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Recommendation for a

COUNCIL RECOMMENDATION

with a view to bringing an end to the situation of an excessive government deficit in Poland

{SWD(2013) 605 final}

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 of the Treaty on the Functioning of the European Union (TFEU) Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) On 7 July 2009, the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC), that an excessive deficit existed in Poland and issued a recommendation to correct the excessive deficit by 2012 at the latest[1], in accordance with Article 104(7) TEC and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[2]. In order to bring the general government deficit at or below 3% of GDP in a credible and sustainable manner, the Polish authorities were recommended to implement the fiscal stimulus measures in 2009 as planned, ensure an average annual structural budgetary adjustment of at least 1¼% percentage points of GDP starting in 2010, spell out detailed measures that are necessary to bring the deficit below the reference value by 2012 and introduce reforms to contain primary current expenditure over the following years. The Council established a deadline of 7 January 2010 for effective action to be taken.

(4) On 3 February 2010, the Commission concluded that based on the Commission 2009 autumn forecast, Poland had taken necessary action in compliance with the Council recommendation of 7 July 2009 to bring its government deficit within the Treaty reference value and considered that no additional step in the excessive deficit procedure was therefore necessary. On the basis of its 2011 autumn forecast, the Commission considered that Poland was not on track and asked for additional measures, which Poland adopted and publicly announced until 10 January 2012. Thus,

1 All documents related to the excessive deficit procedure of Poland can be found at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/poland_en.htm

2 OJ L 209, 2.8.1997, p. 6.

on 11 January 2012 the Commission confirmed the Polish authorities had taken effective action towards a timely and sustainable correction of the excessive deficit and no further steps in the excessive deficit procedure of Poland were needed at the time[3].

(5) On 21 June 2013, the Council concluded that Poland had taken effective action but adverse economic events with major implications on public finances had occurred, and issued revised recommendations[4]. Thus, Poland fulfilled the conditions for the extension of the deadline for correcting the excessive general government deficit as laid down in Article 3(5) of Regulation (EC) No 1467/97. The Council recommended that Poland should put an end to the excessive deficit situation by 2014. Poland should reach a headline general government deficit target of 3.6% of GDP in 2013 and 3.0% of GDP in 2014, which is consistent with an annual improvement of the structural budget balance of at least 0.8% of GDP and 1.3% of GDP in 2013 and 2014, respectively, based on the Commission updated 2013 spring forecast. Poland should rigorously implement the measures already adopted, while complementing them with additional measures sufficient to achieve a correction of the excessive deficit by 2014. Poland should use all windfall gains for deficit reduction. The Council established the deadline of 1 October 2013 for Poland to take effective action and, in accordance with Article 3(4a) of Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets. On 2 October 2013, Poland submitted the report on effective action, which was subsequently analysed by the Commission.

(6) On [10 December 2013], the Council established in accordance with Article 126(8) TFEU that Poland had not taken effective action in 2013 in response to the Council recommendation according to Article 126(7) of the Treaty of 21 June 2013.

(7) In accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97, the Council is required to make recommendations to the Member State concerned with a view to bringing the situation of an excessive deficit to an end within a given period. The recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0.5% of GDP as a benchmark.

(8) After recording an an average real GDP growth of 4% per year over 2001-2011, the pace of economic activty slowed down in 2012 to 1.9%. The macroeconomic scenario underpinning the report on effective action projects real GDP growth to slow down further in 2013 to 1.5% before rebounding in 2014 and 2015 with real GDP expanding by 2.5% and 3.8%, respectively. According to the Commission 2013 autumn forecast, real GDP is set to grow at 1.3% in 2013 and accelerate to 2.5% in 2014 and 2.9% in 2015. Compared to the Polish authorities, the Commission has a less optimistic view on domestic demand growth over the forecast horizon, private consumption and private investment in particular.

3 Communication from the Commission to the Council on assessment of budgetary implementation in the context of the ongoing Excessive Deficit Procedures after the Commission services' 2011 autumn forecast - COM(2012) 4 final, 11.1.2012.

4 Council Recommendation with a view to bringing an end to the situation of an excessive government deficit in Poland, 21 June 2013.

(9) The Polish authorities foresee a general government deficit of 4.8% of GDP in 2013, up from 3.9% of GDP in 2012. Subsequently, the Polish Ministry of Finance projects a surplus of 4.5% of GDP in 2014 on the back of the planned pension reform, which in particular results in a one-off transfer of assets worth 8.5% of GDP. In 2015, the general government balance is expected to turn back into a deficit of 3% of GDP.

(10) For 2013 and 2014, the Commission forecast is similar to the Polish authorities'. It also projects a deficit of 4.8% of GDP in 2013. The deterioration compared to the 3.9% of GDP in the EDP baseline scenario is mainly due to revenue shortfalls. In 2014, the general government balance is projected to be in surplus (+4.6% of GDP) as a consequence of the planned pension reform. For 2015 the Commission is less optimistic than the Polish authorities and expect a general government deficit of 3.3% of GDP. The 0.3 pp. of GDP difference is mainly due to lower current revenues based on a lower projection for nominal GDP growth as well as higher government expenditure on intermediate consumption. The deficit targets are subject to implementation risks.

