



REPUBLIC OF POLAND

CONVERGENCE PROGRAMME
2007 UPDATE

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INTRODUCTION

According to the provisions of the Stability and Growth Pact¹, the Member States which have adopted the euro are obliged to submit updated stability programme updates each year to the Council. The Member States which have not adopted the common currency are obliged to submit updated convergence programmes to the Council.

The latest update of the Polish Convergence Programme was approved by the Government of the Republic of Poland on 16 October 2007. The 2007 update reflects the draft 2008 budget act approved by the Council of Ministers on 25 September 2007 and transmitted to the Sejm². Given the present political situation and early parliamentary elections, *Convergence Programme – 2007 Update* will be discussed by committees at both houses of the Parliament of the 6th term of office.

The format and the content of the Programme conform to the guidelines on the format and content of stability and convergence programmes agreed by Economic and Financial Committee of the European Union in September 2005.

The *Convergence Programme 2007 Update* is the fourth update of the programme sent in 2004. It contains a macroeconomic projection for the years 2007-10, presents actions taken by the Government in the field of public finances and their effects on the consolidation path of the general government in this period.

¹ Council Regulation (EC) No 1055/2005 of 27 June 2005 amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

² The presented forecasts are fully consistent with the 2008 budget act assumptions, however, they do not account for the latest revision of the Central Statistical Office (GUS) data of 1 October 2007 for national accounts (except for data referring to general government, calculated according to the new nominal GDP for the years 2006-10: PLN 1,060.2 bn; PLN 1,159.4 bn; PLN 1,255.2 bn; PLN 1,355.2 bn; PLN 1,459.6 bn respectively).

I. OVERALL POLICY FRAMEWORK AND OBJECTIVES

I.1. FRAMEWORK

Favourable macroeconomic conditions, in particular stable public finance and high employment rate, are necessary for the economic policy to face the challenges of the Polish economy, such as making it modern and competitive, improving the condition for technical and social infrastructure, enhancing rural development and regional and social cohesion.

The Convergence Programme should first of all support the improvement of the quality of the Polish public finance. These are not only the general government balance and debt developments that should be taken care of but also the efficiency of public finance. Therefore, apart from striving for low deficit and debt, institutional enhancement is necessary to transform the public finance sector into a modern, efficient and economical sector.

Achievement of the objective is to be supported by the draft public finance reform prepared by the Ministry of Finance and sent to the Parliament and the pilot project on the task-oriented budget. Such changes, together with tight budget regulations and rules governing the budget process in Poland, will enable to improve efficiency of public finances, the control of expenditure especially. These will be achieved by introduction of modern rules of organization and operating of public finances.

I.2. OBJECTIVES OF MACROECONOMIC POLICY

Maintenance of fast and sustainable economic growth and increase in employment leading to the improvement of the level and quality of the citizens' standards of living, remains the priority of the Government's economic policy. The policy is also oriented towards ensuring the achievement and then maintenance of the long-term fiscal balance through the reduction of general government deficit and debt to GDP ratios. It will be conducted in the environment of high economic growth and increasing employment and on the other hand, of systematically growing level of resources for co-financing of the EU projects, and costs of implemented necessary structural reforms, pension and labour cost reforms in particular.

Striving for a better structure and quality of public finance will allow meeting the Council recommendations on excessive deficit and abrogating the excessive deficit procedure in 2008 and further to achieve medium-term budgetary objective. As a result, within the horizon covered by the update, Poland will meet nominal convergence criteria, including the fiscal criterion. The exchange rate and legal convergence criteria remain an exception as due to formal reasons they cannot be met right now.

The Government has never declared the official date for Poland's adoption of the euro. The priority was to set up a realistic scenario for meeting nominal convergence criteria, being optimal for real convergence and taking into account the pace of fiscal consolidation. Basing on the latest forecasts of the general government development in the years 2008-10 Poland will meet the fiscal convergence criterion. At the same time it is expected that Poland will still meet the price stability and long-term interest rate criteria. The volatility of the zloty against the euro will also be lessening. Increasing nominal convergence will be accompanied by real convergence, maximizing the benefits from the adoption of the common European currency by the Polish economy. The evaluation of the real convergence will enable to set the date for the adoption of the common currency.

I.3. FISCAL POLICY IN THE EUROPEAN CONTEXT

As a Member State of the European Union, Poland participates in the coordination of economic policies. This relies mainly on the implementation of the *Broad Economic Policy Guidelines* including Council recommendations for the entire EU and for the individual Member States with respect to macroeconomic and structural policy. The manner of implementing macroeconomic recommendations, mainly budgetary ones, is presented in detail in the stability and convergence programmes submitted to the European Commission. Such programmes and their annual updates are subject to the Council opinion.

In its opinion on the previous Convergence Programme update the Council recommended mainly that Poland corrected the excessive deficit in 2007. The recommendation to correct the excessive deficit in a credible and sustainable way in 2007 was repeated in the new Council recommendation under Article 104(7) of the Treaty establishing the European Community (TEC), issued in parallel under the excessive deficit procedure. This was accompanied by calling upon Poland to reduce a structural deficit by at least 0.5 percentage points of GDP in 2007.

The 2006 update of the Convergence Programme forecast the reduction of general government deficit to 3.4% of GDP in 2007. However, according to the latest projections, the general government deficit in 2007 will be significantly lower, accounting for 3.0% of GDP. This supports the expectation of abrogating the excessive deficit procedure for Poland in 2008. The general government debt will remain below 50% of GDP, and thus much below the reference value in the entire projection period. Moreover, the estimated improvement of the structural deficit in the current year will exceed 0.5% of GDP required by the Council recommendation and the Stability and Growth Pact. After the abrogation of the excessive deficit procedure Poland will take further actions aimed at achieving the medium-term budgetary objective (structural deficit of 1% of GDP). Detailed estimates of the general government deficit, structural deficit and general government debt will be presented in the further part of the Convergence Programme update.

Considering the long-term impact on the economy and public finance, the Government introduced a substantial the tax wedge cut. Reduction in social contributions together with changes in the personal income tax should contribute to an improvement of the labour market and strengthen upward trends in the economy, at the same time limiting the scope of hidden economy. Reduction in the tax wedge also means implementation of the recommendation for Poland formulated in this year's update of the *Broad Economic Policy Guidelines*.

II. CURRENT ECONOMIC SITUATION AND OUTLOOK

II.1. CYCLICAL DEVELOPMENTS AND CURRENT PROSPECTS

Right before the last developments on the financial markets, the world GDP growth was relatively high, mainly due to the fast expansion of the emerging markets, in Asia in particular. Turbulences on the financial markets negatively affected the consumer and business confidence indices. Their still high levels suggest however, that the expansion of business activity will continue this year though in a lower pace. As a result, the world GDP growth in 2007 is expected to be lower than in 2006, though still close to 5%, being a good result from the historical perspective.

Polish macroeconomic situation is very good, with balanced and dynamic economic growth and inflation maintained below the NBP inflation target. The stable and sound financial system prevented Poland from the negative influence of the turmoil on the world mortgage markets. The national accounts data for the first six months of 2007 together with the assumptions of the indicators influencing the economic growth, show that the GDP growth rate will accelerate against 2006. The real GDP growth in 2007 should equal 6.5% against 6.1% in 2006. High GDP growth is the consequence of the sustained recovery of domestic demand, resulting from both acceleration of investment and recovery of the households' consumption demand.

A positive stimulus to household consumption demand in 2007 are favourable changes on the labour market, reflected both in the increase in wages and employment, which translates into a significant improvement of households' fiscal stance. An additional trigger for consumption is the lowering of the pension contribution paid by the employee by 3 percentage points from July 2007 onwards. It is expected that further growth in the household borrowing, including both mortgage and consumption loans, will continue in 2007, with a slightly lower gross household savings ratio. It should be stressed however, that the indebtedness of Polish households is still at a very low level as compared to other EU economies. The total household indebtedness to GDP ratio at the end of 2006 accounted only for 17.3% and mortgage loans to GDP ratio for some 6.6% at the end of 2006.

Among factors triggering investment demand, the following should be stressed in particular: great interest of foreign investors in investing in Poland, high rate of capacity utilization, growing labour costs against costs of capital, high consumption demand and increasing absorption of the EU funds. The growth of export in 2007 will be lower than in 2006, inter alia as a result of the forecasted weaker growth on the Polish export markets.

Dynamic growth of domestic demand leads to dynamic growth of imports and increasing trade deficit (goods and services), which for 2007 is estimated at 2.2% of GDP. The share of the developing countries in imports is growing systematically.

