



REPUBLIC OF POLAND

**CONVERGENCE PROGRAMME
2023 UPDATE**

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Foreword

The “Convergence Programme” presents a medium-term forecast of the economic situation in Poland and its public finance by 2026. It is also part of the “Multiannual Financial Plan of the State for 2023-2026” adopted by the Council of Ministers, developed in accordance with the Act of 27 August 2009 on public finance (Journal of Laws of 2022, item 1634, as amended). The “Multiannual Financial Plan of the State for 2023-2026”, in accordance with the act, is the basis for the preparation of the draft budget act for 2024.

The “Convergence Programme” was prepared in accordance with EU regulations¹. The macro-fiscal scenario for 2023-2026 uses data available as of 1 April of this year.

¹The Council Regulation (EC) No 1466/97/EC of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies and the Guidelines on the content and format of the Stability and Convergence Programmes adopted in June 2017 by the Ecofin Council.

Summary

The Polish economy came under the influence of a strong shock from the outbreak of war in Ukraine in 2022, which negatively affected the GDP growth rate and caused a strong increase in inflation. Despite this, the Polish economy performed relatively well in 2022, with real GDP growing by 5.1%. This year, however, the economic growth will slow down to 0.9%. A gradual recovery of the economy is expected in the following years.

The general government deficit increased to 3.7% of GDP in 2022, while the general government debt amounted to 49.1% of GDP. Protective measures introduced by the government to mitigate the effects of rising energy prices constituted the main reason for the increase in the deficit. These measures supported households, vulnerable entities and businesses under the Anti-Inflation, Energy and Solidarity Shield. In the current year, too, these measures will be a significant burden for the general government. The projected deficit will increase to 4.7% of GDP in 2023. The macro-fiscal forecast for the current year, in order to make the economic scenario more realistic, takes into account historical differences between projected and realised general government spending.

The European Commission has announced the launch of an excessive deficit procedure in spring 2024 for countries where the general government deficit or debt exceed the reference values in 2023. The programme was therefore designed with the assumption of the deficit reduction from 2024 onwards, in line with EU fiscal rules.

The armed conflict on Ukrainian territory, which has been ongoing for more than a year, may also affect the convergence of the Polish economy and the economies of the euro area countries. Poland will continue to participate in the process of deepening the Economic and Monetary Union, in particular in efforts to ensure stability in the euro area. However, with the current degree of similarity between the Polish and euro area economies – particularly in terms of the level of development as measured, for example, by GDP per capita – Poland's membership in the euro area could be a source of economic disturbances.

Changes to the fiscal surveillance and the coordination of economic policies, which could take effect from 2024, are under discussion in the European Union.

I. Economic outlook

I.1. Current prospects

In 2022, the Polish and global economies were affected by a strong supply and demand shock related to the outbreak of war in Ukraine. A shock of this nature, on the one hand, had a negative impact on the GDP growth rate by, inter alia, lowering the dynamics of economic activity in our export markets, increasing uncertainty and worsening consumer and business sentiment. On the other hand, it caused a strong increase in inflation as a result of a marked rise in global commodity prices and disruptions in global supply chains. It further affected the dynamics of real GDP through the erosion of household purchasing power and an increase in nominal interest rates, which reduced the demand for credit. The war also resulted in a sharp influx of people to Poland from Ukraine.

In 2022, GDP in the euro area – Poland's main export market – increased by 3.5%. In the first half of the year, the overall situation in the European economy was relatively good, helped by an improvement in the epidemic situation, the easing of sanitary restrictions, low unemployment and a good financial situation of households. In the second half of 2022, economic growth in the euro area slowed significantly as a result of the consequences of the Russian aggression against Ukraine described above. At the end of the year, there was a strong weakening in the dynamics of household consumption and investment.

In Poland, a strong recovery in economic activity was followed by a slowdown in post-pandemic 2021, when the average quarterly economic growth rate was about twice the long-term average (q/q, sa). The turn of 2021 and 2022 was still characterised by very strong GDP growth supported by exceptionally strong inventory growth. However, the outlook for the economy changed dramatically after the outbreak of war in Ukraine. Rising inflation, consumer pessimism and nominal interest rates contributed to a reduction in private consumption dynamics, partly mitigated by the spending of Ukrainian citizens who found refuge in Poland after the outbreak of the war. The deterioration in the dynamics of demand for Polish goods and services brought a reduction in the growth rate of exports. Investment, on the other hand, proved relatively resistant to the adverse macroeconomic conditions. As in the previous year, inventories made a significant contribution to the GDP growth. The dynamics of domestic demand turned out to be lower than a year earlier as a result, although it remained relatively high. For 2022 as a whole, GDP grew by 5.1%, up from 6.9% a year earlier.

The high dynamics of economic activity were reflected in further improvements in the labour market. In 2022, the number of employed persons increased by 0.5%, following a high growth of 2.6% a year earlier. By sector, the increase was mainly due to an increase in the number of employed in the services sector, a slight increase in the industrial sector (comprising manufacturing and construction) and a decrease in the agricultural sector. The increase in labour demand contributed to a further decline in unemployment. The unemployment rate fell to 2.9% from 3.4% a year earlier and was the second lowest in the European Union countries. The labour force participation rate – after a high increase of 2 percentage points a year earlier – increased by 0.2 percentage points, to 58.0%. The increase in labour demand, together with the low level of the unemployment rate, contributed to a high double-digit nominal increase in the average wage in the national economy – by 11.7% year-on-year (with an average for 2010-2021 of 5.2%). However, due to high inflation, average wages declined in real terms – by 2.4% (y/y). The decline in real wages was partly offset by tax changes, which affected the net wages of employees.

The outbreak of war in Ukraine contributed to a mass influx of people from Ukraine seeking refuge from the war in Poland, primarily women with children. In mid-March of this year, there were an estimated 1 million persons in Poland with the status of UKR² foreigner (cf. Figure 5) allowing, inter alia, access to social benefits. More than half of them were persons aged 18-64, 76% of whom were women. The consequence of the inflow of people fleeing Ukraine is increased public expenditure related to providing them with access to benefits and social assistance and public services, including health care

² Granted on the basis of the provisions of the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state (Journal of Laws of 2023, item 103, as amended).

and education (more on this in Chapter II.2). In turn, the expenditure of those arriving in Poland due to the war in Ukraine positively influences the growth of consumption. The integration of Ukrainian citizens in the Polish labour market is facilitated by linguistic and cultural similarities and a network of contacts resulting from previous migration of Ukrainians.

The outbreak of war in Ukraine and its consequences in the form of a sharp increase in the prices of raw materials (especially energy and agricultural raw materials) on global markets caused a marked increase in inflation. This phenomenon was widespread and occurred not only in Poland, but also in most developed countries. Consequently, in 2022, there was a high increase in energy and food prices on the domestic market, which significantly increased the overall consumer price index. In addition, core inflation was also on the rise. The increase in this category was, on the one hand, a delayed effect of the recovery of economic activity after the pandemic recession and the effect of the good situation in the labour market, and on the other hand, a consequence of the increase in cost pressures at producers (especially in energy and fuel prices). As a result, inflation in 2022 averaged 14.4% according to the national methodology (CPI) and 13.2% according to the EU methodology (HICP).

Faced with strong inflationary pressures, for most of 2022 the Monetary Policy Council continued the monetary tightening initiated in October 2021. NBP interest rates were raised eight times, by a total of 5 percentage points, including the reference rate to 6.75%. In addition, from 31 March 2022, the MPC increased the required reserve ratio to 3.5% (i.e. to the level in force before the COVID-19 pandemic). Since October 2022, the Council has kept interest rates unchanged. The rationale for no change in monetary policy parameters was awaiting the effects of the tightening of monetary policy to date, as well as the tightening of policy by major central banks and the anticipated weakening of the external economic conditions.

In 2022, the current account deficit was 3.0% of GDP, up from 1.4% of GDP a year earlier. The widening of the deficit was mostly influenced by the rise in global commodity prices as a direct result of the Russian aggression against Ukraine. This translated into a further deterioration in the balance of trade in goods, which was only partly offset by an increase in the surplus in services (which included, inter alia, expenditure by foreigners who planned to stay in Poland for less than a year). The primary income deficit also remained relatively high. In contrast, the outbreak of war had a limited direct impact on Polish exports due to their geographical structure, which is dominated by other EU countries. In 2021, Russia, Ukraine and Belarus together accounted for only around 5.6% of foreign sales of goods. In addition, Poland has become an important source of supply for Ukraine, which, despite the country's severe recession, has translated into strong growth in Polish exports.

In 2022, there was once again a high inflow of foreign direct investment into Poland. The inflow of non-resident capital in this form reached 5.0% of GDP, up from 5.4% of GDP the year before and an average of 2.8% of GDP in 2010-20. It is likely that, at least in part, this inflow can be linked to the process of shortening supply chains by global companies (so-called nearshoring).

In 2022, the exchange rate of the zloty was largely determined by fluctuations in risk aversion caused by Russia's armed aggression against Ukraine. This factor became particularly pronounced at the turn of February and March, when, as a result of capital flows to assets considered by investors as so-called safe havens, the currencies of the CEE region, including the zloty, came under strong pressure. As a result, the EUR/PLN exchange rate rose to its highest level ever (around 5.0), although the zloty subsequently strengthened to around 4.7 per euro. Changes in the perception of geopolitical risk and expectations regarding the development of monetary policy led to significant fluctuations in the exchange rate during the year. On average in 2022, the EUR/PLN exchange rate was at 4.69 and the USD/PLN exchange rate was at 4.46.

I.2. Medium-term scenario

Despite the ongoing war in Ukraine and the resulting rise in commodity prices and energy crisis, the Polish economy performed relatively well in 2022. However, the continuation of the war and the associated energy market turbulence results in further uncertainty for the medium-term macroeconomic scenario.

The presented scenario assumes that Poland's economic growth rate will slow down significantly this year, with real GDP growing by 0.9%. The following years will see a gradual recovery of the economy, with real GDP growth rates of 2.8% in 2024 and 3.2% and 3.0% respectively in 2025-2026. The main reason for the slowdown in growth in 2023 will be a significant weakening of private consumption dynamics, especially in the first half of this year, triggered by high inflation and its associated consequences: a temporary decline in real wages, tighter monetary policy and strong pessimism among consumers. The anticipated weakening of the impact of these factors should lead to a gradual recovery of the economy from the second half of this year onwards – with falling inflation, a return to positive real wage dynamics, improving consumer sentiment and, in the longer term, the slight easing of monetary policy anticipated by the market. The recovery of the economy will be supported by a significant increase in public investment, driven by, among other things, the start of projects planned in the National Recovery and Resilience Plan (NRRP) and increased deliveries of military equipment.

Private consumption will increase by 0.7% in real terms in 2023. The marked decline in the dynamics of private consumption compared to previous years is related to the deterioration of the overall economic situation and the situation in the labour market (a slight increase in unemployment is expected this year). Also, the persistence of a restrictive monetary policy will have the effect of reducing household consumption. In turn, a factor limiting the decline in the dynamics of private consumption is the maintenance of a reduced VAT rate on basic foodstuffs and programmes increasing household disposable income, e.g. the support that households receive in connection with the significant increase in energy and gas prices (price freezes, protective allowances), the reduction of personal income tax (the Low Taxes programme) and the so-called mortgage holidays. In the following years, the dynamics of private consumption will gradually increase, reaching 2.5% in 2024 and 2.7% in 2025-2026. This will be influenced mainly by a fall in inflation and an increase in real wages.

Real growth rate of the gross fixed capital formation will amount to 1.1% in 2023. This result is made up of a slight decline in private investment, due to the economic downturn, the high cost of capital and uncertainty related to the geopolitical situation, which is offset by a projected marked increase in public investment. The increase in public investment will come primarily from the start of NRRP projects and from increased deliveries of military equipment. In the following years, the dynamics of private and public investment will increase, influenced by the implementation of investments from NRRP and the falling cost of capital. In 2024, total gross fixed capital formation will increase by 4.3%. In addition, spending from the 2021-2027 multi-annual financial framework will intensify in 2025, with a 5.3% increase in investment. In 2026, the investment growth rate will reach 4.7%. The contribution of stock growth to GDP growth is assumed to be negative in the current year and neutral from next year onwards.

The scenario presented assumes that the implementation of the NRRP will have a direct impact on GDP growth through increased investment (private and public) and, to a lesser extent, public consumption. An analysis of the projects planned under the NRRP indicates that the public sector will be the beneficiary of about two-thirds of the grant funds and half of the funds from the loan part.

The decrease in the export dynamics in the current year will be due to the significant economic downturn in the EU countries. The real growth rate of this category in 2023 will be 1.7%. In subsequent years, as the economic situation in export markets improves, exports will grow at a rate of around 4%. In contrast, the dynamics of imports will decline markedly this year, primarily as a result of the decline in domestic demand. The real growth rate of this category in 2023 will be -0.3% – significantly lower than in previous years. In subsequent years, imports will grow at a rate similar to exports. As a result, the contribution of net exports to GDP growth will be 1.2 percentage points in 2023 and 0.1-0.2 percentage points in 2024-2026.

The projected growth rate of potential output is 3.2% in 2023, around 3.0% in 2024-2025 and 2.7% in 2026. The main factors influencing the dynamics of the economy's potential will be declining labour supply, the accumulation of productive capital and factor productivity growth. The output gap, after a clearly positive reading of 1.7% in 2022, will fall to -0.5% and -0.8% respectively in 2023-2024. In the following years, the negative output gap will start to close, reaching -0.3% at the end of the forecast horizon. Despite the projected increase in labour force participation in the following years, negative trends in the size of the working-age population will affect lower potential GDP dynamics. While the

NAWRU equilibrium unemployment rate has been declining since 2003, it is projected to stabilise at 2.5% in the last two years of the forecast horizon and reduce its positive impact on potential growth dynamics to almost zero.

The scenario assumes that inflation will gradually decline in the following months to a single-digit level at the end of 2023. On average, the inflation rate will reach 12.0% this year. In the following years, inflation will continue to fall, but the rate of decline will be increasingly slower. According to the forecast, the average annual inflation rate will be 6.5% in 2024, 3.9% in 2025 and 3.1% in 2026. The main factors that will drive inflation down will be the stabilisation of energy and food commodity prices on global markets, the relatively low dynamics of private consumption (especially this year) and a restrictive monetary policy.

The scenario was developed assuming no new supply shocks in the food and energy markets. In the case of imported energy commodity prices, the assumptions were prepared on the basis of futures contracts available at the time the forecast was prepared (6-10 March). In the case of crude oil, it was assumed that the price per barrel of Brent crude oil would fall by 18% in 2023 and that there would be minor price declines in subsequent years (cf. Table 14). For natural gas, futures contracts (Dutch TTF Gas) indicate a decline in natural gas prices of 37% on average in 2023 and 41% in 2024 and further smaller declines in subsequent years. Based on futures prices, the average gas price in 2025 will be similar to that in 2021. However, price volatility in this market is significant. In the case of the exchange rate, a technical assumption has been made that the PLN exchange rate will stabilise at 4.70 EUR/PLN and 4.43 USD/PLN respectively (average values from 10 working days from 27 February to 10 March inclusive).

Table 1. Economic growth - key elements of the forecast

	2022	2023	2024	2025	2026
GDP in real terms, growth in %	5.1	0.9	2.8	3.2	3.0
Gross fixed capital formation, growth in %	5.0	1.1	4.3	5.3	4.7
LFS unemployment rate, in %	2.9	3.2	3.1	3.0	3.0
CPI, in %	14.4	12.0	6.5	3.9	3.1

Source: Ministry of Finance.

Poland remains a country with a very low unemployment rate. Unemployment is expected to remain low in the coming years as a result of demographic trends, economic growth rates remaining around potential and increasing public investment. In 2023, the number of employed is expected to fall slightly due to the downturn in the economy – by 0.3%. As a result, with the assumed increase in the labour force participation rate, the average annual unemployment rate by LFS will rise to 3.2%. In the next two years, the number of employed people will grow at a rate of 0.4%, and will remain unchanged in 2026. The unemployment rate will stabilise at 3.0% over the forecast horizon. Changes in the total number of employed people take into account the Programme's assumption of no change in the number of employed people in the general government until 2026.

