflation (CPI), excluding employee groups covered by existing indexation systems. As a result, labour costs in the general government in relation to GDP in the period 2018-2021 will be accordingly at 9.9%, 9.7%, 9.4%, 9.2%.

It is assumed that indirect consumption, i.e. purchases of goods and services by the general government units, excluding the EU funds, would remain at the level of 5.5% of GDP over the Programme period.

General government expenditure over the Programme period will also be affected by the introduction of Employee Capital Plans (PPK) (cf. Chapter IV.1). By introducing an incentive mechanism from the State budget in the form of a welcome bonus and an annual bonus paid from the Labour Fund to those PPK participants who fulfil conditions regarding the level of savings. The PPK is intended to gradually cover all employees paying social security contributions, including general government employees. The cost for the general government will result from financing of incentives (bonuses) and contributions of employees of public institutions. After covering also the general government employees and it will range from 1.3 billion PLN in 2019 to 2.8 billion PLN in 2021.
II. General government balance and debt

II.4. Structural balance

Poland is subject to requirements of the preventive arm of the Stability and Growth Pact, which states that the EU Member States should formulate and achieve the so-called medium-term budgetary objective (MTO) within a specified period of time. Compliance with the MTO is intended to prevent the nominal deficit from rising above 3% of GDP. Poland has defined its medium-term budgetary objective (MTO) as a general government structural balance of minus 1% of GDP. The assessment of compliance with the preventive arm of the Stability and Growth Pact is based on two pillars: the structural effort, i.e. the change in the structural balance and the expenditure benchmark.

The baseline scenario of the Programme assumes consolidation on the expenditure side in line with the stabilising expenditure rule and strengthening the revenue side by implementing measures sealing the tax system, described in the Annex. The structural deficit is forecast to be reduced from 2.8% of GDP to 1.3% of GDP in 2018-2021 on the assumption that the expenditure is implemented at a level consistent with expenditure limits (see Table 1). The structural balance path will be consistent with the requirements of reaching the MTO.

---

9 Council Regulation No 1466/97/EC of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

### II. General government balance and debt

Table 1. Structural general government balance *

<table>
<thead>
<tr>
<th></th>
<th>% of GDP</th>
<th>ESA code</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Real GDP growth (%)</td>
<td>4.6</td>
<td>3.8</td>
<td>3.8</td>
<td>3.7</td>
<td>3.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Net lending of general government*</td>
<td>EDP B.9</td>
<td>-1.5</td>
<td>-2.1</td>
<td>-1.5</td>
<td>-1.1</td>
<td>-0.7</td>
<td></td>
</tr>
<tr>
<td>3. Interest expenditure</td>
<td></td>
<td>EDP D.41</td>
<td>1.6</td>
<td>1.4</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>4. One-offs and temporary measures</td>
<td></td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>4.1 One-offs on the revenue side: general government</td>
<td></td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>4.2 One-offs on the expenditure side: general government</td>
<td></td>
<td>-0.04</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>5. Potential GDP growth (%)</td>
<td>3.2</td>
<td>3.7</td>
<td>3.7</td>
<td>3.8</td>
<td>3.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Output gap</td>
<td>1.2</td>
<td>1.4</td>
<td>1.5</td>
<td>1.4</td>
<td>1.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Cyclical budgetary component</td>
<td>0.6</td>
<td>0.7</td>
<td>0.8</td>
<td>0.7</td>
<td>0.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Cyclically-adjusted balance (2-7)</td>
<td></td>
<td>-2.1</td>
<td>-2.8</td>
<td>-2.3</td>
<td>-1.8</td>
<td>-1.3</td>
<td></td>
</tr>
<tr>
<td>9. Cyclically-adjusted primary balance (8+3)</td>
<td></td>
<td>-0.6</td>
<td>-1.4</td>
<td>-0.8</td>
<td>-0.3</td>
<td>0.2</td>
<td></td>
</tr>
<tr>
<td>10. Structural balance (8-4)**</td>
<td></td>
<td>-2.1</td>
<td>-2.8</td>
<td>-2.3</td>
<td>-1.8</td>
<td>-1.3</td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

*Estimates for the years 2018-2021 assuming that the expenditure is executed at the level consistent with expenditure limits. The historical under-execution of expenditure is 0.4-0.6% of GDP.

** In 2017, the impact of a one-off measure concerning the disbursement by the Bank Guarantee Fund of guaranteed funds following the bankruptcy of SKOK was taken into account: "Wybrzeże", "Nike", "Twoja" and "Wielkopolska" in the amount of 724 million PLN.

From 2017, expenditure benchmark has been the leading tool for assessing progress towards the MTO, i.e. the achievement of the required adjustment of 0.5% of GDP. The expenditure benchmark represents the annual growth rate of government expenditure, and, if followed, it ensures compliance with the requirements of the Stability and Growth Pact. It is set by the European Commission on the basis of the medium-term reference growth rate of the economy. At the same time, for countries that have not yet reached the MTO, the medium-term reference growth rate of the economy is reduced by the required adjustment to the MTO. The European Commission examines compliance with the expenditure benchmark by comparing with it the expenditure aggregate of the general government adjusted according to its methodology.

In 2016, Poland's adjustment on the path to the MTO was in line with the requirements of the preventive arm of the Stability and Growth Pact. The annual real growth rate of general government expenditure in 2016 amounted to 2.4% and was lower than the expenditure benchmark by 0.1 percentage point. In 2017, the expenditure growth rate amounted to 2.0% compared to the expenditure benchmark of 1.8%. This means that in 2017 the adjustment on the path to the MTO amounted to 0.4 percentage points of GDP, while in the two-year period i.e. in 2016 and 2017, it reached on average 0.5 percentage points of GDP, and was in line with the requirements of the Stability and Growth Pact.

---

11 This is the 10-year average of real potential GDP growth (t-5; t+4), which in 2014-2016 amounted to 3.7% in Poland, in 2017 decreased to 3.1%, and in 2018 it amounted to 2.9%.  
12 After taking into account the required adjustment the MTO, the expenditure benchmark is at the level of 2.5% by 2016, 1.8% in 2017 and 1.7% in 2018.  
13 This includes deducting discretionary revenue measures as well as one-off and other temporary revenue and expenditure measures.  
The analysis of compliance with the expenditure benchmark in 2017 took into account the impact of the projected total value of discretionary measures on the income side, amounting to PLN 14.0 billion, as well as the disbursement by the Bank Guarantee Fund of guaranteed funds following the bankruptcy of SKOKs: "Wybrzeże", "Nike", "Twoja" and "Wielkopolska", amounting to PLN 724 million (one-off measure).

A similar concept to the expenditure benchmark is the stabilising expenditure rule (SER). The adjustment by 0.5% of GDP required in the benchmark is built into the correction mechanism of the SER, which requires a reduction in expenditure dynamics by 1.5-2 percentage point in the situation of public finance imbalance specified in the Public Finance Act.

Estimating, a consistent with the stabilising expenditure rule, the initial level of expenditure for 2019, is based on the level of expenditure for 2018 as specified in Article 1(3) of the Budget Act for 2018 of 11 January 2018 in the amount of PLN 803 950 079 thousand. Discretionary measures in 2019 in the amount of 7.2 billion PLN included in the initial level of expenditure include in particular the effects of solutions described in the appendix increasing the effectiveness of tax compliance enforcement, changes in the refund procedure and the method of withholding tax, solutions aimed at eliminating aggressive tax optimisation and the draft law on supporting new investments. As a result, the initial amount of the level of expenditure for 2019 amounts to 844.9 billion PLN (37.8% of GDP).

The differences between the national and EU rules concern: the use of the 8-year average real GDP growth rate in the SRW (instead of the 10-year average potential GDP growth rate in the benchmark), the inflation goal (instead of the GDP deflator projection), the scope of discretionary measures on the revenue side, as well as not correcting of the amount of the SRW. For the purposes of assessing compliance with the Pact, analysed government expenditure are adjusted for: debt servicing costs, expenditure fully financed by EU funds, national investment expenditure (in year t) lowered by a 4-year average of this expenditure (t-3; t), cyclical expenditure on unemployment benefits.

Detailed calculations of the amount of expenditure for 2018 are included in the explanatory memorandum to the draft budget law for 2018.
On the basis of Article 112aa of the Public Finance Act, and taking into account further measures in order to improve the compliance of the tax system, it is estimated that the level of expenditure for 2020 will amount to PLN 886.7 billion (37.4% of GDP), and for 2021: 930.8 billion PLN (37.0% of GDP).

Over the whole Programme period, the adjustment for public finance imbalances amounts to -1.5 percentage points. This is due to the fact that in the period 2017-2019 the public debt calculated in accordance with Article 38a point 4 of the Public Finance Act will be in the range of 43-48% of GDP specified in the correction mechanism of the rule.

II.5. Government debt

In the period covered by the Programme update, debt management will, as in previous years, aim at achieving the objective specified in the Public Finance Debt Management Strategy i.e. at minimization of debt service costs in the long run subject the assumed risk limitations.

Debt management will be conducted under the conditions of gradual reduction of the general government deficit in subsequent years and of uncertainty in financial markets resulting, i.a. from the monetary policy of the main central banks, including the European Central Bank and Fed, as well as from economic policy in the USA. On the domestic market, measures related to limiting the general government deficit should have a significant impact on the level and shape of the yield curve, and thus on the costs of servicing the State Treasury debt.

Changes in the debt to GDP ratio in 2018-2021 will be primarily a consequence of the borrowing needs of the state budget (the debt of the State Treasury represents over 85% of the general government debt) and the rate of GDP growth. Changes in the debt of other general government entities will result mainly from the change in the debt of the National Road Fund (the increase in debt will be related to incurring liabilities for the implementation of road projects).

The debt to GDP ratio according to the EU definition is projected to gradually decrease over the Programme period from 50.6% at the end of 2017 to 46.0% at the end of 2021. The average interest rate on general government debt and debt service costs will mainly result from the expectations as to the increase of interest rates over the Programme period.
## General government balance and debt

### 2018 Update

Table 2. General government debt (end of the year)

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>ESA code</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Gross debt</td>
<td>50.6</td>
<td>50.4</td>
<td>50.4</td>
<td>48.7</td>
<td>46.0</td>
<td></td>
</tr>
<tr>
<td>2. Change in the gross debt ratio</td>
<td>-3.5</td>
<td>-0.3</td>
<td>0.1</td>
<td>-1.7</td>
<td>-2.7</td>
<td></td>
</tr>
</tbody>
</table>

#### Contributions to changes in gross debt

| 3. Primary balance* | -0.1 | 0.6 | 0.0 | -0.4 | -0.9 |
| 4. Interest expenditure | 1.6 | 1.4 | 1.5 | 1.5 | 1.5 |
| 5. Stock-flow adjustment | -5.0 | -2.3 | -1.5 | -2.8 | -3.4 |
| of which: difference between cash and accruals | -0.5 | 0.3 | 0.6 | -0.2 | -0.6 |
| net accumulation of financial assets | 0.1 | 0.4 | 0.8 | 0.3 | 0.0 |
| of which: privatisation proceeds | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| valuation effects and others | -4.7 | -3.0 | -2.8 | -2.9 | -2.8 |
| p.m. implicit interest rate on debt (%) | 3.1 | 3.0 | 3.2 | 3.2 | 3.3 |

#### Other relevant variables

| 6. Liquid financial assets | 3.9 | 3.8 | 3.6 | 3.5 | 3.2 |
| 7. Net financial debt (=1-6) | 46.7 | 46.6 | 46.8 | 45.2 | 42.7 |
| 8. Debt amortisation (existing bonds) from the end of the previous year** | 6.1 | 5.5 | 5.3 | 4.5 | 5.5 |
| 9. Percentage of debt denominated in foreign currency (%) | 31.8 | 30.5 | 29.1 | 28.2 | 28.0 |
| 10. Average maturity*** | 5.1 | 5.1-5.2 | 5.0-5.2 | 4.9-5.3 | 4.8-5.4 |

Source: Ministry of Finance.