Data related to labour market for the first half of 2007 confirm that the situation has greatly improved. In 2007 as in 2006, labour demand³ grows at a very high rate (employment rate for people aged 15-64 increased from 53.0% in 2005 to 54.5% in 2006 and to approximately 57.0% in 2007). For the second year in a row a strong drop in unemployment is observed (by 23% in 2006 and approximately 32% in 2007). The scale of reduction of unemployment

³ Employment (LFS, 15 and more).

exceeds, however, the increase in employment, resulting in decreasing economic activity of the population⁴. Low activity remains one of the main problems of the Polish economy.

Continued high economic growth and growing tensions on the labour market both accompanied by the risk of strengthening of the inflationary pressure inclined the Monetary Policy Council (MPC) to raise NBP interest rates three times from January to September 2007. As a result, the reference rate increased to 4.75%.

Inflation in 2007 remains under control despite high economic growth, improved labour market conditions and high dynamics of food prices resulting from weather conditions and the situation on the international agricultural product markets. Its upward trend can however be noticed. In most of the months of 2007 the annual CPI stayed below the NBP inflation target (2.5%). Also core inflation measures still remain low.

II.2. MEDIUM-TERM SCENARIO

The baseline scenario assumes the orderly adjustment process on the international financial markets and no crisis will occur. However, it is expected that the growth rate of the world GDP will be subject to further decrease next year, due to e.g. the United States growing below potential and the weaker than the previous year expansion in the euro zone. The growth of the global economy will remain relatively high in the forecast horizon. In the assessment of the global economy developments the downside risks prevail over the upside ones. This may result in the actual scenario being worse than expected. In particular, the risk of a stronger deterioration of economic condition in the United States, resulting from weaker consumption, increased, which implies greater threat for the European Union economy and, consequently, for the growth rate of imports on the Polish export markets. Moreover, it is expected that oil prices will remain high.

A medium-term forecast for Poland shows slowing down of the average real GDP growth in the years 2008-10 against the growth observed in the years 2006-07. In 2008 the GDP will grow at the potential growth rate estimated for approximately 5.5%. It is expected that the positive output gap will be closing within the forecast horizon. Considering the fact that the size of the output gap will not be large (approximately 0.2 percentage points on average in the years 2008-10), potential additional inflation pressure related to this gap should not be strong. What is more it will be additionally mitigated by effects of globalisation and expected appreciation of the zloty.

The growth rate of households' consumption will be slightly higher in 2008 (6.2%) than in 2007 owing to further decrease in the tax wedge. An additional trigger for the consumption increase in 2008 will be high accumulated indexation of pension (in 2007, in accordance with the statutory mechanism, pensions were not subject to indexation).

Investments in the years 2008-10 will be marked by a favourable assessment of Polish economy development by entrepreneurs, maintained recovery of domestic consumption demand and overlapping EU payments from financial perspectives for the years 2004-06 and 2007-13, in the view of their growing absorption.

In 2008 further growth of imbalances in foreign trade is expected, up to 3.7% of GDP due to the maintained higher growth rate of imports than exports. Increased imports will contribute

⁴ Economic activity rate for population aged 15 and more decreased from 54.9% in 2005 to 54.0% in 2006 and to approximately 53.8% in 2007.

to the increase in the current account deficit up to some 4% of GDP in 2007 and over 5% in 2008. In the years 2009-10 average real export growth is forecasted to reach some 7%, and growth of imports at some 7.5%. Polish economy will open further to the foreign trade. The increase in the current account deficit up to 6.0% of GDP will result mainly from the widening trade deficit and still significant deficit on the income account. High imbalance will not threaten macroeconomic stability, owing to favourable financing structure of the deficit, with prevailing foreign direct investments.

Increased consumption and investment demand, stimulating economic growth in the years 2008-10, will contribute to the growing labour demand, including the increase in new work places. Lowering of tax wedge will indirectly, through favourable impact on domestic demand, contribute to the strengthening of labour demand. Therefore it is assumed that the growing labour demand present in the years 2005-07 will continue. It is estimated that in the years 2008-10 employment will increase by approximately 0.7 million. Moreover, it is assumed that the fast growing salaries will become an incentive for active participation in the labour market, which will be reflected in the enhanced willingness to seek and take up jobs. Considering the above assumptions, it is estimated that the unemployment rate will decrease from 13.8% in 2006 to approximately 4.8% in 2010 (according to LFS data).

The forecasts of the NBP interest rates assume that in the years 2008-10 the MPC decisions on the central bank interest rates will be made in view of maintained risk of the increase in inflation pressure due to high growth of domestic demand and unfavourable relation between the increase in labour productivity and salaries in the Polish economy. The expected further tightening of monetary policy should allow maintaining inflation within the tolerance range for deviations in the monetary policy transmission horizon.

Forecasts of the exchange rate in the years 2008-10 assume further gradual appreciation of the zloty, mainly resulting from strong macroeconomic foundations of the Polish economy, increased attractiveness of assets denominated in the Polish currency consequently to the tightening of the MPC monetary policy and inflow of foreign direct investments to Poland.

In 2008, the average annual CPI will be similar to the expected for 2007 and will equal to 2.3%. The inflation will be influenced, on the one hand, by high dynamics of domestic demand and improved labour market conditions, resulting in the increased labour costs, and on the other hand, by the expected appreciation of the zloty, globalisation processes contributing to lower prices of goods subject to strong international competition, and tightening of the monetary policy. In subsequent years, the aim of the monetary policy will be to strive for stabilizing the inflation at the MPC inflation target level, i.e. at 2.5%.

II.3. GROWTH IMPLICATIONS OF MAJOR STRUCTURAL REFORMS

The Government proposing one of the most important structural reforms, i.e. the lowering of non-payroll labour costs (reduction of the tax wedge), took into account the objectives formulated in the Lisbon Strategy. The government concentrated in particular on the priorities of the renewed Strategy, i.e. increase in the economic growth and employment, as well as the key importance of the increasing employment in the medium term for the sustainable achievement of the medium-term budgetary objective (MTO). The launch of this mechanism has been also formulated in this year's edition of the *Broad Economic Policy Guidelines*.

The implemented reform is of vital importance when a very low employment rate in Poland is considered. The employment rate in 2006 equalled 54.5% (the Eurostat data), which was the lowest rate in the EU. In addition, tax and tax-related burdens in Poland are definitely higher

than in other EU Member States. High tax wedge limits potential employment or shifts employment to the shadow economy, which does not generate revenues of the general government. However, the implemented reform involves substantial reduction of the general government sector’s revenues and negatively affects the level of deficit in the short-term.

Chart 1. Tax wedge in 5 selected EU countries in 2005

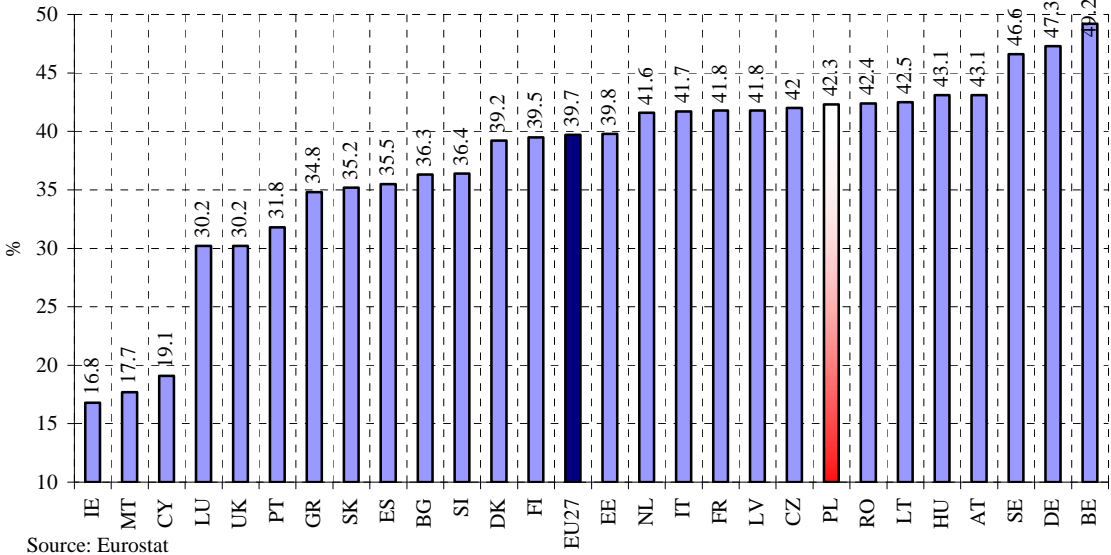
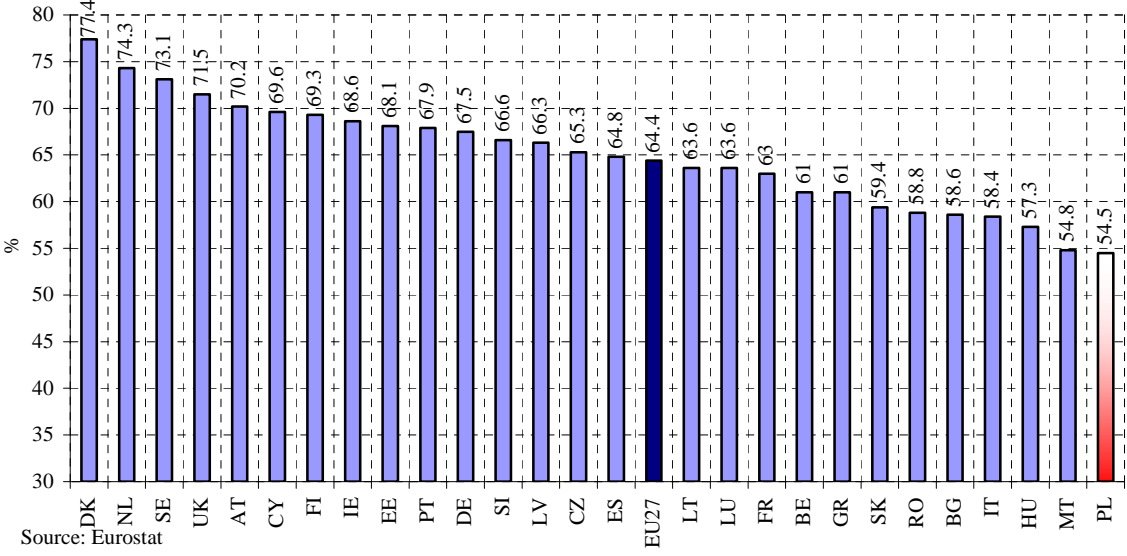


