REPUBLIC OF POLAND

CONVERGENCE PROGRAMME
2015 UPDATE

Warsaw, April 2015

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Summary

The annual update of the *Convergence Programme* (hereafter referred to as the *Programme*) presents medium-term forecasts for Poland's economy and public finances. The document has been prepared in accordance with the guidelines on the format and content of stability and convergence programmes of the European Union Member States.

The *Programme* constitutes a part of the *Multiannual Financial Plan of the State* (MFPS), developed pursuant to the *Public Finance Act*. The MFPS was accepted by the Council of Ministers on 28 April 2015 and shall successively provide basis for the preparation of the draft Budget Act for 2016.

The current *Programme* update 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 recommendations formulated on the basis of the NRP analysis of 2014[1]. Both the *Programme* and the NRP will be submitted to the European Commission and the Council in April, within the framework of the European Semester. The Council recommendations issued on the basis of the assessment of the two programmes should be taken into account before taking key decisions on the budget for next year.

Drafts of the *Programme* and the NRP were subject to discussion of the combined parliamentary committees for EU affairs, public finances and the economy on 23 April this year. It was the first such meeting. As in previous years, the Council opinion on this *Programme* and the Council's recommendations of 2015 concerning the NRP will also be discussed by the Polish Parliament.

I. Overall policy framework and objectives

I.1. Fiscal policy in the EU context

In 2009 the Ecofin Council (i.e. Economic and Finance Ministers of the EU Member States) established the existence of an excessive deficit in Poland and it recommended that the deficit be brought below 3% of GDP in 2012 at the latest. In June 2013the Ecofin Council, positively assessed the efficiency of measures taken by Poland to reduce the deficit. However, due to a significant economic slowdown [2] and as a consequence, failure to achieve the budgetary target set for Poland, the Council decided to extend the deadline for eliminating the excessive deficit to 2014[3]. Subsequent recommendations of the Ecofin Council moved this deadline by another year, i.e. to 2015[4].

In the new recommendation, the deficit targets for Poland in the period 2013-2015 were defined as nominal deficits of: 4.8% of GDP, 3.9% of GDP and 2.8% of GDP, respectively (excluding the impact of the assets transfer from the open pension funds to the Social insurance Fund). The Ecofin Council also stated that the achievement of the budgetary targets would require an improvement in the structural balance (i.e. this part of the nominal deficit the government may directly influence through the policy implemented) by 1% of GDP in 2014 and 1.2% GDP in the

[1] *Council Recommendation of 8 July 2014 on the Polish National Reform Programme for 2014 and delivering a Council opinion on the subject submitted by Poland's convergence programme for 2014., Available at* http://ec.europa.eu/europe2020/pdf/csr2014/csr2014_council_poland_en.pdf

[2] In 2012, real GDP grew in Poland by 2.0% compared to 4.5% in 2011; in 2013, this rate decreased to 1.6%.

[3] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-07_council/2013-06-21_pl_126-7_council_en.pdf

[4] http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-07_council/2013-12-10_pl_126-7_council_en.pdf

following year. As compared to European Commission's forecasts[5] this would imply a need of Poland taking additional structural measures of 0.4% of GDP in 2014 and 1% of GDP in 2015.

Furthermore, the Ecofin Council recommended that Poland should:

- improve the quality of public finances, in particular through minimising cuts in growth-enhancing infrastructure investments, a careful review of social expenditures and their efficiency;
- improve tax compliance and increase the efficiency of tax administration
- make the institutional framework of public finances more binding and transparent, including through adjusting the definitions used in national accounting to the European System of National and Regional Accounts (ESA) standards and ensuring sufficiently broad coverage, improving intra-annual monitoring of budget execution and ensuring an effective and timely monitoring of compliance with the permanent expenditure rule, based on reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities.

Finally, according to the Ecofin Council, fiscal consolidation should be supported by comprehensive structural reforms, consistent with the Council recommendations issued in the context of the European Semester.

The status of the implementation of Poland's recommendations on public finances are presented primarily in chapters III and VII of the present *Programme*. In addition, every six months, Poland prepares special reports on the progress in implementing the abovementioned Ecofin Council recommendations, which are subject to assessment by the European Commission. Based on the report of 15 October 2014[6], the European Commission kept in abeyance the excessive deficit procedure, recognising that further steps towards Poland are not needed.

The forecasts of the European Commission published in February this year[7] indicate that Poland achieved its budgetary targets for 2013-14. The estimated nominal deficit in 2013 (4.0% of GDP) was lower than recommended by the Ecofin Council. Also the deficit for 2014 (3.6% of GDP[8]) was better than recommended one. However, the deficit projected for 2015 (2.9% of GDP) is slightly above the deficit target but below the reference value of 3% of GDP, therefore at a level which, if achieved, should allow timely abrogation of the procedure against Poland. In 2016, the European Commission expects that nominal deficit will decrease to 2.6% of GDP, while the general government debt will remain below 50% of GDP.

Another half-yearly report on implementing the Council's recommendation was submitted by Poland on 15 April this year[9]. In accordance with the information and forecasts presented in the report and in this *Programme*, the nominal deficit has been reduced in a sustainable manner to below 3% of GDP in 2015. The government remains committed to reducing the imbalance in public finances in the manner which would not pose a threat to medium-term perspectives of Poland's economic development. Therefore, the further years will be oriented towards meeting the medium-term budgetary objective (MTO) by Poland, i.e. the structural deficit at a level of 1% of GDP. The reduction of the deficit, reaching the MTO and maintaining the government debt much below the reference value of 60% of GDP will be fostered by the compliance with the stabilising expenditure rule introduced in 2013.

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[5] http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee7_en.pdf
[6] The report is available on the website of the Ministry of Finance under: Information on the actions taken by Poland to implement the recommendations of the Council within the framework of the excessive deficit procedure-October 2014
[7] http://ec.europa.eu/economy_finance/publications/european_economy/2015/pdf/ee1_en.pdf
[8] In accordance with ESA2010.
[9] The report is available on the website of the Ministry of Finance under: Information on the actions taken by Poland to implement the recommendations of the Council within the framework of the excessive deficit procedure - April 2015

I.2. Coordination of 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 Semester, the Member States strive to reflect the EU recommendations in their policies.

In its opinion of 8 July 2014 to the previous *Programme*, the Ecofin Council recommended to Poland, among others[10], reinforce the budgetary strategy to ensure the correction of the excessive deficit in a sustainable manner by 2015 through achieving the structural adjustment effort specified in the Council recommendation under the excessive deficit procedure. After the correction of the excessive deficit and until the medium-term objective is achieved, pursue an annual structural adjustment of 0,5 % of GDP as a benchmark. A durable correction of the fiscal imbalances requires, according to the Council, a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. Therefore, the Council recommended Poland additional measures, like minimising cuts in growth-enhancing investment, improving the targeting of social policies and the cost effectiveness of spending and the overall efficiency of the healthcare sector, broadening the tax base for example by addressing the issue of an extensive system of reduced VAT rates, and improving tax compliance, in particular by increasing the efficiency of the tax administration. The Council also recommended the establishment of an independent fiscal council.

In chapters III and VII, this *Programme* presents the status of implementation of recommendations on public finances, issued by the Ecofin Council within the excessive deficit procedure and formulated in the opinion of the *Programme* issued in 2014. In addition, the progress of structural reforms recommended by the Ecofin Council on the basis of NRP analysis from 2014 was discussed in this year's edition of the NRP. This *Programme* focuses on the most essential reforms for the economic potential and long-term sustainability of public finances.

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. In order to enhance and strengthen the economic recovery, in the latest edition of AGS[11], the European Commission suggested the concentration of economic policies of the European Union in the next year on:

- stimulating investment,
- speeding up the implementation of structural reforms,
- implementing growth-friendly fiscal consolidation.

The European Council also recognised the measures of all Member States and the whole European Union in these 3 areas as this year priorities[12]. Until the end of April, Member States will traditionally submit to the European Commission and the Ecofin Council updates of *National Reform Programmes* and stability or convergence programmes. They should take into account the abovementioned economic policy priorities identified by the European Council. Based on the analysis of the received documents, the Ecofin Council will issue

[10] Cf. footnote 1.
[11] http://ec.europa.eu/europe2020/pdf/2015/ags2015_en.pdf
[12] The European Council conclusions of 19-20 March 2015:
http://www.consilium.europa.eu/en/press/press-releases/2015/03/20-conclusions-european-council/

recommendations in July for the economic policies of the Member States, thus ending the European Semester. Member States should take into account the recommendations when drafting budgets for the next year during the national semester.

With regard to the support of investments promoted by the European Council, the forecast presented in the *Programme* indicates further restoration of private investment by 2018, which, together with maintaining public investment at a level above 4% of GDP, i.e. well above the EU average, will allow for increasing the share of total investment to GDP to 21.6%. Projects co-financed from EU funds will constitute a significant contribution to investments – Poland remains one of the leaders in their absorption. According to data for 2014, the absorption rate of structural funds (the ratio of paid funds to the available budget) under the financial perspective 2007-13 amounted to 89.6%[13], which puts Poland in 8th place among all beneficiaries. Poland has already received more than EUR 60 billion from the EU budget – the most in the EU – and measures are taken to allocate fully available EU funds by the end of this year. Preparations are in progress to utilise EUR 82.5 billion from the cohesion policy budget for 2014-20 - Poland is among the EU countries with all operational programs approved by the European Commission.

The European Commission, together with the publication of AGS 2015, presented the *Investment Plan for Europe*, which in the years 2015-17 is expected to improve conditions for investment and generate additional public and private investments in the European Union at least for the amount of EUR 315 billion. The launch of the European Fund for Strategic Investments (EFIS), which is one of the three pillars of the plan, is expected for June/July this year. In Poland, the co-financing of projects by the EFIS will be particularly available through the *Polish Investment* programme and via the so-called investment platforms, which are to be established within the work on the creation of EFIS (chapter II.3).

Growth-friendly fiscal consolidation, recommended by the European Council, is also a priority of the Polish government. The strategy of reducing excessive deficits will continue to be implemented mainly by reducing the expenditure ratio to GDP with the use of stabilising expenditure rule, which should bring more durable consolidation effects than raising the share of revenue in GDP (chapter III). At the same time, prioritisation of expenditures enables measures to strengthen the growth potential of the Polish economy in the long term. In particular, actions are being carried out in response to changes in the demographic structure and aimed at improving the financial situation of families, especially families with many children (chapter II.3). The consistent deficit reduction through a positive impact on domestic savings and a decrease in the risk premium taken into account in the price of capital will allow within the horizon of the *Programme* for the faster accumulation of capital in the private sector and across the economy. As a result, the potential GDP growth rate in Poland is expected to increase from 3.2% in 2014 to 4.0% in 2018.

I.3. Integration with the euro area

The introduction of the euro constitutes Poland's strategic objective, whose realisation at the current stage includes activities for the maximisation of benefits and limiting the risks resulting from the future change of currency. Therefore, the strategy for the safe integration of Poland with the euro area has been based on four conditions (pillars).

The first pillar concerns targeting sustainable fulfilment of the convergence criteria in the Polish economic policy framework, with particular focus on fiscal discipline. The credible prospect of meeting the criteria within two years of inclusion in ERM II as well as reaching the political agreement concerning legislative changes necessary for the common currency adoption are the conditions for joining this mechanism. In 2010, the government specified these conditions in the

[13] https://cohesiondata.ec.europa.eu/EU-Cohesion-Funding/Bar-chart-Funds-Absorption-Rate-Cohesion-Policy-20/g67v-zjyr

Prerequisites for Implementation of the Next Stages of the Roadmap for Euro Adoption in Poland.

The second pillar constitutes the implementation of additional measures aimed at strengthening the potential of the Polish economy, including institutional measures. As can be seen on the example of some euro area countries, the fulfilment of the nominal convergence criteria does not provide protection from losing competitiveness and does not guarantee the efficiency of alternative adjustment mechanisms. Hence, the scale of the benefits resulting from the adoption of the euro depends on the economic policy in the given country. The lack of the adequate preparation to functioning within the currency union, which as a result of the institutional reform is characterised by increasing limitations of the autonomy of the economic policy – extending well beyond monetary and exchange rate policies – could lead to a repetition of the crisis scenario observed in the periphery countries of the euro area. Therefore, as part of preparation for the introduction of the euro in Poland, necessary analyses are being carried out, also in cooperation with the World Bank, in order to designate the desired shape of the economic policy on the way to the euro, taking into account the changing conditions. These research projects aim at identifying potential challenges and proposing solutions to increase the competitiveness of Polish exports and improve the flexibility of the product market.

The third pillar includes a thorough preparation of the technical and organisational aspects of the process. So far, two key documents have been developed: *Strategic Guidelines for the National Euro Changeover Plan*, approved by the Council of Ministers in 2010, and *the National Euro Changeover Plan*, approved by the European Affairs Committee in 2011. Therefore, most works regarding practical preparations which can be done at the current stage (without knowing the euro changeover date) have been completed. However, taking into account the scale of institutional changes in the European Union and the euro area, it was deemed proper to update the *National Euro Changeover Plan* as regards the consequences of these changes for the preparation strategy. The outcome of these changes determines the area of the necessary institutional and legal adjustments as well as the national balance of costs and benefits arising from introduction of the common currency. The date of completion of works on the update of the *Plan* depends on the completion of the main works on the institutional reform of the Economic and Monetary Union.

The fourth pillar comprises stabilisation of the situation in the euro area, especially confirming the actual effectiveness of the adopted reforms and the completeness of the institutional architecture of the euro area. The crisis revealed the flaws and incompleteness of the existing institutional system of the euro area. As a result, numerous new solutions of a fundamental nature are being implemented, which is a response to the identified weaknesses of the EMU. The reforms implemented within the EU and the euro area significantly influence the balance of costs and benefits of the euro changeover in Poland. However, the actual effectiveness of the new solutions, and thus the benefits of their implementation, will be revealed only during their practical operation.

Due to the significant uncertainty concerning the time horizon in which the requirements for the safe adoption of the common currency can be met, the government at present is not specifying a target date for the euro adoption. However, the government regards the continuation of preparations for the introduction of the euro as beneficial to Poland, especially within the scope of pillars one and two of the integration strategy. Moreover, the inter-organisational structure for the adoption of euro in Poland is analysing the institutional changes in the euro area in terms of their consequences for the euro preparation process in Poland. Furthermore, the government actively participates in efforts aimed at permanent improvement of the stability of the common currency area, thus contributing to the realisation of the fourth pillar of the integration strategy.

Currently, the immediate goal of the indicated government's actions is therefore to ensure the readiness to adopt the euro at a time when the conditions described above are satisfied. Hence the present approach is referred to as "get ready and see". The activities of the inter-organisational structure go far beyond passive monitoring of the development of external conditions.

I.4. Economic policy objectives

The Medium-term National Development Strategy 2020 [14] (hereinafter referred to as the *Strategy*), adopted by the Council of Ministers in September 2012, defines the main medium-term objective of the government as one that will *strengthen and make use of the economic, social and institutional capabilities in order to ensure rapid and sustainable development of the country, and to improve the quality of life of the population.* The *Strategy* indicates three strategic areas on which the main measures aimed at accelerating development processes should focus: *Effective and efficient State*, *Competitive economy* and *Social and territorial cohesion*, providing also the basis for the preparation of successive updates of the NRP, including the NRP 2015/2016.

At the same time, the emphasis is put on the complexity of the challenge posed by the necessity to ensure the sustainability of public finances and the increase in savings together with implementing a development vision based on the elimination of major bottlenecks to growth through education, digitalisation and innovation. The assumptions of the *Strategy* which refer to the consolidation of public finances (carried out in line with subsequent updates of the *Programme*) mean that the rationalisation of expenditure and its steering towards actions vital to the socio-economic and spatial development of the country are the prerequisites for the implementation of this development vision.

Sustainable public finances are key for macroeconomic stability and, in consequence, for the long-term economic growth. Other drivers of macroeconomic stability in Poland include, among others, the establishment of a macro-prudential supervisory board and a legal framework for obligatory restructuring of banks. The tasks of the board will include, inter alia, the identification, evaluation and control of systemic risk in the national financial system and its environment and measures aimed at eliminating or limiting this risk. In particular – strengthening the resilience of the financial system in the event of systemic risk – providing long-term support of sustainable economic growth of the country. The draft act on macro-prudential supervision of the national financial system and crisis management in the financial system was adopted by the Committee of the Council of Ministers and recommended to the Council of Ministers. On the other hand, the currently drafted Act on the Bank Guarantee Fund, the deposit guarantee scheme and obligatory restructuring will implement the *Directive of the European Parliament and of the Council 2014/59/EU of 15 May 2014 establishing a framework for carrying out corrective actions and restructuring and orderly liquidation with respect to credit institutions and investment firms* (...) (BRRD).

[14] *National Development Strategy 2020 – Active society, competitive economy, efficient state*, adopted by the Council of Ministers on 25.09.2012, available at: https://www.mir.gov.pl/english/Regional_Development/Development_Policy/NDS_2020/Documents/NDS%202020.pdf

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 for the past year and a half at an average rate of 0.8% (q/q, sa), i.e. above the rate recorded in 2012, but still slightly below the long-term average. Export continued to show a clear upward trend, which was favoured by the relatively high competitiveness of Polish enterprises and an improvement of the dynamics of activity in Polish major export markets. This was reflected in higher growth in industrial output and investment, particularly in the category of purchases, including machinery and equipment and means of transport. The situation on the labour market also gradually improved. This was visible in the growth of labour demand and falling unemployment, with moderate wage pressures. The result was an upward trend in private consumption. Since the second half of 2013, domestic demand played an increasingly important role in the growth of GDP (y/y), which since the second quarter of 2014 has become the sole driver of economic growth, with a negative contribution of net exports.

In 2014. GDP grew in real terms by 3.4%, i.e. twice more than in the previous year. For the second year in a row, export growth accelerated, which was largely contributed to the improved economic situation in other EU countries, including in the euro area. EU GDP grew by 1.3% after stagnating a year earlier, and the source of this growth was increased domestic demand growth. As a result, a relatively strong increase in EU imports was observed, which is the main indicator of demand for Polish goods and services (EU accounts for almost 80% of Polish exports of goods), which in 2014 amounted to 4%, against 1.4% in the previous year. The increase in EU imports as well as imports of other developed countries and other developing countries and the consequent increase in Polish exports to these markets, offset the decrease in Polish exports to Eastern markets (in particular to Russia and Ukraine), caused by the conflict between Russia and Ukraine, slowdown in the activity in these countries and significant depreciation of their currencies as well as the embargo on the export of food products to Russia.

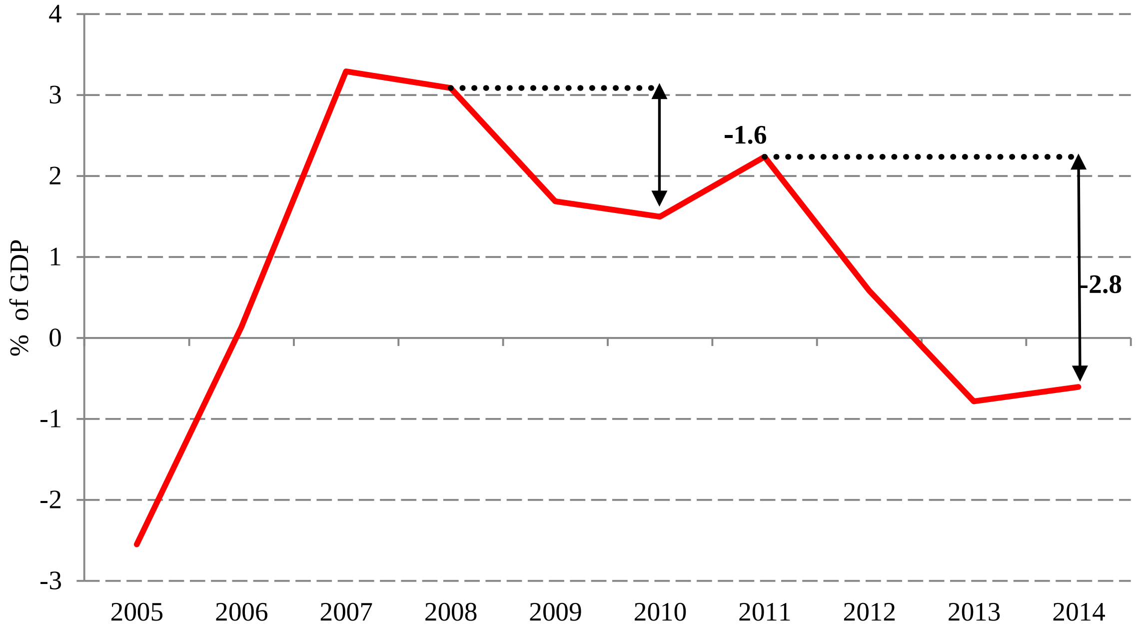
The improvement in economic activity last year, including a marked increase in the investment growth rate, resulted in an improvement in the labour market[15]. The number of employed grew by 1.9%, against a slight decline a year earlier. This increase resulted almost entirely from an increase in the number of employees, the highest in five years. The number of employers and self-employed persons also increased after two years of decline. In sectoral terms, these changes are largely due to a marked increase in the number of employed in the service sector and to a lesser extent, in the broadly defined industrial sector (including industry and construction), but even here growth was highest in three years. The downward trend of the number of employed in agriculture was continued. The increase in labour demand contributed to a significant decline in unemployment. The unemployment rate fell to 9.0% against 10.3% a year earlier, and 10.2% on average in the EU.