In 2023, the average wage in the national economy is projected to increase by 11.9%, i.e. 0.1 percentage points below the projected inflation rate. Between 2024 and 2026, the situation will normalise and real wages will grow at a rate close to that of labour productivity. Real wage growth will peak at 2.9% in 2024 and will reach 2.6-2.7% in subsequent years. In nominal terms, average wages in the national economy will increase by 9.6% in 2024, by 6.6% in 2025 and by 5.9% in 2026. Similar dynamics will be achieved by the labour costs per employee presented in Table 12.

II. General government balance and debt

II.1. Policy strategy and medium-term objectives against the background of EU conditionality

The European Union Member States submit annual updates of their stability or convergence programmes to the European Commission and the Council of the EU. On the basis of an analysis of these documents, the Council of the EU issues recommendations for the budgetary policies of the Member States to be taken into account when drafting their budgets for the following year. The EU Council, in its opinion³ on the “Convergence Programme. 2022 update” recommended that Poland ensures that the growth of primary current expenditure (nationally financed) is in line with a neutral fiscal policy stance in 2023, taking into account the continuation of temporary and targeted support to households and businesses most affected by the increase in energy prices and support to the Ukrainian population seeking refuge from war.

The draft budget law for 2023 was therefore prepared with the aim of achieving a neutral fiscal policy stance, i.e. that the growth of planned primary current expenditure (nationally financed) does not translate into consolidation or fiscal expansion. The stabilising expenditure rule modified in 2022 was applied in the design of that draft budget. The modification of the rule allowed for the implementation of a flexible fiscal policy, consistent with the recommendations of the EU Council, in particular, it allowed for the expansion of measures aimed at tackling the economic consequences of Russia's invasion of Ukraine, i.e. the energy crisis and the increase in inflation.

According to the estimates of the Ministry of Finance, the achievement of a neutral fiscal policy stance in 2023 will be ensured when considering expenditure related to mitigating the increase in energy prices and expenditure on assisting persons with UKR foreigner status.

Shield measures introduced by the government to mitigate the effects of energy price increases, supporting households, vulnerable entities and businesses under the Anti-Inflation, Energy and Solidarity Shield were the main reason for the widening of the deficit in 2022 compared to 2021. These measures will mostly continue in 2023. The largest part of the expenditure will be spent on compensation payments to gas, coal, heat and electricity sellers for sales at regulated prices to households, public utilities.

³ Council Recommendation of 12 July 2022 on the 2022 National Reform Programme of Poland and delivering a Council opinion on the 2022 Convergence Programme of Poland

Table 2. Government shielding support in conjunction with energy price increases (EU methodology)

Measure	ESA Code (item expenditure/ revenue)	2022 % of GDP	2023 % of GDP	2024 % of GDP
Revenue		-1.3	0.6	0.0
1. Proceeds from electric and gas write-off	D.21	0.0	0.9	0.0
2. Anti-Inflation Shield	D.21	-1.3	-0.3	0.0
Expenditure		1.1	2.6	0.3
1. Financing the payment of carbon allowance, shielding and other intended for households	D.62	0.5	0.1	0.0
2. Financing the payment of compensation mechanism as foreseen in Act of 15 September 2022 on special solutions regarding certain heat sources due to the situation on the fuel market (Journal of Acts, item 1967, as amended)	D.31/D.39/D.62/D.73/D.75	0.1	0.3	0.0
3. Payment of gas and energetic compensations ⁴	D.31	0.3	2.0	0.2
4. Financing compensations for energy-intensive sectors due to the increase in energy and gas prices, including gas purchases by bakeries and confectioneries	D.39	0.0	0.2	0.1
5. Intervention purchases of energy raw materials	P.2/P.52	0.2	0.0	0.0
Total shielding support		-2.4	-1.9	-0.3

Source: Ministry of Finance on the basis of information received from Ministry of Climate and Environment. In order to present data in accordance with EU methodology the data was supplemented additionally with data received from Zarządcy Rozliczeń SA oraz Bank Gospodarstwa Krajowego.

At the same time, from 2022, activities directed at assistance and support to citizens of Ukraine financed primarily by the Assistance Fund established under the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state are implemented. According to the preliminary report, the expenditures of the Assistance Fund, the resources of which are specifically intended to finance or co-finance tasks related to assistance to the citizens of Ukraine in connection with the armed conflict on the territory of that country, amounted to approximately PLN 11.3 billion (0.4% of GDP) in 2022. The largest share was accounted for by tasks implemented and coordinated by the minister responsible for internal affairs (0.2% of GDP) and social benefits granted to persons with the status of UKR foreigners (0.1% of GDP).

In addition, funds were transferred from the Fund to finance health care services (to the National Health Fund) and funds to support local government units in the field of pre-school education, schools and facilities and pupil transport. According to preliminary data, local governments received and spent a total of around PLN 7 billion (0.2% of GDP) from the Assistance Fund and other sources. Assistance to

⁴ Act of 26 January 2022 on special solutions regarding protection of consumers of gaseous fuels due to the situation on the gas market (Journal of Acts, item 202, as amended), Act of 7 October 2022 on special solutions regarding protection of consumers of electricity in 2023 due to the situation on the electricity market (Journal of Acts of 2023, item 269, as amended), Act of 27 October 2022 on extraordinary measures to reduce level of electricity prices and support for certain consumers in 2023 (Journal of Acts, item 2243, as amended), Act of 15 December 2022 on special protection of certain consumers of gaseous fuels in 2023 due to the situation on the gas market (Journal of Acts, item 2687, as amended).

Ukrainian citizens was implemented in many areas, and half of these funds were spent in benefits to individuals.

The aforementioned act also caused additional consequences for the state budget in the area of social assistance tasks and family benefits, the upbringing benefit, the Good Start benefit, the family care capital, subsidising the reduction of a parent's fee for a child's stay in a crèche, a children's club or with a day care provider, and the costs of the stay of refugee children of Ukrainian citizens in foster care. These were financed by appropriate transfers of funds, including reserves. Approximately PLN 0.9 billion was spent within the general and specific reserves.

In addition, since the start of the armed conflict in Ukraine, projects to assist refugees from Ukraine have been financed within the framework of programmes financed from the EU budget. This includes both Structural Funds and funds from the Asylum, Migration and Integration Fund (AMIF).

With the assumption that the situation will stabilise in 2024, especially with regard to energy prices, the EU Council recommended that Poland pursue a fiscal policy after 2023 that is oriented towards achieving a prudent fiscal position in the medium term. There is an ongoing discussion in the European Union about economic governance reform, including how to ensure sound public finances in EU countries (see Box 1 for more details). It could lead to a revision of EU rules on the surveillance of public finances as early as 2024.

Box 1. Main elements of the European Commission's proposals regarding economic governance in the EU

In November 2022, the European Commission proposed changes to EU economic governance, i.e. the surveillance of Member States' public finances and the coordination of their economic policies⁵. At the centre of the new system would be medium-term plans prepared by Member States for the current year and four subsequent years. The plans would replace stability or convergence programmes and national reform programmes. After assessment by the European Commission, they would be approved by the Ecofin Council. Countries would report annually to the EU on the implementation of the plans. Annual budgetary surveillance would be based solely on an assessment of adherence to the expenditure path.

Central to the plan would therefore be the medium-term path of primary expenditure after adjustment for possible revenue measures. Once approved by the EU, it would be binding for at least 4 national annual budgets. It could be revised before the end of the medium-term horizon of the plan in case of objective circumstances preventing the implementation of the plan, but without the possibility of mitigation. Significant reforms and investments could be a rationale for extending the horizon of the expenditure path from 4 to a maximum of 7 years. For countries with macroeconomic imbalances, medium-term plans would include reforms and investments leading to the correction of these imbalances.

The general government debt threshold – 60% of GDP – would remain unchanged. However, as the Commission notes, the debt levels of some countries are so high that applying the rule of 1/20th of a yearly reduction of the surplus above 60% of GDP would be too large a fiscal effort that would jeopardise economic growth. The Commission has therefore proposed to differentiate the debt reduction effort for each country depending on its challenges. For countries with a significant or moderate debt challenge, a multi-year path of at least four years of national primary expenditure would be prepared by the Commission, based on a debt sustainability analysis (DSA). This path would ensure that debt is declining after the horizon of the plan (without additional fiscal measures). The deficit, in turn, should not exceed 3% of GDP within 10 years of the end of consolidation, the horizon of which would depend on the magnitude of the fiscal challenges.

The Commission proposed to leave unchanged the excessive deficit procedure initiated when the deficit exceeds the 3% of GDP threshold. The procedure initiated on account of debt would be strengthened. It would be automatically triggered if a country with the general government debt above 60% of GDP and

⁵ Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Communication on orientations for a reform of the EU economic governance framework, Brussels, 9.11.2022 COM(2022) 583 final.

with a “significant debt challenge” did not respect the primary expenditure path of the medium-term plan approved by the Council. This procedure could also be taken against a country with a “moderate challenge” to debt if a deviation from the primary expenditure path was considered a major fiscal policy error.

The Commission would keep a control account for each country to track the accumulation of deviations from the agreed expenditure path over time. This would be to prevent small deviations from turning into larger ones. Cumulative high deviations could be considered as a major fiscal policy error and trigger the excessive deficit procedure.

The Commission would like to keep the possibility of announcing a general escape clause in case of events with major consequences for the EU (as during a pandemic). It would also be possible for the clause to be extended to a single country as a result of an extraordinary event outside government control with a significant impact on public finances. It would allow a temporary departure from the established primary expenditure path. The activation of any clause would require the approval of the EU Council. Once the clause is lifted, the country would implement a new plan with a new spending path.

As at present, it would be possible for the EU to suspend access to the Structural Funds and the Instrument for Reconstruction and Enhanced Resilience if a Member State fails to take effective action in an excessive deficit procedure. In addition, should a country fail to deliver on its stated commitments to reform and investment, the EU would request that the medium-term expenditure path in the Member State concerned be changed to a more restrictive one. Euro area Member States could then be subject to financial sanctions.

The European Commission has also proposed to increase the involvement of independent fiscal institutions in the surveillance of EU countries' public finances. The European Commission and the Ecofin Council would take into account the views of these institutions when monitoring the implementation of the plan.

Source: Ministry of Finance on the basis of Commission's communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Communication on orientations for a reform of the EU economic governance framework, Brussels, 9.11.2022 COM(2022) 583 final.

In line with the conclusions of the EU Council of 14 March this year on economic governance reform, further discussion is required, among other things, on the methodology of the technical expenditure path prepared by the European Commission, the possibility of formulating provisions that ensure debt reduction at a satisfactory pace and prevent backloading of consolidation to later years of the plan, an escape clause to allow departure from the plan in extraordinary circumstances, enforcement of plan implementation and the establishment of minimum standards for independent fiscal institutions. Countries urged the European Commission to take into account the converging views of EU countries before publishing the draft rules.

Poland, in the discussion on EU economic governance, stresses that one should be very cautious in giving the DSA a central role in the surveillance of member states' public finances. The key elements of the DSA methodology should be agreed within the EU, as DSA is very sensitive to the assumptions made, in particular regarding potential growth, interest rates or the primary structural outcome. Despite the Commission's declared departure from unobservable variables, they would be used in the DSA and in the formulation of the medium-term expenditure path and, very importantly, the projection horizon would be extended very significantly (up to 17 years).

Poland in the discussion on reforming EU rules also emphasises that increased defence spending by EU states strengthens international solidarity and helps achieve the Union's political objectives. They can therefore be treated in the same vein as contributions by euro area member states to aid facilities created in connection with the financial crisis⁶. Consequently, increased defence spending should be taken into account as a relevant factor in the EDP as well as in the DSA.

⁶ European Financial Stability Facility and its successor, the European Stability Mechanism.

Moreover, in Poland's view, the choice of reforms and investments presented in future medium-term plans should be up to the Member States. Reforms and investments could constitute a country's commitment against the EU if the country in question seeks a longer period for the reduction of excessive debt (i.e. an extension of the adjustment path).

If Member States reach an agreement on the reform, the European Commission will publish a draft of the new EU rules. Once a common position of the Member States is agreed, it will be necessary to negotiate the final shape of the reform with the European Parliament, whose term ends in May 2024.

The European Commission, in a communication in March this year⁷, encouraged Member States to keep their Stability or Convergence Programmes this year (in Poland, the “Convergence Programme”) close to their future medium-term plans for budgetary and structural policies. However, EU countries are yet to discuss the DSA methodology and the rules for classifying countries on the basis of risks to the sustainability of public finances. These arrangements are essential for developing a medium-term expenditure path. For this reason, inter alia, the Programme has been prepared on the basis of current EU legislation.

With a nominal deficit projected for 2023 in excess of 3% of GDP, this year's Programme has been designed on the assumption of deficit reduction from 2024 onwards, in line with the EU fiscal rules that will again apply in the EU once the so-called general escape clause expires (cf. Box 2). The programme therefore assumes an improvement in the structural balance by an average of 0.5 percentage points. GDP per year over the period 2024-2026.

Box 2. General escape clause

Since 2020, the EU has had a so-called general escape clause, which *de facto* has suspended the EU's fiscal rules (3% of GDP for the nominal general government deficit, 60% of GDP for the general government debt, a satisfactory pace of debt reduction, a medium-term budgetary objective and the pace at which it is achieved) EU countries were thus able to increase spending, which was necessary to combat the Covid-19 pandemic and support an economy weakened by its effects. This policy continued in the EU in 2021-2022. The general escape clause also affected the operation of national budgetary rules (cf. Chapter V).

Russia's aggression against Ukraine in February 2022, unprecedented increases in energy prices, further disruptions in supply chains meant that the EU and euro area economies did not return to a state of normality. The general escape clause was extended until the end of 2023.

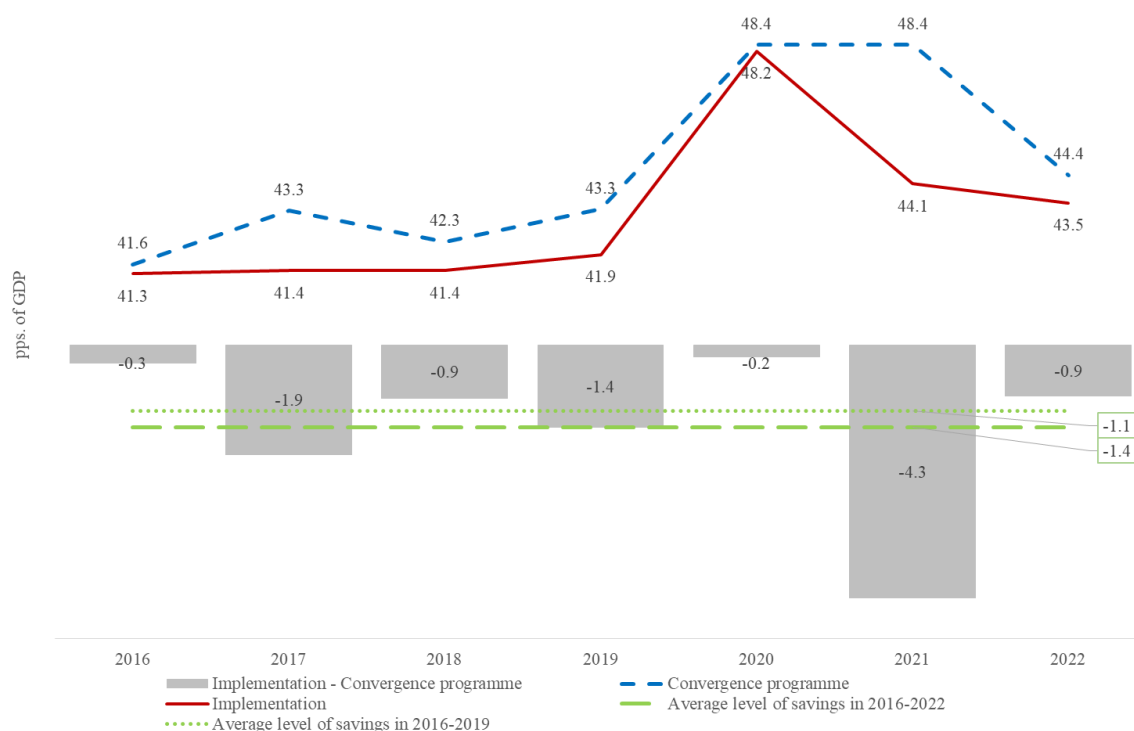
From 2024 onwards, EU Member States should conduct their budgetary policies in line with EU fiscal rules.