(11) Moreover, it has to be noted that the current deficit forecast is based on ESA-95. As of autumn 2014, a new set of rules will be in place (ESA-2010). Under the new set of rules, a transfer of assets would no longer count as general government revenue, thus, the general government balance is expected to show a deficit of 4.2% of GDP in 2014 and 3.9% of GDP in 2015[5]. Since the Council will decide on an abrogation based on the EDP figures assessed by Eurostat in spring 2015 under ESA2010, additional measures are required to compensate for those elements of the pension reform, which will not reduce the deficit any longer under ESA2010.

(12) Both the Polish authorities and the Commission projects the general government gross debt to remain below the 60% threshold over the entire period under consideration. According to the Commission 2013 autumn forecast, the debt-to-GDP ratio is forecast to fall from 55.6% in 2012 to 51% in 2014, mainly as an effect of the announced transfer of pension funds' assets of 8.5% of GDP, before edging up to 52.5% in 2015.

(13) In order to correct the excessive deficit by the 2014 deadline under the then prevailing ESA-2010 rules and ensure its sustainability, the required additional structural effort for 2014 would amount to at least 1.6% of GDP, on top of the measures already included in the Commission 2013 autumn forecast (which under ESA2010 would yield an improvement in structural deficit of 0.6% of GDP in 2014). Since part of the adjustment need is the result of the change from ESA-95 to ESA-2010 and in addition, such an annual effort (higher than requested in the Council Recommendation of 7 July 2009 (1¼ % of GDP) and higher than the 1.3% of GDP requested in the Council Recommendation of 21 June 2013) would result in a significant output loss at a time when the output gap is still negative, it is appropriate to set the deadline of 2015.

(14) Against the background of high uncertainties regarding economic and budgetary developments, the budgetary target recommended for the final year of the correction period should be set at a level clearly below the reference value, in order to guarantee an effective and lasting achievement of the correction within the requested deadline.

5 Under ESA-2010 the following effects of the planned pension reform would not result any longer in a deficit reduction: one-off asset transfer of 8.5% of GDP in 2014, regular asset transfer in 2014 (0.3% of GDP) and 2015 (cumulated effect of 0.6% of GDP). Only the change in the number of contributors to the first pillar would remain under the new rules (0.2% of GDP in 2014, cumulated effect of 0.4% of GDP in 2015). While the switch to ESA2010 is estimated to have a positive impact on GDP figures, the size of the impact of higher GDP on fiscal figures is expected to be negligible.

(15) Therefore, correcting the excessive deficit by 2015 would be commensurate with the intermediate headline deficit target of 3.9% of GDP for 2014 (net of pension asset transfer) and the final target of 2.8% of GDP in 2015. The underlying improvement in the structural budget balance implied by these targets is 1% of GDP in 2014 and 1.2% of GDP in 2015, taking into account the measures included in the Commission 2013 autumn forecast yielding an improvement in structural balance under ESA2010 of 0.6% of GDP in 2014 and 0.2% of GDP in 2015. This implies a need of additional measures of 0.4% of GDP in 2014 and 1% of GDP in 2015, on top of those already included in the Commission 2013 autumn forecast (excluding the asset transfers of the pension reform),

HAS ADOPTED THIS RECOMMENDATION:

(1) Poland should bring an end to the excessive deficit situation by 2015 in a credible and sustainable manner.

(2) Poland should reach a headline deficit target of 4.8% of GDP in 2013, a deficit of 3.9% of GDP in 2014 and of 2.8% of GDP in 2015 (excluding the impact of the assets transfer of the pension reform). For 2014 this is consistent with an improvement of the structural balance of 1% of GDP and 1.2% of GDP for 2015, based on the Commission 2013 autumn forecast.

(3) Poland should rigorously implement the measures already announced and adopted, while complementing them with additional measures sufficient to achieve a correction of the excessive deficit by 2015 in a sustainable manner. Poland should use all windfall gains for deficit reduction.

(4) The Council establishes the deadline of 15 April 2014 for Poland to take effective action and, in accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets.

Furthermore, the Polish authorities should (i) improve the quality of public finances, in particular through minimising cuts in growth-enhancing infrastructure investments, a careful review of social expenditures and their efficiency; (ii) improve tax compliance and increase the efficiency of tax administration and (iii) make the institutional framework of public finances more binding and transparent, including through adjusting the definitions used in national accounting to ESA standards and ensuring sufficiently broad coverage, improving intra-annual monitoring of budget execution and ensuring an effective and timely monitoring of compliance with the permanent expenditure rule, based on reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities. Finally, to ensure the success of the fiscal consolidation strategy, it will be important to back the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to Poland in the context of the European Semester. Beyond the report foreseen in recommendation (4), the Polish authorities should report on progress made in the implementation of these recommendations at least every [six months] as well as in a separate chapter in the convergence programmes, until full correction of the excessive deficit has taken place.

This recommendation is addressed to the Republic of Poland.

Done at Brussels,

For the Council
The President