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| Subject: | Recommendation for a COUNCIL RECOMMENDATION on the 2017 National Reform Programme of Poland and delivering a Council opinion on the 2017 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(2017) 520 final.

COUNCIL RECOMMENDATION

of...

on the 2017 National Reform Programme of Poland

and delivering a Council opinion on the 2017 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,

¹ OJ L 209, 2.8.1997, p. 1.

Whereas:

- (1) On 16 November 2016, the Commission adopted the Annual Growth Survey, marking the start of the 2017 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council², 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 2017 country report for Poland was published on 22 February 2017. It assessed Poland's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the country-specific recommendations adopted in previous years and Poland's progress towards its national Europe 2020 targets.
- (3) On 28 April 2017, Poland submitted its 2017 National Reform Programme and its 2017 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 (ESI Funds) for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council³, 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 that provision in guidelines on the application of the measures linking effectiveness of the ESI Funds to sound economic governance.
- (5) Poland is currently in the preventive arm of the Stability and Growth Pact. In its 2017 Convergence Programme, the Government plans a gradual improvement of the headline balance from a deficit of 2,4 % of GDP in 2016 to 1,2 % of GDP in 2020. The medium-term budgetary objective, a deficit of 1 % of GDP in structural terms, is not expected to be reached by 2020, i.e. the programme horizon. According to the 2017 Convergence Programme, the general government debt-to-GDP ratio is expected to increase from 54,4 % of GDP in 2016 to 55,3 % of GDP in 2017 and to decline to 52,1 % by 2020. The macroeconomic scenario underpinning those budgetary projections is favourable.
- (6) On 12 July 2016, for 2017, the Council recommended Poland to achieve an annual fiscal adjustment of 0,5 % of GDP towards the medium-term budgetary objective. Based on the Commission 2017 spring forecast, there is a risk of some deviation from that recommended adjustment in 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).

- (7) In 2018, in light of its fiscal situation, Poland is expected to further adjust towards its medium-term budgetary objective of a structural deficit of 1 % of GDP. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure⁴ that does not exceed 3,7 % in 2018. It would correspond to a structural adjustment of 0,5 % of GDP. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2018. Overall, the Council is of the opinion that Poland needs to stand ready to take further measures in 2017 and that further measures will be needed in 2018 to comply with the provisions of the Stability and Growth Pact. However, as foreseen in Regulation (EC) No 1466/97, the assessment of the budgetary plans and outcomes should take account of the Member State's budgetary balance in light of the cyclical conditions. As recalled in the Commission Communication on the 2017 European Semester accompanying these country-specific recommendations, the assessment of 2018 budget outcomes will need to take due account of the goal to achieve a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Poland's public finances. In that context, the Council notes that the Commission intends to carry out an overall assessment in line with Regulation (EC) No 1466/97, in particular in light of the cyclical situation of Poland.
- (8) The 2017 country report finds that some progress was made in improving tax collection, as Poland undertook a number of reforms aimed at tightening the tax system. Their full impact on tax collection and the costs of tax compliance should be closely monitored. In contrast, Poland made no progress in limiting the extensive use of reduced VAT rates, which have an adverse impact on VAT revenue and are not an effective social policy instrument.

⁴ Net government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

- (9) Poland faces expenditure pressures in various areas, in particular those related to population ageing. This makes it necessary to put mechanisms in place to assess the efficiency and effectiveness of public spending to enable the reallocation of resources. With this in mind, the Government has announced plans to strengthen the budgetary process, in particular with regard to the medium-term budgetary framework and incorporating spending reviews into the budgetary process. 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.
- (10) A decrease in the working-age population in Poland is expected to limit growth potential in the decades to come. The performance of the Polish labour market has been strong in recent years. Employment rates have continued to increase, but several recent policy measures may reduce labour force participation, especially that of women, the low-skilled and older people. Lowering the statutory retirement age in late 2017 is expected to encourage some older workers to exit the labour force. The Polish social protection system provides only limited incentives to take up work. The new child benefit is expected to reduce poverty and inequality, but it may also have a negative effect on the labour market participation of parents, mostly women. The size of the child allowance and limited means-testing offsets work incentives built into other social benefits. The obligation to attend pre-school for five-year-olds was removed as of September 2016 and formal childcare enrolment for children under the age of three remains among the lowest in the Union. Despite measures taken, labour market segmentation continues to be high, with negative effects on productivity and the accumulation of human capital. Obstacles to wider use of permanent contracts remain. The codification committee is preparing new draft individual and collective labour codes. This is an opportunity to address these obstacles.

