REPUBLIC OF POLAND

CONVERGENCE PROGRAMME

2016 UPDATE

Warsaw, April 2016

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Summary

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 will then issue recommendations for the economic policies of the Member States, which shall take due account of the guidance addressed to them when designing budgets for the next year. In the opinion of 14 July 2015 on the last year's update of the Convergence Programme, the Ecofin Council recommended that Poland shall:

— reduce the structural deficit by 0.5 percentage point of GDP both in 2015 and 2016;

— establish an independent fiscal council;

— broaden the tax base, in particular by reducing the use of the extensive system of reduced VAT rates .

This *Convergence Programme* (hereinafter referred to as the *Programme*) presents in Chapters III, VI and VII the status of implementation of the policy guidance provided by the Ecofin Council on the previous *Programme*. Moreover, it presents the medium-term forecast of the Polish economy and public finances through 2019. This document was developed in accordance with the Council Regulation No. 1466/97/EC *on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies* and guidelines for stability and convergence programmes of EU Member States approved by the Ecofin Council in September 2012.

The Polish *Programme* is a part of the *Multiannual Financial Plan of the State* (MFPS), developed pursuant to the *Public Finance Act*. The MFPS was approved by the Council of Ministers on 26 April 2016 and shall provide the basis for the preparation of the draft Budget Act for 2017.

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 after an analysis of the previous NRP[1]. Information on the *Programme* and NRP was discussed at a joint meeting of parliamentary committees for EU affairs, public finances and the economy and development on 13 April this year.

As in previous years, the opinion of the Council on this *Programme* and the Council recommendations concerning the NRP of 2016 will also be the subject of discussion of the Polish Parliament.

[1] *Council Recommendation of 14 July 2015 on the 2015 National Reform Programme of Poland and delivering a Council opinion on the 2015 Convergence Programme of Poland*, available at http://ec.europa.eu/europe2020/pdf/csr2015/csr2015_council_poland_en.pdf

I. Overall policy framework and objectives

I.1. Fiscal policy in the EU context

Fiscal policy in Poland is conducted within limitations contained in national and EU laws, including:

- the upper limit of the state budget expenditure - which is set for the next year based on the stabilizing expenditure rule contained in the *Public Finance Act* (cf. Chapter III);
- respecting reference values for the nominal deficit (3% of GDP) and the debt (60% of GDP), and attaining the so-called medium-term budgetary objective (cf. below).

The Treaty on the Functioning of the European Union (TFEU) requires in the Article 126 (1) the EU Member States to avoid excessive nominal, i.e. above 3% of GDP. This obligation has been clarified in the *Council Regulation (EC) No 1467/97 on speeding up and clarifying the excessive deficit procedure,* which creates the so-called corrective arm of the *Stability and Growth Pact.* In turn, the *Council Regulation 1466/97/ EC on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies* obliges EU Member States to formulate the so-called medium-term budgetary objective (MTO) and achieve it within specified time limits. Compliance with the MTO shall, among others, prevent the growth of the nominal deficit above 3% of GDP (therefore that regulation is called a preventive arm of the *Stability and Growth Pact*).

The Ecofin Council abrogated on 19 June 2015 the excessive deficit procedure for Poland initiated in May 2009. As a result, Poland is currently subject to requirements of the preventive arm of *the Stability and Growth Pact*. Fiscal policy remains focused on maintaining stability of public finances while supporting an inclusive economic growth (cf. Chapter III).

I.2. Coordination of the economic policies

In accordance with Art. 121 of the *Treaty on the functioning of the EU*, Member States regard their economic policies as a matter of common concern and coordinate them within the Ecofin Council. Since 2011, the budgetary year has been divided into two semesters so as to strengthen the effectiveness of this coordination. In the first semester, called the European Semester, the EU institutions analyse the economic situation in the EU and formulate recommendations for Member States, while in the second semester, called the national one, the Member States strive to reflect the EU policy guidance in their policies.

The European Semester begins in November with the publication of the *Annual Growth Survey* (AGS), in which the European Commission describes the economic situation and challenges for the European Union for the following year. Based on the AGS and the discussions of the Member States in various formations of the EU Council, the European Council adopts priorities for economic policies of all EU Member States in March of the following year. The European Commission has suggested in the latest edition of AGS[2] focusing the economic policies of the EU Member States in 2016 - in order to enhance and strengthen the economic recovery – on:

- stimulating investment,
- implementation of structural reforms[3],
- conducting responsible economic growth-friendly budgetary policies.

As a follow-up, the European Council has also recognized measures of all Member States and the whole European Union in these 3 areas as this year's priorities[4].

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[2] http://ec.europa.eu/europe2020/pdf/2016/ags2016_annual_growth_survey.pdf
[3] Current edition of the NRP was devoted to this issue.
[4] Cf. Conclusions of European Council of 17-18 March 2016 , available at http://www.consilium.europa.eu/press-releases-pdf/2016/3/40802210110_pl_635939253000000000.pdf.

Supporting investment, promoted by the European Council, is one of key elements of the *Plan for responsible development* adopted by the Council of Ministers on 16 February 2016 (cf. Chapter I.3). Since last year, Poland has been participating in implementing the *Investment Plan for Europe* prepared by the European Commission and the European Investment Bank, which between 2015-17 is expected to improve conditions for investment and generate additional public and private investments in the European Union at least of EUR 315 billion. The main pillar of the Plan is the European Fund for Strategic Investment. The guarantees granted so far[5] by EFSI (i.e. EIF component) worth EUR 19 million enabled Poland to sign 4 agreements with financial institutions, which should generate funding worth EUR 658 million intended to support investment projects undertaken by small and medium-sized enterprises. It is estimated that more than 10,000 small and medium-sized enterprises and start-ups will benefit from this type of funding. Furthermore, 1 large investment project eligible for EFSI support was notified, and several more are under the process of evaluation.

The forecast presented in the *Programme* indicates a further restoration of private investment until 2019. At the same time public investment will remain at a level above 4% of GDP, i.e. well above the EU average. As a result, the share of total investment to GDP shall increase to 22.8%[6]. The projects co-financed by the EU will have a significant share in investment - Poland remains one of the leaders in the use of EU funds. According to data for 2015, the rate of absorption of structural funds (the ratio of paid funds to the available budget) under the financial perspective 2007-13 amounted to 94.9%[7]. This puts Poland in 10th place among all beneficiaries. Poland has already received EUR 63.7 billion from the EU budget – the most in the EU – and actions are taken to fully distribute the EU funds from the period 2007-13. A plan has been implemented to ensure a full allocation from the cohesion policy budget – EUR 82.5 billion between 2014-20, and the absorption of EU funds shall positively impact on Poland's social and economic development in the long run. Planned actions are aimed at, among others, acceleration in announcing calls for tender in individual programmes, investing resources in the most efficient manner, and consequently increasing the dynamics and sustainability of development processes in Poland.

A growth-friendly fiscal consolidation, commended by the European Council, is also a priority of the Polish government. Poland supports initiatives of the EU and the OECD for reducing tax evasion and measures for a more efficient tax administration. Focusing efforts on reducing aggressive tax planning and on fighting tax fraud (cf. Annex *Actions improving tax compliance between 2017-19*) shall help provide revenues necessary e.g. to finance investment and actions against social exclusion. Planned deficit reduction will translate into higher national savings and a lower risk premium that is included in the price of capital. This, in turn, shall allow a faster accumulation of capital in the private sector and throughout the economy in the *Programme* horizon. As a result, an acceleration of potential GDP growth in Poland is expected: from 3.1% in 2015 to 4.0% in 2019.

I.3. Economic policy objectives

The priority objective of the government is to promote inclusive economic growth while pursuing fiscal policy within the constraints of national and EU laws, such as in particular the stabilizing expenditure rule and the limit of 3% of GDP for the nominal deficit. Increased collection of income tax (cf. Chapter III / Annex) shall allow to implement already planned actions while maintaining the sustainability of public finances which is an essential condition for macroeconomic stability and, consequently, long-term economic growth. A high effectiveness of the fight against informal economy and against tax evasion can create some fiscal space for implementation of new solutions in the area of the social and economic policy.

[5] As of 14 March 2016, cf. http://ec.europa.eu/priorities/sites/beta-political/files/poland-ip-state-of-play-march-2016_en_0.pdf

[6] The forecast does not take into account the implementation of the *Plan for responsible development* - it will be possible only after the development of the strategy clarifying this plan.

[7] http://ec.europa.eu/regional_policy/index_en.cfm

Directions of the economic development in Poland in the coming years are indicated in the *Plan for responsible development* adopted by the Council of Ministers on 16 February 2016. It provides for increasing the potential of the Polish economy through building a strong industry, promoting investment and creating a favorable institutional and legal environment for the creation, strengthening and foreign expansion of Polish business with effective use of domestic and foreign funds. Specific actions for the implementation of the *Responsible Development Plan* will be presented in the strategy currently under development. The strategy will also establish a system of coordination of its implementation, setting specific roles for public entities and ways of cooperation with the world of business, science and civil society.

Implementation of reforms aimed at strengthening the capacity and performance of the Polish economy should result in bridging the gap between Poland and the euro area. However, differences observed so far between the Polish economy and the euro area - in particular in terms of the level of development, as measured e.g. by GDP *per capita* – could pose a threat of negative shocks affecting the Polish economy after the euro adoption[8]. In addition, analysis of the situation at European level indicates that the prospect of stability of the euro area, which is a prerequisite for Polish accession to the common currency area, remains unclear.

[8] Cf. *Monitor of Convergence with the Economic and Monetary Union*, Ministry of Finance, March 2016, (Polish version only) available on http://www.mf.gov.pl/c/document_library/get_file?uuid=f17d01f0-2e73-4b8a-b3c1-d0b884eb45d3&groupId=764034

II. Economic outlook

II.1. Cyclical developments and current prospects

In the second quarter of 2013 the Polish economy entered the path of higher growth, growing by the end of 2015 at an average rate of 0.9% (qoq, sa). In the whole of 2015, GDP grew in real terms by 3.6%, i.e. 0.3 percentage point more than a year earlier. The main growth driver remained domestic demand, although its growth was lower than that recorded in 2014. Lower domestic demand growth was mainly the effect of a slowdown in investment growth, the negative contribution of inventories, and - to a lesser extent - weaker growth in public consumption. The growth rate of exports was higher than the growth rate of imports, which resulted in a positive contribution of net exports to GDP growth.

In 2015, there was a further improvement in the economic situation in the EU countries (GDP growth in the EU accelerated to 1.9% from 1.4% a year earlier). At the same time we observed a further increase in EU imports, the main indicator of demand for Polish goods and services (the EU accounts for almost 80% of Polish export of goods), which in 2015 amounted to 5.7%, against 4.7% a year earlier. The increase in EU imports, and imports of other developed countries and other developing countries and as a result an increase in Polish exports to these markets, offset the decrease in exports from Poland to eastern markets (in particular Russia and Ukraine). As a result, the growth rate of total exports remained at a relatively high level (6.8% yoy). This was reflected, among others, in a growth rate of industrial production higher than in the previous year.

The improvement in economic activity in 2015 was reflected in a further improvement in the labor market[9]. The number of employed increased by 1.4%, i.e. at a rate only slightly slower than a high one of 1.9% recorded a year earlier. This increase mainly resulted from an increase in the number of employees. The second year in a turn the number of employers and self-employed increased too, after the previous two years of decline,. These changes are primarily due to the increase in the number of employed in the service sector, to a lesser extent in the broadly defined industrial sector (including industry and construction), as well as in the agricultural sector. The increase in the labor demand has contributed to a significant decline in unemployment. The unemployment rate fell to 7.5% from 9.0% a year earlier and compared to 9.4% on average in the EU. The activity rate stabilized at 56.2%.

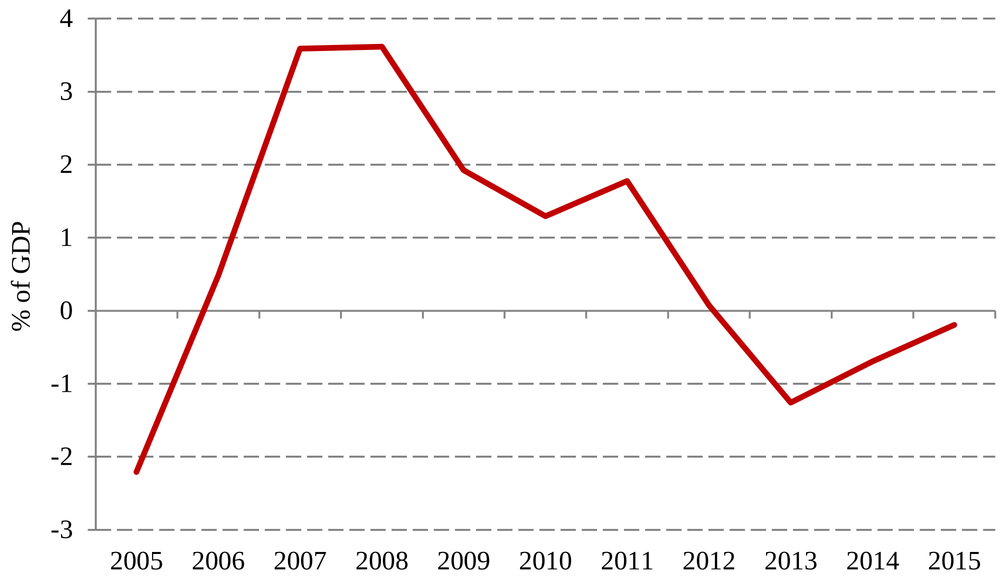
The improved situation on the labor market, at the consumer price deflation, contributed to the significant increase in the growth of real disposable income of households and consequently to acceleration of the rate of growth of household consumption (to 3.1% from 2.6% a year earlier). Consumption growth was also supported by improvement of consumer sentiment and the dynamics of consumer loans. Last year, the growth rate of gross fixed capital formation slowed to 5.8% from 10% in 2014, which was among others the effect of significantly lower growth rate of investment in the general government. Despite the slowdown the investment growth was higher than the GDP growth (especially in nominal terms), which translated into an increase in the investment rate by approx. 0.4 percentage point (to 20.1% of GDP). Investment growth was supported by the relatively high cost competitiveness of Polish companies, its stable financial position and record low interest rates (decrease in financing costs).

Estimates of the potential growth of the Polish economy are prepared in accordance with the methodology of the European Commission[10]. The adopted methodology used for estimating an equilibrium unemployment rate in the Polish economy (NAWRU) based on the concept of neo-keynesian Phillips curve indicates that in recent years in Poland, along with the rapid decline in the observed unemployment rate (2.8 percentage points in the years 2013-15) also the NAWRU decreases. As a result, in 2014-15 the potential GDP growth accelerated to 3.1% in 2015, which was driven by the increasing rate of growth of total factor productivity (TFP). Despite the observed relatively fast rate of GDP growth (3.6% in 2015 and 3.3% in 2014, against 1.3% in 2013) within 2013-15, the output gap in 2015 was still negative at the level of -0.2% of potential output. However, a positive

[9] Information on labor market are based on LFS data (15 years and more).
[10] cf. Havik K. and others, *The Production Function Methodology for Calculation Potential Growth Rates & Output Gaps*, European Committee, *Economic Papers 535*, November 2014.

signal demonstrating the improved cyclical conditions for doing business is its closing in recent years, which is presented in the chart below.

Chart 1. Output gap



Source: Ministry of Finance

Relatively weak demand pressure, low inflation expectations and weak cost pressures caused the core inflation to remain low in 2015. On average, in the year, it amounted to only 0.3%, which was significantly below the lower limit of the permissible deviations from the inflation target. The overall inflation rate was even lower and in all months of 2015 the prices of consumer goods and services remained below the levels of the previous year, and on average they were 0.9% lower than in 2014. To a large extent it was due to supply shocks in the energy market and the market of agricultural products. The decline in industrial prices and as a result in consumer prices was supported by the sharp decline in oil prices recorded in the second half of 2014 and in 2015. In addition, a decline in food prices, which was the result of high supply of agricultural products on the domestic and world market, contributed to lower consumer prices. In the 1st quarter of 2016 the deflation still persisted both in terms of consumer prices, and industrial ones.

In March 2015 in view of the prolonging deflation and a significant increase in the risk of inflation remaining below the target in the medium term, the Monetary Policy Council (MPC) decreased the interest rates by 0.5 percentage point. The main interest rate – the reference rate – was reduced to a new record low of 1.5%. At the same time, the Council announced that this decision concludes the monetary easing cycle in Poland. According to this declaration, the NBP interest rates remained unchanged until the end of the year. As a result, the average reference rate in 2015 was 1.6%. Keeping the cost of central bank money unchanged, the MPC argued that the observed decline in consumer prices on an annual basis was mainly due to supply-side shock in the form of lower commodity prices on world markets. At the same time it was assessed that in the coming quarters, the growth of prices should rise slowly, and it will be supported by the gradual closing of the output gap, amid improving economic conditions in the euro area and the good situation on the domestic labor market.

Stable growth in exports accompanied by slower growth in imports translated in 2015 to an increase in the trade surplus. In addition the decline in energy commodity prices caused that the favorable change in the balance in real terms have been further strengthened by the positive impact of the terms of trade, i.e. higher – in PLN – price dynamics of exports than imports. As a result, the total nominal surplus in trade in goods and services to GDP reached a record level of 2.8%. The main source of external imbalances was still the negative primary income component, reflecting mainly the income of non-residents from direct investment, as well as, but to a lesser extent, income of non-residents from portfolio investment. As a result, the current account deficit in 2015 decreased to only 0.2% of GDP. External imbalance of the Polish economy was financed by long-term capital inflows with a large surplus, i.e. the surplus of the capital account, where mainly the inflow of funds from the European Structural Funds and the positive balance of direct investment are classified.

In 2015 the exchange rate of the zloty was determined mainly by global factors. After a temporary weakening in January, caused by the decision of the Swiss central bank to abandon the defense of the EUR/CHF, the zloty has strengthened against the euro, reaching, the year's strongest level at 3.97 in mid-April. At that time the Polish currency was supported by the start of the programme of quantitative easing by the European Central Bank and the MPC statement about the end of the monetary policy easing cycle. In the following months the exchange rate of the zloty to the euro followed an upward trend. Pressure on the zloty was initially exerted by growing concerns about a Greek default and then by uncertainties about the outlook for the Chinese and global economy. The last quarter of 2015 was characterized by a relative stabilization of the zloty to the euro, interrupted in December by a significant, albeit only a temporary weakening of the Polish currency (EUR/PLN rate rose to 4.37). On average in 2015 the zloty exchange rate amounted to 4.18 EUR/PLN and 3.77 USD/PLN.

II.2. Medium-term scenario

Winter forecasts of the European Commission concerning the economic situation of Polish main trading partner, which is the EU, indicate a slowdown in foreign demand for Polish goods. The European Commission predicts though that GDP growth in the EU will remain at the level of 2015 (1.9%) in 2016 and in 2017 it will accelerate slightly to 2.0%, but the rate of growth of EU imports between 2016-17 will reach 5.1% and 5.5%, i.e. below the 5.7% of the growth in 2015. The main factor of growth in the EU over the forecast horizon will be domestic demand, including private consumption and investment to a less extent. For the purposes of the macroeconomic scenario presented in the *Programme* it is assumed that the rate of GDP growth and imports the EU will return to the long-term average in subsequent years, which means that real GDP growth will reach 1.8% in 2018 and 1.6% in 2019, with the real growth rate of imports at the level of 5.0% and 4.6%, respectively.

Despite the weakening of external demand dynamics, an important engine of economic growth in Poland shall be public investment. It is estimated that in 2016, as was the case in the last year, the share of public investment in GDP shall decrease by 0.1 percentage point of GDP to 4.3%. From 2017, in connection with the expected acceleration of spending of EU funds, the share of the general government investments to GDP shall increase to 4.6% in 2017 and then an average to 4.7% in the years 2018-19.

The conditions of demographic projections presented in the *Programme* are based on the assumption of the realization of the demographic changes expected in a scenario EUROPOP2013 adjusted by CSO data available in March 2016. In the horizon to 2019, Poland expects, therefore, a slight decrease in the total population, by approx. 0.1% compared to the level of 2015, despite the gradual disclosure of the positive effects of the *Family 500 plus* programme in the form of a higher number of births (more in Chapter II.3). The population aged 15-74 years (i.e. age, which is adopted by the European Commission as a working age) will fall by approx. 0.6% to 2019. It is assumed that over the forecast horizon to 2019, the activity rate (according to the LFS methodology, age group 15 years and older) shall increase by approx. 0.3 percentage point as compared with 2015.

It is expected that in 2016 the number of employees will increase on an average by 1.0%. In subsequent years, this growth will gradually decrease to 0.5% in 2017 and to 0.4% within 2018-19. Changes in total employment include the assumption adopted the *Programme* about maintaining the number of employed in the general government at a level recorded in the 4th quarter of 2015 until 2019. Assuming the development of the above presented activity rate and projected increases in employment, in the horizon of the *Programme*, a further systematic reduction in the unemployment rate is expected after the period of its growth within 2009-13. It is estimated that in 2016 the unemployment rate will fall to 6.6% from 7.5% recorded in the previous year. In 2017, on an average, it shall be at a level of 6.2%, lowering to a record level of 5.5% in the period up to 2019. This means that the strong decline in the unemployment rate in Poland observed in 2014-15 will continue, although at a slower rate.

The continuation of the improvement in labor market conditions will be conducive to the growth of wages in the market sector. Taking into account the changes in wages in the public finance sector units (Chapter III), it is expected that the nominal growth rate of the average wage in the national economy will be 4.4% in 2016. In subsequent years, it will reach 4.4% in 2017, 4.9% in 2018. and 5.5% in 2019, which will be accompanied by an increase in labor productivity.

Taking into account the estimated growth of the average remuneration, number of employees and the number of beneficiaries, it is forecasted that the average real growth in disposable income of households within 2016-17 will be slightly higher than the average GDP growth in this period, and then stabilize at approx. 3.7-3.9%. Such a development of disposable income is mainly related to the expected effects of the *Family 500 plus* programme. In the horizon of the forecast the additional support for the disposable income of households will be the continuation of favorable trends in the labor market, especially in the market sector, and the planned payment of one-time supplements to retirement and disability pensions in 2017. Taking into account the above factors, it is expected that in 2016 the real private consumption growth will accelerate to 4.0% against 3.0% of the last year, despite the expected increase in voluntary savings rate. In subsequent years, the real growth rate of consumption shall amount to 4.1% in 2017, and 3.8% in the years of the period 2018-19.

Real growth in public consumption will depend on government actions aimed at compliance with the applicable fiscal rules and a desire to achieve the MTO. It is estimated that the real growth rate in this economic category shall amount to 3.4% in 2016, 2.4% in 2017, and then 2.6% in the years of the period 2018-19.

The continuing high price competitiveness of Polish products allows companies to achieve relatively high rates of sales profitability despite the relatively unfavorable situation in the external environment. In recent years the recovery of the share of private investment is observed also after a sharp drop in 2009-10. It is estimated that the share of private investment in GDP amounted to 15.7% in 2015, i.e. by 0.5 percentage point more than in 2014, however, still 2.0 percentage points below the high level of 2008. In the period under forecast, it is expected that the trend of the recovery of investment demand of the private sector will continue. In 2016 the private investments will increase in real terms by 6.0%, growing at an average rate of 7.3% in the coming years, wherein it is expected that the visible acceleration of the rate of growth of this economic category will occur within 2018-19. As a result, the share of private investment in GDP shall increase to 18.1% of GDP at the end of 2019. The factors supporting the growth in investment demand of the private sector will be: the cost of capital kept on a relatively low level due to low interest rates and government measures aimed at the transformation of the Polish economy towards knowledge-based economy with innovative manufacturing sector and modern services sector.

The state of inventories is related to the level of demand on the domestic and foreign markets. It is estimated that in the period covered by the *Programme* contribution of changes in inventories to GDP growth will be slightly negative in 2016. (minus 0.1 percentage point compared to minus 0.2 percentage point in 2015), and it shall remain neutral for economic growth in subsequent years.

Within 2009-15 the share of exports in GDP in Poland increased from 37.6% to 49.4%. Such a dynamic change in the structure of the Polish GDP results from the continuing high competitiveness of Polish enterprises and, which is also important, the relative weakness of domestic demand, especially in the period up to 2013. It is expected that by 2019 the share of exports in GDP will continue to rise, though more slowly. Real export growth will remain on the average above the rate of growth of export markets and will reach 6.0% in 2016, 5.5% in 2017, 5.2% in 2018 and 5.1% in 2019, which will result in the increase in the share of exports in GDP to the historically high level of 52.3%.

Development of final demand, next to the exchange rate, will be the primary determinant of import growth in Poland. In connection with the expected acceleration of domestic demand growth, the real growth of imports in the horizon of the *Programme* will remain higher than the increase in exports and will amount to 6.6%, 6.4%, 6.0% and 5.8% in the years 2016-19, respectively. As a result, the contribution of net exports to GDP growth will be minus 0.2 percentage point in 2016, as compared to plus 0.3 percentage point in 2015. In subsequent years, this contribution will stabilize at minus 0.4 percentage point.