Source: Ministry of Finance.

Since 2016, the general government expenditure as a share of GDP projected in the Convergence Programme has systematically exceeded its actual execution in each year. Due to the reliance on spending limits, the average difference between the forecast and execution over the 2016-22 period was 1.4% of GDP; excluding crisis years, i.e. over the 2016-19 period, the difference was 1.1% of GDP. In the current Programme, the macro-fiscal forecast for the current year takes into account the aforementioned differences in the implementation of general government expenditure (projected – according to the financial plans – expenditure has been adjusted by 1.1% of GDP), in order to make the economic scenario more realistic.

⁷ Communication from the Commission to the Council, Fiscal policy guidelines for 2024, Brussels, 8.3.2023 COM(2023) 141 final.

Figure 1. Difference between forecast and actual expenditure of the general government



Remark: in the general government expenditure in order to ensure comparability of data in 2017 a one-off operation of redemption of loans from state budget granted to the Social Security Fund, which were of no impact on the government balance. This is in line with analytical approach as presented in Convergence programme 2017 Update (cf. Convergence programme 2017 Update, page 31, figure 7).

Source: Ministry of Finance.

Table 3. General government - key elements of the forecast

% of GDP	2022	2023	2024	2025	2026
Nominal balance	-3.7	-4.7	-3.4	-2.9	-2.9
- revenue	39.8	41.8	41.3	41.4	40.8
- expenditure	43.5	46.6	44.7	44.3	43.8
Structural balance	-4.5	-4.5	-3.1	-2.7	-2.8
Gross debt	49.1	50.5	52.4	53.6	55.4

Source: Ministry of Finance.

The headline deficit projected for 2024 is close to the 3% of GDP reference value and below this threshold in subsequent years. The 3% of GDP exceedance is, in this regard, solely due to increased defence spending, which, according to Poland, should be treated as an important mitigating factor in the assessment of the public finance position (cf. pp. 14-15).

II.2. Actual balances

The situation of the general government in 2022 was determined by the macroeconomic situation of the country (the outbreak of war in Ukraine, the energy crisis) and the scale of protective measures taken, including: measures mitigating the increase in prices of energy carriers, supporting households,

vulnerable entities and enterprises under the Anti-Inflation, Energy and Solidarity Shield; measures directed at assisting foreigners who were guaranteed shelter by Poland as a result of the war in Ukraine; and measures taken to significantly increase expenditure on the modernisation of the armed forces. The government's activities directed at providing aid and assistance to Ukrainian citizens were primarily financed by the Assistance Fund (established in March 2022 at Bank Gospodarstwa Krajowego⁸). On the other hand, in order to significantly increase spending on the modernisation of the armed forces, the Armed Forces Support Fund was established in May 2022 at Bank Gospodarstwa Krajowego⁹. A Cyber Security Fund was also established in 2022 to support the protection of ICT systems against cyber threats.

The general government deficit (according to the ESA2010 methodology) amounted to 3.7% of GDP, a deterioration of about 1.9 percentage points compared to 2021. The increase in the sector deficit was the result of a significant reduction in revenue as a percentage of GDP of 2.5 percentage points (a significant impact of tax changes under the Anti-Inflation Shield and the Low Tax Programme) with a 0.6 percentage point decline in the general government expenditure.

The level of revenue and expenditure of the general government in 2022 and their detailed structure in relation to GDP are presented in Table 15.

General government expenditure

The general government expenditure in 2022 amounted to 43.5% of GDP and was nominally higher than the previous year by 15.5% y/y, while in relation to GDP it was lower by 0.5 percentage points.

Determinants of the increase in (nominal) the general government expenditure in 2022 included expenditure related to shielding measures aimed at mitigating the energy crisis targeted at households (carbon allowance, shielding allowance) and enterprises (payment of compensation under the Act of 26 January 2022 on special solutions to protect consumers of gaseous fuels due to the situation on the gas market). In addition, current expenditure related to purchases of goods and services (a nominal increase in intermediate consumption of around 24% y/y – the effect of inflation, i.e. to 6.3% of GDP) and expenditure related to debt service costs (a nominal increase of around 65% y/y, i.e. to 1.6% of GDP) recorded higher growth than total expenditure.

2022 also proved to be a year of accelerating public investment dynamics (nominal growth of 14.3% y/y), which reached 4.0% in relation to GDP. The increase in investment was mainly driven by an increase in investment in the local government subsector (nominally by around 21% y/y), which was influenced, inter alia, by funds transferred to local government units from the Government Fund for Local Investments¹⁰, the Government Fund for the Polish Deal: Strategic Investment Programme¹¹ or additional funds transferred from the state budget in 2021 to financially support investments in water mains and water supply and to support investments in sewerage.

In addition, in 2022, local government units received PLN 13.7 billion to support the implementation of their tasks, including in the field of improving energy efficiency, developing renewable energy sources and reducing the costs of purchasing heat or energy borne by consumers. The funds received could be used for both current and investment expenditures, with each local government unit being obliged to spend no less than 15% of the additional income received in 2022 from its share of personal income tax revenue on tasks in the field of energy efficiency improvement, development of renewable energy sources and reduction of heat or energy purchase costs incurred by consumers, in the years 2022-2027.

⁸ The Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state.

⁹ The Act of 11 March 2022 on the defence of the Homeland (Journal of Laws, item 2305, as amended).

¹⁰ <https://www.gov.pl/web/premier/rzadowy-fundusz-inwestycji-lokalnych>

¹¹ <https://www.gov.pl/web/premier/program-inwestycji-strategicznych>

At the same time, in the central government subsector, there was a nominal increase in investment of around 9% as a result of the implementation of multi-year programmes in the area of road construction and railway infrastructure modernisation and the acceleration of military supplies compared with the previous year.

In 2022, social programmes from previous years were continued. These were:

- the Family 500 plus programme with the cost (excluding service costs, childcare supplement and the supplement to the lump sum) at PLN 40.2 billion compared to PLN 39.8 billion in 2021 and PLN 30.5 billion in 2019. Since 2022, the payment of 500 plus has been taken over by the Social Insurance Institution (ZUS),
- the Supplementary Benefit programme for persons unable to live independently worth, according to preliminary data, PLN 3.4 billion, paid from the Solidarity Fund,
- the Mama 4+ program addressed to women who have given birth and raised four or more children and do not receive an old-age pension or receive it in an amount lower than the minimum old-age pension, cost approx. at PLN 0.5 billion,
- the total cost of Pension plus programme – the annual supplementary benefit for old-age, disability and other pensioners (the so-called 13th pension), amounted to PLN 12.6 billion, paid from the Solidarity Fund,
- family and care benefits and benefits from the Alimony Fund amounted to PLN 12.5 billion (without contributions),
- the Good Start programme with the cost at PLN 1.3 billion (in the following years, its costs are planned at a similar level),
- benefits financed from the State Budget to be paid by the Social Insurance Institution (ZUS) and the Agricultural Social Insurance Fund (KRUS) (inter alia, benefits for veterans, electricity allowance, coal in-kind allowances, excluding the Mama 4+ programme) amounted to PLN 2.8 billion. Costs will increase in the following years due to the high indexation of pensions in the period 2023-2024,
- social pension and funeral allowance paid from the Solidarity Fund – cost at PLN 4.6 billion. This expenditure will increase in the following years due to the indexation of social pension.

In 2022, an additional annual benefit for old-age, disability and other pensioners, the so-called 14th pension, was also paid. The total value of payments reached approximately PLN 10.4 billion. In 2022, both the 13th and 14th pensions were exceptionally exempt from personal income tax.

To further support families, the Family Care Capital programme was introduced from 2022, i.e. a benefit of PLN 1 000 per month paid for one year or PLN 500 per month paid for two years. The Family Care Capital is available for the second and subsequent child in a family between the age of 12 and 35 months. The benefit does not depend on family income. The total cost in the first year of application was PLN 3.4 billion, with a lower cost in subsequent years due to cohort effects that emerged in the first year of application.

In addition, due to high energy prices, households were entitled to cash support in the form of an allowance in 2022 in form of:

- shielding allowance for a total amount of PLN 2.5 billion. This was a one-off benefit paid depending on income and household size. If the income criterion was exceeded, the “złoty for złoty” principle was applied, i.e. the benefit was reduced by the amount by which the criterion was exceeded;
- coal and other heat sources allowance. These were one-off benefits ranging from PLN 3 000 paid to a household whose main source of heating is coal or coal-based fuels to PLN 500 in the case of gas boilers. Around PLN 11.7 billion was received by households. The coal allowance and the allowance for other sources of heat were granted without an income criterion, and only one of them could be received.

As a result of Russia's aggression against Ukraine, Poland became a host country for a large number of foreigners. Pursuant to the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state, persons with the status of a UKR foreigner were granted the right to, inter alia, family benefits, the child-rearing benefit (500 plus), the Good Start benefit and the Family Care Capital. Expenditure on these benefits amounted to PLN 2.1 billion from the Assistance Fund in 2022.

Social transfers including social security benefits increased by around 11.1% y/y in nominal terms in 2022 (against a nominal increase of 8.8% y/y in 2021) and as a proportion of GDP amounted to 17.1%, a decrease of 0.8 percentage points.

In 2022, there was a nominal increase of 11.4% y/y in government consumption, which translated into a decrease of 0.9 percentage points as a share of GDP, to 17.9%. The decline in government consumption as a share of GDP was mainly driven by a 0.7 percentage point decline in labour costs, with nominal growth in labour cost expenditure of 9.3% y/y, well below the annual average consumer price index.

General government revenue

In 2022, the general government revenue amounted to 39.8% of GDP (a decrease of 2.5 percentage points compared with 2021), with nominal growth of 10.2% compared with 15.1% in 2021.

Taxes

In 2022, tax revenue according to ESA methodology amounted to 21.3% of GDP, a decrease of about 2.2 percentage points compared to 2021, comprising of both a decrease in tax revenue related to production and imports, down by 1.5 percentage points, and a decrease in revenue from taxes on income, down by 0.7 percentage points. The category “tax revenue” is, however, according to ESA methodology, much broader than tax revenue under national law and also includes various types of compulsory levies that have the economic character of a tax.

Personal income tax (PIT) revenues were lower in 2022 according to the ESA methodology¹² by approximately PLN 2.6 billion, or 1.9%, compared with 2021. In relation to GDP, the general government PIT revenue fell to around 4.5% from 5.4% in 2021. This decline occurred despite a macroeconomic environment that was favourable for tax revenues, which included high nominal growth rates for the national economy wage fund (14.0%), the pension fund (9.1%) and GDP (16.9%).

The main reason for the weaker execution of personal income tax revenues were the reforms of the tax system, which came into force on 1 January 2022 and 1 July 2022, respectively. As part of the aforementioned reforms for taxpayers settling according to the tax scale:

- the tax-free amount was significantly increased (the degressive free amount was replaced by a fixed free amount of PLN 30 000),
- the first tax rate was reduced from 17% to 12%,
- the threshold above which taxpayers are subject to a higher (32%) marginal PIT rate was increased (from PLN 85 528 to PLN 120 000),
- the possibility to deduct part of the health contribution paid from the tax liability has been removed.

As a result of the introduced changes, tax revenues from the tax scale fell in 2022 by approximately PLN 10.9 billion, i.e. 12.9% compared to the previous year, despite the dynamic growth of the national economy salary fund, pension fund and nominal GDP.

As part of the reforms introduced, the rules for calculating the health contribution for persons conducting business activity were also changed, and certain rates of the lump sum on registered income were amended. This resulted in a relative increase in the profitability of lump-sum settlements, which caused some taxpayers to change their form of taxation. Accordingly, tax revenues from the flat tax decreased

¹² According to the ESA methodology, PIT revenues also include receipts from the solidarity levy.

by approximately PLN 6.3 billion (i.e. 16.1%), while those from the lump sum on registered income increased by approximately PLN 10.8 billion (i.e. 203.3%) compared with 2021.

Corporate income tax (CIT) revenues, on the other hand, increased by PLN 17.4 billion in 2022, i.e. by 25.4% compared to 2021, mainly as a result of the good situation in the economy. In 2022, the gross profit of non-financial enterprises was 17.0% higher than in 2021. According to data from the Ministry of Finance, the share of section D - generation and supply of electricity, gas, steam and hot water – increased significantly in tax revenue. In turn, according to the Central Statistical Office, the largest increases in gross profit in 2022 among the non-financial enterprises surveyed were recorded in section C - manufacturing and section D - generation and supply of electricity, gas, steam and hot water.

Excise tax revenues including the fuel fee in 2022 also increased - by PLN 3.8 billion, i.e. 4.5% compared to 2021. Revenues from excise duty alone increased by PLN 4.0 billion (5.2%). Revenues from excise duty on petrol and other motor fuels including fuel fee fell by 1.2% y/y. This was a result of the introduction of the Anti-Inflation Shield reducing rates on selected motor fuels to the minimum rates that member states must meet¹³. Revenue from excise duty on tobacco products increased by 10.9% y/y and on ethyl alcohol by 12.1% y/y as a result of the increase in tax rates under the Act of 29 October 2021 amending the Excise Duty Act and the Act amending the Excise Duty Act and certain other acts (Journal of Laws, item 2313).

VAT revenues, on the other hand, fell in 2022 by PLN 1.7 billion, i.e. by 0.8% y/y, despite the fact that the main element of the VAT base – private consumption – recorded a nominal increase of around 18.2% y/y. The lower level of revenue compared to 2021 was influenced by the Anti-Inflation Shield, which reduced VAT rates on food, fuels, fertilisers, natural gas, electricity, thermal energy.

The introduction of the Anti-Inflation Shield may also affect the estimate of the VAT gap in 2022-2023. For the estimation of the VAT gap in 2022, the top-down method was used, which uses macroeconomic data on the VAT base (private consumption, intermediate consumption, general government investment). According to preliminary estimates from the Ministry of Finance¹⁴, the VAT gap increased (by 1.8 percentage points) in 2022 and amounted to around 4.9% of potential revenues (cf. Figure 2).

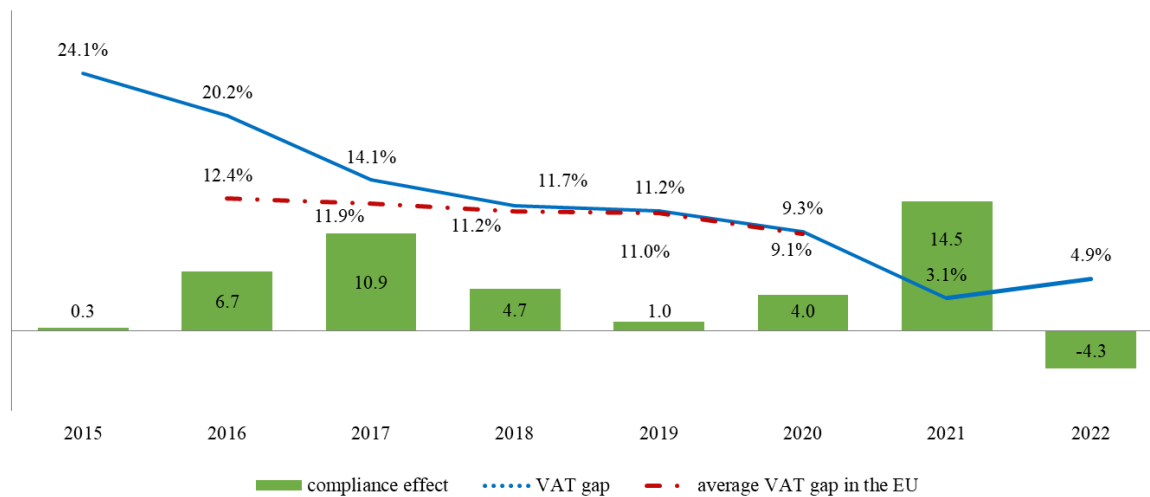
The preliminary estimate of the VAT gap for 2022 indicates that the gap remains at a very low level. Also, when compared to available VAT gap estimates in other countries, Poland ranks among the countries with the lowest VAT gap readings.