The improved situation on the labour market with the stabilisation of prices of consumer goods and services, has influenced the improvement of the dynamics of real disposable income of households, resulting in an acceleration of household consumption growth (to 3.1% from 1.2% in the previous year). The increase in consumption was also supported by improving consumer confidence indicators and higher growth in consumer loans. Last year, there was also a significant increase in the growth rate of investment expenditure (to 9.2% from 1.1% in 2013). High dynamics of investment with weaker dynamics of value added in construction (visible especially in the second half of 2014) is the result of high growth in investments in machinery, equipment and means of transport that are realised mainly in the corporate sector. Good results in this area can be explained by the relatively high cost competitiveness of Polish enterprises, their good financial results and a decrease in financing costs, which with maintained level of capacity utilisation above the long-term average, favoured decisions to increase the production capacity. The increase in gross fixed capital formation - after two years of their clear reduction - was also recorded in the general government.

[15] Information on the labour market are based on LFS data (15 years and older).

It is estimated that last year, for the first time in two years, the growth rate of real GDP exceeded the potential growth rate of the Polish economy, which is estimated (according to the methodology of the European Commission) at approx. 3.2%. This allowed for a reduction of the negative output gap to approx. minus 0.6% of potential GDP compared to minus 0.8% in 2013. That is a slight improvement in cyclical conditions for businesses, but supply still prevails over demand in the Polish economy. The total deterioration of the economic cycle in Poland in the years 2012-14 measured as change in the output gap was almost twice as high as the deterioration observed in 2009-10. This is reflected, among others, in indicators describing the nominal sphere of the economy.

Chart 1. Output gap



Source: Ministry of Finance

Negative output gap and moderate wage pressures resulted in continued low core inflation. The annual change in the CPI excluding food and energy prices on average in 2014 was 0.6%, significantly below the lower limit of acceptable deviations from the NBP inflation target. The overall rate of inflation turned out to be even lower and amounted to 0.0%, with the level assumed in the Budget Act for 2014 at 2.4%, and in the revised forecast of the *Programme* from 2014 - 1.2%. It largely resulted from supply shocks in the agricultural products market and the energy market. The decline in food prices was due to high supply of agricultural products in the domestic market resulting from very good crops and the embargo on food imports from EU countries, including Poland, introduced by Russia. In addition, the decline in industrial prices and as a result in consumer prices was favoured by a sharp decline in oil prices recorded in the fourth quarter of 2014 . As a result, since July 2014, prices of consumer goods and services remained at a level lower than the year before.

Improvement of the domestic demand growth and higher growth of the volume of imports than exports translated last year only to a slight deterioration in the trade balance. Changes to balances in real terms have been largely offset by the positive impact of the terms of trade, i.e. larger - in PLN terms - decrease in prices of imports than exports. As a result, the nominal trade balance in relation to GDP was close to balanced. The main driver of the overall external imbalance was still the negative primary income component, reflecting mainly high income of non-residents from foreign direct investment and, although to a lesser extent, income of non-residents from portfolio investments. As a result, current account balance remained negative in the previous year, at 1.4% of GDP. The main role in the financing of the external imbalance of the Polish economy was taken over by the capital account, which mainly classifies the inflow of funds from the European Structural Funds.

In line with the forward guidance from March 2014, the Monetary Policy Council (MPC) kept NBP interest rates unchanged until the end of the third quarter of 2014 . In October, the Council reduced the interest rates by 0.5-1.0 percentage points (except the deposit rate, which remained unchanged), assessing that the incoming data indicate a slowdown in economic activity and an increased risk of inflation remaining below the target in the medium term. The main interest rate - the reference rate - was reduced to 2.0%. At the same time the MPC did not rule out further monetary policy adjustments, which contributed to a strong increase in market expectations for another interest rate cut as soon as in November last year. However, the Council maintained the central bank's cost of money unchanged until the end of the year. On average, in 2014, the reference rate stood at 2.4%. NBP interest rates were lowered again in March 2015. The scale of the reduction was 0.5 percentage points, which brought the reference rate to a new record low of 1.5%. At the same time, the Council declared that this reduction means the end of the monetary policy easing cycle in Poland.

In 2014, the zloty exchange rate was determined mostly by global factors. The Polish currency was relatively resistant both to the reduction of the asset purchase program by the Fed as well as to increases in geopolitical tensions (the conflict in Ukraine). For the better part of the year, the EUR/PLN exchange rate fluctuated in a relatively narrow range of 4.15-4.24. Stronger appreciation of the zloty took place in early June, when the EUR/PLN exchange rate fell below 4.10, resulting from improved global sentiment after lowering the interest rates by the ECB. On the other hand, in December, the EUR/PLN exchange rate increased above 4.30 due to deterioration in sentiment in the CEE region and low liquidity on the foreign exchange market at the end of the year. Since July 2014, the Polish currency weakened steadily against the US dollar strengthening on the world markets. The average exchange rate of the zloty in 2014 stood at the level of 4.1852 EUR/PLN and 3.1551 USD/PLN.

II.2. Medium-term scenario

The current forecasts of the European Commission concerning the economic standing of the main trade partner of Poland, which is the EU, allow for an optimistic assessment of the economic growth perspectives in Poland. In accordance with the estimates published in February 2015 and used to prepare the forecast presented in the Programme, the European Commission expects that the growth rate of GDP in the EU in 2015-16 will amount to 1.7% and 2.1% respectively (against 1.3% in 2014). The main growth factor within the time horizon of the forecast will be domestic demand, mainly private consumption and to a lesser extent investment, with neutral contribution from net exports. The improvement of the growth of domestic demand in the EU will be conducive to higher EU import growth, the main indicator of Polish export markets. The European Commission forecasts that EU import in 2015-2016 will increase by 4.3% and 5.4% respectively (against 4.0% in the previous year). For the needs of the macroeconomic scenario presented in the Programme it was assumed that in the following years the growth rate of GDP and import in the EU will return to the long-term average, which means that the real growth of GDP will amount to 1.9% in 2017 and 1.7% in 2018 and the real growth of import will amount to 5.0% in 2017 and 4.6% in 2018.

In the years 2015-2016 the share of public investment in GDP shall stabilise at 4.5% and will be similar to the level observed in 2014 (4.4% of GDP). A certain decline in this share may be expected in the period 2017-2018. However, the decline in the public investment share in GDP in Poland will not be considerable, and it should fall to approximately 4.2% of GDP in 2018, whereas the share itself shall remain as one of the highest among the EU member States.

The demographic determinants of the forecast presented in the *Programme* are based on the assumption of demographic changes foreseen in the EUROPOP2013 adjusted with current GUS data. According to the assumed scenario, in the horizon up to 2018, a slight overall decline in the population in Poland is expected, by 0.1% in relation to the level in 2014. The number of working-age population (aged 15-74) will decrease by approx. 0.6% in this period. The assumed scenario of the activity rate (using the LFS methodology, age group 15-74), taking into account i.a. significant limitations on earlier retirement and raising the retirement age, nevertheless, will allow to reduce the negative demographic effects on the labour market. The labour supply in 2018 will increase by approx. 0.1 % in relation to the level from 2014 (however, from its level will start to decrease from the beginning of 2017). The upward trend in economic activity rate will be maintained until the end of the period covered by the forecast, at a slightly lower rate than the relatively high rate observed in 2014.

It is expected that in 2015 the average number of employed persons will increase by 1.1%. In subsequent years, this increase will gradually decline from 0.7% in 2016 to 0.5% in 2018. Changes in total employment take into account the assumption of the *Programme* about maintaining the number of people employed in the general government at the level recorded in the fourth quarter of 2014. Taking into account the previously presented changes in active population and projected increases in employment, a further systematic reduction in the unemployment rate is expected over the forecast period after its growth in the years 2009-13. It is estimated that in 2015, the unemployment rate will fall to 8.2% from 9.0% recorded in the previous year. In 2016, it will amount to an average of 7.6%, to decrease to 6.5% by 2018.

The decrease of the unemployment rate and a gradual increase in the price level will foster the growth of nominal wages in the market sector. As regards changes in remuneration in the state budget units (chapter III), it is expected that in 2015, the nominal growth rate of the average remuneration will be about 0.1 percentage points higher than last year and will amount to 3.5%. In the following years, it will gradually accelerate and will reach 3.6% in 2016, 3.8% in 2017 and 4.6% in 2018.

Taking into account the estimated growth of average remuneration, the number of employees and the number of beneficiaries, it is expected that the average real growth in disposable income of households in the years 2015-18 will be close to average GDP growth in this period. In the forecast horizon disposable income of households is expected to be supported by relatively rapid growth of operating surplus in this sector, namely income of natural persons conducting business activities, whose changes should be linked to a greater extent to the dynamics of the development of the market sector than the entire GDP dynamics. Support for disposable income - apart from favourable trends in the labour market - should also include a further increase in state aid to families with children and a one-off increase in indexation of pensions in 2015. Considering the above factors, it is expected that in 2015, real growth of private consumption will increase to 3.4% from 3.0% last year, despite the expected increase in voluntary savings rate in the following years - along with the expected improvement in the consumer sentiment index due to better economic conditions - it will increase to an average of 3.8%.

The real growth in public consumption shall be determined by government actions aimed at achieving the medium-term budgetary objective. As a result of the consolidation activities the share of public consumption in GDP will be reduced.. The estimated real growth rate in this economic category in 2015-2018 is, respectively, 2.7%, 1.1%, 1.1% and 1.4%.

The continued price competitiveness of Polish products prices helps companies to achieve high return on sales. Despite a relatively unfavourable situation in the external environment, since 2011 recovery of private investments has also been observed, after a severe deterioration in this economic category in 2009-2010. The share of private investment in GDP grows systematically and in 2014 it reached 15.1%, i.e. 0.1 percentage points below the level recorded at the beginning of the previous investment recovery (i.e. in the period of accession to the EU in 2004). In spite of the observed growth trends, the share of private investment in GDP remains considerably below the level noted in the period of economic boom preceding the financial crisis (it reached 17.8% in 2008). It is expected that within the forecast horizon, the trend of recovery of investment demand in the private sector shall continue. In 2015, private investment will show real growth by 6.6%, to reach the growth rate at a level of 7.6%, 8.3% and 8.2% in the following years. As a result, the share of private investment in GDP at the end of 2018 will increase to 17.4%. Apart from the expected improvement in the external environment, another factor supporting the growth in private sector investment demand will be maintaining the relatively low level of the cost of capital due to low interest rates and as a result of the Polish Investments programme. The Ministry of Finance is also carrying out analytical works on the introduction of tax relief related to expenditure on research and development.

The state of inventories is related to the level of demand on the domestic and foreign markets. It is estimated that with the stabilisation of the growth rate of final demand at approx. 4.5% (against 5.2% in 2014), in the period covered by the Programme, the contribution of the change in inventories will be close to neutral for economic growth, against the contribution of 0.4 percentage points recorded in 2014.

In the period 2009-2014 the share of export in GDP in Poland increased from the level of 37.6% to 46.9%. Such a dynamic change in the structure of the Polish GDP results from a high competitiveness of Polish enterprises and, which is also important, from the relative weakness of the domestic demand in this period, especially observed until 2013. It is forecasted that the share of export in GDP will continue to grow until 2018, but at a much lower rate. The real growth rate of export will be even higher than the growth rate of export markets, reaching 5.7% in 2015, 5.9% in 2016, 5.6% in 2017 and 5.5% in 2018,. as a result of which export share in GDP will reach its historically high level of 49.2%.

The development of final demand will be, next to the exchange rate, the main determinant of the growth of Polish import. It is expected that the real import growth will remain higher than the forecasted export growth, reaching in 2015-2016 respectively 6.9% and 6.1% and 5.7 in 2017-2018. As a consequence, the contribution of net exports to GDP growth in 2015 will amount to minus 0.6 percentage points, against 1.4 percentage points in 2014. In the consecutive years, it will stabilise at 0.1 percentage points.

The development of the net export is a determinant of the trade balance and a vital factor influencing the current account balance in the balance of payments. In 2015, the current account deficit will fall to 1.2% of GDP in comparison with 1.4% of GDP in 2014. The main source for the external imbalance will continue to be an income deficit triggered by the negative net international investment position of the Polish economy. Over the next years of the forecast, the deficit on the current account in the balance of payments will start to deepen gradually and it will reach, respectively, 1.9% in 2016, 2.2% in 2017 and 2.4% in 2018. It is expected that until 2018, this deficit will be financed with a surplus by the inflow of long-term capital, i.e. resources classified on the capital account (mainly the European structural funds) and foreign direct investments.

In summary, the expectations concerning the development of GDP components enable to expect that the economic growth in Poland in 2015 will reach 3.4%, which is the same as in 2014. The key factor behind the acceleration of the economic growth will continue to be private domestic demand. The real GDP growth rate is forecast to accelerate and reach 3.8% in 2016, 3.9% in 2017 and 4.0% in 2018.

Until 2016, the macroeconomic policy will be implemented under the conditions of the continued negative output gap, although its gradual closing will occur. It is estimated that in 2015 the output gap in relation to the potential GDP will decrease to minus 0.5% from minus 0.6% in the previous year. In 2016, the gap will decrease faster, to minus 0.2%, to reach the level of 0.0% of the potential GDP in 2017 and will remain at this level in the following year. The potential GDP growth rate in the period covered by the forecast will gradually increase from the level of 3.2% estimated for 2014 to 4.0% in 2018, i.e. to the average level for 2007-11. The improvement of the growth of the potential of the Polish economy will be mainly supported by to the expected acceleration of growth of the total factor productivity and a gradually increase in the share of capital in creating economic growth.

In the entire period covered by the forecast, the continuation of the trend of zloty appreciation is expected. The strengthening of the Polish currency should be supported by the strength of the Polish economy, including a relatively small current account deficit, an inflow of foreign investments and a significant decrease in risk premium related to the limiting of the imbalance of public finances. It is assumed that this last factor will have a significant impact on the currency exchange rate, including the planned abrogation of the excessive deficit procedure for Poland.

In the case of inflation, it is predicted that after a marked decrease at the end of 2014, also in the current year the inflationary pressure will be low. As a result of supply factors, among others, a significant increase in deliveries from the USA, in the period from October 2014 to February 2015, oil price on world markets decreased by approx. 40%, from USD 97 per barrel of Brent crude oil to USD 58. On the other hand, fuel prices in the domestic market fell in this period by approx. 17%, which resulted in a direct way in a reduction of the CPI by 0.9 percentage points. Additionally, there was an indirect influence, which results from a reduction in production costs and transport costs, and thus contributes to lower prices of goods purchased by households. Growth of food prices remains very low, which in the period from October 2014 to February 2015 was 0.5%, while in the same period in the last 5 years, an average price increase of 3.4% was recorded[16] (at the lowest growth dynamics of 2.1%). Moreover, in the years 2015-16 inflationary pressures will also be reduced by the still negative output gap. Therefore, it is forecasted that the prices of consumer goods and services will fall in 2015 by an average of 0.2%, and in the subsequent years, the CPI will gradually come back in the vicinity of the middle of fluctuations acceptable in the context of the monetary policy. In 2017, inflationary pressure will be further reduced by the planned return of the VAT rates to 22% from 23% and to 7% from 8%.

II.3. Growth implications of "major structural reforms"

The government, through a number of integrated strategies, has been implementing the policy oriented towards providing favourable conditions for the development of entrepreneurship and the potential for the economic growth of the country. These measures are mainly aimed at improving the access of enterprises to capital, creating the enterprising attitudes, institutional, organisational and financial strengthening of the business environment as well as filling up the information gap and counteracting the adverse effects of the forecasted demographic changes on the balance of individual sectors of the Polish economy. It is expected that the ongoing actions will result in improvement of the total factor productivity and increase of the available resources of this factor, which will consequently enable to achieve a higher level of economic growth and enhance the average standard of life of the citizens. The actions described below are also aimed at implementing the inclusive economic growth policy.

At the same time, there are continued efforts to stimulate entrepreneurship. In this area, measures to improve the institutional business environment so as to ensure stable and favourable development conditions for the functioning of entrepreneurs are crucial. They are of a comprehensive nature and include both legislative actions (deregulation), introducing specific facilitations and simplifications in the legislation governing the conditions for businesses, as well as measures to improve the legislating system, including measures aimed at dialogue with entrepreneurs. These activities are designed to provide the appropriate conditions for the effective use of domestic and European funds.

One of the actions under implementation is the *Polish Investment* programme, the objective of which is to ensure maintaining the high dynamics of investment in infrastructure projects of key importance for the state economy and the strategic interests of the state. The *Polish Investment* programme shall focus on providing conditions for long-term financing of profitable investment projects in the area of energy and gas infrastructure, shale gas management, transport infrastructure, local infrastructure (waste processing, public transport), industrial and telecommunication infrastructure. As a consequence, it will contribute to the achievement of the goals planned in *Transport Development Strategy by 2020* (with the perspective by 2030) and in *Energy Security and the Environment Strategy* (the perspective by 2020). It also fits in the *Investment Plan for Europe*, presented by the European Commission on 26 November 2014, where such institutions are one of the pillars of boosting investment in Europe because of their ability to catalyze private investment. The programme includes a national open investment platform through which the European Strategic Investment Fund, after its creation, will be able to co-finance investment projects in Poland.

Consistent implementation of the *Strategy for Innovation and Efficiency of the Economy* will support innovation and efficiency of the economy and as a result will improve the competitiveness of the economy understood as a long-term ability to cope with external competition. Credit for technological innovation will support the innovative activities of micro, small and medium-sized enterprises by increasing access to investment funds for implementing new technological solutions (developed independently or in cooperation with the science sector). The main emphasis will be put on research and development, its commercial application and creating incentives for cooperation between science and business environments and the implementation of projects by enterprises. Joint initiative of science and business will be rewarded. Mechanisms will also be developed to fund research infrastructure and operations of research units, which will help to ensure high-quality research infrastructure. To this end, solutions to help apply for funds for its financing will be introduced.

[16] Food price growth lower by 2.9 percentage points, results in lower CPI by approx. 0.7 percentage points.

The improvement of the business environment will be also supported by implementation of the *Digital Poland Operational Programme for 2014-2020*. This Programme, addressing the objectives of the *Digital Agenda for Europe*, shall focus, in particular, on supporting the development of broadband networks and public e-services at a central level.

At the same time, Poland takes actions in response to changes in the demographic structure. Since 2011, a decrease in the working age population has been observed. This phenomenon is so strong that even the expected continuation of the improvement in professional activity rates may not be enough to prevent a decline in labour supply. Decreasing labour supply together with increasing convergence of the factor productivity growth rate to levels seen in developed countries will constitute a serious barrier to the potential growth of the Polish economy. To minimize the negative effects on the economy arising from these trends, measures are being implemented with regard to different age groups.

In the first place, incentives for early retirement were withdrawn. This had a positive impact on increasing labour market participation and employment rates among older workers. Furthermore, as in most European Union countries, a gradual extension of the retirement age for women and men was introduced. In addition to the expected increase in the amount of future pensions it also has a positive effect on labour supply. These measures will mostly affect the age group of 45+, where the professional activity indicators recorded so far have been clearly lower than, on average, in the developed economies. The change in the social security system from a defined benefit system to a defined contribution system introduced in 1999 also has a positive influence on increasing activity. In the system created as a result of this change, postponing the decision to retire has a much stronger impact on the growth of future benefits than previously.

The professional activity of the Poles should also improve in connection with the convergence of the economic structure towards a structure with a higher share of the service sector. This will allow for easier entry of younger cohorts to the labour market, in the case of which the professional activity ratio recorded at present is clearly lower than the EU average. The obligation of municipalities to provide places in kindergartens for all four-year-old children, and later also for all three-year-old children, as well as the education reform introducing the compulsory school education covering six-year-old children, will support the activation of the aforementioned age group.

