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2021 UPDATE

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Foreword

The European Union (hereinafter referred to as the EU) Member States submit annually the updates of stability or convergence programmes to the European Commission and the Ecofin Council. Based on the analysis of these documents, the Ecofin Council subsequently issues recommendations for the economic policies of the Member States, which shall be taken into account when designing budgets for the next year.

The last year's Convergence Programme (hereinafter referred to as the Programme) was prepared at a time of exceptional uncertainty regarding the impact of the COVID-19 pandemic on the economy and public finance. In accordance with the guidelines of the European Commission, its format was streamlined and the 2020 Programme focused on measures taken in response to the pandemic.

This year, the Programme returns to its standard time horizon and presents the medium-term forecast of Poland's economic situation and its public finances up to 2024. At the same time, it is a part of the Multiannual Financial Plan of the State (MFPS) developed on the basis of the Public Finance Act of 27 August 2009 (hereinafter referred to as the Public Finance Act). The MFPS was adopted by the Council of Ministers on 30 April this year and shall provide the basis for the preparation of the draft Budget Act for 2022.

The document was prepared in compliance with Council Regulation 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 format and content of Stability and Convergence Programmes adopted by the Ecofin Council in June 2017.

Information presented in the Programme is valid as of 22 April 2021, unless otherwise stated.

The Programme was created simultaneously with the national Recovery and Resilience Plan (hereinafter referred to as the RRP), which shall be submitted to the EU institutions by the end of April. The RRP shall present the plan of reforms and investments in 2021-26, financed by grants and loans from the Recovery and Resilience Facility. Timely implementation of the RRP is a positive risk for the economic growth forecast presented in the Programme.

The Programme suggests taking the impact of military expenditure on the general government balance and debt into account in the upcoming discussion on budgetary frameworks in the EU.

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Summary

The outbreak of the COVID-19 pandemic and efforts taken by the government to prevent a rapid increase of infections led to a sharp slowdown in the economic activity in mid-March last year. In 2020, the GDP decreased by 2.7% in real terms. The recession was observed for the first time since the early 1990s. It was milder than expected and noticeably shallower in comparison to the majority of EU countries. It is forecast that in 2021 the real GDP will grow by 3.8%. At the end of the horizon forecast the real GDP will grow by 3.5%.

Implementation of funds from the EU's Recovery and Resilience Facility would translate into an additional increase in the real GDP: by 1.2% in 2022, and 1.3% in the year following the Programme horizon.

In 2020, the recession caused by the economy freeze and anti-crisis measures led to an unavoidable and significant increase in general government deficit up to 7% of GDP and in the general government debt up to 57.5% of GDP. A general escape clause improved the Member States' capacity to take the appropriate measures. Following the same approach, Poland temporarily suspended its stabilising expenditure rule in 2020.

According to the European Commission, anti-crisis measures should be continued, and all Member States should implement their fiscal policies without any restrictions to the expenditure growth rate imposed by EU. When analysing the budgetary position in the Member States, the European Commission shall allow for the persisting high uncertainty as to the economic outlook, the impact of anti-crisis measures on public finance and recommendations of the EU Council of 20 July 2020. [1]

Considering the EU context for conducting the fiscal policy, this year's Programme has been based on the assumption of reducing the general government deficit from 2023 onwards. At the same time, relevant adjustments related to the stabilising expenditure rule have been proposed. The reduction of the general government deficit to 2.5% of GDP in 2024 shall be accompanied by a gradual improvement of the structural balance. The general government debt will be gradually reduced to 57.7% of GDP by the end of 2024.

The COVID-19 situation may affect the processes of convergence of the economies of Poland and the euro-area countries. Poland will continue its participation in strengthening the Economic and Monetary Union, in particular in the measures aiming to ensure stability in the euro area. Due to the scale and strength of political and economic links between Poland and the euro area countries, the condition of the euro area significantly affects the processes taking place in Poland. Taking into account the similarity of Poland and euro area economies – including in particular the level of development measured e.g. by GDP per capita – Poland's accession to the euro area could disturb the domestic economy. Since the COVID-related crisis poses an additional risk to the economy, tackling the pandemic effects and improving capacity and competitiveness of the economy are the priorities of the Polish economic policy.

It would be desirable to discuss the fiscal framework in the EU level as soon as possible. The Programme proposes to include the impact of military expenditure on the general government balance and debt in this discussion.

[1] Communication from the European Commission - One year since the outbreak of COVID-19: fiscal policy response, 3 March 2021, COM(2021)105

I. Economic outlook

I.1. Current prospects

The outbreak of the COVID-19 pandemic in China and its further rapid spread throughout the world in 2020, as well as the necessary measures taken by the authorities to prevent a sharp development of the outbreak constituted a negative supply-demand shock of unprecedented magnitude. Starting from mid-March last year, it resulted in a rapid slowdown of economic activity and a collapse of trends in vast majority of macroeconomic categories. It was primarily linked to implementation of restrictions concerning the activity of enterprises and mobility of persons, followed by changes in household and enterprise behaviours. As a result, dynamics of economic activity in Poland and in the remaining EU Member States i.e. on our key export markets recorded a sharp decline.

Situation in the Polish economic environment deteriorated significantly in early spring 2020. In the second quarter, the European economy contracted by as much as 11.2%. As a result, the EU's GDP in the second quarter of 2020 was by 14.1% lower in comparison to the end of 2019. After a powerful economic recovery in the third quarter (q/q, sa), the end of 2020 brought a renewed deterioration in the economic activity, although at a more moderate scale in comparison to the first stage of the pandemic. For the year 2020 as a whole, the GDP in the EU dropped by 6.1%. The strongest decrease in the activity was recorded in the service sector, in particular in the industries that suffered the most due to the need to maintain social distancing. Value added in the industry decreased to a lesser extent. At the same time, the situation in this sector was relatively favourable at the end of year, due to increased foreign demand and progressing adjustment of enterprises to operation in the pandemic restrictions conditions.

The first cases of COVID-19 in Poland were reported in March 2020. At that time, the first economic lockdown was implemented. Changes to morbidity affecting the consumer and enterprise behaviours, as well as the response of the authorities in the form of introduced restrictions were the main factors determining the GDP dynamics in each quarter of 2020. The profile of quarterly changes in GDP was similar to the one in the EU, however the amplitude of fluctuations was milder. A good beginning of the year resulted in only a minor decrease of GDP in the first quarter (qoq, sa). It was followed by a rapid drop in the second quarter (qoq, sa), which was the deepest in the available history of this series. As expected, a relatively strong economic activity rebound was recorded in the third quarter (qoq, sa), although the GDP level remained lower than a year earlier. In the fourth quarter, the scale of GDP decrease was – despite the second wave of COVID-19 and return to wide-scale restrictions – noticeably more moderate than in the spring, mainly due to good condition of industry and export. Good results achieved by these categories comparing to the other economic sectors resulted primarily from intensive activity in the international production chains involving the Polish companies and were also affected by better adaptation of business entities in the country and in our main trading partners to operating in pandemic conditions.