The situation of 2020-2022 (the pandemic, the war in Ukraine and the related population influx) may have caused changes in the structure of private consumption and thus significantly affected the structure (relative to rates) of the VAT base. The Anti-Inflation Shields introduced in 2022, i.e. the temporary reduction of VAT rates on selected goods, may also have affected the structure of consumption. The estimate of the VAT gap in 2022 takes into account the introduction of the Anti-Inflation Shield and its impact on the volume of theoretical VAT revenues (VTTL). The factors indicated above may affect significant differences in the VAT gap estimates for 2020-2022, which will be made in future years using CSO data.

¹³ English: the minimum excise duty rates that Member States must apply.

¹⁴ For the years 2020-2022, the data are preliminary due to the lack of statistical data in sufficient detail to make a full estimate.

Figure 2. VAT gap (in %) and so-called compliance effect (in PLN billion)

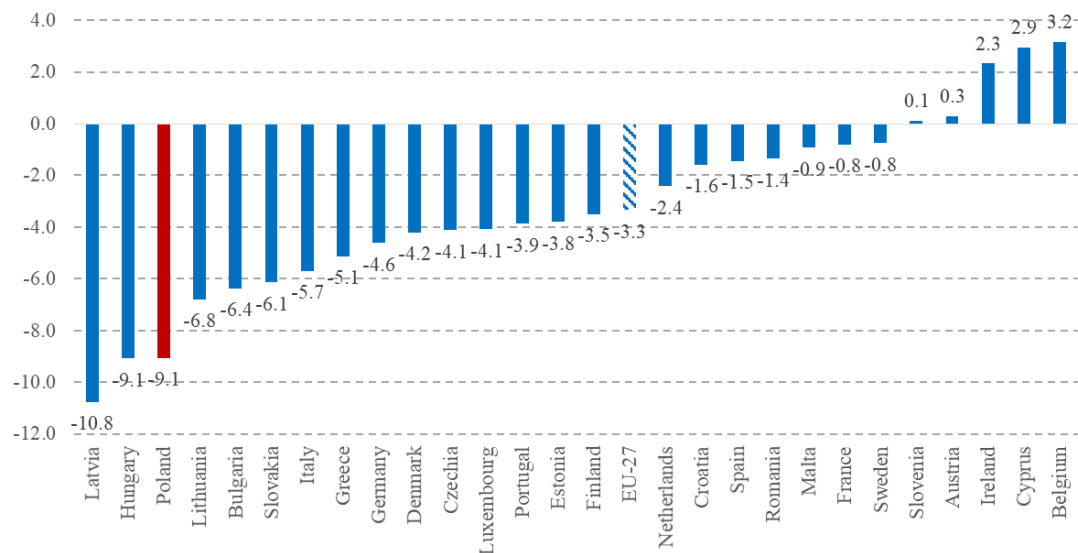


Source: estimates of Ministry of Finance (VAT Gap and compliance effect). Data on the average VAT Gap in the EU - CASE Report for the European Commission, VAT Gap in the EU. Report 2022.

In 2020¹⁵, the VAT gap in Poland was slightly higher than the European average: it reached 9.3% according to the Ministry of Finance's estimate and 11.3% according to CASE's estimate for the European Commission. At the same time, Poland was, according to the European Commission, among the countries where the VAT gap fell the most (cf. Figure 3).

The VAT gap estimate for 2019-2021 has been updated as more recent data has become available. The current VAT gap estimate is lower than that presented in last year's Programme. This is mainly due to an update based on detailed CSO data on the VAT base for 2019. In last year's estimate, the latest available CSO data was for 2018. The decrease in the gap in Poland between 2016 and 20 was one of the largest in the EU.

Figure 3. Change in VAT Gap in 2016-20 in pp.



Source: CASE report for the European Commission, VAT Gap in the EU. Report 2022.

¹⁵ Estimates from the CASE report for the European Commission (September 2022) on the VAT gap in EU countries were used for comparison. For comparison purposes, an indicator is used that compares actual VAT revenue as a percentage with the theoretical revenue under the legislation (VTTL – VAT Total Tax Liability). Cf. *VAT Gap in the EU. Report 2022*, <https://op.europa.eu/en/publication-detail/-/publication/030df522-7452-11ed-9887-01aa75ed71a1>

Social security contributions

Revenue from social security contributions was 14.5% higher y/y (a decrease in the ratio by 0.3 percentage points to 13.7% of GDP), i.e. slightly above the estimated growth rate of the national economy wage fund, which was around 14% y/y. The amount of contributions depended on the base, of which the remuneration fund is the main component, and on systemic tax and contribution changes introduced in 2022 positively affecting the amount of health insurance contributions paid to the National Health Fund (NFZ). Foreigners working legally in Poland also had a positive impact on the level of social insurance contributions. The number of foreigners with pension insurance in June 2022 exceeded one million people.

II.3. Medium-term budgetary outlook

The government's actions limiting the effects of rising prices of energy carriers for households and businesses will play an important part in influencing the fiscal path during the period covered by the Programme. While tax cuts and direct social transfers to households dominated among the measures in 2022, the role of statutory regulation of tariffs of selected energy carriers combined with compensation payments to their sellers and distributors has significantly increased in 2023.

Figure 4. General government balance



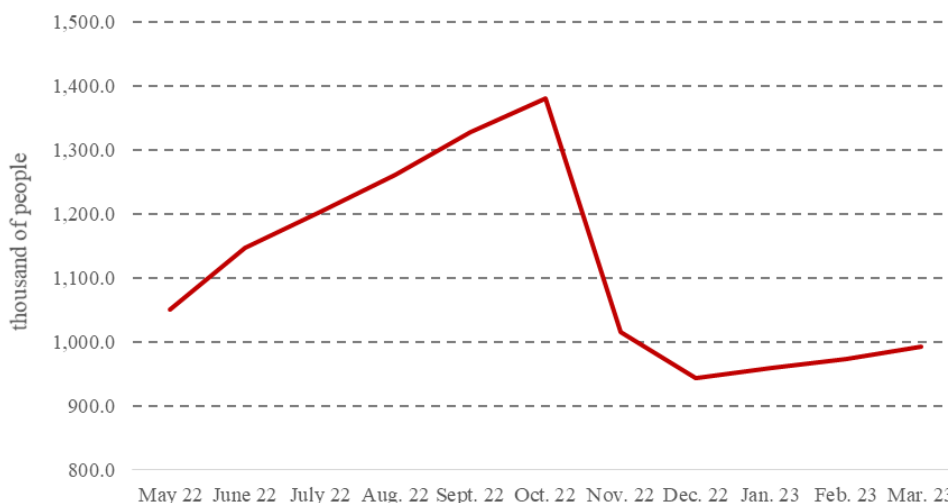
Source: Ministry of Finance.

In the current year, according to the financial plan of the Assistance Fund, continued financing or co-financing the implementation of tasks for the assistance of Ukraine, in particular for Ukrainian citizens affected by the armed conflict on the territory of Ukraine, implemented on the territory of the Republic of Poland, as well as outside it, and also the implementation of tasks related to food security of the country in connection with the armed conflict on the territory of Ukraine are expected. The current spending plan for 2023 is 0.3% of GDP.

The number of people who, as a result of the outbreak of war, have left Ukraine and are staying in Poland is approximated by the number of people who have been granted the status of UKR foreigner based on the provisions of the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state. In May last year, approximately 1 million people held this

status. This number increased to nearly 1.4 million in October 2022 and then decreased to approximately 1 million following the inclusion in the statistics of an automatic mechanism for revoking the status of a foreigner after 30 days of registered departure from the territory of Poland (cf. Figure 5). However, the aforementioned measure is not precise, inter alia, it does not include non-Ukrainian nationals who received assistance under the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state.

Figure 5. Number of people with UKR status of foreigner



Remark: * - on basis of regulation of Act of 12 March 2022 on aid to Ukrainian citizens in connection with an armed conflict of that state.

Data as at the beginning of the month. Data for the next months are not fully comparable. Statistics do not include people, who lost the status of a foreigner, e.g. due to death, obtaining a Pole's card, a permanent residence card, leaving the territory of Poland, etc. From 5 May 2022 statistics include data on children born on Poland territory. From 6 October 2022 an automatic mechanism of withdrawing the status of a foreigner after 30 days from registered leaving the territory of Poland is operational, which resulted in visible fall on the figure in the number of people with UKR status.

Source: The Chancellery of the Prime Minister.

Factors determining the general government expenditure

It is expected that in 2023 the general government expenditure in relation to GDP will be at 46.6%. In 2026, it will decrease to 43.8% of GDP, but its level will still be by approx. 2 percentage points higher compared to the pre-pandemic level (in 2019, expenditure in relation to GDP was 41.9%).

Current expenditure

The general government current expenditure over the years covered by the forecast horizon will be largely driven by the continuation of social policy programmes and, in the shorter term, by measures taken to mitigate the effects of rising fuel, heating and electricity prices, in addition to social measures.

Social transfers

The permanent introduction of an additional annual cash benefit for pensioners, the so-called 14th pension, is planned in 2023. Until now, this benefit has been paid on a discretionary basis between 2021 and 2022 under separate laws. It is a benefit equal to the minimum pension, with an income criterion (calculated in relation to the pension paid) of PLN 2 900. It is accompanied by a mechanism of reducing the benefit by the amount of exceeding the criterion, i.e. “złoty for złoty”. Approximately PLN 11.6 billion will be allocated for this purpose in 2023, with the costs rising to approximately PLN 13.1 billion in 2026.

Between 2023 and 2026, it is expected that payments will continue, among other things:

- The so-called 13th pension, for which around PLN 15.3 billion from the Solidarity Fund will be allocated in 2023. In subsequent years, total expenditure on the 13th pension will increase from PLN 17.1 billion in 2024 to PLN 19.1 billion in 2026 as a result of, inter alia, the indexation of pensions,
- The 500 plus benefit – these expenditures will decrease from approximately PLN 40.2 billion in 2023 to approximately PLN 38.5 billion in 2026,
- Family Care Capital – these expenditures will decrease from approximately PLN 2.4 billion in 2023 to PLN 2.3 billion in 2026. Expected costs between 2023 and 2026 will be lower than in 2022 due to cohort effects in the first year of the start of the programme,
- family and Alimony Fund benefits in the amount of approximately PLN 14.5 billion in 2023 to approximately PLN 20.8 billion in 2026.

The stated amounts of the 500 plus benefit and family benefits do not include payments under the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state. Approximately PLN 3.5 billion from the 2023 Assistance Fund is provided for this purpose.

In March 2023, there was a significant indexation of pensions at the rate of 14.8%, with the additional introduction of a quota-percentage mechanism as a result of which the minimum increase could not be lower than PLN 250. As a result, the amount of the minimum pension increased from PLN 1 338.44 gross from March 2022 to PLN 1 588.44 from March 2023, i.e. by 18.7%. In addition, pursuant to the Act of 13 January 2023 amending the Act on social insurance of farmers (Journal of Laws, item 337), the value of the basic pension was increased to 90% of the minimum pension, effectively raising this amount from PLN 1 084.58 to PLN 1 429.60, i.e. by 31.2%. In the following years, a relatively high indexation factor of pensions is also expected.

The Programme forecast uses data available as of 1 April. As such, it does not take into account the financial effects of the draft law on supportive benefit adopted by the Council of Ministers in April this year. This draft envisages the introduction from 2024 of a support benefit of 200%, 100% and 50% of the social pension, depending on the degree of need for support, as determined by special panels. The draft also envisages allowing gainful employment of up to half the minimum wage for carers of people with disabilities who receive support benefits.

The year 2023 will be another year of increases in healthcare spending (an increase of 25 basis points of GDP). In accordance with the Act of 27 August 2004 on health care services financed from public funds (Journal of Laws of 2022, item 2561, as amended), the rate of expenditure on health in relation to GDP¹⁶ in 2023 will be 6%, and in subsequent years it cannot be lower than respectively: 6.2% in 2024, 6.5% in 2025 and 6.8% in 2026.

Continued support for households in the face of high energy prices is also foreseen in 2023. The payment of an electricity allowance for households heating with electricity in the amount of PLN 1.0 billion and a VAT refund for households using gas for heating purposes in the amount of PLN 0.6 billion are envisaged for this year.

Measures to mitigate the effects of the increase in the price of fuel, heating and electricity, in addition to those of a social assistance nature, will also include:

- compensation to heat-generating enterprises for limiting the increase in the price of heat and the cost of heating hot water for households and public utility institutions;
- compensation to companies for frozen energy prices at the 2022 level for households, small and medium-sized enterprises and vulnerable consumers and municipalities;

¹⁶ According to the law, this ratio is determined using the latest available data on the value of annual GDP known at the time of preparation of the budget act.

- companies selling natural gas to tariff-protected customers will be compensated for the introduction of a maximum gas price for households and vulnerable customers and the freezing of the distribution fee;
- support in relation to energy and gas price increases for energy-intensive sectors;
- compensation for entrepreneurs - purchase of gas at a reduced price by bakeries and confectioneries;
- compensation for coal sellers - sale of coal by municipalities at preferential prices for households.

Public investment

Public investment is an important part of the economic stimulus strategy. The gradual recovery of government investment is expected to continue in 2023. Their level as a share of GDP will rise to around 4.2% and will remain at an average of 4.2-4.3% in 2024-26. The general government investment level will be shaped by the government's multi-year programmes, the key moment of the breakthrough of the EU perspectives: the ending 2014-20 financial perspective (use by 2023) and the beginning of the 2021-2027 multi-year financial framework, support instruments for local governments prepared by the government and military spending. In addition, the EU Recovery and Resilience Facility will be an important source to support investment projects.

Investment tasks in the government sub-sector will be carried out under multi-annual programmes, inter alia:

- The new Government National Road Construction Programme until 2030 (with an outlook until 2033), adopted by the Council of Ministers on 13 December 2022, financed mainly from the National Road Fund, EU funds (Operational Programme European Funds for Infrastructure, Climate, Environment and Connecting Europe Facility 2021-2027) and the state budget. The programme is complemented by additional road programmes: Programme for the Construction of 100 Ring Roads for 2020-2030 that defines investment objectives and priorities with respect to the construction of city ring roads within the national road network, Safe Road Infrastructure Programme for 2021-2024, Programme on Strengthening the National Road Network until 2030, National Road Safety Programme 2021-2030,
- National Railway Programme until 2023, covering capital expenditures on the construction and modernisation of railway network, carried out by PKP Polskie Linie Kolejowe S.A. and financed by the Railway Fund, the state budget, EU funds, own funds of PKP PLK S.A., and complementary programmes, such as: Railway Station Investment Programme for 2016–2023, Programme to Supplement Local and Regional Railway Infrastructure – Railway+ until 2029, Government Programme to Construct or Modernise Railway Stops for 2021–2025,
- Solidarity Transport Hub Investment Programme.

Apart from infrastructure programmes, investment in the central sub-sector will be significantly affected by programmes aimed at modernising the armed forces. The Act of 11 March 2022 on the defence of the Homeland (Journal of Laws, item 655) has visibly increased expenditures on national defence – from the planned 2.2% of GDP in 2022 to 3% of GDP from 2023. In order to finance multi-annual programmes to increase Poland's military potential, a Armed Forces Support Fund was established in 2022 at Bank Gospodarstwa Krajowego.

Public investments are significantly influenced by the ongoing investments of local government units supported by funds from government programmes, including the Government Strategic Investment Programme created in 2021, according to which non-refundable co-financing is provided for investments made by local government units or their unions. The level of co-financing, reaching up to 95% of the project value, depends on the area of the economy (the higher the priority, the lower the required own share of the local government unit in the investment). Supported areas include construction or modernisation of road infrastructure, construction or modernisation of water and sewage infrastructure, zero-emission heat sources, construction or modernisation of waste management infrastructure, renewable energy sources, zero-emission transport, electricity infrastructure, digitisation

of public and municipal services, revitalisation of urban areas, cultural and tourist or sports infrastructure.