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 2016, the current account balance will be almost fully balanced compared to a deficit of 0.2% of GDP in 2015. 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. In subsequent years of the forecast the current account balance of payments will reveal a deficit, which will gradually deepen and reach 0.7% in 2017. 1.2% in 2018 and 1.7% in 2019. It is expected that until 2019 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 summary, the expectations for development of the GDP components allow predicting that economic growth in Poland will amount to 3.8% in 2016, or 0.2 percentage point above the level of 2015. The main factor of growth will remain private domestic demand. It is predicted that the real GDP growth will gradually accelerate in the coming years and reach 3.9% in 2017, 4.0% in 2018 and 4.1% in 2019.

In the period to 2015 the macroeconomic policy was carried out under conditions of negative, but a closing output gap. It is estimated that since 2016 the output gap relative to potential GDP will close and the forecast horizon will remain at zero. Potential GDP growth in the forecast period will be gradually increased from 3.1% estimated for 2015 to 4.1%, which will be supported by the expected acceleration of growth rate of the productivity of production factors, decreasing balance unemployment rate and gradual increase of the share of capital in creation of economic growth.

Throughout the forecast period it is expected to maintain the trend of appreciation of the zloty, but due to the weakening of the zloty against the euro from the beginning of this year, the average exchange rate of PLN/EUR will be somewhat weaker in 2016 than in the previous year. Strengthening of the Polish currency should be supported by the strong fundamentals of the Polish economy, including small current account deficit, the inflow of foreign investment and a gradual decrease in the risk premium associated with the determination of the Government to maintain public finance imbalance at a safe level, not threatening the stability in the medium and long term period.

In the case of inflation it is predicted that, after a period of deflation in 2015, inflationary pressures will be very limited also in this year. Persistent low prices of energy resources and the lack of pressure on their strong growth in connection, among others, with the slowdown of economic growth in developing countries and the potential to increase of supply on global markets by manufacturers, significantly reduce the costs in the Polish economy. Food prices still remain low. Therefore it is predicted that in 2016 the prices of consumer goods and services in Poland will fall by an average of 0.4% compared to 2015. In subsequent years the CPI will gradually come back in the vicinity of the center of the fluctuations allowed under the conducted monetary policy and will amount to 1.3% in 2017, 1.8% in 2018 and 2.2% in 2019, whereas in 2017 the price pressure will be limited by the expected reduction in VAT rates (cf. Chapter III).

II.3. Growth implications of “major structural reforms”

The Polish fiscal policy remains focused on maintaining the stability of public finances while supporting inclusive economic growth. The implemented solutions in the area of socio-economic policy, in particular activities that will serve the implementation of the *Plan for responsible development* (cf. Chapter I.3) and those provided for in this year's edition of the NRP should help to increase the potential of the Polish economy. Indirectly, through a positive impact on revenue, they should also support the long-term sustainability of public finances.

Strengthening the long-term sustainability of public finances will also be supported by the implementation of a set of pro-family measures (cf. description in last year's *Programme*) in response to the unfavorable demographic trend continued since 1989. While just before the political transformation the total fertility rate (below referred to as TFR) stood in Poland at a level similar to that of the replacement of generations in developed countries (2.1), in the 90s it steadily declined and since 1998 it is in the range of 1.2-1.4. In 2014, the fertility rate in Poland was 1.32. Low fertility is accompanied by changes in the biological structure of families with children. A number of households with one child increases and the relative share of families with two or more children decreases.

The pro-family measures implemented through impact on the increase in labor supply shall translate into an acceleration of potential economic growth in the longer term. In this year, the catalog of these measures was completed by the *Family 500 plus* programme, pursuant to the *Act of 11 February 2016 on State aid in raising children* (cf. also Chapter V).

According to estimates of the Ministry of Finance the increase in fertility rate by 10% compared to the baseline scenario, thanks to the implementation of the *Family 500 plus* programme, will result in an increase in labor supply in the years 2050-60, i.e. the last decade of the available long-term forecast, by 2.5%. Assuming no change in equilibrium unemployment rate and the productivity of production factors relative to a scenario without the *Family 500 plus* programme it would mean that the level of GDP in this period will be higher by 1.6-2.5% in relation to GDP in the baseline scenario, depending on the speed and scale of capital level adjustment to higher labor resources.

In connection with supporting the disposable income of households under the *Family 500 plus* programme it can be expected that beyond the positive effects for economic growth associated with higher rates of fertility and, consequently, higher labor supply in the medium and long term, there will also be positive effects for potential economic growth related to improving the quality of human capital. The potential scale of these benefits, which will directly result in a faster growth of productivity of production factors, it is difficult to estimate, and it is a positive risk factor for GDP growth in the long term.

Under the *Family 500 plus* programme it can also be expected a strong demand impulse to the economy already in the short term. The scale of the impulse will be derived from assumptions about the proportion in which households choose to share additional disposable income between consumption and savings. It is estimated that the funds from the *Family 500 plus* programme shall allow for acceleration of real private consumption growth to 4.0-4.1% in 2016-17 against 3.0% growth in 2015. The estimates of consumption growth of households in these years are even slightly lower than those presented by the NBP with the publication of the latest edition of the *Inflation Report* of March 2016 (NBP expects 4.1% growth in private consumption in 2016 and 4.2% in 2017). The NBP experts expect that funds from the *Family 500 plus* programme shall allow for additional growth in household consumption on a scale of 0.7 percentage point in 2016, and then 0.5 percentage point in 2017.

III. General government balance and debt

III.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 implementing the *Plan for responsible development* (cf. Chapter I.3) will be taken in a way that does not harm the sustainability of public finances. In particular, EU regulations provided in the *Stability and Growth Pact* will be respected as well as limitations laid down in national legislation, mainly those implied by the application of the stabilizing expenditure rule.

Due to the ongoing work on the final version of new measures in the socio-economic policy, the presented baseline scenario does not include discussed changes to the statutory retirement age and the amount of tax-free income. For discussion and possible consequences of these measures for the general government see Chapter III.6.

Presented forecast of the macroeconomic and fiscal situation is based on a scenario that takes into account effects of already implemented measures e.g. *Family 500 plus* programme and planned ones, which have been specified and it was possible to assess their impact. This scenario assumes the implementation of measures aimed at increasing the degree of respecting tax obligations by taxpayers and at fight against tax fraud (see Annex). Within the years 2016-19, these measures will include in particular the reform of tax and customs administration, sealing tax regulations, as well as fitting the institutions with modern tools to detect and combat the tax fraud. It is also planned to continue the educational campaigns to encourage the fulfillment of tax obligations and to combat the ill-defined economic freedoms. Assuming successful implementation of these measures, the baseline scenario of the *Programme* includes the improvement of tax collection.

III.2. Actual balances

In 2015 the improvement in the general government situation occurred. According to preliminary Central Statistical Office (GUS) estimates the general government deficit (according to ESA2010) amounted to 2.6% of GDP and it decreased by approx. 0.7 percentage point compared to 2014. The decrease in the general government deficit was influenced by both the reduction of expenditure and increase in revenue of the general government. In the last year, the ratio of domestic expenditures[11] to GDP reached the level of 40.1%, i.e. 0.6 percentage point lower than in 2014, and domestic revenue the level of 37.5%, i.e. 0.1 percentage point higher than in 2014.

The main factor in lowering expenditures were current expenditures, particularly purchases of goods and services carried out by public sector entities, which in relation to GDP declined by approx. 0.3 percentage point. Moreover, in 2015, the reduced spending on labor costs in relation to GDP by approx. 0.2 percentage point was reported, which was influenced mainly by keeping the salaries in the state budgetary units at the nominal level of 2014, considering committed budget reserves distributed in 2014, and an additional annual remuneration calculated in accordance with the statutory set rules. The exception was among the salaries of judges delegated to the Ministry of Justice or other organizational unit subordinated to the Minister of Justice or supervised by him, whose salaries are financed from the resources at the disposal of the Minister of Justice, prosecutors and assessors. At the same time in 2015, it was carried out the next stage of growth of salaries of employees of universities by 9.1% compared to the previous year. As a result of the balances of the above spending categories the public consumption was reduced in relation to GDP by approx. 0.3 percentage point of GDP. Public consumption increased nominally only by 2.6% yoy (vs. 4.5% yoy in 2014.), and in real terms by 3.5% yoy.

[11] Domestic expenditures/revenue means the expenditures /revenue adjusted by expenditures financed from the EU funds for which the ultimate beneficiaries are the general government units. According to the EU methodology ESA2010, the EU funds implemented by the sector units are neutral to the balance.

The reduction of expenditures in 2015 was also influenced by lower debt service costs, which fell in relation to GDP by approx. 0.2 percentage point. The reduction of debt servicing costs was the result of a gradual decline in yields on treasury securities (TS) in recent years (for example, average yields on 5 year's bonds decreased from 4.6% in 2012 to 2.2% in 2015) and the increase in the share of TS issued at a later date at lower yields, along with buyout of Treasury securities issued in previous years at higher yields.

In 2015, spending on social benefits other than social transfers in kind in relation to GDP remained at a level of approx. 14.3%. Within this group of expenditures, the expenditures on old pensions and disability pensions paid by the Social Insurance Institution (ZUS) (representing the largest share in this category) increased in a moderate scale, i.e. approx. 3.6% yoy. In contrast, significant increase in spending were noted under "social benefits other than pensions" (an increase of approx. 8.4% yoy), in particular in the category of "maternity benefits".

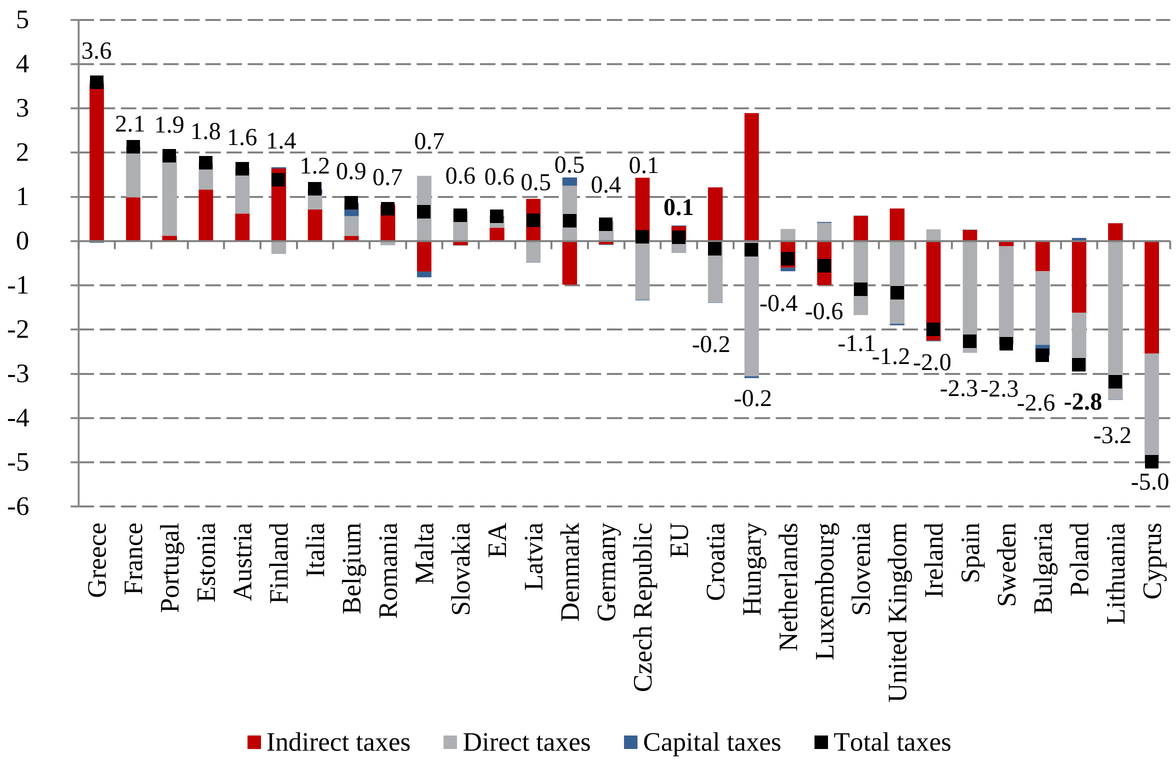
The increase in old pensions and disability pensions fund was influenced by moderate indexation of those benefits, and a reduction in spending on disability benefits, which resulted from declining number of persons receiving disability benefits.

Spending on public investment increased nominally by approx. 1.8% yoy (and decreased by 0.1 percentage point in relation to GDP), which was the result of the recovery in the central government, where investments have increased in relation to GDP by 0.2 percentage point, i.e. nominally by 12.1% yoy (against 7.5% yoy increase in 2014), and the decrease in capital expenditures of the local government, i.e. nominally by 7.8% yoy. In 2014, a very large (approx. 20% yoy) increase in investment occurred in the local government due to the end of the EU financial perspective 2007-13. The increase in capital expenditures of the central government in 2015 was primarily due to an increase in infrastructure spending carried out by the National Road Fund as part of *National Road Construction Programme* (increase by approx. 30% yoy, against a fall in 2014 by approx. 33% yoy), and an increase in capital expenditures of PKP PLK (by approx. 4.7% yoy), which has been incorporated into the central government since 2014.

In addition to a decrease in expenditures, the improvement of general government balance in 2015 was contributed by the increase – by approx. 0.4 percentage points (in nominal terms by approx. 7% yoy) – of revenue arising from social security contributions recorded in the social security subsector. This increase was partly due to changes in the pension system introduced pursuant to the *Act of 6 December 2013 on the amendment of certain acts in connection with the determination of the rules for payment of pension from resources collected in the open pension funds*. The impact on the level of contributions arises both from the determination of the level of contribution transferred to OFE at 2.92%, as well as from the introduction of a possibility to choose the participation in OFE. In 2015, an additional statistical effect occurred resulting from the fact that in 2014 the changes introduced by the Act did not apply throughout the whole year.

The year 2015 was a period of stabilization of tax revenues to GDP, both in respect of taxes on production and imports, as well as income taxes. However, the level of revenues is significantly lower than eight years ago: in 2007 the tax revenues amounted to 22.7% of GDP, while in 2015 revenues amounted only to 19.8% of GDP. This means a loss of tax revenue by 2.8 percentage points of GDP. Decrease in the ratio of tax revenues to GDP in Poland in the years 2008-15 was one of the highest in the European Union, the greater loss of revenues in relation to GDP occurred only in Lithuania and Cyprus (see chart 2).

Chart 2. Changes of the ratio of tax revenue to GDP in the years 2007-15 in the EU member states



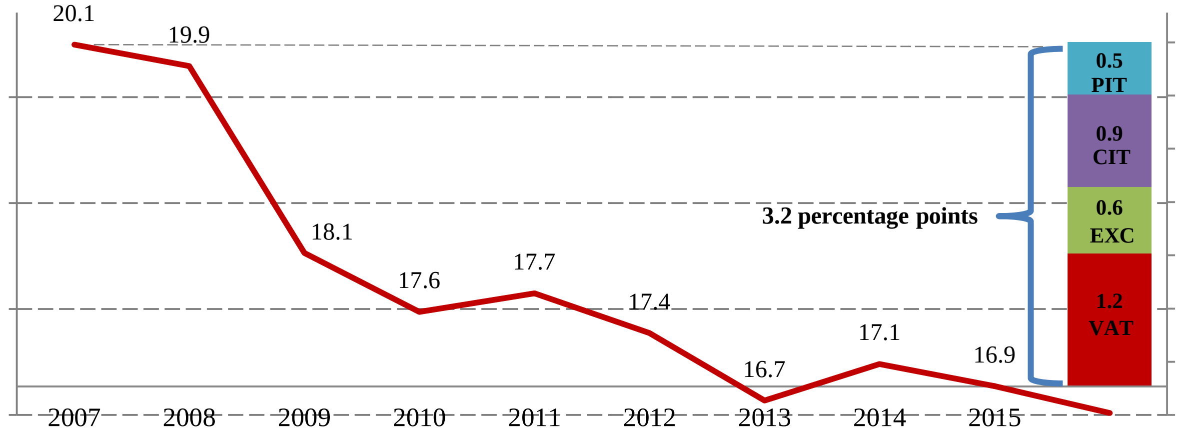
Source: Ameco (*Annual macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs* (DG ECFIN)), for Poland preliminary execution in 2015

The average ratio of tax revenue to GDP in the European Union fell to 25.0% in 2009 from 26.5% in 2007. However, for the EU countries – in contrast to the situation observed in Poland – this ratio returned to the level recorded immediately before the recession, i.e. to 26.5% as early as 2014.

In Poland in 2015, compared to 2007, despite the relatively good macroeconomic situation, the ratio of tax revenue to GDP substantially decreased. Significantly, 2/3 of this decline (i.e. 1.9 percentage points of GDP) was due to negative developments in indirect taxes (mainly VAT and excise duties). Only two EU countries recorded deeper fall in the ratio of indirect taxes to GDP – in Ireland, by 2.3 percentage points of GDP and in Cyprus by 2.5 percentage points of GDP. Importantly, the fall in the ratio of indirect taxes to GDP in Poland took place despite the increase of VAT rates by 1 percentage point from 2011 (simultaneously, the rate for some basic food products was lowered from 7% to 5%).

Data on the basic central taxes on a cash basis (the taxes being the revenue of the central budget, together with shares of local government units in PIT and CIT) indicate that the fall in the ratio of those revenues to GDP was even higher and reached 3.2 percentage points of GDP, which in the conditions of 2015, means nearly PLN 60 billion. In years 2007-15, decrease in the ratio of tax revenues to GDP was to the greatest extent due to lower VAT revenues, which fell by 1.2 percentage point. A significant decrease in the ratio of revenue to GDP has also occurred in CIT, the smallest was in PIT (cf. chart 3).

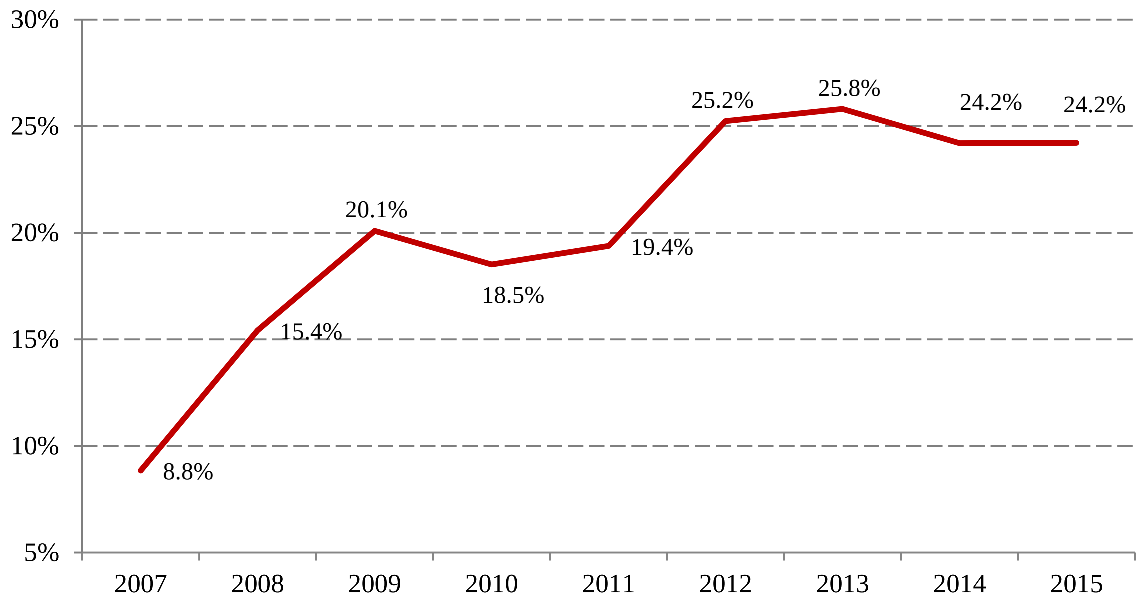
Chart 3. The ratio of revenues from main taxes (State Budget revenues and local government units shares) to GDP (in %) and the structure of the loss divided into individual taxes



Source: Ministry of Finance

Changes in a stream of VAT revenues in recent years, are largely the result of growth in the so-called "tax gap", which reflects the broadly defined degree of fulfillment of tax obligations. "Tax gap" is calculated as a difference between the actual tax proceeds and theoretical proceeds that result from the current regulations. For the purpose of estimating the "tax gap" the *top-down* method was applied, which uses macroeconomic data on VAT base (private consumption, general government investments) and takes into account other aggregates, which are finally charged VAT. Since 2007, an increase in the VAT gap has been observed. According to preliminary estimates of the Ministry of Finance[12], it exceeded PLN 40 billion in 2015 i.e. amounted approx. to 24.2% of potential proceeds (cf. chart 4).

Chart 4. VAT gap in % of theoretical receipts

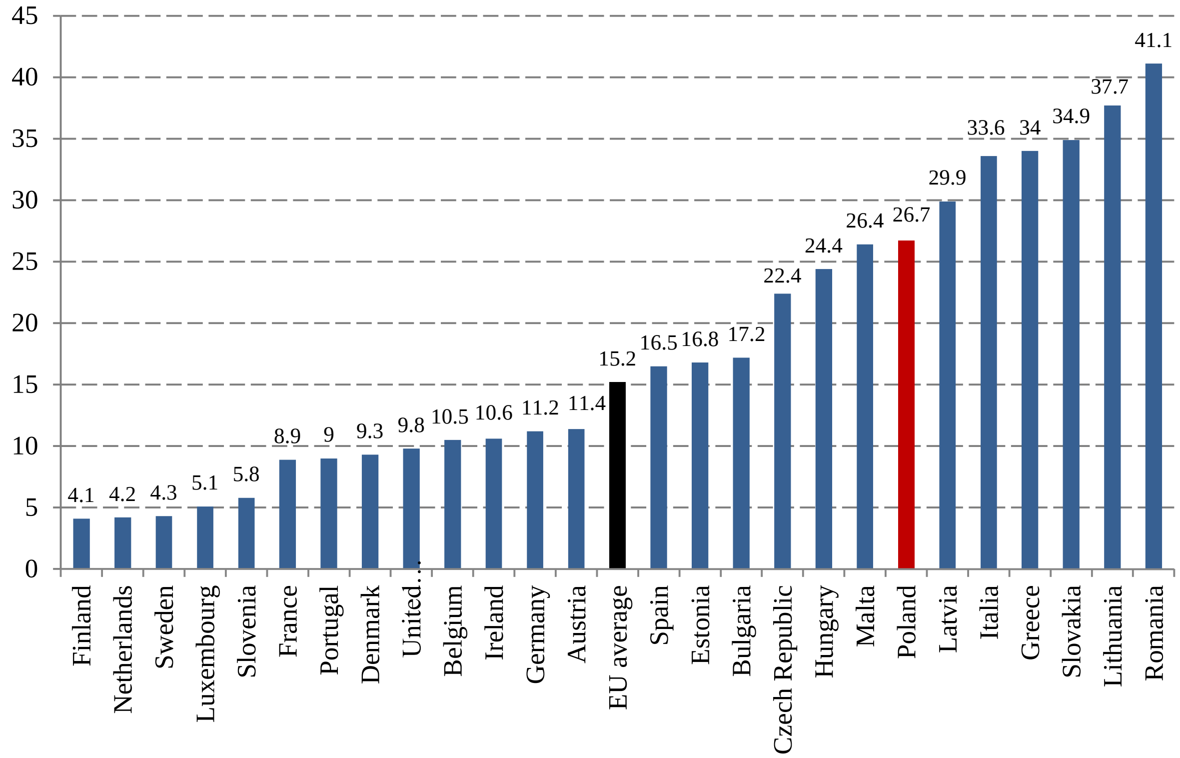


Source: Ministry of Finance

[12] Data for 2014 and 2015 are preliminary due to the lack of statistics to carry out complete estimates.

According to the European Commission (as of end-2013)[13], Poland has one of the highest VAT gaps in the European Union. A higher gap was recorded only in 6 countries. The VAT gap in Poland was higher by 11.5 percentage points from the EU average. The VAT gap below the EU average is recorded only by the countries of the so-called old European Union, excluding Spain and Italy. The countries of the former socialist bloc record the VAT gap significantly higher than the EU average. However, among the emerging markets, better result (lower gap) than in Poland was recorded in the Czech Republic, Hungary, Bulgaria and Estonia.

Chart 5. VAT gap (% of theoretical receipts) in the EU member states in 2013



Source: Ministry of Finance estimates on the basis of the European Commission data

Therefore, the overall assessment of the current fiscal situation cannot be done without taking into account much worse fulfillment of tax obligations in respect of VAT. It should be noted, however, that the relatively unfavorable situation of Poland compared to other Member States as to the VAT gap shows a high potential for additional revenues. Implemented and planned measures aimed at reducing the gap, not only in VAT, can bring an increase in tax revenues.