It is assumed that a new family benefit for families with children - parental provision - will be an instrument neutralising the negative effects of demographic change in the long-term. It will be intended for all those who are not entitled to the maternity benefit or maternity salary in its present form because of the failure to pay sickness insurance contributions. Persons entitled to receive this benefit will be, amongst others, the unemployed, students, as well as persons employed on the basis of civil law contracts. At the same time, in order to avoid a situation in which the insured person would receive a maternity allowance in an amount lower than the new parental benefit, it was proposed to introduce a minimum amount of maternity benefit payments and benefits for childbirth in other systems than the general insurance system (concerning farmers or members of the uniformed services) and to define it in an amount corresponding to the parental benefit, i.e. PLN 1000. The right to parental benefits will depend on the person's income and will be awarded in the amount of PLN 1000 per month for a period of 12 months from the birth of the child (in the case of multiple pregnancy for 71 weeks).

The parental benefit is just one of the currently introduced instruments for supporting people in a difficult material situation. In the tax returns submitted by the end of April 2015, families will benefit from the amendment rules on tax relief for children. Firstly, the amount of deductions was increased for the third, fourth and subsequent child in the family, respectively to 180% and 243% of the amount for the first or second child. In addition, taxpayers from lower income deciles can expect a larger relief, especially if they have three or more children. Under the new rules, in the case of too low payable personal income tax, it is possible to be returned up to the amount of social and health security contributions paid by the taxpayer and which are deductible. This solution will contribute to a reduction of the tax wedge for relatively low-earning families with children, which will have a positive effect on the income of these families and their private consumption. It should also lead to an increase in formal employment (reducing shadow economy). The expected effect of the introduced changes will be the reduction of child poverty and building human capital.

At the same time, in order to improve the situation of people at risk of poverty in the labour market the mechanism for determining family benefits will be changed. Exceeding the income threshold entitling to the receipt of the family benefit including allowances will not result in automatic withdrawal of benefits, but only lowering their amount to the difference between the amount of family benefits and the amount of income earned in excess of the income criterion, i.e. in accordance with the principle of "1 PLN for 1 PLN". This action will increase the incentives to take up professional activity by reducing the so-called poverty trap and will optimise the rules for obtaining family benefits.

In addition, there are ongoing consultations between the Ministry of Labour and Social Policy and the Ministry of Finance on the verification of family benefits resulting from the obligation set out in Article 18 of the *Act on Family Benefits*. Based on results of a study of the threshold for income support for families, an increase in the amount of family benefits should be expected. Also income criteria for social assistance benefits will be subject to verification, in accordance with Art. 9 of the *Act on Social Assistance*, taking into account the results of studies of the social intervention threshold.

According to the draft act amending the act on family benefits and certain other acts, as of 1 July 2015, new rules will come into force regarding benefits for people who decided not to take up gainful employment or abandon it in order to take care of a disabled adult (mostly immediate family) - i.e. at least 25 years of age. This group, as long as the income criterion per person in the household of the caregiver and the disabled do not exceed PLN 1000 (previously PLN 664), will be covered by the nursing care benefit in the amount of PLN 800 per month (previously PLN 520).

A complementary action, particularly strongly affecting the improvement of the situation of families with many children, is a program of discounts for members of families with at least three children in the form of the Large Family Card. Holding such cards by members of a household entitles the parents and spouses of parents to use discounts on train tickets, passport fees (75% for children and 50% for the parents) and free admission to national parks. Based on contracts, the program is joined by public entities (e.g. museums) as well as non-public ones, offering discounts for members of large families, mainly regarding food, clothing, footwear, tourism, healthcare, insurance, books and education.

Professional activation and the improvement of working conditions for young parents is supported by the draft amendment to the act on personal income tax and the act on corporate income tax. It increases the tax write-off for employers who have decided to create nurseries or kindergartens at their premises. Allowances for employees may also be of a monetary nature: the employer may, within the scope of tax deduction, provide funding to an employee in connection with the child attending a kindergarten run by another entity, if the employer does not run such an institution. At the same time, the *act on personal income tax* is being amended so that to include the gain created for the employee into the catalogue of allowances exempt from taxation.

In 2015, expenditure on the creation and functioning of institutions providing care for children under the age of 3 was increased as part of the *Departmental Programme for the Development of Institutions of Care for Children Under the Age of 3 "Maluch" ("Toddler")* implemented by the Ministry of Labour and Social Policy. The programme is aimed at implementing the government family policy through a systematic development of places of care for children aged up to 3 years.

Taking into account the relationship between pro-family expenditure and the fertility rate, it is estimated that the activities carried out as part of the pro-family package including the above-described initiatives should help to increase the fertility rate by 0.03 percentage points in 2015, by 0.04 percentage points in 2016 and by 0.05 percentage points from 2017 onwards. This policy, by affecting the growth of labour supply in the longer term, will translate to the acceleration of potential economic growth. The positive impact of the implementation of the pro-family package on the growth of potential GDP will increase steadily from approx. 0.01 percentage points in 2034 to approx. 0.08 percentage points in 2060. Activities under this package will also reduce the negative impact of demographic changes on public finances and strengthen the sustainability of public finances.

State financial stability in the medium and long term is, a basic condition for inclusive economic growth, and inclusive economic growth, in turn, supports the public finances. Healthy public finances are conducive to improving the performance of the economy. Through a positive impact on national savings and a decrease in the risk premium taken into account in the price of capital allow for faster capital accumulation and ultimately contribute to the acceleration of growth of potential GDP. Stable public finances also allow the realisation of other functions of the fiscal policy, i.e. the allocative, redistributive and stabilisation functions.

The provision of the medium- and long-term financial stability of the state is supported among others by the stabilising expenditure rule introduced in 2013, aimed at reducing the excessive growth of expenditure not reflected in the changes of the tax base. In addition, the introduction of the rule and the resulting budgetary limitation for the total expenditure pool shall result in reorganisation of the public expenditure structure, creating a space for increasing pro-growth expenditure. Public expenditure management in the context of requirements resulting from the stabilising expenditure rule will be supported by expenditure reviews.

Another key element of the fiscal policy is the consolidation strategy adopted by the government, fostering the economic growth, which aims, on the one hand, at minimising the adverse effects of fiscal multipliers on the social and economic situation of the country, on the other hand - at consolidation of public finance so that the change in their structure optimum in terms of economic growth can be achieved.

The legitimacy of the measures carried out by the government is confirmed by the results of the Polish economy following the financial crisis. In the years 2008-2014, Poland was the EU leader as regards aggregate real GDP growth and investment growth, which is best indicated by the highest potential GDP growth rate among the Member States.

III. General government balance and debt

III.1. Policy strategy and medium-term objectives

The government is committed to continue the reduction of the imbalance in the public finances in order to create secure and sustainable foundations for the development of the country. The following part of this chapter presents actions aimed at limiting the imbalance of the public finances in the successive years of the forecast.

A key factor influencing the level of fiscal consolidation and therefore also the shape of the fiscal policy is the stabilising expenditure rule introduced to Polish legislation in 2013 (through the amendment to the *Public Finance Act)*. The objective of the rule is to provide the stability of public finances in Poland and to adjust their potential excessive imbalance and, at the same time, to prevent the need of excessive tightening of fiscal policy, particularly, under the conditions of significant economic downturn. The rule introduced meets the requirements arising from the *Council directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States*.

III.2. Measures taken to reduce the excessive deficit

Nominal deficit of the general government was reduced in 2014 to a much greater extent than recommended by the Council, to 3.2% of GDP. Taking into account the costs of the systemic pension reform (introduced in 1999) still incurred in 2014, amounting to 0.4% of GDP, it is estimated that the corrected (i.e. comparable with countries that have not implemented a pension fund system) deficit amounted to 2.8% of GDP and was thus reduced below 3% of GDP[17].

The reduction of the nominal deficit in relation to GDP by 0.8 percentage points compared to 2013 was a result of favourable fiscal consolidation implemented since 2010 and a structure of economic growth beneficial for public finances.

Consolidation measures by the government, undertaken in the years 2010-2014, led to a reduction of expenditure by 3.3 percentage points of GDP. In turn, expenditure after deducting the expenditure financed from EU funds for which the general government is the final beneficiary were decreased by as much as 3.8 percentage points of GDP, and additionally taking into consideration expenditure related the inclusion of PKP PLK to the general government (since 2014), the expenditure decreased by as much as 4.0 percentage points of GDP.

Such a scale of reduction of the expenditure was possible, among others, through:

- currently binding – modified in 2009 – fiscal rules for local government units:
  - a rule that as a minimum, the current account result must be balanced, arising from Article 242 of the *Public Finance Act* (since 2011);
  - individual limits of debt – stipulated in Article 243 of the *Public Finance Act* (from 2014 – the limit will be calculated based on a three-year moving average, initially for the years 2011-2013). In 2013, in order to facilitate the absorption of the EU funds, the rule was modified through extending the range of exclusions by repayment of liabilities incurred in connection with an agreement concluded for implementation of a programme, project or task financed at least in 60% from the non-refundable EU aid, in its part corresponding to the expenses incurred on the national co-financing, financed by means of such liabilities;

[17]Article 2 paragraph 7 of the Council Regulation (EC) No 1467/97 on speeding up and clarifying the excessive deficit procedure, as amended, provides for special treatment in the excessive deficit procedure of countries with capital reform of the pension system. In countries with a system of mandatory private pension pillar, net cost of the pension reform for the public fund should be taken into consideration. This cost stems from the fact that the contributions that were once classified as income of the general government are transferred to the capital fund classified outside the general government. The EU institutions take into account the cost of pension reforms also when considering abolishing the excessive deficit procedure, if exceeding the reference value of 3% of GDP is solely the result of the reform cost.

— reducing (since 2009) entitlements to earlier retirement ;

— temporary (while Poland is subject to the excessive deficit procedure) prohibition of adopting draft acts by the Council of Ministers that may result in a decrease of revenue in public finance sector units in relation to the amounts resulting from applicable regulations and projects that would lead to an increase in expenditure (Article 112 c of the *Public Finance Act*). This regulation was replaced by the stabilising expenditure rule at the end of 2013 ;

— disciplinary expenditure rule binding from 2011 (Article 112a of the *Public Finance Act*), reducing the growth rate of discretionary expenditure and new fixed expenditure to 1% annually in real terms, In 2013 this rule was replaced by the stabilising expenditure rule (cf. chapter VII.1), additionally used in the development of budget for 2014; the stabilising expenditure rule shall be binding starting from the Budget Act for 2015;

— reducing (since 2011) the remuneration fund in the state budget units, through adopting a general rule on freezing this fund at the nominal level of the previous year; in the analysed period, only remuneration of certain professional groups increased (e.g. teachers, employees of institutions of higher education, judges, prosecutors, court clerks and assessor prosecutor, National Fire Service officers, Government Protection Bureau officers, Border Guards and Penitentiary Service officers);

— reducing (since 2011) the funerary benefit to PLN 4000;

— reducing (since 2012) deductions for the company social benefits fund by establishing the basis for calculating the deduction at the level from 2011;

— introducing the income criterion for the entitlement to receive the one-off allowance due to a child birth;

— changes (since 2013) in the pension system, which by gradually raising and equalising the retirement age for women and men to 67 years of age limit the growth of expenditure on new pension in the first period of the regulation being in force;

— reducing debt servicing costs as a result of the transfer a part of certain categories of assets (e.g. bonds and bills issued by the State Treasury, bonds issued by Bank Gospodarstwa Krajowego on the terms specified in the *Act on Toll Motorways and the National Road Fund* guaranteed by the State Treasury) to the Social Insurance Institution by open pension funds and thanks to consolidating liquidity management of public finance sector units (since 2011) [18];

— reducing (since 2014) the amounts of sickness benefits for the uniformed services (soldiers and officers), judges and prosecutors (in principle, covering them by the general scheme, i.e. in the period of the sickness they receive 80% of salary).

[18]The provisions of the Act of 6 December 2013 amending certain acts in connection with the definition of principles for pension payments from funds accumulated in open pension funds provide that on 3 February 2014 the open pension fund shall redeem 51.5% of the units of account to the account of each member of the open pension fund on 31 January 2014 and transferred to the Social Insurance Institution, acting on behalf of and for the benefit of the Social Insurance Fund,

- bonds and bills issued by the State Treasury;
- bonds issued by Bank Gospodarstwa Krajowego on the terms specified in the Act on Toll Motorways and the National Road Fund, guaranteed by the State Treasury;
- other securities amounting to cash benefits guaranteed by the Treasury;
- cash denominated in the Polish currency with value corresponding to the total value of the redeemed units of account,

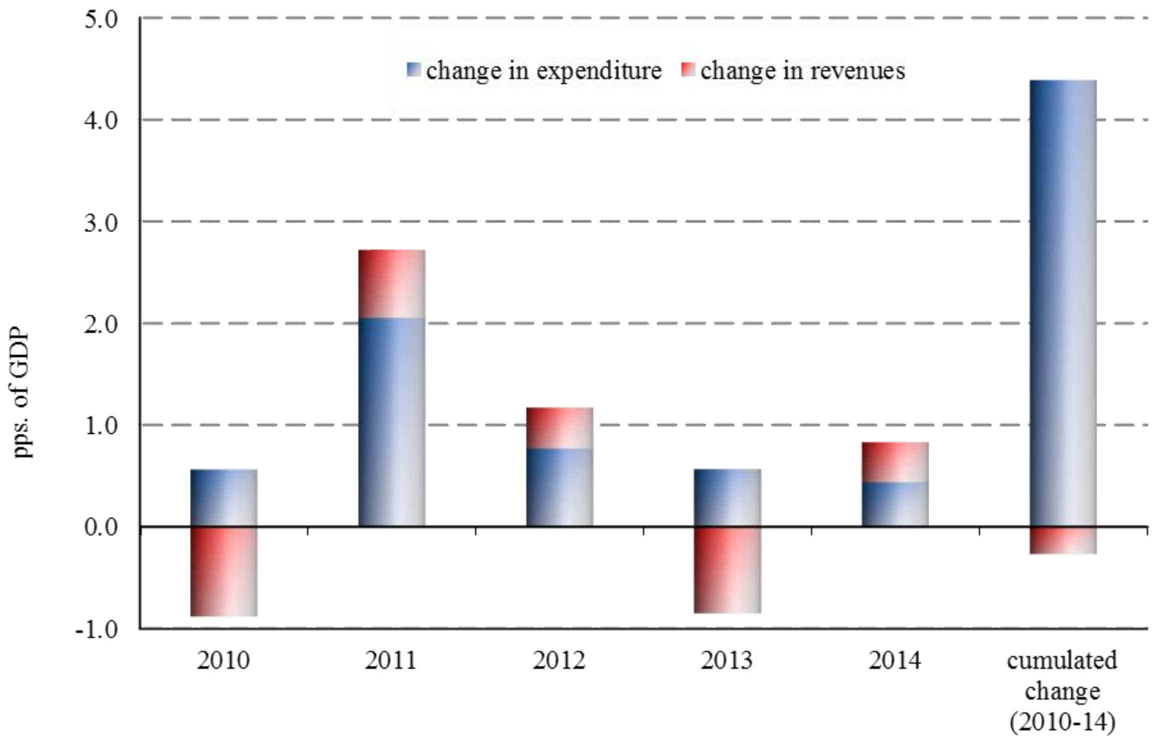
while the open pension fund transfers to the Social Insurance Institution the above-indicated categories of assets, in the following order, until reaching the value corresponding to the total value of redeemed units of accounts of 51,5% of the units of account in the account of each member of the open pension fund, as at 31 January 2014.

On the other hand, the major structural measures regarding revenues included:

- freezing tax thresholds and lump sum of tax deductible costs in PIT at a nominal level of 2009;
- increasing the excise duty for cigarettes (annually since 2010 until the end of 2014), for ethyl alcohol (since 2014) and for oil and fuel fee (since 2012);
- increasing VAT rates from 22% to 23% and from 7% to 8%, while simultaneously decreasing the rates for basic food products from 7% to 5% (since January 2011) ;
- reduction of the right to deduct VAT on purchasing personal vehicles with certification of approval for goods vehicles, and their fuel (since 2011) ;
- reduction of the share of the pension contribution transferred to the Open Pension Funds – OFE (the part transferred to OFE was reduced as of May 2011 from 7.3% of the base to 2.3%; since February 2014 the voluntary contribution transferred to the Open Pension Funds is 2.92%);
- increasing the disability contribution, constituting a burden on the employer, by 2 percentage points (since February 2012) ;
- introducing a fee for using certain natural resources (tax on mining copper and silver since April 2012);
- extending the use of the *reverse charge* mechanism (extending the catalogue of goods, to which the reverse charge mechanism applies since 2013);
- introducing the joint and several liability in VAT of the purchaser for tax liabilities of the supplier of steel products and fuel (to which the *reverse charge* mechanism shall not apply) and non-processed gold, as well as for sellers of these goods (since 2013);
- introducing the system of trading CO2 emission allowances (in 2013);
- reducing the limit authorising tax payers to exemption from the obligation to keep the cash register (from PLN 40 thousand to PLN 20 thousand) (since 2013) ;
- reducing the 50% of tax deductible costs due to copyrights and related rights (since 2013);
- limiting the Internet tax relief and modification of tax relief credit for children (since 2013);
- limiting (since 2014) the possibility to obtain reimbursement of a part of VAT on certain expenditures incurred for housing purposes (the Act on state aid in the purchase of a first dwelling for young people);
- gradually increasing road sections for which tolls are collected in the ETC system (via TOLL);
- introducing (since 2014) taxation of limited joint-stock partnerships.

In spite of so many structural measures of significant effect the revenues of the general government in the years 2010-2014 increased by only 0.7 percentage points of GDP, while these revenues, after deducting the revenues financed from EU funds for which the general government is the final beneficiary and revenues of PKP PLK S.A. increased only by 0.1 percentage points. Therefore, the effects of fiscal consolidation on revenues are several times smaller than in the case of expenditure. On the one hand, it was the result of the economic slowdown in that period and the pro-cyclical nature of important revenue sources, and on the other hand - of the care taken to maintain low tax burdens that are conducive, in the circumstances of economic slowdown, to economic growth, in particular to market sector investments, whose share of GDP has increased by 0.9% of GDP since 2010.

Chart 2. The impact of the change in revenue and expenditure on the change in general government balance in relation to GDP



Explanations: grants from EU funds, which are neutral for the general government, are excluded from revenue and expenditure.
Source: Ministry of Finance

A key factor determining the expenditure level is, from 2015 onwards, the stabilising expenditure rule. Due to the operating principle of the rule consisting in defining the maximum expenditure level of almost the entire general government, the introduction of the rule enforced a change in the approach to the budget process from bottom-up to top-down. Currently, attention in the budget process is therefore focused on how to distribute the expenditure level and not on its amount, which is pre-determined (calculated based on the basis of algorithm). The fact that the binding expenditure limit is determined at an early stage of the budget process means that changes in expenditure covered by the rule (an increase or the introduction of new categories of expenditure) are possible, subject to appropriate adjustments in the size of other categories of expenditure or significant discretionary actions in the area of taxes or contributions. Possible legislative changes that generate new expenditure for entities under the scope of the rule (e.g. an increase in expenditure on defence – the new Ministry of National Defence rule) are therefore neutral for the level of total expenditure covered by the rule.

In addition, by including discretionary measures regarding taxes and contributions in the rule, potential discretionary measures having a negative impact on revenue (e.g. increasing tax relief credit for children in personal income tax) are neutral to the balance of the sector. This changes the context of the analysis of structural measures in the area of taxes and contributions that currently, decreasing or increasing the maximum expenditure level, automatically ensure sustainability of public finances.

The rule was first applied in a binding manner during the works on the Budget Act for 2015. Article 1 of the Budget Act for 2015 determined the level of planned expenditure of bodies and units referred to in Article 9 paragraph 1-3 and 8 with the exception of the Social Insurance Institution and paragraph 9 of the *Act of 27 August 2009 on Public Finance*, the Labour Fund, as well as funds created, entrusted or transferred to Bank Gospodarstwa Krajowego (BGK) under separate acts. This level (hereinafter referred to as the level of expenditure) therefore covers the expenditure of almost the entire general government with two exceptions: excluding expenditure financed from the budget of the European Union and non-refundable funds from the aid granted by the EFTA member states and expenditure of units that do not have the capacity to generate high deficits.

The level of expenditure for 2015 was obtained in three steps. The first of these was the calculation pursuant to Article 14 of the *Act of 8 November 2013 amending the Act on Public Finance and some other acts* of the planned consolidated sum of expenditure in 2013 covered by the stabilising expenditure rule, which amounted to PLN 657 582 426 thousand. The second step was obtaining a consolidated level of expenditure for 2014. For this purpose the following were used:

- planned consolidated sum of expenditure in 2013,
- indicators and the correction defined in Article 14 of the *Act of 8 November 2013 amending the Act on Public Finance and some other acts,*
- the total value of significant discretionary measures in the area of taxes and contributions forecasted for 2014.

The consolidated entry level of expenditure for 2014 amounted to PLN 690 629 525 thousand. In the third step, using entry level of expenditure for 2014 and the relevant macroeconomic indicators and the total value of significant discretionary measures forecasted for 2015, the level of expenditure for the year 2015 was calculated, which amounted to PLN 696 735 739 thousand. The stabilising expenditure rule enforced planning expenditure for 2015 which, in relation to GDP, is about 0.8 percentage points lower than in 2013. Detailed calculations of the level of expenditure for 2015 were, in accordance with Article 142 paragraph 6a and 6b of the *Act on Public Finance*, included in the explanatory memorandum to the draft Budget Act for 2015.