With the change in the government's programme to support local government investment from the Government Fund for Local Investments to the Government Fund for the Polish Deal: Strategic Investment Programme, the funding pattern for these investments has changed. In the case of Government Fund for Local Investments, local governments received support “upfront”, whereas in the case of Strategic Investment Programme, financing is “downstream”, i.e. through a system of promises, local governments receive reimbursement of incurred expenses – depending on the length of the investment implementation period – either on a one-off basis or in tranches upon completion of specific stages. Until 2025, municipalities will have to spend the funds received in 2021 to financially support investments in sewerage, water mains and water supply.

In addition, the amended Act of 13 November 2003 on revenues of local government units¹⁷ (Journal of Laws of 2022, item 2267) introduced a new part of the general subsidy – the development part, which provides permanent support to local governments in the investment area. The algorithm for the distribution of the development part of the general subsidy takes into account the number of inhabitants, but also the level and dynamics of investment expenditure per capita of a given unit in comparison with corresponding data for the whole country.

Other expenditure supporting households' investment expenditure

On 14 March 2023, the government adopted the First House programme. The programme¹⁸ consists of two instruments:

(1) **Safe Mortgage 2%**, i.e. a system of subsidised loans for the purchase of the first flat

The loan will be available to a person up to the age of 45 who does not have and has not had a flat, house or cooperative right to a flat or house. As a rule, the state budget will subsidise the difference between the fixed rate (2%) and the interest rate on the loan for 10 years. The maximum loan is PLN 500,000, and in the case of married couples or parents with at least one child, PLN 600,000. The loan can be obtained for premises from both the primary and secondary markets. The purchaser of the first flat will be free to choose the standard and location of the flat, as there will be no limit on the price per square metre.

(2) **Housing account** – a programme to help savers buy their first flat

The second solution is a special savings account, operated by commercial banks. It will be able to be opened by a person who does not have and has not had a dwelling (including a single-family house or a cooperative right on a dwelling or a single-family house). The programme can also be used by a person who lives with at least two of his/her own or adopted children in a single small dwelling he/she owns (a dwelling of up to 50 m² with two children, 75 m² with three children and 90 m² with four children, no m² limit with five or more children). As a rule, the saving period on the account is between 3 and 10 years. Systematic payments (at least 11 payments per year of a certain amount) are a guarantee of an additional Housing Bonus from the state budget. The accumulated funds together with the bonus will be able to be spent on the purchase of a first flat, house or a financial contribution to an investment, e.g. within a housing cooperative. If the saving is terminated, the funds can be spent within 5 years.

¹⁷ The Act of 14 October 2021 on amending the Act on revenues of local government units and certain other acts (Journal of Laws, item 1927, as amended).

¹⁸ According to the Assessment of Regulatory Effects, the cost of the entire programme in the horizon of 10 years, i.e. from 2023 onwards, is approximately PLN 18 billion, while in the first years of operation, i.e. in the horizon of the Convergence Programme, it is proportionally smaller. cf. <https://www.sejm.gov.pl/sejm9.nsf/druk.xsp?nr=3096>

Factors determining the general government revenue

The general government revenue is determined mainly by revenue from taxes and social security contributions. Between 2023 and 2026, the general government revenue as a share of GDP will fall by around 1 percentage point, i.e. from 41.8% to 40.8%, mainly due to the occurrence of electricity and gas write-offs only in 2023.

Taxes

Tax revenues are determined by the development of their base, primarily the nominal levels of: private consumption, public investment, labour income, pensions and corporate profits. Over the forecast horizon, the level of tax revenues will be influenced, among other things, by measures introduced in previous years and continuing to further tighten the tax system – mainly in the areas of CIT and VAT.

In 2023, PIT revenues will continue to be heavily influenced by systemic changes introduced during the previous fiscal year. The Low Tax Reform has affected the amount of advance income tax payments collected in the second half of the year, but it will cover income earned throughout 2022 in the annual tax return. As a result, the majority of taxpayers settling under the tax scale will receive significantly higher refunds of overpaid tax in 2023 than in other years. Due to the increased progressivity of the tax system as a result of the reforms introduced in 2022, the projected growth rate of PIT revenue is higher than the projected growth rate of the national economy wage fund and pension fund. As a result, the projected PIT revenues in relation to GDP increase significantly over the forecast horizon.

In the following years, the level of CIT revenues will be affected by the changes introduced by the reforms of the tax system (from 2022 onwards):

- changes in tax preferences - e.g.: changes in the lump-sum taxation of corporate income, changes concerning the relaxation of the conditions for the formation and operation of tax capital groups, enabling the deduction of the costs of the Initial Public Offering (IPO),
- the sealing of the income tax system and repeal of Article 15e of the Corporate Income Tax Act of 15 February 1992 (Journal of Laws of 2022, item 2587), limitation of income transfers and limitation of overstatement of deductible costs, inter alia, by: abolishing the tax neutrality of restructuring transactions where the taxpayer overestimates the tax value of assets as a result of the transaction and thus taxing the disclosed “silent reserves”, taxing cross-border asset transfers also in the case of events such as in-kind contributions or mergers, limiting the phenomenon of Polish residents registering business entities in the territory of another country that do not conduct actual business operations there, eliminating the possibility of obtaining tax benefits through tax schemes aimed at transferring income to jurisdictions with a negligible effective tax rate,
- introduction of a Polish holding company regime,
- relief for robotisation, aimed at companies that want to improve production through the use of industrial robots - tax support for the automation of industrial robotisation is an important argument for foreign entities and foreign investors to relocate part of their production to Poland. It is also a tool that will help Polish companies to increase their productivity and competitiveness in the domestic and international markets. Polish companies, for which the decision to invest in industrial robots is still a serious investment, difficult due to the necessity to incur large investment outlays, will benefit from the robotisation relief. Thanks to the relief, these investments will become more accessible and relatively cheaper for them. The relief consists of an above-normal deduction of up to 50% of the so-called robotisation costs and will be valid for 5 years.

Tax revenues in 2023 will also be affected by:

- the extension of the 0% VAT rate on food (subject to a 5% VAT rate until 31 January 2022) introduced under the Anti-Inflation Shield. The other VAT rate reductions introduced under the Anti-Inflation Shield, i.e. on natural gas (0%), electricity and heat (5%), certain fuels (8%), fertilisers and inputs used in agricultural production (0%) were in force until the end of 2022,

- changes to VAT groups effective from January 2023. - introduction of the possibility for financially, economically and organisationally related entities to settle jointly for VAT purposes (the solution is voluntary),
- the withdrawal of the Anti-Inflation Shield in the area of excise duty, which reduced rates on certain motor fuels and electricity and introduced exemptions for electricity used by households,
- an increase in excise duty rates on alcohol and tobacco products in order to implement health-oriented policies,
- the simplification of the rules of the so-called bad debt relief in income taxes.

Tax revenues in the following years will additionally be affected by:

- mandatory e-invoicing (with entry into force, in principle, from 1 July 2024), which will cover activities subject to VAT in Poland, including domestic supplies of goods and services between businesses (B2B), to public authorities (B2G), excluding invoices issued to consumers (B2C). The obligation to issue e-invoices using the National e-Invoicing System (KSeF) will apply to taxpayers performing activities required to be invoiced under Polish VAT regulations, who have their registered office or permanent place of business in Poland. Other taxpayers will generally be able to use this system on an optional basis. In addition, the KSeF will allow RR VAT invoices to be issued on an optional basis,
- the implementation of Council Directive (EU) 2020/284 of 18 February 2020 amending Directive 2006/112/EC as regards the introduction of certain requirements for payment service providers (the so-called PSP Directive). It imposes obligations on PSPs (inter alia, national banks, branches of foreign banks, credit institutions, electronic money institutions) to: (i) keep quarterly records of payments and payment recipients in respect of payment services provided, if certain conditions are met, (ii) to keep the records for a period of three years from the end of the fiscal year in which the payment took place, (iii) to make the records available by means of a standard electronic form in the xml format to the Head of the National Fiscal Administration. The purpose of the draft law implementing the directive is to tighten VAT collection, particularly in the e-commerce sector, and to provide additional tools for the tax administration to more effectively detect unreliable businesses committing fraud and other irregularities,
- the entry into force of the minimum corporate tax provisions from 2024.

The statutory condition¹⁹ of increased VAT rates of 23%, 8% 7% and 4% is expected to be met over the forecast period, i.e. defence spending will remain above 3% of GDP.

In addition, the level of tax revenues in 2023 will be affected on a one-off basis by taxes on products related to measures taken to mitigate the effects of the energy crisis, introduced by the Act of 27 October 2022 on emergency measures aimed at limiting the level of electricity prices and supporting certain consumers in 2023 (Journal of Laws, item 2243, as amended) and the Act of 15 December 2022 on special protection of gas fuel consumers in 2023 in connection with the gas market situation. Deductions will be made to the Price Difference Payment Fund by gas production companies and electricity production and distribution companies.

Social security contributions

Social security contributions constitute a significant part of the general government revenue. In the forecast period, contributions will be determined by macroeconomic factors, in particular the situation on the labour market, and measures taken by the government. Revenues from contributions depend on the base for its calculation, mainly the wage fund in the national economy. The amount of health insurance contributions paid to the National Health Fund will be positively affected by the tax and

¹⁹ Pursuant to Article 146ef of the Value Added Tax Act of 11 March 2004 (Journal of Laws of 2022, item 931, as amended).

contribution changes introduced in 2022. Social insurance contributions as a proportion of GDP are expected to reach 13.7% in 2023 and increase to 13.9% in 2026.

II.4. Structural balance

The Stability and Growth Pact requires EU Member States to define and reach the so-called medium-term budgetary objective (MTO). Poland has adopted the general government structural deficit at the level of 1% of GDP as its medium-term budgetary objective. At the same time, the EU has a general escape clause until the end of 2023 (cf. Box 2). As a result, EU Member States do not have to, inter alia, achieve an improvement in the structural balance on the path towards the MTO this year. Instead, as recommended by the Council of the EU in 2023, the growth rate of primary current expenditure (domestically financed) should be in line with a neutral fiscal policy stance (cf. Chapter II.1).

From 2024 onwards, EU fiscal rules will again apply. The programme therefore assumes an improvement in the structural balance by an average of 0.5 percentage points. GDP per year over the period 2024-2026. At the same time, there is an ongoing discussion in the EU on changes to the EU's surveillance of public finances (cf. Box 1).

Table 4. General government structural balance

% of GDP		2022	2023	2024	2025	2026
1.	Real GDP growth (%)	5.1	0.9	2.8	3.2	3.0
2.	Net lending of general government	-3.7	-4.7	-3.4	-2.9	-2.9
3.	Interest expenditure	1.6	2.1	2.2	2.1	2.2
4.	One-offs and temporary measures	0.3	0.0	0.0	0.0	0.0
4.1	One-offs on the expenditure side: general government	0.3	0.0	0.0	0.0	0.0
4.2	One-offs on the revenue side: general government	0.0	0.0	0.0	0.0	0.0
5.	Potential GDP growth (%)	3.6	3.2	3.0	2.9	2.7
6.	Output gap	1.7	-0.5	-0.8	-0.5	-0.3
7.	Cyclical budgetary component	0.8	-0.3	-0.4	-0.3	-0.1
8.	Cyclically-adjusted balance	-4.6	-4.5	-3.1	-2.7	-2.8
9.	Cyclically-adjusted primary balance	-3.0	-2.4	-0.9	-0.5	-0.6
10.	Structural balance	-4.8	-4.5	-3.1	-2.7	-2.8

* The forecast takes into account the impact of revenue from sales of greenhouse gas emission allowances (one-off measure on the revenue side) in 2022 of PLN 8.3bn.

Source: Ministry of Finance.

Following the extension of the general escape clause in the EU until the end of 2023, the adaptation of the rules defining the stabilising expenditure rule (SER) to the challenges posed to fiscal policy continued last year (cf. Chapter V).

In accordance with the applicable national regulations (Articles 112aa and 112d of the Public Finance Act of 27 August 2009), the preliminary amount of expenditure of the stabilising expenditure rule for 2024 is estimated at PLN 1 480 644 million (39.3% of GDP). The amount of expenditure is significantly affected by the correction of the inflation forecast error for 2022-2023, resulting from Article 112aa of the above-mentioned Act, as well as discretionary measures on the revenue side in the amount of PLN 13 059 million. These measures include, inter alia, the effects of:

— the indexation of excise duty rates on stimulants,

- revenues from deductions related to the Energy Shield,
 - VAT compliance measures,
 - tax system reforms, which came into force on 1 January and 1 July 2022, respectively,
- referred to in Chapters II.1 and II.2.

As a result of the unfavourable macroeconomic situation, the adjustment for public finance imbalances defined in Article 112aa, paragraph 4 of the Public Finance Act of 27 August 2009 will be minus 2 percentage points in 2024. In 2025-2026, an adjustment of the same amount, i.e. minus 2 percentage points, is projected to be applied. The projected preliminary amounts of expenditures of the stabilising expenditure rule for the following years are: PLN 1 562 577 million in 2025, PLN 1 633 278 million in 2026.

Taking into account the ongoing discussion on budget rules in the EU, the current geopolitical situation triggered by Russia's aggression against Ukraine and the deep, leapfrogging consolidation implied by the stabilising expenditure rule in its current form, further adjustments to the national fiscal framework are necessary. In this regard, the Government is considering special treatment in the stabilising expenditure rule for above-average military spending vis-à-vis EU/NATO countries (cf. Chapter V). The macro-fiscal scenario presented in the Programme is designed assuming consolidation at the pace implied by the Stability and Growth Pact. Therefore, it does not assume expenditure restraint implied by the current shape of the stabilising expenditure rule.

II.5. General government debt

During the period covered by the Programme, debt management will be geared towards the objective set out in the “Strategy for Debt Management of the Public Finance Sector”, i.e. to minimise the cost of debt servicing in the long term with the assumed risk constraints.

Debt management will take place in an environment of a primary general government deficit, with the nominal general government deficit of 4.7% of GDP in 2023, diminishing to 2.9% in 2026. Uncertainty in the financial markets can still be expected to arise from, among other things, the geopolitical situation, including above all the war in Ukraine, monetary policy and the growth rate of the global economy, particularly in Europe.

Changes in the debt-to-GDP ratio will primarily be a consequence of the evolution of the borrowing needs of the state budget and the funds established at Bank Gospodarstwa Krajowego (cf. Chapter V) and the rate of nominal GDP growth. The general government debt-to-GDP ratio is projected to reach 50.5% in 2023 and 55.4% in 2026. The projected increase in debt despite the decline in the deficit will be mainly due to the pre-financing of military equipment purchases, which Poland has significantly increased in the face of Russian aggression against Ukraine.

The evolution of average interest rates on the general government debt will be driven primarily by interest rate expectations over the update horizon and the maturing of debt incurred in the past at correspondingly different yields from current ones.

Table 5. General government debt (end of the year)

% of GDP	ESA Code	2022	2023	2024	2025	2026
1. Gross debt		49.1	50.5	52.4	53.6	55.4
2. Change in the gross debt ratio		-4.5	1.3	1.9	1.3	1.7
Contributions to changes in gross debt						
3. Primary balance*		2.2	2.7	1.3	0.8	0.7
4. Interest expenditure	EDP D.41	1.6	2.1	2.2	2.1	2.2
5. Stock-flow adjustment		-7.9	-3.4	-1.5	-1.7	-1.2

Source: Ministry of Finance.

* Impact of primary balance on debt: (-) means primary surplus.

III. Sensitivity analysis and comparison with the previous update

III.1. Risk factors

The first risk factor for the forecast is the further course of the war in Ukraine and its impact on the domestic and global economy. In the event of an escalation of the conflict, a renewed rapid influx of people from Ukraine to Poland, an outflow of foreign investors from the CEE region and increased uncertainty among consumers and businesses negatively affecting domestic consumption and investment are possible. An escalation of the conflict would also likely lead to an increase in global commodity prices above the prices assumed in the forecast, and thus to a higher inflation rate. In particular, this would affect the prices of oil, natural gas and some agricultural products.