III.3. Medium-term budgetary outlook

The baseline scenario of the *Programme* foresees that the general government deficit in 2016 will be 2.6% of GDP and in subsequent years 2.9% of GDP, 2.0% of GDP and 1.3% of GDP, respectively.

Deficit scenario for 2016 and 2017 is the result of the implementation of priority reforms of the new government to support inclusive economic growth in the conditions of one of the highest tax gap in the EU, which is a result of fraud and low productivity of tax administration found by the new

[13] For comparison the most recent data from the European Commission covering the EU countries was used. Estimates of the VAT gap relate to 2013. For comparative purposes the percentage index is applied - that is, 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.

government. Increasing the tax efficiency will be gradual, since rapid adjustment of expenditure policy to the erosion of tax revenues (which deepened over many years, cf. Chart 3) would cause too much interference in the implementation of socio-economic policy, and as a result could aggravate fiscal problems, while increasing levels of social exclusion. The reforms promoting family-friendly policies cannot be postponed for the future due to the accrued significant demographic risk factors.

In subsequent years it is assumed a significant fiscal adjustment that will allow the achievement of the medium-term budgetary objective (MTO) just after the year 2019. Fiscal adjustment in the period 2018-19 will be determined by, among others, the following factors:

- moderate increase in the cost of public administration (labor costs and expenditures for the purchase of goods and services) – the impact on the consolidation of approx. 0.4 percentage point of GDP in the years 2018-19;
- moderate growth of pension expenditures, which is a consequence of functioning of the defined contribution scheme and a sustainable downward trend in the number of pensioners – the impact on the consolidation of approx. 0.5 percentage point of GDP in the years 2018-19;
- a significant improvement in the income situation of households and consequently the reduction in the number of families benefiting from social assistance – the impact on the consolidation of approx. 0.2 percentage point of GDP in the years 2018-19;
- savings on debt servicing costs – the impact on the consolidation of approx. 0.1 percentage point of GDP in the years 2018-19;
- measures improving tax compliance – the impact on the consolidation of approx. 0.8 percentage point of GDP in the years 2018-19.

At the same time it was assumed an increase in development-oriented expenditures, i.e. public investments to approx. 4.7-4.8% in the period 2018-19 (against 4.3% in 2016). Additionally, the basic tax rates are maintained unchanged, including rates of excise tax, which due to their nature cause a reduction of tax revenue in relation to GDP by approx. 0.2 percentage point in the years 2018-19.

Factors determining the general government revenues

It is predicted that the ratio of the general government revenue to GDP in the period 2016-17 shall reach 39% and remain at a similar level to that recorded in 2015 (38.9%), and will increase to 39.4% in the years 2018-19.

The level of tax revenue to GDP will be determined by the introduction of two new sectoral taxes and measures improving tax collection.

Social security contributions

The most important source of the general government revenues will be social insurance contributions. Revenues from contributions will depend on the development of the base for their calculation, which main component is the wage fund in the national economy, and on the results of the anticipated changes to the system. The nominal growth rate of the wage fund, after the increase in 2015 by approx. 4.2% yoy, should accelerate in the coming years, although remaining below the nominal GDP growth rate. In relation to GDP, social security contributions in the years 2016-19 will amount to 13.7%, 13.6%, 13.4% and 13.3%, respectively.

A systemic factor, which will affect the amount of social insurance contributions is the amendment to the *Act of 13 October 1998 on the social insurance system*, which broadened the scope of those subject to compulsory retirement and disability pension insurance by persons who are members of the supervisory boards (previously members of the supervisory boards were subject to mandatory health insurance only).

In addition, a rule was introduced that in the case of execution of contracts for mandate or contracts for mandate in confluence with other titles subject to retirement and disability pension insurance, in a situation when the basis of social insurance contributions does not exceed the amount of the minimum wage in a given month, titles of insurance are accumulated (and thus also the contribution base for the retirement and disability pension insurance).

Moreover, farmers and household members performing civil law contracts (e.g. contracts for mandate) whose agricultural activities constitute a permanent source of income, and who therefore are subject to social insurance of farmers will be able to continue voluntarily insurance in KRUS, despite the requirement to join insurance in ZUS under civil law contracts, if their monthly income from the exercise of civil law contracts does not exceed half of the minimum wage (exceeding this threshold means exclusion from the farmer system).

Taxes on production and import

Another important source of the general government revenues are receipts from taxes on production and import, among them mainly indirect taxes. In relation to GDP, these taxes shall amount to 13%, 12.7%, 12.9% and 12.9% in the years 2016-19. Decrease in the ratio of this group of taxes in 2017 is due to both the lower relation to GDP of taxes on producers and the slight decrease in the relation of indirect taxes to GDP. In the case of taxes on producers it should be noted that in 2017, as well as in subsequent years, it is not assumed to occur, as it will take place in 2016, one-off revenue related to the restoration of the mandatory reserves of banks under the Fund for Protection of Guaranteed Assets, which reserves, were used for the payment of guaranteed deposits to depositors of the Cooperative Bank for Agriculture and Crafts[14] (in 2015, those payments, according to the methodology of ESA2010, were recorded as the general government expenditures). Increase of indirect taxes in 2017 is a result of measures to improve collection of indirect taxes and it will mitigate, assumed in the baseline scenario, the effect of lower VAT rates.

The most important indicator of the VAT tax base is private consumption, which is forecasted to accelerate the pace of growth in 2016, but growth in nominal terms will remain at a slightly lower level than the nominal GDP growth throughout the forecast horizon. As regards VAT, it assumed that improvement of tax collection which will allow to maintain in 2017 a VAT in relation to GDP at constant level – despite a reduction of tax rates. In subsequent years this ratio should gradually increases by approx. 0.2 to 0.3 percentage point of GDP annually.

Throughout the forecast horizon no changes in rates of excise duty were assumed, which in this case, due to the fact that most of the rates of excise duty are expressed in amounts (only in the case of excise duty on cigarettes the amount-percent rate is applied and in the case of excise duty on passenger cars – the percentage one), causes automatic and continuous reduction in the relation of revenues from the excise tax to GDP. This reduction is faster, when the GDP deflator increases faster. Additionally, other changes were taken into account, such as e.g. the introduction of exemptions for taxpayers from excise tax on electricity used for purposes of chemical reduction, in electrolytic, metallurgical and mineralogical processes as well as for energy-intensive undertakings – that will slightly lower the growth rate of revenues from excise taxes in 2016. As concerns the excise tax, an introduction of a number of facilities for entrepreneurs being the payers of excise tax is planned. These changes will be administrative and procedural in nature and should not significantly affect the revenue stream. As a result, the ratio of revenue from excise tax in the forecast horizon will be reduced by approx. 0.1 percentage point of GDP per year, partly compensated by VAT revenues.

The category of taxes on production and import also includes revenue from the new sector taxes – taxes on certain financial institutions and retail sales tax. In 2017, it was assumed an increase of these taxes (due to the full-year effect), in the following years a nominal stabilization was assumed.

Taxes on income, wealth, etc.

Taxes on income and assets in relation to GDP over the forecast horizon grow from 7.0% of GDP in 2016 to 7.5% in 2019.

Receipts from income taxes (PIT and CIT) will depend on the evolution of their base, namely, first of all the income from labor, pensions and corporate profits, as well as systemic changes. According to

[14] By the decision of Eurostat of April, FOŚG was included into the general government.

the proposed measures, it will be introduced a lower – 15% CIT rate, which will cover the taxpayers whose income from the sale, together with the amount of VAT did not exceed the equivalent of 1.2 million euros in the previous fiscal year. This preference will be also applied to the taxpayers starting the activity, which will create incentives for newly created businesses by increasing the potential return on investment. In the baseline scenario, the changes of the main parameters of the tax (tax brackets, deductible expenses and the amount deducted from the tax), as regards the personal income tax, are not assumed.

In the case of CIT it was assumed also the increased tax collection rate, which allows us to expect a slight increase in the relation of revenue from this source to GDP in the coming years.

Improving tax compliance

In the following years the tax revenues will be determined not only by the macroeconomic situation, but also by the planned systemic changes, which will be mainly focused on strengthening the enforcement of taxes, through the fight against pathologies of both criminal nature, involving a fraud of tax in respect of VAT as well as fight against using aggressive tax optimization and avoidance of taxation of profits in the country of their origin. For this purpose, we have developed a package of measures to increase the degree of respecting tax obligations by taxpayers and the fight against tax fraud (cf. Annex), which includes i.a.:

- the introduction of the *General Anti-Avoidance Rule* – GAAR), whose objective is to combat artificial structures and transactions, usually containing foreign components, typically used by large corporations to avoid payment of tax;
- reducing the limit on cash transactions between companies from EUR 15 000 to PLN 15 000, aimed at increasing the number of transactions between undertakings made in non-cash form, and thereby reducing the number of tax frauds related to the issuing of unreliable invoices;
- organizational changes in the tax and customs administration - establishment of the National Fiscal Administration, which will allow for better use of key competencies already possessed by the existing services and their concentration, increasing the efficiency of collection by reducing the costs of servicing the primary and secondary processes, and consequently increase the revenues by reducing the tax gap;
- computerization of auditing the tax books – the introduction of the *Standard Audit File*, and thereby unification of reports from tax books and accounting documents, providing access to the data unfit for analysis;
- establishing a special purpose company by the State Treasury, which will carry out the tasks related to the modernization and expansion of information and communication systems of the Ministry of Finance to support the tax administration and fiscal control in the detection of violations of tax law;
- establishing the Register of Debtors of Public Liabilities, thanks to which fiscal discipline and state budget revenues will increase, through the creation of an instrument encouraging debtors to voluntary payment of liabilities, reduction of costs for recovery of debts, as well as reducing the size of the liabilities, which would expire as a result of ineffective enforcement of taken measures.

It is expected that implementation of these measures will help to increase tax revenues in the *Programme* horizon from PLN 22 to 33 billion.

Table 1. Financial effects of the measures improving tax compliance in the years 2017-19

Financial effects*		2017	2018	2019
Revenue (in PLN billion)	min.	6.5	11.9	21.7
	max.	16.7	27.0	33.4

Source: Ministry of Finance estimates
** - presented on a cumulative basis*

Factors determining the general government expenditures

The ratio of general government expenditures to GDP will amount to 41.6% in 2016, i.e. the level of approx. 0.1 percentage point higher than in 2015. In subsequent years, the ratio will amount to 41.9%, 41.4% and 40.7% respectively. As a result, expenditures to GDP ratio will be reduced by approx. 1.4 percentage point by 2019. The level of expenditures over the forecast horizon does not exceed the amounts implied by stabilizing expenditure rule (cf. chapter III.4).

Social transfers

A significant impact on the increase in expenditure over the forecast horizon, and therefore on the shape of fiscal policy will be exerted mainly by the government measures aimed at an active pro-family policy of the state (*Family 500 plus* programme) and in the area of social policy. The main goal of the *Family 500 plus* programme (cf. Chapter II.3, and V.1) is to support families bringing up children and to counteract the demographic decline in Poland, by granting families the new child benefit.

In addition to *Family 500 plus* programme the additional measures were implemented to support the poorest persons. The key change is the verification of thresholds and the amount of family allowances. The income thresholds for entitlement to family benefits will be raised in two stages: November 1, 2015 by PLN100, and on November 1, 2017 by a further PLN 80, which together will give an increase by approx. 30% (31.4% for general criterion and 27% for the criterion for a family with a disabled child). Simultaneously the amounts of family benefits will be increased (in three stages) and some additions to the family allowances.

Since January 1, 2016, a new allowance is effective for families in which children will be born – the parental allowance in the amount of PLN 1000 per month (depending on the number of children born at the delivery, from 52 to 71 weeks) for parents, who are not entitled to maternity benefit or maternity salaries. Thus, it is anticipated that the benefit will go primarily to families affected by unemployment, students, farmers and working on civil contracts. The Act provides also for the alignment of the maternity benefits to the amount of PLN 1000, if the person is entitled to a lower amount of the benefit.

The measure affecting the amount of expenditures on family benefits is also the introduced gradual withdrawal of family benefits in accordance with the principle of "1 PLN for 1 PLN" from 1 January 2016. This mechanism involves reduction of benefits by the amount of income per family in excess of the established criteria. It is expected that the changes have a positive effect on the labor supply of beneficiaries of family benefits.

In addition, some measures has changed income thresholds and the amount of certain allowances, which result from the *Act of 12 March 2004 on Social Assistance*. From 1 October 2015, there are higher income thresholds for entitlement to social assistance allowance (for a single person – an increase from PLN 542 to PLN 634, and for a person in the family - from PLN 456 to PLN 514). The thresholds affect the amount and the number of entitled to temporary benefit granted i.a. because of long illness, disability, unemployment (system of gradual withdrawal of allowances as it approaches the threshold of income). In addition the maximum amounts of certain benefits were also increased, the most important of which is the permanent benefit (from PLN 529 to PLN 604) addressed to persons meeting the income threshold, unable to work because of age or totally unable to work. As a result, the expenditures on social assistance will increase from 2.1% of GDP in 2016 to 3.3% of GDP in 2017. In the next few years they will remain at the level of approx. 3% of GDP.

Payments of social security benefits will be determined by the annual indexation of retirement and disability pensions, determined by the inflation and real wage growth recorded in the previous year. It should be remembered that the majority of pensions in the non-agricultural social insurance system will be from the defined contribution scheme. Additionally, the number of persons receiving disability benefits will continue the downward trend, which is the result of a more restrictive granting of those benefits.

In 2016 the indexation of retirement and disability pension benefits was made using the indexation rate amounting to 100.24%. In addition, people receiving the lowest benefits (less than PLN 2 000) were given a single allowance designed to offset the low rate of indexation. The amounts of allowances are varied depending on the amount of retirement or disability pensions: PLN 400 – if the benefit or sum of benefits payable to an entitled person does not exceed PLN 900, PLN 300 – for benefits between PLN 900 and PLN 1100, PLN 200 – for benefits between PLN 1 100 and PLN 1 500 and PLN 50 – for benefits between PLN 1 500 and PLN 2 000. According to the *Act of 15 January 2016 on one-time extra cash allowance for some retired, disabled persons and persons receiving pre-retirement benefits, pre-retirement allowances, bridging pensions or teachers' compensation benefits in 2016* the maximum limit of expenditures being the financial result from the payment of these allowances is PLN 1.4 billion. The forecast of the amount of retirement and disability benefits for 2017 includes the one-time allowance of a similar amount.

Since March 1, 2016 the new amounts of the lowest retirement and disability pensions apply additionally, as well as the amounts of allowances and cash benefits paid together with the retirement or disability pensions, or by itself, as well as the maximum amount of reduction of retirement and disability pensions when pensioner is achieving income from gainful activity.

Taking into account the macroeconomic parameters and, among others, actuarial projections of ZUS and KRUS it is forecasted that during the expected acceleration of nominal GDP growth, the amounts of those social security benefits will grow more slowly than nominal GDP, which will contribute to reducing the deficit in subsequent years.

Public investments

Public investments, which in accordance with the recommendations of the Ecofin Council should not be subject to consolidation, after a slight decline to 4.3% of GDP in 2016, resulting mainly from the termination of the EU financial perspective for 2007-13, shall accelerate in the coming years, staying on the average in relation to the GDP at a level of approx. 4.7% - above the EU average amounting to approx. 3.1% in the years 2010-15 – within the whole forecast horizon.

The level of general government investments will be determined by multiannual governmental programs, particularly in the area of infrastructure and by the implementation of the EU financial perspective for 2014-20. The investment projects related to construction and reconstruction of national roads and motorways are funded from the means of the National Road Fund (KFD), as well as from the state budget. The objectives and priorities for the development of road infrastructure (including maintaining the proper technical condition of the road network already existing) together with indications on level and sources of the necessary financing, in particular the use of the new EU financial perspective for 2014-20, are included in the *National Road Construction Programme for 2014-2023 (with the prospect until 2025*).

At the beginning of 2016 the government has taken the initiative, whose goal is to optimize the implementation of road projects included in the *National Road Construction Programme*, both in the legal and technological context as well as financial. Due to the fact that the limit of the *National Road Construction Programme* amounts to PLN 107 billion, while the value of the tasks contained therein is approx. PLN 200 billion, it is necessary to take measures to ensure funds for the implementation of this program. On January 15, 2016, the Steering Committee was set up with five working groups for techniques and technologies – a recommendation of optimal solutions for planning and construction of roads; public procurement – a recommendation of the ordering model friendly to contracting authorities and contractors; general law – verification of existing regulations and recommendations of changes; infrastructure financing – examination of the methods for development of funding sources; contract forum – to develop a model of cooperation between construction companies and investors. On April 7, 2016, the Minister of Infrastructure and Construction presented the recommendations of the Steering Committee for optimization of the road investment implementation process, forming a package of measures that will lead to the improvement of the road construction process and reduction of its costs, which shall allow the realization of all investments entered into the *Programme*.

These recommendations include:

- development of a catalog of typical solutions of engineering structures: bridges, viaducts, overpasses, culverts;

- separation of the financing of facilities and equipment necessary for road traffic control from the financing of facilities and equipment for the environmental protection and the revision and re-analysis of excessively stringent provisions of environmental decisions;
- in the field of financial measures: the development of financing sources of the KFD, including a fuel charge; expanding the road network covered by the electronic toll collection from heavy vehicles (via TOLL) and the change in the structure of charges; the use of the model of the road special purpose company in the implementation of road projects and an analysis of opportunities for the involvement of private partners in the implementation of road projects.

The other major multiannual programme determining the investment level of the sector is the *National Railway Programme to 2023*, including the capital expenditures for the construction and modernization of railway lines, operated by PKP PLK S.A. These investments are financed by the Railway Fund, the state budget, EU funds and the own resources of PKP PLK S.A., coming from EIB loans and the issuance of bonds. According to the *National Railway Programme to 2023* and financial projections of PKP PLK S.A., after a temporary decline in capital expenditures in 2016, which is associated with the gradual use of funds from a new EU perspective, from 2017 spending will be expedited.

In addition, the level of the general government investments will be determined by the scale of the local government investment expenditures. It is forecasted that the investments of local government units will be influenced decisively by the absorption of EU funds from the new financial perspective for 2014-20. It is expected that the implementation of the investments of local government units from EU funds will be in such areas as urban transport, low-carbon economy, revitalization, environmental protection (with particular emphasis on water conservation). It is worth noting that local governments will have to bear significant financial outlays to adapt their infrastructure to the requirements of environmental protection, including water and wastewater management (construction and/or modernization of wastewater treatment plants, sludge network reconstruction, construction of sewage systems). Undoubtedly the conduct of investments by local governments will be facilitated by a new instrument – Integrated Territorial Investments – facilitating the investments in the administrative area of more than one unit of local government.

Investments in the local government and the absorption of EU funds should be encouraged by the provisions of the *Public Finance Act*, because throughout the period of liability repayment, the redemptions of securities, repayments of loans and borrowings, together with accrued interest and discount are excluded from the debt limits, respectively, issued or incurred in connection with an agreement on the implementation of the program, project or task financed at least in 60% from the non-returnable aid from the EU in the part of expenditures on national contribution funded with these liabilities. Current regulations *de facto* exclude the liabilities incurred to finance the investments co-financed with the EU funds from the debt limits, which should encourage local governments to change the structure of expenditures towards increasing the level of investment. This favors the minimization of cuts in growth-enhancing investments in infrastructure recommended by the Ecofin Council.

In addition, since 2016 local government units can create shared service centers, i.e. the units providing common services (in particular the administrative, financial and organizational) for local organizational units without legal personality or local government legal persons belonging to the public finance sector. This measure, in addition to increasing the independence and flexibility of local government units, will contribute to a better use of resources, reduction of operating costs and specialization and thus to generate savings in the current part of the budget, which the unit will be able to spend on investments. Savings in the current part of the budget will also contribute to improve the ability of local governments to contract liabilities, referred to in Article 243 of the *Public Finance Act*.

Other current expenditures

An important factor determining the expenditures is also the development of labor costs in the general government.

It is assumed in the draft Budget Act for 2016 that remuneration in state budgetary units for employees covered by the provisions of the *Act of 23 December 1999 on the shape of remunerations in the* *government sector and on change of some other acts*, in comparison to 2015, shall increase by approx. PLN 2 billion. This amount includes additional funds for remunerations for groups of employees, which – as a rule – from 2010 were subject to "freeze", wherein that amount applies only to wages and salaries in state budget units covered by the above mentioned Act.

In subsequent years, i.e. from 2017 onwards, with the improvement of the fiscal situation and within the expenditure limit from the stabilizing expenditure rule, a gradual increase of the wage fund of state budget units is assumed, with simultaneous maintaining of the currently existing indexation systems for a part of employees of the general government. For example, in accordance with the provisions of the Act, the basis for determining the basic salary of a judge in a given year is the average wage in the national economy in the second quarter of the previous year but not less than the previous base.

As a result, labor costs in the general government in relation to GDP in the period 2016-19 will be at the level of 10.0%, 9.8%, 9.5% and 9.4% respectively.

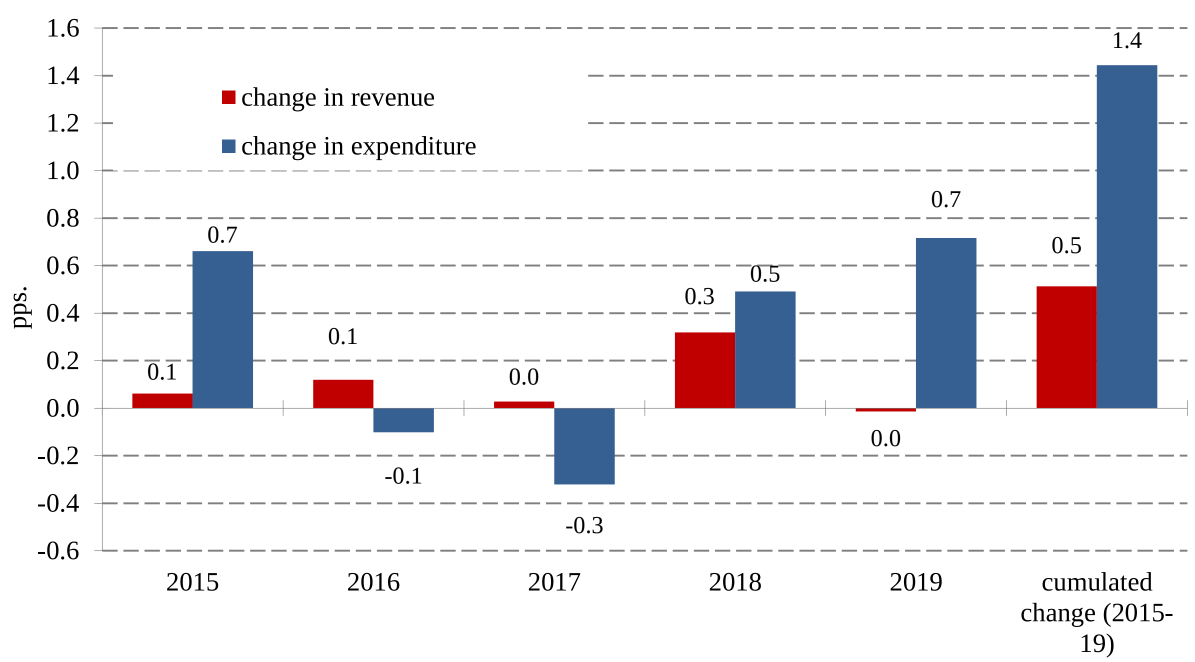
Throughout the forecast horizon it was assumed that the rate of growth of intermediate consumption, i.e. purchases of goods and services implemented by the sector, with the exception of EU funds will grow at a rate of nominal GDP growth.

In 2016, a single factor affecting the general government expenditures will be proceeds from the so-called “digital dividend” (sales of reservations of selected LTE frequencies through auction).

In 2017, the decrease in debt servicing costs will result from replacing higher interest-bearing debt bonds with lower coupons and to some extent from the assumed strengthening of the zloty. From 2018 onwards, the average interest rate on the general government debt will stabilize, and the ratio of debt servicing costs to GDP will result primarily from the falling debt to GDP ratio.

As a result, it is forecasted that the general government deficit will be 2.6% of GDP in 2016 and in subsequent years 2.9% of GDP, 2.0% of GDP and 1.3% of GDP, respectively.