1) Impact of primary balance on debt: (-) means primary surplus.
2) In the case of public finance units’ debt other than the State Treasury – estimate based on available reports.
3) Interval forecast for State Treasury debt.
III. Sensitivity analysis and comparison with the previous update

III.1. Risk factors

The baseline scenario of the Programme was constructed assuming the full use of the expense limits. Under-execution of state expenditure in 2017 amounted to 0.4% of GDP and in 2011-2017 on average to 0.6% of GDP. Bearing in mind historical deviations from plans, execution of expenditure may be expected at a level lower than implied by the limit, therefore the general government deficit and the structural deficit could be lower than in the presented forecast. Lower level of expenditure, depending on the structure of the savings, may also have an impact on the macromodel scenario presented in the Programme.

The forecast presented in the Programme assumes that economic growth in the EU, which is the largest trading partner of Poland, is consistent with the scenario presented by the European Commission in the Winter forecast from February 2018. According to the Commission’s experts, the risks to this forecast are balanced. Among the main reasons why the economic growth in the euro area may be faster, there is very upbeat consumer sentiment that translates into strong consumer demand supported by rising wages and investments. The Commission notes, however, that due to limitations of the supply-side the factors are relevant only in the short-term horizon of the forecast. In the longer term, closer co-operation within the Economic and Monetary Union should increase confidence and hence the resilience of the EU economies to negative economic shocks.

On the other hand, there are growing concerns about potential negative effects on international trade resulting from increased protectionism in US trade policy and faster normalization of monetary policy by the Fed. This overlaps with the risk of adjustments to the current rise in asset prices, which was encouraged by the environment of low interest rates, and uncertainty about the results of the negotiations in connection with the Brexit. Additionally, the importance of the risks associated with geo-political tensions in the Middle East and on the Korean peninsula increased.

The economic growth scenario presented in the Programme assumes a significant acceleration in the use of EU funds allocated to Poland in the framework of the financial perspective 2014-2020. The actual scenario in this field may be different from the target, which would have relevance for the adopted path of investment and consequently the GDP growth. Increased expenditure on public investments co-financed by the EU funds and prosperity abroad may contribute to higher growth of investment in fixed assets than assumed in the Programme. Additionally, optimistic consumer sentiment and a good situation on the labour market may result in higher consumer demand and, as a result, faster economic growth than expected. Cautious expectations regarding the GDP growth, however, are dictated by necessity to plan budgetary expenditure responsibly. Therefore moderate optimism seems justified given that there is no shortage of risk factors suggesting a slower economic growth.

Due to the aforementioned risk factors and for the needs of the path presented in the Programme, the conservative macromodel assumptions, similar to the medium-term equilibrium path, were adopted. Such approach allows to avoid the expectation of excessive cyclical improvement in the general government i.a. regarding pro-cyclical elasticities in revenues. Nevertheless, there is a chance that the real GDP growth, especially in 2018, will be faster than assumed.

A particular risk factor related to structural changes taking place in the labour market in Poland is the volume of labour supply over the Programme period. The high labour demand, also for less-qualified and less-paid, supported by a low replacement rate, translates into an increase in professional activity and postponing the decision to retire. Incoming workers from Ukraine also significantly increase labour supply in the country and help meet the growing demand for it. However, labour supply resources are not unlimited, and the so-called labour market flexibility is difficult to estimate. In the case of emerging shortages on the supply side, it can be expected that the space for increasing production and expansion of enterprises will be limited, and competition for employees with higher wages will translate into an increase in core inflation. As a result, a lower GDP growth rate is possible and a faster price growth than in the scenario of the Programme.
III. Sensitivity analysis and comparison with the previous update of the Programme

The risk factor for the inflation forecast is also the possibility of, other than assumed, price building on global energy commodity and food markets, which will directly translate into the path of price changes in Poland. In particular, the oil prices, that have a significant impact on fuel prices in Poland, and therefore transport costs depend on the unknown today OPEC supply strategy for the years 2019-2021, and a difficult to estimate demand for this raw material especially on the part of developing countries. The above phenomena contribute to the uncertainty of predictions of energy prices.

III.2. Sensitivity analysis

The sensitivity of the general government balance and debt in the years 2018-2021 to a depreciation of the zloty exchange rate and the increase in the domestic interest rate is presented below. The analysis was performed on the basis of the econometric Model of Public Finance (eMPF) developed by the Ministry of Finance. The results of simulations should be interpreted with great care, since they are based on historical elasticities estimated for assumed behavioural equations.

The exchange rate impulse was introduced as a permanent 10% depreciation of the EUR/PLN exchange rate. The weakening of the zloty improves the competitiveness of domestic products, which directly results in an increase in the volume of exports. Due to the high import intensity of exports, the growth in exports is also accompanied by the growth in imports. An increase in demand for Polish goods fosters the improvement of labour market conditions and an acceleration of investment activity, which is favourable for the GDP growth over the Programme period. A higher economic growth triggers a rise in general government revenues which exceeds the growth in expenditure associated with servicing debt denominated in foreign currency, which ultimately leads to improvement in the general government balance and, as a consequence, in the shock scenario, the general government debt to GDP ratio in 2021 shall be lower than in the baseline scenario.
Sensitivity analysis and comparison with the previous update of the Programme

The interest rate impulse has been defined as an increase in the nominal short-term interest rate of 1 percentage point for the entire period covered by the analysis. A rise in short-term interest rates results in an increase in long-term interest rates and consequently leads to a higher cost of capital acquisition, which results in limiting of the investment level against the baseline scenario and higher debt financing costs. As a result of a shift in consumption over time due to inter-temporal substitution and tightened conditions for granting loans, the level of private consumption is also decreasing. As a result, the monetary impulse triggering the enhancement of monetary policy restrictiveness leads to a decrease in GDP volume over the Programme period. Along with growing debt servicing costs and a relatively lower GDP level, the general government balance to GDP ratio deteriorates and the share of the general government debt to GDP grows in comparison with the baseline scenario.

III.3. Comparison with the previous update

The real GDP growth in 2017 was by 1.0 percentage point higher than in the last year's Programme due to a faster growth in private consumption and accumulation, and a more favourable contribution of net exports to the GDP growth. Compared with the previous update of the Programme the forecast of the real GDP growth in the years 2018-2021 has been revised slightly down (on average by 0.1 percentage point). The most important reason for the correction are more conservative assumptions with regard to the contribution of net exports to the GDP growth.

The general government deficit in 2017 reached 1.5% of GDP and was by 1.4 percentage points lower than expected. The lower general government deficit resulted from a stronger increase in the revenues against expenditure, which in turn was reflected in a very good balance of the state budget. The forecast deficit for 2018 was decreased compared to last year's update of the Programme. The revised path is the result of expected faster growth of government revenues compared to expenditure, which is determined by the stabilizing expenditure rule.

Lower ratio of the general government debt to GDP in 2017 compared to the forecast from the previous update of the Programme was mainly due to lower than planned borrowing needs, lower foreign exchange rates, in which approx. 1/3 of debt is denominated, and a faster nominal GDP growth. The lower forecast for the years 2018-2021 arises from the lower State budget borrowing needs, lower foreign exchange rates and a faster nominal GDP growth relative to the forecast in the previous update.
### III. Sensitivity analysis and comparison with the previous update of the Programme

Table 3. Divergence from the previous update

<table>
<thead>
<tr>
<th></th>
<th>ESA code</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP growth (%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous update</td>
<td>3.6</td>
<td>3.8</td>
<td>3.9</td>
<td>3.9</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Current update</td>
<td>4.6</td>
<td>3.8</td>
<td>3.8</td>
<td>3.7</td>
<td>3.6</td>
<td></td>
</tr>
<tr>
<td>Difference</td>
<td>1.0</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td><strong>General government net lending (% of GDP)</strong></td>
<td>EDP B.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous update</td>
<td>-2.9</td>
<td>-2.5</td>
<td>-2.0</td>
<td>-1.2</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Current update</td>
<td>-1.5</td>
<td>-2.1</td>
<td>-1.5</td>
<td>-1.1</td>
<td>-0.7</td>
<td></td>
</tr>
<tr>
<td>Difference</td>
<td>1.4</td>
<td>0.4</td>
<td>0.5</td>
<td>0.1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td><strong>General government gross debt (% of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Previous update</td>
<td>55.3</td>
<td>54.8</td>
<td>54.0</td>
<td>52.1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Current update</td>
<td><strong>50.6</strong></td>
<td><strong>50.4</strong></td>
<td><strong>50.4</strong></td>
<td><strong>48.7</strong></td>
<td><strong>46.0</strong></td>
<td></td>
</tr>
<tr>
<td>Difference</td>
<td>-4.7</td>
<td>-4.4</td>
<td>-3.6</td>
<td>-3.4</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Finance, Central Statistical Office
IV. Sustainability of public finances

IV.1. Long-term budgetary prospects, including the implications of ageing population

Sustainable public finances support long-term economic growth and constitute a critical element of macroeconomic stability. It is therefore necessary to monitor the sustainability of public finances in a short and long term for the early identification of possible threats and to introduce countermeasures at early stage. In this context, it is crucial for the sustainability of public finances to have a strong, sustainable fiscal framework.

The elements of the Polish fiscal framework are fiscal rules which include public debt rules, the stabilizing expenditure rule and rules limiting the growth in debt of local government units. The above-mentioned set of fiscal rules reduces the risk of high deficits and excessive debt growth, and thus the risk to the sustainability of the Polish public finances.

The European Commission regularly assesses the situation in the EU Member States in terms of the sustainability of their public finances, based on fiscal gap ratios in the medium (S1 indicator), long, and infinite horizon (S2 indicator). The fiscal gap reflects the scale of the necessary adjustments to the primary structural balance, so that the public debt is at a certain level (S1 indicator), or so that the solvency condition is satisfied in the infinite horizon (S2 indicator). The indicators are derived assuming the no-policy change scenario. Therefore, the fiscal gap indicators reflect whether the current policy is sufficient to maintain fiscal sustainability. However, their aim is not to show the most likely scenario. The increase in an indicator means that a greater improvement of the primary structural result is needed.

Table 4. Fiscal sustainability indicators

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>S1</td>
<td>low risk</td>
<td>medium risk</td>
<td>low risk</td>
<td>low risk</td>
<td>low risk</td>
</tr>
<tr>
<td></td>
<td>medium risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S2</td>
<td>medium risk</td>
<td>medium risk</td>
<td>medium risk</td>
<td>low risk</td>
<td>low risk</td>
</tr>
</tbody>
</table>

Source: European Commission, Ministry of Finance.

Table 4 above shows the S1 and S2 indicators estimated by the Ministry of Finance as compared with the assessment of European Commission contained in Debt Sustainability Monitor of January 2018 (base year 2019, macro-fiscal assumptions from the Autumn forecast of European Commission). The assessment by the Ministry of Finance is based on the forecasts of macro-fiscal indicators presented in the Programme and on the forecast of ageing related costs prepared by the Economic Policy Committee’s Working Group on Ageing Populations and Sustainability (AWG) and presented hereunder in this chapter. The indicators were estimated in four options, taking the years 2018-2021 as a base year.

Assuming that the consolidation will be carried out in line with the forecast presented in this Programme, the S1 and S2 indicators for Poland are expected to improve in the coming years. The forecasted improvement of the primary structural balance and decline in public debt in the years 2018-2021 shall have a reducing effect on those indicators. Further fiscal consolidation focused on achieving the MTO (chapter 2.4) and economic recovery will lead to reduction of risk to the sustainability of Poland’s public finances in a medium and long term.

17 Estimates for 2018-2021 with the assumption of 100% implementation of limits resulting from stabilizing expenditure rule and plans of the units. Historical under-execution of expenditure amounts to 0.4-0.5% of GDP.
A similar level of risk to the sustainability of public finances is indicated by stochastic simulations of debt development based on the approach adopted by the European Commission and the International Monetary Fund. The forecasts were derived based on the baseline scenario presented in the Programme and using shocks occurring for various macro-fiscal variables. The analysis shows that even with a considerable combination of adverse shocks, the general government debt over the Programme period shall not exceed the reference value of 60% of GDP. Based on the applied method with a probability of around 80%, the general government debt in 2021 is expected to amount to less than 55% of GDP.