According to the *Act on Public Finance*, the update of the *Convergence Programme* which forms part of the National *Multi-annual Financial Plan* defines the preliminary level of expenditure on the basis of the stabilising expenditure rule. Estimating expenditure for 2016 consistent with the stabilising expenditure rule was made on the basis of the level of expenditure for the year 2015 amounting to PLN 696.7 billion defined in Article 1 of the Budget Act for 2015 and the total GDP growth in the years 2009-14 at constant prices published by the Central Statistical Office on 16 April 2015 as well as macroeconomic assumptions and forecasts assumed in the preparation of the *Programme,* which were as follows:

- 1.0314 – medium-term GDP growth indicator,
- 1.017 – CPI inflation forecasted for 2016,
- 0.9852 – adjustment due to the update of the inflation index for the years 2014-15[19].

Additionally, a correction of -1.5 percentage points due to imbalances in public finances and the total value of discretionary measures of PLN 3.2 billion forecasted for 2016, including the effect of the implementation of solutions that improve the efficiency of enforcement of tax claims and the effect of limiting the possibility to deduct VAT on the purchase of motor vehicles and other expenses associated with these vehicles, were taken into account. As a result, the estimated level of expenditure for 2016 amounts to PLN 712 750 180 thousand and is higher by 2.30% than the level of expenditure for 2015 defined in the Budget Act for 2015, which means a decrease in expenditure to GDP ratio by 1 percentage point compared to 2015.

The current estimate of the level of expenditure for 2016 is 2.8% (PLN 20.4 billion) lower than the estimate obtained for the purposes of the *Convergence Programme. 2014 Update (2014 Programme).*

[19]The value of CPI in 2014 (1,000) and the current index forecast for 2015 (0.998) against the CPI planned execution for 2014 and CPI level forecasted for 2015 (1,012) in the period of work on the budget act for 2015 (1,001).

This means a decrease in expenditure to GDP ratio by 0.3 percentage points in comparison with the ratio projected for 2016 in the *2014 Programme*.

Pursuant to Article 112aa of the *Act of 27 August 2009 on Public Finance*, estimates of the levels of expenditure for the years 2017-18 were also calculated. The correction due to imbalances in public finances until 2018 will be at -1.5 percentage points, because it is predicted that the public debt to GDP ratio calculated in accordance with Article 38a paragraph 4 of the *Act on Public Finance* will exceed the threshold of 43% both in 2015 and in 2016. The estimated level of expenditure for 2017 amounts to PLN 732 162 676 thousand (36.7% of GDP), and PLN 764 350 378 thousand (36.0% of GDP) in 2018.

Table 1. Level of expenditure (according to the SER) in 2014-18

	2014	**2015**	**2016**	**2017**	**2018**
	values as determined in the Budget Act for 2015		values as forecasted in the *Convergence programme 2015*		
medium-term GDP growth indicator	1.0346*	1.0317	1.0314	1.0331	1.0335
CPI index	1.024*	1.012	1.017	1.018	1.025
correction due to inflation forecast update	1**	0.9775**	0.9852	-	-
correction***	-2 pps.	-2 pps.	-1.5 pps.	-1.5 pps.	-1.5 pps.
total value of discretionary measures (in PLN billion)	7.4	5.5	3.2	-6.6	0
Level of expenditure	690.6	696.7	712.8	732.2	764.4

* indicators defined in Art. 14 of *Act of 8 November 2013 amending the Act on Public Finance and some other acts*,
** according to Art. 14 of *Act of 8 November 2013 amending the Act on Public Finance and some other acts*,
*** according to Art. 112aa *Act of 27 August 2009 on Public Finance.*
Source: Ministry of Finance.

III.3. Actual balances

Fiscal consolidation continued in 2014 included the reduction of expenses and an increase in government revenues. The ratio of national expenditure to GDP (adjusted for expenditure financed from EU funds, for which the ultimate beneficiary are units of the general government) last year stood at 40.4%, i.e. by 0.4 percentage points lower than in 2013, and after excluding expenditures of PKP PLK S.A., which was incorporated into the general government beginning with data for 2014 (in data for 2013, the above-mentioned company remains in the private sector, so certain categories, including expenses, revenues and results of the sector are not comparable in those years) lower by approx. 0.7 percentage points. Expenditure on public investment, which in accordance with the recommendations of the Ecofin Council, should not be an area of consolidation, increased by 0.3 percentage points in relation to GDP, i.e. 11.9% y/y. This was primarily the result of a significant recovery in the local government sub-sector, where investments increased in relation to GDP by 0.3 percentage points, i.e. 18.6% y/y (in 2013 they fell by 1.9% y/y).

Expenditure on central government investments increased by 6.0% y/y, i.e. in relation to GDP by 0.04 percentage points. The increase in expenditure in this sub-sector, despite lower expenditure on infrastructure projects implemented by the National Road Fund under the *National Road Construction Programme for 2011-2015* (a decrease of expenditure by 32.8% y/y), is the result of, among others, inclusion in 2014 of PKP PLK to the central government subsector. The company has already implemented investments supported by government subsidies in previous years, but due to the classification of the company in the private sector in previous years, investments of that entity were recorded in that sector. It should be noted that this is not the only example of financing or co-financing by general government of investments carried out by entities registered in accordance with ESA'2010 in other institutional sectors. For this reason it is worth taking account investments throughout the entire economy, and those increased in real terms by 9.2% in 2014.

The inclusion of PKP PLK S.A. to the general government also resulted in a one-off surge in public consumption. In 2014, public consumption increased nominally by 4.6% y/y (against 3.2% y/y in 2013), and in real terms by 4.7% y/y. This increase resulted both from an increase in labour costs (nominally by 2.9% y/y), and an increase in intermediate consumption, i.e. public sector purchase (nominally by 6.4% y/y). The reduction of expenditures on labour costs in relation to GDP by approx. 0.1 percentage points recorded in 2014 was possible mainly due to the freezing of wages in the state budget units and reducing the growth of nominal labour costs in the local government sub-sector to just 1.6% y/y. The reduction of expenditure on labour costs has been carried out despite the statistical increase in labour costs in 2014 compared to 2013, as a result of the inclusion of PKP PLK S.A. in the general government and the negative effect of inflation at a much lower level than originally forecasted. It is worth noting that the negative inflation surprise in 2014 significantly reduced, relative to the expectations, the effect of freezing the wage fund in the state budget units on the limit of the ratio of expenditure to GDP.

Furthermore, in 2014 saw an increase in intermediate consumption, i.e. purchases of the public sector, in relation to GDP by 0.1 percentage points, which is mostly the effect of an abrupt increase in expenditures due to the inclusion of PKP PLK S.A. in the central government subsector.

In 2014, the nominal growth of the category of social benefits other than social transfers in-kind increased 3.3% y/y, and in relation to GDP a decrease by 0.1 percentage points of GDP was noted. In 2014, these expenditures grew slightly higher than the pension and retirement fund (i.e. the biggest part in this category) in the period discussed (growth by approximately 2.6% y/y), which was affected mainly by the increased expenditure of the Social Insurance Fund (FUS) on social benefits other than old pensions and disability pensions (an increase by 19% y/y), in particular maternity benefits. The increase in maternity benefits is a consequence of the actions carried out by the government to combat negative demographic trends. Changes in this regard included e.g. prolonging maternity leaves. In 2013, the length of the additional maternity leave was increased (and of the leave on the conditions of the maternity leave), and the so-called parental leave (26 weeks) was introduced.

The level of social benefits paid by FUS was also influenced by the enforcement of the decisions of the Constitutional Court on the constitutionality of certain articles of the Act of 16 December 2010 Amending the Act on Public Finance and some other acts. In 2014, a one-off amount of pension payments suspended since 1 October 2011 until 21 November 2012 amounted to - PLN 630.6 million, while the amount of interest paid - PLN 162.1 million.

In 2014, the ratio of domestic revenue of the general government to GDP increased by 0.5 percentage points to 39% of GDP. Such a significant improvement was supported by measures to strengthen the revenue side (cf. chapter III.2 and VII.2), macroeconomic factors (apart from inflationary processes) and extending the scope of the general government, including PKP PLK (chapter VII.2). In particular, the rate of real GDP growth was two times higher than that recorded in 2013. Also, the very structure of GDP growth in 2014 was favourable, particularly for revenues from VAT, the execution of which turned out to be higher than planned. Economic growth, unlike in 2013, was driven mainly by an increase in private consumption and a recovery in investment. Noteworthy is the increase in public investments that are an essential component of the VAT tax base.

III.4. Medium-term budgetary outlook

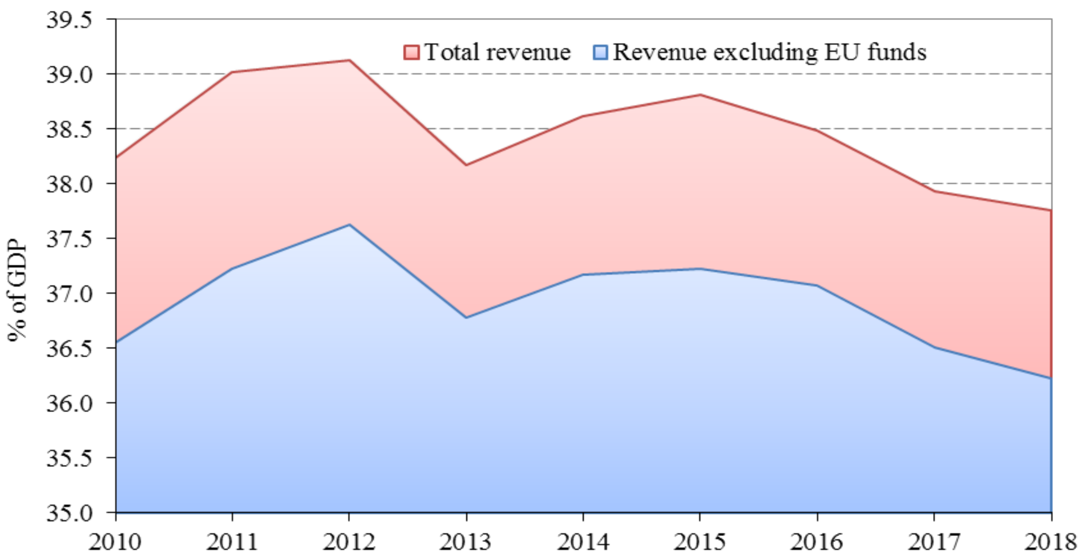
Factors determining the general government revenues

Deflationary processes observed in 2015, which remain beyond the control of the government, weaken the revenue stream. The greatest impact of lower price level is to be expected in terms of revenue from VAT. This is due to the fact that the main element of the tax base of VAT is private consumption (including fuel, where price declines were relatively large). It should be noted, however, that a low inflation rate also applies to food products, which because of a lower rate of VAT constitute a much smaller share in revenues from VAT, hence the effect of inflation on lower VAT revenues should be limited.

The lower price level will have the smallest impact on revenues from excise duty - due to the fact that tax rates are quoted (independent of prices except for excise duty on cars and tobacco products). In some situations, a relatively positive effect can be expected due to negative price elasticity of demand. At the same time, lower wage levels, resulting from lower inflation, will directly affect revenues from personal income tax, but this effect should not be proportional to the reduction of inflation. Deflation also indirectly affects the amount of revenues for business, but this negative effect is mitigated by the simultaneous reduction in the cost of business - e.g. by a decline in fuel prices.

It is predicted that the ratio of revenues of the general government to GDP will amount to 38.8% in 2015, i.e. by 0.2 percentage points higher than in 2014. In the years 2016-18 it will amount to respectively 38.5%, 37.9% and 37.8%.

Chart 3. General government revenue



Source: Central Statistical Office, Ministry of Finance

The most important source of revenue of the general government is the revenue from the taxes related to production and import, obviously, including indirect taxes. For this group, the major indicator of the tax base growth is the growth of private consumption, for which an acceleration of the growth rate (2015 and onward) is predicted. The growth in nominal terms will be most visible after 2015. In turn, investments and net purchases by general government, which also comprise an important part of the tax base, will remain relatively stable in relation to GDP within the horizon of the forecast. As a consequence of the expected sustainable economic recovery, i.e. closing the output gap, the occurrence of the procyclical effects of indirect taxes against the tax base is very probable. However, due to the difficulties in precise estimation of such effect and the intention to maintain the conservative nature of the presented forecast of the revenues of the general government, the potential increase in revenues from pro-cyclic effects was not taken into consideration. The structure of GDP growth (GDP will grow thanks to domestic demand growth) will also foster the accumulation of tax revenues - in particular from indirect taxes.

The sustainable improvement of the economic growth allows for expectation of the gradual acceleration of growth in inflows gained from taxation of revenues from business operations, inter alia, owing to the annual reduction of the amounts of losses incurred during the period of downturn.

Tax revenues over the forecast horizon will be determined mainly by the aforementioned improving economic situation in real terms. Starting from 2016, also the nominal conditions for the collection of tax revenues will improve significantly. A significant acceleration of growth of nominal GDP is expected - above 5% in 2016-18. For comparison, nominal GDP growth in 2014 and 2015 will amount to 4.0% and 3.9% respectively.

The revenues from the aforementioned taxes will be determined not only by the macroeconomic situation but also by the systemic changes discussed in chapter III.2.

In the case of income tax from individuals over the entire forecast horizon, there are no changes assumed to the act in the part concerning tax thresholds and lump sum deductible costs and the amount decreasing the tax.

The level of revenues after 2016 will be affected by the reduction of VAT rates planned as of the beginning of 2017.

In addition the government keeping in force activities which, by their mechanism annually - in terms of economic growth - lower the deficit, the following changes strengthening the income side have been planned and implemented in 2015:

- limiting (since 2014) the possibility of reimbursement of expenses for housing purposes in VAT - resulting in an increase in VAT revenues mainly in 2015;
- introducing a levy on fuel - in line with the *Act amending the act on stocks of crude oil, petroleum products and natural gas and the rules of conduct in situations of fuel security threats to the State and disruption on the petroleum market and amending certain other acts* adopted in May 2014,
- additional revenues from the so-called digital dividend (the sale of some frequencies by means of auction).

The revenues of the general government in 2016 will be affected by the planned changes:

- liquidation of a limited 50% forest tax rate for protected forest,
- limiting tax preferences in tax on real estate related to business activity that cannot be used to carry out this activity for technical reasons, to buildings and structures excluding land,
- limiting the exemption due to the acquisition of ownership over property constituting a farm or its part from inheritance tax and gift tax and tax on civil law transactions.

The horizon of the forecast takes into account the reduction of VAT rates - in 2017 - however, significant changes in excise duty rates are not expected. In addition, a positive effect on general government revenues will be exercised by the decision of the Bank Guarantee Fund to increase the annual fee paid by banks and cooperative savings and credit unions, as well as prudential fees paid by banks. In addition, the strengthening of the revenue side of the general government will be supported by the implementation a package of measures to facilitate fulfilling taxpayers’ obligations to the state and to improve the efficiency of tax administration (chapter VI.2).

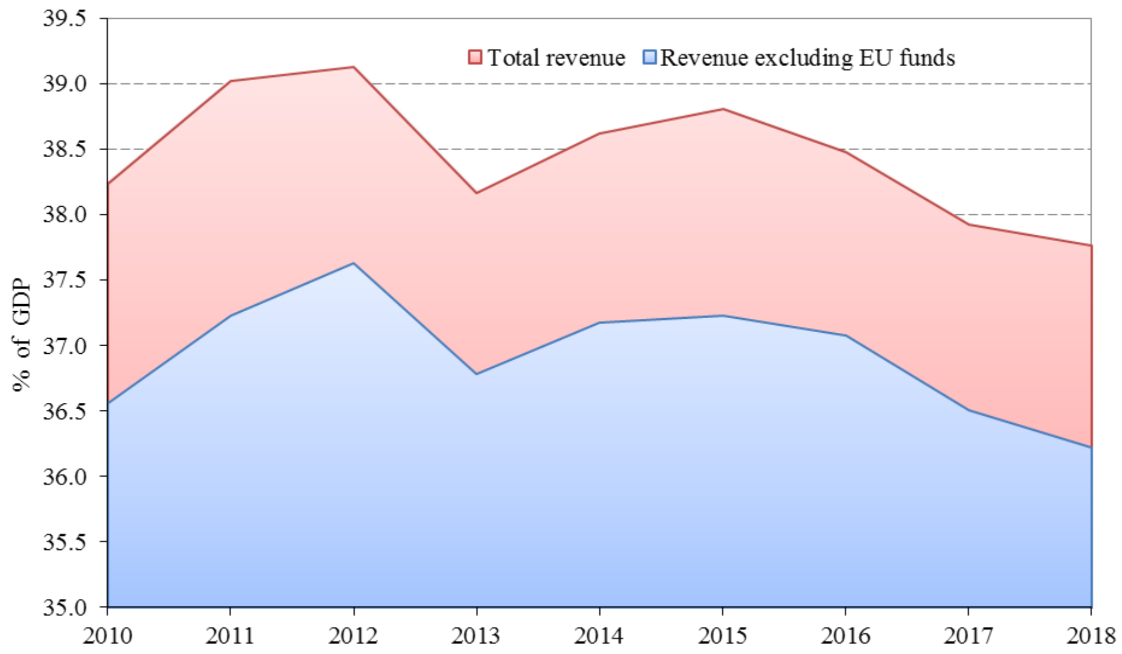
The second biggest position in the revenues of the general government is from social insurance contributions. This category will depend on the shaping of the base for their calculation, the main component being the remuneration fund in the national economy, as well as on institutional changes. The nominal growth rate of the remuneration fund, after the growth in 2014 by approx. 3.5% y/y, should accelerate in the coming years, but remain below the nominal growth rate of GDP throughout the entire forecast horizon.

The main institutional factor which influence the size of social insurance contributions in 2015 are the 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 - the legislator assumed that half of OFE members holding the right of choice will decide to stay in OFE, but much fewer people actually did. At the beginning, i.e. in 2014, this effect was to be lower than the effects anticipated for 2015, since the changes introduced by the aforementioned act did not apply for the whole year.

Factors determining the general government expenditures

According to the latest forecasts, the relation of the domestic general government expenditure to GDP in 2015 will reach the level of 41.5% of GDP, i.e. by 0.3 percentage points less than in 2014. In 2016-18, the downward trend of domestic expenditure will be continued and this relationship will reach, respectively, the level of: 40.8%, 39.8% and 39.0%. As a result, in 2015-18, the relation of expenditure to GDP will be reduced by approx. 2.8 percentage points, however the real expenditure will increase by approx. 8.2% y/y.

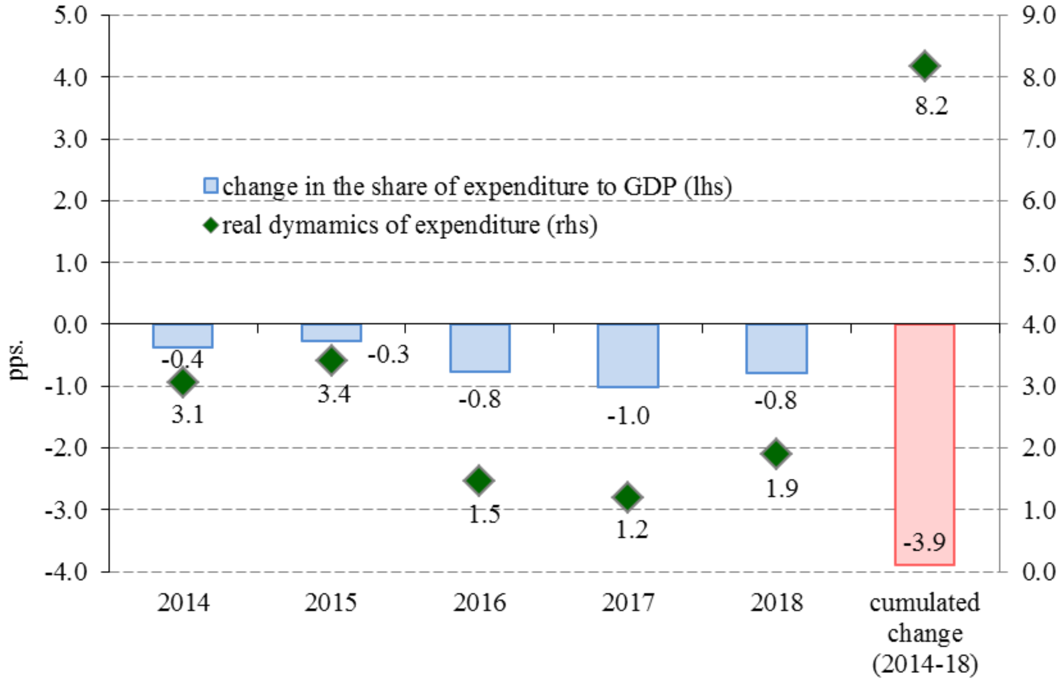
Chart 4. General government expenditure



Source: Central Statistical Office, Ministry of Finance

A key factor influencing the level of expenditure, and therefore also the shape of the fiscal policy, is the stabilising expenditure rule introduced to the Polish legislation in 2013 (chapter III.2). The decrease in expenses is primarily the result of already taken measures (chapter III.2). In parallel to fiscal consolidation, the Government implements actions within the framework of pro-family policy aimed at countering negative demographic trends (chapter III.7).