Chart 6. The impact of changes in revenue and expenditures for the general government balance in relation to GDP

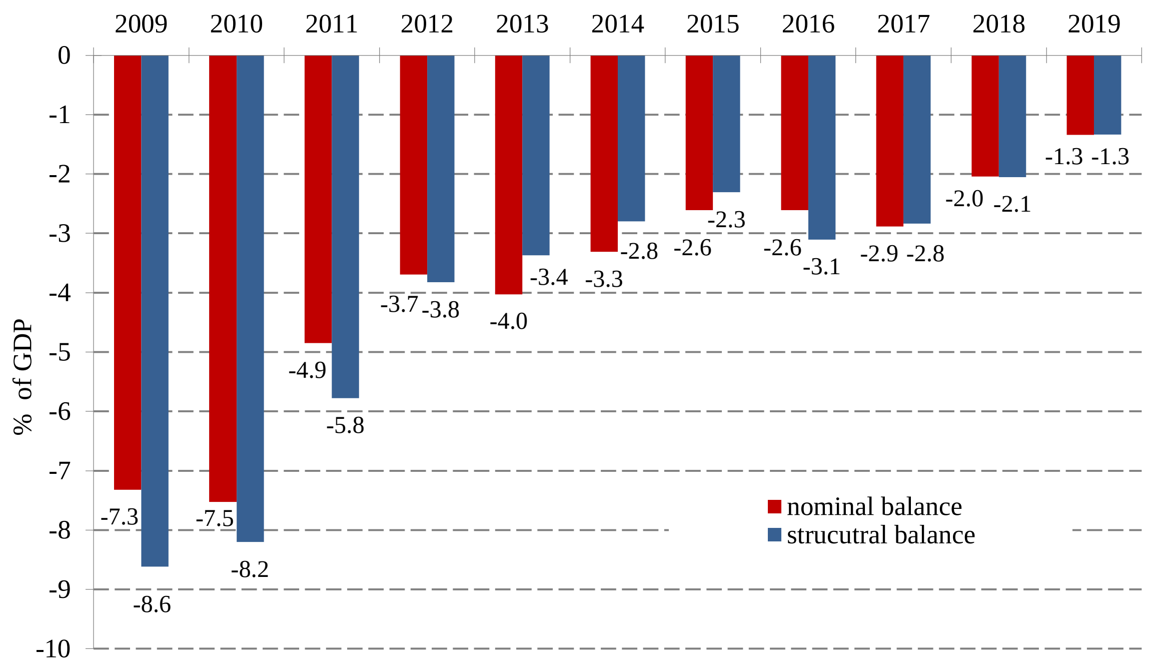


Source: Ministry of Finance
Explanations: revenue – “plus” column means an increase of the share of revenue to GDP for respective years, “minus” column – the decrease. Expenditure – “plus” column means the reduction of the share of expenditure to GDP for respective years, “minus” column – the increase.

III.4. Structural balance

Poland has adopted its medium-term budgetary objective, i.e. target for structural balance of the general government at the level of -1% of GDP. On the basis of the matrix, which specifies the annual fiscal adjustment towards the MTO under the preventive arm of the *Stability and Growth Pact*[15], until the MTO is reached, the improvement in the structural balance should be 0.5 percentage point of GDP (assuming that the output gap in Poland will be within ± 1.5%, and the debt will remain at a level below 60% of GDP). According to the European Parliament and Council Regulation No 1175/2011[16], the assessment of the fulfillment of the preventive arm of the *Stability and Growth Pact* by the member state is based on two pillars: a structural effort (change in the structural balance) and expenditure benchmark.

Chart 7. Nominal and structural balance of the general government



Source: Ministry of Finance

In the baseline scenario of the *Programme*, which assumes, in particular the implementation of the package of measures improving tax compliance, as described in the Annex, it is forecasted that in the years 2015-19 the structural deficit (see chart 7) will be significantly reduced, from 2.8% of GDP in 2014 to 1.3% of GDP in 2019. The following one-off measures were taken into account to perform the calculation of the structural deficit:

— reduced VAT revenues on a cash basis due to changes in the provisions on the settlement of VAT on the import by authorized economic operators (AEO) in the amount of PLN 0.6 billion in 2015;

— net effect of the adjustments of the EU budget resulting from the revision of VAT and gross national income in the amount of PLN -0.8 billion in 2015 and PLN -0.7 billion in 2016;

[15] Communication from the Commission – *Making the best use of the flexibility within the existing rules of the Stability and Growth Pact (COM/2015/012).*
[16] *Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.*

- expenditures of the Fund for Protection of Guaranteed Assets (FOŚG) for the disbursement of guaranteed funds to depositors of the Cooperative Bank of Crafts and Agriculture, bankrupted in 2015, in the amount of PLN 2.0 billion in 2015;
- revenues of FOŚG resulting from the disbursement of guaranteed funds to depositors of the Cooperative Bank of Crafts and Agriculture in the amount of PLN 2.0 billion in 2016;
- CIT loss due to the decline in bank profits as a result of expenditures for the benefit of FOŚG, in the amount of PLN 0.4 billion in 2016;
- revenues (negative expenditure by ESA) from the sale of LTE frequency reservations through auction in the amount of PLN 9.2 billion in 2016;
- expenditures resulting from a one-off cash allowance for some retirees, pensioners, persons receiving pre-retirement benefits, pre-retirement allowances, bridging pensions or teachers' compensation benefits in the amount of PLN 1.4 billion in 2016 and PLN 1.5 billion in 2017.

Table 2. Cyclical developments

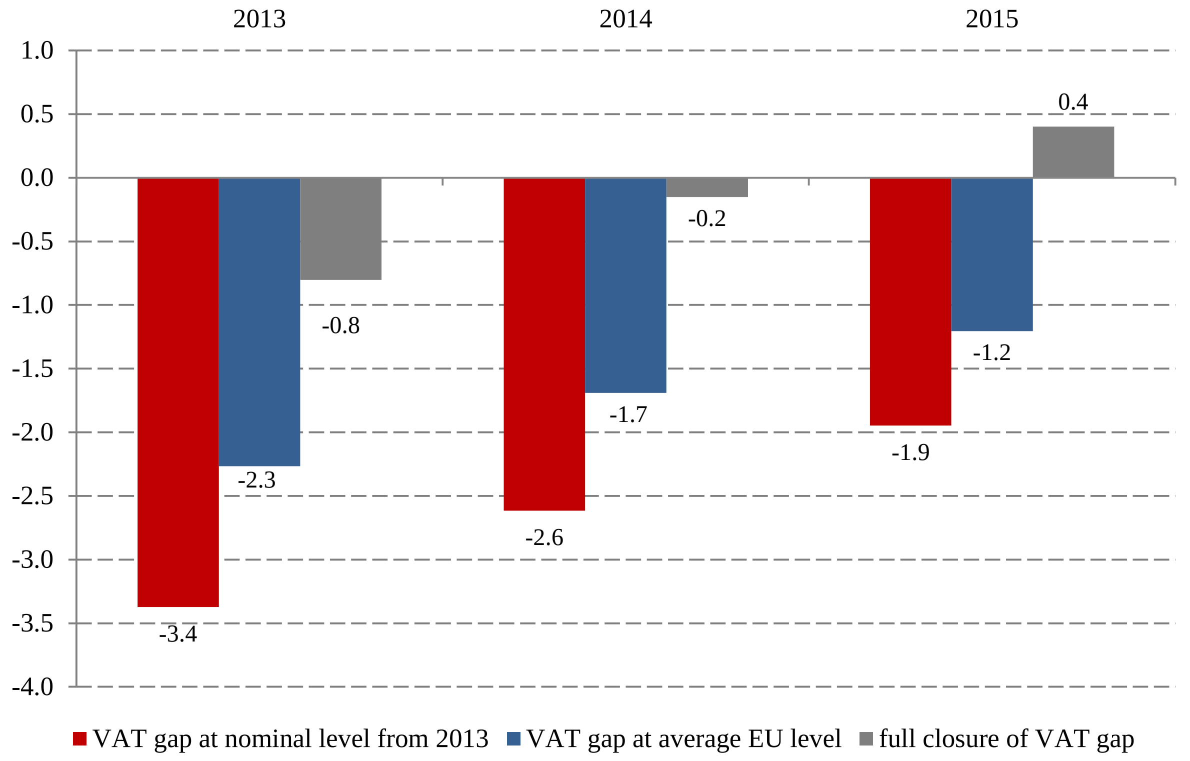
	% of GDP	ESA Code	2015	2016	2017	2018	2019
1.	**Real GDP growth** (%)		3.6	3.8	3.9	4.0	4.1
2.	**Net lending of general government**	EDP B.9	-2.6	-2.6	-2.9	-2.0	-1.3
3.	**Interest expenditure**	EDP D.41	1.8	1.7	1.5	1.4	1.4
4.	**One-offs and temporary measures**		-0.2	0.5	-0.1	0.0	0.0
5.	Potential GDP growth (%)		3.1	3.5	3.9	4.0	4.1
6.	Output gap		-0.2	0.0	0.0	0.0	0.0
7.	Cyclical budgetary component		-0.1	0.0	0.0	0.0	0.0
8.	Cyclically-adjusted balance (2-7)		-2.5	-2.6	-2.9	-2.1	-1.3
9.	Cyclically-adjusted primary balance (8+3)		-0.7	-1.0	-1.4	-0.6	0.1
10.	**Structural balance (8-4)**		-2.3	-3.1	-2.8	-2.1	-1.3

Source: Ministry of Finance

According to the Ministry of Finance estimates, the structural effort in 2015 amounted to 0.5 percentage point of GDP, meeting the requirements resulting from the adjustment path towards the MTO. This adjustment was achieved through a restrictive expenditure policy while problems associated with the revenue side of public finances, precisely – the tax gap, particularly the VAT gap, remain. In subsequent years a gradual achievement of the MTO is planned. As indicated above, the rapid adjustment of expenditure policy to the erosion of tax revenues would cause too much interference in the implementation of socio-economic policy and as a result could aggravate fiscal problems. Thereby, in the following years, the government measures will be focused on combating tax fraud and thereby rebuilding the stream of public revenue (cf. Annex).

Chart 8 presents the structural balance scenario simulations for the years 2013-15, illustrating the potential effects of reducing the VAT gap (cf. also Chapter III.2). The simulation shows that reducing the gap to the average level in the EU would be almost sufficient to achieve the MTO already in 2015.

Chart 8. Structural balance assuming hypothetical scenarios



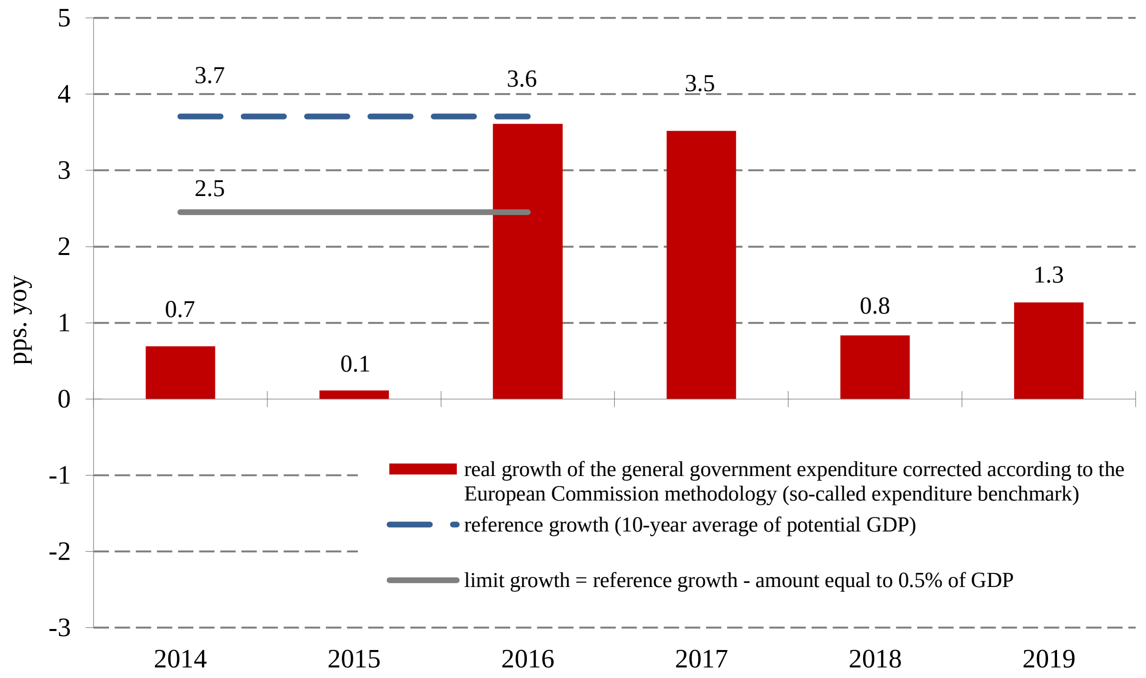
Source: Ministry of Finance estimates on the basis of the European Commission data

The second pillar of the assessment of the progress towards the MTO is the annual rate of general government expenditures – adjusted according to the methodology used by the European Commission (expenditure growth is modified, among others, by subtracting from it the discretionary measures on the revenue side, cf. Table 3), which should not exceed the reference rate minus the amount corresponding to the required adjustment towards the MTO, i.e. 0.5% of GDP. The reference rate (10-year's average of the real growth of potential GDP (t-5, t+4)) used for evaluation of the expenditures of Poland amounts currently to 3.7%, which after the adjustments resulting from the need to achieve the MTO gives the required limit rate equal to 2 5%.

In 2015, Poland has fulfilled with a very large safety margin the above mentioned requirement for the rate of expenditure growth (the so-called "expenditure benchmark"). The annual real rate of spending modified according to the methodology of the European Commission amounted to only 0.1%. Due to the accelerated adjustment in the 2015 the analysis of 2016 should be conducted on basis of two years average. Thus, in the years 2015-16 the expenditure benchmark will be met[17] despite negative inflation surprise in the years 2015-16[18].

[17] The projected growth rate of expenditures in 2016 exceeds the limit rate to less extent than the positive deviation in 2015.
[18] If the GDP deflator in 2016 had been at the level of long-term average, the requirement for expenditure growth would be satisfied with a safety margin .

Chart 9. General government expenditure modified according to the methodology of the European Commission



Source: Ministry of Finance

A similar concept to expenditure benchmark is the stabilising expenditure rule (SER)[19], which has determined the level of public expenditure in Poland since 2015 (more in chapter VII.1). The adjustment by 0.5% of GDP, required in the benchmark, is also built in the correction mechanism of the SER. It requires a reduction in expenditure dynamics by 1.5-2 percentage points in the situation of public finance imbalance, caused by accumulated deviations from the MTO or by exceeding the reference values, set out in the *Public Finance Act*, by the general government deficit or public debt. However, the level of expenditure of the stabilising expenditure rule is obtained with the use of the inflation target, reflecting the medium-term price dynamics, while requirements for expenditure benchmark refer to the GDP deflator forecasted for the given year. Therefore, in periods of significant negative inflation surprise the requirements from the expenditure benchmark are excessively restrictive and do not include downward rigidity characterizing most categories of expenditures.

According to the *Public Finance Act*, an update of the *Convergence Programme* which is part of the *Multiannual Financial Plan of the State* determines the preliminary level of expenditure on the basis of the stabilising expenditure rule. The estimation of the level of expenditure for 2017 consistent with the stabilising expenditure rule was made on the basis of the level of expenditure for 2016 equal to PLN 728 465 733 thousand[20] specified in Article 1 of the Budget Act for 2016 and the total GDP dynamics in the years 2010-15 at fixed prices published by the Central Statistical Office of Poland

[19] The differences between the rules are following: application of the 8-year average of the real growth of GDP in the SER instead of the 10-year average of potential growth of GDP in the benchmark, the inflation target instead of the average GDP deflator forecast, as well as absence in the SER of an exclusion of the debt servicing costs and cyclical component of unemployment benefits, and finally replacing the in-year investment level with the 4-year average.

[20] Detailed calculation of the level of expenditure for the year 2016, in accordance with point 6a and 6b of Article 142 of the *Public Finance Act*, was included in the explanatory memorandum to the draft Budget Act for 2016.

(GUS) on April 15, 2016, and on the forecasts of the real GDP growth, adopted to prepare the *Programme*. As a result, to obtain the level of expenditure for 2017 the following indicators were used:

- 1.0325 – medium-term GDP growth indicator,
- 1.025 – Monetary Policy Council (NBP) inflation target,
- -1.5 percentage point – correction due to the public finance imbalance,
- PLN 2.8 billion – forecast value of the total discretionary measures, which is a result of measures increasing tax compliance, reducing VAT rates and negative effect of the establishment of the Borrowers' Support Fund in 2016.

As a result, the estimated level of expenditure for 2017 amounts to PLN 762 544 230 thousand (38.8% of GDP).

On the basis of Article 112aa of the *27 August 2009 Public Finance Act* the level of expenditure for 2018-19 was estimated too. In line with the correction mechanism, the adjustment in expenditure dynamics due to public finance imbalance in the years 2018-19 will be -2 percentage points, which is a result of exceeding by the forecasted public debt, calculated in accordance with Article 38a point 4 of the *Public Finance Act*, the threshold of 48% of GDP in the years 2016-17. The estimated level of expenditure for 2018 amounts to PLN 799 768 738 thousand (38.4% of GDP), while for 2019 – PLN 837 600 112 thousand (37.7% of GDP).

Table 3. Level of expenditure in 2016-19

	2016	2017	2018	2019
Medium-term GDP growth indicator	1.0314	1.0325	1.0330	1.0320
NBP inflation target	1.025	1.025	1.025	1.025
Correction*	-1.5	-1.5	-2.0	-2.0
Total value of discretionary measures (in PLN billion)	10.0	2.8	8.0	8.0
Level of expenditure – *Convergence programme. Update 2016*	728.5**	762.5	799.8	837.6

Source: Ministry of Finance
** - according to Art. 112aa Act of 27 August 2009 on Public Finance*
*** - estimated on the basis of a starting point, defined in Art. 2 of Act of 10 December 2015 amending the Public Finance Act, and taking into account inflation forecast errors for 2014-15*

III.5. General government debt

In the *Programme* horizon the debt management will be focused, as in previous years, on achieving the objective set out in *the Public Finance Sector Debt Management Strategy*, i.e. minimization of debt servicing costs in the long term, subject to assumed constraints on risk.

Debt management will be conducted at the conditions of continuing uncertainty in the financial markets, resulting, among others, from the divergence in monetary policy conducted by the ECB (continuation of quantitative easing) and the Fed (expectations of interest rate hikes and the normalization of monetary policy), as well as the economic slowdown in China, affecting the increase of investors' risk aversion. Measures related to the reduction of the general government deficit should have a significant impact on the level and shape of the yield curve, and thus the costs of servicing the State Treasury debt.

Changes in the ratio of debt to GDP in the period 2016-19 will result mainly from the borrowing needs of the state budget (the State Treasury debt represents more than 85% of the general government debt), the GDP growth rate and the exchange rate of zloty against other currencies, especially euro.

Changes in the debt of other general government units will result mainly from the change in the debt of the National Road Fund (the increase in debt will be associated with financial obligations incurred for the implementation of road projects) and from stabilization of the debt of local government units.

It is expected that in the *Programme* horizon, the debt, as defined by the EU, to GDP ratio, after rising to 52.5% in 2017 will decrease in subsequent years, reaching the level of 50.4% at the end of 2019.

Table 4. General government debt (end of the year)

	% of GDP	ESA Code	2015	2016	2017	2018	2019
1.	**Gross debt**		51.3	52.0	52.5	52.0	50.4
2.	**Change in the gross debt ratio**		0.8	0.7	0.4	-0.5	-1.6
	Contributions to changes in gross debt						
3.	**Primary balance**[1)]		0.8	0.9	1.4	0.6	-0.1
4.	**Interest expenditure**	EDP D.41	1.8	1.7	1.5	1.4	1.4
5.	**Stock-flow adjustment**		-1.8	-1.8	-2.4	-2.5	-3.0
	of which: difference between cash and accruals		1.0	0.6	-0.1	0.0	0.0
	net accumulation of financial assets		-0.9	-0.1	0.7	0.9	0.5
	of which: privatisation proceeds		0.0	0.0	-0.1	0.0	0.0
	valuation effects and others		-1.9	-2.3	-3.0	-3.4	-3.5
	p.m. implicit interest rate on debt (%)		3.7	3.3	2.9	2.9	2.9
Other relevant variables							
6.	Liquid financial assets		3.2	3.1	3.0	2.8	2.7
7.	Net financial debt (=1-6)		48.1	48.9	49.5	49.2	47.7
8.	Debt amortisation (existing bonds) from the end of the previous year[2)]		4.2	4.7	4.5	4.1	4.2
9.	Percentage of debt denominated in foreign currency (%)		35.0%	34.1%	33.5%	33.1%	32.5%
10.	Average maturity[3)]		5.2	5.0-5.2	5.0-5.2	4.9-5.2	4.9-5.3

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.6. Budgetary implications of "major structural reforms"

Due to the ongoing work on the final version of new socio-economic policy measures, the presented baseline scenario does not include the discussed changes to the statutory retirement age and the amount of tax-free income. Current proposals for changes in these areas and their potential effects on the general government are presented below.

Retirement age

The draft act on amending the law on retirement and disability pensions from the Social Insurance Fund and other acts, presented by the President of the Republic of Poland, assumes restoration of the retirement age to at least 60 years for women and to at least 65 years for men. According to the draft act the proposed changes should have come into force on 1 January 2016. The draft act was subject to a first reading at the session of the Sejm on 9 December 2015, and was referred to the Parliamentary Committee on Social Policy and Family for consideration. At the meeting held on December 15, 2015, the Commission adopted a resolution on public hearing. The public hearing was held on January 12, 2016. However, at a meeting of the Committee on Social Policy and Family held on March 10, 2016, the Commission's presidium proposed to transfer this draft act to the work in the extraordinary sub-committee. Legislative work in the sub-committee has not yet been taken.

The effects of the proposed restoration of the retirement age to at least 60 years for women and to at least 65 years for men from 2017 are shown in Table 5.

At the same time Task Force for Social Security in the Council for Social Dialogue has undertaken works on defining conditions for acquisition of pension rights. The goal of the Council's work is not only to reach an agreement on the reduction of the retirement age, but also on the possibility of early retirement after working for a reasonably long period of time. At the moment there is no final agreements and decisions as regards lowering the retirement age for men and women. However, currently discussed proposal assumes stopping the changes in the retirement age at a level of 61 years for women and 66 years for men. Additionally, introduction of a requirement with regard to the contribution period entitling to retirement, together with requirement to work out at least a minimum pension, is also considered.

Freezing the retirement age at 61 years for women and at 66 years for men would result in a significant reduction in the effects for the public finance sector. According to preliminary estimates of the Social Insurance Institution (ZUS), the changes would be almost neutral for public finances in the first year of the reform, leading to a systematic increase in the deficit of the Social Insurance Fund (FUS) in further years compared to a scenario of no changes in the retirement age. However, in the *Programme* horizon the effect on the general government balance of this variant would be significantly lower than in the presidential one.

Tax-free amount

The *draft act on amending the act on personal income tax* presented by the President of the Republic of Poland assumes increasing the amount decreasing the tax from PLN 556,02 to PLN 1.440. This would increase the tax-free amount from PLN 3.091 to PLN 8.000 and increase the amount decreasing the income tax-advance from PLN 46,33 to PLN 120. The project was the subject of a first reading at the sitting of the Sejm on 9 December 2015, and was referred to the Public Finance Committee for consideration. Legislative work on the Commission has not yet been taken. The effects of the solution proposed in the Presidential project are estimated to be approx. PLN 21 billion per year.

The Ministry of Finance is working on a government project in this area. A gradual increase of the tax-free amount by PLN 1.000 per year from 2017 until reaching the level of PLN 8.000 is currently under consideration. The effects of the proposal are shown in Table 5. At the same time the issue of introducing the gradual reduction in the tax-free amount, allowing for the realization of social objectives and limitation of the effects of changes in the area of public finances even by up to a quarter per year is under discussion. The project is currently under analytical work.

Moreover, the issue of tax-free amount was raised in the Constitutional Court's judgment of 28 October 2015 (Journal of Laws, item 1784).

Table 5. Estimated impact of planned measures on the general government balance

	Measure		2017	2018	2019
1.	**Expenditure increase as a result of decrease of retirement age to 60/65***	bln PLN	-8.6	-10.2	-11.9
		% of GDP	-0.4	-0.5	-0.5
2.	**Gradual increase of tax free amount (MoF proposal)**	bln PLN	-4.0	-8.0	-12.0
		% of GDP	-0.2	-0.4	-0.5
3.	**Reduction of VAT rates (current regulations)**	bln PLN	-7.2	-7.6	-8.1
		% of GDP	-0.4	-0.4	-0.4

Source: Ministry of Finance and Social Insurance Instituion estimates
** - financial effect for Social Insurance Fund (FUS)*

Measures to ensure the sustainability of public finances

In the context of national and European fiscal requirements, in particular regarding the stabilizing expenditure rule, simultaneous realization of the planned changes in both the retirement age and the tax-free amount would require substantial re- prioritization of expenditure or additional measures on the revenue side, beyond the currently implemented package of measures, focused particularly at reducing the VAT gap within 3 years to the EU average level.