Table 5. Long-term sustainability of public finances

<table>
<thead>
<tr>
<th></th>
<th>% of GDP</th>
<th>2016</th>
<th>2030</th>
<th>2040</th>
<th>2050</th>
<th>2060</th>
<th>2070</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total expenditure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which age-related expenditure</td>
<td></td>
<td>20.3</td>
<td>20.4</td>
<td>20.6</td>
<td>21.4</td>
<td>22.1</td>
<td>21.4</td>
</tr>
<tr>
<td>Pension expenditure</td>
<td></td>
<td>11.2</td>
<td>11.0</td>
<td>10.8</td>
<td>11.2</td>
<td>11.1</td>
<td>10.2</td>
</tr>
<tr>
<td>Social security pension</td>
<td></td>
<td>11.2</td>
<td>11.0</td>
<td>10.8</td>
<td>11.2</td>
<td>11.1</td>
<td>10.2</td>
</tr>
<tr>
<td>Old-age and early pensions</td>
<td></td>
<td>9.9</td>
<td>10.2</td>
<td>10.0</td>
<td>10.4</td>
<td>10.4</td>
<td>9.5</td>
</tr>
<tr>
<td>Other pensions (disability, survivors)</td>
<td></td>
<td>1.3</td>
<td>0.8</td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Health care</td>
<td></td>
<td>4.3</td>
<td>4.5</td>
<td>4.8</td>
<td>5.0</td>
<td>5.2</td>
<td>5.2</td>
</tr>
<tr>
<td>Long-term care (previously as a component of health care)</td>
<td></td>
<td>0.5</td>
<td>0.7</td>
<td>0.9</td>
<td>1.0</td>
<td>1.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Education expenditure</td>
<td></td>
<td>4.3</td>
<td>4.2</td>
<td>4.1</td>
<td>4.2</td>
<td>4.6</td>
<td>4.7</td>
</tr>
<tr>
<td>Other age-related expenditure</td>
<td></td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which: from pension contributions</td>
<td></td>
<td>7.9</td>
<td>8.3</td>
<td>8.4</td>
<td>8.3</td>
<td>8.3</td>
<td>8.3</td>
</tr>
</tbody>
</table>

**Assumptions**

Stochastic projections are developed using Monte Carlo simulation based on 1000 draws.
IV. Sustainability of public finances

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>2016</th>
<th>2030</th>
<th>2040</th>
<th>2050</th>
<th>2060</th>
<th>2070</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour productivity growth</td>
<td>2.1</td>
<td>2.7</td>
<td>2.2</td>
<td>1.9</td>
<td>1.7</td>
<td>1.5</td>
</tr>
<tr>
<td>Potential GDP growth</td>
<td>2.7</td>
<td>1.9</td>
<td>1.2</td>
<td>0.7</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Participation rate males (aged 20-64)</td>
<td>73.9</td>
<td>72.9</td>
<td>71.7</td>
<td>68.2</td>
<td>68.7</td>
<td>71.0</td>
</tr>
<tr>
<td>Participation rate females (aged 20-64)</td>
<td>58.0</td>
<td>57.4</td>
<td>55.7</td>
<td>52.6</td>
<td>54.4</td>
<td>56.4</td>
</tr>
<tr>
<td>Total participation rate (aged 20-64)</td>
<td>65.8</td>
<td>65.1</td>
<td>63.7</td>
<td>60.4</td>
<td>61.6</td>
<td>63.8</td>
</tr>
<tr>
<td>Unemployment rate (aged 20-64)</td>
<td>6.0</td>
<td>5.5</td>
<td>5.5</td>
<td>5.4</td>
<td>5.4</td>
<td>5.4</td>
</tr>
<tr>
<td>Population aged 65+ over total population</td>
<td>16.3</td>
<td>23.3</td>
<td>26.1</td>
<td>30.9</td>
<td>34.1</td>
<td>33.3</td>
</tr>
</tbody>
</table>

Source: European Commission and Ageing Working Group (AWG) of the Economic Policy Committee (EPC).

The forecasts of long-term general government expenditure presented in Table 5 were prepared by the Economic Policy Committee’s Working Group on Ageing Populations and Sustainability (AWG). They will be published by the European Commission in 2018 in a report on the effects of population ageing expected by 2070 (Ageing Report 2018). The forecasts were based on demographic assumptions developed by Eurostat, the extrapolation of the historical trends and technical assumptions about the convergence of the fundamental factors of economic growth i.e. labour, capital and labour productivity. It should be noted that after the AWG's work on health care forecasts has come to an end, the Act on amending the Act of 24 November 2017 on health care services financed from public funds entered into force, which assumes a gradual increase in outlays on health protection until 2025 up to the level of 6% of GDP 19.

According to the AWG forecasts, pension expenditure remains stable in the long run and will decline from 11.2% of GDP in 2016 to 10.2% of GDP in 2070. Fluctuations mainly result from changes in the demographic structure of the population. Compared to previous forecasts, expenditure is slightly higher, which was affected by the lowering of the retirement age for women (60 years) and men (65 years) from 1 October 2017. The change in macroeconomic assumptions also influenced the forecasts. However, demographic changes still have the greatest impact on the level of expenditure. The AWG forecast is constructed on the basis of the statutory retirement age, while the Polish pension system specifies only the minimum retirement age, and further continuation of professional activity results in a significant increase in the amount of future benefits.

There is a slight increase in total age-related expenditure - from 20.3% of GDP to 21.4% of GDP. The main determinant of the expenditure is expenditure on health care and long-term care. Demographic change is a significant challenge for the long-term sustainability of public finances in most European countries. Compared to them, Polish situation seems to be advantageous. However, further aging observed in recent years should be expected as it has its sources is lengthening life expectancy, low fertility rate and the current population age structure. As a result, the old age dependency ratio will deteriorate, i.e. the relation between the number of post-working age population (65 years and more) and the number of working age population (15-64 years) expressed as a percentage. According to the AWG forecasts, this ratio will increase from 23.7% in 2016 to 62.2% in 2070.

From 1 January 2019, Employee Capital Plans (PPK) are planned to be introduced, which aim to increase the level of long-term savings and assets of future pensioners. Ultimately, the plans will cover all employees paying social security contributions, including general government employees. PPK will be a system of voluntary savings plans, which will consist of contributions paid by the employee and the employer, supported by financial incentives from the State. Funds collected in the PPK will be invested in the financial market and paid when the PPK participant turns 60 years old. PPK is an element of Capital Construction Programme. One of the main effects of the proposed solution should be an increase in long-term savings rate of Poles, which will be used to limit the effect of the fall in replacement rates of pension stemming from the participation in the first pillar of pension system.

19 Pursuant to the act, this relation is determined with the use of latest available data on annual GDP known in the period of budget preparation.
IV. Sustainability of public finances

(retirement savings under the PPK will indeed transfer consumption on future periods). To some extent, the PPK can support improvement in the net international investment position of Poland, as well as be conducive to investment growth and the potential GDP growth.

IV.2. Contingent liabilities

Potential contingent liabilities on account of sureties and guarantees granted by general government in Poland amounted to 6.1% of GDP in Poland at the end of 2017 against 6.9% of GDP at the end of 2016 (in accordance with updated GDP for 2016 and the preliminary GDP estimate in the fourth quarter of 2017). A significant share in this category were sureties and guarantees provided by the State Treasury – at the end of 2017, they represented 5.9% of GDP against 6.7% of GDP at the end of 2016.

The activity of the State Treasury in the area of guarantees and sureties does not pose any significant risks to public finances. At the end of 2017, approximately 98% of contingent liabilities on account of sureties and guarantees granted by the State Treasury were classified as a low-risk group. The long-term risk ratio for the portfolio of guarantees and sureties granted by the State Treasury fell to approximately 4.1%, compared to approximately 6.5% in 2016. Together with the decrease in potential contingent liabilities on account of sureties and guarantees granted by the State Treasury a decrease in the share of those liabilities in the GDP was observed. In particular, it resulted from a slower than expected increase in the volume of guarantees, significant repayments of liabilities, and a lower the exchange rate.

As part of the surety and guarantee portfolio, the State Treasury guarantees given for the liabilities of the financial sector (excluding guarantees given to support the National Road Fund by Bank Gospodarstwa Krajowego) amounted to only approximately 0.1% of GDP as of the end of 2017, and did not relate to any anti-crisis measures.

Table 6. Contingent liabilities

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public guarantees</td>
<td>6.1</td>
</tr>
<tr>
<td>Of which: linked to the financial sector*</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance.

* Data on potential liabilities of other public finance sector entities on account of sureties and guarantees for the financial sector are not subject to reporting (only total potential liabilities are available). Therefore, the presented value of guarantees granted for financial sector liabilities refers to the State Treasury sureties and guarantees portfolio (excluding guarantees granted for supporting the KFD at BGK).

In subsequent years, potential contingent liabilities on account of guarantees and sureties granted by the State Treasury are expected to increase, which may translate into a slight increase in the ratio of those liabilities to GDP. Granting Treasury sureties and guarantees in order to support investments fostering development in the area of road and rail infrastructure will continue. In addition, it is possible to grant guarantees and sureties for other purposes permitted by the Act, in particular regarding export support, environmental protection, job creation, innovation, enterprise restructuring, regional development, entrepreneurship and programmes or projects under EU aid programmes.

Sureties and guarantees will be mainly granted for investments co-financed by EU funds (loans and bonds underwritten or guaranteed by the State Treasury should enable the acquisition of EU funds), as well as for other investment tasks arising from potential new support programmes stipulating granting sureties and guarantees. At the same time, maintaining of the long-term risk factor for the portfolio of sureties and guarantees granted by the State Treasury at a level of up to 10% is anticipated.

The value of new sureties and guarantees granted by the State Treasury in a given year is limited by the Budget Act. In the Budget Act for 2018, this limit was set at PLN 200 billion and, apart from
IV. Sustainability of public finances

supporting the aforementioned projects, it may be used, if necessary, to react in the event of a deterioration in the conditions of functioning of the Polish financial system in the face of a global financial and economic crisis.
V. Quality of public finances

V.1. Composition, efficiency and effectiveness of expenditure

In view of the constraints imposed by the application of fiscal rule ensuring the long-term sustainability of public finances, active fiscal policy requires a stronger emphasis on assessing the quality of existing expenditure. A measure of the quality of public expenditure is the degree to which it contributes to effective implementation of strategic objectives and development priorities, including, in particular, those related to supporting economic growth and reducing social inequalities.

Spending reviews performed since 2014 have helped to strengthen the ability to shape the structure and quality of public expenditure. From 2015, the Steering Committee for public expenditure reviews has been an assisting body of the Minister of Finance in matters related to spending reviews. Its tasks include in particular the approval of public spending reviews programmes and the validation of conclusions and recommendations formulated during the reviews.

In 2017, spending reviews concerning the following were carried out: 1) mechanisms of motivating teachers and the system of their professional advancement, 2) tasks implemented by the Voluntary Labour Corps, as well as 3) valorisation and indexation mechanisms and legal conditions determining the level of fixed expenditure, in particular in the area of social expenditure (second stage). In 2018, expenditure reviews related to (1) prisons, (2) physical culture and sport and (3) support to maritime affairs, inland navigation and fisheries continued. Public spending reviews are foreseen to cover further areas.

Experience with spending reviews has shown the need to institutionalise this budgetary policy tool and to integrate it into the budgetary process in a way that supports expenditure management and the fiscal space in the subsequent years.

V.2. Structure and efficiency of revenue systems

In 2017, measures aimed at improving tax compliance and the efficiency of the tax administration were implemented, as outlined in last year's Convergence Programme. The most important activities affecting the level of revenues in 2017 included:

— general anti-avoidance rule introduced in mid-2016,

— modification of the rules for accounting VAT on intra-Community purchases of motor fuels (a so-called fuel package), in force since 1 August 2016,

— grounds for registration refusal and precise terms for taxpayer removal from the VAT register, in force since the beginning of 2017,

— reintroducing sanctions - up to 100% - for taxpayers who overstate input VAT, in force since January 2017,

— increase of penalties for tax offences - up to 25 years in prison for falsifying invoices above PLN 10 million, in force since March 2017,

— extended confiscation of assets obtained under false pretences and assets used for fiscal offences, in force since April 2017, introduced by amendments to the Criminal Code and other acts.

