Council of the European Union

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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2016 national reform programme of Poland and delivering a Council opinion on the 2016 convergence programme of Poland

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2016) 341 final.

COUNCIL RECOMMENDATION

of …

on the 2016 National Reform Programme of Poland

and delivering a Council opinion on the 2016 Convergence Programme of Poland

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

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1 OJ L 209, 2.8.1997, p. 1.

Whereas:

(1) On 26 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council[2], the Commission adopted the Alert Mechanism Report, in which it did not identify Poland as one of the Member States for which an in-depth review would be carried out.

(2) The 2016 country report for Poland was published on 26 February 2016. It assessed Poland's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and Poland's progress towards its national Europe 2020 targets.

(3) On 28 April 2016, Poland submitted its 2016 National Reform Programme and its 2016 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

[2] Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[3], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking effectiveness of the European Structural and Investment Funds to sound economic governance.

(5) Poland is currently in the preventive arm of the Stability and Growth Pact. In its 2016 Convergence Programme, the Government plans for the headline deficit to increase from 2,6 % of GDP in 2015 to 2,9 % of GDP in 2017 before declining to 1,3 % of GDP in 2019. The medium-term budgetary objective — a deficit of 1 % of GDP in structural terms — is not expected to be achieved by 2019, the period covered by the programme. According to the convergence programme, the government debt-to-GDP ratio is expected to increase from 51,3 % in 2015 to 52,5 % in 2017 before declining to 50,4 % in 2019. The macroeconomic scenario underpinning these budgetary projections is plausible in 2016 and favourable thereafter. Based on the Commission 2016 spring forecast, there is a risk of a significant deviation from the recommended adjustment both in 2016 and, under unchanged policies, in 2017. Based on its assessment of the Convergence Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that there is a risk that Poland will not comply with the provisions of the Stability and Growth Pact. Therefore further measures will be needed to ensure compliance in 2016 and 2017.

[3] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(6) Poland is the only Member State without a fully-fledged independent fiscal council and with no known plans to create one, even though it has independent fiscal institutions covering some of its functions. In addition to the debt brake built into the Polish constitution, Poland introduced an expenditure stabilising rule in 2013, which was fully applied for the first time in the 2015 budget. The rule was, however, amended in December 2015 and will allow for higher expenditure, particularly in the current low inflation environment. There are significant fiscal sustainability risks in the longer term due to an unfavourable initial budgetary position and the projected increase in the costs of population ageing, mainly in relation to healthcare spending. From a debt sustainability perspective, under unchanged policies the medium-term fiscal risk is high, owing to the projected increase in the stock of debt.

(7) VAT revenues for 2015 are projected to have remained low as a proportion of GDP, despite the measures introduced so far, which include the reverse charge mechanism and the joint liability of firms in sensitive sectors. Increasing VAT collection and fighting VAT fraud are priorities for the Government and a strategy is being prepared in this respect. It is expected to include measures such as new IT tools for detecting and combating VAT fraud and a reform of the tax administration. A lower limit for cash payments between companies will be introduced in January 2017. Poland still faces the long-standing challenge of inefficient tax administration. The cost-of-collection ratio, i.e. administrative costs per net tax revenue collected, is the highest in the Union.

(8) Poland continues to apply reduced VAT rates to a large number of goods and services. This contributes to lost revenues and reduces the efficiency of the VAT system. Evidence suggests that reduced VAT rates are not an effective social policy instrument, particularly as they are not specifically targeted to vulnerable households. They tend to translate into significant subsidies to rich taxpayers. Social benefits and income tax are considered to be better targeted and thus more suitable for achieving redistributive goals. The potential lost revenue due to reduced VAT rates and optional exemptions is among the highest in the Union.

(9) Despite recent improvements, the Polish labour market faces significant challenges — an ageing labour force, low productivity and high segmentation of the labour market. These are coupled with shortcomings in the education system. Although the education system has improved significantly in recent years, it still fails to equip pupils sufficiently with the transversal skills needed for the rapidly changing labour market and innovation. The relatively low average standing of Polish higher education and science has a negative effect on the quality of provision. The degree of internationalisation of Polish higher education is very limited, both in terms of the number of foreign students and participation in international scientific collaboration. The financing model of higher education does not promote quality sufficiently, as it largely uses past university standings and quantity variables, such as the number of students and academic staff. According to employers, graduates lack transversal skills such as problem solving, critical thinking, or teamwork. Participation in lifelong learning is low, and vocational education and training do not correspond to market needs.