The second risk factor, strongly related to the first one, is the impact of Ukrainian persons currently residing in Poland with a special status on the domestic labour market. As indicated in Chapter I.1, there are currently about 1 million persons staying in Poland with the status of UKR foreigners based on the provisions of the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state. Their good integration into the domestic labour market is fostered by the similarity of language and culture and the network of contacts created by economic immigrants working in Poland even before the Russian aggression against Ukraine. The forecast assumes no change in the number of incomers from Ukraine compared to the 2022 values, their impact on labour market indicators and their additional contribution (positive or negative) to basic economic categories on a y/y basis, such as private consumption. However, there is considerable uncertainty about these assumptions. The number of people arriving from Ukraine for whom Poland is a destination country is unknown, as is the number of those who intend to return to Ukraine if the conflict begins to die down. In the medium to long term, the inflow of immigrants should have a positive impact on Poland's economic potential, partially offsetting the negative impact of demography on labour supply. However, the scale of this impact is unknown.

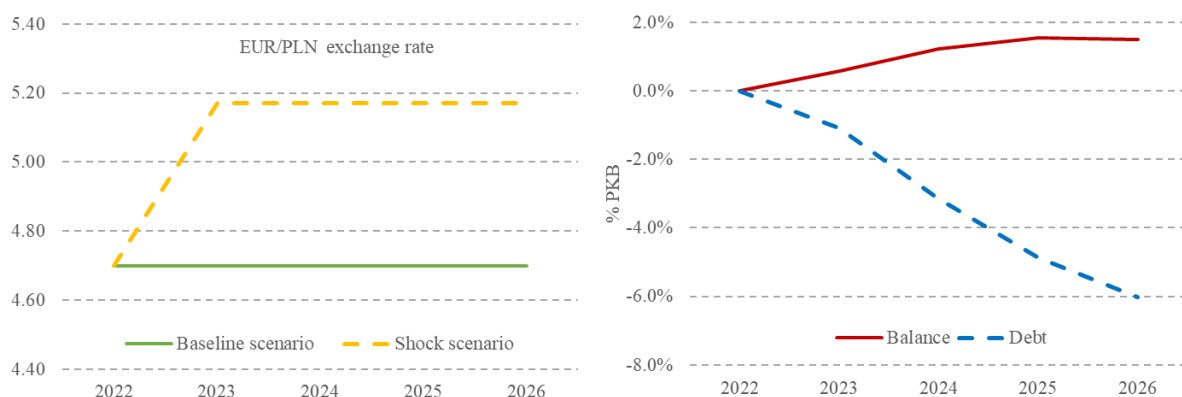
The third risk factor towards the baseline scenario is the timing and degree of implementation of projects from the NRRP, which envisages the use of funds from the EU Recovery and Resilience Facility of €23.9 billion in grants and €11.5 billion in the loan part. This risk is minimised by the pre-financing of some projects by the Polish Development Fund.

The fourth factor is the economic situation in the European Union. The scenario presented in the Programme assumes that economic growth in the EU, Poland's largest trading partner, will be in line with the scenario presented by the European Commission in its forecast of February this year. (0.8% in 2023 and 1.6% in 2024). According to the Commission, the balance of risk factors for this forecast is balanced. The threat of a gas shortage appears to be less than it was just a few months ago, although it still cannot be underestimated. Another risk detailed by the Commission is the possible difficulty for some operators to adjust to a high interest rate environment. On the other hand, demand could turn out to be stronger than forecast if recent falls in wholesale gas prices spill over more strongly into consumer prices. In addition, the reopening of China's economy may boost external demand more than expected, while the likelihood of supply chains being disrupted again due to local lockdowns in China is diminishing.

III.2. Sensitivity analysis

The sensitivity of the general government balance and debt in 2023-2026 to the depreciation of the zloty exchange rate and an increase in the domestic interest rate is presented below. The analysis is based on the econometric model of public finances being developed at the Ministry of Finance. The simulation results are based on historical elasticities estimated for the adopted forms of behavioural equations.

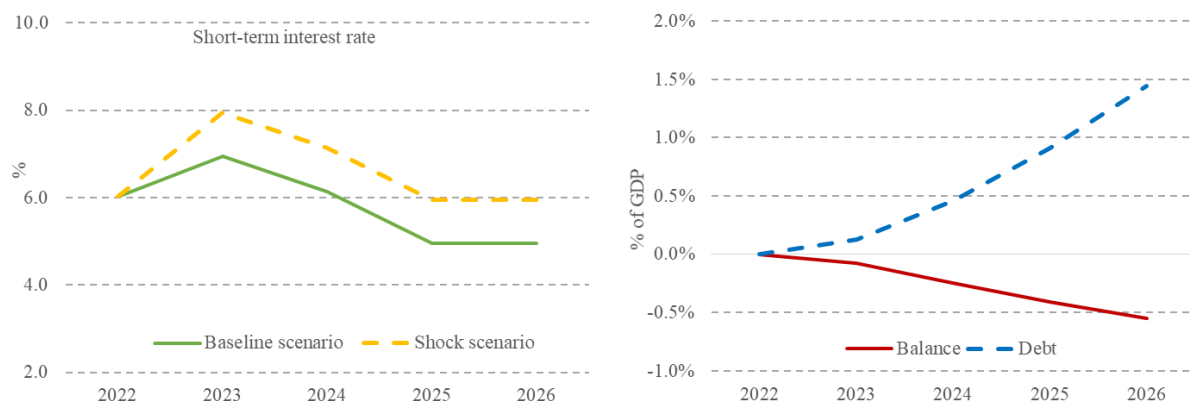
Figure 6. EUR/PLN exchange rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance.

The exchange rate impulse (cf. Figure 6) was introduced in the form of a permanent 10% depreciation of the zloty against the euro. The weakening of the zloty improves the competitiveness of domestic products, which has the direct effect of increasing the volume of exports. The increase in exports, due to its high import intensity, is also accompanied by an increase in imports. The increase in demand for Polish goods is conducive to an improvement in the labour market and an acceleration of investment activity, which supports GDP growth over the forecast horizon. Higher economic growth leads to an increase in government revenues, which outweighs the increase in expenditure related to servicing foreign currency-denominated debt, ultimately leading to an improvement in the sector's result. Consequently, in the shock scenario, general government debt is significantly lower as a share of GDP in 2026 than in the baseline scenario.

Figure 7. Short-term interest rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance.

An interest rate impulse (cf. Figure 7) is defined as a 1 percentage point jump in the nominal short-term interest rate over the entire analysis horizon. An increase in short-term interest rates entails an increase in long-term rates and consequently leads to an increase in the cost of raising capital, resulting in a reduction in the level of investment relative to the baseline scenario and an increase in the cost of debt financing. As a result of a shift in intertemporal substitution consumption and tighter credit conditions, the level of private consumption also decreases. As a result, the impulse interpreted as an increase in monetary policy restrictiveness leads to a reduction in the volume of GDP over the forecast horizon. With rising debt servicing costs and a relatively lower GDP level, the general government's balance as a share of GDP deteriorates, and the share of the sector's debt to GDP increases relative to the ratio in the baseline scenario.

III.3. Comparison with previous update

Real GDP growth in 2022 was higher than assumed in last year's Programme. Despite the ongoing war in Ukraine, rising inflation, nominal interest rates and consumer pessimism, the Polish economy proved relatively resilient to external shocks and recorded a high growth rate for the second consecutive year. However, towards the end of the previous year, there were signs of a slowdown in the economy as a result of the above-mentioned factors, which has an impact on the clear downward revision of the forecast for real GDP in the current year. The projected economic growth rate for 2024-2025, on the other hand, is similar to that of the previous Programme.

The general government deficit in 2022 amounted to 3.7% of GDP and turned out to be lower than expected by 0.6 percentage points, as a result of lower-than-planned general government expenditure as a proportion of GDP (44.4 % of GDP was planned, while according to preliminary data, expenditure execution was 43.5 % of GDP). The forecast higher general government deficit in 2023-2025 than the previous update is mainly due to the inclusion of activities related to, inter alia, the Energy Shield, changes in the tax and contribution area, expenditure related to assistance to persons with UKR foreigner status and military expenditure. In addition, in order to make the economic scenario more realistic, the macro-fiscal forecast for the current year takes into account historical differences between projected and realised expenditure (cf. Chapter II.1).

The lower general government debt-to-GDP ratio in 2022 compared to the forecast in the previous Programme was mainly due to lower borrowing needs of the government subsector, including the state budget and funds in Bank Gospodarstwa Krajowego (BGK), as well as higher nominal GDP and depreciation of the zloty. In the following years, the increasing path of debt in relation to GDP (compared to the declining path of the previous Programme) will be mainly related to the need to pre-finance purchases of military equipment, which Poland has significantly increased in the face of Russian aggression against Ukraine.

Table 6. Differences from the previous update

	ESA Code	2022	2023	2024	2025	2026
Real GDP growth (%)						
2022 Programme		3.8	3.2	3.0	3.1	-
Current update		5.1	0.9	2.8	3.2	3.0
Difference		1.3	-2.3	-0.2	0.1	-
General government net lending (% of GDP)						
	EDP B.9					
2022 Programme		-4.3	-3.7	-3.1	-2.5	
Current update*		-3.7	-4.7	-3.4	-2.9	-2.9
Difference		-	-	-	-	-
General government gross debt (% of GDP)						
2022 Programme		52.1	51.5	51.0	49.7	
Current update*		49.1	50.5	52.4	53.6	55.4
Difference		-	-	-	-	-

* Remark: value incomparable due to taking into account historical differences between forecasted and realized expenditure (cf. chapter II.1).

Source: Statistics Poland, Ministry of Finance.

IV. Sustainability of public finance in the long term

IV.1. Sustainability of public finance, including the implications of ageing population

Stable public finance supports long-term economic growth and constitutes a key element of macroeconomic stability. It is therefore necessary to monitor the sustainability of public finances in the short, medium and long term for early identification of possible risks and implementation of countermeasures. Therefore, an adequate fiscal framework is essential for the sustainability of public finances.

The Polish fiscal framework consists of fiscal rules including:

- public debt rules,
- a stabilising expenditure rule, which has a stabilising effect on public finances in the short, as well as in the long term, and corrects possible imbalances, minimising the risk of an excessive tightening of fiscal policy,
- rules limiting the increase in local government debt.

The occurrence of the COVID-19 pandemic required the mobilisation of additional budgetary resources to overcome the health crisis, maintain the functioning of the state during the pandemic and rebuild the economy afterwards. It therefore became reasonable to support the economy beyond the spending limit under the fiscal rules, in particular the stabilising expenditure rule. As expected, Poland's fiscal stability improved as the macroeconomic situation improved in 2021.

Russia's invasion of Ukraine and its consequences for the Polish economy pose another challenge to the sustainability of public finance. In the face of rising geopolitical tensions, defence spending has been increased. Measures were also taken to mitigate the effects of high inflation and the energy price crisis on citizens and businesses. These factors have contributed to increased pressure on Poland's fiscal sustainability.

The European Commission has so far assessed Member States in terms of the sustainability of public finance on the basis of fiscal gap indicators in the medium (indicator S1) and long, indefinite horizon (indicator S2). The fiscal gap reflects the magnitude of the necessary adjustment in the primary balance adjusted for the impact of the cycle, so that the public debt reaches a certain level in the medium term (S1)²⁰ or the solvency condition is met in the long term (S2 indicator). These indicators depend on the initial fiscal position (expressed in terms of the structural primary outcome), on the current and projected level of debt as a % of GDP and on the cost of population ageing.

The S1 and S2 indicators make it possible to determine whether the macroeconomic scenario presented in the Programme assuming an improvement in the structural balance between 2024 and 2026 by 0.5 percentage points per year on average would be sufficient to preserve the sustainability of public finances in the medium and long term. An increase in the value of the indicators implies that a larger improvement in the cycle-adjusted primary balance is required, while a decrease implies that there is an improvement in fiscal sustainability and the required additional adjustment to the cycle-adjusted primary balance will be lower.

²⁰ An approach consistent with the European Commission's "Fiscal Sustainability Report 2021" has been used, i.e. S1 measures the necessary fiscal effort to bring debt to 60% 15 years from the end of the forecast (currently: in 2041). This effort, measured by the additional improvement in the structural primary balance (SPB) compared to the baseline, is assumed to be concentrated in the 5 years following the period covered by the Programme, i.e. from 2027 to 2031. Thereafter, the SPB will remain unchanged, except for the cost of ageing.

Table 7. Fiscal sustainability indicators in the subsequent periods

	base year 2023	base year 2026
S1	2.4 medium risk	0.5 medium risk
S2	4.6 medium risk	2.8 medium risk

Remarks: the S1 indicator's value of less than 0 indicates low risk, from 0 to 2.5 medium risk, and above 2.5 high risk. In the case of the S2 indicator, a value lower than 2 indicates low risk, from 2 to 6 medium risk, above 6 high risk.

Source: Ministry of Finance

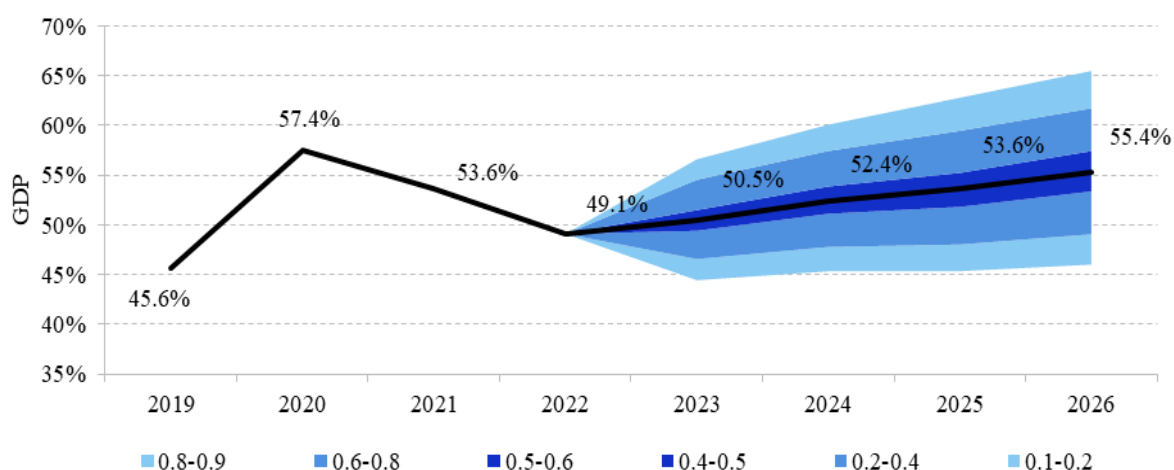
Table 7 shows the Ministry of Finance's estimate of the S1 and S2 ratios for the two base year variants. The Ministry of Finance's estimate is based on the projections of macro-fiscal indicators presented in the Programme, assumptions for variables beyond the Programme horizon²¹, and the projection of population ageing costs prepared under the Ageing Working Group (AWG) of the EU Economic Policy Committee presented in the following section.

The fiscal effort undertaken to increase defence spending has negatively affected the fiscal gap indicators taking the base year as 2023. However, thanks to a significant decline in government debt in 2022 to 49.1% of GDP, the risk assessment remained in the medium risk category, an improvement to the corresponding year in the last year's update of the Programme. Assuming the fiscal path is consistent with the projection presented in the Programme, the S1 and S2 indicators for Poland can be expected to improve in subsequent years. The projected improvement in the cycle-adjusted primary balance results in a reduction in the necessary fiscal adjustment for both indicators by about 1.9 percentage points of GDP and moving significantly closer to the low-risk category (determined in accordance with the European Commission's methodology).

The presented assessment of fiscal sustainability is subject to uncertainty due to the difficult to predict impact on the Polish economy of Russia's invasion of Ukraine. Given the good starting position in the debt level in % of GDP, there is a low probability of an increase in risks to the sustainability of public finances in the Programme horizon.

²¹ Specifically: for potential GDP growth according to the "Guidelines to ensure the use of uniform macroeconomic indicators" (Ministry of Finance, October 2022) and with assumptions for interest rates and inflation according to the "Fiscal Sustainability Report 2021" (European Commission, April 2022).