In 2018-2021, the measurements aimed at improving tax system compliance will be continued, with a particular focus on increasing the collection of VAT and combating related fraud. Poland also supports the initiatives of the European Union and the OECD to reduce tax evasion and taxation of the digital economy. Improving the tax system compliance will be facilitated by, i.a.:

— SAF-T [pl. JPK] analyser, i.e. an IT system supporting the detection of invoices documenting fictitious activities,

— the IT System of the Clearing House (STIR) limiting the possibilities of using the financial sector for fiscal frauds,
split payment mechanism, which will impede malpractices at the stage of the transaction and ensure better transparency of the accounts,

— developing a system for monitoring road transport,

— regulations limiting the use of mechanisms of the so-called aggressive tax planning in income taxes,

— introducing an obligation to provide the tax authorities with information on tax schedules to which the so-called promoters who prepare or offer arrangements under the services related to taxation will be subject to,

— introducing changes concerning withholding tax due to paid out receivables for non-residents exceeding the amount of PLN 2 million,

— taxation of liquid for electronic cigarettes and novel tobacco products, which will enable equal treatment of substitutes and traditional tobacco products, ensuring better state control over the circulation of these products,

— introducing the online cash registers for sales recording in favour to natural persons not running a business and flat-rate farmers as a key tool in the fight against the black economy and in strengthening fair competition,

— reduction in the quantity of fuel imported from third countries with exemption from import duties and excise duty, which would result in a reduction in the resale of cheaper fuel imported from the eastern border of Poland,

— measures aimed at improving the efficiency of administrative enforcement.

The main ongoing and planned actions aimed at improving tax compliance and efficiency of the tax administration in 2018 and 2019 are discussed in an annex to the Programme. The financial effects of measures presented therein are estimated at PLN 10.6 billion in 2018 and an additional PLN 5.9 billion in 2019. In the subsequent years, the measures will be aimed at further reducing the tax gap by, respectively, PLN 4 billion in 2020 and PLN 2 billion in 2021. The total effect of the implemented measures planned for 2018-2020 within the Programme horizon is estimated at approx. 1 percentage point of GDP.

Concurrently to measures aimed at reducing the VAT gap efforts have been made to design such a method of identifying goods and services that would give taxpayers and tax authorities a greater certainty with respect to correctness of the rate applied. Such a method could also help rationalise the structure of VAT rates. Poland applies reduced VAT rates coherently with practices of other Member States, and their scope corresponds to the framework laid down by Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax. The scope of reduced VAT rates in Poland is balanced by the 23% standard rate, which belongs to the group of higher VAT rates currently applied in the EU. The European Commission, in its legislative proposal, to amend the above-mentioned directive, decides on giving Member States greater flexibility in fixing the reduced rates. It's only condition aimed at securing general government revenue states that Member States are required to guarantee that the weighted average of VAT rate will be above 12% at all times. The weighted average of VAT rates in Poland significantly exceeds this minimum (17.1% in 2016).

Moreover, the Social Insurance Institution [ZUS] undertakes efforts aimed at increasing the effectiveness of collecting contributions. From 1 January 2018, the method of paying and settling contributions for social insurance, health insurance, Labour Fund, Guaranteed Employee Benefits Fund and Bridge Pension Fund has changed. Thanks to the so-called e-payment, the payer makes one simple money transfer to his individual contribution account with the Social Insurance Institution, while the Social Insurance Institution distributes the payment proportionally to all insurances and funds. It has positively influenced correct filling of transfers (approx. 40 erroneous deposits per month for 2.4 million transfers) and deposits are identified more quickly. In January 2018, payments to

2.3 million payer accounts were settled for the amount of PLN 18.8 billion, and in February for the amount of PLN 20.0 billion. Payments in January 2018 were higher by approx. 10% compared to January 2017. This increase cannot be entirely explained by the good economic situation.

The Social Insurance Institution is also engaged in a dialogue with employer organisations, trade unions and representatives of government administration on the phenomena influencing the contribution gap: unfair employee outsourcing, improper determination of the contribution base, the grey market, abuses resulting from multiple insurance titles and the level of benefits. The effect of the cooperation will be an improvement in closing the loopholes in the Social Insurance Fund, levelling the playing field for entrepreneurs and protecting the insured.
VI. Institutional features of public finances

When assessing the implementation of Council Directive 2011/85/EU of 8 November 2011 on requirements for the budgetary frameworks of the Member States, the European Commission has indicated that Poland has not fully transposed the following requirements:

— presentation of comparisons of the budgetary authority’s forecasts with those of the European Commission (Article 4(1) of the directive), in relation to the annual budgetary documents,

— presentation of sensitivity analysis in government forecasts (Article 4.4), in relation to annual budgetary documents,

— assessment of government projections (Article 4.6).

In order to supplement the implementation of the directive, the legislative works are underway on the amendment of the Public Finance Act, which is aimed at introducing the obligation to include in the justification attached to the draft Budget Act information on the following issues:

— the macroeconomic scenario and its comparison with the most recent forecasts of the European Commission and other independent institutions,

— actions taken in the event of significant adverse developments affecting macroeconomic forecasts in the period of the four years preceding the development of macroeconomic scenario,

— sensitivity analysis on general government deficit and debt, public domestic debt and expenditure levels referred to in Article 112aa(1) with different growth and interest rates assumptions.

This project imposes obligations on the Ministry of Finance, some of which are already being implemented. The explanatory memorandum to the draft budget law compares the government's projections with those of international institutions and the update to the Convergence Programme includes a sensitivity analysis of the general government balance and debt to depreciation of the Zloty and to an increase in the national interest rate.

The draft law was adopted by the Council of Ministers on 11 April 2018. It is assumed that the amended regulation will apply for the first time to the draft budget law for 2019.

At the same time, work on the budgetary system reform, initiated in 2016, will be continued. The improvement and further development of the multiannual planning is a complex process of a multi-annual nature. Activities related to the optimisation of the multiannual planning and its closer integration with the annual planning in the budgetary process were reflected in the Regulation of the Minister of Development and Finance of 13 June 2017 on the detailed method, procedure and deadlines for preparing materials for the draft budget act. This is the so-called budgetary note, which is henceforth a legal act which does not refer to just one budgetary year. The continuation of analyses and work in this area will be ensured, drawing on the experience and lessons learned from the solutions already implemented in the area of budgetary planning.
### Table annex

#### Table 7. Macroeconomic prospects

<table>
<thead>
<tr>
<th>ESA Code</th>
<th>2018 Rate of change</th>
<th>2019 Rate of change</th>
<th>2020 Rate of change</th>
<th>2021 Rate of change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Real GDP (PLN billion)</strong></td>
<td>B1*g</td>
<td>3.8</td>
<td>3.8</td>
<td>3.7</td>
</tr>
<tr>
<td><strong>2. Nominal GDP (PLN billion)</strong></td>
<td>B1*g</td>
<td>6.2</td>
<td>6.1</td>
<td>6.2</td>
</tr>
</tbody>
</table>

**Componenta of real GDP**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Private consumption expenditure</td>
<td>P.3</td>
<td>3.8</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>4. Government consumption expenditure</td>
<td>P.3</td>
<td>3.0</td>
<td>2.2</td>
<td>1.9</td>
</tr>
<tr>
<td>5. Gross fixed capital formation</td>
<td>P.51</td>
<td>9.1</td>
<td>8.4</td>
<td>6.4</td>
</tr>
<tr>
<td>6. Changes in inventories and net acquisition of valuables (% of GDP)</td>
<td>P.52+ P.53</td>
<td>1.9</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td>7. Exports of goods and services</td>
<td>P.6</td>
<td>6.2</td>
<td>6.0</td>
<td>5.0</td>
</tr>
<tr>
<td>8. Import of goods and services</td>
<td>P.7</td>
<td>7.6</td>
<td>6.9</td>
<td>5.2</td>
</tr>
</tbody>
</table>

**Contributions to real GDP growth**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>9. Final domestic demand</td>
<td></td>
<td>4.3</td>
<td>4.0</td>
<td>3.7</td>
</tr>
<tr>
<td>10. Changes in inventories and net acquisition of valuables</td>
<td>P.52+ P.53</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>11. External balance of goods and services</td>
<td>B.11</td>
<td>-0.5</td>
<td>-0.3</td>
<td>0.0</td>
</tr>
</tbody>
</table>

The levels of real volumes are expressed in constant prices of 2016.

#### Table 8. Price developments

<table>
<thead>
<tr>
<th>ESA Code</th>
<th>2017 Rate of change</th>
<th>2018 Rate of change</th>
<th>2019 Rate of change</th>
<th>2020 Rate of change</th>
<th>2021 Rate of change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. GDP deflator</strong></td>
<td></td>
<td>1.9</td>
<td>2.3</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>2. Private consumption deflator</strong></td>
<td></td>
<td>1.9</td>
<td>2.3</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>3. HICP</strong></td>
<td></td>
<td>1.6</td>
<td>2.0</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>3a. CPI</strong></td>
<td></td>
<td>2.0</td>
<td>2.3</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>4. Public consumption deflator</strong></td>
<td></td>
<td>2.0</td>
<td>2.3</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>5. Investment deflator</strong></td>
<td></td>
<td>1.1</td>
<td>2.3</td>
<td>2.3</td>
<td>2.5</td>
</tr>
<tr>
<td><strong>6. Export price deflator (goods and services)</strong></td>
<td></td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>7. Import price deflator (goods and services)</strong></td>
<td></td>
<td>1.5</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
</tbody>
</table>
### Table 9. Labour market developments

<table>
<thead>
<tr>
<th>ESA Code</th>
<th>2017 Level</th>
<th>2017 Rate of change</th>
<th>2018 Rate of change</th>
<th>2019 Rate of change</th>
<th>2020 Rate of change</th>
<th>2021 Rate of change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Employment</strong> (thousands of persons)*</td>
<td>16423</td>
<td>1.4</td>
<td>0.7</td>
<td>0.2</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>2. Employment (hours worked)</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>3. Unemployment rate (%)</strong>*</td>
<td>4.9</td>
<td>4.9</td>
<td>4.2</td>
<td>3.9</td>
<td>3.6</td>
<td>3.3</td>
</tr>
<tr>
<td><strong>4. Labour productivity (PLN thousand)</strong>**</td>
<td>119.5</td>
<td>3.2</td>
<td>3.1</td>
<td>3.5</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td><strong>5. Labour productivity (PLN thousand)</strong>***</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>6. Compensation of employees (PLN billion)</strong></td>
<td>D.1</td>
<td>762.0</td>
<td>7.9</td>
<td>6.7</td>
<td>5.6</td>
<td>5.5</td>
</tr>
<tr>
<td><strong>7. Compensation per employee (PLN thousand)</strong></td>
<td>58.3</td>
<td>6.0</td>
<td>6.0</td>
<td>5.4</td>
<td>5.3</td>
<td>5.3</td>
</tr>
</tbody>
</table>

* Average employment based on LFS (aged 15 and older).
** National accounts definition.
*** Harmonised unemployment rate, Eurostat definition, levels.
**** Real GDP per person employed.
***** Real GDP per hour worked.