Chart 5. Changes in share of general government expenditure in relation to GDP



Source: Ministry of Finance

The main categories of expenditure for which slower growth than the growth of GDP is predicted in the period 2015-18 will be: public consumption (a decrease in relation to GDP by 1.5 percentage points), including labour costs (a decrease by 1.2 percentage points), social security benefits (a decrease of 0.7 percentage points) and debt servicing costs (a decrease by 0.4 percentage points). Public investment, which in accordance with the recommendations of the Council should not be an area of consolidation, on average, will remain in relation to GDP at the level from 2014 in the years 2015-18.

The share of general government investment, after reaching its record level in 2011, amounting to 5.9% of GDP, gradually decreased to 4.1% of GDP in 2013 and increased to 4.4% in 2014 thanks to investment growth in the local government in relation to GDP by 0.3 percentage points. It is projected that in the years 2015-16, the share of investment in the GDP will remain at a high level of 4.5%, and in the following years will gradually decrease – to 4.2% in 2018, however, still remaining above the EU average over the entire forecast horizon, i.e. 3.1% GDP in the years 2010-14.

The level of investments in the sector is largely determined by the implementation of long-term programmes. The biggest of them is the *Programme for Construction of National Roads for the years 2011-2015*, encompassing investment tasks connected with the construction and re-construction of national roads and highways, financed from the National Road Fund (NRF) and the state budget. In 2013, the programme was supplemented by “Appendix no. 5” comprising the sections of express roads and highways and “Appendix no. 6” comprising the by-passes of cities, the construction of which will be financed under the new EU financial framework for the years 2014-20. In 2015, the Council of Ministers plans to adopt a new *Programme for Construction of National Roads for the years 2014-2023* (based on public consultations pursuant to Article 6 and Article 19a of the Act of 6 December 2006 on the rules of development policy[20], currently at the stage of the strategic assessment of the environmental impact). It will cover objectives and priorities in the scope of the development of the road infrastructure (including maintaining the existing road network in a good technical condition) and will indicate the level and sources of the necessary financing, in particular as regards the use of funds

[20]Journal of Laws of 2014, item 1649.

from the new EU financial perspective. Another significant long-term programme is the *Multi-Annual Programme of Railway Investments to 2015 with a perspective to 2020*, encompassing the investment expenditure on the construction and modernisation of railway lines, performed by PKP PLK S.A. These investments are financed from the Railway Fund, the state budget, the European Union funds and by own funds of PKP PLK S.A. from EIB loans and emission of bonds. In accordance with the *Multi-Annual Programme…,* a significant increase in the investment expenditure on the development of railway will occur in 2015. As indicated in III.1, the general government also co-finances investments implemented by entities from other institutional sectors through transfers of funds to these entities. Such expenditure is not recorded as investment expenditure of the general government, although in fact they are of such a nature, but as subsidies outside the sector.

The investment level in the sector will also be determined by the scale of investment expenditure in the local government sub-sector. It is foreseen that the investment of the local government units will be mainly determined by the use of the EU funds. The investment in the local government sub-sector and the absorption of the EU funds should be fostered by the solutions introduced pursuant to the Act of 8 November 2013 *on the amendment to the Public Finance Act and some other acts*, easing some strict rules arising from art. 243 of the *Public Finance Act.* In accordance with the amendment to the *Public Finance Act*, throughout the entire period of repayment of the liability, the exclusion shall be applied to the redemption of securities, repayment of credits and loans including the interest and discount due, respectively, issued or incurred in connection z the agreement concluded for the implementation of the programme, project or task funded at least in 60% from the non-refundable EU aid, in its part corresponding to the expenditure on the national contribution financed by such liabilities. Thus, the current regulations *de facto* exclude the liabilities incurred for financing of the investment funded with the share of the EU funds, based on debt limits, which should encourage the local government units to change their structure of expenditure towards increasing the level of investment. This supports the implementation of the recommendation of the Ecofin Council concerning the minimising of cuts in growth-enhancing infrastructure investment.

Another important factor determining expenditure are the tendencies concerning the costs of labour in general government. It is assumed in the draft of the budget act for 2015 that remuneration in central government 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* are at the nominal level from 2014 taking into account the special-purpose reserves distributed in 2014 and additional annual remuneration in accordance with the rules set out in legislation. Exceptions will include the remuneration of judges delegated to the Ministry of Justice or another organisational unit supervised by the Minister of Justice, whose remuneration is financed from the funds at the disposal of the Minister of Justice, prosecutors and assessor prosecutors. At the same time, another stage of growth of remuneration of employees of institutions of higher education, which is to grow at the rate of 9.14% annually, will be implemented, so that its growth in 2013-2015 reaches a total of 30%.

In subsequent years, i.e. from 2016 onwards, with the improvement of the fiscal situation and within the limit of expenditure provided for the stabilising 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.

The payments of social security benefits will be determined by annual indexation of old age pensions and disability pensions. A modification of the minimum amount of indexation of pensions was introduced in 2015, according to which the above minimum amounts are: PLN 36 in the case of retirement, bridging pensions, teachers' compensation benefits, pensions for total disability to work, survivor's pensions, retirement allowances and benefits; PLN 27 in the case of pensions for partial disability to work and PLN 18 in the case of the partial pension. In subsequent years, the indexation rate will be determined by the Act on pensions from the Social Insurance Fund.

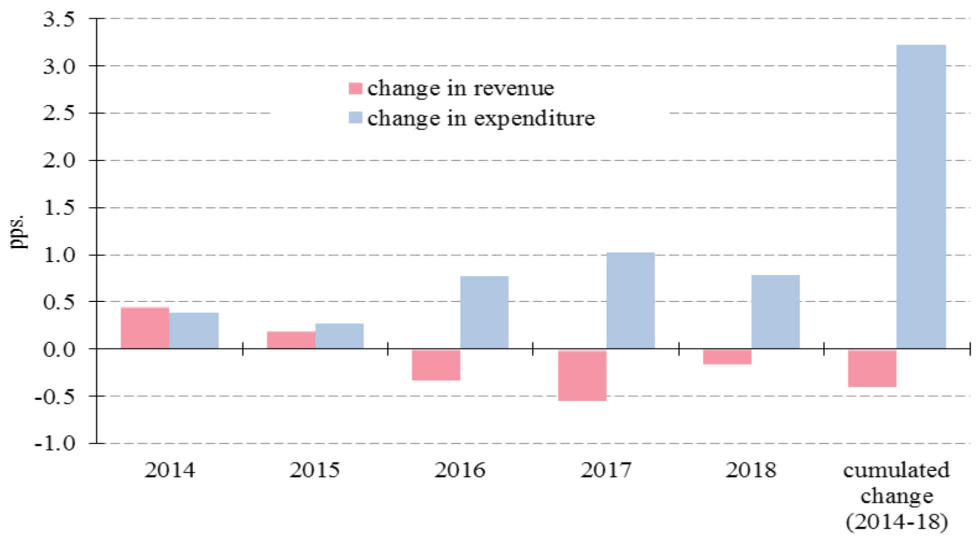
Taking into account the moderate increase in the number of beneficiaries and the rate of indexation of social insurance benefits, which depends on the inflation and real wage growth recorded in the previous year, it is forecasted that in the period of the expected acceleration of nominal GDP growth, the amounts of the said benefits will grow at a slower rate than nominal GDP, which will contribute to reducing the deficit in subsequent years.

Furthermore, the stability of the public finances will be supported by significant changes in the pension system of the recent years, mainly increasing and equalising the retirement age for women and men at a level of the age of 67. This change shall, on the one hand, increase the future pensions and, on the other hand, improve the balance of the public pension fund, limiting the imbalance of public finance. Moreover, raising of the statutory retirement age will influence the increase in the labour supply which, in turn, shall foster the economic growth.

At the same time, there are efforts aimed at rationalising public expenditure. One example is the action of the Social Insurance Institution covering in particular the implementation and development of IT tools for communication with external customers (Electronic Services Platform - PUE) as well as internal management processes (e.g. workflow enabling the wider use of electronic documents in the internal circulation), the introduction of eWUŚ (electronic verification of eligibility of beneficiaries) reducing the scale of fraud involving the use of healthcare services by unauthorised persons, centralisation of services provided by the Social Insurance Institution for institutional clients and the consistent introduction and use of a competitive mode for contractors (suppliers of goods and services).

As a result, it is forecasted that the deficit of the general government in 2015 will amount to 2.7% of GDP, i.e. below the level of nominal deficit of 2.8% of GDP recommended for Poland. In the years 2016-18, the deficit will reach 2.3% of GDP, 1.8% of GDP and 1.2% of GDP respectively.

Chart 6. The impact of the change in national revenue and expenditure on general government balance in relation to GDP



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

As a result of the implementation of the announced consolidation strategy pursuit of the MTO will be primarily a result of a reduction in expenditure in relation to GDP (Chart 6).

III.5. Structural balance

Within the horizon of the *Programme* the structural deficit will gradually decrease, in total, by approximately 1.5 percentage points, and consequently, in 2018 it will reach the level of 1.2% of GDP. The following one-off measures were considered for the calculation of the structural deficit:

- payments of funds from the Bank Guarantee Fund (BGF) in connection with the restructuring of Cooperative Savings and Credit Unions in the amount of PLN 3.1 billion (approx. 0.2% of GDP) in 2014;
- the net effect of the adjustments to the EU budget resulting from a revision of VAT and gross national income to PLN 1.5 billion (approx. 0.1% of GDP) in 2014;
- expenditure related to the execution of the Constitutional Court ruling in connection with disbursements from the Social Insurance Fund related to persons who acquired retirement entitlement before 1 January 2011, with no need to resign from work, in the amount of PLN 0.8 billion in 2014;
- execution of the Constitutional Court ruling in connection with the payment of overdue carer's allowances in the amount of PLN 0.3 billion in 2014;
- revenue from sales of radio frequencies in the amount of PLN 1.8 billion (approximately 0.1% of GDP) in 2015 (moved from 2014).

According to the presented structural deficit path (compare section III.4) the structural deficit in 2014, taking into consideration all one-off actions, will decrease by 0.9 percentage points, only slightly below the targets defined in the recommendations of the Ecofin Council of December 2013 (1.0 percentage points). The effort adjusted for error in the forecast of nominal potential GDP growth and the extraordinary changes in revenue and taking into account changes in the sector in relation to the time of the adoption by the Council of the recommendation was 1.0 percentage points, i.e. it met the recommendations of the Council.

Due to starting point for further improvement of the balance being more favourable than expected in the recommendations of the Council, structural effort in 2015 is forecasted at 0.2 percentage points of GDP, which will reduce the nominal deficit to 2.7% of GDP.

Table 2. Cyclical developments

	% of GDP	ESA Code	2014	2015	2016	2017	2018
1.	**Real GDP growth** (%)		3.4	3.4	3.8	3.9	4.0
2.	**Net lending of general goverment**	EDP B.9	-3.2	-2.7	-2.3	-1.8	-1.2
3.	**Interest expenditure**	EDP D.41	2.0	1.8	1.5	1.5	1.5
4.	**One-offs and temporary measures**		-0.2	0.1			
5.	Potential GDP growth (%)		3.2	3.3	3.4	3.7	4.0
6.	Output gap		-0.6	-0.5	-0.2	0.0	0.0
7.	Cyclical budgetary component		-0.3	-0.3	-0.1	0.0	0.0
8.	Cyclically-adjusted balance (2-7)		-2.9	-2.5	-2.2	-1.8	-1.2
9.	Cyclically-adjusted primary balance (8+3)		-0.9	-0.7	-0.6	-0.3	0.4
10.	Structural balance (8-4)		-2.7	-2.6	-2.2	-1.8	-1.2
11.	Structural balance corrected for the changes in general government		1.0	0.6			

Source: Ministry of Finance.

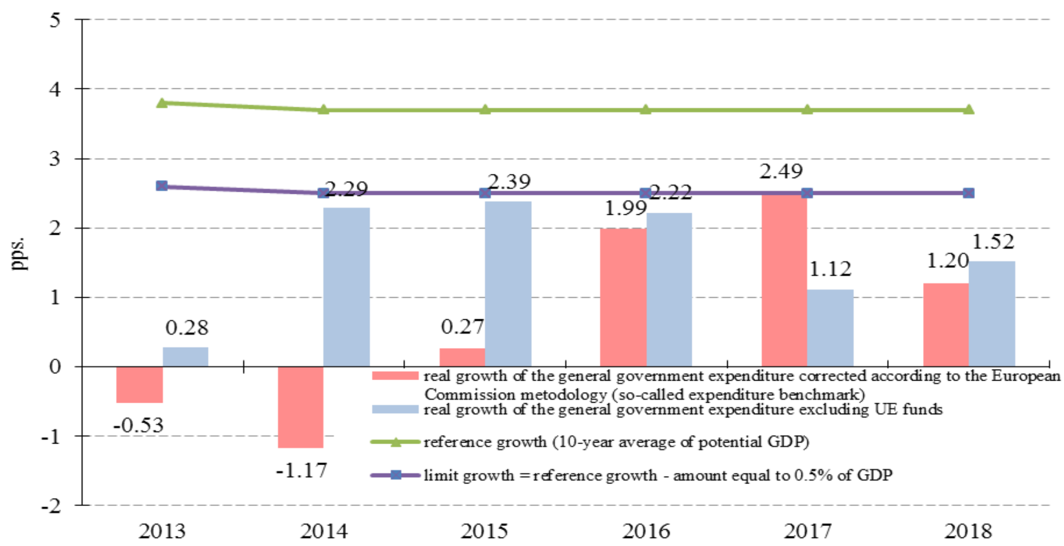
According to the *Stability and Growth Pact*, sufficient progress towards the budgetary objective shall be evaluated on the basis the structural balance. After the completion of the excessive deficit procedure, entry into the adjustment path leading to the MTO takes place. As long as the MTO is not achieved, improvement in the structural balance should be 0.5 percentage points of GDP, assuming that the output gap in Poland will be within the range of ± 1.5%, and the debt will remain at a level below 60% of GDP.

Poland adopted its medium-term budgetary objective, i.e. the target structural general government balance at the level of -1% of GDP. It is forecasted that in the years 2016-18, Poland should follow the adjustment path towards the MTO. It is forecasted that in 2018, the structural balance will amount to -1.2% of GDP and the MTO should be achieved in the following year. The factors to contribute to the fulfilment of this goal include the stabilising expenditure rule, which requires the expenditure growth rate to be slower than medium-term growth in case of imbalance of public finances defined, among others, as the general government deficit higher than the medium-term budgetary objective and individual debt limits of local government units (see: chapter VII).

Another reference point in the assessment of the progress towards the MTO is the annual rate of general government expenditures – adjusted according to the methodology applied by the European Commission, which should not exceed the reference rate reduced by a value corresponding to the required adjustment to the MTO, i.e. 0.5% GDP. Currently, the reference rate[21] for Poland amounts to 3.7%, which, considering the correction arising from the need to achieve the medium-term budgetary objective, gives the required lower reference rate of 2.5%.

According to forecasts, Poland will meet the above mentioned requirement regarding the expenditure growth rate (the so-called expenditure *benchmark*). It is expected that the annual real expenditure rate modified according to the methodology of the European Commission (as well as the real growth rate of domestic expenditure, i.e. expenditure after deducting the expenditure financed from the EU funds which is neutral for the deficit) will vary within the range 0.3% – 2.5% in the years 2015-2018, which is below the lower reference rate threshold. The growth of expenditure is modified, inter alia, through reducing the discretionary measures on the revenue side (cf. table 17).

Chart 7. General government expenditure modified according to the methodology of the European Commission



Source: Ministry of Finance.

[21] The 10-year average of real growth of potential GDP (t-5; t + 4).

III.6. Debt levels and developments

In the period covered by the *Programme update*, debt management will, as in previous years, focus on the achievement of the objective set out in the *Public Finance Sector Debt Management Strategy*, i.e. on the minimisation of long-term debt servicing costs subject to the constraints on the level of risk.

Debt management will be influenced by the gradual reduction of the general government deficit and the uncertainty in the financial markets arising, among others, from divergence of the monetary policy adopted by the ECB (continued quantitative easing) and by the Fed (expected increases in the interest rates and normalisation of the monetary policy). In the domestic market, measures associated with limiting the general government deficit should have a considerable impact on the level and shape of the yield curve, and as a consequence on the State Treasury debt servicing costs.

The changes in the pension system introduced in 2013 had a significant impact on the nominal reduction of public debt in 2014 and then on its further reduction in relation to GDP until 2018.

The changes in the debt–to--GDP ratio in 2015-2018 will result mainly from the state budget borrowing requirements (the State Treasury debt constitutes over 85% of the general government debt), GDP growth rate and the zloty exchange rate in relation to other currencies, especially to the euro. An essential condition influencing the borrowing requirements of the state budget shall be the disbursement of funds from the new EU financial framework for 2014-2020, which will be reflected in the European funds budget balance in the following years. The level of the borrowing requirements will be also influenced by the balance of liquid funds of the public finance sector units which are subject to the public finance sector liquidity management consolidation. In 2015, another stage of public finances units liquidity management consolidation was implemented, which will contribute to reducing the state budget borrowing requirements this year.

Changes in the debt of other general government entities will result mostly from changes in the indebtedness of the NRF (the debt increase will result from incurring liabilities to implement road investments within the new EU financial framework) and a relatively limited growth in local government units debt.

In the timeframe of the update, the debt-to-GDP ratio according to the EU methodology will reach the level of 49.1%.

Table 3. General government debt developments (end of the year)

	% of GDP	ESA Code	2014	2015	2016	2017	2018
1.	**Gross debt**		**50.1**	**51.7**	**51.6**	**50.7**	**49.1**
2.	**Change in the gross debt ratio**		**-5.6**	**1.6**	**-0.1**	**-0.9**	**-1.6**
	Contributions to changes in gross debt						
3.	**Primary balance**[1)]		**1.2**	**1.0**	**0.7**	**0.4**	**-0.2**
4.	**Interest expenditure**	EDP D.41	**2.0**	**1.8**	**1.5**	**1.5**	**1.5**
5.	**Stock-flow adjustment**		**-8.8**	**-1.1**	**-2.4**	**-2.7**	**-2.9**
	of which: difference between cash and accruals		-8.9	0.1	0.6	0.1	0.0
	net accumulation of financial assets		0.9	1.0	0.0	0.3	0.7
	of which: privatisation proceeds		0.0	0.0	0.0	0.0	0.0
	valuation effects and others		-0.8	-2.2	-3.1	-3.2	-3.6
	of which: exchange rate		0.8	-0.2	-0.5	-0.5	-0.5
	change in GDP		-2.1	-1.9	-2.5	-2.8	-3.1
	p.m. implicit interest rate on debt (%)		**3.9**	**3.4**	**3.0**	**2.9**	**3.1**

% of GDP		ESA Code	2014	2015	2016	2017	2018
Other relevant variables							
6.	Liquid financial assets		4.0	2.8	2.7	2.6	2.4
7.	Net financial debt (=1-6)		**46.2**	**48.9**	**48.9**	**48.1**	**46.7**
8.	Debt amortisation (existing bonds) from the end of the previous year[2)]		4.5	4.2	5.6	3.6	3.7
9.	Percentage of debt denominated in foreign currency (%)		34.8%	33.3%	32.5%	32.3%	32.1%
10.	Average maturity[3)]		5.24	5.1 – 5.2	5.1 – 5.3	5.2 – 5.4	5.2 – 5.5

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.
Source: Ministry of Finance

Net accumulation of financial assets results from many factors. The most important include the utilisation of the liquid funds under the public finance sector liquidity management consolidation (introduced in 2011 and extended in 2015) and proceeds from privatisation and the cash balance of the European funds of the state budget.

III.7. Budgetary implications of "major structural reforms"

The most important decisions of the government affecting the balance of the general government within the horizon of the *Programme* include the measures related to mitigating the negative impact of demographic changes, mainly changes in the rules regarding the tax relief for children in PIT, a new family benefit for families with children (parental benefit), a structural change of the family benefit system introducing the mechanism of gradual withdrawal of benefits after exceeding the income threshold and increasing the availability of pre-school education (more in chapter II.3).