In 2020, the Polish economy has recorded a recession for the first time since the early 1990s, however, the recession was milder than expected and noticeably shallower comparing to the majority of EU countries. Polish GDP decreased by 2.7%. Consumption in household sector and investments slowed down significantly. Decrease in private consumption resulted primarily from the restrictions in operation of the companies and mobility of persons, followed by uncertainty about future situation on the labour market. Given the growth of real disposable income of households, this contributed to strong increase in the savings rate in this sector. Decrease in investments was recorded outside the general government sector, mainly due to high uncertainty as to future demand. Only net exports and public consumption provided strong support to GDP. The implemented restrictions covered the vast majority of the economic sectors. Gross value added decreased in the industry, construction and most market services. The need to maintain social distancing and restricted mobility were a serious blow to the hospitality, food services and recreation sectors.

The government and the central bank have jointly taken a number of measures to prevent the disruption of supply chains, mass bankruptcies and loss of liquidity among enterprises, and thus a strong increase in unemployment. The range and depth of state intervention have been subject to major changes along with inflow of data and forecasts on the course of pandemic.

The estimates of the potential growth rate of the Polish economy, prepared in accordance with the methodology of the European Commission, indicated that in 2020 the Polish economy recorded a significantly negative output gap. One of the factors supporting the potential GDP is the non-accelerating wage rate of unemployment (NAWRU) that decreases continuously since 2002. Thanks to so-called labour hoarding, largely co-financed by public funds, the situation on the labour market in 2020 did not affect negatively the economic potential of the country. Negative demographic trends, significantly decreased capital accumulation and slowed-down absorption of new technologies contributed, however, to decreased growth rate of the potential of Polish economy from 3.2% in 2019 to 2.6% in 2020. Fall of real GDP in 2020 brought as a result of the negative output gap of 1.4% of the potential GDP.

The outbreak of the COVID-19 pandemic contributed to the deterioration of the situation on the labour market in Poland in 2020, although the scale of this deterioration was much milder than projected at the onset of pandemic. This was the outcome of among others the support programmes for the enterprises introduced under the Anti-Crisis Shields and milder scale of decrease in economic activity in comparison to the other EU Member States. The number of employed decreased by 0.1%, the same as a year earlier. This resulted from noticeable reduction in the number of temporary workers, followed by a marked increase in the number of permanent employees and of self-employed. In terms of sectors, decrease in the number of employed primarily concerned the industrial sector (covering industry and construction), followed by – to the lesser extent – service sector, while the agricultural sector recorded the first increase from five years. Decreased labour demand did not affected the increase in unemployment due to decrease of economic activity of the population. The unemployment rate declined slightly to 3.2% from 3.3% a year earlier and remained lower in comparison to the EU average (by about 4 percentage points) for a consecutive year in a row. Poland is a country of one of the lowest unemployment rate among the EU Member States. The participation rate – for a third year in a row – slightly decreased by 0.1 percentage points to 56.1%.

After three years of low inflation, in 2020 the consumer price index reached the value of 3.4% (according to HICP: 3.7%). This was caused by the increased growth of prices at the end of 2019 and in the first months of 2020 and was linked, on one hand, to the delayed effects of high dynamics of economic activity and favourable situation on the labour market and, on the other hand, with supply limitations on the food market. In the first quarter of 2020, the average inflation rate amounted to 4.5%. In the subsequent quarters (in particular in the second quarter, after a rapid drop of oil prices on the global market as a result of pandemic), inflation in Poland decreased significantly. At the end of the year, it reached 2.4% i.e. slightly below the inflation target of the National Bank of Poland (NBP). The core inflation (i.e. the change in prices of consumer goods and services excluding food and energy prices) remained at a relatively high level throughout the whole year. Its annual average amounted to 3.9% and remained affected by high service prices. The producer price index (PPI) in 2020 was lower by 0.6% on average than a year earlier. After a minor increase in the first quarter, the subsequent quarters brought deflation, which however demonstrated a downward trend.

In response to the outbreak of the COVID-19 pandemic, the Polish monetary authorities have taken swift and decisive actions to ease the monetary policy. Between March and May 2020, the key interest rates were lowered three times – the reference rate by 1.4 percentage point in total, down to 0.1%. The lombard rate was reduced to 0.5%, while the deposit rate was set at the level of 0.0%. The required reserve ratio was decreased from 3.5% to 0.5% to support liquidity of the banking sector. NBP introduced also the additional instruments covering repo operations, bill discount credit and an asset purchase programme. This programme has been implemented by purchasing of government securities and government-guaranteed debt securities on the secondary market. These operations aim at changing the long-term liquidity structure in the banking sector, ensuring liquidity of the secondary market of purchased securities and strengthening the monetary transmission mechanism. Between March 2020 and the end of March 2021, the central bank purchased the debt securities of a nominal value of PLN 113.4 billion in 19 operations, which accounts for approx. 4.9% of GDP.

In 2020, the current account surplus increased to 3.5% of GDP in comparison to 0.5% of GDP a year earlier. Deep recession on the main Polish export markets translated into a significant drop of export at the turn of the first and second quarter of 2020. Following the gradual lifting of restrictions and activity

rebound in the international production chains, the foreign sales entered into a noticeable upward trend. They proved also to be relatively resilient to the second wave of infections. Balance on goods improved following weaker results of import limited in nominal terms by lower prices of imported energy raw materials. Despite a diminishing turnover, in particular with reference to travelling abroad, the balance on services maintained a high surplus. In addition, the primary income deficit narrowed, primarily as a consequence of lower income of foreign investors from their capital involvement in the Polish entities.

The pandemic and related capital flows on the global financial market had a major impact on the zloty exchange rate in 2020. A rapid growth in global risk aversion, resulting from concerns about the impact of the pandemic and related restrictions on the global economy growth outlook, in the second half of March led to a mass outflow of capital to the assets which are traditionally considered by the investors to be safe havens. This has weakened the emerging market currencies, including the zloty. The scale of depreciation of the Polish currency was however moderate and as soon as in the second half of May, the zloty has notably strengthened. Deterioration of pandemic situation contributed to repeated weakening of the zloty in September – October 2020 and increasing of the EUR/PLN exchange rate above the spring's levels. Noticing the appreciation pressure on the zloty growing since the end of October, the NBP performed a series of interventions on the currency market in the second half of December, which were focused on weakening of the Polish currency. These operations aimed at strengthening the impact of monetary policy easing on the economy. As a result, at the end of the year, the EUR/PLN exchange rate bounced back above 4.60. The average EUR/PLN exchange rate in 2020 amounted to 4.44, while the USD/PLN exchange rate was 3.90.