### Table 10. Sectoral balances

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>ESA Code</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Net lending / borrowing vis-à-vis the rest of the world</strong>*</td>
<td>B.9</td>
<td>1.6</td>
<td>1.1</td>
<td>0.8</td>
<td>1.0</td>
<td>0.6</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- balance on goods and services</td>
<td>4.2</td>
<td>3.5</td>
<td>3.1</td>
<td>3.0</td>
<td>2.9</td>
<td></td>
</tr>
<tr>
<td>- balance of primary incomes and transfers</td>
<td>-3.8</td>
<td>-4.0</td>
<td>-4.1</td>
<td>-4.1</td>
<td>-4.0</td>
<td></td>
</tr>
<tr>
<td>- capital account</td>
<td>1.3</td>
<td>1.7</td>
<td>1.8</td>
<td>2.0</td>
<td>1.7</td>
<td></td>
</tr>
<tr>
<td><strong>2. Net lending/borrowing of the private sector</strong></td>
<td>B.9</td>
<td>3.1</td>
<td>3.2</td>
<td>2.3</td>
<td>2.1</td>
<td>1.3</td>
</tr>
<tr>
<td><strong>3. Net lending/borrowing of general government</strong></td>
<td>EDP B.9</td>
<td>-1.5</td>
<td>-2.1</td>
<td>-1.5</td>
<td>-1.1</td>
<td>-0.7</td>
</tr>
<tr>
<td><strong>4. Statistical discrepancies</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

* Balances level in line with the balance of payments statistics. Net lending/borrowing vis-à-vis the rest of the world is equal to sum of capital and current account.
Table annex

Table 11. Basic assumptions

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term interest rate (annual average)</td>
<td>1.7</td>
<td>1.7</td>
<td>1.8</td>
<td>2.4</td>
<td>2.9</td>
</tr>
<tr>
<td>Long-term interest rate (annual average)</td>
<td>3.5</td>
<td>3.4</td>
<td>3.4</td>
<td>3.7</td>
<td>3.8</td>
</tr>
<tr>
<td>Nominal effective exchange rate*</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Exchange rate vis-à-vis the EUR (annual average)</td>
<td>4.26</td>
<td>4.15</td>
<td>4.15</td>
<td>4.15</td>
<td>4.15</td>
</tr>
<tr>
<td>World excluding EU, GDP growth**</td>
<td>3.8</td>
<td>4.1</td>
<td>4.1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>EU GDP growth**</td>
<td>2.4</td>
<td>2.3</td>
<td>2.0</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Growth of relevant foreign export markets**/***</td>
<td>4.6</td>
<td>4.5</td>
<td>4.3</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td>World import volumes **</td>
<td>-</td>
<td>4.7</td>
<td>4.5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Oil prices (Brent, USD/barrel) **</td>
<td>54.2</td>
<td>68.3</td>
<td>64.2</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

* Nominal growth of EUR/PLN exchange rate.
*** EU import as an indicator of the foreign export markets.

Table 12. General government budgetary prospects

<table>
<thead>
<tr>
<th></th>
<th>ESA Code</th>
<th>2017 PLN million</th>
<th>2017 % of GDP</th>
<th>2018 % of GDP</th>
<th>2019 % of GDP</th>
<th>2020 % of GDP</th>
<th>2021 % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net lending (EDP B9) by sub-sector</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. General government</td>
<td>S.13</td>
<td>-29 836</td>
<td>-1.5</td>
<td>-2.1</td>
<td>-1.5</td>
<td>-1.1</td>
<td>-0.7</td>
</tr>
<tr>
<td>2. Central government</td>
<td>S.1311</td>
<td>-71 980</td>
<td>-3.6</td>
<td>-2.3*</td>
<td>-1.4</td>
<td>-0.8</td>
<td>-0.3</td>
</tr>
<tr>
<td>3. State government</td>
<td>S.1312</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Local government</td>
<td>S.1313</td>
<td>1 543</td>
<td>0.1</td>
<td>-0.1</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>5. Social security funds</td>
<td>S.1314</td>
<td>40 601</td>
<td>2.0</td>
<td>0.4*</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.2</td>
</tr>
</tbody>
</table>

General government

<table>
<thead>
<tr>
<th></th>
<th>TR</th>
<th>TE</th>
<th>EDPB.9</th>
<th>EDPD.41</th>
<th>1 292</th>
<th>724,1**</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Total revenue</td>
<td>784 024</td>
<td>813 859</td>
<td>-29 836</td>
<td>31 127</td>
<td>1 292</td>
<td>0.0</td>
</tr>
<tr>
<td>7. Total expenditure</td>
<td></td>
<td></td>
<td>-1.5</td>
<td>-1.5</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>8. Net lending/borrowing</td>
<td></td>
<td></td>
<td>-1.5</td>
<td>-1.5</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>9. Interest expenditure</td>
<td></td>
<td></td>
<td>1.6</td>
<td>1.5</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>10. Primary balance</td>
<td></td>
<td></td>
<td>1.6</td>
<td>1.5</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>11. One-off and other temporary measures</td>
<td></td>
<td></td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>
Table annex

<table>
<thead>
<tr>
<th>ESA Code</th>
<th>2017 PLN million</th>
<th>2017 % of GDP</th>
<th>2018 % of GDP</th>
<th>2019 % of GDP</th>
<th>2020 % of GDP</th>
<th>2021 % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>12. Total taxes (=12a+12b+12c)</td>
<td>417 031</td>
<td>21.0</td>
<td>21.5</td>
<td>21.6</td>
<td>21.6</td>
<td>21.6</td>
</tr>
<tr>
<td>12a. Taxes on production and imports</td>
<td>D.2</td>
<td>270 821</td>
<td>13.7</td>
<td>14.0</td>
<td>14.0</td>
<td>13.9</td>
</tr>
<tr>
<td>12b. Current taxes on income, wealth, etc</td>
<td>D.5</td>
<td>145 915</td>
<td>7.4</td>
<td>7.5</td>
<td>7.6</td>
<td>7.7</td>
</tr>
<tr>
<td>12c. Capital taxes</td>
<td>D.9</td>
<td>295</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>13. Social contributions</td>
<td>D.61</td>
<td>275 454</td>
<td>13.9</td>
<td>13.8</td>
<td>13.8</td>
<td>13.6</td>
</tr>
<tr>
<td>14. Property income</td>
<td>D.4</td>
<td>11 349</td>
<td>0.6</td>
<td>0.5</td>
<td>0.6</td>
<td>0.7</td>
</tr>
<tr>
<td>15. Other</td>
<td>80 189</td>
<td>4.0</td>
<td>4.3</td>
<td>4.3</td>
<td>4.0</td>
<td>3.4</td>
</tr>
<tr>
<td>16. Total revenue</td>
<td>TR</td>
<td>784 024</td>
<td>39.6</td>
<td>40.2</td>
<td>40.3</td>
<td>39.9</td>
</tr>
<tr>
<td>Tax burden (D.2+D.5+D.61+D.91-D.995)</td>
<td>689 923</td>
<td>34.8</td>
<td>35.2</td>
<td>35.2</td>
<td>35.1</td>
<td>35.0</td>
</tr>
</tbody>
</table>

Selected components of expenditure

| 17 Compensation of employees + intermediate consumption | D1+P2 | 312 627 | 15.8 | 15.7 | 15.4 | 15.1 | 14.9 |
| 17a. Compensation of employees | D.1 | 199 692 | 10.1 | 9.9 | 9.7 | 9.4 | 9.2 |
| 17b. Intermediate consumption | P.2 | 112 935 | 5.7 | 5.8 | 5.8 | 5.7 | 5.7 |
| 18. Social payments (18=18a+18b) | | 337 616 | 17.0 | 17.1 | 16.7 | 16.4 | 16.2 |
| of which Unemployment benefits | | 2 539 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| 18a. Social transfers in kind supplied via market producers | D.6311, D.6312, D.6313 | 37 706 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| 18b. Social transfers other than in kind | D.62 | 299 910 | 15.1 | 15.2 | 14.8 | 14.6 | 14.3 |
| 19. Interest expenditure | EDP D.41 | 31 127 | 1.6 | 1.4 | 1.5 | 1.5 | 1.5 |
| 20. Subsidies | D.3 | 10 086 | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 |
| 21. Gross fixed capital formation | P.51 | 73 683 | 3.7 | 4.5 | 4.6 | 4.3 | 3.9 |
| 22. Capital transfers | D.9 | 12 131 | 0.6 | 0.6 | 0.6 | 0.6 | 0.5 |
| 23. Other | 36 589 | 1.8 | 2.3 | 2.4 | 2.3 | 2.2 |
| 24=7. Total expenditure | TE | 813 859 | 41.1 | 42.3 | 41.8 | 41.0 | 39.8 |
| p.m.: Government consumption (nominal) | P.3 | 350 300 | 17.7 | 17.5 | 17.3 | 17.0 | 16.6 |

Source: Ministry of Finance, Central Statistical Office.
* Data includes the impact of one-off transaction due to the redemption of loans granted to the Social Insurance Fund (FUS) from the state budget in the years 2014–16 (7.2 bln PLN, which is about 0.3% of GDP). Due to the consolidation, the aforementioned redemption shall not affect the general government balance (ESA2010).
** For 2017 one-off measure was included, which regards disbursement by the Bank Guarantee Fund of guaranteed funds following the bankruptcy of SKOKs: "Wybrzeże", "Nike", "Twoja" and "Wielkopolska", amounting to PLN 724 million.

Convergence Programme. 2018 Update

40
### Table annex

#### Table 13. No-policy change projections

<table>
<thead>
<tr>
<th></th>
<th>2017 PLN million</th>
<th>2017 % of GDP</th>
<th>2018 % of GDP</th>
<th>2019 % of GDP</th>
<th>2020 % of GDP</th>
<th>2021 % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Total revenue at unchanged policies</td>
<td>770 000</td>
<td>38.9</td>
<td>39.8</td>
<td>40.1</td>
<td>39.7</td>
<td>39.2</td>
</tr>
<tr>
<td>2. Total expenditure at unchanged policies</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

#### Table 14. Amounts to be excluded from the expenditure benchmark

<table>
<thead>
<tr>
<th></th>
<th>2017 PLN million</th>
<th>2017 % of GDP</th>
<th>2018 % of GDP</th>
<th>2019 % of GDP</th>
<th>2020 % of GDP</th>
<th>2021 % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Expenditure on EU programmes fully matched by EU funds revenue</td>
<td>21 340</td>
<td>1.1</td>
<td>1.5</td>
<td>1.7</td>
<td>1.4</td>
<td>0.8</td>
</tr>
<tr>
<td>1a. of which investment fully matched by EU funds revenue</td>
<td>17 280</td>
<td>0.9</td>
<td>1.3</td>
<td>1.4</td>
<td>1.2</td>
<td>0.7</td>
</tr>
<tr>
<td>2. Cyclical unemployment benefit expenditure</td>
<td>-1 239</td>
<td>-0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>3. Effect of discretionary revenue measures</td>
<td>14 024</td>
<td>0.7</td>
<td>0.4</td>
<td>0.2</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>4. Revenue increases mandated by law</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
Table 15. General government expenditure by function

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>COFOG code</th>
<th>2016</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. General public services</td>
<td>1</td>
<td>4.7</td>
<td>*</td>
</tr>
<tr>
<td>2. Defence*</td>
<td>2</td>
<td>1.6</td>
<td>*</td>
</tr>
<tr>
<td>3. Public order and safety</td>
<td>3</td>
<td>2.2</td>
<td>*</td>
</tr>
<tr>
<td>4. Economic affairs</td>
<td>4</td>
<td>4.1</td>
<td>*</td>
</tr>
<tr>
<td>5. Environmental protection</td>
<td>5</td>
<td>0.4</td>
<td>*</td>
</tr>
<tr>
<td>6. Housing and community amenities</td>
<td>6</td>
<td>0.6</td>
<td>*</td>
</tr>
<tr>
<td>7. Health</td>
<td>7</td>
<td>4.6</td>
<td>*</td>
</tr>
<tr>
<td>8. Recreation, culture and religion</td>
<td>8</td>
<td>1.1</td>
<td>*</td>
</tr>
<tr>
<td>9. Education</td>
<td>9</td>
<td>5.0</td>
<td>*</td>
</tr>
<tr>
<td>10. Social protection</td>
<td>10</td>
<td>16.9</td>
<td>*</td>
</tr>
<tr>
<td>11. Total expenditure (=item 7+24 in Table 14)</td>
<td>TE</td>
<td>41.2</td>
<td>39.8</td>
</tr>
</tbody>
</table>

* expenditure’s disaggregation by function is a part of the budgetary process
Measures increasing tax compliance in the years 2018 and 2019

SUMMARY

This document presents the most important measures implemented and planned in the area of tax compliance and effectiveness of tax administration in the years 2018 and 2019.