- (11) The average effective retirement age has increased in recent years, but it remains too low. A higher effective retirement age is crucial for economic growth, the adequacy of future pensions and the fiscal sustainability of the pension system. However, the recent decision to lower the statutory retirement age to 60 for women and 65 for men goes in the opposite direction and may negatively affect the effective retirement age. The costly special social insurance system for farmers (KRUS) is another reason for low labour mobility and hidden unemployment in agriculture.
- (12) The education system has significantly improved over the last two decades, with the basic skills of 15-year-olds well above the Union average and one of the lowest early school leaving rates in the Union. Nevertheless, there is still room to improve the way pupils are equipped with skills that are adequate for the rapidly changing labour market. The forthcoming changes concerning primary and secondary education give rise to major organisational challenges and shorten the period of general education, which may have a negative impact on educational equality. Additional changes to adapt vocational education and training to labour market needs have also been announced, but their potential to address existing shortcomings remains to be seen. The Government has launched consultations on the higher education reform to improve the performance of the sector and its labour market relevance. Poland features insufficient participation in adult learning and the average level of older adults' basic skills is low, hampering their employability.
- (13) Weaknesses in spatial planning increase the administrative burden related to the need for construction permits. Land-use plans cover a limited part of Poland's territory and are often of low quality. In areas without them, construction permits are granted on the basis of one-off administrative decisions on land development, which create risk and uncertainty for investors. The draft Construction Code aims at consolidating spatial planning processes and easing the administrative burden for investors. The reform offers the chance to improve matters, depending on the final version of the law and its implementation.

- (14) The business environment is generally favourable. However in 2016, investment activity declined significantly due to less use of the Union structural funds, resulting, *inter alia*, from the transition between programming periods, and increased uncertainty among private investors. Furthermore, business confidence was affected by the increase in the number of regulatory changes and limited public consultations on a number of key laws. Legal certainty and trust in the quality and predictability of regulatory, tax and other policies and institutions are important factors that could allow an increase in the investment rate. The rule of law and an independent judiciary are also essential in this context. Addressing serious concerns related to the rule of law will help improve legal certainty. With the Government aiming to increase its role in the economy, ensuring the economic viability of investment decisions will be important. There continues to be a significant regulatory burden in several areas.
- (15) The road network has developed rapidly thanks to Union funding, but the road fatality rate is still among the highest in the Union, resulting in high social costs. Despite the availability of significant Union funds, the railway sector continues to face major bottlenecks in project implementation. There also remains the challenge of ensuring the long lifetime of railway assets, given a missing multi-annual railway infrastructure maintenance programme.
- (16) Around 60 % of Poland's installed fossil fuels capacity is older than 30 years. It therefore requires significant investment in the coming years. In 2016, the electricity interconnection level was among the lowest in the EU. Together with a significant amount of capacities to be decommissioned and increasing electricity demand, this contributes to the poor outlook in terms of ensuring power generation adequacy. Achievement of the binding national 2020 target for renewable energy is at risk. Following the launch of the liquefied natural gas terminal, Poland has significantly improved the security of its gas supply. It has also developed its national gas transmission and distribution network. However, the work on regionally important gas interconnectors has not advanced according to schedule.

- (17) In the context of the 2017 European Semester, the Commission has carried out a comprehensive analysis of Poland's economic policy and published it in the 2017 country report. It has also assessed the 2017 Convergence Programme, the 2017 National Reform Programme and the follow-up given 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 Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (18) In the light of this assessment, the Council has examined the 2017 Convergence Programme and its opinion⁵ is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Poland take action in 2017 and 2018 to:

1. Pursue a substantial fiscal effort in 2018, in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Poland's public finances. Take steps to improve the efficiency of public spending and limit the use of reduced VAT rates.
2. Take steps to increase labour market participation, in particular for women, the low-qualified and older people, including by fostering adequate skills and removing obstacles to more permanent types of employment. Ensure the sustainability and adequacy of the pension system by taking measures to increase the effective retirement age and by starting to reform the preferential pension arrangements.
3. Take measures to remove barriers to investment, particularly in the transport sector.

Done at Brussels,

*For the Council
The President*

⁵ Under Article 9(2) of Regulation (EC) No 1466/97.