I.2. Medium-term scenario

The GDP decline in 2020, unprecedented in the history of Poland after 1989, proved to be shallower than forecasted in the previous Programme, also due to protective measures. The prolonged pandemic and resulting restrictions in business activity will, however, have long-term effect on the economy, in particular on the labour market. Forecasting of pandemic end still involves high risk of error. The macroeconomic scenario presented below adopted assumption that the lifting of the restrictions on business activity will begin in May this year and they will not be re-implemented in the autumn, due to, among others, the National Vaccination Programme.

Winter forecasts of the European Commission concerning the growth of aggregate economic activity of Poland's main trade partner, i.e. the European Union, indicate that this region shall recover from pandemic crisis at a similar pace as Poland. According to the estimations of the European Commission, GDP of the euro area will grow in 2021- 22 by 3.8%, while EU's GDP by 3.7% and 3.9%, respectively. In February this year, the European Commission reduced the forecasted economic growth for 2021 by 0.4 percentage points in comparison to the forecasts prepared in last year's autumn due to persisting high number of infections, which require continued restrictions in business activity.

The pandemic deteriorated the demographic indicators of Poland in 2020 and shall certainly affect them this year. The forecasts for the upcoming years assume that population aged 15-72 shall decrease by 0.2% per annum and by 0.4% in 2024.

The impact of factors delaying exit from the labour market and neutralising a decline in the working age population number, such as low replacement rate, growing share of services in the economy or growing share of workforce of people with higher education was reduced by the negative impact of COVID pandemics on health, including in particular among the elderly. In consequence, at the end of forecast horizon, the participation rate (LFS, 15 years and above) shall decrease below the currently observed level.

It is expected that in 2021 the number of people working in the Polish economy will slightly increase, while in the following years the growth rate of employment will approach zero. The changes in the total number of employed take into account the assumption of stabilisation in the number of employed in the general government sector until 2024 as adopted in the Programme. Despite the pandemic, numerous protective programmes managed to mitigate the unemployment growth. It is estimated that in 2021, the unemployment rate according to LFS will increase only by 0.2 percentage points: from 3.2% to 3.4%,

remaining one of the lowest unemployment rates in the European Union. In the subsequent years, the unemployment rate shall noticeably decline – in 2022 to 3%, while in 3023 to 2.5%, mainly due to the above-mentioned negative demographic trends.

Despite continuously favourable situation on the labour market, it is expected that the average wage growth observed before the pandemics shall reverse in the next 2 years. In 2021, an increase of the average wage in the national economy by 6.2%, while in 2022 by 6.4%, is still expected. In the next 2 years, the growth rate will decline – in 2023 the wages are supposed to grow by 5.8%, while in 2014 – by 5.3%. The real wage growth will reach its peak in 2022 at the level of 3.5%, only to gradually decrease by 2.8% in the forecast horizon. It is projected that along with lifting the restrictions and progresses of the National Vaccination Programme, the consumers will pursue the demand accumulated in the period of uncertainty. In consequence, the private consumption will remain the main driver of economic growth and increase by 4.3% in 2021 and by 4.4% in 2022 in real terms. In the following years of the forecast horizon, the real growth rate of consumption will amount to 3.7% on average.

The real growth in public consumption shall be determined by the actions of the government focusing on the fastest possible economic recovery after the pandemic and supporting the private sector. It is estimated that the real growth rate in this economic category shall amount to 3.4% in 2021, to stabilise at the level of 4% on average in 2022-24.

The factors supporting the growth in the investment demand of the private sector in the forecast horizon will include: the cost of capital remaining on a relatively low level in connection with low interest rates and the effective implementation of the government's measures aimed at increasing the investment rate, growth in innovation and productivity of the economy. In accordance with the foregoing, it is expected that the share of investment in GDP will grow. It is foreseen that in 2021 the share of gross expenditures on fixed assets of the private sector in GDP will amount to 13.9%, to increase by nearly 1.2 percentage points within the horizon of the Programme. The total gross fixed capital expenditure in the whole economy will increase from 16.4% of GDP in 2021 to 17.1% of GDP in the last year of the forecast, among others due to use of funds from the EU's new financial perspective for 2021-27. The balance of working capital is linked to the level of demand on the domestic market and foreign markets. It is estimated that after an economically unstable 2020, the contribution of stock changes to the GDP growth over the Programme period will be neutral.

Since Poland's accession to the EU, the Polish economy has been systematically opening up to foreign markets, which was not impeded even by the pandemic. As a result, the share of exports in GDP is growing rapidly and in 2020 it reached a record level of 55.8%. One of the factors explaining such a dynamic change in the structure of the Polish GDP is the persistently high competitiveness of Polish enterprises. Moreover, periods of relatively weak domestic demand, especially in 2012-13, forced domestic entrepreneurs to look for new markets. Along with the forecasted economic recovery of all main trade partners of Poland, it is expected that the export will grow by 9.8% in 2021 and by 5.3% on average within the forecast horizon.

The growth rate of imports will be a consequence of final demand development. The estimated real growth in import in the horizon of the Programme in the years 2021-24 will be 9.4%, 7.8%, 5.2% and 4.6%, respectively. Consequently, the trade balance will remain positive in the whole forecast horizon, although it will gradually approximate the neutral level.

The overall conclusion is that real GDP growth is expected to reach 3.8% in 2021 and 4.3% in 2022. Despite the expected increase in the share of investments in GDP, it is the private consumption, supported by recovered consumer optimism and the lowest unemployment rate in the EU, that shall remain the core element of economic growth. In 2023-24, the real GDP growth rate will reach 3.7% and 3.5%, respectively. The macroeconomic scenario does not consider any positive impact that funds from the EU's Recovery and Resilience Facility allocated to Poland would have on the dynamics of economic activity (cf. Chapter I.3).

The growth rate of potential output within the forecast horizon will be maintained at the level of approx. 3%. The main factors influencing the dynamics of the economy potential will include the accumulation of production capital and the increase in the efficiency of production factors. A significant increase in public investment supported by EU funds and private investment supported by programmes aimed at

innovation growth translates into a faster accumulation of capital in the economy. The output gap, after markedly negative records in 2020-21 (-1.4% and -0.6%, respectively) shall successively grow, to reach 1.9% within the forecast horizon. In the following years, negative trends in the size of the working-age population will result in a lower dynamics of potential GDP.