Since 1 January 2018, all entrepreneurs have been obliged to send information about their purchases and sales records in the form of JPK_VAT on a monthly basis. Thanks to the use of the **SAF-T [JPK] Analyser** ICT system, used for automatic identification of discrepancies in VAT settlements between taxpayers and their contractors, it is basically impossible to use invoices documenting fictitious activities (the so-called “empty invoices”) to deduct input VAT from such documents.

At the same time, the **IT System of the Clearing Chamber** has been implemented, which narrows the possibility of using the financial sector for fiscal fraud. Its aim is to limit the exploitation of imperfections in the flow of information within the banking system by criminals involved in VAT frauds.

The introduction of the so-called **split payment model** as of 1 July 2018 will also help to close the gaps in the payment of Value Added Tax. The main assumption of this mechanism is to divide the payment for the goods supplied or services provided into a net amount, which is paid by the purchaser to the account of the supplier or service provider, and the amount of tax, which is transferred directly to a separate VAT account. This model will impede tax fraud at the stage of the transaction itself and ensure better transparency of the accounts.

The **monitoring system for the road carriage of goods** introduced in 2017 will also be developed.

Since the beginning of 2018, legislation aiming at closing the loopholes in the income tax system has been implemented. It should limit the use of so-called aggressive tax planning mechanisms.

Taxation of **liquid for electronic cigarettes and novel tobacco products**, introduced on 1 February 2018, will enable equal treatment of substitutes and traditional tobacco products, ensuring better state control over the trade in those products.

Among the planned changes to the tax law system is the **introduction of the obligation to provide the tax authorities with information on tax schemes**. It will cover so-called promoters, such as a lawyer, tax adviser, legal adviser, as well as any other natural person, legal person or organisational unit without legal personality, who i.a. prepares, offers arrangements as services related to taxation.

It is also planned to introduce changes concerning **withholding tax** regime regarding payments exceeding the amount of PLN 2 million paid out to non-residents. The objective of this mechanism is to verify the conditions of benefiting from withholding tax regime by non-residents in respect to interest, dividends, royalties or other payments subjected to withholding tax regime in Poland on the basis of treaties for the avoidance of double taxation or exemptions resulting from the provisions implementing the EU directives.

The control system for the transferring of data concerning sales records kept with the use of **online cash registers**, which have the function of data transfer to the ICT system via an ICT network, will be one of key tools for combating the shadow economy and will contribute to the strengthening of fair competition.

The **reduction in the amount of fuel imported from third countries with exemption from import duties** will result in a reduction in the resale of cheaper fuel imported from the eastern border of Poland. In addition, actions will be taken to **improve the effectiveness of administrative enforcement**.

The above listed actions constitute a further stage of systemic work to close the loopholes in the tax system. Significant **already implemented** solutions will also have an impact on tax revenues over the **Programme** period, and they include, in particular:
Annex. Measures increasing tax compliance in the years 2018 and 2019

— general anti-avoidance rule introduced in mid-2016,

— modification of the rules for accounting VAT on intra-Community purchases of motor fuels (a so-called fuel package), in force since 1 August 2016,

— grounds for registration refusal and precise terms for taxpayer removal from the VAT register, in force since the beginning of 2017,

— reintroducing sanctions - up to 100% - for taxpayers who overstate input VAT, in force since January 2017,

— increase of penalties for tax offences - up to 25 years in prison for falsifying invoices above PLN 10 million, in force since March 2017,

— extended confiscation of assets obtained under false pretences and assets used for fiscal offences, in force since April 2017, introduced by amendments to the Criminal Code and other acts.

In the coming years measures will be oriented towards limiting the tax gap by further PLN 4 billion in 2020 and PLN 2 billion in 2021, respectively. Actions in this area will be presented in the next year's update of the Convergence Programme.

Table 16. Budgetary impact of implemented and planned measures increasing tax compliance

<table>
<thead>
<tr>
<th>Revenue (PLN million) yoy</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>10 571</td>
<td>5 932</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance estimates.
Table of contents

Measures increasing tax compliance in the years 2018 and 2019

1. Reducing the tax gap due to VAT fraud and preventing VAT evasion
   1.1. Introduction of an obligation for the taxpayer to submit monthly records of VAT purchases and sales to the tax authorities and analysis of the obtained data using IT systems
   1.2. Analysis and identification of threats associated with using the activity of banks and credit unions for criminal activities associated with fiscal fraud in the scope of VAT (STIR)
   1.3. Introduction of the split payment mechanism
   2. Closing loopholes in the income tax system
   3. Introduction of changes concerning withholding tax to payments exceeding PLN 2 million for non-residents (WHT)
   4. Introduction of an obligation to provide tax authorities with information on tax schemes (MDR)
   5. Introduction of a limit on the quantity of fuel imported from third countries, with exemption from import duties and excise duty
   6. Introduction of online cash registers for sales to non-business individuals and flat-rate farmers
   7. Improving the efficiency of administrative enforcement
   8. Introduction of a tax on liquids for electronic cigarettes and novel tobacco products
   9. Development of a monitoring system for the road carriage of goods
1. Reducing the tax gap due to VAT fraud and preventing VAT evasion

1.1. Introduction of an obligation for the taxpayer to submit monthly records of VAT purchases and sales to the tax authorities and analysis of the obtained data using IT systems

Tools:
I. the Act of 13 May 2016 amending the Tax Ordinance and certain other acts introduced the obligation to provide monthly information on the records of purchases and VAT sales by taxpayers who keep online tax books, using computer software - JPK_VAT

Following parties are obliged to follow these regulations:
— since 1 July 2016, large enterprises within the meaning of the Act of 2 July 2004 on Freedom of Economic Activity,
— since 1 January 2017, small and medium-sized enterprises within the meaning of the Act of 2 July 2004 on Freedom of Business Activity,
— from 1 January 2018, micro-entrepreneurs within the meaning of the Act of 2 July 2004 on Freedom of Economic Activity

II. SAF-T Repository [JPK] - an IT system which collects information on VAT purchases and sales records (JPK_VAT) sent by taxpayers

The SAF-T repository is maintained by the Head of the National Revenue Administration. It contains information on the records of purchases and sales of VAT by individual taxpayers, however:
— in 2016 contained VAT records for approximately 10,000 taxpayers (large enterprises),
— in 2017 contained VAT records for approximately 107,000 taxpayers (large, medium and small enterprises),
— in 2018, it will contain VAT records for approximately 1.600.000 taxpayers (all VAT payers).

The SAF [JPK] repository, to which authorised employees of the National Revenue Administration authorities have current access for the purpose of performing their official tasks, also has the following functionalities:
— review and collection of JPK_VAT files of the taxpayer and its contractors,
— identification of entities with signalling features among the taxpayer's contractors, e.g. entities removed from the VAT register in Poland and selected EU countries, covered by SCAC applications or reports from the Tax Information Exchange Office,
— carrying out automated risk assessment of the taxpayer and his contractors, for the taxpayer who is applying for the refund of excess input VAT over the due tax, or assessment of registration risk,
— identification of taxpayers' liabilities, having due public and legal receivables, on account of sales invoices issued by them for the purpose of applying an enforcement measure or for the purpose of securing them by the head of the tax office.

III. SAF-T Analyser [Analizator JPK] - an IT tool supporting the detection of invoices documenting fictitious activities. It automatically enables identification of discrepancies in VAT settlements, including activities consisting in using invoices issued by taxpayers documenting fictitious activities or issued by non-taxpayers for illegal reduction of tax liability or overstatement of the amount of VAT refund.

21 Art. 6 of the Act of 13 May 2016 amending the Tax Ordinance Act and some other acts.
The discrepancy reports generated centrally by the SAF-T analyser are sent electronically to the tax office for verification. At the same time, a notification is sent to the taxpayer with a request to correct the VAT return or the JPK_VAT file. Thus, the SAF-T allows:

— for a prompt identification of persons issuing VAT invoices without open VAT obligation, making it impossible to underestimate the tax liability or overstate the amount to be refunded by means of those invoices,

— honest taxpayers - to quickly identify irregularities in their VAT settlements.

The SAF-T analyser prevents the introduction of invoices documenting fictitious activities or the use of such invoices for the purpose of committing a tax fraud.

IV. From 1 July 2018, the tax authorities will be able to demand from the entrepreneurs that their tax books and accounting documents will be made available. At the same time tax authorities will be able to demand from non-business taxpayers that their tax documents will be made available in electronic form, in a logical structure in accordance with the template specified in the Public Information Bulletin of the Ministry of Finance. This applies to collections such as books of account, simplified books and records, VAT invoices, bank statements and stock exchanges. In November 2017, the National Revenue Administration field units were provided with a manual for conducting inspections with the use of SAF-T, including sets of scripts for analysing downloaded data. The KAS units performing audits were obliged to improve the methodology of applying IT data analysis techniques and to improve their professional qualifications in this area.

Addressees:
all taxpayers of value added tax and the authorities of the National Revenue Administration.

Responsible authority:
Minister of Finance, Head of the National Revenue Administration.

Deadline:
implementation of the measure started on 1 July 2016, with the selected legal regulations coming into force in 2018.

1.2. Analysis and identification of threats associated with using the activity of banks and credit unions for criminal activities associated with fiscal fraud in the scope of VAT (STIR)

Tools:
the Act of 24 November 2017 amending certain acts in order to counteract the use of the financial sector for fiscal fraud, which provides for:

— risk analysis by the Head of the National Revenue Administration of using the activity of banks and cooperative savings and credit unions (SKOK) for criminal activities associated with fiscal fraud (e.g. issuing empty invoices). This system will be equipped with advanced analytical solutions. In the analysis the Head of the National Revenue Administration will use, supplementary to data from tax databases, daily information on accounts of qualified entities within the meaning of the STIR Act (i.e. other than accounts of natural persons used for private purposes) and transactions between such entities, as well as the risk indicator determined by the clearing house in its information and communication system [STIR]. As a result, the analyses carried out by the Head of the National Revenue Administration will take into account both information from his own databases and bank sourced data,

— automatic determination of risk index of using the activity of banks and credit unions for criminal activities associated with fiscal fraud on the basis of information provided by banks and SKOK and publicly available data provided from tax databases. The risk indicator will be determined by the Clearing Chamber on the basis of the banking sector's experience in combating money laundering.
— the option for the Head of the National Revenue Administration, on the basis of risk analysis results, to block the account of a qualified entity for 72 hours with the possibility to extend the blockade for a period of up to 3 months. The blockade shall be applied if the statutory prerequisites for its application are met.

— keeping electronic lists of entities which have not been registered as VAT payers, have been removed from the register ex officio without the need to notify the entity or have been reinstated as VAT payers. The lists are available in the Public Information Bulletin of the Ministry of Finance. This regulation will provide a significant support for entrepreneurs in the proper fulfilment of their tax obligations, i.a. through the possibility of verifying the reliability of the contractors’ operations.

**Addressees:**
domestic banks (including cooperative banks), branches of credit institutions, branches of foreign banks, cooperative savings and credit unions, National Clearing Chamber, National Cooperative Credit Union [Krajowa Spółdzielcza Kasa Oszczędnościowo-Kredytowa], authorities of the National Revenue Administration.

**Responsible authority:**
Minister of Finance, Head of the National Revenue Administration.

**Deadline:**
the Act entered into force on 13 January 2018, with the exception of the provisions concerning the blocking of the qualified entity’s account, which enter into force on 30 April 2018.

1.3. Introduction of the split payment mechanism

**Tools:**
the main assumption of the split payment mechanism is to divide the payment for the goods or services supplied into a net amount, which is paid by the purchaser to the account of the supplier, and an amount of tax, which is credited directly to a separate VAT account. From this separate VAT account, a taxpayer could pay input VAT on the invoices he receives from his suppliers and could also pay his tax liability to the tax office. In addition, a taxpayer could receive refunds of excess input VAT to his VAT account on an accelerated basis. The Split Payment is a voluntary mechanism, the purchaser of the goods or services will decide on its application by on a case-by-case basis, and the parties to the transaction must be active VAT payers.