Chart 2. Employment rate in 2006 (LFS, aged 15-64)



The tax wedge reduction was started in 2007. Details and the schedule of the reform are presented in the box below.

⁵ For a single person without children earning 67% of the average wage.

Mechanism and stages of the tax wedge reduction in Poland

Reduction of labour burdens by the personal income tax and social insurance contributions (tax wedge reduction) was implemented in two stages.

Firstly, by way of amendment of the act on personal income tax of 16 November 2006, indexation of tax thresholds, tax allowance and deductible costs was recovered in the personal income tax from 2007. Moreover, from the beginning of 2009, two tax rates of 18% and 32% will be introduced (with one tax threshold amounting to PLN 84,426, tax allowance amounting to PLN 556.02 and deductible costs amounting to PLN 1,335).

Secondly, the amendment of the act on social insurance system adopted by the Sejm on 15 June 2007 introduced two-stage reduction of pension contributions (i.e. disability pension, survivors' pension and death grants). The contribution will be reduced in total by 7 percentage points, i.e. from 13% to 6%. In the first stage, from 1 July 2007, the contribution was reduced by 3 percentage points, i.e. from 13% to 10% on the employee's side only. As a consequence, the employee's pension contribution decreased from 6.5% to 3.5% of the assessment basis. In the second stage, from 1 January 2008, the pension contributions will be reduced by further 4 percentage points (from 10% to 6% of the assessment basis). The reduction will be done both on the side of the contribution paid by the employer (by 2 percentage points from 6.5% to 4.5%) and the employee's side, where it will be reduced by further 2 percentage points, i.e. from 3.5% to 1.5% of the assessment basis.

As a result of the changes discussed in the box (reduction of pension contribution and changes in personal income tax), the tax wedge calculated for the average wage in the national economy will decrease from 44.0% in 2006 to 42.1% in the second half of 2007, to 39.9% in 2008 and to 39.4% in 2009. On the other hand, the tax wedge calculated as a ratio of the change in the tax and tax-related burden (resulting from social insurance system and income tax) to the total burden for the entire economy is planned to lower by approximately 12%, compared to the situation before introduction of the reform.

Chart 3. Tax wedge in Poland in 2006 and 2009



The reduction of the tax burden to the labour income, will indirectly, through favourable impact on domestic demand, contribute to the strengthening of labour demand and thus to further decrease in unemployment. An additional effect of the abovementioned changes will be the increase in net wages in 2007 and in 2008. It is estimated that the average net wage will increase by some 4.2% in 2008, compared to 2007. Moreover, it is expected that, the

introduced changes will contribute to the reduction of the recently observed strong upward pressure on the level of wages.

The analysis⁶ of tax wedge flexibility to employment shows that the impact of tax wedge on employment is significant, in particular in the new EU Member States. It can be assumed that the tax wedge increase by 1% causes a drop in labour demand by approximately 0.5%. Labour demand forecast for the years 2008-10 takes into account the positive effect of the introduced reduction of the non-payroll labour costs. It is estimated that the employment rate in 2010 will equal 59.7% against 54.5% in 2006.

⁶ See e.g. Daveri F., Tabellini G. *Unemployment and Taxes: Do taxes affect the rate of unemployment*, Economic Policy, Vol. 15 Issue 30, 2000; Góra M., Radziwiłł A., Sowa A., Walewski M. *Tax Wedge and skills: case of Poland in international perspective*, CASE Reports, No 64/2006.

III. GENERAL GOVERNMENT BALANCE AND DEBT

III.1. POLICY STRATEGY AND MEDIUM-TERM BUDGETARY OBJECTIVE

The priority of the government economic policy remains the maintenance of fast and sustainable economic growth, as well as employment growth. The implemented policy aims at ensuring the achievement and maintenance of a long-term fiscal balance through putting emphasis on the reduction of the general government deficit and debt to GDP ratios.

III.2. ACTUAL BALANCES AND IMPLICATIONS FOR NEXT YEAR BUDGET

According to the latest estimations, in 2006 the general government deficit equalled 3.8% of GDP. In 2007, the deficit is planned to be reduced to the reference level of 3.0% of GDP. Such a significant reduction of the deficit will be possible both owing to the very good economic condition and to the favourable fiscal situation, the State budget in particular (the planned reduction of cash deficit to PLN 23 bn from the assumed PLN 30 bn). Considering the decision on the special treatment of the pension reform costs when assessing fiscal policy, the general government deficit estimated for 2007 should allow abrogation of the excessive deficit procedure for Poland.

Draft 2008 budget act adopted by the Council of Ministers on 25 September 2007 assumes further gradual reduction of general government deficit. Despite the significant encumbrance of the budget with reform costs (manly tax wedge and old-age pension reform costs), general government deficit to GDP ratio in 2008 should remain unchanged as compared to 2007 and fall below 3% of GDP in 2009.

Table 1. General government net lending/borrowing and debt

% of GDP	ESA Code	2006	2007	2008	2009	2010
Net lending/borrowing (B.9)	S.13	-3.8	-3.0	-3.0	-2.8	-2.5
Central government	S.1311	-4.2	-3.6	-3.7	-3.3	-2.9
Local government	S.1313	-0.3	0.1	0.5	0.2	0.2
Social security funds	S.1314	0.7	0.5	0.2	0.3	0.3
General government debt	S.13	47.6	47.0	47.6	47.8	47.8

Source: 2006 – CSO, 2007–10 Ministry of Finance.

III.3. STRUCTURAL BALANCE

According to the new Council recommendations of 27 February 2007 (on the basis of Article 104.7 of TEC) Poland should reduce a structural deficit by at least 0.5 percentage points of GDP in 2007 and correct the excessive deficit in a credible and sustainable way in 2007. Latest forecasts show the reduction of the structural deficit to GDP ratio by 0.6 percentage points in 2007 and its gradual decrease in subsequent years. Further consolidation of the public finance should allow the reduction of the structural deficit to the level of the medium-term budgetary objective (set for Poland at -1% GDP) after 2010.

The structural to GDP⁷ ratio will decrease in the years 2006-2007 and further in 2009-10. In 2008 it will stabilize at the level of 2007, mainly due to the further significant decrease in the level of pension contributions in 2008. The most substantial decrease of 0.6 percentage points is forecasted for 2007. In the years 2009-2010 the reduction will continue, yet at a slightly slower annual pace of 0.2 and 0.4 percentage points respectively. This will be due to the further decrease in the burdens on wages.

In line with the reformed Stability and Growth Pact (which to the greater extent supports the economic growth and orders to take the cost of structural reforms into account when assessing the budgetary standing), the costs of the tax wedge reform are presented in table 2. If the tax wedge reform was not introduced, the structural deficit would be lower and the medium-term budgetary objective could be reached in 2010.