Due to the sustainable balance of risk factors in the external environment of the Polish economy, for the needs of the macroeconomic scenario it was assumed that throughout the entire forecast period, the exchange rate of the zloty will remain at a level of 10 business days until 5 March 2021, inclusive (i.e. 4.5285 EUR/PLN and 3.7468 USD/PLN). This is a technical assumption, and the date is related to the beginning of the forecasting work on the Programme. In view of the costs of servicing foreign debt and its level as a share of GDP in the medium term, the assumption of exchange rate stability seems relatively conservative. In the case of lack of external shocks, strengthening of the Polish currency in the coming years should be fostered by the fundamentals of the Polish economy.

The beginning of 2021 brought an increase in the annual growth rate of consumer prices to 2.6% in January, decline to 2.4% in February and growth to 3.2% in March. Inflation is expected to reach the average level of 3.1% throughout 2021, while in the following years of the forecast it will approximate the inflation target of 2.5%.

I.3. Impact of Recovery and Resilience Plan (RRF) on the economy

The impact assessment of reforms and investments provided for in the national Recovery and Resilience Plan (RRP) was performed with the structural econometric model of the Ministry of Finance (eMPF) used also for forecasting the macroeconomic scenario for the purposes of the Programme and budgetary act.

The eMPF model is an annual macroeconomic model of the Polish economy. It was estimated on the basis of data from the 1995-2019 sample. The model structure is based on the stochastic ECM type equations. The long-term model is theory-based and derives from optimization conditions of the market participants. Microeconomic foundations of the long-run equilibrium impose constraints for dynamics of the model to force it to converge to the steady state. In the short run the model is demand driven with elasticities estimated to reflect a historical path of the variables and rigidities in the economy. There are two sectors identified in the model: the market sector and the general government, both summing up to the total economy according to the ESA2010 methodology. Within the market sector two additional sub-sectors are recognised: households and companies, however only a part of the institutional accounts is incorporated for these two sub-sectors. To address the needs of the Ministry of Finance for the fiscal policy analyses, the model has quite detailed public finance block.

Long-term effects are measured on the basis of the potential GDP estimates performed on the model developed within the Output Gap Working Group (OGWG) at the Economic Policy Committee. Population changes are projected on the cohort model of the Polish population developed in the Ministry of Finance and fed with Statistics Poland and Eurostat data as well as assumptions from the Ageing Working Group (AWG) at the Economic Policy Committee.

Assumptions

The baseline scenario to simulate the impact of the RRP implementation, assuming the use of funds from the EU's Recovery and Resilience Facility amounting to EUR 34.6 billion (EUR 23.9 billion from grants and EUR 10.8 billion from loans), is the macroeconomic scenario presented in the Programme. The starting point of the simulation is 2020. The funds were disaggregated by allocation (use) i.e. to public and private investments and by years according to their use plan. Detailed breakdown by years is presented in Table 1.

Table 1. Distribution of funds from RRF in years 2020-2026 by destination

PLN million	2020	2021	2022	2023	2024	2025	2026
Public investment	0.2	1 916.1	12 915.6	20 561.2	19 314.1	20 888.7	11 352.6
Private investment	702.3	2 252.5	9 822.0	14 633.9	14 672.1	13 350.0	13 416.6

Source: Ministry of Development Funds and Regional Policy

In addition, the simulation assumes, that the use of available allocation from the Recovery and Resilience Facility by all Member States shall foster economic growth in the EU27 in accordance with the projections of the European Commission published in the autumn forecast in 2020 (European Economic Forecast – Autumn 2020, p. 66) in the "low additivity" scenario. The European Commission reports positive impact of the RRP on the EU's GDP growth differentiated in time horizon of 10 years, which shall directly translate into increased external demand on domestic products. The simulation assumes the EU27's GDP growth higher by 0.9 percentage points on average in comparison to the baseline scenario, provided that the highest impact on the EU27's GDP is forecasted for 2024.

From the perspective of the long-term impact of RRP on the potential of the Polish economy, the changes in population and labour force important. The simulation of macroeconomic effects assumes, in accordance with the estimates of the Ministry of Health, gradual decrease of mortality rate, that in 2040 will be lower by 0.12% on average for the population in comparison to the baseline scenario. Simultaneously, the analogical decline of exit rate from the labour market was assumed. Using the cohort model for the population of Poland, which takes the population assumptions of the Aging Working Group into account, the above-mentioned assumptions laid the foundations for the preparation of the forecast of the population number in Poland, working age population number, participation rate and labour supply.

Results

In the short-time simulation horizon, the RRP implementation will lead to real GDP growth by 1.2% in 2022 (year t+2 of simulation) in comparison to the baseline scenario. In the first three years of the use of funds, the pace of real economic growth will increase by 0.56 percentage points on average in comparison to the baseline scenario. In 2025 (t+5), GDP rate will be higher in comparison to the baselines scenario presented in the Programme by 1.3%. Implementation of RRP will also positively affect the labour market. It is estimated that after two years, in comparison to the baseline scenario, 0.3% more new jobs will be created. After five years of the use of funds as stipulated in the draft RRP, the number of created jobs will increase by 0.4% in comparison to the baseline scenario.

Table 2. RRF comparison with the baseline scenario in the short- and the medium-term

Difference vis-à-vis the baseline scenario	t+2	t+5
GDP (%)	1.2	1.3
Employment (%)	0.3	0.4
General government balance (in pps.)	0.3	0.3

Source: Estimates of the Ministry of Finance.

Long-term effects of the use of funds from the Recovery and Resilience Facility linked primarily to the reforms and investments in the area of green transformation, digital transformation and health protection system were estimated on the basis of the potential output of Poland. The estimates were performed on the basis of econometric model scenario using the model of the European Commission improved by the Output Gap Working Group (OGWG). In 2040, i.e. after 20 years from the commencement of the RRP implementation, the real GDP rate of Poland will be higher by 1.9% in comparison to the baseline

scenario, of which 1.3% will be attributed to labour and competence resources, while the remaining 0.6% will result from accumulation of productive capital.

In the long-term perspective, the main factors supporting the economic growth of Poland under the RRP, shall include, apart from productivity growth, favourable population changes resulting from improved effectiveness, accessibility and quality of the healthcare system and increased activity on the labour market. According to the forecast performed with the use of cohort model of the population of Poland, population number in 2040 will increase by 303 thousands, while the participation rate will increase by 0.9 percentage points in comparison to the baseline scenario. As a result, better competences of employees and labour demand will be followed by the expected employment rate growth by 1.4% in comparison to the baseline scenario in 20-year time perspective.