This model allows tax authorities to monitor and block funds on VAT bank accounts, eliminating the risk of disappearance of tax payers with VAT disbursed to them by customers and not paid to tax authorities. In principle, this model shall impede, or even prevent occurrence of fraud already at the stage of the transaction. At the same time, it will provide for better transparency of VAT settlements and impede transfer of untaxed funds abroad.

**Addressees:**
VAT taxpayers.

**Responsible authority:**
Minister of Finance, Head of the National Revenue Administration.

**Deadline:**
1 July 2018.

**Estimated financial impact for the activities discussed in sections 1.1–1.3:**
estimated financial effects arise from the planned result of implemented legal and IT tools allowing for reducing the VAT gap through (1) preventing deduction of input tax from invoices documenting
Measures increasing tax compliance in the years 2018 and 2019

fictitious activities, (2) limiting the scale of tax fraud by criminal groups, and (3) eliminating the risk of tax payers’ disappearance without settlement of tax liabilities to the state.

In addition, the planned tools are of preventive and disciplinary nature.

The measures implemented so far have been reflected in very good VAT revenues in 2017. The main effect has been caused by the obligation to send JPK_VAT information by large, medium and small enterprises and a wide range of verification activities carried out by the tax administration on the basis of the data received. The result of these activities is a 42.5% reduction in the gap VAT in the use of invoices documenting fictitious activities to deduct input VAT from such invoices. The higher value of the reduction of the VAT gap in this respect than expected in 2017 results from a skillful use of the information obtained by the tax administration.

Having regard to:

— very good results of efforts to reduce the VAT gap in 2017,
— obligation to submit JPK_VAT file for all VAT payers from 2018 onwards,
— further development of automated verification tools and advanced analytical methods including, in addition to JPK_VAT, STIR and the split payment, measures aimed at combating fraud activities,

in 2018, the expected effect of closing VAT gap resulting from the above actions is expected to be at the level of 50% compared to 2015, which means an increase by 18% year on year.

Estimates of budget revenues resulting from split payment in 2019 were based on the assumption that the currently estimated losses of revenues from VAT fraud amounting to PLN 10 billion will be reduced in 2019 compared to the current situation by 75%. Based on the above it is estimated that the effects of the introduction of the split payment will amount to PLN 3.336 million year on year in 2019.

It is expected that budget revenues in 2019 resulting from implementing the Clearing Office IT System (STIR) will be higher than forecast in the Commission’s Impact Assessment [OSR] due to the planned extension of the scope of information used for the calculation of risk coefficients provided by eligible entities. It is estimated that in 2019 the effectiveness of the risk analysis system influencing the amount of budget revenues may, due to the above factors, increase in comparison with the PLN 2,505 million forecast for 2018 by approx. 10 percentage points (PLN 1,000 million) in relation to the lower limit of the estimated VAT gap. The estimates are conservative.

<table>
<thead>
<tr>
<th>Revenue (PLN million) yoy</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>6 500</td>
<td>7 660</td>
<td>4 336</td>
</tr>
<tr>
<td>(JPK)</td>
<td></td>
<td>(JPK, STIR, split payment)</td>
<td>(STIR, split payment)</td>
</tr>
</tbody>
</table>

2. Closing loopholes in the income tax system

Objective:
changing regulations used in optimisation schemes applied by taxpayers.

Tools:

22 According to the results of the audit of the Supreme Audit Office, the tax inspection authorities detected fictitious invoices in the amount of PLN 81.9 billion in 2015. Information on the results of the control "Counteracting the introduction to economic circulation of invoices documenting fictitious activities", Supreme Audit Office, Warsaw, 2016, p. 9. These invoices were used to deduct input tax of PLN 15.31 billion.

23 For the purposes of the calculation, it was assumed that the estimated value of the VAT gap is between PLN 10 and 15 billion annually. The original STIR calculation assumed that the amount of this gap was about PLN 10 billion (conservative option).
the process of improving the income tax system compliance shall be supported by the Act of 27 October 2017 amending the Act on Personal Income Tax, the Act on Corporate Income Tax and the Act on Flat-Rate Income Tax on Certain Revenues Available to Individuals, which entered into force on 1 January 2018. It implements the Council Directive (EU) 2016/1164 of 12 July 2016 laying down regulations aimed at counteracting tax avoidance practices which have a direct impact on the functioning of the internal market (ATAD Directive). The most important changes are as follows:

— recognizing separately in the Corporate Income Tax Act of a source of income in the form of capital gains and recognizing separately the income obtained from this source from other income of the taxpayer,

— modification of the rules limiting the amount of deductible interest (debt financing costs),

— modification of the Controlled Foreign Company legislation,

— introduction of regulations limiting the amount of tax deductible costs related to agreements on intangible services (e.g. licence agreements, advisory, management and control services) and related to the use of intangible assets, as well as regulations clarifying the concept of "acquisition" of an intangible asset,

— introduction of the so-called minimum income tax in relation to taxpayers who own commercial real estates of significant value.

Addressees:
taxpayers of income tax from natural persons and legal entities, in particular those who bear costs of debt financing, costs of intangible services for the benefit of related entities or who own commercial real estates.

Responsible authority:
Minister of Finance, Head of the National Revenue Administration.

Deadline:
the Act of 27 October 2017 amending the Act on Personal Income Tax, the Act on Corporate Income Tax and the Act on Flat Income Tax on Certain Revenues Generated by Natural Persons entered into force on 1 January 2018

Estimated financial impact:

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>2035</td>
<td>124</td>
</tr>
</tbody>
</table>

3. Introduction of changes concerning withholding tax to payments exceeding PLN 2 million for non-residents (WHT)

Objectives:

— verification of conditions (criteria) for non-residents to benefit from preferential taxation of interest, dividends, royalties or other receivables subject to preferential withholding tax in Poland on the basis of agreements on avoidance of double taxation or exemptions resulting from provisions implementing EU directives,

— verification of the beneficiary owner criterion.

Tools:
amendment of the regulations of the Corporate Income Tax Law and the Personal Income Tax Law.

Addressees:
legal persons and natural persons, i.e. taxpayers with limited tax liability (non-residents) who receive payments (interest, royalties, dividends or other income subject to withholding tax in Poland) paid by Polish entities (tax remitter). In the case of dividends paid out, the new rules will also apply to Polish residents. The new rules will apply after exceeding the threshold of PLN 2 million of paid payments for the same taxpayer in a given tax year. Up to this threshold, the existing rules will apply.

**Responsible authority:**
Minister of Finance, Head of the National Revenue Administration

**Deadline:**
planned entry into force of the solutions - 1 January 2019.

**Estimated financial impact:**

on the basis of data from the IFT-2R declaration, it was established that the amount of payments (dividends, interest, licenses, intangible services, etc.) to the EU countries and countries outside the EU for 2013-2016 amounted to nearly PLN 365 billion in total\(^{24}\). At that time, from the above-mentioned payments, the tax was paid in the amount of PLN 5.97 billion on the taxable income amounting to PLN 72.4 billion.

According to IFT-2R data for 2013-2016, the average number of taxable persons covered by the new rules would be around 4,000 per year (payments > 2 million). The average annual amount of payments to these taxpayers in the above-mentioned period amounted to approx. 84.75 billion PLN, of which the taxable income amounted to approx. 15.8 billion PLN, and the tax paid amounted to 1.24 billion PLN.

Assuming that 10% of the disbursements subject to the amended withholding tax refund procedure at the stage of verifying the validity of the preferential rate/exemption would not show any grounds to apply the requested preference to the payees (assuming the reimbursement of half of the amounts charged at the statutory rate due to the application of the rates from the relevant agreement), the additional amount of withholding tax would be:

<table>
<thead>
<tr>
<th>Revenue (PLN million)</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td></td>
<td>790</td>
</tr>
</tbody>
</table>

The regulation in question (WHT) may also have a positive effect on the amount of budget revenue resulting from a reduction in payments in relation to entities which do not meet the conditions for the application of withholding tax collection rights. Limiting these payments may have an indirect effect of reducing the erosion of the tax base (by excluding the payments in question from the tax base of Polish entities), which may indirectly affect the growth of income tax revenues. For precautionary reasons, this effect is not included in the above calculation.

4. **Introduction of an obligation to provide tax authorities with information on tax schemes (MDR)**

**Objectives:**
— early information to tax authorities on aggressive planning abuses,
— preventing taxpayers and their advisors from aggressive tax planning.

**Tools:**

amendment of the provisions of the *Tax Ordinance*.

**Addressees:**

---

\(^{24}\) The calculations are based on the average value from the IFT-2R declarations for the years 2013-2016.
the planned solutions assume broad imposition of the obligation to disclose information on tax schedules. In general, these will be the so-called promoters, i.e. advocates, tax advisors, legal advisers, as well as any other natural person, legal entity or organisational unit without legal personality, which i.a. prepares, offers arrangements within the framework of providing services related to taxation. In special circumstances, planned amendments include the obligation for beneficiaries (taxpayers) to provide information under tax schemes.

**Responsible authority:**
Minister of Finance, Head of the National Revenue Administration

**Deadline:**
planned entry into force of the solutions – 1 January 2019.

**Estimated financial impact:**
planned solutions will contribute to an increase in the effectiveness of risk analysis and, as a result, to a more accurate selection of entities for control. When estimating the amount of revenue, it was assumed that detailed information obtained in connection with the reporting of the tax schemes would allow to reduce the number of conducted controls, and more precise selection of taxpayers for controls would allow to make better use of working time and control staff, which would result in an increase in budget revenue from taxes.

Taxpayers are expected to reduce overstatement of tax deductible costs as a result of not applying aggressive tax schemes, and thus increase the value of the tax base, which should translate into an increase in state budget tax revenues. In 2016, the total cost of revenues from CIT and PIT amounted to PLN 5,780.8 billion. Assuming an increase in budget revenues due to the reduction of the amount of tax deductible costs in the first year of the regulation's validity (Mandatory Disclosure Rules, MDR) by approx. 0.05% in CIT and 0.015% in PIT on a straight-line basis, it should be expected that the tax losses in 2019 should decrease by approx. PLN 490 million in total.

At the same time, it is assumed that increasing the effectiveness of risk analysis in the first year of operation of new MDR regulations by 3% in CIT and 1% in PIT should translate into an increase in control arrangements at the level of about PLN 43.6 million in CIT and PLN 2.8 million in PIT. Taking CIT and PIT control in the total amount of PLN 1,732.5 million as the basis for establishing control, it can be expected that the amount of income (arrangement) will increase by about PLN 46.3 million.

In total, the amount of losses may decrease by approx. PLN 536 million.

<table>
<thead>
<tr>
<th>Revenue (PLN million) yoy</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>0</td>
<td>536</td>
</tr>
</tbody>
</table>

It is not possible to precisely determine the preventive effect of discouraging promoters and beneficiaries from preparing and implementing aggressive tax schemes. The preventive effect of MDR regulation should be strengthened over time, once the practice of its application has been shaped and judicial decisions have been taken. MDR should also result in the introduction, on the basis of identified tax avoidance schemes, of legal and tax regulations aimed at mitigating the negative effects of such activities.

5. **Introduction of a limit on the quantity of fuel imported from third countries, with exemption from import duties and excise duty**

**Objectives:**
— limiting the resale of cheaper fuel imported from third countries (from the eastern border of Poland) in vehicle tanks in breach of the rules in force by reducing the possibility of its import free of import duties and excise duty to a quantity of 200 litres,

— ensuring consistency in customs and tax legislation. According to the regulations, fuel transported in standard tanks of vehicles is exempt from import duties without quantitative restrictions, while the import of motor fuels transported is exempt from excise duty:
  • in the standard tanks of motor vehicles, not more than 600 litres per vehicle,
  • in special containers, a quantity of not more than 200 litres per container.

**Tools:**

a draft act amending the *Customs Law* and the *Excise Duty Act*.

**Addressees:**

organisational units of customs and tax control offices from the external land border of Poland with third countries which are not members of the European Union (23), entities operating in the field of international transport (approx. 44,000), domestic fuel producers and distributors (approx. 6,550) and entities importing goods from outside the EU into Poland.