(10) While the availability and take-up of pre-school education has increased significantly in recent years, the availability of early childcare services remains among the lowest in the Union. Raising the obligatory school starting age to the age of seven years, and removing the obligation for five year olds to attend pre-school, combined with the new child benefit, may have negative effects on labour market participation, especially of women, and deserves close monitoring.

(11) Despite a strong rise in permanent employment contracts in 2015, the proportion of fixed-term employment in Poland is among the highest in the Union. Poland has recently taken a number of measures to tackle labour market segmentation. An amendment to the Labour Code has been introduced, the social security contributions connected to some civil law contracts have been increased and a minimum hourly remuneration for those working on civil law contracts is expected to be introduced in January 2017. However, certain features of the Labour Code create disincentives for employers to hire people on open-ended contracts and the use of these contracts remains limited. This is predominantly due to the complexity of labour regulation and the high implicit costs of dismissals under such contracts. These include high procedural costs, costs associated with lengthy and uncertain dispute resolution mechanisms and provisions such as the special protection of older workers from layoffs.

(12) Preferential sector-specific social security arrangements, in particular the highly subsidised pension systems for farmers and miners, have high budgetary costs and may contribute to reducing labour mobility. The number of insured persons under the special security system for farmers has been slowly decreasing since 2007, and the Government expects that in 2019 it will amount to 1,18 million people, while the cost of retirement benefits, which amounts to 1,229 million, will probably grow until 2018. Since 2011, the share of state budget expenditure for KRUS in GDP has been constant at 1 %. There is no general tax requirement for the farmers or an obligation to have an accounting system, and the self financing of KRUS is low. There were 1,382 million farms in Poland in 2014 of which 52 % under 5 ha (GUS). Miners are exempt from the general defined-contribution public pension system with special preferential pension multiplier coefficients, which is a significant yearly cost to the public finances of over 0,5 % of GDP. The unfavourable demographic outlook has already translated into a declining working-age population. Preserving the positive trend in employment, especially of older workers, is therefore essential, also with a view to preserving public pension system adequacy and sustainability. Although the average effective retirement age increased in recent years, it remains significantly below the statutory retirement age. Therefore, an increase in the effective retirement age is crucial for the longer-term social adequacy of future pensions and the stability of public finances, as well as to increase labour market participation.

(13) Despite sizeable investment in recent years, bottlenecks and deficiencies in transport, energy and communication networks persist. Investment activity is hampered by barriers in relation to the functioning of the public administration, taxation, the environment for research, development and innovation activities, and lengthy contract enforcement. Weaknesses in managerial and administrative capacity have a negative effect on the timely implementation of investment projects in the railway sector and other transport, energy and telecommunication infrastructure projects. The Polish economy is still energy- and carbon-intensive, and the potential gains from improving energy efficiency are significant. Electricity generation facilities are ageing and remain heavily dependent on coal. The power network is insufficiently connected to neighbouring countries. The renewable energy support scheme, which was meant to take effect on 1 January 2016, has been delayed, creating investment uncertainty. Key factors hampering investments, in particular in construction, are very low coverage of and instability in spatial planning, especially at the local level, as well as over-regulation and regulatory and administrative inconsistencies that impede the issuing of construction permits.

(14) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Poland's economic policy and published it in the 2016 country report. It has also assessed the Convergence Programme and the National Reform Programme and the follow-up to the recommendations addressed to Poland in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Poland but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations (1) to (3) below.

(15) In the light of this assessment, the Council has examined the Convergence Programme, and its opinion[4] is reflected in particular in recommendation (1) below.

[4] Under Article 9(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Poland take action in 2016 and 2017 to:

1. Achieve an annual fiscal adjustment of 0,5 % of GDP towards the medium-term budgetary objective in 2016 and in 2017. Strengthen the fiscal framework, including by establishing an independent fiscal council. Improve tax collection by ensuring better VAT compliance, and limit the extensive use of reduced VAT rates.

2. Ensure the sustainability and adequacy of the pension system and increase participation in the labour market, by starting to reform the preferential pension arrangements, removing obstacles to more permanent types of employment and improving the labour market-relevance of education and training.

3. Take measures to remove obstacles to investment in transport, construction and energy infrastructure, and increase the coverage of spatial planning at local level.

Done at Brussels,

For the Council
The President