Table 2. Cyclical developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Real GDP growth		6.1	6.5	5.5	5.2	5.0
2. General government net lending/borrowing	B.9	-3.8	-3.0	-3.0	-2.8	-2.5
3. Interest expenditure	D.41	2.7	2.4	2.4	2.5	2.5
4. One-off and other temporary measures		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth		5.3	5.5	5.6	5.5	5.3
6. Output gap		-0.4	0.5	0.4	0.2	-0.1
7. Cyclical budgetary component		-0.1	0.1	0.1	0.0	0.0
8. Cyclically-adjusted balance (2-7)		-3.7	-3.1	-3.1	-2.9	-2.5
9. Cyclically-adjusted primary balance (8+3)		-1.0	-0.7	-0.7	-0.4	0.0
10. Structural balance (8-4)		-3.7	-3.1	-3.1	-2.9	-2.5
11. Net costs of tax wedge reform			-0.3	-1.3	-1.8	-1.9
12. General government net lending/borrowing excl. net costs of the tax wedge reform (2-11)			-2.7	-1.8	-1.0	-0.5
13. Structural balance excl. net costs of the tax wedge reform (8-11)			-2.9	-1.9	-1.1	-0.5

Source: Ministry of Finance.

III.4. GENERAL GOVERNMENT DEBT

Debt management will still aim at reaching the objective⁸ of the minimization of debt servicing cost over a long time horizon with accepted limitations regarding the level of risk. The debt-to-GDP ratio will remain much below the 60% reference value.

⁷ The structural deficit forecast has been prepared having considered the output gap estimation performed on the basis of Hodrick-Prescott filter. Elasticities of the general government revenues to the cycle, based on OECD data and the data of the European Commission (*New and updated budgetary sensitivities for the EU budgetary surveillance*), have been used when calculating a cyclical component of the general government deficit.

⁸ *Public Finance Sector Debt Management Strategy in the years 2008-2010; Ministry of Finance, September 2007.*

Table 3. General government debt developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Gross debt		47.6	47.0	47.6	47.8	47.8
2. Change in gross debt ratio		0.6	-0.6	0.5	0.2	0.0
Contributions to changes in gross debt						
3. Primary balance		-1.1	-0.6	-0.6	-0.4	0.0
4. Interest expenditure	D.41	2.7	2.4	2.4	2.5	2.5
5. Stock-flow adjustment		-3.2	-3.6	-2.5	-2.6	-2.5
of which: Differences between cash and accruals		0.2	0.5	0.3	0.5	0.4
Net accumulation of financial assets		0.7	0.2	0.2	0.4	0.4
<i>of which: privatisation proceeds</i>		0.0	-0.2	-0.1	0.0	0.0
Valuation effects and other		-4.1	-4.3	-3.1	-3.5	-3.3
p.m.: Implicit interest rate on debt (%)		6.0	5.2	5.3	5.4	5.4
Other relevant variables						
6. Liquid financial assets*		1.3	1.1	0.9	0.9	0.8
7. Net financial debt		46.4	46.0	46.6	46.9	47.0

* Data covers the State Treasury only.

Source: Ministry of Finance.

Forecast changes in debt-to-GDP ratio will mainly result from the State budget borrowing needs (State Treasury debt constitutes approx. 95% of the general government debt), the estimated GDP growth rate and the zloty exchange rate against other currencies, the euro in particular.

In the years 2008-2010 the level of State budget borrowing needs will be mainly influenced, apart from the deficit (that includes funds to the Social Insurance Fund due to the loss of contributions forwarded to Open Pension Funds) by the balance of pre-financing of programs run with the European Union funds and loans granted from the State budget.

Changes of the debt of other general government entities will mainly result from the increase in the local government debt (at a pace depending mostly on the accumulation of cash deficits of these entities), the decrease in the social security debt (mainly the Social Insurance Fund) as well as changes of debt of the National Road Fund issuing loans mainly to finance road infrastructure projects.

III.5. THE EFFECT OF MAJOR STRUCTURAL REFORMS ON GENERAL GOVERNMENT

The structural reforms aim at bringing positive results in the medium and long term, while costs of their initiating constitute large burden on public finance in the introductory stage in particular. The costs limit the possible reduction of the general government deficit, which is reflected in its forecasted path. The reform of the old-age pension system (implemented in 1999) and the decrease in the tax wedge (initiated in 2007) will significantly influence the balance and debt of the general government sector.

Table 4. Net costs of the pension and tax wedge reforms

% of GDP	2007	2008	2009	2010
Forecasted total net costs	3.1	4.0	4.7	5.0
1. Net costs of the pension reform	2.8	2.7	2.9	3.1
a) Transfer from the State budget to the Social Insurance Fund related to:	1.9	1.8	1.9	2.0
- loss in contribution	1.4	1.4	1.5	1.6
- earnings exceeding 30 times and more the average wage	0.5	0.4	0.4	0.4
b) Net interest	0.9	0.9	1.1	1.2
2. Net costs of the tax wedge reform	0.3	1.3	1.8	1.9

Source: Ministry of Finance.

The reduction of the tax wedge will be implemented by reducing pension contributions and reforming the personal income tax system, which will be based on altering the tax rates, i.e. introducing two rates of 18% and 32% since 2009 (see Box on p. 12).

Additionally, in September this year the Parliament adopted an Act which raises the amount of the so-called tax relief for families with children deducted from the amount of due tax from PLN 120 (a year) per child to the equivalent of the double amount lowering the tax in the first tax threshold, i.e. PLN 1,145.08 in 2007. It can be expected that in the years 2008-2010 revenues from PIT will decrease due to the above-mentioned tax relief by ca. 0.5% (as GDP ratio).

The increase in employment in the short and long term generated thanks to the lowering of employment costs will be conducive to the increase in the general government revenues from social insurance contributions and PIT, as well as indirectly by the increase in revenues from CIT and indirect taxes (by limiting the costs incurred by employers and strengthening the demand).

The factor influencing the projected path of the deficit and debt will also be the pressure on further development of the infrastructure in the coming years. The 5-year programme of road construction adopted by the government in September envisages spending ca. PLN 121 billion mainly from the State budget and from EU funds on building and modernising roads by 2012.

Table 5. General government expenditure on the program of road construction

% of GDP	2008	2009	2010
General government expenditure on the program of road construction (incl. EU funds)	1.7	2.4	2.2

Source: *Programme for Domestic Road Construction for the years 2008-12.*

In 2007 the government adopted a draft act on public finance envisaging its further consolidation and submitted it to the Parliament. The introduction of consolidation mechanisms was supposed to generate savings of ca. 0.9-1% of GDP within two years since their full implementation. Yet, due to the dissolution of the Parliament and inability to continue the work on the draft, the effects of the proposed changes have not been included in the projected general government deficit path.

IV. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS PROGRAMME UPDATE

IV.1. RISK FACTORS AND SENSITIVITY ANALYSIS

Risk factors that could have a negative impact on general government include the following:

(1) macroeconomic risk:

- increase in supply constrains for the economy on the labour market (i.a. due to economic migration, deactivation of people in working age as a result of the changes to the legislation which provide for the expiry of the possibility for early retirement or the introduction of excessively wide scope of the authorised to benefit from bridge pensions);
- higher than expected increase in the supply constrains in the economy, leading to the increase in inflationary pressure and the further tightening of the monetary policy;
- observed turbulence on the global financial markets (especially on the mortgage market) and their potential impact on the economies of Poland' main trading partners and the domestic financial market;
- significant changes in investment sentiment towards the region (resulting in the increased volatility of the zloty exchange rate) and different than expected US dollar exchange rate developments on the global foreign exchange market;

(2) political risk.

The potential risk is also related to the absorption of the EU funds and results i.a. from possible delays due to the implementation of the new system of programme implementation under the new financial perspective (*National Strategic Reference Framework 2007-2013*) and the possible delays in the implementation of projects due to prolonged public procurement procedures. After the first two years of the new programming period (i.e. after the completion of their implementation stage), the importance of risk related to ensuring the appropriate number of domestic public funds for co-financing will increase as well. The delays in the implementation of operational programmes may also prove to be an important risk factor, particularly with regard to the infrastructural projects and the Cohesion Fund projects. The lower absorption may result in the failure to use the public funds for co-financing and the decrease in the potential tax revenues from the investments. There is also the risk of return or decrease in the allocation of funds or the return of funds as a result of financial adjustments due to potential irregularities detected in the co-financed projects.

The pension scheme reform conducted in 1999, which consisted in adding the capital element to the pay-as-you-go pension scheme, allowed to significantly reduce the risk of the negative impact of the aging of population on the long-term public finance balance. The costs of the reform currently constitute a significant burden on the public finance.

The issues related to the lack of legislative solution of restitution remain a significant source of risk. Total amount of restitution claims has been estimated at PLN 91.5 billion, and the one planned for disbursement at PLN 27.5 billion. Payments are to be made from the established Restitution Fund, starting from 2009 and to continue over the next 4-5 years.