Table 3. RRF comparison with the baseline scenario in the long-term

Difference vis-à-vis the baseline scenario	t+20
GDP (%)	1.9
Employment (%)	1.3
Labour force participation (in pps.)	0.9
Working-age population (aged 15-74, in '000 people)	88
Population (in '000 people)	303
General government balance (in pps.)	0.9

Source: Estimates of the Ministry of Finance.

The general government balance and debt forecast as presented in the Programme does not take into account the impact of measures provided for in the RRP, which would be financed by the Recovery and Resilience Facility. According to Eurostat, the Facility grants will have a neutral impact on deficit path, similarly as the other EU measures that are recorded as income and expenditure at this time. In the case of debt, grant flows may have a transitional impact related to non-alignment of cash inflows and expenses in time. For the purposes of the simulation it was assumed that loans under the Recovery and Resilience Facility will finance additional expenditure of the general government, in consequence of which they shall have a direct, negative impact on its balance and debt. According to the intentions of the government, loans will be paid by the final beneficiaries, which may have a positive impact on the above-mentioned effect for the general government balance, provided that the beneficiaries will be entities from outside the sector. The effects related to higher economic growth described above will have an impact on reducing the deficit and debt.

II. General government balance and debt

II.1. Policy strategy and medium-term objectives

Due to a severe economic downturn caused by the pandemic a so called general escape clause was activated in the European Union. The clause enabled the Member States to depart from recommendations of the EU Council establishing a maximum allowable growth rate of expenditure and therefore it streamlined implementation of anti-crisis measures. The European Commission underlined that the expenditure growth cannot put at risk the sustainability of public finance of the Member States in the medium term.

The 2020 recession caused by the economic freeze and anti-crisis measures led to a significant deterioration of the general government balance and to an increased general government debt. Therefore, the European Commission intends to open the excessive deficit procedure for the Member States. At the same time, despite mass vaccinations and anti-crisis measures, the outlook for the EU economy remains uncertain. When analysing the budgetary situation in the Member States, the European Commission will therefore take this high uncertainty, impact of anti-crisis measures on public finance and recommendations of the EU Council of 20 July of the previous year (cf. Chapter II.4) into account.

The European Commission encourages the Member States to continue emergency measures in 2021. As tackling the pandemic progresses, supporting the economic recovery will become more necessary. For this reason, according to the guidelines of the European Commission, the forecasts to the stability or convergence programmes should assume that the 2022 budgetary policies will be carried out without any EU's restrictions on the expenditure growth rate.

Considering the EU context for conducting the budgetary policy, this Programme has been based on the assumption of reducing the general government deficit from 2023 onwards. At the same time, relevant adjustments have been proposed to the domestic budgetary framework, in particular with regard to the stabilising expenditure rule (cf. Chapter V).

II.2. Actual balances

The situation of the general government in 2020 depended largely on the macroeconomic situation of the country and the measures taken to tackle the COVID-19 pandemic. According to the preliminary estimates, the general government deficit (according to the ESA2010 methodology) in 2020 amounted to 7.0% GDP. This translates into deterioration by approx. 6.3 percentage points in comparison to 2019. The higher general government deficit resulted from increased expenditure in general government as a ratio to GDP by 6.9% percentage points (including subsidies on production by 3.3 percentage points) accompanied by increase of revenue by 0.6 percentage points. The general government revenue and expenditure in 2020 and their detailed structure relative to GDP are presented in Table 16.

The pandemic-related measures required deviating from fiscal rules both in the EU and in Poland. This allowed for increasing the general government expenditure on an unprecedented scale, which was in line with the recommendations of the EU Council. Support of the labour market, business activity of companies , households, healthcare and public investments was financed primarily by the COVID-19 Counteracting Fund established in April 2020 in the Bank Gospodarstwa Krajowego (BGK) and by the Polish Development Fund (PFR) under the Government Programme Financial Shield for Micro, Small and Medium Enterprises and the Government Programme Financial Shield for Large Enterprises (Financial Shield 1.0 and 2.0).

The measures focused on containing and counteracting the effects of the COVID-19 pandemic and on supporting the affected entities were appropriately registered in the statistical data of general government. Their scale is presented in Table 4.

General government expenditure

The ratio of general government expenditure to GDP in 2020 amounted to 48.7% of GDP, which translates into a sharp increase by 6.9 percentage points. The main factor determining the expenditure growth in 2020 was the costs of the COVID-19 pandemic counteracting measures. These were reflected

primarily in the "subsidies for entrepreneurs" category, which increased by 3.3 percentage points up to 3.8% relative to GDP, reaching the nominal dynamics of 744.1% y/y.

Assessment of impact of certain measures related to the pandemic on the general government expenditure may be subject to adjustments in the following years due to the fact that certain instruments will be non-refundable only when the supported company fulfils in the future the conditions envisaged in the support agreement. Failure to fulfil these conditions will result in reimbursement of aid in total or in part.

The spread of the pandemic in the first half of 2020 and the economic lockdown were factors not conducive for public investments. The investments reached 4.4% of GDP i.e. only by 0.1 percentage points more than in 2019. Multi-annual government programmes in the area of roads construction and modernisation of rail infrastructure have been continued to a limited extent. Given the role of public investments in economic recovery and following the recommendations of the international institutions (European Commission, International Monetary Fund) on increasing the expenditure in this area, the measures aiming at establishing additional support mechanisms, including support of the activity of local governments in investments, have been adopted in the third quarter after lifting of the restrictions. In July 2020, by the resolution of the Council of Ministers, the Government Local Investment Funds (GLIF) programme of the value of PLN 13.25 billion and financed by the COVID-19 Counteracting Fund was established. By December 2020, the local governments obtained support of the value of nearly PLN 10 billion, which means that these transfers will contribute to investment activity in the local government sub-sector mainly in 2021.

At the same time, the social programmes implemented in the previous years were continued in 2020, including among others:

- family and care benefits and benefits from the Alimony Fund: PLN 12.0 billion (without contributions),
- Good Start programme: PLN 1.3 billion,
- benefits financed from the State Budget commissioned for payment by the Social Insurance Institution (ZUS) and the Agricultural Social Insurance Fund (KRUS) (veteran benefits, electricity allowance, coal in-kind allowances, excluding the Mama 4+ programme): PLN 3.2 billion,
- social pension, since 2020 paid by the Solidarity Fund; PLN 3.9 billion.