**Responsible authority:**

Minister of Finance, Head of the National Revenue Administration.

**Deadline:**

planned date of entry into force of the Act - 1 June 2018.

**Estimated financial impact:**

<table>
<thead>
<tr>
<th></th>
<th>Revenue (PLN million)</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>220</td>
<td></td>
<td>170</td>
</tr>
</tbody>
</table>

6. **Introduction of online cash registers for sales to non-business individuals and flat-rate farmers**

**Objective:**

fight against the grey area and strengthening of fair competition among entrepreneurs

**Tools:**

introduction of a solution allowing to use the cash registers transferring data to a central IT system in recording the sales and amounts of tax due on sales to natural persons not conducting business activity and flat-rate farmers, hereinafter referred to as "online cash registers", maintained by the Head of the National Revenue Administration, hereinafter referred to as "the Central Repository of the Treasury". The online cash registers will send information about each transaction recorded on the cash register, with details allowing to determine the amount of sales and due tax, VAT rate, type of goods/services, as well as the place of installation of the cash register. Data transmission from online cash registers will be carried out continuously and automatically or at the request of the Head of the National Revenue Administration.

Sales data will be received by the Central Repository of Cash Registers practically in real time and will contain a time stamp, which will enable detailed analyses to be made to determine the probability that a given taxpayer does not record its sales on the cash register or records only a part of the sales. It is assumed that the planned solutions will contribute not only to the strengthening of control over the correctness of VAT settlements, but also to the simplification of the very process of control of settlements with the entrepreneurs due to the possibility of remote monitoring by tax authorities of the amounts recorded at sales registers. The proposed solutions will also enable the increase of the state
budget revenues as a result of the assumed increase in VAT collection at the last stage of trade in goods and services - the retail sale.

At the same time, according to the draft act amending the VAT Act and the Measuring Act, the legislator allows for the use of cash registers already used for recording sales by taxpayers, i.e. cash registers with paper copy records and cash registers with electronic copy records. Cash registers with paper copies and electronic copies will be phased out of the market as solutions that do not meet the requirements of the new cash register scheme.

The draft does not provide for the obligation to exchange the registers for online cash registers, with the exception of certain industry specific exceptions. With the main objective of counteracting VAT fraud, taxpayers carrying out business activities in sectors which are particularly vulnerable to irregularities in the area of keeping sales records will in the first place be subject to an absolute obligation to use cash registers fulfilling new functions for sales records.

**Addressees:**
value added tax taxpayers, in particular those who keep sales records using cash registers.

**Responsible authority:**
Minister of Finance, Head of the National Revenue Administration.

**Deadline:**
planned date of entry in force the act – 1 October 2018.

**Estimated financial impact:**
in connection with the introduction of online cash registers, it is estimated that in 2027 the increase in the state budget revenues from the value-added tax will amount to approx. PLN 1,688.50 million. This amount was estimated on the basis of statistical data concerning the final consumption of households, where a 1.5% increase in the tax due on the introduction of online cash registers was assumed. Moreover, in connection with the regulation contained in the Act, it is envisaged to refund a part of the amounts spent on the purchase of a new type of cash registers for taxpayers beginning to record sales using online cash registers.

<table>
<thead>
<tr>
<th>Revenue (PLN million) yoy</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>180.30</td>
<td>169</td>
</tr>
</tbody>
</table>

7. **Improving the efficiency of administrative enforcement**

**Objectives:**
— increase in the efficiency of tax collection,
— increase the level of voluntary compliance with tax obligations,
— increase of taxpayers’ awareness concerning the benefits of voluntary payment of public-law liabilities and of the financial consequences of compulsory enforcement of an obligation that is subject to administrative enforcement,
— implementation of Constitutional Tribunal judgement of 28 June 2016 (ref. no. SK 31/14),
— simplification of procedures in the enforcement proceedings, including the procedure of examining charges and motions for discontinuance of the enforcement proceedings by eliminating the duplication of procedural steps taken by the creditor and the enforcement authority,
— simplification of procedures for recovering the joint property of the spouses and the debtor in rem, while ensuring the legal protection of those persons in administrative proceedings, and reducing the cost of the recovery for the debtor and debtor in rem,
Annex. Measures increasing tax compliance in the years 2018 and 2019

— simplifying the convergence of enforcement by changing the rules for settling the convergence of maintenance and customs duties and simplifying the procedure for transferring documents between enforcement authorities,

— simplifying the execution of movable property by introducing a new form of sale of movable property by the debtor under the supervision of the enforcement authority.

Tools:
I. amendment to the Act on enforcement proceedings in administration and the Act on court costs in civil cases, consisting in, i.a. the following:

— establishing a new system for calculating the costs of enforcement in administrative enforcement proceedings - implementation of the judgment of the Constitutional Tribunal of 28 June 2016, ref. no. SK 31/14,

— introduction, under the new system of charging and collecting enforcement costs, of preventive and disciplinary tools, resulting in limiting irregularities in the timely payment of public-law liabilities.

II. amendment to the Act on enforcement proceedings in administration and some other acts, i.a. by improving administrative execution as regards the procedures, conversions and forms of sale of seized movable property.

Addresses:
debtors, Head of the National Revenue Administration and other bodies of National Revenue Administration, other creditors and enforcement authorities, referred to in Act of 17 June 1966 on enforcement proceedings in administration.

Responsible authority:
Minister of Finance, Head of the National Revenue Administration.

Deadline:
1 January 2019 – draft act amending the Act on enforcement proceedings in administration and on amending the Act on court fees in civil cases;

1 January 2020 – draft act amending the Act on enforcement proceedings in administration and some other acts.

Estimated financial effect:

<table>
<thead>
<tr>
<th>Revenue (PLN million) yoy</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td></td>
<td>96.66</td>
</tr>
</tbody>
</table>

8. Introduction of a tax on liquids for electronic cigarettes and novel tobacco products

Objectives:
— ensuring a uniform tax treatment of substitute products vis-a-vis traditional tobacco products,

— improved control of the state over the production, movement and sales of liquids for electronic cigarettes and novel tobacco products,

— taxation of liquids for electronic cigarettes and novel tobacco products with excise duty will result in the obligation to mark them with fiscal stamps. As a consequence, an additional measure confirming the legal origin of these products will be introduced.

Tools:
the Act of 12 December 2017 amending the Excise Duty Act, which provides for:
zero taxation of liquid for electronic cigarettes and novel tobacco products until 31 December 2018,

the obligation to submit the tax return to the competent head of the tax office,

taxation of the electronic cigarette liquids at a rate of PLN 0.5 per millilitre and novel tobacco products at a rate of PLN 141.29 per kilogram and 31.41% of the weighted average retail selling price of smoking tobacco as of 1 January 2019,

obligation to mark with excise stamps liquids for electronic cigarettes and novel tobacco products intended for sale after 1 January 2019,

application of either the excise duty suspension procedure to the above-mentioned goods within the territory of the country, or the production of the said goods outside the taxed warehouse, using the institution of prepayment of excise duty, effective from 1 January 2019.

Addressees:
22 entities conducting activity in the field of production, import and intra-Community acquisition of liquids for electronic cigarettes and novel tobacco products.

In addition, 16 chambers of tax administration and 44 tax offices competent for excise tax and 16 customs and tax control offices in connection with imposing excise duty on new products and the obligation to mark them with excise duty stamps.

Responsible authority:
Minister of Finance, Head of the National Revenue Administration.

Deadline:
the Act entered into force on 1 February 2018. However, until 31 December 2018, a zero rate will apply to novel tobacco products and liquid for electronic cigarettes. These products will be taxed with a positive excise duty rate as of 1 January 2019.

Estimated financial effect:
there is no available data regarding the current sales volume of electronic cigarette liquid and therefore the analysis assumes approximate annual sales of electronic cigarette liquids of about 150,000 litres. Novel tobacco products appeared on the Polish market at the beginning of April 2017. Therefore, the market of novel tobacco products is an emerging one, for which no data is available. Thus, no significant share of excise tax on novel tobacco goods in the revenues from excise tax on new excise goods is expected. It is estimated that the amount of excise revenue on novel tobacco products will be marginal.

It is estimated that in the area of electronic cigarette excise stamps the expenditure of the state budget in Part 19 of Chapter 75095 per annum will amount to approximately PLN 383,000. However, due to the fact that entities obliged to mark excise goods with excise tax stamps pay into the budget an amount constituting at least 80% of the cost of manufacturing a tax stamp, the actual cost incurred by the state budget will amount to approximately PLN 80,000. Covering the novel tobacco products and liquids for electronic cigarettes with the excise duty suspension regime in the territory of Poland will require the EMCS system to be adapted to the introduced changes. The Zefir system will also need to be adjusted, i.a. as regards the new model of tax return. Due to the fact that these systems are maintained and developed as part of long-term projects, it is not possible to separate the amounts of funds related to the measures introduced by this bill. However, due to a small number of taxpayers, it is assumed that the collection of the tax on new products will be carried out within the current structure and human resources of the National Revenue Administration.

<table>
<thead>
<tr>
<th>Revenue (PLN million) yoy</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>74.9</td>
<td></td>
</tr>
</tbody>
</table>
9. Development of a monitoring system for the road carriage of goods

Objectives:

— closing loopholes in the tax system by collecting data on carriage of selected “sensitive” goods, in relation to their delivery in the territory of the country, intra-Community supply, intra-Community purchase, export and import and transport through the territory of Poland;

— disciplining the taxpayers (business entities and natural persons purchasing heating oils) and entities transporting “sensitive” goods to and through the territory of Poland to show taxable transactions, including value added tax and, in the case of excise goods, excise duty, which will increase tax revenues and revenues in the fuel charge.

Tools:

a data register of transport of selected "sensitive" goods (in particular liquid fuels, denatured alcohol, raw tobacco and vegetable oils), which is kept in the IT system by the Head of the National Revenue Administration. The transfer of data on taxable activities for some goods is connected with the declaration of transport by obliged persons, and also will automatically be connected with the collection of geolocation data sent by GPS locators. The inspection services have access to data from the system on the road in order to aim the inspections at undeclared transports.

Addressees:

entities conducting business activity participating in the trade of "sensitive" goods set forth in the Act and a regulation issued on its basis, the carriers and managers of means of transport. In addition, natural persons purchasing fuel oils falling within code CN 2710, persons not covered by the exemption from excise duty on account of their intended use, covered by a specific, reduced rate of excise duty related to their intended use for heating purposes.

Responsible authority:

Minister of Finance, Head of the National Revenue Administration.

Deadline:

the Act of 9 March 2017 on the monitoring system for the road carriage of goods entered into force on 18 April 2017. Three draft amendments to the Act were prepared. First draft includes adding GPS trackers to the monitoring – planned entry into force in the first half of 2018. The second draft includes in the monitoring system the rail transport and export of medicines, which may not be available for patients in the territory of Poland – planned entry into force in the first half of 2018. The third draft includes in the monitoring system the supply of heating oils of code CN 2710, which are not exempt from excise duty due to their intended use, as defined in Article 89(1) section 9, 10 and 15(a) of the Excise Duty Act (subject to a specific, reduced rate of excise duty related to the use of these oils for heating purposes). The effects of the introduced regulations will also occur in the following years.

Estimated financial effect:

proposed regulations should have a positive impact on the state budget revenues and reduce the shadow economy, particularly as regards the VAT gap. When designing the Act, it was planned that the total revenues from excise duty, VAT and fuel surcharge would increase by PLN 6.5 billion over 10 years, including PLN 330 million in 2017. Including the system of monitoring the transport of vegetable oils, it is planned that this will increase revenues of the state budget by PLN 657 million over 10 years, including PLN 100 million in the first year of the regulation's operation. Additionally, after the introduction of the obligation to notify about the transport of heating oils, in the first year of the regulations' operation an increase in the state budget revenues by PLN 200 million was envisaged.

<table>
<thead>
<tr>
<th>Revenue (PLN million)</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>expected outcome</td>
<td>927</td>
<td>-376</td>
</tr>
</tbody>
</table>