Public-private partnership transactions and the guaranties granted by the general government entities, including the State Treasury, may also constitute risk of additional burden on public finances. The limit to which the government administration authorities may take out financial liabilities related the public-private partnership contracts has been set at PLN 5 billion in the

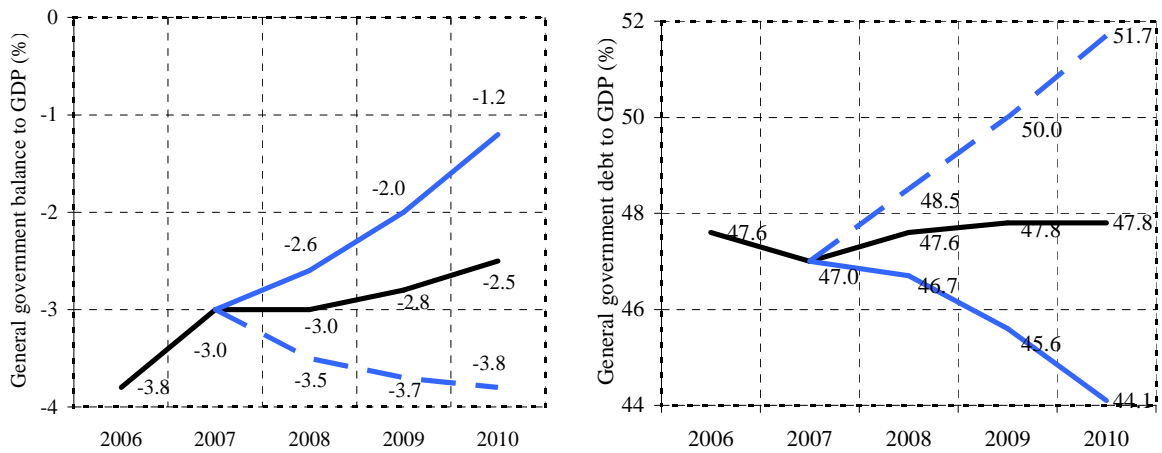
draft budget act for 2008. In the following years the level of potential liabilities of the State Treasury due to granted guarantees is expected to increase (from 3% of GDP at the end of 2006 to approximately 4% of GDP at the end of 2010) while the portfolio risk is expected to seriously decline (from ca. 30% to approximately 24%). According to the adopted strategy, the sureties and guaranties granted will mainly be used to support the development-oriented investments in infrastructure, environmental protection and creation of new jobs. The anticipated payments under guarantees should not exceed 1% of the GDP annually (with the limit set in the strategy⁹ at 1.4% of the GDP). The objective of the implemented strategy is not to allow for a situation in which the State Treasury would take over outstanding debt of the entity to which it had granted guarantee.

The general government finances are influenced by the economic external and internal factors, as well as legal conditions (structural and institutional solutions). The general government balance is determined not only by macroeconomic factors, such as: GDP growth, inflation, exchange rate, level of interest rates and size of wages, or the employment level in the economy. An important role is also played by the indexation mechanisms resulting from legal regulations which make expenditures dependent on the basic macroeconomic factors (e.g. military defence expenditures (GDP), old-age and disability pensions (actual wages increase, inflation rate)). The tax burdens (proceeds from contributions and tax revenues) constitute a significant percentage of the general government sector's revenues. They are closely related to the level of nominal consumption and wages and salaries fund in the economy. The factors which determine the level of the general government debt include the balance of the general government entities and, due to the debt structure, the exchange rate and the general economic situation. To evaluate the impact of macroeconomic situation on the general government balance and debt the impact of such macroeconomic factors as the GDP growth, interest rates and the exchange rate was presented (chart 4).

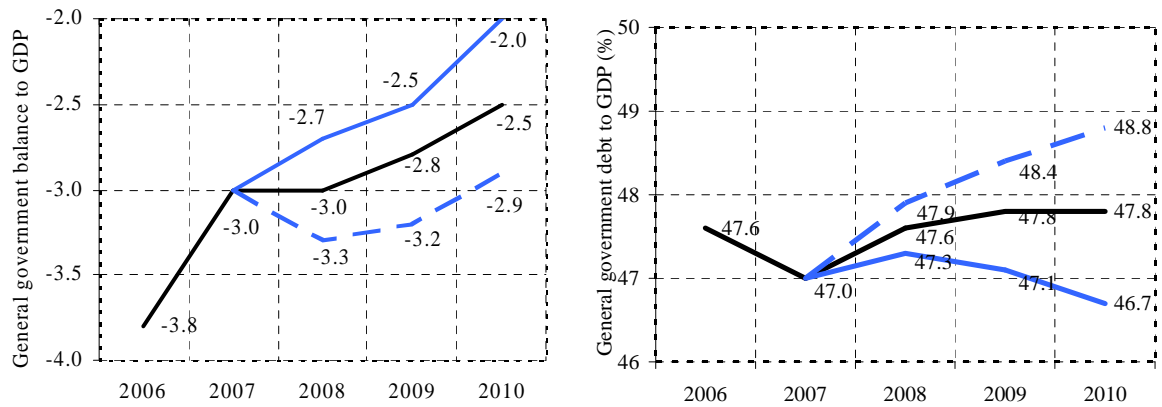
⁹ *Update to the medium-term strategy of granting the guaranties and sureties of the State Treasury by 2013*, adopted by the Council of Ministers in June 2006.

Chart 4. Sensitivity of general government net lending/borrowing and debt to changes of real GDP growth, interest and exchange rates.

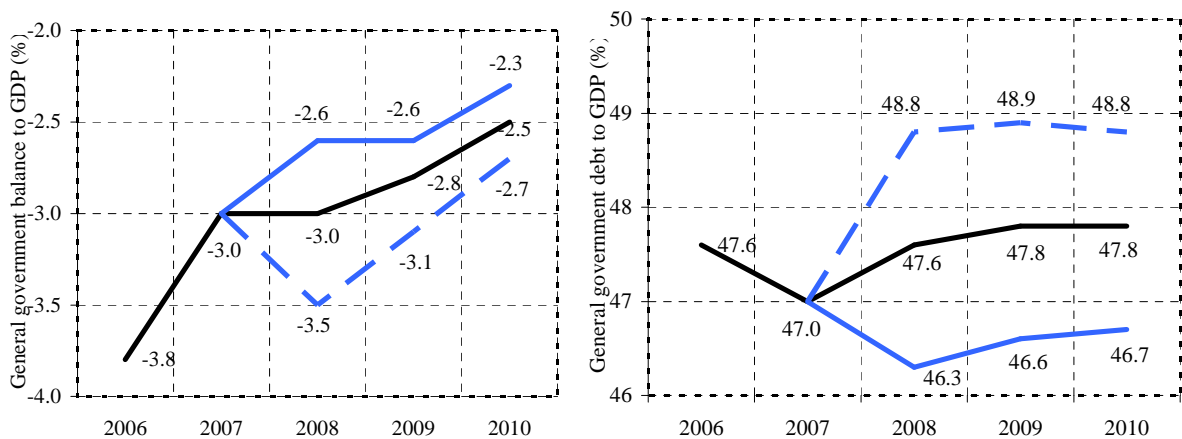
a) changes of real GDP growth by 1 per cent



b) changes of interest rates by 1 percentage point



c) changes of exchange rates by 10 per cent



IV.2. COMPARISON WITH THE PREVIOUS CONVERGENCE PROGRAMME UPDATE

Table 6. Divergence from the Convergence Programme 2006 Update

	ESA Code	2006	2007	2008	2009	2010
Real GDP growth (%)						
Update 2006		5.4	5.1	5.1	5.6	-
Current update		6.1	6.5	5.5	5.2	5.0
Difference		+0.7	+1.4	+0.4	-0.4	-
General government net borrowing/lending (% of GDP)						
Update 2006	EDP B.9	-3.9	-3.4	-3.1	-2.9	-
Current update		-3.8	-3.0	-3.0	-2.8	-2.5
Difference		+0.1	+0.4	+0.1	+0.1	-
General government debt (% of GDP)						
Update 2006		48.9	50.0	50.3	50.2	
Current update		47.6	47.0	47.6	47.8	47.8
Difference		-1.3	-3.0	-2.7	-2.4	

Source: Ministry of Finance.

As compared to the Convergence Programme 2006 Update, the fiscal path improved in 2007 and remained almost unchanged in the next years. The improvement of the forecast of the general government balance in 2007 stemmed from i.a. very good current economic situation, including the faster than assumed earlier economic growth. Despite the decrease in revenues resulting from the structural changes the previously forecasted path for 2008 and 2009 could be maintained. The decrease in the revenues has been partly compensated by a significant reduction in the general government expenditure to the GDP ratio and the revised forecasts regarding the flow of the EU funds. Very good conditions of the State budget, along with the improvement of the current macroeconomic situation and its forecasts, also contributed to the reduction of the borrowing needs, and thus the issue of debt in order to finance them.