Figure 8. Stochastic debt projections from 2023



Source: Ministry of Finance

The stochastic debt projections are an attempt to show the uncertainty around the baseline path over the projection horizon. The projections, which have been developed on the basis of the approach used by the European Commission²², are based on the baseline scenario presented in the Programme using quarterly shocks obtained for the historical realisations of the following variables: nominal GDP growth, the short and long interest rate, the primary balance and the exchange rate. The cone covers 80% of all simulated debt paths over a 5-year horizon. The chart does not include the debt paths resulting from the 20% most extreme shocks as tail events.

The results of the analysis indicate that if future shocks follow the same pattern as in the past, there is a 80% probability that Poland's debt will be between 46% of GDP and 65% of GDP in 2026, where the median is 55% of GDP. In light of the European Commission's proposal of last November (cf. Box 1), the results of this analysis would contribute to a lower risk to the sustainability of public finances, despite the fact that, due to the pre-financing of defence spending, general government debt over the Programme horizon rises in the context of a significant decline in the cycle-adjusted primary outcome (to minus 0.6% of GDP in 2026).

²² Stochastic projections are developed using a Monte Carlo simulation based on 2 000 draws. Source: Fiscal Sustainability Report 2021 (European Commission, April 2022).

Table 8. Long-term sustainability of public finances

% of GDP	2019	2030	2040	2050	2060	2070
Total expenditure						
Of which age-related expenditure	20.1	22.2	22.2	23.0	24.1	24.1
Social security pension:	10.6	11.0	10.5	10.7	10.8	10.5
- old-age and early pensions	9.7	10.2	9.7	10.0	10.2	9.9
- other pensions (disability, survivors)	1.0	0.8	0.8	0.8	0.7	0.6
Health care	4.9	6.3	6.7	7.0	7.4	7.4
Long-term care	0.8	1.1	1.5	1.7	2.1	2.4
Education expenditure	3.8	3.8	3.5	3.6	3.8	3.8
Interest expenditure	0.0	0.0	0.0	0.0	0.0	0.0
Total revenue						
Of which from pension contributions	8.4	8.6	8.7	8.7	8.7	8.7
Assumptions						
Labour productivity growth	3.2	3.2	2.2	2.1	1.8	1.5
Potential GDP growth	3.5	2.3	1.4	0.9	1.1	1.0
Participation rate males (aged 20-64)	83.5	84.1	82.6	82.8	83.4	82.9
Participation rate females (aged 20-64)	68.0	69.6	67.2	67.6	69.3	68.5
Total participation rate (aged 20-64)	75.7	76.9	75.0	75.3	76.5	75.9
Unemployment rate (aged 20-64)	3.2	4.9	5.0	5.0	5.0	5.0
Population aged 65+ over total population	17.9	22.8	25.5	30.4	33.9	34.0

Remark: the calculations were based on the macroeconomic assumptions available at the stage of preparing the report (Ageing Report 2021), i.e. from 2020. The report is prepared every 3 years and its long-term forecasts of age-related expenditure are used until a new report is published.

Source: European Commission and Ageing Working Group (AWG) of the Economic Policy Committee (EPC).

The long-term government expenditure projections presented in the table were prepared by the Ageing Working Group (AWG) of the Economic Policy Committee (EPC). They were published by the European Commission in 2021 in a report on the projected impact of population ageing up to 2070 (Ageing Report 2021). The projections were based on demographic assumptions developed by Eurostat, extrapolation of historical trends and technical assumptions on the convergence of the basic drivers of economic growth, i.e. labour, capital and labour productivity. According to the AWG projections, pension expenditure remains stable in the long term and will decline slightly from 10.6% of GDP in 2019 to 10.5% of GDP in 2070. The fluctuations are mainly due to changes in the demographic structure of the population. Compared to previous forecasts, expenditure is slightly higher, influenced by the lowering of the retirement age for women (60 years) and men (65 years) from 1 October 2017. In addition, the forecast was affected by a change in macroeconomic assumptions. However, demographic changes continue to have the greatest impact on spending. The AWG forecast is constructed taking into account the statutory retirement age, while the Polish pension system only sets a minimum retirement age, and continuing to work results in a significant increase in future benefits.

Total age-related expenditure is increasing – from 20.1% of GDP to 24.1% of GDP. The main determinant of the increase in this expenditure is expenditure on health and long-term care. A gradual increase in health spending to 6% of GDP by 2024 has been included in the forecast. Following the completion of the AWG's work on healthcare projections, the Act of 11 August 2021 amending the Act on healthcare services financed from public funds and certain other acts (Journal of Laws, item 1773).

It assumes a gradual increase in health care expenditures until 2027, until the level of 7% of GDP is reached. It should be emphasised that for organisational (the report is prepared every 3 years) and technical reasons, incorporating changes into the forecasting models requires time and an appropriate procedure²³.

Demographic changes pose a significant challenge to the long-term sustainability of public finances of most European countries. In this context, Poland's current situation appears favourable. However, the phenomenon of population ageing observed in recent years, which has its roots in longer life expectancy, low fertility rates and the current age structure of the population, is expected to continue. As a result, the old-age dependency ratio, i.e. the ratio between the population of post-working age (65 and over) and the population of working age (i.e. 20-64) expressed as a percentage, will worsen. According to AWG projections, this ratio will increase from 29% in 2019 to 67.8% in 2070.

From 1 January 2019, Employee Capital Plans (ECPs) were introduced as an instrument aimed at increasing the level of long-term savings and the assets of future pensioners. ECPs are a voluntary savings system consisting of contributions paid by the employee and the employer supported by financial incentives from the state. The funds accumulated in ECPs are invested in the financial market and will be paid out when the ECP participant reaches the age of 60. ECPs are an element of the Capital Building Programme. One of the main effects of the proposed solution should be an increase in the long-term savings rate of Poles, which will serve to limit the effect of a decrease in replacement rates from the pension received as part of participation in the first pillar of the pension system (pension savings within ECPs will in fact be a transfer of consumption to future periods). ECPs, to some extent, may be conducive to an improvement in Poland's net international investment position, as well as an increase in the investment rate and an acceleration in the growth rate of potential GDP.

A gradual increase in ECP participation has been observed. At the end of 2022, 2.52 million employees participated in the programme, representing a participation rate of 34.6%, while at the end of 2021 there were 2.27 million participants, representing a participation rate of 30.8%. In addition, a re-enrolment of ECPs takes place in 2023, in which those who previously declared to opt out of ECP contributions must re-declare their opt-out. If they do not make such a declaration, they will be automatically enrolled in the ECP. The auto-enrolment will be renewed every four years.

IV.2. Contingent liabilities

Potential contingent liabilities on account of sureties and guarantees granted by general government entities amounted to 14.9% of GDP in Poland at the end of 2022 compared to 13.7% of GDP at the end of 2021. Guarantees and sureties granted by the State Treasury accounted for the main share of this category – at the end of 2022 they represented 14.1% of GDP compared with 13.6% of GDP at the end of 2021.

The increase in contingent liabilities in 2022 was due to the granting of Treasury guarantees relating in particular to:

- support for the functioning of the energy sector (guarantees securing the financial obligations of gas sellers to acquire funds to ensure the continuity of gas fuel supplies and guarantees for financing centrally directed coal purchases to stabilise the coal market), i.e. support to counteract the negative economic effects of Russian aggression against Ukraine,
- financing of the newly created Armed Forces Support Fund to meet the country's defence needs,
- the continuation of financing of the COVID-19 Counteracting Fund,

²³ The projections of health and long-term care expenditures presented in the table, in accordance with the methodology of the work adopted by the Working Group, are made by the European Commission. The incorporation of the revised law into the forecasting models, i.e. the inclusion of 7% of GDP as an expenditure level, will take place in the next edition of the AWG.

- the continuation of support for infrastructure development (guarantees for the liabilities of the National Road Fund and the railway sector),
- financing of the Assistance Fund under the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state.

At the end of 2022, the majority of potential contingent liabilities on account of surety and guarantee liabilities resulted from guarantees provided by the State Treasury in connection with the effects of the COVID-19 pandemic (58% of the portfolio). The next group was infrastructure guarantees (28% of the portfolio). The third major group was new guarantees resulting in particular from the difficult geopolitical and energy situation in 2022 (13% of the portfolio).

Among the Treasury's sureties and guarantees, guarantees granted for financial sector liabilities accounted for less than 0.1% of GDP at the end of 2022 and did not relate to potential measures against crisis situations.

Table 9. Contingent liabilities

% of GDP	2022
Public guarantees	14.9
Of which: linked to the financial sector*	0.1

* Data on potential liabilities of other public finance sector entities on account of sureties and guarantees for the financial sector are not subject to reporting (only total contingent liabilities are available). Therefore, the presented value of guarantees granted for financial sector liabilities refers to the State Treasury sureties and guarantees portfolio. Due to its specificity guarantees granted to support funds, of which Bank Gospodarstwa Krajowego is an operator, are not presented here, i.e. these refer to current guarantees for the support of: the COVID-19 Counteracting Fund, the National Road Fund, the Armed Forces Support Fund and the Aid Fund.

Source: Ministry of Finance.

The amount of potential liabilities under sureties and guarantees issued by the Treasury in subsequent years will depend on the final shape of solutions concerning the functioning of funds serviced by Bank Gospodarstwa Krajowego (cf. Chapter V).

Currently, no expenditure is envisaged by the Treasury on account of calling of guarantees. Also, in recent years, expenditures of this type have not been made.

At the end of 2022, approximately 95% of contingent liabilities under sureties and guarantees issued by the Treasury belonged to the low-risk group, and the long-term risk factor for the portfolio of sureties and guarantees issued by the Treasury remained at a low level. In particular, the design of the financing of the liabilities incurred for the COVID-19 Counteracting Fund minimises the risk of pay-outs from on these guarantees. With regard to new and projected guarantees, the possible method of financing the Funds nor the projected situation of the entities also does not currently result in a significant increase in projected pay-outs from guarantees and sureties.

V. Institutional features of public finances

The Ministry of Finance is pursuing the budgetary system reform, which is the first element of the reform of the fiscal framework in the NRRP. The main objective of the budgetary system reform is to introduce a budgetary system that supports the achievement of strategic objectives and development priorities in a multi-year perspective. Specific objectives include:

- the introduction of a medium-term budgetary framework and the integration of multi-year and annual planning processes,
- the introduction of a new budgetary classification,
- improvement of data collection systems (budgetary reporting and financial reporting).

The objectives and directions of the budgetary system reform address to the recommendations of the EU Council of 9 July 2019 and 12 July 2022 in which the EU Council recommended improving the efficiency of public spending in Poland, including by continuing the reform of the budgetary system.

Taking into account the interdependencies between various components of the budgetary system reform, the development of a standardised chart of accounts integrated with the budgetary classification was considered a priority. This undertaking was carried out jointly with the International Monetary Fund as part of a project financed, inter alia, from the Structural Reform Support Programme.

On 31 March 2022, the Ministry of Finance published the “Concept note on the new classification system”²⁴. Thus, the first milestone (A1G) of the budgetary system reform set out in the NRRP was achieved. The publication concluded the stage of basic conceptual works and enabled to initiate consultations of the proposed solutions with external stakeholders.

The first group of stakeholders, i.e. central government budgetary subsector entities, was consulted in 2022. The consultation addressed issues such as the interface between the new classification system and other elements of the new budgetary system, the application of a standardised chart of accounts for recording certain specific transactions and other economic flows, or the embedding of the new classification system in the IT environment. The comments and feedback provided by stakeholders did not affect the overall conceptual framework of the new classification system (segmentation, functions of the various segments, building blocks), but proved useful in identifying and filling gaps in the detailed classifications. The consultation report was published in January 2023²⁵. The Ministry of Finance will consult other stakeholder groups this year, including representatives of local government units (within the framework of the Joint Commission of Government and Local Government).

The new classification system will provide the information basis for the other elements of the new budgetary system. In accordance with the second milestone (A2G) of the reform of the budgetary system, set out in the NRRP, the new budgetary system will also consist of a new budget management model and a redefined medium-term budgetary framework.

The deadline for achieving the second milestone of the budgetary system reform is the first quarter of 2025. The amendment to the Public Finance Act, which will establish the new budgetary system, will also set out the detailed modalities and timeline for the phased implementation of the system.

As part of the reform of the budget framework planned in the NRRP, a review of the functioning of the stabilising expenditure rule is also planned, with a particular focus on its scope (milestone A4G). The conclusions of the project will be published on the website of the Ministry of Finance in Q1 2025 at the latest. Bearing in mind the ongoing discussion on the reform of the EU rules (cf. Box 1), of which the stabilising expenditure rule is an implementation, the timing and scope of the stabilising expenditure rule review will be aligned with the final settlements in the EU.

²⁴ <https://www.gov.pl/web/finanse/reforma-systemu-budzetowego>

²⁵ Cf. footnote 23.

Following the European Commission's extension of the general escape clause until the end of 2023 (cf. Box 2), two amendments to the stabilising expenditure rule (SER) took place last year.

The Act of 23 June 2022 amending the Public Finance Act and the Act – Environment Protection Act (Journal of Laws, item 1747) was aimed at:

- adjusting the formula of the stabilising expenditure rule to the current macroeconomic situation,
- extending the scope of entities and bodies covered by the stabilising expenditure rule,
- introducing organisational changes enabling a transition to an updated methodology of calculating the amount of expenditure.

In this connection and in view of the significant deviation of the average annual consumer price index from the inflation target of the Monetary Policy Council (MPC), the indicator in the form of the inflation target determined by the MPC used in calculating the amount of expenditure based on the stabilising expenditure rule was replaced by the average annual consumer price index (CPI). In addition, the amendment to the law introduced an investment clause for 2023, which allowed for special treatment of expenditure by entities covered by the stabilising expenditure rule allocated for investment purposes. Another objective of the law was to extend the scope of the stabilising expenditure rule to include the National Water and Environment Fund. This action was consistent with the commitments made in the NRRP and allowed the rule to better fulfil its original objectives.

The second amendment to the Act of 27 August 2009 on public finance, which was significant from the point of view of the stabilising expenditure rule, entered into force on 24 December 2022 (Article 4 of the Act of 16 November 2022 amending the Act on tax on certain financial institutions and certain other acts, Journal of Laws, item 2745). The solution introduced in this way made it possible not to include in the report on the implementation of the Budget Act for 2022 the expenditures of entities covered by the binding expenditure limit related to the fight against inflation, the energy crisis and the financing of the armed forces. At the same time, the sum of the above-mentioned financial impacts will be calculated on the basis of the data provided for the 2022 Budget Law Implementation Report and will be published in it, which should ensure transparency in the application of the stabilising expenditure rule. This solution has been agreed with the European Commission in the context of the implementation of the NRRP milestone on the stabilising expenditure rule (A3G – amendment of the Public Finance Act of 27 August 2009 to extend the scope of the stabilising expenditure rule to state special purpose funds).

Special treatment of above-average military expenditure vis-à-vis EU/NATO countries is currently under consideration. This is due to the need to adapt the stabilising expenditure rule to the current geopolitical situation caused by Russia's aggression against Ukraine. The development of defence capabilities requires above-average defence spending, which would significantly reduce the expenditure space under the current shape of the stabilising expenditure rule. In order for these expenditures not to have a negative impact on other areas of state activity, it is necessary to adjust the stabilising expenditure rule accordingly. Failure to make the above-mentioned change in the stabilising expenditure rule would result in a deep, leapfrogging consolidation, threatening macroeconomic stability.

Special treatment of defence spending is also advocated by Poland in the EU. In the EU, Member State spending that strengthens international solidarity and helps achieve the Union's policy objectives is treated as a mitigating factor in the assessment of public finances and taken into account by the European Commission and the Ecofin Council when opening the excessive deficit procedure. The issue of such treatment of increased defence spending was raised by Poland already in the 2021 Convergence Programme, i.e. even before Russia's aggression against Ukraine. The war in Ukraine confirmed the validity of this demand and it became even more important.