Bearing in mind the above significant implications of planned changes for public finances, which may reduce the fiscal space for the implementation of other measures, the Government during drafting process of the Budget Act for 2017 will make the final decision on the reduction of VAT rates, the effects of which are included in the baseline scenario of the *Programme* (cf. Table 5). According to the Article 146a of the currently binding *Act on the tax on goods and services*, the highest VAT rate of 23% and the minimum of 8% are valid until the end of 2016.

IV. Sensitivity analysis and comparison with the previous update

IV.1. Risk factors

1) Economic situation of Poland's trade partners

The development of economic activity of Poland's major trade partners is a basic risk factor for the macroeconomic forecast presented in Chapter II. The adopted scenario assumes that economic growth in the EU, which is the largest trade partner of Poland, will be consistent with the scenario presented by the European Commission in the Winter edition of forecasts published in February 2016.

The negative risk factors in the European Commission’s economic growth forecast include:

- deeper than expected slowdown of growth in China coupled with the normalization of monetary policy in the US, which may threaten the foundations of global economic growth. Materialization of such a scenario may also result in increased volatility in the financial markets, further increasing the risk for growth in the EU;
- a greater than expected impact of the uncertainty associated with persistent geopolitical conflicts on the investment decisions of enterprises;
- the continuing need to reduce the debt of the enterprise sector in selected Member States, and the potential negative impact of irregular loans on bank balances;
- faster than expected growth in prices of energy resources, which can reduce the level of real disposable income of households. On the other hand, the low prices of these raw materials will lead to a reduction in external demand from the countries that export them;
- social perception of the growing number of refugees in the EU, which through the channel of trust can lead to a reduction in household consumption. Negative effects on growth due to migration problems could be further enhanced if the Member States decided to introduce restrictions on the movement of people and goods within the EU.

The positive risk factors according to the European Commission include:

- a greater than the estimated positive impact of low oil prices on the aggregate demand;
- higher than expected depreciation of the euro exchange rate in connection with the European Central Bank's quantitative easing policy;
- positive effects of the European Investment Plan;
- successful implementation of structural reforms in the EU Member States;
- faster than expected integration of refugees and their greater participation in the EU labor market.

According to the European Commission, compared to the Autumn forecast of 2015, in the balance of risk factors, the negative ones still outweigh them. This may mean that after the Spring forecasting round, the European Commission revises downwards its previous forecast for GDP growth in the EU countries, which are the basis for the scenario of GDP growth in Poland presented in the *Programme*.

In the case of Poland, apart from the aforementioned risk factors for the economic projections of our largest trade partner, the direct effect on the growth perspectives of the Polish economy of the possibility of aggravation of the conflict behind our eastern border should be mentioned. Economic sanctions against Russia and low oil prices, which negatively affect the economy of that country, pose a threat of a clear weakening in the dynamics of economic activity in the countries of the Commonwealth of Independent States and, as a consequence, the reduction in the dynamic of trade exchange of Poland with this region. The exposure of the Polish export on the markets of Russia and Ukraine systematically decreases and direct risk decreases from year to year. The potential escalation of the conflict may also translate to a significant increase of turbulences in the financial and raw material markets.

2) Implementation of the EU requirements concerning CO_2 emission reduction

Both quantitative and qualitative analyses assessing the effects of implementing the climate and energy policies framework to 2030 in Poland indicate that this carries the risk of a range of negative effects in the areas of energy, economic and social policy. Challenges for the Polish economy related to the implementation of EU climate and energy policy objectives result from the dependence of the Polish energy sector on fossil fuels – over 83% of electricity in Poland comes from lignite and hard coal-fired power plants. Fulfilment of these objectives will require significant investments in the emission intensive sectors. Furthermore, due to an increase in electricity prices, a slowdown in the rate of economic growth may be expected, as well as a lowering of the state budget income, with an increase in unemployment, lower household disposable income and an increase in the cost of energy as a proportion of household budgets (i.e. the risk of the so called "energy poverty" phenomenon). It should be noted, however, that, the negative consequences of currently implemented climate and energy package (until 2020) for the Polish energy sector, and thus the entire economy, will be more severe within 2016 to 2019 than it was in the previous period. The increase in the negative impact of climate policy on the competitiveness of the Polish energy sector and industry can occur, among others, as a result of the provisions of IED, possible further tightening of decarbonization policy in the EU, as well as the ongoing European Commission's work on the preparation of future climate and environmental solutions (including the so-called “environmental footprint”). Implementation of the frames of climate and energy policy until 2030, in a way adapted to the specific socio-economic situation of Poland may, however, help to increase the quality of life of citizens by improving their health or growth of economy innovation, and to enhance the country's energy security.

Polish enterprises are characterized by a potential to improve their energy efficiency. The lack of measures for realizing this potential may consequently mean that domestic enterprises operating in sectors with high energy consumption per unit of manufactured product will be exposed to the risk of a significant increase in operating costs and a loss of international competitiveness. In addition, domestic entities are at risk of the so-called carbon leakage - transferring energy-intensive and high-emission operations from EU Member States conducting a policy of reducing greenhouse gas emissions to countries with lower environmental standards.

3) Sureties and guarantees

In the coming years, the possibility of a further increase in potential liabilities resulting from sureties and guarantees granted by the State Treasury is anticipated, which may translate to a slight increase of the ratio of these liabilities to GDP. Further concentration of sureties and guarantees granted by the State Treasury to support the investments facilitating development in the area of road and rail infrastructure is expected. In addition, it is possible to grant sureties and guarantees for other purposes permitted by the Act, in particular as regards support for: export, environmental protection, creation of new jobs, innovation, corporate restructuring, regional development, entrepreneurship, and programs or projects under the EU assistance programs.

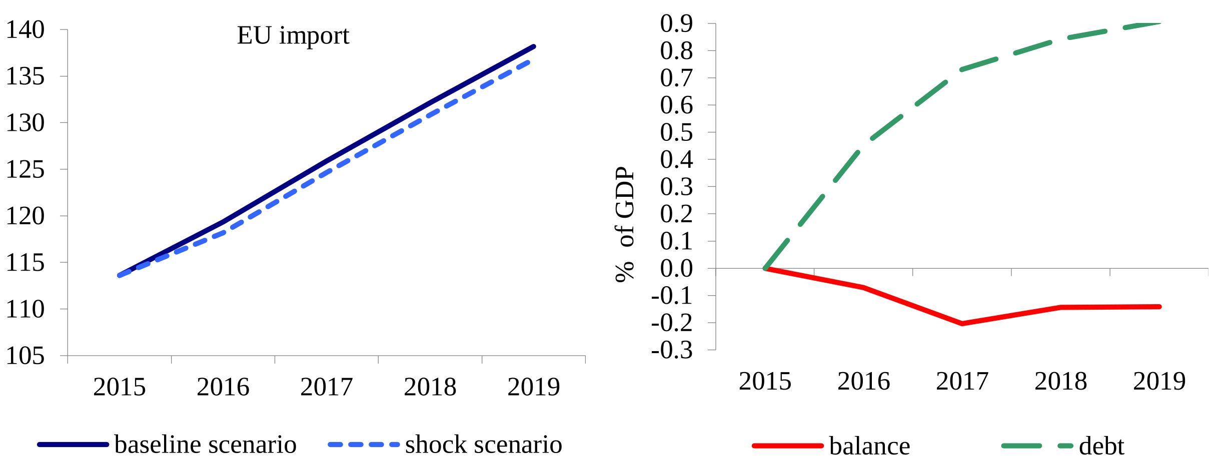
Sureties and guarantees will mainly be granted for investments utilizing EU funds (loans and bonds underwritten or guaranteed by the State Treasury should enable the obtaining of EU funds), as well as for other investments arising from potential new support programs for which sureties and guarantees may be granted according to EU regulations. At the same time, maintaining the long-term risk factor for the portfolio of sureties and guarantees granted by the State Treasury at the level of 5-10% is anticipated.

The value of new sureties and guarantees granted by the State Treasury in a given year is limited by the Budget Act. The 2016 limit in the Budget Act was determined at PLN 200 billion and, apart from supporting the above projects, may also be allocated to measures which may have to be undertaken should the global financial and economic crisis cause a worsening in the functioning of the Polish financial system.

IV.2. Sensitivity analysis

The sensitivity of the general government balance and debt in the years 2016-2019 to a decrease in global demand, increase in public investments, depreciation of the exchange rate of the zloty and the increase in the domestic interest rate is presented below. The analysis was made 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 a great care, since they do not take into account potential changes in economic policy in response to imposed shocks, are based on historical flexibilities estimated for the assumed forms of behavioral equations, and the same model, despite its great range, is not capable of including all mechanism present in the real economy.

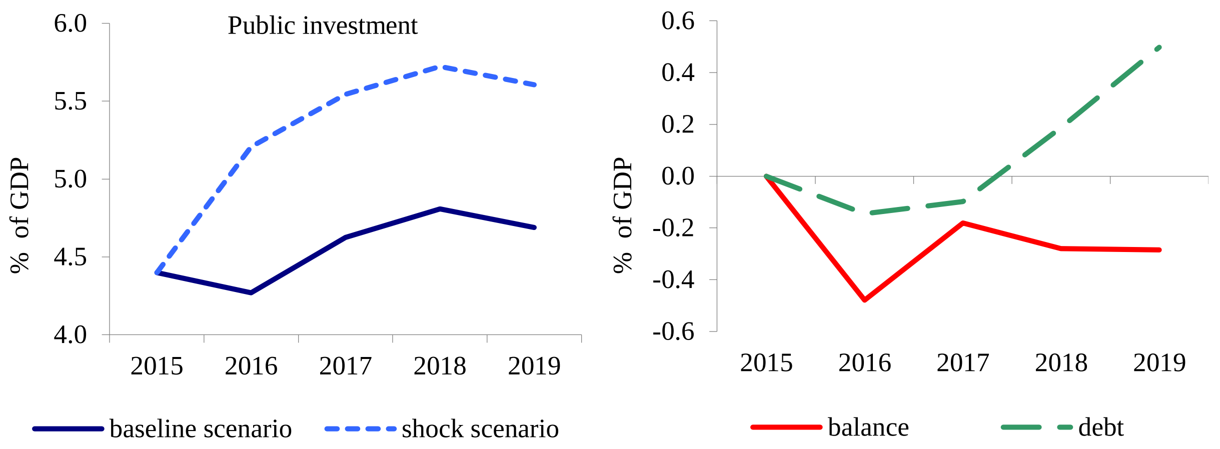
Chart 10. EU import (left chart) and the impact of a change in global demand on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The impulse of the slowdown in global demand has been defined as a permanent 1% decrease in the global demand indicator (EU imports in the model) as compared to the baseline scenario. A direct effect of disturbances in the external environment for the national economy is a reduction in foreign trade. In the first year from the occurrence of the shock the volume of exports declines by 0.7% against the baseline scenario, and in subsequent years it remains lower by 0.5-0.4%. Due to the high import intensity of exports, the decrease in the export volume is accompanied by a decline in imports (by 0.6% in 2016), additionally supported by depreciation of the national currency. The decrease in global demand translates into a limiting of enterprise investment activity (gross fixed capital formation of the private sector in the first two years after the shock remains lower by 1.2% and in the subsequent years by 1.7-1.5%, as compared to the baseline scenario, and in the following two years they drop below the base path to the level of 2.0% and 2.2%), reducing employment and remuneration. Household disposable income goes down, which limits private consumption by 0.3% in 2016 and 0.5-0.4% in the following years. As a result of these disruptions, GDP remains persistently lower in the projected period by 0.5% in 2016 and 0.5-0.4% in the remaining years as compared to the non-shock scenario. A lower domestic demand is accompanied by the lowering of inflationary pressure (in the subsequent years CPI accelerates slightly due to the depreciation of zloty) and a decrease in interest rates. Lower economic growth negatively affects the fiscal condition of the country. The general government deficit increases (by approximately 0.14% within 2016-2019), as a result of which in 2019 the government debt in the shock scenario is 0.9% of GDP higher than in the baseline scenario, taking into account depreciation of zloty.

Chart 11. Volume of public investment (left chart) and its impact on the general government balance and gross debt (right chart)

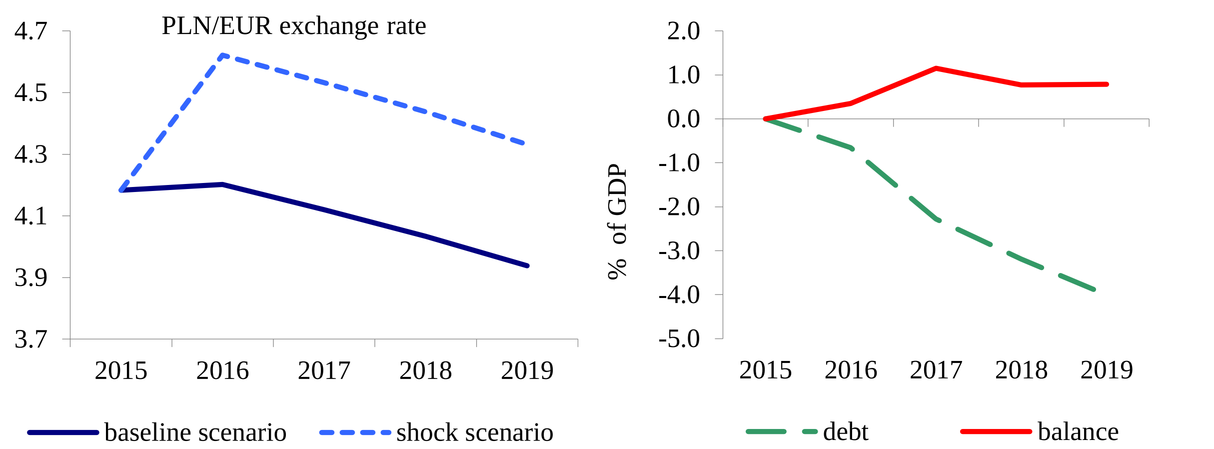


Source: Ministry of Finance

The fiscal impulse has been defined as a sustained increase relative to the baseline path in general government investment by 1% of GDP assumed for the given year in the non-shock scenario. The direct effect of an increase in public expenditures is the increase in deficit, which in 2016 increases by 0.5% of GDP compared to the baseline scenario, and in the following years remains at a level of 0.2-0.3% of GDP above the base path. Higher public expenditures also imply an increase in private demand which results in an improvement of the condition of the labor market, an increase in inflationary pressure and interest rates as well as worsening of the foreign trade balance.

As a result of the introduced shock, the level of economic activity grows, accordingly, the share of investment in GDP increases less than it would result from the disruption which was defined in relation to the GDP level of the base path. Higher economic growth neutralizes the negative effects of the increase in public expenditure at the beginning of the simulation period, however, in subsequent years, at a sustained worsening of the general government balance, the effects become increasingly more visible – in 2019 the general government debt is by 0.5% of GDP higher than in the ‘no expenditure increase scenario.

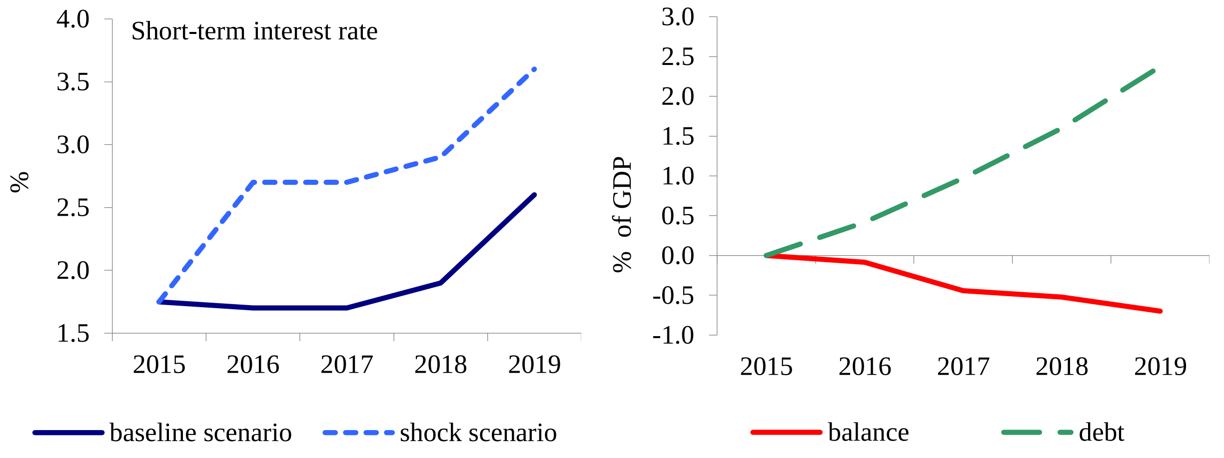
Chart 12. PLN/EUR exchange rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The exchange rate impulse has been introduced as a sustained 10% depreciation of the PLN/EUR 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 export is also accompanied by growth in import. An increase in demand for Polish goods also fosters the improvement of labor market conditions and an acceleration of investment activity, which supports the permanent increase of the GDP level within the horizon of the forecast. The higher economic growth facilitates the increase in general government revenue, which exceeds the growth of expenditures associated with the servicing of debt denominated in foreign currencies, and the general government balance improves, as a result of which the level of general government debt in the shock scenario is 4.0% of GDP lower in 2019 than in the baseline scenario.

Chart 13. Short-term interest rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

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 obtaining capital and therefore lower investment (with permanently higher interest rates, private investments in 2019 are by 6.2% lower than in the baseline scenario) and higher debt financing costs. Due to a shift in consumption over time due to inter-temporal substitution and as a result of tightened conditions for obtaining loans, private consumption decreases from 0.8% in 2016 to 1.2% in 2019 compared to the baseline scenario. As a result, the monetary impulse leads to a decrease in GDP volume of 0.9-1.7% in the forecast horizon. The general government balance systematically deteriorates to 0.7% of GDP in 2019 and the general government debt in 2019 is by 2.4% of GDP higher than in the baseline scenario.

IV.3. Comparison with the previous update

Compared with the previous *Programme* update, the predicted real GDP growth rate decreased in 2016-2018 did not changed. The GDP growth in 2015 was higher than the expectations, although its structure appeared slightly different. The contribution to growth from net exports was positive, at a level of 0.3 percentage point in relation to the expected negative contribution in the amount of 0.6 percentage point. In turn, the contribution to GDP growth from domestic demand was lower, mainly due to the lower than expected contribution of changes in inventories, public investment and private consumption. Regarding the forecast for 2016, despite the maintenance of real GDP growth rate at a level as before, now it is expected a slightly different growth structure. Although contributions to GDP growth from domestic demand and net exports are similar, it is now expected a slightly higher contribution to GDP growth from private consumption, among others, in connection with the effects of the *Family 500 plus* programme, with lower contribution of investment and changes in inventories.

The scale of negative contribution to GDP growth from net exports was increased in the forecast for 2017-18 as a consequence of faster increase in domestic demand than that estimated in the previous edition of the *Programme*. Higher growth of domestic demand during this period is due to a faster forecasted growth rate of consumption, both public and private, and slightly faster growth in investment as a result of the expected acceleration of public investment. As concerns the private investment it is assumed that their share in GDP will increase over the forecast horizon, but on a smaller scale compared to the expectations formulated at the stage of the previous *Programme*.

The general government deficit in 2015 amounted to 2.6% of GDP and was lower by 0.1 percentage point than anticipated in last year's *Programme*, which resulted primarily from the balance of central government more favorable than expected one. In connection with the implementation of the priority objectives of Government policy, in particular in the field of pro-family policy (*Family 500 plus* programme), the forecasted path of the general government balance within 2016-18 worsened compared to last year's *Programme* (by 0.3-1.1 percentage point). Thanks to intensive efforts aimed at recovery of tax revenue it will be possible to orientate the fiscal policy to support the inclusive growth while respecting the constraints of national and EU law.

The general government debt in 2015 amounted to 51.3% of GDP and turned out to be lower by 0.5 percentage point compared to the forecast of the previous *Programme*, which was influenced on the one hand by lower borrowing needs of the state budget and a lower level of debt of the National Road Fund (KFD), on the other hand by higher exchange rates of foreign currencies in which approximately 1/3 of the debt is nominated, and slower nominal GDP growth. The higher forecast for 2016-19 is due to the increased borrowing needs of the state budget, higher exchange rates of foreign currencies and slower nominal GDP growth compared to that assumed in the previous update of the *Programme*.

Table 6. Difference from previous update

	ESA Code	2015	2016	2017	2018	2019
Real GDP growth (%)						
2015 update		3.4	3.8	3.9	4.0	-
Current update		**3.6**	**3.8**	**3.9**	**4.0**	**4.1**
Difference		0.2	0.0	0.0	0.0	-
General government balance (% of GDP)	EDP B.9					
2015 update		-2.7	-2,3	-1.8	-1.3	-
Current update		**-2.6**	**-2.6**	**-2.9**	**-2.0**	**-1.3**
Difference		0.1	-0.3	-1.1	-0.7	-
General government gross debt (% of GDP)						
2015 update		51.7	51.6	50.7	49.1	**-**
Current update		**51.3**	**52.0**	**52.5**	**52.0**	**50.4**
Difference		-0.5	0.4	1.8	2.9	-

Source: Ministry of Finance and Central Statistical Office

V. Long-term sustainability of public finances

V.1. Sustainability of public finances, including the implications of an ageing population

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

One of the elements of the Polish fiscal framework are fiscal rules, including public debt rules, stabilising expenditure rule, which has a stabilizing effect on public finances in the medium and the long term and corrects possible imbalances, minimizing the risk of over-tightening of fiscal policy, and rules limiting the increase of 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 Polish public finances.

The European Commission regularly assesses situation in Member States in terms of the sustainability of their public finances, based on fiscal gap ratios in the medium (S1 indicator), and the long, infinite horizon (S2 indicator). The fiscal gap reflects the scale of the necessary adjustments to the primary structural balance, so that the public debt would be at a certain level (S1 indicator), or so that the solvency condition would be 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, their aim is not, however, to show the most likely scenario. The increase of an indicator means that a greater improvement of the primary structural result is needed.

Table 7. Fiscal sustainability indicators of public finance

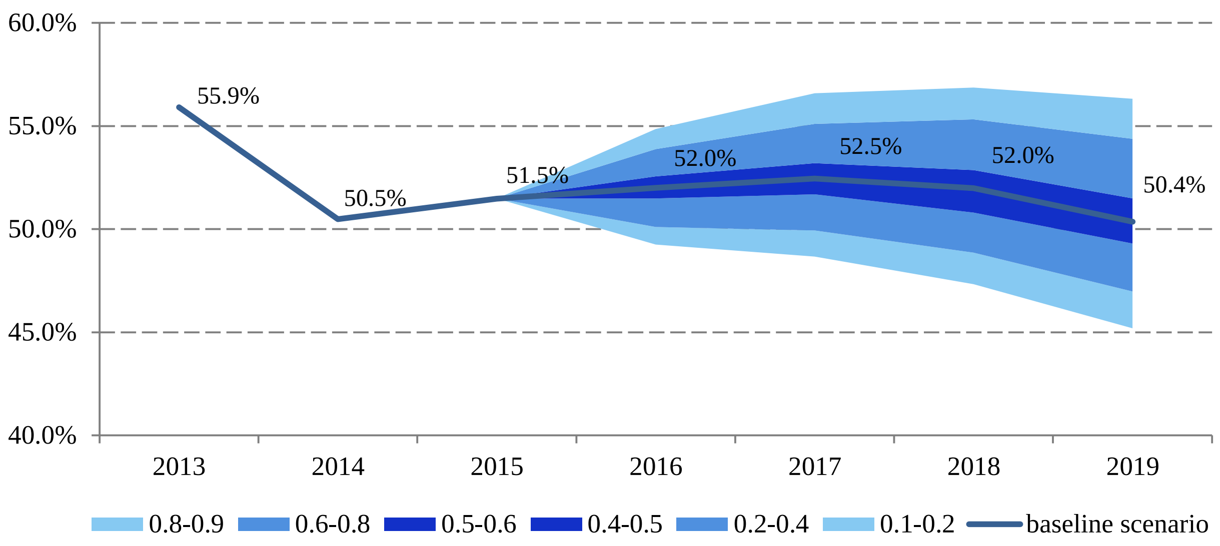
% of GDP	*Fiscal Sustainability Report* 2015	CP update 2016 base year 2016	CP update 2016 base year 2017	CP update 2016 base year 2018	CP update 2016 base year 2019
S1	1.0 medium risk	-0.4 low risk	0.2 medium risk	-0.7 low risk	-1.6 low risk
S2	3.5 medium risk	3.2 medium risk	3.7 medium risk	3.0 medium risk	2.0 medium risk

Source: European Commission, Ministry of Finance

Table 7 shows the indicators S1 and S2 estimated by the Ministry of Finance as compared with the assessment of the European Commission performed in the *Fiscal Sustainability Report*, December 2015. The Ministry of Finance estimate is based on projections of macroeconomic indicators developed by the Ministry and the current forecast of aging cost, prepared by the Economic Policy Committee's Ageing Working Group (AWG) and presented later in this chapter. Indicators were estimated in four variants, taking as the base year the years 2016-19.