V. QUALITY OF PUBLIC FINANCE

V.1. STRATEGY

The government aims at the consolidation of public finance in order to increase the efficiency of the allocation of public funds. It was to be achieved by putting from the beginning of 2008 into force solutions provided for in the new public finance act. However, the works on the project submitted to the Parliament have been suspended. On the other hand, the process aimed at the introduction of the target-based budgeting has been started. The first pilot draft budget in such a system, including certain general government entities (in particular the ministries and voivodship authorities), was presented in the draft budget act for 2008.

The efforts aimed at further increase in the EU funds absorption have been continued. Ensuring the funds for the project financing is one of the main objectives of the draft budget act for 2008 adopted by the government in September. The emphasis is also put on the implementation of activities included in the National Reform Programme 2005-2008 (NRP). The government has also begun works on another programme for 2008-2011. Due to the early stage of the works, the detailed consequences of all new NRP priorities for the fiscal path are difficult to evaluate at present. However, they should not have a significant impact on the envisaged general government deficit reduction.

Table 7 Basic data on general government

	Kod ESA	2006	2006	2007	2008	2009	2010
		PLN billion	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Total revenues	TR	424.2	40.0	39.9	39.3	38.7	38.3
Total expenditure	TE	464.3	43.8	42.9	42.3	41.5	40.8
Balance	S13	-40.2	-3.8	-3.0	-3.0	-2.8	-2.5

Source: 2006 – CSO, 2007-10 forecasts – Ministry of Finance.

V.2. EXPENDITURE OF THE GENERAL GOVERNMENT

Undergoing activities aim mainly at the rationalisation of expenditure and the increase in efficiency of disbursed funds. It was necessary in the forecasts concerning the fiscal path to reconcile these aims with costly development-oriented activities and the tasks aimed at solving the current social problems. Apart from the structural reforms, the additional burden on the sector's expenditure will in near future result from the implemented changes related mainly to the old-age and disability pension system and, to a lesser extent, from the activities in the field of health care and social care. From 2008 the annual indexation of old-age and disability pensions will be restored (according to the following formula: average annual CPI + 20% of the real growth of the average wages) and from 2008 the pensioners will receive the benefits calculated on the basis of the base amount increased to 100% of average wage adopted to establish the amount for the benefit on the date on which it was granted (the liquidation of the so-called old portfolio). In addition, the period in which the rules governing the right to early retirement on the current conditions are in force was prolonged by the end of 2008.

Table 8. General government expenditure related to recent changes in the pension system

% of GDP	2008	2009	2010
Reintroduction of annual indexation of old-age and disability pensions and liquidation of so called 'old portfolio'	0.5	0.3	0.5
Prolonging the period of entitlements to early retirement under unchanged conditions	0.1	0.1	0.1

As regards the changes in the health care system, the act was adopted which introduced the mechanism allowing for gradual increase in remuneration of people employed in the independent public health care units and retained the possibility for the National Health Fund to transfer the financial resources for the increase in wages of the benefit providers. The change will not have an impact on the general level of the National Health Fund's expenditure but will influence the division of funds from the contracts in the independent public health care units. Another act was passed which increased the basis for the calculation of the health insurance contribution paid from the State budget for some groups of people (increase in the expenditure of the State budget and the increase in the revenues of the National Health Fund). The basis for the calculation of the health insurance contribution for the farmers who carry out the activities under the special divisions of the agricultural production was also changed (increase in the revenues of the National Health Fund, the decrease in the revenues of the State budget). The acts aimed at the optimal use of the health care resources (draft act on the hospital network was sent to the Parliament in July this year) and the computerization of the health care service (the government works on this project) are at the draft stage.

The adopted new solutions with regard to alimony and maintenance disbursement should not have a negative impact on the social expenditure. Within the framework of the family support activities, the government adopted and submitted to the Parliament a set of solutions aimed at i.a. gradual extension of the maternity leave and the periodical exemption of the persons who return to work after the maternity or child care leaves from the obligation to pay contributions to the Labour Fund and the Employee Guaranteed Benefits Fund.

Table 9. General government expenditure by function (COFOG)

% of GDP	COFOG Code	2005	2010
1. General public services	1	6.1	5.9
2. Defence	2	1.1	1.1
3. Public order and safety	3	1.7	1.8
4. Economic affairs	4	3.8	4.0
5. Environmental protection	5	0.6	0.6
6. Housing and community amenities	6	1.4	1.3
7. Health	7	4.5	5.0
8. Recreation, culture and religion	8	1.0	0.8
9. Education	9	6.2	5.9
10. Social protection	10	17.0	14.5
Total expenditure		43.3	40.8

Source: 2005 – CSO, forecast for 2010 – Ministry of Finance.

Between 2005¹⁰ and 2010 the expenditure to GDP ratio will decrease by 2.5 percentage point. The social protection expenditure to GDP ratio will be most significantly reduced (by 2.5 percentage points). The decrease in the ratio results from the lower growth rate of the expenditure for social purposes than the GDP growth rate, which is related to the decreasing number of people using the social benefits, as a result of e.g. reduction of unemployment. The lower social expenditure growth rate is to a significant extent compensated by the introduction of the family support tax allowances on the revenue side. The expenditure for general public services to the GDP ratio will also decrease (by 0.2 percentage point) as a result of the decrease in the debt servicing costs to GDP ratio (by 0.3 percentage point). The ratio of the expenditure for education to the GDP will also decrease (by 0.3 percentage point), but in 2010 the expenditure for education will be nominally higher by over 40% than the expenditure in 2005. The ratio of the health care expenditure to the GDP will increase (by 0.5 percentage point) which will reflect the government policy in this regard. The increase in the ratio (by 0.2 percentage point) will also be recorded in the economic affairs, mostly due to the increase in expenditure for infrastructure.

V.3. REVENUES OF THE GENERAL GOVERNMENT

The forecast of the general government revenues for 2007-2010 takes into consideration the assumptions concerning the development of the macroeconomic situation in the national economy and the effects of the structural changes, the major of which include the following:

- changes in social insurance contributions and personal income tax PIT i.e. the reduction of the tax wedge (discussed in the box on page 12) and the introduction of the tax allowance for the families with children;
- changes of the excise tax – the increase in excise tax on tobacco products, including the cigarettes by 23.3% in 2008 and 26.2% in 2009; increase in the allowance for each litre of biocomponent added to petrol and fuel oil, resulting from the establishment of national indicative targets¹¹.

By the change of the basis for calculating the VAT, the change of the excise tax allowance for each litre of biocomponent added to petrol and fuel oil also has (to a much lower extent) an impact on the VAT revenues. Due to the fact that the costs of the biocomponents production (using modern technologies) largely exceed the costs of the traditional fuels production, the provisions of the corporate income tax were amended by introducing a tax allowance which is to compensate a part of the biocomponents production costs.

¹⁰ By the end of December 2007 the Central Statistical Office will send Table 11 entitled “Expenditure of general government according to function” with data for 2006 to Eurostat.

¹¹ The regulations concerning the setting of national indicative targets implement Article 3 (1a) of the Directive 2003/30/EC of 8 May 2003 on the promotion of the use of biofuels or other renewable fuels for transport.

VI. SUSTAINABILITY OF PUBLIC FINANCES IN LONG-TERM

The forecasts presented in Table 10 were prepared in 2005 (and will be adjusted only in 2009) in the course of works of the Economic Policy Committee (EPC) and are consistent with the forecasts published in the report by the EPC and the Commission¹². Further forecasts will be presented following the completion of works on the second edition of the report. Therefore, the presented forecasts do not take into account the effect of certain changes made in 2007, and in particular the reduction of the tax wedge, the extension by one year of a period in which the right to early retirement may be obtained, the restoration of the annual indexation of benefits and the increase in financial resources allocated for health care.

¹² Economic Policy Committee (EPC) and the European Commission, *The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)*, *European Economy Special Report No. 1/2006*, 2006.