The outbreak of the pandemic as well as the Russian aggression against Ukraine and the related energy crisis have become a major challenge for public finances in many countries. In Poland, due to the design of the national fiscal rules (the prudential threshold in the Public Finance Act and the constitutional debt limit), it was decided to finance a significant part of the crisis spending through off-budget mechanisms, not included in the national definition of public debt, mainly through funds created in the state development bank – BGK. As a result of BGK's involvement in raising funds for the pandemic and

energy crisis, there has been an increase in the gap between public debt according to national (sovereign public debt) and EU (ESA) methodologies.

Beginning in 2024, it is planned that the state budget will take over the financing of the tasks carried out by the Covid-19 Counteracting Fund. This action coincides with the objective of reforming the fiscal framework in the NRRP (milestones A1G and A4G) and the European Commission's demands for transparency and efficiency in public finances, as outlined in the 2022 Country Report, as well as the recommendations of the EU Council of July 2022²⁶. In practice, this measure will mean that no more debt will be incurred for this fund. At the same time, limiting the possibility of transferring treasury securities free of charge to funds located in BGK and the introduction of an obligation for the Minister of Finance to accept free resources of the above-mentioned funds on deposit are planned.

The anticipated effect of the reform will be an increase in the effectiveness of financing the state's borrowing needs, as well as a gradual reduction in the difference between public debt according to the national and EU definition – as the funds' debt at BGK is refinanced from the state budget. The whole process will take place in a gradual manner, so that there is no rapid increase in debt according to the national methodology and thus too close to the limits arising from the national fiscal framework, which could significantly reduce flexibility in public finances in crisis situations.

In addition, as part of the reform, it is planned to broaden the justification of the draft budget law by including in its content the financial plans of funds created, entrusted or transferred to BGK on the basis of separate laws and to include in the report on the implementation of the budget law a discussion of the implementation of the aforementioned financial plans in order to increase the transparency of public finances.

Revised rules for the conducting of spending reviews have been developed in 2021. The changes are a result of recommendations from the Organisation for Economic Co-operation and Development (OECD) issued as part of the project titled “The OECD. Technical support to build capacity for spending reviews – Poland (20PL24)”. In 2022, two pilot spending reviews were launched under the revised rules. The first one is conducted in the area of health and concerns the purchase and use of medical equipment and selected high-cost medical devices intended for the provision of diagnostic and therapeutic services. The second relates to lost state budget revenue from tax credits supporting innovation. The realisation of the above spending reviews is carried out in cooperation with OECD experts, within the framework of the Technical Support Facility funded by the European Commission.

In addition, a draft amendment to the Public Finance Act of 27 August 2009 has been prepared in 2022, which provides for the institutionalisation of spending reviews. The draft legislation was developed primarily based on the experience of the Ministry of Finance in the implementation of spending reviews and the aforementioned 2021 OECD recommendations.

Additionally, work is ongoing in the area of public accounting. The main objective is to develop legal and institutional framework to enable issuing Consolidated Financial Statement of the State. This financial statement should make it possible to present a coherent and reliable picture of the financial position of the entire public finance sector, as well as facilitate the assessment of the effectiveness of the management of state assets. This is an action with a long-time horizon. In 2020, the first stage related to the preparation of the reform concept was completed. Currently, activities related to the preparation of relevant legislative solutions are in progress.

²⁶ Cf. footnote 3.

Table annex

Table 10. Macroeconomic prospects

	ESA Code	2022 Level	2022 Rate of change	2023 Rate of change	2024 Rate of change	2025 Rate of change	2026 Rate of change
1. Real GDP (PLN billion)	B1*g	2 766.4	5.1	0.9	2.8	3.2	3.0
2. Nominal GDP (PLN billion)	B1*g	3 078.3	17.0	12.0	9.4	7.1	6.1
Components of real GDP							
3. Private consumption expenditure	P.3	1 527.0	3.3	0.7	2.5	2.7	2.7
4. Government consumption expenditure	P.3	483.2	-2.0	0.4	2.4	2.5	2.5
5. Gross fixed capital formation	P.51	464.7	5.0	1.1	4.3	5.3	4.7
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-	7.2	5.6	5.3	5.0	4.7
7. Exports of goods and services	P.6	1 611.9	6.2	1.7	3.9	3.9	3.7
8. Import of goods and services	P.7	1 519.1	6.2	-0.3	3.7	3.8	3.7
Contributions to real GDP growth							
9. Final domestic demand		-	4.9	-0.3	2.6	2.9	2.8
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	2.6	-1.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	0.2	1.2	0.2	0.2	0.1

Remark: the levels of real volumes are expressed in constant prices of 2022.

Source: Ministry of Finance.

Table 11. Price developments

	ESA Code	2022 Level	2022 Rate of change	2023 Rate of change	2024 Rate of change	2025 Rate of change	2026 Rate of change
1. GDP deflator		-	11.3	10.9	6.4	3.8	3.0
2. Private consumption deflator		-	14.5	11.9	6.5	3.9	3.1
3. HICP		-	13.2	11.6	6.5	3.9	3.1
3a. CPI		-	14.4	12.0	6.5	3.9	3.1
4. Public consumption deflator		-	13.8	11.9	6.5	3.9	3.1
5. Investment deflator		-	10.4	7.6	5.1	3.2	2.8
6. Export price deflator (goods and services)		-	18.8	5.5	3.6	3.4	2.9
7. Import price deflator (goods and services)		-	23.0	4.4	3.0	2.9	2.6

Source: Statistics Poland, Ministry of Finance.

Table 12. Labour market developments

	ESA Code	2022 Level	2022 Rate of change	2023 Rate of change	2024 Rate of change	2025 Rate of change	2026 Rate of change
1. Employment (thousands of persons)*		16 742	0.5	-0.3	0.4	0.4	0.0
2. Employment (hours worked)**		-	-	-	-	-	-
3. Unemployment rate (%)***		-	2.9	3.2	3.1	3.0	3.0
4. Labour productivity (PLN thousand)****		165.2	4.6	1.2	2.4	2.7	3.0
5. Labour productivity (PLN thousand)*****		-	-	-	-	-	-
6. Compensation of employees (PLN billion)	D.1	1 173.4	15.2	11.4	10.1	7.1	6.0
7. Compensation per employee (PLN thousand)		87.5	15.0	11.6	9.6	6.6	5.9

* Average employment based on LFS (aged 15-89).

** National accounts definition.

*** Harmonised unemployment rate. Eurostat definition. levels.

**** Real GDP per person employed.

***** Real GDP per hour worked.

Source: Statistics Poland, Ministry of Finance.

Table 13. Sectoral balances

% of GDP	ESA Code	2022	2023	2024	2025	2026
1. Net lending / borrowing vis-à-vis the rest of the world*	B.9	-2.7	0.5	0.8	1.4	1.0
of which:						
- balance on goods and services		1.9	3.2	3.6	3.9	4.1
- balance of primary incomes and transfers		-4.8	-4.1	-4.0	-3.8	-3.9
- capital account		0.3	1.5	1.2	1.3	0.8
2. Net lending/borrowing of the private sector	B.9	1.0	5.2	4.2	4.3	3.9
3. Net lending/borrowing of general government	EDP B.9	-3.7	-4.7	-3.4	-2.9	-2.9
4. Statistical discrepancies		-	-	-	-	-

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

Source: Statistics Poland. Ministry of Finance.

Table 14. Basic assumptions

	2022	2023	2024	2025	2026
Short-term interest rate * (annual average)	6.0	7.0	6.1	5.0	5.0
Long-term interest rate (annual average)	6.1	6.5	6.5	6.5	6.7
Nominal effective exchange rate	-	-	-	-	-
Exchange rate vis-à-vis the EUR (annual average)	4.69	4.70	4.70	4.70	4.70
World excluding EU. GDP growth ***	3.1	3.0	3.3	-	-
EU GDP growth ***	3.5	0.8	1.6	-	-
Growth of relevant foreign export markets **	7.9	1.9	3.5	-	-
World import volumes ***	4.4	2.4	3.6	-	-
Oil prices (Brent. USD/barrel)	100.9	82.2	77.7	73.4	70.1

* Level of short-term interest rate was assumed on the basis of market expectations.

** As an indicator of export markets – the EU import.

Source: Ministry of Finance with exception of position marked with ***, where the source is *European Economic Forecast. Winter 2023* of European Commission.

Table 15. General government budgetary prospects

	ESA Code	2022 PLN million	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP	2026 % of GDP
Net lending (EDP B9) by sub-sector							
1. General government	S.13	-115 137	-3.7	-4.7	-3.4	-2.9	-2.9
2. Central government	S.1311	-101 673	-3.3	-4.1	-3.7	-2.8	-2.9
3. State government	S.1312						
4. Local government	S.1313	-12 804	-0.4	-0.3	0.3	0.0	-0.1
5. Social security funds	S.1314	-660	0.0	-0.3	0.0	-0.1	0.0
General government							
6. Total revenue	TR	1 225 032	39.8	41.8	41.3	41.4	40.8
7. Total expenditure	TE	1 340 169	43.5	46.6	44.7	44.3	43.8
8. Net lending/borrowing	EDPB.9	-115 137	-3.7	-4.7	-3.4	-2.9	-2.9
9. Interest expenditure	EDPD.41	47 948	1.6	2.1	2.2	2.1	2.2
10. Primary balance		-67 189	-2.2	-2.6	-1.2	-0.8	-0.7
11. One-off and other temporary measures *		8 330	0.3	0.0	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (=12a+12b+12c)		656 093	21.3	22.4	22.2	22.3	22.3
12a. Taxes on production and imports	D.2	420 580	13.7	15.0	14.4	14.4	14.2
12b. Current taxes on income, wealth, etc	D.5	234 958	7.6	7.4	7.8	7.9	8.1
12c. Capital taxes	D.91	555	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	420 535	13.7	13.7	13.9	13.9	13.9
14. Property income	D.4	31 622	1.0	1.0	0.8	0.7	0.6

	ESA Code	2022 PLN million	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP	2026 % of GDP
15. Other		116 782	3.8	4.7	4.4	4.5	4.0
16. Total revenue	TR	1 225 032	39.8	41.8	41.3	41.4	40.8
Tax burden (D.2+D.5+D.61+D.91-D.995)		1 072 646	34.8	35.9	35.9	36.1	36.0
Selected components of expenditure							
17 Compensation of employees + intermediate consumption	D1+P2	493 256	16.0	16.1	16.2	16.0	15.8
17a. Compensation of employees	D.1	299 702	9.7	9.8	9.9	9.7	9.6
17b. Intermediate consumption	P.2	193 554	6.3	6.3	6.3	6.2	6.2
18. Social payments (18=18a+18b)		525 729	17.1	17.2	17.4	17.9	18.1
<i>of which Unemployment benefits</i>		2 588	0.1	0.1	0.1	0.1	0.1
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	54 640	1.8	1.8	1.8	2.0	2.2
18b. Social transfers other than in kind	D.62	471 089	15.3	15.4	15.6	15.9	15.9
19. Interest expenditure	EDP D.41	47 948	1.6	2.1	2.2	2.1	2.2
20. Subsidies	D.3	26 579	0.9	2.9	0.8	0.4	0.4
21. Gross fixed capital formation	P.51	124 029	4.0	4.2	4.2	4.2	4.3
22. Capital transfers	D.9	50 946	1.4	1.4	1.3	0.9	0.8
23. Other		71 682	2.6	2.7	2.6	2.8	2.2
24. Total expenditure	TE	1 340 169	43.5	46.6	44.7	44.3	43.8
p.m.: Government consumption (nominal)	P.3	549 687	17.9	17.9	17.9	17.8	17.7

* In 2022 revenue from sales of greenhouse gas emission allowances of PLN 8.3bn was included.

Source: Statistics Poland, Ministry of Finance.

Table 16. No-policy change projections

	2022 PLN million	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP	2026 % of GDP
1. Total revenue at unchanged policies	1 273 868	41.4	40.3	41.7	41.3	40.8
2. Total expenditure at unchanged policies	-	-	-	-	-	-

Source: Ministry of Finance.

Table 17. Amounts to be excluded from the expenditure benchmark

	2021 PLN million	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	30 701	1.0	1.8	1.7	1.7	1.3
1a. of which investment fully matched by EU funds revenue	23 789	0.8	1.1	1.0	1.1	0.9
2. Cyclical unemployment benefit expenditure*	120	0.0	0.0	0.0	0.0	0.0
3. Effect of discretionary revenue measures	-48 836	-1.6	1.5	-0.4	0.1	0.0
4. Revenue increases mandated by law	-	-	-	-	-	-

* Estimation of cyclical unemployment expenditure is based on expenditure code D.62 and code D.63 in COFOG function, code 10.5. They cover expenditure exclusively related to social protection in the form of a cash benefit and a benefit in kind paid to households. This is in accordance with approach applied in the Convergence programme 2022 Update (cf. page 40).

Source: Ministry of Finance.

Table 18. General government expenditure by function

	% of GDP	COFOG Code	2021	2026*
1. General public services		1	4.1	
2. Defence		2	1.6	
3. Public order and safety		3	2.2	
4. Economic affairs		4	6.0	
5. Environmental protection		5	0.6	
6. Housing and community amenities		6	0.5	
7. Health		7	5.8	
8. Recreation, culture and religion		8	1.2	
9. Education		9	4.9	
10. Social protection		10	17.3	
11. Total expenditure		TE	44.1	43.8

* Expenditure's disaggregation by function is a part of the budgetary process.

Source: Eurostat, Ministry of Finance.

Table 19. Table on the RRF - Loans

Cash flow from RRF loans projected in the programme (% of GDP)							
	2020	2021	2022	2023	2024	2025	2026
Disbursements of RRF loans from EU							
Repayments of RRF loans to EU							
Expenditure financed by RRF loans (% of GDP)							
	2020	2021	2022	2023	2024	2025	2026
Compensation of employees D.1	-	-	-	-	-	-	-
Intermediate consumption P.2	-	-	-	-	-	-	-
Social payments D.62+D.632	-	-	-	-	-	-	-
Interest expenditure D.41	-	-	-	-	-	-	-
Subsidies, payable D.3	-	-	-	-	-	-	-
Current transfers D.7	-	-	-	-	-	-	-
TOTAL CURRENT EXPENDITURE	-	-	-	0.0	0.0	0.0	0.0
Gross fixed capital formation P.51g	-	-	-	-	-	-	-
Capital transfers D.9	-	-	-	-	-	-	-
TOTAL CAPITAL EXPENDITURE	-	-	-	0.2	0.2	0.2	0.0
Other costs financed by RRF loans (% of GDP)							
	2020	2021	2022	2023	2024	2025	2026
Reduction in tax revenue	-	-	-	-	-	-	-
Other costs with impact on revenue	-	-	-	-	-	-	-
Financial transactions	-	-	-	-	-	-	-

Source: Ministry of Development Funds and Regional Policy.

Table 20. Table on the RRF - Grants

Revenue from RRF grants (% of GDP)							
	2020	2021	2022	2023	2024	2025	2026
RRF grants as included in the revenue projections							
Cash disbursements of RRF grants from EU							
Expenditure financed by RRF grants (% of GDP)							
	2020	2021	2022	2023	2024	2025	2026
Compensation of employees D.1	-	-	-	-	-	-	-
Intermediate consumption P.2	-	-	-	-	-	-	-
Social payments D.62+D.632	-	-	-	-	-	-	-
Interest expenditure D.41	-	-	-	-	-	-	-
Subsidies, payable D.3	-	-	-	-	-	-	-
Current transfers D.7	-	-	-	-	-	-	-
TOTAL CURRENT EXPENDITURE	-	-	0.0	0.3	0.3	0.3	0.1
Gross fixed capital formation P.51g	-	-	-	-	-	-	-
Capital transfers D.9	-	-	-	-	-	-	-
TOTAL CAPITAL EXPENDITURE	-	-	-	0.4	0.5	0.6	0.2
Other costs financed by RRF grants (% of GDP)							
	2020	2021	2022	2023	2024	2025	2026
Reduction in tax revenue	-	-	-	-	-	-	-
Other costs with impact on revenue	-	-	-	-	-	-	-
Financial transactions	-	-	-	-	-	-	-

Source: Ministry of Development Funds and Regional Policy.