At the same time, the year 2020 was the first year of the full implementation of the following programmes:

- Family 500 plus programme with withdrawn since July 2019 income criterion for the first child in the family. In 2020, the expenditure for the programme amounted to PLN 40.1 billion in comparison to PLN 30.5 billion in the previous year and PLN 22.1 billion in 2018,
- Pension plus programme – annual supplementary financial benefits for pensioners, to be continued in the following years. Total cost of this benefit amounted to PLN 11.9 billion and was financed by the Solidarity Fund and State Budget,
- Supplementary benefits programme for persons unable to live independently (implemented in December 2019), performance of which in 2020 amounted to PLN 3.5 billion and was financed by the Solidarity Fund,
- Mama 4+ programme (implemented in March 2019) addressed mostly to women who gave birth and raised four or more children and receive no pension or receive a pension in the amount below the minimum pension. Total costs of the programme in 2020 amounted to PLN 0.4 billion.

Social transfers including social insurance benefits increased by 10.1% y/y in nominal terms and amounted to 18.7% of GDP.

In 2020, a growth in public consumption by 8.2% y/y in nominal terms was recorded, which means an increase by 1.2 percentage points of GDP i.e. up to 19.2% of GDP. Public consumption-to-GDP-ratio increase was mainly affected by surge in labour cost by 0.6 percentage points of GDP to 10.9% of GDP,

provided that the increase in labour cost expenditures amounted to 7.0% y/y in nominal terms (increase by 3.5% y/y in real terms).

General government revenue

In 2020, the general government revenue reached the level of 41.7% of GDP (increase by 0.6 percentage points in comparison to 2019), while its nominal dynamics declined significantly (2.9% in 2020 in comparison to 7.5% in 2019). Increase in the ratio to GDP resulted largely from lower pace of nominal growth of GDP than in the previous years.

Taxes

In 2020, tax revenue amounted to 22.0% of GDP in accordance with the ESA methodology, which is an increase by nearly 0.3 percentage points in comparison to 2019. Revenue from taxes related to production and imports grew by 0.2 percentage points, while revenue from income taxes by 0.1 percentage points. According to the EAS methodology, the "income taxes" category is much more comprehensive compared to income taxes according to national law and covers also various obligatory fees having the economic nature of tax, for example, incomes from auctioning off CO_2 allowances.

Revenue from PIT in 2020 dropped by PLN 0.9 billion i.e. by 0.8% in comparison to 2019. This was associated with the personal income tax reforms, which had favourable impact on tax payers, but decreased the general government revenue. In 2019, the relief for young people was implemented (since third quarter), lower tax rate, higher tax deductible expenses for the employees (since fourth quarter) and thermomodernization relief. Vast majority of fiscal effects of these reforms has manifested this year, while the changes implemented in the *Anti-Crisis Shield,* government wage subsidies as well as write-off of the ZUS contributions (resulting in lower deductions of contributions from revenue) had a positive impact on revenue from PIT.

Pandemic has also negatively affected the revenue from excise, in particular on motor fuels. Total revenue from excise duty, including fuel fee declined in 2020 by PLN 0.9 billion i.e. by 1.1% in comparison to 2019. Total revenue from excise on motor fuels on an accrual basis decreased in 2020 by 3.8%. Increase of excise duty rates by 10% on legal drugs: tobacco products, alcoholic beverages, beer and wine since 1 January 2020 had a positive impact on revenue from excise.

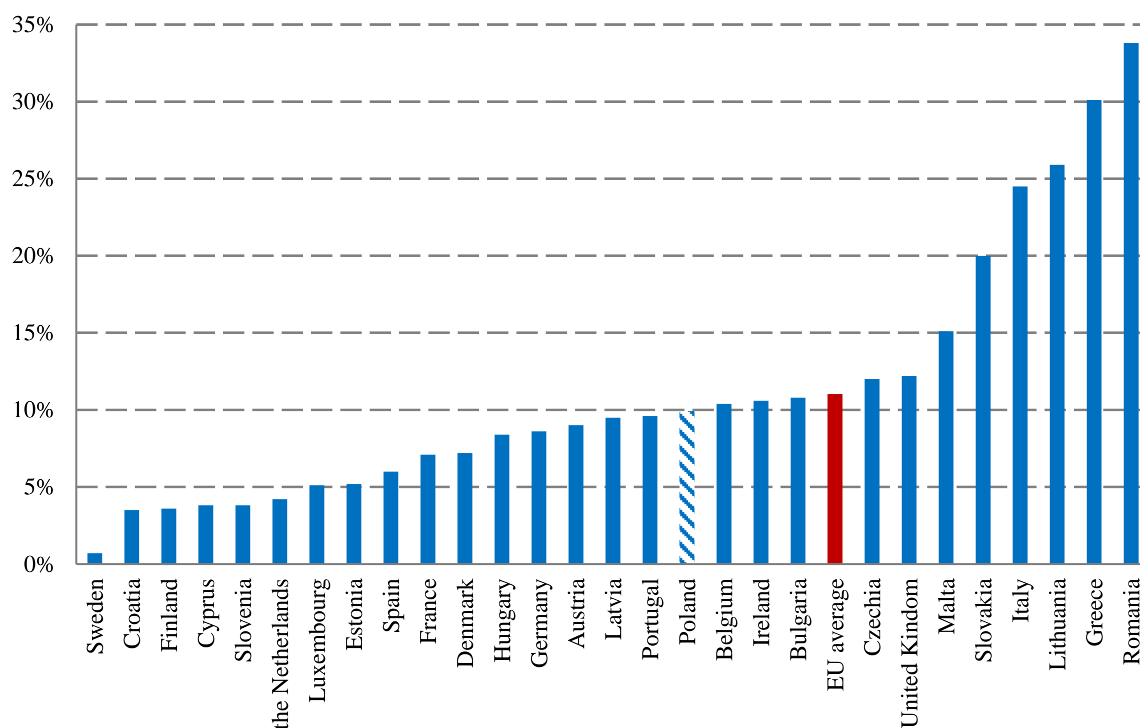
In 2020, VAT revenues increased by PLN 3.8 billion i.e. 2.1%. Growing VAT revenues have been recorded despite the negative effect of recession on the core component of VAT base – individual consumption. In 2020 individual consumption increased only by 0.1% in nominal terms.

The CIT revenues grew by PLN 2.2 billion i.e. by 4.4% in comparison to 2019. In 2020, the date of the annual settlement od CIT has been postponed to a later date. Changing the deadline aimed at improving the liquidity of enterprises at the onset of pandemic and had no impact on annual CIT revenues.

According to CASE estimates for the European Commission, in 2018[2] the VAT gap in Poland was slightly lower than the European average (cf. graph 1).