The indicators included in the *Fiscal Sustainability Report* 2015 are calculated choosing 2017 as the base year and using the Autumn forecast of the European Commission from November 2015. Assuming that the consolidation will be carried out in a manner consistent with the forecast presented in this *Programme* it can be expected that the indicators S1 and S2 for Poland will be improved in the coming years. The forecasted improvement of the primary structural balance and the forecasted decrease in public debt within 2017-19 shall have reducing effect on indicators. In the future, the continuation of fiscal consolidation leading to stabilizing the balance at the level of MTO and the observed economic recovery will work towards reducing the risk to the sustainability of public finances of Poland in the medium and long term.

Chart 14. Stochastic debt projections from year 2016



Source: Ministry of Finance

A similar level of risk to the sustainability of public finances is indicated by stochastic simulations of the debt developed in accordance with the approach adopted by the European Commission and the International Monetary Fund[21]. The forecasts are based on the baseline scenario presented in the *Programme* and using the annual shocks obtained for the following variables: real GDP growth, real effective rate of yield of general government debt, the primary balance and the exchange rate. The analysis shows that even with a considerable combination of adverse shocks the general government debt over the forecast horizon shall not exceed the reference value of 60% of GDP. In the graph shown above 80% of the possible paths of the debt obtained from the afore-mentioned approach are presented (the paths below 10 and above 90 percentile, representing the scenarios associated with the most extreme set of shocks in the economy, were excluded). Based on the employed method, with the probability of about 80% it is expected that the debt of the sector in 2019 shall be less than 55% of GDP.

Forecast of the long-term sustainability of public finances used to calculate sustainability indicators S1 and S2 have been published by the European Commission in 2015. These forecasts (cf. Table 8) indicate that spending on retirement and disability pensions will fall from 11.3% of GDP in 2013 to 10.7% of GDP in 2060.

[21] Stochastic forecasts are developed using Monte Carlo simulation based on 1000 draws.

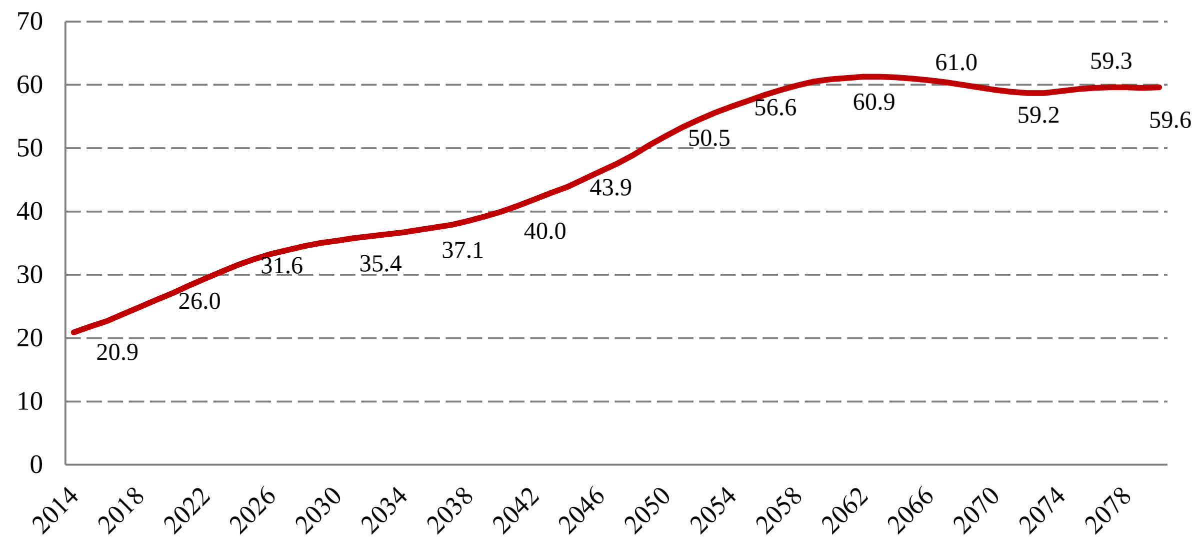
Table 8. Long-term sustainability of public finances

% of GDP	2013	2020	2030	2040	2050	2060
Total expenditure						
Of which **age-related expenditure**	20.7	20.1	20.4	20.1	21.0	22.1
Pension expenditure	11.3	10.6	10.4	10.0	10.4	10.7
Social security pension	11.3	10.6	10.4	10.0	10.4	10.7
Old-age and early pensions	9.8	9.5	9.3	8.6	9.0	9.5
Other pensions (disability, survivors)	1.5	1.1	1.1	1.4	1.4	1.2
Health care	4.2	4.4	4.8	5.1	5.2	5.5
Long-term care (previously as a component of health care)	0.8	0.9	1.1	1.3	1.5	1.7
Education expenditure	4.4	4.1	4.1	3.8	3.9	4.3
Other age-related expenditures						
Interest expenditure	0.0	0.0	0.0	0.0	0.0	0.0
Total revenue						
Of which: from pension contributions	6.8	7.3	7.5	7.7	7.7	7.7
Assumptions						
Labour productivity growth	2.8	3.1	2.3	1.9	1.8	1.5
Real GDP growth	3.2	2.6	1.9	1.3	0.6	0.7
Participation rate males (aged 20-64)	80.2	82.4	82.8	81.5	81.8	82.2
Participation rate females (aged 20-64)	65.2	66.7	68.3	68.4	69.3	69.8
Total participation rate (aged 20-64)	72.7	74.5	75.6	75.0	75.6	76.1
Unemployment rate (aged 20-64)	10.3	8.5	8.4	7.3	7.3	7.3
Population aged 65+ over total population	14.5	18.4	22.7	25.1	29.9	33.0

Source: European Commission. *The 2015 Ageing Report. Economic and budgetary projections for the EU-28 Member States (2013-2060).* May 2015

Demographic changes constitute one of the major challenges for the long-term sustainability of public finance in most European countries. Against that background the current situation in Poland can be seen as advantageous as Poland is a country of relatively young people. On the other hand, it should be expected that the ageing population phenomenon observed in recent years will continue, which is caused by the extension of the life expectancy, low fertility and the current age structure of the population. As a result, the demographic burden ratio shall deteriorate, i.e. the relationship between the number of population at post-productive age (65 and more) against the number of population at productive age (i.e. aged 15-64), expressed as percentage. According to the Eurostat forecast of April 2014, this ratio will increase from 20.9% in 2014 to 59.6% in 2080. (Cf. Chart 15).

Chart 15. Demographic burden ratio in Poland in the years 2014-80



Source: Eurostat

Measures aimed at reducing the negative impact of demographic changes on public finances can be divided into those directly related to the demographic transformation, namely supporting fertility and migration and those reducing public expenditure related to aging population, mainly through the reforms of pension systems. A set of pro-family measures in Poland includes parental benefits and the minimum maternity allowance in the amount of PLN 1000, tax deduction in the child tax credit, a mechanism for gradual withdrawal of family benefits for households with an income higher than the income threshold and an increase in the amounts of family allowances (cf. also the entry in last year's *Programme*). This catalog was recently completed by the *Family 500 plus* programme, implemented on the basis of the *Act on State aid in raising children* in force from 1 April 2016.

The Act allows for the provision of child care benefit in the amount of PLN 500 per child under 18 years of age. The right to benefits is vested in the Polish citizens and foreigners on the basis of Community legislation and international agreements. The *Family 500 plus* programme is a benefit for the second and subsequent child in the family. It also provides the benefit for the first child, if the family income per capita does not exceed PLN 800 or 1200, or when a family member is a child with a disability (i.e. possessing a decision about disability or decision about disability in moderate or severe degree).

The main objective of the Act is the economic support for the families with children and enhancement of the incentives to make decisions about having children, especially the second and subsequent one. The proposed solution shall also counteract child poverty, especially in families with many children. For this reason, the income from the child care benefits was excluded from the catalog of the income that is taken into account in the granting of family benefits and social assistance benefits.

According to estimates of the Ministry of Family, Labor and Social Policy, the introduction of the *Family 500 plus* programme shall increase the total number of births by 289 thousands. (i.e. approx. by 7.6%) in the period 2016-26. This corresponds to a fertility rate of 1.6 in 2025., which means an increase in the projected fertility rate by 0.16 this year compared to a scenario without the *Family 500 plus* programme. An additional advantage from the implementation of this programme will be the increase in the disposable income of the poorest households. Table 9 shows the average increase in the disposable income of households divided with respect to different deciles of income per capita. The household in the lowest deciles will benefit the highest relative and total profits, which is associated with a greater number of children in poorer households and with the obligation of the income criterion in obtaining the right to child care benefit for the first child. The increase in the disposable income will contribute to poverty reduction. It is estimated that the statutory poverty will drop (depending on the adopted methodology) by approx. 4 to 6 percentage points, and the relative poverty calculated according to the Eurostat methodology by approx. 4 percentage points[22]. More about the effects of the *Family 500 plus* programme in Chapter II.3.

Table 9. *The Family 500 plus* programme effects on disposable income of households in 2016

Disposable income deciles	Coverage (within decile)	Average share of benefits in disposable income*	Average annual transfer per household [in PLN]*	Amount of household receiving benefits	Aggregate cost for general government sector [PLN mln]
1	52.6	38.7%**	8 650	746 756	6 459
2	47.5	18.2%	7 347	644 572	4 736
3	23.4	12.3%	6 056	316 094	1 914
4	15.6	9.8%	5 802	212 294	1 232
5	9.7	8.1%	5 765	132 047	761
6	7.3	6.9%	5 399	98 814	534
7	5.5	5.8%	5 015	74 118	372
8	5.6	5.0%	5 162	75 291	389
9	5.0	4.4%	5 301	67 708	359
10	4.2	2.7%	5 295	56 822	301

Source: Ministry of Finance, estimation based on MF-MICROMOD.
** - Calculated only among households which will receive the benefits.*
*** - Calculated for disposable income greater than 0.*

The aforementioned *Act of 11 February 2016* on *State aid in raising children* assumes - a year after its entry into force – the review of all systems of family benefits in terms of their consistency, impact on economic activity and efficiency. It also provides the opportunity to increase the amount of the benefit by the Council of Ministers, by regulation, taking into account the inflation forecasted in the Budget Act. In addition, after three years, an assessment of the impact of the Act effects will be performed and the Council of Ministers will propose on that basis the introduction of a permanent mechanism of indexation of the amount of benefits and income criteria. As a result of the verification the amount of financial outlays may increase in subsequent years.

V.2. Contingent liabilities

Potential contingent liabilities on account of sureties and guarantees granted by general government in Poland reached 6.5% of GDP at the end of 2015, against 6.7% of GDP at the end of 2014 (in accordance with updated GDP for 2014 and estimated GDP in the fourth quarter of 2015). A significant share in this category was represented by sureties and guarantees granted by the State Treasury – at the end of 2015 they reached about 6.3% of GDP against 6.4% of GDP as of the end of 2014.

The State Treasury exposure with regard to sureties and guarantees does not impose a significant risk to public finances. At the end of 2015 about 85% of contingent liabilities on account of sureties and

[22] The expected decline in poverty assumes no change of income thresholds in the *act on social assistance*. Estimates based on MF-MICROMOD and the data of Household Budget Survey 2014.

guarantees granted by the State Treasury were classified as a low-risk group. The long-term risk ratio for the State Treasury sureties and guarantees portfolio increased slightly to approx. 7%, compared to 2014, when it reached the level of approx. 6%. Simultaneously, potential contingent liabilities on account of sureties and guarantees granted by the State Treasury increased despite their decrease in relation to GDP. As in the previous year, that increase was mainly the result of a significant volume of guarantees granted for the support of infrastructure development.

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 (BGK)) amounted to only approx. 0.1% of GDP as of the end of 2015, and did not relate to potential measures against the crisis.

Table 10. Contingent liabilities

% of GDP	2015
Public guarantees	6.5
Of which: linked to the financial sector*	0.1

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).*

VI. Quality of public finances

VI.1. Composition, efficiency and effectiveness of expenditure

According to the forecast, the general government expenditure to GDP ratio will decrease from 41.5% in 2015 to 40.7% in 2019. Consequently, in comparison to 2014, the general government expenditure share of GDP will decrease by 1.4 percentage points. However, it is the change in domestic expenditure[23], which has a more significant impact on the general government balance and should decrease in terms of share in GDP from 40.7% in 2014 to 38.9% in 2019.

The expenditure structure is influenced by systemic changes, both planned and those already implemented which are aimed at supporting inclusive growth by reduction of poverty and more effective distribution of monetary and non-monetary benefits (cf. chapter III and V). Changes in the expenditure policy for 2016 and subsequent years are carried out taking into account the *National Development Strategy 2020*, which assumes a reduction of poverty among children and youth (implemented, among others, by the *Family 500 plus* programme and other reforms in the system of family and social benefits) as well as disabled persons (*i.a*, by verification of benefits from the *Act on Social Assistance*).

It should be noted that the introduction of stabilizing expenditure rule (cf. Chapter V and VII), which determines the maximum level of spending almost the entire general government forced a change in approach to the budget process from bottom-up to top-down. Currently attention in the budget process is focused on how to distribute the amount of expenditure and not on their level, which is pre-determined (calculated on the basis of the algorithm). The fact that the binding spending limit is determined at an early stage of the budget process, means that changes in the expenditure covered by the scope of the rule (increase or introduction of new categories of expenditure) are possible, provided, however – as in the expenditure benchmark – that important discretionary measures are taken up in the area of taxes or contributions, or appropriate adjustment of the level of other expenditure categories is made. By including the discretionary measures concerning taxes and contributions in the rule, any discretionary measures having a negative impact on revenue are neutral to the balance of the sector. It changes the context of the analysis of structural measures in the area of taxes and contributions, which currently, diminishing or increasing the maximum amount of expenditure, automatically ensure sustainability of public finances.

The project that started in 2014, aimed at institutionalizing the public expenditure reviews, which are an instrument of prioritization of public expenditure through their systematic and in-depth analysis in the given area of state activity, was continued in 2015. In 2015, the Minister of Finance appointed a Steering Committee for public expenditure reviews, which is an consultative and advisory body to the Minister of Finance on matters of public expenditure reviews. The Committee's tasks include in particular the acceptance of programs of public expenditure reviews and approvement of conclusions and recommendations formulated during reviews.

In 2015, the implementation of three pilot public expenditure reviews in the areas of (1) supporting low-income families, (2) housing policy, and (3) the flexibility of budgetary expenditure was completed. Based on the findings and experience gathered during the pilot reviews, amongst others, a methodical document that defines the objectives, methodology and organization of expenditure reviews, was prepared.

Starting from 2016, it is planned to conduct three to five expenditure reviews per year, which in the cycle of 3-4 years shall allow covering with reviews most of the areas in which significant expenditure from public funds are incurred. At the same time, work was initiated in order to introduce specific solutions that allow the systemic inclusion of expenditure reviews to the budget process.

[23] Domestic expenditure / revenue means the expenditure/ revenue after adjusting by expenditure financed from the EU funds for which the ultimate beneficiary are the general government units. According to the EU methodology ESA2010 the EU funds implemented by the sector units are neutral to the balance.

Within the *Programme* horizon, the largest decrease in expenditures is expected in the "general public services" – by 0.6 percentage point of GDP, due to the substantial reduction in debt servicing costs – by 0.5 percentage point compared to 2014.

Table 11. General government expenditure by function

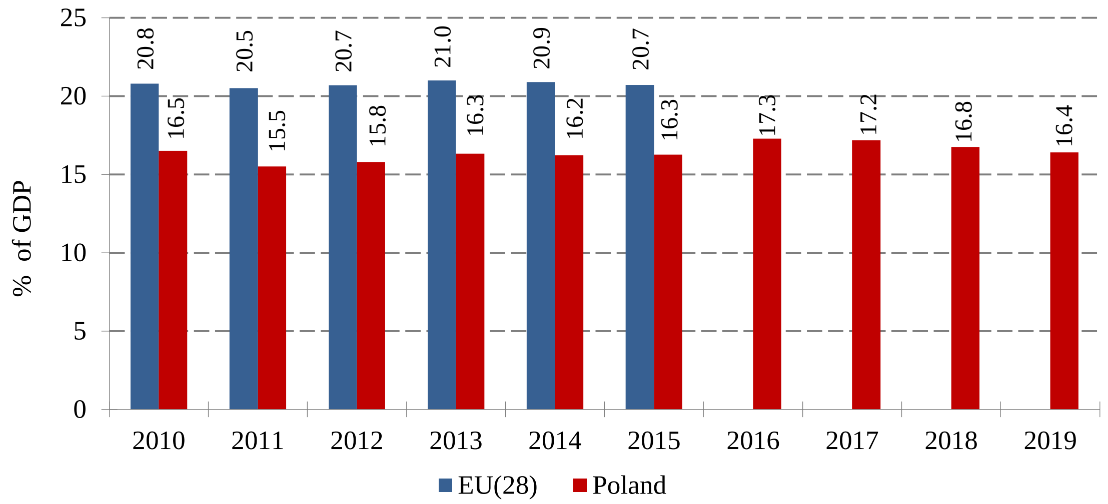
	COFOG code	2014 % of GDP	2019 % of GDP	Real increase 2019/2014 in %
1. General public services	1	5.0	4.4	8.4
2. Defence*	2	1.5	1.5	24.3
3. Public order and safety	3	2.2	2.1	14.2
4. Economic affairs	4	4.6	4.6	22.8
5. Environmental protection	5	0.9	0.8	18.4
6. Housing and community amenities	6	0.7	0.7	27.4
7. Health	7	4.6	4.5	19.2
8. Recreation, culture and religion	8	1.2	1.1	21.3
9. Education	9	5.3	4.9	15.5
10. Social protection	10	16.1	16.1	24.1
11. Total expenditure	TE	42.1	40.7	19.9

Source: Ministry of Finance, Central Statistical Office

** - The main difference between military expenditure recorded according to the EU methodology (COFOG function: defense) and defense expenditures resulting from national legislation (the statutory rate of spending on national defense in % of GDP, currently 2% of GDP) is a method of recording expenditure on pensions for the uniformed services (0.4% of GDP in 2014). According to the EU methodology (COFOG), social transfers are not treated as expenditure on national defense (included in the "social protection"), while according to national methodology, expenditure on social benefits for the uniformed services are included in the calculation of the statutory rate of spending on national defense.*

Development of the relationship of social benefit expenditures to GDP (cf. Chart 16) shall result primarily from the consideration of the *Family 500 plus* programme and the system of indexation of retirement and disability pensions (cf. Chapter III).

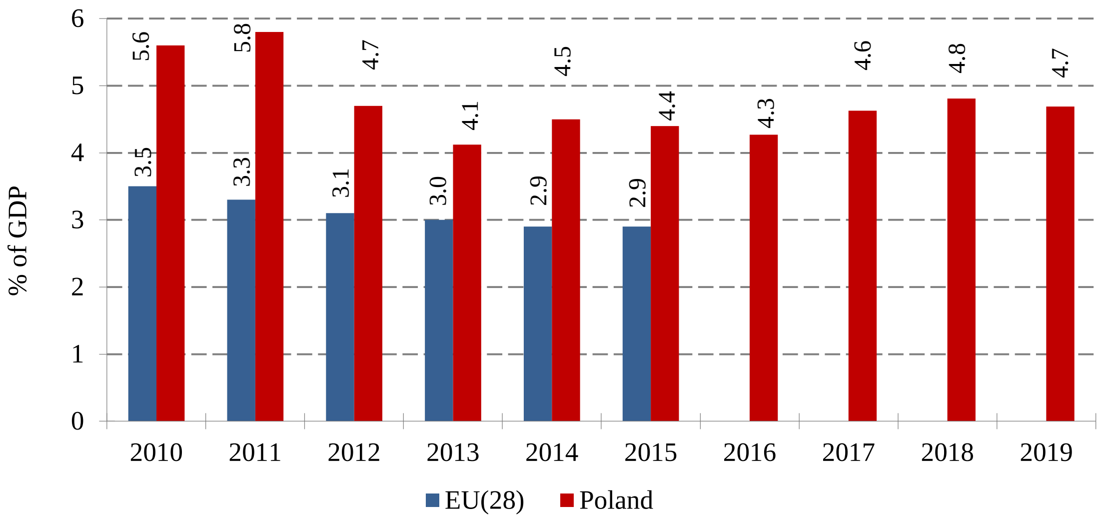
Chart 16. Social expenditure



Source: AMECO, Ministry of Finance

The expected increase in expenditures under the function "economic matters" should be analyzed against the background of the recommendations of the EU Council recommending to minimize the cuts in growth-enhancing investments in infrastructure (cf. Chart 17).

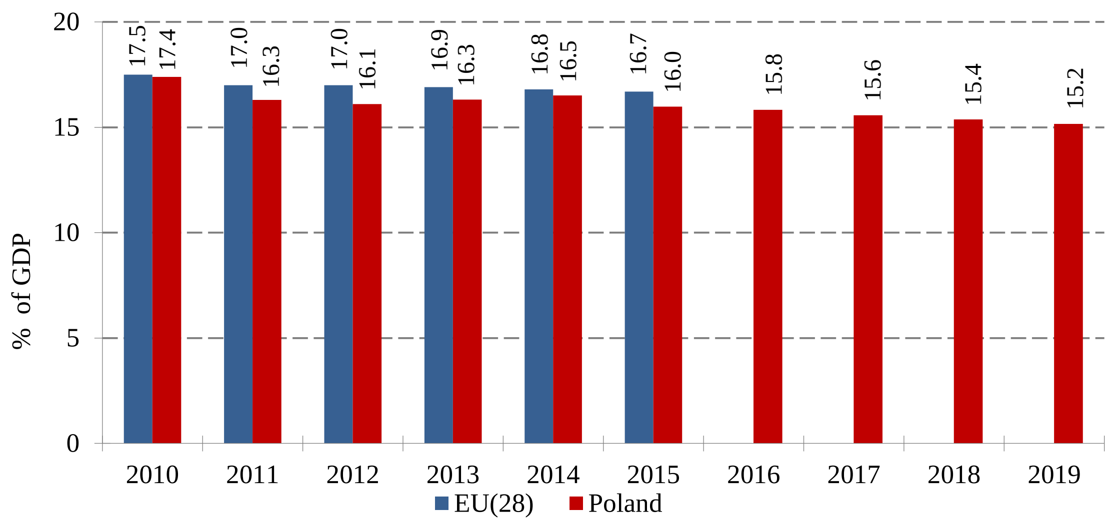
Chart 17. Gross fixed capital formation



Source: AMECO, Ministry of Finance

The planned reduction of the cost of the administration is shown in the graph below.

Chart 18. Administration costs (as a sum of remuneration and indirect consumption)



Source: AMECO, Ministry of Finance

VI.2. Structure and efficiency of revenue systems

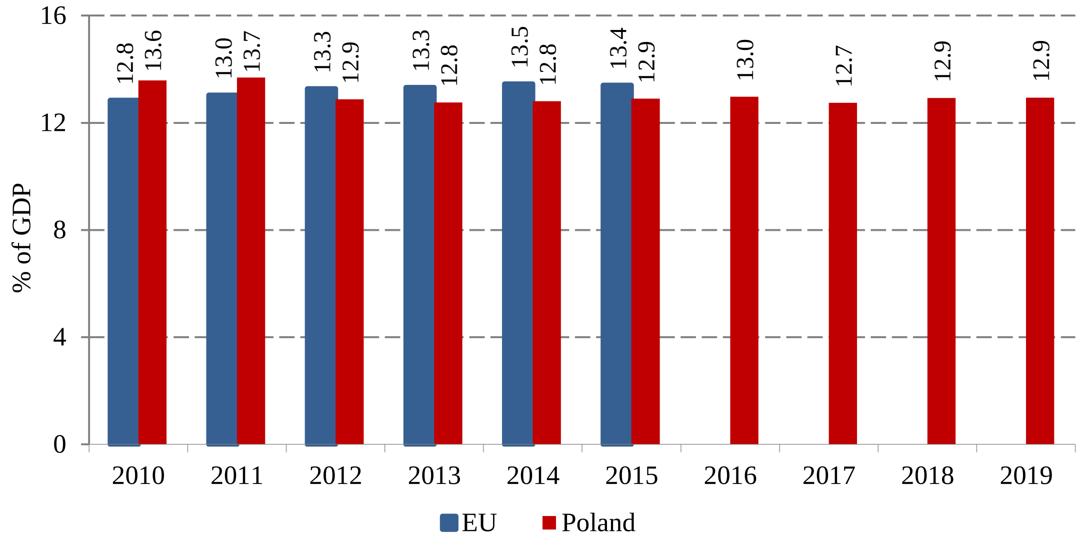
The general government revenue in the forecast horizon 2014 will be determined by both the improving economic situation, as well as system changes described in Chapter III. According to the forecast, their level in relation to GDP will increase from 38.9% in 2015 to 39.4% in 2019.