At the same time, there are a number of measures to support the so-called inclusive growth policy, more efficient distribution of cash and non-cash benefits and as a result, reducing poverty. Particularly noteworthy are the changes described in chapter II.3 to the system of benefits for people who have decided not to take or give up gainful employment in order to take care of an adult with a disability and the *Senior-WIGOR* programme for the years 2015-20 approved by the Council of Ministers. The implementation of the project will allow for greater integration of seniors into the local environment and to combat the marginalisation and social exclusion of this group, which according to demographic forecasts will grow. It is expected that in 2015, approx. 100 day care institutions for the elderly will be established or re-equipped. In 2020, the total number of operating units will be 1200 institutions. To ensure high performance and efficiency of social assistance expenditure, the draft act assumes the evaluation of the project after the first year of functioning of the new solutions.

It is worth noting that since the introduction of the stabilising expenditure rule, changes in legislation that generate new expenses for entities covered by the rule are neutral for the level of total expenditure covered by the rule. The increase or the introduction of new categories of expenditure are possible, provided there are appropriate adjustments to other categories of expenditure or significant discretionary measures in the area of taxes or contributions. Public expenditure management in the context of the requirements arising from the stabilising expenditure rule will be supported by expenditure reviews.

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 2015.

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

- a possibility of further exacerbation of the conflict between Russia and Ukraine, in the Middle East and in North Africa;
- an increase in volatility in the financial markets in the light of the developments in Greece, the potential impact of low nominal economic growth of on the stability of public debt and the stability of monetary policy normalization in the US;
- delays in the planned implementation of structural reforms in EU Member States;
- deepening of deflationary processes and persistently low inflation expectations of economic entities in the EU, which will lead to a reduction in aggregate demands and a rise in real interest rates and, consequently, a negative wage-price spiral;
- prolonged hysteresis effect on the labour market resulting in a prolongation of the period to return the unemployment rate to lower levels, and a slower-than-expected growth in the productivity of production factors.

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.

Despite the emergence of positive risk factors in the winter edition of the European Commission's forecasts, the negative ones still outweigh them. This does not mean, however, that the achieved GDP growth in the EU in 2015 cannot be higher than projected. In March of this year, the ECB began its policy of quantitative easing. The European Commission set up in the winter forecast that EUR / USD rate will stabilize at 1.17, while in March it shaped significantly below this level (the EUR / USD, in its period with the strongest depreciation, reached levels of about 1.05). In the recent period, the euro zone also observed a strong increase in consumer confidence and an accompanying increase in real retail sales. The PMI has also improved. As a result, despite the negative balance of risks next, the spring update of the European Commission forecasts economic growth in the EU that could result in an increase in real GDP growth predictions in the economic sector in 2015.

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 still remains moderate and in 2014, due to a decline in trade, it additionally decreased. Exposure to the market of Ukraine only, i.e. direct risk, is minor, reaching only 1.9%, however, jointly with Russia, it reaches 6.2% (a year earlier it was 8.1%). An essential factor which so far has partly mitigated the negative consequences of the potential decline in the demand of the eastern markets is also the improvement in the dynamics of EU import, and the positive impact of this factor should also be maintained in the coming years. The potential escalation of the conflict may also translate to a significant increase of turbulences in the financial and raw material markets. Also the possibility of the introduction of limits on import of other product groups by Russia may not be disregarded.

2) Implementation of the EU requirements concerning CO2 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 90% 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 contrary to the initial expectations of the effects of currently implemented climate and energy package (to 2020), so far have not proved as negative for the Polish economy as indicated by assessments of the potential effects carried out by many entities before and at the beginning of the implementation period. The implementation of the framework for climate and energy policies until 2030 in a way adapted to the specific socio-economic situation of Poland may contribute not only to the increase in the quality of life of citizens through improving health and growth of economic innovation, but may also enhance the energy security of the country.

Polish enterprises are characterised by a potential to improve their energy efficiency. The lack of actions for realising 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

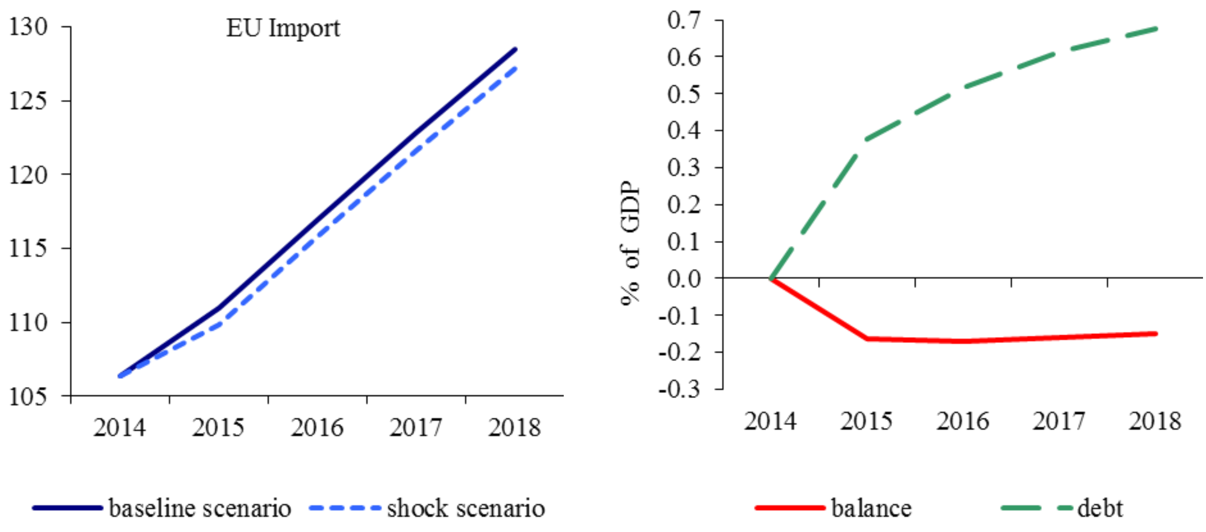
In the coming years, the possibility of a further increase in potential liabilities resulting from sureties and guarantees granted by the State Treasury is anticipated, which may translate to a slight increase of the ratio of these liabilities to GDP. Further concentration of sureties and guarantees granted by the State Treasury on investments facilitating developments in the road and rail infrastructure as well as environmental protection, creating new jobs and regional development is anticipated. Sureties and guarantees will mainly be granted for investments utilising 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 programmes 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 2015 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 2015-2018 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 simulations were performed for the years 2015-2018 when the economy is not in a steady state.

Chart 8. EU import (left chart) and the impact of a change in global demand on general government balance and gross debt (right chart)

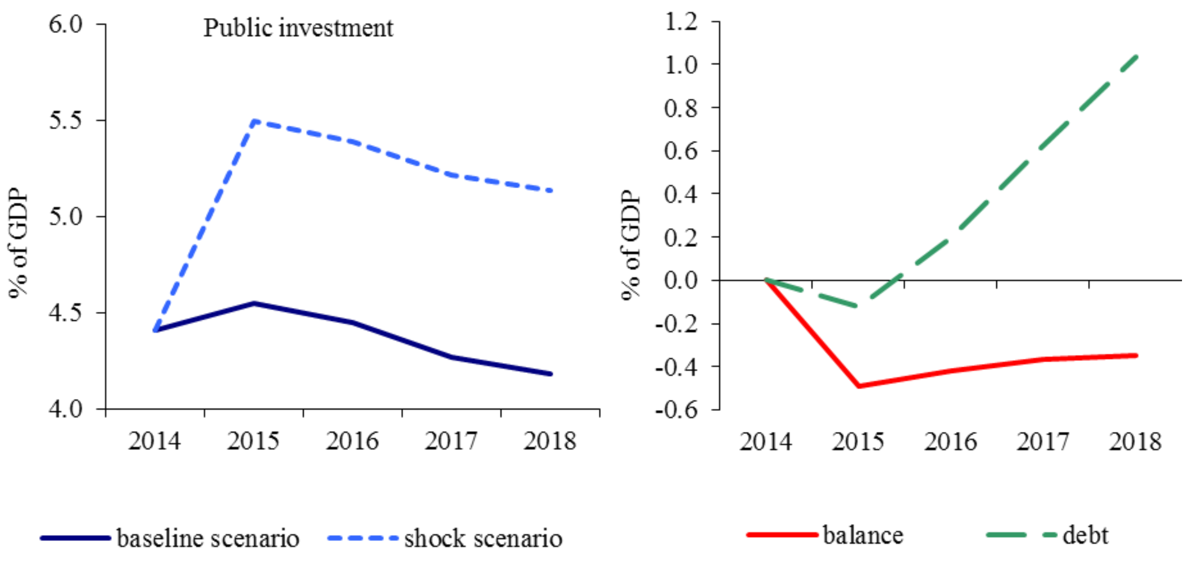


Source: Ministry of Finance.

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 0.8% against the baseline scenario, and in subsequent years it remains lower by 0.7%. 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 2015), 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, respectively, 1.4% and 1.9%, 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 0.2% in 2015 and 0.5-0.7% in the following years.

As a result of these disruptions, GDP remains persistently lower in the projected period by 0.5% in 2015 and 0.7-0.8% in the remaining years as compared to the non-shock scenario. A lower domestic demand is accompanied by the lowering of inflationary pressure and a decrease in interest rates. Lower economic growth negatively affects the fiscal condition of the country. The general government deficit increases (by approximately 0.2% in 2015-2018), as a result of which in 2018 the government debt in the shock scenario is 0.7% of GDP higher than in the baseline scenario.

Chart 9. Volume of public investment (left chart) and its impact on general government balance and gross debt (right chart)

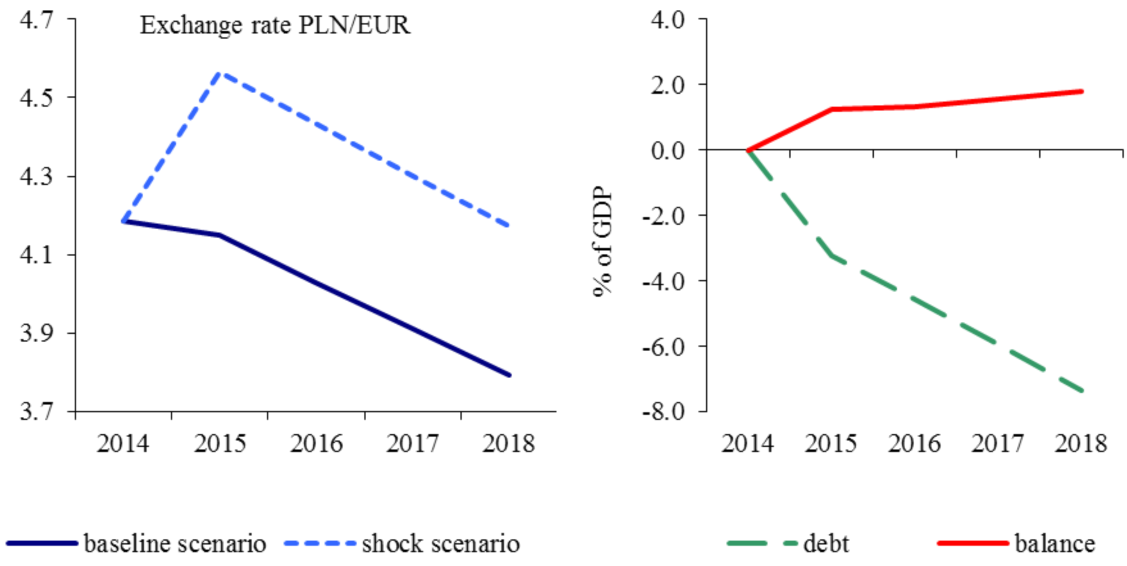


Source: Ministry of Finance.

The fiscal impulse has been defined as a sustained increase in general government investment by 1% of GDP as compared to the non-shock scenario. The direct effect of an increase in public expenditures is the increase in debt, which in 2015 increases by 0.5% of GDP compared to the baseline scenario, and in the following years remains at a level of 0.3-0.4% 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 labour 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 neutralises 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 2018 the government debt is by 1.0% of GDP higher than in the ‘no expenditure increase’ scenario.

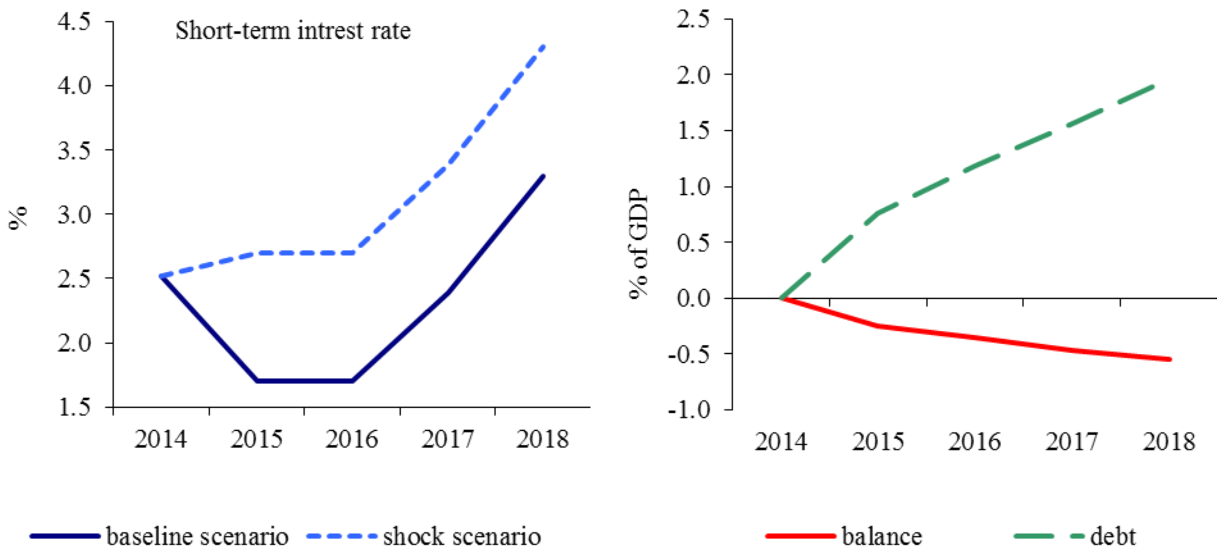
Chart 10. PLN/EUR exchange rate (left chart) and its impact on general government balance and gross debt (right chart)



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 labour 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 balance of the sector improve, as a result of which the level of sector debt in the shock scenario is 7.4% of GDP lower in 2018 than in the baseline scenario.

Chart 11. Short-term interest rate (left chart) and its impact on 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 2018 are by 9.7% 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 2015 to 1.8% in 2018 compared to the baseline scenario. As a result, the monetary impulse leads to a decrease in GDP volume of 1.1-2.6% in the forecast horizon The general government balance remains permanently lower by 0.3-0.5% of GDP and the general government debt in 2018 is by 2.0% 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 2015-2017 by 0.4-0,5%. The GDP growth in 2014 was close to the expectations, although its structure appeared slightly different - the growth was entirely generated by domestic demand with an input from net export at the level of minus 1.4 percentage points, whereas it was expected that the input would be positive (0.5%). The contribution of net exports to GDP growth in the forecast for 2015 was revised downwards from 0.0 to minus 0.6 percentage points. At the same time the pace of domestic demand growth was slightly increased from 3.8% to 4.0%.

The forecast for the years 2016-17 lowered the domestic demand growth (to 3.9% in both years from respectively 4.6% and 4.9% projected in the previous update), which also negatively affected the change in inventories. It is currently assumed that the contribution of changes in inventories until 2018, inclusive, will be neutral to economic growth (0.1 percentage pts. in 2016 and 0.0 percentage pts. in subsequent years). In the previous Programme, it was assumed that it would be significantly positive (0.5 percentage pts. in 2016 and 0.4 percentage pts. in 2017). The negative impact on the GDP growth from net exports was also reduced.

The forecast of the general government for 2014 presented in the *Programme* for 2014, amounting to 5.8% of GDP, was drawn up in accordance with the then-applicable ESA95 national accounts methodology. This forecast takes into account the financial consequences of the pension scheme introduced by 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*. As a result of the amendments referred to in said Act, there occurred a one-time transfer of assets from privately managed pension funds (OFE) to the central government. As part of the changes, 51.5% of the units of accounting to the accounts of each member of OFE were discontinued (i.e. the part, among others, invested in treasury securities and bonds guaranteed by the State Treasury) and their equivalents recorded on sub-accounts in ZUS. The acquisition of assets with a market value of PLN 153.2 billion (approx. 9.0% of GDP) was registered by the government as revenue. A similar transfer (to FUS) of assets was recorded form the accounts at OFE, of people who have less than 10 years to retirement age - resulting from the gradual transfer of assets to the Social Insurance Fund (within the so-called. "safety slider" idea). The forecast for 2014 estimated the impact (positive) on the outcome of this transaction in the amount of PLN 5.3 billion (approx. 0.3% of GDP).

Since September 2014, a new methodology of national accounts is in operation, the ESA2010, which affects the registration of certain transactions. According to it, the transfer of assets and the safety slider are not treated as income, but as a financial advance – with no impact on the general government balance. Therefore, in order to facilitate the comparative analysis in the *Programme*, these transactions are not included in the *Programme*'s 2014 edition.

The nominal deficit of the general government in 2014 was recorded at a level by 0.3 percentage points lower than anticipated in the last *Programme* update, which resulted from , on the one hand, consolidation measures introduced in the years 2010-14 by the government and, on the other hand, the introduction of ESA2010 and clarifying the rules of ESA with regard to the government statistics (the new *Manual on Government Deficit and Debt* [Pol. "*Podręcznik deficytu i długu sektora*"]). The biggest impact on the revision of the deficit of the general government was made mainly by the change in sector classification of units, specifically the decision of the General Government Statistics Team appointed by the President of the Central Statistical Office in February this year for the general government (a sub-division of the central-level general government) to include PKP Polskie Linie Kolejowe S.A. At the same time *Eurostat* has decided to include BFG to the general government, starting from 2014.

The slight deterioration of results in the general government in the period for 2016-17, compared to the previous *Programme*, is primarily a result of the modification of macroeconomic assumptions while maintaining a fiscal policy aimed at consolidating, conducted within the framework of the stabilizing expenditure rule.

The higher debt ratio of the general government to GDP compared to the forecast of the previous *Programme* resulted primarily from higher foreign exchange rates in which the nominee is approx. 1/3 of the debt, and in the years 2015-17 - due to higher borrowing needs of the national budget and a slower nominal GDP growth compared to the one projected in the previous update.

Table 4. Difference from previous update

	ESA Code	2014	2015	2016	2017	2018
Real GDP growth (%)						
2014 update		3.3	3.8	4.3	4.3	-
Current update		**3.4**	**3.4**	**3.8**	**3.9**	**4.0**
Difference		0.1	-0.4	-0.5	-0.4	-
General government balance (% of GDP)	EDP B.9					
2014 update		5.8	-2.5	-1.8	-1.2	
2014 update*		-3.5	-2.7	-2.0	-1.4	
Current update		**-3.2**	**-2.7**	**-2.3**	**-1.8**	**-1.3**
Difference*		0.3	0.0	-0.3	-0.4	
General government gross debt (% of GDP)						
2014 update		49.5	49.5	47.5	45.5	**-**
Current update		**50.1**	**51.7**	**51.6**	**50.7**	**49.1**
Difference		0.6	2.2	4.1	5.2	-

According to ESA2010 methodology as it concerns the pension reform
Source: Ministry of Finance, Central Statistical Office

V. Long-term sustainability of public finances

V.1. Strategy

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, 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.

Table 5. Fiscal stability indicators of public finance.

% of GDP	*Fiscal Sustainability Report* 2012	European Commission June 2014[22]	European Commission October 2014[23]	CP update 2015 base year 2015	CP update 2015 base year 2016	CP update 2015 base year 2017	CP update 2015 base year 2018
S1	0.1	0.2	0.2	-0.4	-0.5	-0.8	-1.5
	medium risk	medium risk	medium risk	low risk	low risk	low risk	low risk
S2	1.5	2.5	2.5	2.7	2.6	2.4	1.8
	low risk	medium risk	medium risk	medium risk	medium risk	medium risk	low risk

Source: European Commission, Ministry of Finance

Table 5 shows the evolution of the S1 and S2 indicators in time. The Ministry of Finance estimate is based on projections of macroeconomic indicators developed by the Ministry and the current forecast of costs associated with an aging population, prepared by the Economic Policy Committee’s Ageing Working Group (AWG) (see chapter V.2). Indicators were estimated in four variants, taking 2015-18 as base years.