[2] The comparison was based on estimates from the CASE report for the European Commission (September 2020) concerning the VAT gap in EU countries. For comparison purposes, an indicator is used which compares actual VAT receipts with theoretical VAT Total Tax Liability (VTTL) receipts. Cf. *Study and Reports on the VAT Gap in the EU-28 Member States: 2020 Final Report*, https://op.europa.eu/en/publication-detail/-/publication/48f32ee9-f3dd-11ea-991b-01aa75ed71a1/language-en

Figure 1. VAT gap (% of theoretical revenues) in the EU member states in 2018



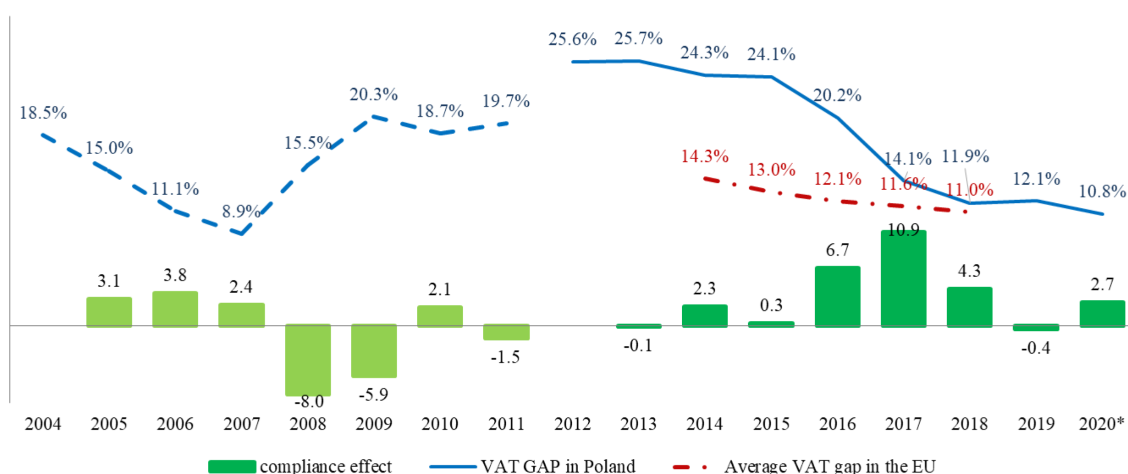
Source: CASE Report for the European Commission, Study and Reports on the VAT Gap in the EU-28 Member States: 2020 Final Report.

For the purpose of simplified estimating the VAT gap in 2020 the top down method was applied, which uses macroeconomic data on VAT base (private consumption, intermediate consumption and investments of general government). According to the initial estimates by the Ministry of Finance[3], in 2020, despite a recession, the VAT gap was further reduced (by 1.3 percentage points), although it still amounted to approx. 10.8% of potential revenues (cf. graph 2).

Based on the European Commission's approach related to analysing the so-called *compliance effect,* it can be assessed that in 2020, the improvement in VAT revenues due to better tax payers' compliance amounted to PLN 2.7 billion. This confirms that the instruments introduced to combat criminal practices in VAT and other measures aimed at tightening up the tax system have produced measurable effects also in the difficult 2020.

[3] For years 2018–20 the figures are preliminary due to the lack of sufficiently detailed statistical data .

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



Source: Estimates of the Ministry of Finance (VAT gap and compliance effect). Data on the average VAT gap in the EU - CASE Report for the European Commission, Study and Reports on the VAT Gap in the EU-28 Member States: 2020 Final Report

*Remark: VAT gap estimates starting from 2012 are based on data from the national accounts based on the ESA2010 methodology.

Social security contributions

Revenues due to social security contributions were higher by 5.1% y/y (increase of y/y ratio by 0.5 percentage points to 14.7% of GDP) i.e. above the growth rate of the wage fund in the national economy (excluding so-called small enterprises), which amounted to 3.6% y/y. The amount of contributions depended on their base, core component of which is the wage fund in the national economy, and systemic solutions, including in particular the measures under the *Anti-Crisis Shield*. Statistical increase of contributions on an accrual basis was affected by recording in the transaction of social security contributions the lost contributions due to allowed writes-off. At the same time, pursuant to the Act of 2 March 2020 on special solutions related to preventing, counteracting and combating COVID-19, other infectious diseases and the resulting crisis situations, such write-off did not jeopardise the continuity of pension, healthcare and sickness benefits rights. In 2020, the value of contributions imputed to the social insurance sub-sector amounted to nearly PLN 13.5 billion.

II.3. Medium-term budgetary outlook

It is forecast, that the general government deficit will decline from 6.9% of GDP in 2021 to 2.5% of GDP in 2024. The forecast is based on the assumption that the fiscal consolidation, at a minimum pace resulting from exclusion of so called stabilising expenditure rule escape clause (cf. Chapter V) and from the EU rules, shall start in 2023.

In consequence of the second and third wave of the pandemic, costs of the measures counteracting its effects addressed primarily to the enterprises affected by restrictions constitute a significant position in the general government expenditure in 2021. Details are presented in Table 4. It contains information on the measures, including these not related to pandemic, of substantial (at least 0.1% of GDP) impact on the general government. The scale of subsidies under the existing and new programmes will depend on the support period and number of supported industries. Progress in vaccinations and gradual lifting of restrictions should result in a sharp decrease of subsidies in 2022.

In the period between November 2020 – March 2021, the government adopted a number of additional measures aiming at protection of the economy, mitigating the effects of the COVID-19 pandemic and in particular protecting jobs. In contrast to the restrictions introduced in the spring of 2020 that applied to the economy as a whole, the restrictions imposed in November 2020 applied to the activity of the

individual sectors of economy, related primarily to services. Therefore, in the autumn of 2020 and winter of 2021, the Anti-Crisis Shield addressed mostly the businesses from the sectors most severely affected by the restrictions: cultural activity, catering services, hospitality, transport and tourism. The key document was the Act of 9 December 2020 amending the act on special solutions related to preventing, counteracting and combating COVID-19, other infectious diseases and the resulting crisis situations and of certain other acts, which reactivated measures already applied in the Anti-Crisis Shield of spring 2020. These include:

- co-financing of the employee wages by the Guaranteed Employee Benefits Fund (for 3 months),
- standstill benefits for the self-employed and persons working under civil law contracts (one-off)
- exemption from social security, health insurance, Labour Fund, Solidarity Fund, Guaranteed Employee Benefits Fund or Bridging Pensions Fund contributions (one month),
- subsidies granted by the county governors from the Labour Fund for micro- and small entrepreneurs to cover the running costs of business activity (one-off).