In the structure of general government revenues, the tax revenue is of great importance, whose share in the total revenue in 2015 reached 50.7%. Another important source of general government revenue is social contributions. The total share of general government revenue from taxes and social contributions amounted to 85.6% in 2015.

There are differences in the structure of the tax burden between Poland and the old EU countries. The revenues from direct taxes outweigh in the old EU countries, while in Poland the tax revenues of the general government are obtained from indirect taxes to a greater degree.

The sector revenues from taxes and social insurance contributions (the so-called tax burden) in 2015 accounted for 32.5% of GDP. In the following years, thanks to improved collection of tax liabilities, a gradual increase in this relationship is forecasted, so as to achieve 33% in 2019.

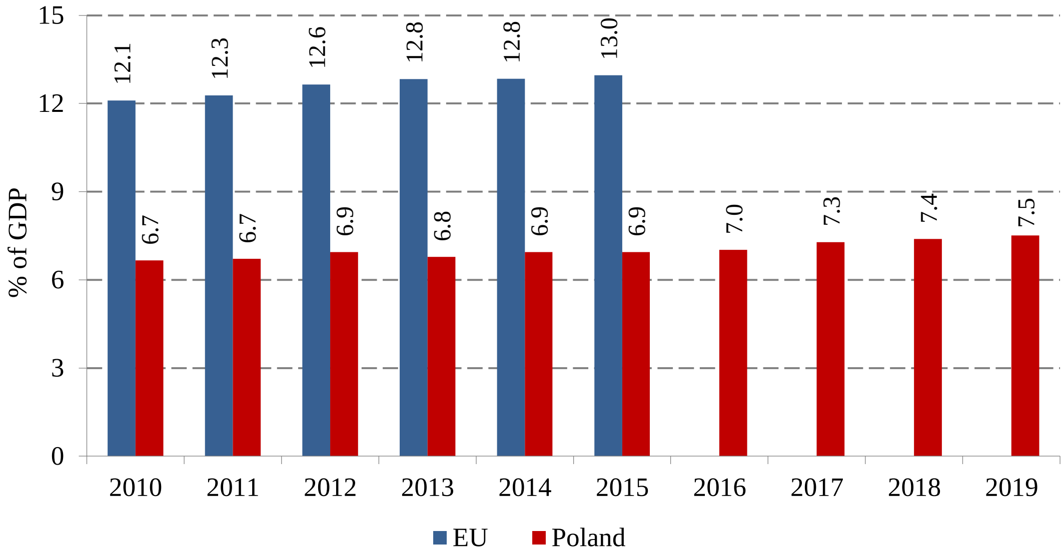
Chart 19. General government revenue from taxes on production and import



Source: AMECO, Ministry of Finance

The average share of general government revenue from taxes on production and imports in GDP in the years 2010-15 reached 13.1%. In the years 2016-19 a slight decline in this share is forecasted. In Poland, slightly higher share of revenue of the general government from taxes on production and imports is recorded than the average of the EU Member States – in 2010-15, by 0.12 percentage point, on average.

Chart 20. General government revenue from taxes on income and wealth, etc.

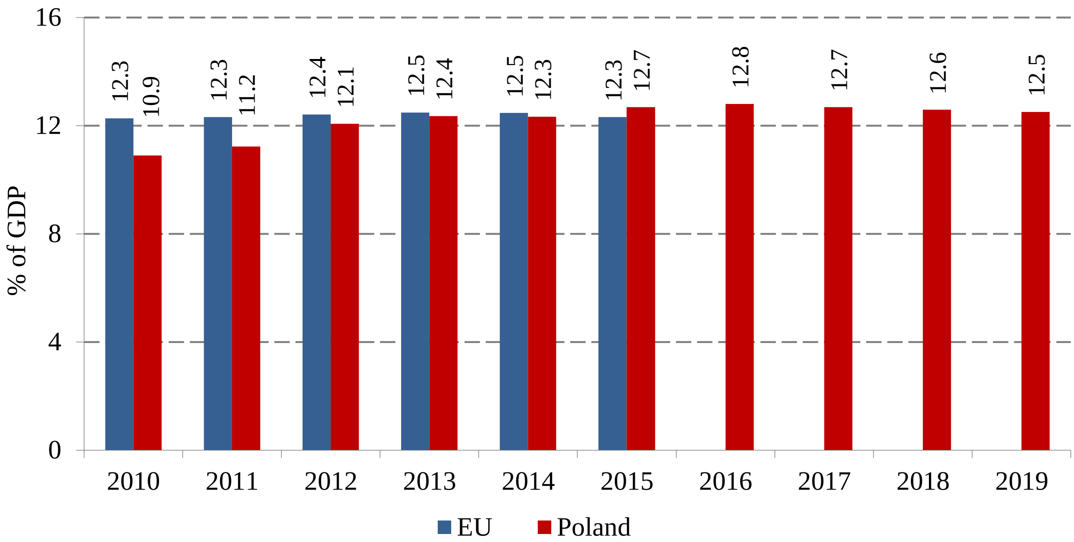


Source: AMECO, Ministry of Finance

The average share of general government revenue from taxes on income and assets in GDP in the years 2010-15 reached 6.8%. In the years 2016-2019, its stabilisation at a moderate level of 7.1% is expected.

In Poland, as compared to the EU, the share of general government revenue from taxes on income and wealth in GDP is lower. In 2010-2015 the average share of general government revenue from taxes on income and wealth in GDP was lower by 5.8 percentage points than the EU Member States average. It is associated with a different structure of tax systems in the "old" EU countries, which rely primarily on direct taxes.

Chart 21. General government revenue from social insurance contributions



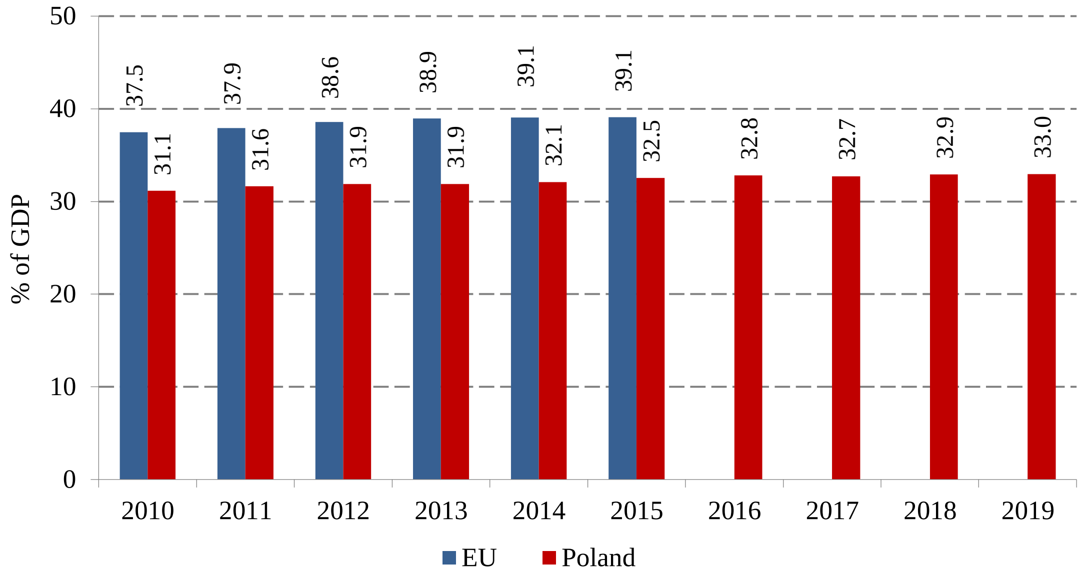
Source: AMECO, Ministry of Finance

**Without contractually attributed contributions*

In the years 2010-15 the average share of the general government revenue from social contributions (without imputed social contributions) in GDP reached 11.9%, and 12.3% in 2015. In the following years a gradual decrease of the share of the general government revenue from social contributions in the GDP is projected, from 12.8% of GDP in 2016 to 12.5% in 2019.

Similar to revenue from taxes on income and wealth, etc. the share of the general government revenue from social contributions in the GDP is lower in Poland than the average for the EU Member States. In 2010-15 the average share of the general government revenue from social contributions in the GDP was lower by 0.5 percentage point than the EU Member States average.

Chart 22. Tax burden



Source: AMECO, Ministry of Finance
**Without contractually attributed contributions*

In 2010-15, the average share of the general government tax burdens in GDP in Poland was lower by 6.7 percentage points than the EU Member States average. It is forecasted that in 2016-2019 the general government tax burdens as a percentage of GDP shall reach the level of ca. 32.8%.

VII. Institutional features of public finances

VII.1. Fiscal rules

The basic objective of fiscal rules is to reduce the discretion in shaping the fiscal policy through imposing restrictions on the size of budget aggregates such as expenditure, revenues, deficit or public debt. Fiscal rules contribute to maintaining budget discipline, ensuring fiscal and macroeconomic stability as well as to maintaining (possibly reducing) the size of the general government at a given level.

The fiscal framework in Poland is based on the set of rules. At the level of the general government it is the stabilizing expenditure rule, at the level of public finance sector - the debt rule, and at the level of local government units – individual debt limits. The debt rule, whose main objective is to prevent public debt (calculated according to the Polish methodology) from breaching the threshold of 60% of the GDP is enshrined in the most important Act - the *Constitution of the Republic of Poland*, and the constitutional rule is supplemented with prudential thresholds defined in Article 86 of *the Public Finance Act* and the conditions of the correction mechanism of the stabilizing expenditure rule defined in Article 112aa paragraph 4. The stabilizing expenditure rule therefore unifies the domestic and European fiscal policy frameworks, at the same time increasing the stability of the fiscal policy. Contrary to the debt rule, it imposes restrictions on public finance on an annual basis, not only after exceeding the threshold and enables the conduct of an anticyclical fiscal policy.

The aim of the stabilizing expenditure rule is to ensure the stability of the Polish public finances by stabilizing the general government balance in the medium term at the level of medium-term budgetary objective (MTO) and by preventing the ratio of public debt to GDP, calculated in accordance with art. 38a the *Public Finance Act*[24], from breaching the precautionary thresholds, 43% and 48%, defined in the correction mechanism of the rule.

In the original shape of the stabilizing expenditure rule, the prudential thresholds were set at the levels of 50% and 55%. Their levels were reduced by 7 percentage points, down to 43% and 48% through the *Act of May 9th, 2014 amending the Public Finance Act and the Act amending the Public Finance Act and other acts*. Reduction of the thresholds has been made in connection with the entry into force of the *Act of December 6th, 2013 amending certain acts in connection with the definition of principles for pension payments from funds accumulated in open pension funds*, which caused a rapid decrease in the ratio of public debt to GDP as a result of the transfer of assets worth PLN 153,151.2 million from open pension funds to ZUS. The value of Treasury securities that were acquired by the Treasury for redemption amounted to PLN 130,187.6 million (approx. 7.6 per cent of GDP in 2014, projected in the Budget Act for 2014). The aim of reduction of the thresholds was to stabilize public debt at a lower level and to positively impact the credibility of the Polish fiscal policy.

As a result of the introduced changes, *the Public Finance Act* specifies four prudential thresholds - thresholds of 55% and 60% of GDP, defined in Article 86 of the *Public Finance Act*, and thresholds of 43% and 48% of GDP, included in the correction mechanism of the stabilizing expenditure rule, defined in Article 112aa of the *Public Finance Act*. After exceeding the thresholds referred to in Art. 86 of *the Public Finance Act*, appropriate sanctions apply, including the need for the Council of Ministers to propose a restructuring programme aimed at reducing the level of public debt and its ratio to GDP. In contrast, the prudential thresholds of the expenditure rule constitute part of a correction mechanism according to which the dynamics of the level of expenditure is automatically reduced if thresholds are exceeded. This system of thresholds established within two types of fiscal rules - the debt rule and the expenditure rule – is intended to prevent the risk of the public debt exceeding 55% of GDP.

Each year, under Polish law, the Supreme Audit Office (NIK), fulfilling its constitutional duty, submits to the Parliament a document entitled "*The analysis of the national budget and monetary*

[24] That is after conversion of liabilities in foreign currency to Polish zloty using the arithmetic mean of the average exchange rates of each of the foreign currencies announced by the National Bank of Poland and applicable on weekdays in the respective budget year, and after deduction of the amount of available funds for financing the borrowing needs of the state budget for the next financial year.

policy guidelines", which includes an evaluation regarding both planning and execution of the state budget, taking into account its compliance with applicable fiscal rules. Regional Accounting Chambers are obliged to exercise control *ex ante* and *ex post* over the financial situation of the local government units.

VII.2. Budgetary procedures, including public finance statistical governance

The Budget Act for 2015 was, for the first time, based on the principles laid down in art. 112aa of the *Public Finance Act of August 27th, 2009*, which implied a change in the approach to the budget process from *bottom-up* to *top-down*. Currently, the focus in the budgetary process is concentrated on methods of distributing a predetermined (according to the formula of the stabilising expenditure rule) amount of spending, and not at their levels (for more information see Section III.2).

Since September 2014, the data on the general government are prepared in accordance with *Regulation of the European Parliament and the Council (EU) no. 549/2013 of May 21st, 2013 on the European System of National and Regional Accounts in the European Union* (the so-called "ESA2010"). In August 2014, Eurostat also published the latest version of the *Deficit and Debt Manual*. *Introduction of ESA2010*. In connection with the change to the ESA rules last year, the Group for General Government Statistics focused on the implementation of the new ESA2010 provisions. The visit of Eurostat experts in Poland on September 2, 2014 also served this purpose.

In 2014, a written consultation was carried out with Eurostat on the classification of the Bank Guarantee Fund (BGF), and the manner of recording transactions related to pension reform. Following the consultations, the BFG has been classified to the general government. In addition, based on analysis, the general government has been extended with new units. Among them, the entity that holds a significant impact on the deficit and the debt – *PKP Polskie Linie Kolejowe S.A.*, which was reclassified into the general government based on the market/non-market test[25]. Preliminary figures for 2014 and forecasts provided by *PKP PLK S.A.* show that the rate used in the test has dropped below 50% and will be and maintained below set level over a longer period.

During the consultation with Eurostat on 2014 changes implemented in the pension system, a method of recording individual transactions according to the ESA2010 was agreed upon:

- the contribution that goes to open pension funds, does not constitute the general government revenue, since OFEs are classified outside the general government,
- the transfer of assets from OFE to the general government in exchange for pension obligations does not constitute the general government revenue upon acquisition (contrary to ESA'95), the transaction is classified in the financial account with no impact on the general government balance. In the case of OFE transfers, the value of the acquired assets was lower than the assumed liabilities (values registered on the sub-accounts), so there existed a difference classified as a general government expenditure on acquisition,
- the acquired assets in the form of debt securities issued by other units of general government are consolidated, reducing the debt in the fiscal notification (i.e. the EDP debt),
- pension payments - at the time of payment of pensions expenditure will be recorded in the amount of pensions paid in cash (decrease of cash), at the same time revenues corresponding to the originally assumed liabilities (without indexation) will be recorded, the same value will reduce the level of liabilities presented in the financial accounts.

[25] The ability to undertake market activity is primarily checked with a simple quantitative criterion (i.e. the 50% criterion), using the ratio of sales in relation to production costs. For a public entity to be considered a market producer (classified outside the general government), its sales must cover at least 50% of its costs over a sustained multi-year period.

The Ministry of Finance analytical work is underway on how to adjust the scope of the stabilizing expenditure rule in connection with the on-going changes in the classification of the general government.

As part of the fulfillment of the requirements of the *Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States*, the following data are subject to publication on the website of the Ministry of Finance[26]:

- monthly data (with a one month delay) - concerning the central government sub-sector and social security funds sub-sector,
- quarterly data (with a one quarter delay) - concerning the local government sub-sector,
- data concerning contingent liabilities of the general government of potentially material impact on the budgetary situation.

This website also features a reconciliation table showing the transition from public accounting data to the statistics of the general government, developed in accordance with the methodology of the ESA.

On 23 July 2015 the *Act amending the act on public statistics and other acts* came into force. This amendment concerns the strengthening of public statistics statutory mandate to process personal data, specifying the limits and sources of such data directly from individuals whom this data concerns or public administration information systems that are in the possession of personal data collected for other purposes. The change is also intended to extend the guarantee of free and timely access of official statistics services to administrative data sources, and to reduce to a minimum the burden on respondents of transmission of data directly to the statistics officials, while authorizing the President of GUS to create proposals regarding the scope of administrative information systems to be used for statistical purposes, including international ones. The amendment also aims to change the formula for the Statistical Survey Programme, taking into account technological change in data collection process, starting since 2018.

[26] English version: http://www.mf.gov.pl/en/ministry-of-finance/fiscal-data-for-eu-budgetary-surveillance

List of tables

Table 12. Macroeconomic prospects

	ESA Code	2015 Level	2015 Rate of change	2016 Rate of change	2017 Rate of change	2018 Rate of change	2019 Rate of change
1. Real GDP (PLN billion)	B1*g	1 781.9	3.6	3.8	3.9	4.0	4.1
2. Nominal GDP (PLN billion)	B1*g	1 789.7	4.1	4.1	5.6	6.0	6.5
Component of real GDP							
3. Private consumption expenditure	P.3	1062.9	3.0	4.0	4.1	3.8	3.8
4. Government consumption expenditure	P.3	325.5	3.4	3.4	2.4	2.6	2.6
5. Gross fixed capital formation	P.51	359.1	5.8	4.7	6.7	7.3	7.6
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	6.8	0.4	0.3	0.3	0.3	0.4
7. Exports of goods and services	P.6	871.6	6.8	6.0	5.5	5.2	5.1
8. Import of goods and services	P.7	844.1	6.3	6.6	6.4	6.0	5.8
Contributions to real GDP growth							
9. Final domestic demand			3.3	3.9	4.3	4.3	4.5
10. Changes in inventories and net acquisition of valuables	P.52+ P.53		-0.2	-0.1	0.0	0.0	0.0
11. External balance of goods and services	B.11		0.3	-0.2	-0.4	-0.4	-0.4

* The levels of real volumes are expressed in fixed prices of 2014.

Table 13. Price developments

	ESA Code	2015 Level	2015 Rate of change	2016 Rate of change	2017 Rate of change	2018 Rate of change	2019 Rate of change
1. GDP deflator			0.4	0.4	1.6	1.9	2.3
2. Private consumption deflator			-1.2	-0.4	1.3	1.8	2.2
3. HICP			-0.7	0.0	1.3	1.8	2.2
3a. CPI			-0.9	-0.4	1.3	1.8	2.2
4. Public consumption deflator			-0.8	-0.4	1.3	1.8	2.2
5. Investment deflator			0.5	1.1	2.4	2.5	2.6
6. Export price deflator (goods and services)			1.3	0.8	1.6	1.8	2.0
7. Import price deflator (goods and services)			-1.3	0.0	1.6	1.9	2.1

Table 14. Labour market developments

	ESA Code	2015 Level	2015 Rate of change	2016 Rate of change	2017 Rate of change	2018 Rate of change	2019 Rate of change
1. Employment (in thousands of persons)*		16083	1.4	1.0	0.5	0.4	0.4
2. Employment (hours worked)**		-	-	-	-	-	-
3. Unemployment rate (%)***			7.5	6.6	6.2	5.8	5.5
4. Labour productivity (in thousands of persons)****		111.7	2.2%	2.8%	3.4%	3.6%	3.7%
5. Labour productivity (hours worked)*****		-	-	-	-	-	-
6. Compensation of employees (PLN billion)	D.1	659.0	1.6	5.1	4.5	5.1	5.7
7. Compensation per employee (PLN thousand)		52.0	0.1	4.1	4.1	4.7	5.3

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

Table 15. Sectoral balances

% of GDP	ESA Code	2015	2016	2017	2018	2019
1. Net lending / borrowing vis-à-vis the rest of the world*	B.9	2.1	1.7	1.5	1.7	1.0
of which:						
- balance on goods and services		2.8	3.0	2.6	2.2	1.8
- balance of primary incomes and transfers		-3.0	-3.0	-3.3	-3.3	-3.4
- capital account		2.4	1.7	2.2	2.9	2.7
2. Net lending/borrowing of the private sector	B.9	4.7	4.3	4.4	3.7	2.3
3. Net lending/borrowing of general government	EDP B.9	-2.6	-2.6	-2.9	-2.0	-1.3
4. Statistical discrepancies				optional	optional	optional

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

Table 16. Basic assumptions

	2015	2016	2017	2018	2019
Short-term interest rate (annual average)	1.7	1.7	1.7	1.9	2.6
Long-term interest rate (annual average)	2.7	3.1	3.2	3.7	4.0
Nominal effective exchange rate*	0.0	0.4	-1.9	-2.1	-2.4
Exchange rate vis-à-vis the EUR (annual average)	4.18	4.20	4.12	4.03	3.94
World GDP growth**	3.0	3.3	3.5	-	-
EU GDP growth	1.9	1.9	2.0	1.8	1.6
Growth of relevant foreign export markets***	5.7	5.1	5.5	5.0	4.6
World import volumes**	2.4	3.6	4.3	-	-
Oil prices (Brent, USD/barrel)**	53.4	35.8	42.5	-	-

* Nominal growth of EUR/PLN exchange rate.
** Source: EC, *European Economic Forecast. Winter 2016*, February 2016.
*** EU import as an indicator of the foreign export markets.

Table 17. General government

	ESA Code	2015 PLN million	2015 % of GDP	2016 % of GDP	2017 % of GDP	2018 % of GDP	2019 % of GDP
Net lending (EDP B9) by sub-sector							
1. General government	S.13	**-46666**	**-2.6**	**-2.6**	**-2.9**	**-2.0**	**-1.3**
2. Central government	S.1311	-38903	-2.2	-2.3	-2.7	-1.6	-1.4
3. State government	S.1312						
4. Local government	S.1313	-177	0.0	0.0	0.0	0.0	0.1
5. Social security funds	S.1314	-7586	-0.4	-0.3	-0.1	-0.5	0.0
General government							
6. Total revenue	TR	695708	38.9	39.0	39.0	39.4	39.4
7. Total expenditure	TE	742374	41.5	41.6	41.9	41.4	40.7
8. Net lending/borrowing	EDPB.9	-46666	-2.6	-2.6	-2.9	-2.0	-1.3
9. Interest expenditure	EDPD.41	31921	1.8	1.7	1.5	1.4	1.4
10. Primary balance		-14745	-0.8	-0.9	-1.4	-0.6	0.1
11. One-off and other temporary measures							
Selected components of revenue							
12. Total taxes (=12a+12b+12c)		354518	19.8	20.0	20.0	20.3	20.4
12a. Taxes on production and imports	D.2	230008	12.9	13.0	12.7	12.9	12.9
12b. Current taxes on income, wealth, etc	D.5	124272	6.9	7.0	7.3	7.4	7.5
12c. Capital taxes	D.91	238	0.0	0.0	0.0	0.0	0.0

	ESA Code	2015 PLN million	2015 % of GDP	2016 % of GDP	2017 % of GDP	2018 % of GDP	2019 % of GDP
13. Social contributions	D.61	242773	13.6	13.7	13.6	13.4	13.3
14. Property income	D.4	15014	0.8	0.7	0.6	0.6	0.6
15. Other		83403	4.7	4.6	4.8	5.0	4.9
16. Total revenue	TR	695708	38.9	39.0	39.0	39.4	39.4
Tax burden (D.2+D.5+D.61+D.91-D.995)		595037	33.2	33.6	33.5	33.6	33.7
Selected components of expenditure							
17 Compensation of employees + intermediate consumption	D1+P2	286014	16.0	15.8	15.6	15.4	15.2
17a. Compensation of employees	D.1	182351	10.2	10.0	9.8	9.5	9.4
17b. Intermediate consumption	P.2	103663	5.8	5.8	5.8	5.8	5.8
18. Social payments		291175	16.3	17.3	17.2	16.8	16.4
of which Unemployment benefits		3459	0.2	0.2	0.1	0.1	0.1
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	35514	2.0	2.0	2.0	2.0	2.0
18b. Social transfers other than in kind	D.62	255661	14.3	15.3	15.2	14.8	14.4
19. Interest expenditure	EDP D.41	31921	1.8	1.7	1.5	1.4	1.4
20. Subsidies	D.3	8693	0.5	0.5	0.5	0.5	0.5
21. Gross fixed capital formation	P.51	78713	4.4	4.3	4.6	4.8	4.7
22. Capital transfers	D.9	8798	0.5	0.4	0.4	0.4	0.4
23. Other		37060	2.1	1.7	2.1	2.1	2.1
24. Total expenditure	TE	742374	41.5	41.6	41.9	41.4	40.7
p.m.: government consumption (nominal)	P.3	323026	18.0	17.9	17.6	17.3	17.1

Table 18. No-policy change projections

	2015 Level PLN billion	2015 % of GDP	2016 % of GDP	2017 % of GDP	2018 % of GDP	2019 % of GDP
1. Total revenue at unchanged policies	**695.7**	38.9	38.6	38.8	39.0	39.0
2. Total expenditure at unchanged policies	-	-	-	-	-	-

Table 19. Amounts to be excluded from the expenditure benchmark

	2015 Level PLN million	2015 % of GDP	2016 % of GDP	2017 % of GDP	2018 % of GDP	2019 % of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	24 984	1.4%	1.4%	1.6%	1.9%	1.8%
1a. of which investment fully matched by EU funds revenue	20 965	1.2%	1.1%	1.4%	1.6%	1.6%
2. Cyclical unemployment benefit expenditure	-280	0.0%	0.0%	0.0%	0.0%	0.0%
3. Effect of discretionary revenue measures	7 217	0.4%	0.4%	0.2%	0.4%	0.4%
4. Revenue increases mandated by law	-	-	-	-	-	-

Annex – Measures increasing tax compliance in the years 2017–19

A. General part

I. Scope of measures to increase tax compliance

This document presents the most important measures in the area of tax compliance and effectiveness of tax administration. The document sets out a list of measures for the years 2017-19, defining for each project: the purpose, planned tools, the recipients and the estimated positive impact on the public finance sector. It is worth mentioning that the proposed measures are in most cases already the subject of advanced work. Thus, the probability that the regulations proposed in the shape shown in this study will be implemented is assessed as high.