Table 10. Long-term sustainability of public finances

% of GDP	2005	2010	2020	2030	2050
Total expenditure					
Of which: age-related expenditure	18.6	15.2	12.8	12.4	12.4
Retirement and disability pensions	13.7	11.3	9.8	9.4	9.3
Retirement and disability pensions from social security	13.7	11.3	9.7	9.2	8.0
Retirement and Early retirement pensions	11.1	9.4	8.4	7.9	6.6
Other benefits (disability, survivors)	2.6	2.0	1.3	1.3	1.4
Occupational pensions (if in general government)	-	-	-	-	-
Retirement pensions from the obligatory capital part of the system*	0.0	0.0	0.1	0.3	1.3
Health care**	4.1	4.3	4.7	5.0	5.4
Long-term health care***	0.1	0.1	0.1	0.1	0.2
Education expenditure	4.9	3.9	3.0	3.0	3.1
Other age-related expenditure	0.0	0.0	0.0	0.0	0.0
Interest expenditure	0.0	0.0	0.0	0.0	0.0
Total revenue					
Of which: property income					
Contributions	9.3	9.7	10.1	10.1	10.1
Retirement and disability pension contributions paid to Social Insurance Fund	7.8	8.0	8.1	7.9	7.9
Retirement insurance contributions in capital part of the system	1.4	1.7	2.0	2.1	2.1
Assets of Open Pension Funds****	8.3	15.5	33.1	50.7	84.5
Labour productivity growth	4.2	3.6	3.1	2.7	1.7
Real GDP growth	3.3	5.0	3.2	2.2	0.4
Participation rate males (aged 20-64)	77.8	79.9	82.1	84.0	81.7
Participation rate females (aged 20-64)	65.1	67.0	71.3	74.4	70.3
Total participation rate (aged 20-64)	71.4	73.4	76.7	79.2	76.1
Unemployment rate (aged 15-64)	18.2	15.8	9.9	7.0	7.0
Population aged 65+ over total population	13.1	13.5	18.2	22.6	29.4

Source: Ministry of Labour and Social Policy, Real GDP growth and unemployment rate in 2005 – Ministry of Finance estimates.

* There are both voluntary pension schemes for employees and the obligatory capital system in Poland.

** Forecasts made in 2005 under assumption of no changes of the government policy.

*** Long-term health care encompasses nursing and protecting care and palliative-hospital care. Forecasts made in 2005 under assumption of no changes of government policy.

**** Open Pension Funds and Demographic Reserve Fund.

VII. INSTITUTIONAL ASPECTS OF PUBLIC FINANCE

Main domestic fiscal rules and rules governing the budgetary process in Poland are included in the Constitution of the Republic of Poland and the public finance act. In addition, the issues related to the financial management, including some rules concerning the planning and execution of the budgets and financial plans and incurring liabilities were also regulated in specific acts. The main domestic fiscal rules have been presented in Appendix 2.

The works of the Team for general government statistics are continued¹³. In the near future they will concentrate mainly on ensuring the compliance of financial accounts with non-financial accounts and the notification of the general government deficit and debt.

In order to rationalise public expenditure and increase the control of the public funds, the government prepared the public finance system reform. Within the framework of the second stage of the public finance reform, on 26 June 2007 the Council of Ministers adopted and submitted to the Sejm two draft acts: public finance act and the act – regulations implementing the public finance act. The main assumptions of the second stage of the reform refer to the following:

- Consolidation: subject (liquidation of the certain management forms), organisational (transformation of a part of organisational units into budgetary units, e.g. Social Insurance Institution and the Farmers' Social Insurance Fund; of some funds in BGK into earmarked funds, the introduction of a new organisational and legal form, namely, the executive agency) and functional (permanent linking of the financial plans of all units of the central government subsector with the budget act);
- Budget procedure: assigning the target nature to the main stages of the budgeting procedure in the basic areas of the state activity and the extension of the planning period covering a budget year by further 2 years;
- Fiscal rules: tightening of the prudential procedure when the debt to GDP ratio exceeds 55%, the implementation of the balanced budget of the local government units with regard to current expenditure, the establishment of an individual debt ratio for local government entities;
- Implementation of regulations concerning the external audit of the annual financial statement of the sector entities.

The justification to the draft budget act for 2008 submitted to the Parliament in September this year for the first time included the target-oriented pilot budget draft covering a part of the sector entities. The preparations to this stage included inter alia the preparation of methodological assumptions, analysis of foreign solutions and training. The analytic and methodological works, as well as the works on the monitoring and evaluation of the execution of the target-based budget are to continue in the following years. Such a budget is to be implemented first in the State budget (2010). Starting from 2011 the budget in the new form is to be prepared by all units of the central government subsector and the social security funds, and from 2012 by the local government entities. The last stage of works is to include the implementation of the complete accrual-based accounting.

¹³ The Team was appointed by the head of the Central Statistical Office in order to agree the methodology of the general government statistics which would be common for the Central Statistical Office, the Ministry of Finance and the National Bank of Poland.

ANNEX 1. TABLES

Table 11. Macroeconomic prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP (PLN billion)	B1*g	919.6	6.1	6.5	5.5	5.2	5.0
2. Nominal GDP (PLN billion)	B1*g	1057.9	7.6	9.4	8.3	8.0	7.7
Components of real GDP							
3. Private consumption expenditure	P.3	575.2	5.1	6.0	6.2	5.4	4.7
4. Government consumption expenditure	P.3	159.6	3.9	1.3	0.7	0.1	-0.3
5. Gross fixed capital formation	P.51	197.1	16.5	21.5	14.5	11.5	9.5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	6.8	0.7	1.3	1.3	1.1	1.0
7. Exports of goods and services	P.6	351.3	14.5	8.6	8.0	7.0	6.5
8. Imports of goods and services	P.7	370.3	15.8	14.9	12.0	8.6	6.6
Contributions to real GDP growth							
9. Final domestic demand		-	7.0	8.7	7.5	6.5	5.6
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-0.3	0.6	0.0	0.0	-0.1
11. External balance of goods and services	B.11	-	-0.7	-2.7	-2.1	-1.2	-0.5

Note: Forecasts as presented in draft budget Act for 2008, i.e. do not include (with the exception of data on the general government) latest changes in national accounts data introduced by the Central Statistical Office on 1 October 2007.

Table 12. Price developments

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		-	1.4	2.7	2.6	2.6	2.6
2. Private consumption deflator		-	0.9	2.3	2.3	2.5	2.4
3. HICP		-	1.3	2.4	2.4	2.5	2.5
4 Public consumption deflator		-	3.4	2.2	1.2	2.5	2.5
5. Investment deflator		-	0.8	2.8	2.8	3.0	3.0
6. Export price deflator (goods and services)		-	2.3	4.2	3.0	1.5	1.5
7. Import price deflator (goods and services)		-	2.2	2.7	1.8	1.5	1.5

Table 13. Labour market developments

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment (in thousand of persons)*		14 594	3.4	4.7	1.8	1.4	1.4
2. Employment, hours worked							
3. Unemployment rate (%)**		13.8	13.8	9.5	7.1	5.9	4.8
4. Labour productivity (PLN thousand)***		72.6	2.7	1.7	3.6	3.7	3.6
5. Labour productivity, hours worked							
6. Compensation of employees (PLN million)		373.6	6.1	11.4	6.7	8.4	8.6
7. Compensation per employee (PLN thousand)		33.9	0.8	5.5	4.3	6.5	6.9

* Average based on LFS (aged 15 and more).

** Harmonized definition, Eurostat; levels.

*** Real GDP per person employed.

Table 14. Sectoral balances

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	1.7	3.3	4.2	4.9	4.7
of which:						
- Balance on goods and services		0.8	2.2	3.7	4.5	4.6
- Balance of primary incomes and transfers		1.5	1.8	1.5	1.4	1.3
- Capital account		-0.6	-0.7	-1.0	-1.1	-1.3
2. Net lending/borrowing of the private sector	B.9	2.1	0.3	1.2	2.1	2.2
3. Net lending/borrowing of general government	EDP B.9	-3.8	-3.0	-3.0	-2.8	-2.5
4. Statistical discrepancy		-	-	-	-	-

Table 15. Basic assumptions

	2006	2007	2008	2009	2010
Short-term interest rate(annual average)*	4.1	4.4	5.2	5.3	5.3
Long-term interest rate (annual average)	5.3	5.5	5.8	5.8	5.8
Nominal effective exchange rate	-3.5	-3.4	-2.4	-0.4	-0.2
Exchange rate vis-à-vis the € (annual average)	3.90	3.83	3.74	3.72	3.71
World excluding EU, GDP growth**	5.8	5.6	5.3	5.5	-
EU GDP growth **	3.0	2.9	2.4	2.4	-
Growth of relevant foreign markets	11.9	8.7	7.7	8.1	8.1
World import volumes, excluding EU**	8.4	7.7	7.1	7.6	-
Oil prices (Brent, USD/barrel)**	66.2	69.8	76.8	74.5	-

* NBP reference rate (yield on 7-day NBP bills).

** Data for 2006 based on *Economic forecast. Spring 2007, European Commission*, forecasts for 2007-09 – from the draft version of common external assumptions.