On the basis of the data presented, S1 and S2 indicators for Poland decreased relative to previous estimates. The factors that contributed to this decrease include a better initial budgetary position and, in case of the S1 indicator, the new projections of costs associated with an aging

[22] European Commission, Commission Staff Working Document. *Assessment of the 2014 national reform programme and convergence programme for Poland, no-policy change scenario*, June 2014

[23] European Commission, *Identifying Fiscal Sustainability Challenges in the Areas of Pension, Health Care and Long-Term Care Policies*, „European Economy”, Occasional Papers 201, October 2014

population. The improved initial budgetary position is associated with the implemented fiscal consolidation and the entry into force of the *Act of 6 December 2013 amending certain acts in connection with the definition of principles for pension payments from funds accumulated in open pension funds*, which resulted in the decrease of public debt to GDP ratio. In the future, due to the continuation of fiscal consolidation leading to stabilizing the balance at the level of MTO and as a result of the economic recovery, Polish fiscal risks in the medium and long term will be reduced from ‘medium’ to ‘low’.

Measures aimed at reducing the negative impact of the demographic changes on public finances can be divided into two categories: measures directly related to the demographic transition, aimed at promoting birth rates and migration, as well as cuts in public expenditure related to an aging population, including primarily pension system reform.

The measures directly related to the problem of demographic transition are introduced by reforms aimed at promoting birth rates, including, in particular, those discussed in chapter II.3:

- higher tax deduction in the child tax credit (for large and poorer families),
- introduction of parental benefits and a minimum maternity allowance in the amount of 1000 PLN,
- introduction of a mechanism of phasing out family benefits for households with an income higher than the income threshold (“*zloty for zloty*”),
- increase in the values of family benefits planned for November 2015.

It is estimated that as a result of these measures in 2016, the total transfers to households with children[24] will increase by more than 23% compared to 2013. The growth structure of transfers depending on the type of household indicates increasing support for families with many children. A group of households covered by a relatively high increase in the benefits are marriages having three or more children, for whom the rate rises up to 31.24%. This is particularly related to the introduction of beneficial solutions for this group in the context of child tax credit.

Table 6. Children dedicated transfers between 2013 and 2016.

Household type	Increase in transfers (in %) between 2013 and 2016	Level of transfers per household in 2013	Level of transfers per household in 2016	Increase in transfers per household (in %) between 2013 and 2016
Marriage with 1 dependant child	18.51%	1 284	1 509	17.52%
Marriage with 2 dependant children	17.58%	2 119	2 466	16.39%
Marriage with 3 (or more) dependant children	31.24%	4 673	6 081	30.14%
Single parent with dependant children	18.88%	3 625	4 123	13.71%
Other households with at least 1 dependant child	29.66%	2 843	3 568	25.50%

[24] The following have been taken into account: family benefits and additional allowances, alimony from The Alimony Fund, one-off allowance for childbirth (“becikowe”), parental benefit (without subsidies to the minimal level of maternity benefit) and child tax credit in PIT.

Household type	Increase in transfers (in %) between 2013 and 2016	Level of transfers per household in 2013	Level of transfers per household in 2016	Increase in transfers per household (in %) between 2013 and 2016
TOTAL	**23.21%**	**2 514**	**3 053**	**21.44%**

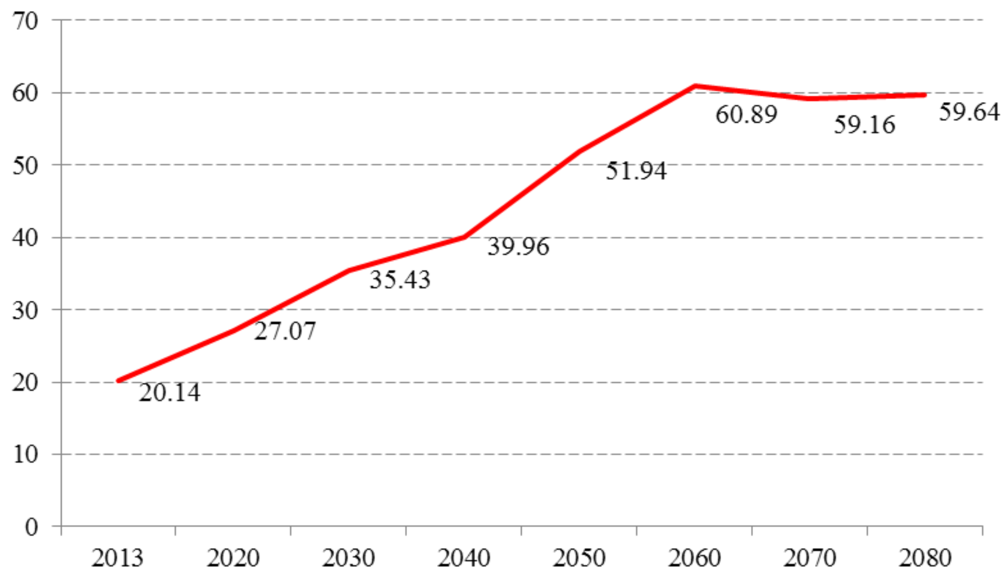
Explanations: The column „Increase in transfers (in %) between 2013 and 2016" relates to the total expenditure, whereas column „Increase in transfers per household (in %) between 2013 and 2016" – expenditure on household. Between 2013 and 2016 the number of beneficiaries is rising, which explains the difference between these columns.
Source: Estimates of Ministry of Finance based on the MF MiCROMOD econometric model.

In recent years, in order to strengthen the long term sustainability of public finances, a number of reforms, aimed at reducing public expenditure related to the aging population, have been implemented. The main reforms were increase and equalisation of retirement age for men and women to 67, which limits the number of entitled to a retirement, and the reduction of pension privileges for certain professional groups: farmers, judges and prosecutors, and uniformed services.

V.2. Long-term budgetary prospects, including the implications of an ageing population

Demographic changes constitute one of the major challenges for the long-term sustainability of public finance in most European countries. Although currently Poland still remains a relatively young country as compared to other European countries, the tendencies observed in the recent years indicate that the situation will be changing. It is associated with the extension of the life expectancy, low birth rate 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 20.14% in 2013 to 59.64% in 2080 (cf. chart 12).

Chart 12. Demographic burden ratio in Poland between 2013-2080



Source: Eurostat.

Forecast of the long-term sustainability of public finance, presented in table 7, was developed within the work of the Economic Policy Committee's Ageing Working Group (AWG) which will be published by the European Commission in the *Ageing Report* 2015 on the expected results of population ageing to 2060. It comprises the current legal status. The forecast is based on the Eurostat demographic assumptions prepared in 2014 and the extrapolation of historic trends and technical assumptions regarding the convergence of basic economic growth factors, i.e. labour, capital and labour productivity.

It is worth noting that the AWG technical scenario for economic growth in Poland by 2060 shows a relatively pessimistic path. It was prepared for the purpose of examining the impact of population aging on the public finances of the EU Member States. The unified methodology focuses on the differences in demographic projections and the resulting consequences for public finances. Issues such as real convergence of the economies of the Member States in this scenario are treated as secondary.

Table 7. 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
Occupational pensions (if within the general government)						
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	1.6	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 and Ageing Working Group (a group within the Economic Policy Committee).

According to the AWG projections, spending on pensions will decrease from 11.3% of GDP in 2013 to 10.7% of GDP in 2060. It should be noted that demographic changes alone, without consistently carried out social security system reforms initiated in Poland in 1999, would cause increase in spending to almost 13% of GDP. Despite the rapid aging of the population, Poland has managed to prevent a sudden increase in expenses due to, among others, reducing the number of future beneficiaries by withdrawing early retirements, raising the retirement age and reducing ease of access to the pension system. The second important factor limiting the increase in spending was replacement of the defined benefit system with notional defined contribution scheme.

As a result of the changes introduced by the pension reform of 2014, ZUS will pay pensions from the capital part of the system. This means that expenditure that so far were accounted as private sector spending will be classified as a general government expenditure. Due to this, expenditure will increase by about 1.2% of GDP in 2060. It is worth mentioning that as a consequence of this reform the Social Insurance Fund (FUS) deficit was significantly reduced. It is a result of higher contributions inflows (lower contributions to private pension funds (OFE), voluntary participation in OFE – a smaller number of OFE members). Additionally, the balance of FUS is affected by transfer of funds from the capital part of the system, which are gradually transferred for future payments, as well as the benefits of redemption.

In conclusion, it is expected that, in spite of unfavourable changes in the demographic structure, the set of pension reforms implemented after 1999 results not only in lower public spending, but also improves the balance of the public pension system and increases labour supply.

V.3. Contingent liabilities

Potential contingent liabilities on account of sureties and guarantees granted by general government in Poland reached 6.6% of GDP at the end of 2014, against 6.5% of GDP at the end of 2013 (in accordance with updated GDP for 2013 and estimated GDP in the fourth quarter of 2014). A significant share in this category was represented by sureties and guarantees granted by the State Treasury – at the end of 2014 they reached about 6.4% of GDP against 6.3% of GDP as of the end of 2013.

The State Treasury activity with regard to sureties and guarantees does not impose a significant risk to public finances. At the end of 2014, about 85% of contingent liabilities on account of sureties and guarantees granted by the State Treasury were classified as a low-risk group. The long-term risk ratio for the State Treasury sureties and guarantees portfolio remained at the level of approx. 6%. The increase in the potential contingent liabilities on account of sureties and guarantees granted by the State Treasury, which translated into an increase in ratios of these liabilities to GDP, was, similarly to the previous year, mainly the result of the 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. 0.12% of GDP as of the end of 2014, and did not relate to said potential actions against the crisis.

Table 8. Contingent liabilities

% of GDP	2014
Public guarantees	6.6
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 NRF 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 41.8% in 2014 to 39.0% in 2018, so in comparison to 2013, the general government expenditure share of GDP will decrease by 3.2 percentage points. However, it is the change in domestic expenditure (i.e. expenses after adjusting for the deficit-neutral expenditures financed with EU funds) which has a more significant impact on the general government balance and should decrease in terms of share in GDP from 40.8% in 2014 to 37.4% in 2018.

The expenditure structure is influenced by systemic changes, both planned and those already implemented which are aimed at consolidating, rationalising and increasing the flexibility of expenditure, as well as additional measures aimed at the strengthening of public finance discipline (cf. chapter III and V). Changes in the expenditure policy for 2015 and subsequent years are carried out taking into account the *Medium-term National Development Strategy*, which assumes a reduction of poverty among children and youth as well as disabled persons. The objective of most reforms introduced in 2014 and continued in 2015 is acting in accordance with inclusive growth policy through reducing the scale of poverty and more effective distribution of monetary and non-monetary benefits.

In addition to the above initiatives, the structure of expenditure in the coming years will influence the increase in national defence expenditure in connection with the planned amendment of the *Act of May 25th, 2001 on the reconstruction and technical modernization and financing of the Polish Armed Forces*, establishing the necessity of funding the Polish Armed Forces. This action will lead to increased national defence spending limit from the state budget, from 1.95% of GDP to at least 2% of GDP. This is expected to increase the spending for national defence in 2016 to approx. PLN 897 billion. Poland will, thus, meet the requirements of the 2014 NATO summit in Newport. According to the act's draft (after the first reading to the parliamentary commission of national defence), at least 20% of the expenditure of money will be spent on capital expenditure, i.e. purchase of weapons and military equipment, joint defence programs and research grants.

Furthermore, under the Act of 23 October 2014 amending the Act on pensions from the Social Insurance Fund and other Acts[25] introduced, in 2015, a minimum amount of indexation of pensions. The amended regulations have begun to take effect on March 1st, 2015 when the pension benefits were raised. The minimum amount of the adjustment amounted to PLN 36 in the case of retirement, bridging pensions, teachers' compensation benefits, pensions for total incapacity to work, survivor's pensions, retirement allowances and benefits, PLN 27 for pensions for partial disability and PLN 18 in cases of a partial retirement. Due to the execution of the CPI at 0 and as a result the low rate of indexation of benefits, the amendments benefited most of the beneficiaries of pensions.

Additionally, the *Act of 22 January 2015 amending the Act on the Functioning of coal mining in the years 2008-2015 and other acts* set at a level of no-higher-than PLN 3 billion of spending budget limit on liquidation of mines, covering current production losses referred to in art. 11f of the *Functioning of coal mining Act*, and employment restructuring in the years 2015-18. Amended regulations (amended art. 8 paragraph 1-3) distinguish the situation of mining companies put into liquidation before 01.01.2016 and after that date. In the case of commencement of liquidation before 01.01.2016, mines are entitled to the decommissioning funds from state subsidies, and, in the event when the formal decision to close the company was made after the date indicated, from the mine closure fund under the meaning of the *Act of 9 June 2011, Geological and Mining Law*[26]. During the liquidation of the mine, mining plant or a designated part thereof, acquired after 01.01.2015 by the liquidating company, employees who

[25] Journal of Laws of 2014, item 1682.
[26] Journal of Laws of 2014 item 613, as amended.

have no pension rights shall be entitled to mining holidays, leaves for coal processing plant employees or a one-time severance pay (financed by the Fund for Guaranteed Employee Benefits up to PLN 1 billion in 2015)[27].

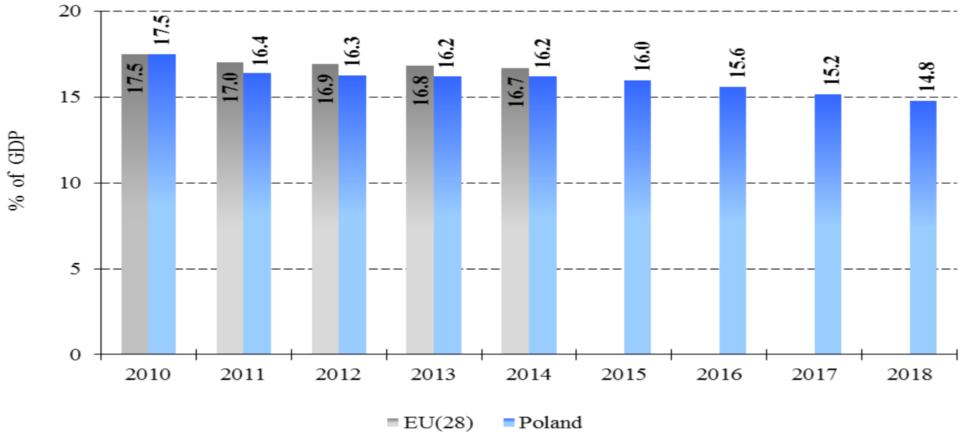
In 2014 a systemic, structural change was introduced in the Ministry of Finance, which focused on isolating an organizational unit responsible for conducting regular evaluations of the effectiveness of public spending in the form of maintenance expenditure. Thus, actions initiated in 2013 led to the implementation of the necessary institutional arrangements in order to enable the conduct of such assessments. In 2014, with the participation of the World Bank and OECD experts, work began on the pilot surveys of public expenditure in the areas of (1) supporting low-income families, (2) housing policy, and (3) the rigidity of budgetary expenditure and the possibility of increasing its flexibility, all of which will be completed in 2015. Conclusions and lessons learned from the pilot survey will be used to develop a methodology for reviewing expenditures, and legislative and organizational solutions enabling the institutionalization of this instrument of fiscal policy and incorporating them into the budget process.

It is assumed that the ultimate overhaul of expenses – in the cycle of 3-4 years – will cover most of the areas in which there are significant expenses from public funds incurred. The on-going review of the analysis of the allocation of funds for the implementation of specific public policies will provide information and data on the efficacy and effectiveness of these policies and expenditures incurred in their implementation. Therefore, the conditions for a wider use of information on the efficiency and effectiveness of public expenditure will be created within the budgetary process, which, in turn, will support public expenditure management in the context of the objectives and requirements arising from the stabilizing expenditure rule.

The planned efficiency improvements in the functioning of the administration are shown on chart 13.

[27] Expenses for the years 2016-2018 will be offset by the profits made from privatization.

Chart 13. Administration costs (as a sum of remuneration and indirect consumption)



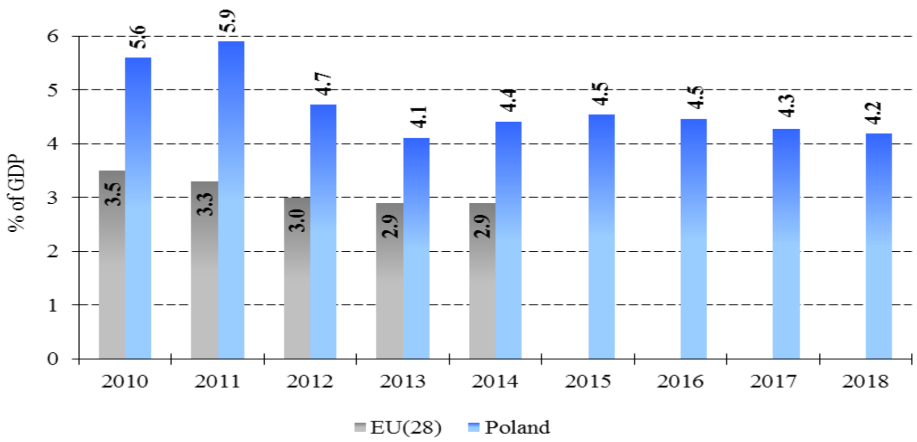
Source: AMECO, Ministry of Finance.

The biggest decrease in spending is expected in general public services - by 1.2 percentage points of GDP, which results from the substantial reduction in debt servicing costs by 0.9 percentage points compared to 2013. The significant decrease in debt servicing costs is a result of the introduction of changes in the pension system, in particular, the redemption of state treasury securities purchased by the Minister of Finance, and reduction of the borrowing needs.

Charts 12 and 13 should be analysed in context of the recommendations of the Council to minimize cuts in growth-enhancing investment in infrastructure, social spending and their review. The “economic matters” function, in which the share of capital expenditure is over 40%, presents stabilization of spending, to GDP at 4.1%, while in the function “social protection” – presents a decrease in spending by 1.0 percentage point of GDP.

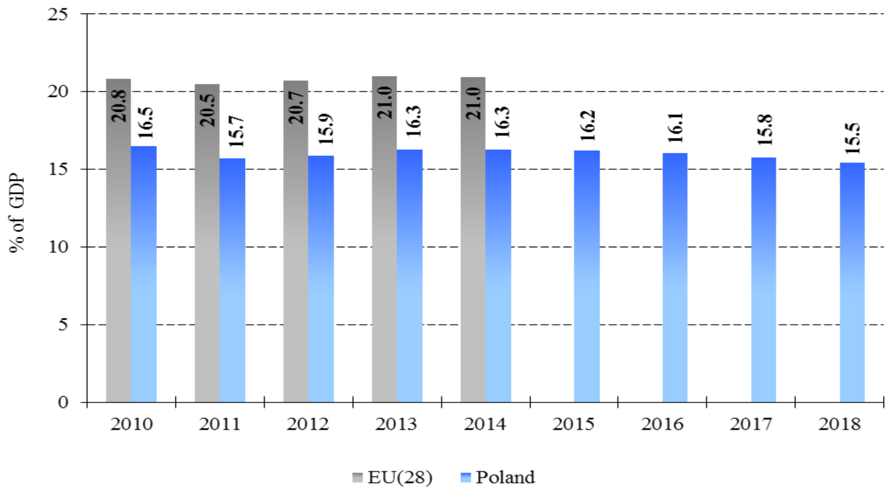
Limiting the relations of social expenditure to GDP is a result of a moderate increase in the number of beneficiaries, the benefit indexation system and the reforms to the pension system.

Chart 14. Gross fixed capital formation



Source: AMECO, Ministry of Finance.

Chart 15. Social expenditure



Source: AMECO, Ministry of Finance.

Table 9. General government expenditure by function

	COFOG Code	2013 % of GDP	2018 % of GDP	Real increase 2018/2013 in %
1. General public services	1	5.7	4.4	-5.5
2. Defence	2	1.7	1.7	25.6
3. Public order and safety	3	2.2	2.0	8.8
4. Economic affairs	4	4.1	4.0	20.0
5. Environmental protection	5	0.7	0.7	16.4
6. Housing and community amenities	6	0.7	0.7	5.3
7. Health	7	4.6	4.3	13.6
8. Recreation, culture and religion	8	1.1	1.0	15.5
9. Education	9	5.3	4.8	9.6
10. Social protection	10	16.2	15.2	13.9
11. Total expenditure	TE	42.2	39.0	11.5

Source: Ministry of Finance, Central Statistical Office.