The measures presented in this study will have a positive impact on improving tax collection and are aimed at discouraging efforts to avoid taxation.

One of the projects that will allow the achievement of the above effects is the introduction of the general anti-avoidance rule. The GAAR will have the task of combating artificial activities (or groups thereof), usually containing foreign components, typically used by large corporations to avoid payment of tax.

To close loopholes in the system of income tax it seems reasonable to amend the provisions of the *Act on personal income tax* and the *Act on corporate income tax*. Change or clarification would affect, among others, the provisions relating to the catalog of cases where the income of a taxpayer subject to limited tax liability is deemed to be acquired "on Polish territory", or the manner of determining the income from the acquisition of shares (stocks) in the company that is a taxpayer of corporate income tax in exchange for a contribution in kind (in a form other than the enterprise or its organized part).

In order to close loopholes in goods and services tax, it is justified to change the provisions of the Act on the tax, involving, among others, the modification of reporting obligations of taxpayers, changes in the method of registration (and deregistration) of taxpayers by the tax authorities, changes in the scope of joint and several liability of taxpayers and the guarantee deposit.

Increasing the transparency of cash flows between businesses is another tool, which aims to reduce the number of tax fraud related to the issuing inaccurate invoices. Increasing the number of transactions between businesses made in non-cash form should help to reduce the negative phenomena in business, including those influencing the sphere of taxation.

A very important factor affecting the efficiency of the tax administration is the structure of its organization that must keep up with the changing economic reality. Work is therefore in progress aimed at the consolidation of tax administration, namely the establishment of the National Fiscal Administration. The effectiveness of tax administration is undoubtedly influenced by the quality of taxpayer service. Consistently a strong emphasis is put on improving this component of the administration, among others, by increasing the use of electronic forms of contact with taxpayers, which should also influence on the level of tax compliance.

The improvement of the effectiveness of tax audits may be affected by introducing a new functionality into accounting systems, i.e. capability of editing tax books and accounting documents based on XML standard widely used in electronic communication. Uniform control file is at the same time aimed at reducing the cost of fulfillment of tax obligations by taxpayers and improving relations between the administration and its clients.

The creation of a special purpose company to implement IT projects with a public purpose in the scope of public finances shall also contribute to the reduction of irregularities in the area of public finances and trade in goods, fraud prevention and efficient detection, market protection by reducing the gray economy and reducing the tax gap.

An important element of measures to increase tax compliance will be the establishment of the Register of Debtors of Public Liabilities. As a result, it will increase the security of business transactions by allowing entrepreneurs to verify the reliability of the business contractors, increasing fiscal discipline and increase of state budget revenues through the creation of an instrument mobilizing debtors to voluntary payment of obligations, reduction of costs for recovery of debts, as well as reduction of the volume of debts that will expire due to the ineffectiveness of enforcement action taken.

A detailed description of the above measures is shown below in the following order:

1. Introduction of the general anti-avoidance rule
2. Increasing the number of non-cash transactions between entrepreneurs
3. Closing loopholes in the system of income taxes
4. Closing loopholes in goods and services tax
5. Establishment of the National Fiscal Administration
6. Computerization of auditing the tax books (Standard Audit File)
7. Establishment of the Register of Debtors of Public Liabilities
8. Establishment of a special purpose vehicle for the implementation of IT projects with a public purpose concerning matters in the scope of public finances.

II. Financial effects

The above presented actions should bring financial effects, which are presented collectively in the tabular form.

Total financial effects*		2017	2018	2019
Revenue (in PLN million)	min.	6 477	11 863	21 667
	only direct effects	3 427	5 331	16 336
	max.	16 697	27 036	33 434
	only direct effects	5 127	12 045	18 442

** - presented on a cumulative basis*

B. Specific Part – description of measures to improve tax compliance and increase the efficiency of tax administration

I. Introduction of the general anti-avoidance rule (GAAR)

Objective:

1. The GAAR shall allow combating artificial structures and transactions (or groups thereof), usually containing foreign components, typically used by large corporations to avoid payment of tax. Tax avoidance leads to market advantage obtained by unfair means. The GAAR shall have a positive impact on the competitiveness on the market.
2. The preventive function – the very existence of the GAAR should discourage efforts to avoid taxation. The GAAR shall determine the limits of acceptable tax optimization through its content and practice.
3. Ensuring equal treatment of taxpayers engaged in economic activities.

Tools: The GAAR will be applied to artificial acts performed primarily in order to achieve a tax benefit contrary to the purpose of provision of the tax act. The taxpayer activity leading to tax avoidance will be associated with the risk of the tax liability assessment in a manner as to nullify tax benefit obtained as a result of this action. The GAAR will apply to all taxes, except for the tax on goods and services. The use of the GAAR will be linked with a number of protective solutions:

- limiting the application of the GAAR to a significant tax benefit that exceeds the level of PLN 100.000,
- issuing advance rulings, so called “the safeguard opinions” at the taxpayer request,
- Council for Counteracting Tax Avoidance reviewing the contentious issues,
- exclusive jurisdiction of the Minister of Finance on matters of the GAAR, and
- the ability to correct declarations in the final stages of tax proceedings in scope of the application of the GAAR.

Addressee: Entities conducting business activity and participating in business activity and deriving profits from it (ownership of shares, stocks, management).

Responsible body: Minister of Finance

Deadline: On 15 March 2016 the Council of Ministers adopted a *draft of the Act on amending the Act - the Tax Code and some other acts* introducing the GAAR. Currently (as at 18 April 2016.) the draft is proceeded in Parliament[27]. The project provides for the entry into force of the Act within 30 days from the date of its announcement.

Estimated financial effect: Decisions issued in connection with the application of the GAAR shall essentially deal with significant amounts. Assuming that the amount of depletion resulting from a single decision will amount to approx. PLN 2-2.2 million, the direct financial effect of the GAAR application relating to the decisions issued by the Ministry of Finance can be estimated at PLN 50 million in 2017 and PLN 100 million in 2018, and in the following years (direct financial effects in 2017 will be associated with the decisions issued in the second half of 2016.).

Assuming that the application of the GAAR will result in the reduction of deductible costs, only in the corporate income tax, in the range of 0.12% -0.5%, the indirect consequences of the introduction of the clause in 2017, and in subsequent years, assuming that the amount of the costs will be reduced in the range of 0.25% -1%, and the tax rate will remain at a similar level, will amount to a minimum of PLN 2.7 billion and a maximum of PLN 10.87 billion.

Financial effects*		2017	2018	2019
Revenue (in PLN million)	min.	2 750	50	0
	only direct effects	50	50	0
	max.	10 920	50	0
	only direct effects	50	50	0

** - presented on year to year basis*

II. Increasing the number of non-cash transactions between entrepreneurs

Objective: Increasing the transparency of cash flows between businesses should contribute to reducing the adverse phenomena in economic trade, including these influencing the sphere of taxation. The measure in question should result in reducing the so-called. shadow economy, as well as in reduction of fraud related to the issuing false invoices.

Tools: Changing the provisions of *the Act of 26 Jul 1991 on personal income tax, the Act of 15 February 1992 on corporate income tax and the Act of 2 July 2004 on freedom of economic activity* involving:

[27] Form No. 367.

— decreasing from the current EUR 15 000 to PLN 15 000 the limit of the value of transactions between entrepreneurs made mandatory through a payment account in the Act on freedom of economic activity,

— the introduction of the regulation in the acts on income taxes that determines the tax effects (exclusion from tax deductible costs) of making the payment within a given transaction with the violation of the obligation to make it through a payment account.

Addressee: The proposed changes affect taxpayers of income taxes engaged in economic activity.

Responsible body: Minister of Finance

Deadline: The draft act containing the described solution[28] was submitted to Parliament on 10 March 2016, and was referred to the Senate on 14 April 2016. The expected date of entry into force of the Act is 1 January 2017.

Estimated financial effect: The proposed regulations will not cause the increase in government expenditure, while they can have a positive impact on the revenue side. Due to the fact that the form of settlements (cash or non-cash) is not in any way demonstrated by taxpayers for tax purposes, there is no possibility of accurate estimation of the scale of the impact.

This prevents the presentation of the estimates - concerning the scale of the reduction of the shadow economy and fictitious transactions, however it is assumed that the prevalence of electronic payments affects the reduction of the shadow economy and the reduction of fictitious transaction, included into the costs of revenues, leading to the undervaluation of the income tax base.

Furthermore, when taxpayers will make payments excluding payment accounts the value of the settlements transferred without this accounts will affect the cost of revenues, i.e. the costs will be lower so there will be an increase of the tax liability.

III. Closing loopholes in the system of income taxes

Objective: Amendment of the provisions of *the Act of 26 July 1991 on Personal Income Tax and the Act of 15 February 1992 on Corporate Income Tax* [29] aims at closing loopholes in the system of income taxes. This action will be implemented through:

— clarifying the currently existing regulations that will eliminate the interpretation doubts, which may result in tax avoidance of certain incomes,

— limiting the application of certain tax preferences for transactions made exclusively or mainly for the purpose of obtaining a tax advantage (without justified economic reasons),

— changing the provisions used in the tax optimization schemes applied by taxpayers.

Tools: Amendment of the provisions of *the Act of 26 July 1991 on Personal Income Tax and the Act of 15 February 1992 on Corporate Income Tax* consisting involving:

— clarification - in *the Act of 26 July 1991 on Personal Income Tax* - and the introduction - in *the Act of 15 February 1992 on Corporate Income Tax* – of a catalog of situations in which the income of a taxpayer subject to limited tax liability shall be deemed to be acquired "in the territory of the Republic of Poland",

— change of the method of determining the income from the acquisition of shares (stocks) in the company subject to corporate income tax in exchange for an in kind contribution (other than the enterprise or its organized part), i.e. determining that income in the amount of the value of in-kind

[28] The draft *Act on amending the Act on Personal Income Tax, Act on Corporate Income Tax and the Act on Freedom of Economic Activity* (Form No. 322).
[29] The draft *Act on amending the Act on Personal Income Tax and Act on Corporate Income Tax* (UA15).

contribution – specified in the company deed or other relevant document - not less than the market value of the contribution,

- clarification of the rules of recognizing tax deductible in case of shares disposal (stocks) of the acquiring company or the newly created one referring to the concept of "*cancellation*" of rights incorporated by shares (stocks),
- clarification of the condition of a legitimate economic reasons for the benefit of the preferential taxation in the case of mergers and divisions of companies and the extension of the scope of the condition by the so-called share exchange transactions,
- clarification of the condition for the application of an exemption from withholding tax, among others, on interest and royalties received by their recipient, who is also their beneficial owner.

Addressee: The proposed changes affect non-resident taxpayers of income taxes, receiving income in the territory of the Republic of Poland, taxpayers of income taxes making an in-kind contribution to capital companies in a form other than the enterprise or its organized part, the taxpayers of these taxes having shares (stocks) subject to “cancellation” in connection with company transformation processes, as well as taxpayers participating in the share (stock) exchange transactions.

Responsible body: Minister of Finance

Deadline: On 25 February 2016 the draft act containing the described amendments was submitted for interministerial and public consultation. The date of entry into force of the Act was set at 1 January 2017.

Estimated financial effect: Introduction of the solutions aiming at closing loopholes in the system of income taxes should positively influence the increase in government revenues in the first year of application of the regulation in the amount of PLN 277 million (including PLN 213 million for the state budget and PLN 64 million for local government units). The financial effects of the proposed solutions were estimated using data resulting from the settlement of corporate income tax for 2014. To estimate the financial consequences in the following year the forecast GDP growth was adopted.

Financial effects*		2017	2018	2019
Revenue (in PLN million)	min.			
	only direct effects			
	max.	277	11	11
	only direct effects – increase in tax revenue from CIT	277	11	11

** - presented on year to year basis*

IV. Closing loopholes in goods and services tax

Objective: Amendment of the *Act on tax on goods and services* is to reduce fraud and abuse occurring in this tax, causing reduction of budget revenue and distortion of competition in the market, which in turn causes deterioration of business conditions for entities running economic activity and honestly fulfilling the tax obligations.

Tools: Changing the provisions of the *Act on tax on goods and services*, inter alia, by on:

- the introduction of the obligation to submit declarations for the tax on goods and services exclusively electronically by some taxpayers;
- the introduction of the obligation to submit recapitulative statement only electronically;
- modification of existing solutions for joint and several liability and the guarantee deposit, in particular in fuel trading, in order to ensure greater effectiveness of these instruments;

- clarifying the regulation defining the circumstances conditioning the deletion of the taxpayer from the register of VAT payers;
- modifying the rules of registration of taxpayers as VAT payers.

Addressee: The proposed changes relate to the taxpayer of tax on goods and services.

Responsible body: Minister of Finance

Deadline: 1 July 2016, wherein the impact of introduced regulation shall also occur in subsequent years.

Estimated financial effect: The introduction of the proposed solutions sealing system of tax on goods and services should affect the growth of government revenues in the first year of the application of the regulation in the amount of PLN 2.3 billion, and PLN 3.4 billion in 2017.

Financial effects*		2017	2018	2019
Revenue (in PLN million)	min,	1 700	0	0
	only direct effects	1 700	0	0
	max.	3 400	0	0
	only direct effects	3 400	0	0

** - presented on year to year basis*

V. Establishment of the National Fiscal Administration (NFA)

Objective: The main objectives of the proposed amendments shall be:

- radical reduction of tax fraud;
- increasing the efficiency of tax and customs duties collection;
- increasing the level of voluntary fulfilment of tax obligations;
- providing customer service at a high level;
- reducing the costs of tax administration in relation to the level of obtained budget revenue;
- development of professional staff.

As a result of the introduced changes at the organizational and process level and information systems the groundwork for creation of a modern, professional, but also friendly tax administration will be established.

The primary objectives that should be achieved through the establishment of the National Fiscal Administration result from the expectations of taxpayers and the internal needs of the Ministry of Finance. They can be seen in the four perspectives according to the *Balanced Scorecard* methodology (BSC).

- Customer perspective:
  - Creation of a uniform and consistent taxpayer service model, in the full range of services - regardless of the kind of public levy charged by the Ministry of Finance;
  - Full implementation of the service approach to the taxpayer, using modern, integrated information tools;
  - Reducing the administrative burden and the cost of the taxpayer.
- Internal perspective:

- Increasing the level of budget revenues as a result of voluntary payment of any taxes (*voluntary compliance*), while maintaining the use of audits based on risk analysis;
- Better use of key competencies already possessed by the existing services and their concentration in order to optimize resource management;
- Clarification of the political role of the Minister of Finance and the executive role of the NFA.

— Development perspective:

- Implementation of the elements of the target strategy of the Ministry of Finance and the preparation of a new development strategy of the National Fiscal Administration in place of the sectoral strategy of the Customs Service, Tax Administration and Fiscal Control;
- Strengthening the efficiency of existing fiscal services, enabling the implementation of new public tasks.

— Financial perspective:

- Increasing the efficiency of collection by reducing the costs of servicing the primary and secondary processes;
- Lowering the cost of the taxpayer;
- Increasing the revenue by reducing the tax gap.

Tools: Establishment of the National Fiscal Administration will be completed by *the Act on the National Fiscal Administration* and a number of organizational activities constituting the implementation of the provisions of this Act.

Addressee: The effects of the task implementation will apply to the entire environment of fiscal administration.

Responsible body: Minister of Finance

Deadline: 1 January 2017

Estimated financial effect: Based on the experience of the Hungarian administration, which in 2011 conducted a consolidation of tax and customs services at regional and local levels, it can be assumed that the efficiency of tax inspections conducted by the units of the tax administration shall increase, among others, as a result of the consolidation of databases available to three divisions of Administration (Tax Administration, Customs Service and Fiscal Control), as well as the introduction of new systems of risk analysis and typing of the entities to be inspected, using the information gathered in these divisions.

Over the years 2012-15 the effectiveness of inspections carried out by the Hungarian authorities has increased from 10% to even 35%, depending on the controlled areas, among others, in the scope of differences between the tax declared and the tax actually due.

Assuming similar assumption for the NFA inspection tasks, referring to the data of the findings presented in inspection proceedings conducted by the tax inspection authorities in 2015, it must be assumed that the increase in the efficiency of tax inspections will translate into additional findings from 5% to 10%, which represents an increase in amounts, i.a, PLN 0.93 billion to PLN 1.9 billion from 2018 year (PLN 18 545 625 000 x 5% = PLN 927 281 250; PLN 18 545 625 000 x 10% = PLN 1 854 562 500). On the basis of the assumptions for the introduction of the Standard Audit File (SAF) the amount of PLN 0.93 billion should be reduced by PLN 0.70 billion, so it is assumed that the actual increase in efficiency resulting from the consolidation of the treasury services will be at the level of PLN 0.23 billion.

In addition, it is assumed that an increase in the efficiency of tax audits will result in the realization of revenues of NFA units (especially for income realized by the tax offices) by 1% to 1.5% within

2018-19 that means an increase of budget revenues by the amount of PLN 2 3 billion to PLN 3.4 billion (228 088 836 536 x 1% = PLN 2 280 888 365; 228 088 836 536 x 1.5% = PLN 3 421 332 548).

It is assumed that the total benefits resulting from the implementation of NFA in 2018 and in 2019 will amount to a minimum of PLN 2.51 billion (PLN 0.23 + PLN 2.28 billion = PLN 2.51 billion). The maximum variant of the increase of budget revenues will be included in the amount of PLN 3.42 billion.

Financial effects*		2017	2018	2019
Revenue (in PLN million)	min.	0	2 511	0
	only direct effects	0	230	0
	max.	0	3 651	0
	only direct effects	0	230	0

** - presented on year to year basis*

VI. Computerization of auditing the tax books (Standard Audit File)

Objective: The purpose of the introduction of the Standard Audit File (SAF)[30] is to improve the efficiency of tax audits by introducing a new accounting system functionality, ie. capability of editing tax books and accounting documents based on XML standard widely used in electronic communication. The benefits of the proposed change is the access to data in a format easy to analyze, facilitation for internal and external auditors, lack of hard copy output, faster control, a significant degree of automation. This will reduce the costs of the functioning of the tax administration. The purpose of this change is to reduce the cost of fulfillment of tax obligations by taxpayers and improving relations between the administration and its clients.

Currently, the audit using electronic techniques is ineffective. The audited entity transmits data stored in electronic formats, unfit for analysis (e.g. PDF, which is an electronic printout rather than the file for quick analysis).

The purpose of the SAF introduction was to standardize the form of electronic reports from tax books and accounting documents in which taxpayers and taxpayer contractors will be obliged to transmit data at the request of the tax authority.

The introduced change in question is already in service in many other European Union countries (the Netherlands, Austria, Portugal, Slovenia, Estonia, Luxembourg). The vast majority of these countries implemented the SAF consistent with the recommendation of the OECD.

Tools: The introduction of the right to request the transfer of the extract of tax books and accounting documents stored electronically in the form of standardized files, in the course of each tax procedure, in *the Tax Ordinance Act*. The data shall be transmitted by means of electronic communication or on an electronic data carrier.

The logical structure of an electronic form of tax books and accounting documents, including the possibility of producing them from computer programs commonly used by entrepreneurs and automated analysis is available on the website of the Ministry of Finance.

Addressee: Each entity keeping the tax books using computer programs.

Responsible body: Minister of Finance

Deadline: 1 July 2016

[30] JPK introduced under the Act of 10 September 2015 on *amending the Tax Ordinance Act and other acts* (Journal of laws, item 1649).

From 1 July 2016, large enterprises will be required to submit data in the form of SAF. In the period of two years, i.e. from July 30, 2016 to June 30, 2018 small and medium entrepreneurs shall provide SAF optionally. Since July 1, 2018 every entrepreneur shall be required to transmit data in the form of SAF.

Financial effects*		2017	2018	2019
Revenue (in PLN million)	min.	350	0	0
	only direct effects			
	max.	700	0	0
	only direct effects			

** - presented on year to year basis*

VII. Establishment of the Register of Debtors of Public Liabilities

Objective: The objective of the establishment of the register is to increase the security of business transactions by allowing entrepreneurs to verify the reliability of the business contractors, increasing fiscal discipline, increase of the state budget revenues through the creation of an instrument encouraging debtors voluntary payment of liabilities, reduction of the costs for recovery of debts, as well as reducing the size of the liabilities, which would expire as a result of ineffective enforcement of taken measures.

Tools: The register will be conducted in the ICT system by the minister responsible for public finances. Passing the data by creditors (heads of tax offices) on the debtor and its arrears will be carried out automatically within the computer systems of the creditors connected to the ICT system that supports the register. Those interested will have access to the register through the tax portal referred to in Article 3 Section 14 of *the Tax Ordinance Act* on the basis of the possessed data on the debtor (e.g. in the case of natural persons: social security number (PESEL)).

Addressee: Debtors, creditors of public liabilities, person interested in obtaining information about the reliability of business partners.

Responsible body: Minister of Finance

Deadline: 1 January 2018

Financial effects*		2017	2018	2019
Revenue (in PLN million)	min.	0	814	-407
	only direct effects	0	814	-407
	max.	0	1 627	-814
	only direct effects	0	1 627	-814

** - presented on year to year basis*

VIII. Establishment of a special purpose vehicle for the implementation of IT projects with a public purpose concerning matters in the scope of public finances

Objective: Developed draft act[31] defines the implementation rules of some IT projects with a public purpose, which are aimed at providing the tax authorities, the customs and tax control authorities with IT systems to support the detection of violations of the tax law, based on the data gathered in the IT systems of the minister responsible for public finance, tax authorities, customs service and tax control. The intention of the designers is that some IT projects shall be implemented by a special purpose vehicle.

The proposed changes are aimed at reducing irregularities in the area of public finance and trade, preventing fraud and their efficient detecting, protecting market by reducing the gray zone and reducing the tax gap. The aim is also to achieve higher efficiency of revenue collection and increase the safety and security market, by increasing the use of information technology in the area of tax administration and fiscal control, in the range of tasks that allow an increase in the efficiency of detection and prosecution of perpetrators of tax crimes and offenses. In particular, this applies to streamline the process (efficiency) of VAT collection and the prevention of fraud in this area.

The deficiency of VAT (the so-called VAT gap) is estimated by various sources at PLN 25 to 40 billion. For example, the report titled. "*Study to quantify and analyze the VAT Gap in the EU Member States*" commissioned by the European Commission by CASE, estimated this amount for Poland at PLN 10 billion 2013.

Tools: Register of VAT invoices.

Addressee: tax, customs service and tax control authorities.

Responsible body: Minister of Finance

Deadline: The Council of Ministers on 5 April 2016 adopted the draft Act of the act in question. Now, the draft is proceeded in Parliament.

Estimated financial effect: Financial effects of the project on the target company results from improved collection of VAT which is assumed to be achieved by increasing the degree of computerization of collection and control of VAT. The baseline scenario assumes implementation of the initial functionality of the system since mid-2017, and its total operational capability in 2018. Assuming the intensification of work on the functionality of the system (associated with the proposed establishment of a special purpose vehicle) and the achievement of its accelerated - in relation to the objectives outlined in the Assessment of Regulation Effects (ARE) - the total operational capability at the beginning of 2018 with obtaining the full analytical and control operational capability of tax services (using tools included in system received from the SPV) in the second quarter of 2018, it can be assumed earlier achievement of positive effects in 2018.

Financial effects*		2017	2018	2019
Revenue (in PLN million)	the ARE scenario	1 400	2 000	10 200
	only direct effects	1 400	2 000	10 200
	stepped-up scenario	1 400	5 000	7 200
	only direct effects	1 400	5 000	7 200

** - presented on year to year basis*

[31] The draft *act on special rules for performing certain tasks in the field of computerization of the activities of tax, customs and tax control authorities* (Form 395).