Table 16. General government budgetary prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-40.2	-3.8	-3.0	-3.0	-2.8	-2.5
2. Central government	S.1311	-44.1	-4.2	-3.6	-3.7	-3.3	-2.9
3. State government	S.1312	does not apply					
4. Local government	S.1313	-3.5	-0.3	0.1	0.5	0.2	0.2
5. Social security funds	S.1314	7.4	0.7	0.5	0.2	0.3	0.3
General government (S13)							
6. Total revenue	TR	424.2	40.0	39.9	39.3	38.7	38.3
7. Total expenditure	TE	464.3	43.8	42.9	42.3	41.5	40.8
8. Net lending/borrowing	B.9	-40.2	-3.8	-3.0	-3.0	-2.8	-2.5
9. Interest expenditure	D.41	29.0	2.7	2.4	2.4	2.5	2.5
10. Primary balance		-11.2	-1.1	-0.6	-0.6	-0.4	0.0
11. One-off and other temporary measures							
Selected components of revenue							
12. Total taxes		230.1	21.7	22.7	22.9	22.6	22.4
12a. Taxes on production and imports	D.2	150.5	14.2	14.4	14.8	14.8	14.6
12b. Current taxes on income, wealth	D.5	79.3	7.5	8.3	8.1	7.8	7.8
12c. Capital taxes	D.91	0.3	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	129.1	12.2	11.9	10.6	10.4	10.3
14. Property income	D.4	17.1	1.6	1.2	1.1	0.8	0.7
15. Other		47.9	4.5	4.1	4.7	4.9	4.9
16. Total revenue	TR	424.2	40.0	39.9	39.3	38.7	38.3
Tax burden		355.3	33.5	35.0	33.9	33.2	32.9
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D1+P2	167.6	15.8	15.3	14.7	14.2	13.7
17a. Compensation of employees	D.1	104.1	9.8	9.6	9.3	9.0	8.6
17b. Intermediate consumption	P.2	63.6	6.0	5.7	5.3	5.3	5.1
18. Social payments		183.9	17.3	16.8	16.4	15.8	15.5
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	22.6	2.1	2.0	1.9	1.8	1.9
18b. Social transfers other than in kind	D.62	161.3	15.2	14.8	14.4	14.0	13.6

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
19. Interest expenditure	D.41	29.0	2.7	2.4	2.4	2.5	2.5
20. Subsidies	D.3	6.1	0.6	0.7	0.8	1.0	0.9
21. Gross fixed capital formation	P.51	40.8	3.9	4.8	5.1	5.2	5.3
22. Other		37.2	3.5	2.8	3.0	2.9	2.9
23. Total expenditure	TE	464.3	43.8	42.9	42.3	41.5	40.8
p.m.: Government consumption (nominal)	P.3	193.7	18.3	17.3	16.5	15.9	15.3

Tab. 17. Impact of the National Reform Programme on general government (% GDP)

NPR Priorities	No. of guideline	Activity	Implementation		Direct budgetary costs*			
			Current status	Time frame	2007	2008	2009	2010
1. Consolidation of public finance and improving public finance management	1,2	1.4 – continuation of the reform of the healthcare organization	under execution		0.0	0.0	0.0	0.0
	2,3	1.5 – rationalization of expenditure on public administration and increase in control over public funds in earmarked funds and government agencies **	under execution		0.0	-0.1	-0.6	-0.3
	3,7,13	1.9 – IT development in public finances	under execution		0.0	0.0	0.0	0.0
	3,7,13	1.10 – further introduction of internal audit obligations in public institutions	under execution	permanent activity	0.0	0.0	0.0	0.0
	3,7,13	1.11 – directing the state aid towards horizontal goals	under execution	permanent activity	0.0	0.0	0.0	0.0
2. Development of entrepreneurship	14	2.2 – simplification of administrative procedures and lowering of costs of business activity	under execution	by 2009	0.2	0.0	0.6	0.0
	14	2.3 – streamlining of justice processes in economic issues	under execution		0.0	0.0	0.0	0.0
3. Increase in innovation of enterprises	7,8,9	3.1 – development of innovation market and institutional environment facilitating cooperation between R&D and the economy	under execution	permanent activity	0.0	0.0	0.0	0.0
	7,8,	3.2 – supporting R&D	under execution	2006-2008; 2009-2010	0.0	0.0	0.0	0.0
	9	3.3 – development of ICT in the economy and administration	under execution	2007-15	0.0	0.0	0.0	0.0
4. Infrastructure development and upgrade, ensuring the competitive environment in network sectors	16	4.1 – creation of a modern transport network (road, local public transport, railways, airports, seaports)	planned	2008-12	0.0	1.0	1.4	1.4
	included in GRID	4.3 - support to development of energy infrastructure	under execution	2007-13	0.0	0.0	0.0	0.0
	16	4.5 – improvement of accessibility to housing	under execution	2006-08	0.1	0.0	0.1	0.1
	14.15.16	4.6 – enhancing development of Public-Private Partnership (PPP)	under execution	permanent activity	0.0	0.0	0.0	0.0
	12.13	4.8 – liberalization of the railway transport	under execution	by 2013	0.0	0.0	0.0	0.0
5. Creation and retention of new jobs and reduction of unemployment	22	5.1 – decreasing burdens to employees with the lowest income	executed	since July 2007	0.3	1.3	1.8	1.9
	18	5.6 – activating the underprivileged in the labour market	under execution	2005-10	0.0	0.1	0.1	0.0

* Direct budgetary costs mean increase in expenditure or decrease in revenues of general government as a result of particular activity; ‘+’ means higher costs as compared to the headline scenario, whereas ‘-’ savings;

** Activity not included in forecasts of general government net borrowing/lending.

Source: Ministry of Economy, Ministry of Finance.

ANNEX 2. MAIN DOMESTIC FISCAL RULES AND RULES GOVERNING THE BUDGETARY PROCESS

Scope of regulation	Description	Form of regulation
1. Budget balance	1) The Sejm while increasing expenditure or limiting revenues cannot increase the level of the State budget deficit approved by the Council of Ministers in the annual draft budget act (on cash basis).	The Constitution of the Republic of Poland
	2) The maximum level of the State budget deficit (on cash basis) cannot exceed PLN 30 billion (so called 'fiscal anchor').	Decision of the Council of Ministers
2. Expenditure	1) Public expenditure can only be used to finance objectives stated in budget acts (of the State budget and local governments) and financial plans and only to the levels stated therein; any revenues higher than expected in the budget act are used to reduce the deficit and not to increase expenditure.	The public finance Act
	2) All but expenditure covered by own revenues of budgetary units stated in budget acts (of the State budget and local governments) and financial plans of budgetary units are limits.	The public finance Act
	3) Any increase in costs stated in annual financial plans of entities from the public finance sector is subject to legal limits.	The public finance Act
	4) In case of the execution of the State budget act being under threat planned budget expenditure can be blocked for the definite period (through an execution act of the Council of Ministers after approval of the budget commission of the Sejm).	The public finance Act
	5) Any reallocation of expenditure (across budgetary items) is subject to strict legal limits.	The public finance Act
3. Outlays	1) Outlays stated in the State budget, local governments' budgets and financial plans of budgetary units are limits.	The public finance Act
4. Public debt	1) Incurrence of debt and issuance of guarantees is forbidden if it should lead to the public debt exceed 60% of GDP. The Minister of Finance controls obeying the rule.	Constitution, the public finance Act
	2) Precautionary and remedial procedures shall be executed in case of public debt exceeding thresholds set at the level of 50%, 55% and 60% of GDP; the procedures constrain mainly the deficits of the State budget and local governments and issuance of guarantees.	The public finance Act
	3) The Minister of Finance prepares a 3-year strategy for managing the State Treasury debt and influencing the public debt (after the Council of Ministers' approval, the document is sent to the Parliament together with the justification to the draft budget act).	The public finance Act

Scope of regulation	Description	Form of regulation
5. Incurrence of liabilities	1) The level of liabilities incurred by entities from the public finance sector is limited by law.	The public finance Act
	2) Objective and amounts of loans incurred by the State Treasury are limited by law.	The public finance Act
	3) Objectives of incurring loans and issuing securities by local governments are limited by law.	The public finance Act
	4) Some parameters of liabilities incurred by entities from the public finance sector entities (excluding the State Treasury) are limited by law (e.g. capitalization of interest, value of discount).	The public finance Act
	5) Annual level of repayments and servicing of liabilities by local governments as well as the level of local government debt is limited by law.	The public finance Act
6. Issuance of guarantees	1) Issuance of guarantees by public finances' sector entities including their amounts is limited by law.	The public finance Act
7. Other rules	1) Any changes in the financial plan of a central government entity included in the budget act require the agreement of the governing minister after approval of the Minister of Finance and a positive opinion of the budget commission of the Sejm.	The public finance Act
	2) The range of financial assets in which given entities from the public finance sector may invest available financial resources is limited by law.	The public finance Act