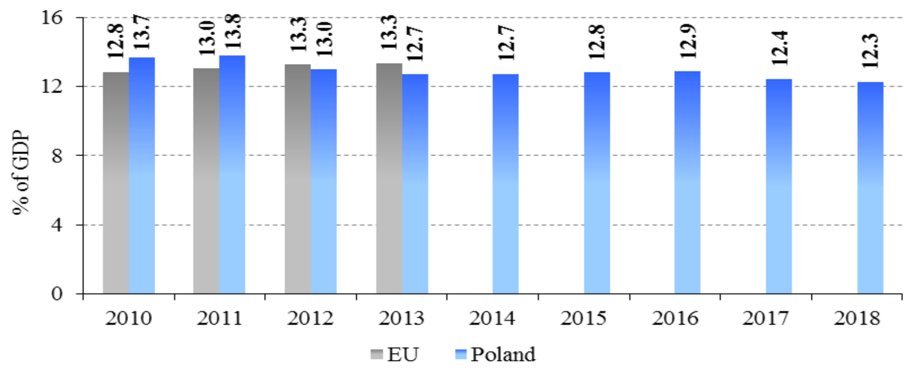
VI.2. Structure and efficiency of revenue systems

The general government revenue in 2014 increased in relation to 2013 by 0.5 percentage points of GDP and reached 38.6% of GDP. In 2015, this ratio is projected to increase further to 38.8%, followed by its return to the level of 38.5% of GDP in 2016. From the perspective of the impact on the general government balance, the change in domestic revenue is more significant (i.e. revenue after adjusting for deficit-neutral transfers related to non-refundable EU aid), whose relation to GDP in 2015 is projected at the level of 37.2% of GDP, and in 2016 and 2017 - at the level of 37.1% and 36.5% of GDP respectively.

In the structure of general government revenues, the tax revenue is the most important, whose share in the total revenue in 2014 reached 51.0%. Another important source of general government revenue is social contributions. The total share of general government revenue from taxes and social contributions amounted to 85.1% in 2014.

The general government revenue from taxes and social contributions (the so-called tax burden) in 2014 constituted 32.0% of GDP. In the years 2015-2016 a slight increase in this relation is projected, whereas in the following two years, its slight decline is foreseen (see: chart 19).

Chart 16. General government revenue from taxes associated with production and import

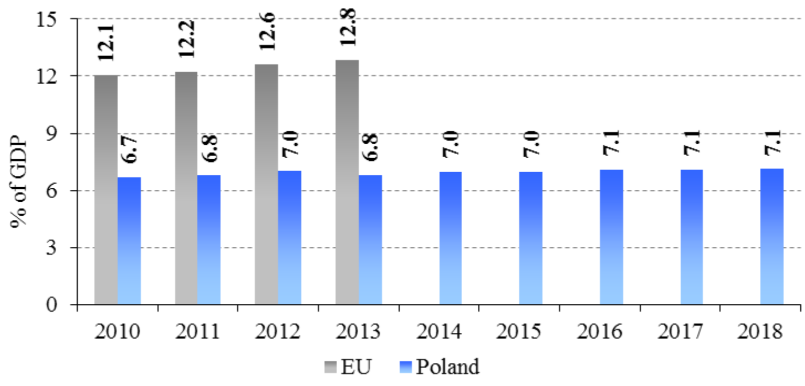


Source: AMECO, Ministry of Finance.

The average share of general government revenue from taxes on production and imports in GDP in the years 2010-2014 reached 13.2%, and in 2014 alone this share amounted to 12.7%. In the period 2015-2016, a slight increase of this revenue expressed as a percentage of GDP is forecasted, and in two following years - a slight decrease. This is associated with the projected decrease in revenue from excise tax in GDP as a result of the gradual reduction of the real excise tax burden of individual products. Moreover, from 2017 the return to the VAT rates at a former level (from 23% to 22% and from 8% to 7%) is planned.

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 2010-2013, by 0.2 percentage points, on average.

Chart 17. General government revenue from taxes on income and assets

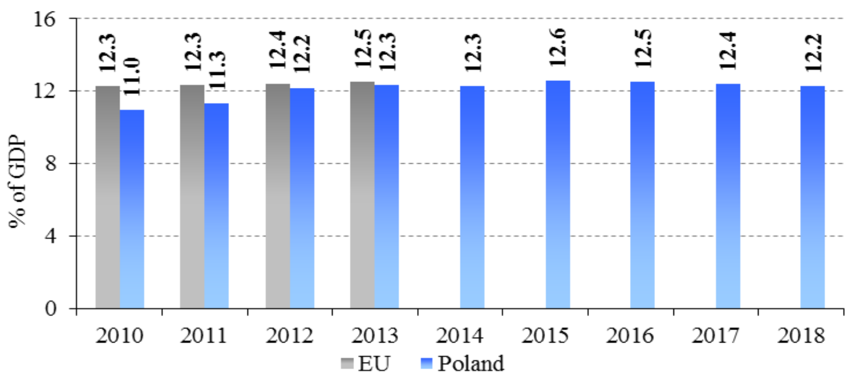


Source: AMECO, Ministry of Finance.

The average share of general government revenue from taxes on income and wealth in GDP in the years 2010-2014 reached 6.8%. In the years 2015-2018, their stabilisation in relation to GDP at the level of 7.1% is expected.

In Poland, as compared to the EU, lower share of general government revenue from taxes on income and wealth in GDP is noted. In 2010-2013 the average share of general government revenue from taxes on income and wealth in GDP was lower by 5.6 percentage points than the EU Member States average. The old EU Member States base their tax systems mainly on direct taxes.

Chart 18. General government revenue from social insurance contributions*

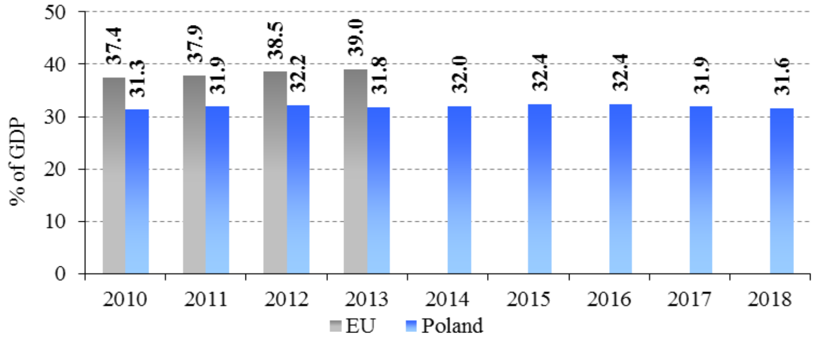


*Without contractually attributed contributions
Source: AMECO, Ministry of Finance.

In the years 2010-2014 the average share of the general government revenue from social contributions in GDP reached 11.8%, and 12.3% in 2014. In the years 2015-2018 a gradual decrease of the general government revenue from social contributions in the GDP is projected, from 12.6% of GDP in 2015 to 12.2% in 2018.

Similar to revenue from taxes on income and wealth 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 2010-2013 the average share of the general government revenue from social contributions in the GDP was lower by 0.7 percentage points than the EU Member States average.

Chart 19. Tax burden*



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

In 2010-13, the average share of the general government tax burdens in GDP in Poland was lower by 6.4 percentage points than the EU Member States average. It is forecasted that in 2015-2018 the general government tax burdens as a percentage of GDP shall reach the level of ab. 32.1%.

The revenue side of the general government is supported by the implementation of the action plan announced by the Ministry of Finance in April last year [28] in response to the recommendations of the Ecofin Council regarding tax compliance and the effectiveness of tax administration.

Among the activities carried out in this plan, one should indicate, in particular, the entry into force on May 11th, 2014 of the *Act amending the act on computerization of entities performing public tasks and other acts*. Under this act, the following solutions were introduced:

- the tax portal - a computerized system used in dissemination of tax information regarding changes to the rules governing the interpretation of provisions and other information of general nature, as well as designed for specific taxpayers;
- the possibility of the tax authorities to express a constant consent to service of documents in electronic form;
- electronic access into case files;
- allowance of use of electronic copies of paper documents, authenticated by the appellant as its annexes;
- electronic admission forms for power of attorney, summons to a hearing, a hearing or testimony in tax proceedings, preparation of an official business annotation.

In March 2015, within the framework of the e-Tax service, a pre-filling service was launched for annual tax returns (in the first stage: the PIT 37 form) by the tax administration, on the basis of information received from employers. As of May of this year, in the section for logged-in users, one will see the launch of the functionality of the Portal of the Ministry of Finance, which allows settling tax matters relating to inheritance tax, gift tax, transfer tax and the flat rate income tax in the form of a tax card (new functionalities planned: income tax from individuals and VAT in the years 2016-17).

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[28] Action plan is available in the *Annex 2: Measures increasing the tax compliance and improving the effectiveness of tax administration in the years 2014-2017* of *Report of April 2014 on action taken by Poland in response to the Council recommendation of 10 December 2013 in order to bring an end to the situation of an excessive deficit* (page 24).

On the other hand, the regulations included in this year's amending the *Act on amending the Act on Customs Service, the Act on tax offices, and other acts* (most of the amended provisions took effect on April 1st, 2015) allowed for:

- consolidating, at the regional level, auxiliary processes carried out in chambers and tax offices. This will allow for the movement of the people employed in cells involved in tasks supporting the tax offices to other tasks, such as handling the taxpayer, tax audits or administrative enforcement. Customer benefits include concentrating work of tax offices for taxpayers and making them more effective;
- centralising the collection of customs duties and other tax by introducing one-stop billing. This allows for faster settlement of entrepreneurs and taxpayers, thus reducing the costs associated with running a business. The entrepreneur and the taxpayer, if there is a need to provide explanations or documents, have to contact only a single body (the Director of the Customs Chamber in Krakow);
- the appointment of only one director of customs chamber (Customs Chamber in Szczecin) to perform the tasks of the creditor. This will speed up errands and streamline communication between the debtor and the creditor. A full knowledge of the debtor's financial situation eliminates the obligation of deliveries of documents by the debtors; debt proceedings would consequently be less cumbersome and bureaucratic to the other party.

On March 31st this year, the Council of Ministers adopted a draft act on tax administration, with its main objective to create a system to provide service and support to the taxpayer in proper performance of their tax obligations by, among others:

- ensuring a uniform and publicly available tax information using the Tax Administration Knowledgebase and engaging in informative and educational activities – thanks to the base, each taxpayer receives uniform information on the application of tax law, regardless of their place of residence;
- service centres, by means of electronic communication and the taxpayer assistants - service centre staff, regardless of the jurisdiction of the tax authority, will accept applications and declarations, issue certificates, provide explanations on tax law, including entities that intend to take up economic activity. Similar solutions will refer to the tasks carried out by ZUS: the payer of social security contributions will be able to submit them to any tax office and billing application documents related to social security. In turn, the taxpayer assistant's task will be to help micro-entrepreneurs with starting business activities, e.g. providing information on completing tax returns or assistance in individual taxpayer cases, including the choice of form of taxation. Micro-entrepreneur's assistant will be bound for a period of no- longer-than 18 months from the date the taxpayer receives their tax identification number confirmation;
- the establishment of the Office of the National Tax Information – out of tax chambers, which are now operating agencies of the National Tax Information for improving the quality of individual interpretations of the tax law, a separate specialized body responsible for the issuance of tax interpretations will be isolated. The Director of the Office of the National Tax Information shall obtain the status of tax authority.

According to the plans, the Act will come into force on January 1st, 2016, with the exception of the provisions concerning service and support centres, which will come into effect on September 1st, 2015.

In addition, the Codification Committee of the General Tax Law will continue to work - the result of their work in 2015 will be the development of assumption direction for the new *Tax Ordinance Act*.

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 stabilising 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 Act on Public Finances* and the conditions of the correction mechanism of the stabilising expenditure rule defined in Article 112aa paragraph 4. The stabilising 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 stabilising 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[29], from breaching the precautionary thresholds, 43% and 48%, defined in the correction mechanism of the rule.

In the original shape of the stabilising 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 art. 86 of the *Public Finance Act*, and thresholds of 43% and 48% of GDP, included in the correction mechanism of the stabilising expenditure rule, defined in art. 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 program 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*

[29] 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 2015's budget bill 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[30]. 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

[30] 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 stabilising expenditure rule in connection with the on-going changes in the classification of the general government.

As part of the fulfilment of the requirements of the *Council Directive 2011/85/UE 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[31]:

- 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 April 9th, 2015 the Polish Sejm passed the *Act amending the act on public statistics and other acts*, and was then submitted to the President and the Speaker of the Senate.

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.

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

Annex

Table 10. Macroeconomic prospects*

	ESA Code	2014 Level	2014 Rate of change	2015 Rate of change	2016 Rate of change	2017 Rate of change	2018 Rate of change
1. Real GDP (PLN billion)	B1*g	1719.2	3.4	3.4	3.8	3.9	4.0
2. Nominal GDP (PLN billion)	B1*g	1728.7	4.0	3.9	5.1	5.7	6.5
	Component of real GDP						
3. Private consumption expenditure	P.3	1042.7	3.0	3.4	3.7	3.8	3.8
4. Government consumption expenditure	P.3	315.7	4.7	2.7	1.1	1.1	1.4
5. Gross fixed capital formation	P.51	341.7	9.2	6.9	6.1	6.5	6.9
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	11.6	0.7	0.7	0.8	0.8	0.8
7. Exports of goods and services	P.6	810.6	5.7	5.7	5.9	5.6	5.5
8. Import of goods and services	P.7	802.1	9.1	6.9	6.1	5.7	5.7
	Contributions to real GDP growth						
9. Final domestic demand			4.4	3.9	3.7	3.9	4.0
10. Changes in inventories and net acquisition of valuables	P.52+ P.53		0.4	0.0	0.1	0.0	0.0
11. External balance of goods and services	B.11		-1.4	-0.6	-0.1	-0.1	-0.1

* The levels of real volumes are expressed in fixed prices of 2013.

Table 11. Price developments

	ESA Code	2014 Level	2014 Rate of change	2015 Rate of change	2016 Rate of change	2017 Rate of change	2018 Rate of change
1. GDP deflator			0.6	0.5	1.3	1.7	2.5
2. Private consumption deflator			-0.4	-0.6	1.7	1.8	2.5
3. HICP			0.1	-0.2	1.7	1.8	2.5
4. Public consumption deflator			-0.1	-0.2	1.7	1.8	2.5
5. Investment deflator			-1.4	-0.7	1.7	2.0	2.6
6. Export price deflator (goods and services)			0.1	-1.2	1.4	1.9	1.4
7. Import price deflator (goods and services)			-2.2	-3.3	2.3	2.2	1.5

Table 12. Labour market developments

	ESA Code	2014 Level	2014 Rate of change	2015 Rate of change	2016 Rate of change	2017 Rate of change	2018 Rate of change
1. Employment (in thousands of persons)*		15862	1.9	1.1	0.7	0.6	0.5
2. Employment (hours worked)**		-	-	-	-	-	-
3. Unemployment rate (%)***			9.0	8.2	7.6	7.0	6.5
4. Labour productivity (in thousands of persons)****		108.4	1.5%	2.4%	3.1%	3.3%	3.4%
5. Labour productivity (hours worked)*****		-	-	-	-	-	-
6. Compensation of employees (PLN billion)	D.1	633.7	1.8	4.7	4.4	4.6	5.4
7. Compensation per employee (PLN thousand)		50.8	-0.7	3.4	3.5	3.8	4.7

* 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 13. Sectoral balances

% of GDP	**ESA Code**	**2014**	**2015**	**2016**	**2017**	**2018**
1. Net lending / borrowing vis-à-vis the rest of the world	B.9	1.0	0.5	0.5	0.5	0.3
of which: - balance on goods and services		1.8	2.0	1.5	1.4	1.3
- balance of primary incomes and transfers		-3.2	-3.2	-3.4	-3.5	-3.7
- capital account		2.4	1.7	2.4	2.7	2.7
2. Net lending/borrowing of the private sector	B.9	4.2	3.2	2.8	2.3	1.5
3. Net lending/borrowing of general government	EDP B.9	-3.2	-2.7	-2.3	-1.8	-1.2
4. Statistical discrepancies				optional	optional	optional

Table 14. Basic assumptions

	2014	2015	2016	2017	2018
Short-term interest rate (annual average)	2.5	1.7	1.7	2.4	3.3
Long-term interest rate (annual average)	3.7	2.3	2.4	3.1	4.0
Nominal effective exchange rate*	-0.3	-0.8	-2.9	-3.0	-3.0
Exchange rate vis-à-vis the EUR (annual average)	4.19	4.15	4.03	3.91	3.79
World GDP growth**	3.3	3.6	4.0	-	-
EU GDP growth	1.3	1.7	2.1	1.9	1.7
Growth of relevant foreign export markets***	4.0	4.3	5.4	5.0	4.6
World import volumes**	2.6	4.3	5.3	-	-
Oil prices (Brent, USD/barrel)**	99.0	61.5	68.8	-	-

* Nominal growth of EUR/PLN exchange rate.
** Source: EC, *European Economic Forecast. Winter 2015*, February 2015.
*** EU import as an indicator of the foreign export markets.

Table 15. General government

	ESA Code	2014 PLN million	2014 % of GDP	2015 % of GDP	2016 % of GDP	2017 % of GDP	2018 % of GDP
		Net lending (EDP B9) by sub-sector					
1. General government	S.13	**-55 241**	**-3.2**	**-2.7**	**-2.3**	**-1.8**	**-1.2**
2. Central government	S.1311	-36 208	-2.1	-2.4	-2.2	-1.9	-1.0
3. State government	S.1312						
4. Local government	S.1313	-2 920	-0.2	-0,1	0,0	0,1	0.1
5. Social security funds	S.1314	-16 113	-0.9	-0.3	-0.1	0.0	-0.3
		General government					
6. Total revenue	TR	667 637	38.6	38.8	38.5	37.9	37.8
7. Total expenditure	TE	722 878	41.8	41.5	40.8	39.8	39.0
8. Net lending/borrowing	EDPB.9	-55 241	-3.2	-2.7	-2.3	-1.8	-1.2
9. Interest expenditure	EDPD.41	33 799	2.0	1.8	1.5	1.5	1.5
10. Primary balance		-21 442	-1.2	-1.0	-0.7	-0.3	0.3
11. One-off and other temporary measures		-2 659	-0.2	0.1	-	-	-
		Selected components of revenue					
12. Total taxes (=12a+12b+12c)		341 007	19.7	19.8	19.9	19.5	19.4
12a. Taxes on production and imports	D.2	220 154	12.7	12.8	12.9	12.4	12.3
12b. Current taxes on income, wealth, etc	D.5	120 589	7.0	7.0	7.1	7.1	7.1

	ESA Code	2014 PLN million	2014 % of GDP	2015 % of GDP	2016 % of GDP	2017 % of GDP	2018 % of GDP
12c. Capital taxes	D.91	264	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	227 486	13.2	13.5	13.4	13.2	13.1
14. Property income	D.4	12 707	0.7	0.7	0.6	0.6	0.7
15. Other		86 437	5.0	4.8	4.6	4.6	4.6
16. Total revenue	TR	667 637	38.6	38.8	38.5	37.9	37.8
Tax burden (D.2+D.5+D.61+D.91-D.995)		566 416	32.8	33.3	33.3	32.8	32.5
	Selected components of expenditure						
17 Compensation of employees + intermediate consumption	D1+P2	280 323	16.2	16.0	15.6	15.2	14.8
17a. Compensation of employees	D.1	176 327	10.2	10.0	9.7	9.4	9.0
17b. Intermediate consumption	P.2	103 996	6.0	6.0	5.9	5.8	5.7
18. Social payments		280 993	16.3	16.2	16.1	15.8	15.4
of which Unemployment benefits		3 625	0.2	0.2	0.2	0.1	0.1
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	34 993	2.0	2.0	2.0	2.0	2.0
18b. Social transfers other than in kind	D.62	246 000	14.2	14.2	14.0	13.8	13.5
19. Interest expenditure	EDP D.41	33 799	2.0	1.8	1.5	1.5	1.5
20. Subsidies	D.3	10 395	0.6	0.6	0.6	0.6	0.6
21. Gross fixed capital formation	P.51	76 251	4.4	4.5	4.5	4.3	4.2
22. Capital transfers	D.9	10 270	0.6	0.4	0.4	0.4	0.4
23. Other		30 847	1.8	2.0	2.1	2.1	2.1
24. Total expenditure	TE	722 878	41.8	41.5	40.8	39.8	39.0
p.m.: government consumption (nominal)	P.3	315 397	18.2	18.0	17.6	17.2	16.7

Table 16. No-policy change projections

	2014 Level PLN million	2014 % of GDP	2015 % of GDP	2016 % of GDP	2017 % of GDP	2018 % of GDP
1. Total revenue at unchanged policies	667 637	38.6	38.3	38.2	38.1	37.6
2. Total expenditure at unchanged policies	-	-	-	-	-	-

Table 17. Amounts to be excluded from the expenditure benchmark

	2014 Level PLN million	2014 % PKB	2015 % PKB	2016 % PKB	2017 % PKB	2018 % PKB
1. Expenditure on EU programmes fully matched by EU funds revenue	25 046	1.4	1.6	1.4	1.4	1.5
2. Cyclical unemployment benefit expenditure	2 969	0.2	0.1	0.1	0.1	0.1
3. Effect of discretionary revenue measures	9 103	0.5	0.6	0.3	-0.1	0.2
4. Revenue increases mandated by law		-	-	-	-	-