At the same time, the act authorised the Council of Ministers to extend the support, by issuing ordinances, for the following months or for other sectors, depending on the development of the pandemic situation and restrictions in force. The Polish Development Fund launched the Financial Shield 2.0 in the autumn of 2020. The aim of the programme is to provide financial support to the companies from 54 sectors that were forced to limit or suspend their activity due to the pandemic. The programme is financed by the PFR, primarily by issuing of the State Treasury-guaranteed bonds on the domestic or foreign market. The type and conditions of support envisaged in the Financial Shield 2.0 were divided according to the size of enterprise:

- approx. PLN 6.5 billion is to be allocated to micro enterprises (employing 1 to 9 people)
- approx. PLN 6.5 billion is to be allocated to SMEs (employing 10 to 250 people)
- up to PLN 25 billion is to be allocated to large companies (over 250 employees)

Under the Financial Shield 2.0, the subsidies allocated to micro enterprises and SMEs are subject to writes-off, provided that they continue their business activity as of 31 December 2021. Additionally, in 2021, the microenterprises need to preserve the average employment at the level recorded in 2020. At the same time, the resolution of the Council of Ministers of 5 January 2021 allowed for a complete write-off of subsidies under the Financial Shield 1.0 for the most affected sectors. For the remaining sectors, the rules of the Financial Shield 1.0 assumed writing-off 75% of subsidies allocated to micro-, small and medium enterprises subject to job retention. In the case of reducing the employment, the write-off rate would be decreased accordingly.

Writing-off the subsidy– financed by the PFR – constitutes for the tax payers a benefit i.e. an additional component of the income tax base. Therefore the planned withdrawal from collecting the tax on the value of written off of received financial subsidy generates, with regard to the existing tax rules, the negative budgetary effect in comparison to the situation, in which the write-off amount would be included into the tax base.

According to the estimates of Statistics Poland, the general government expenditure in 2020 allocated for counteracting and tackling the effects of the COVID-19 pandemic and support of affected entities amounted to PLN 103.2 billion.

Table 4. Discretionary measures

	Measure	ESA Code	Date of adoption	Budgetary impact (% of GDP - change from previous year)			
				2020	2021	2022	2023
	Temporary measure						
	expenditure:						
1.	Financial subsidies-PFR Financial Shields for micro, small and medium enterprises	D.39	2020	-1.77%	1.39%	0.39%	0.00%
2.	Wage subsidies for firms granted from the Guaranteed Employee Benefits Fund and the Labour Fund	D.39	2020	-0.66%	0.42%	0.23%	0.00%
3.	Health care and social security contribution exemptions	D.39	2020	-0.58%	0.46%	0.12%	0.00%
4.	Grants for micro- and small enterprises	D.99	2020	-0.39%	0.18%	0.21%	0.00%
5.	Standstill benefit for persons working under civil law contracts and self-employed persons	D.39	2020	-0.25%	0.19%	0.06%	0.00%
6.	Financial support for the health sector during pandemic and other health expenditures from the Counteracting Fund COVID-19	D.73, P.2	2020	-0.20%	-0.37%	0.56%	0.00%
7.	Other expenditures, i.a.: support for railway operators of passenger transport, payment from Counteracting Fund COVID-19 to the Social Insurance Fund and payment from Counteracting Fund COVID-19 to Minister of Economy (i.a. subsidies to the interest rate of bank loans granted to entrepreneurs)	D.73	2020	-0.16%	0.11%	0.05%	0.00%
8.	Additional parental allowance for school closures	D.62	2020	-0.11%	0.02%	0.09%	0.00%
9.	Additional social benefits from Social Insurance Fund and solidarity allowance from the Labour Fund	D.62	2020	-0.11%	0.04%	0.07%	0.00%

	Measure	ESA Code	Date of adoption	Budgetary impact (% of GDP - change from previous year)			
				2020	2021	2022	2023
10.	Polish Tourist Voucher	D.63	2020	-0.01%	-0.14%	0.15%	0.00%
	revenue:						
11.	Introduction of a power fee (including VAT impact)	D.2	2021		0.27%	0.00%	0.00%
12.	Introduction of the estonian tax and measures aimed at sealing CIT	D.5	2021		-0.05%	-0.10%	-0.02%
13.	Non-collection of tax (CIT, PIT) arising from the value of redeemed payments (financial subsidies) granted from PFR to entrepreneurs in 2020 under Financial Shield	D.5	2021		-0.19%	0.07%	0.05%
	Total Temporary measures			*-4.24*	*2.33*	*1.91*	*0.03*
	Other measures						
	expenditure:						
14.	Local Investment Fund	P.51	2020	-0.10%	-0.30%	0.25%	0.15%
	revenue						
15.	Sales of the unused greenhouse gas emission allowances	D.2	2020	0.25%	-0.04%	-0.01%	-0.20%
	Total Other measures			*0.15%*	*-0.34%*	*0.24%*	*-0.05%*
	Total temporary and other measures			**-4.08%**	**1.99%**	**2.15%**	**-0.02%**

Source: Expenditure measures in 2020 – Statistics Poland. Other measures – Estimates of the Ministry of Finance (cut-off date – March, 31 2021).

The table do not include financial measures as financed from funds as provided for in the RRF.

* Temporary measures = without impact on the general government balance after 2022. By contrast, the measures as adopted/ announced for 2020, 2021 as well as 2022, which, at least till 2023, would have an impact on the general government balance of at least 0.1% of GDP, according to the European Commission guidelines, were presented in the table as “other”.

Factors determining the general government expenditure

Due to the pandemic and recession resulting from it, following an increase in 2020-2021, as the situation normalises the general government expenditure-to-GDP ratio will decrease from 48.4% in 2021 to 43.5% in 2024. Thus, at the end of the forecast horizon, their level will be by approx. 1.7 percentage point higher compared to the pre-pandemic level (in 2019 the expenditure-to-GDP ratio was 41.8%).

Social transfers

It is estimated that all social programmes will be continued within the time horizon of the Programme. The level of general government expenditure will be mostly affected by:

- continued payment of child care allowance in the total amount of approx. PLN 40.7 – 41.0 billion in 2021-25 (Family 500 plus programme),
- annual payment of an additional pension benefit under the Pension + programme, for which PLN 12.5 billion from the Solidary Fund and PLN 0.5 billion from the State Budget will be allocated. In the following years, total expenditure for the 13th pension will increase from PLN 13.1 billion this year to PLN 14.1 billion in 2025 as a result of growth of average pension and the number of pensioners,
- payment of family benefits and benefits from the Alimony Fund of approx. PLN 12.0 billion per annum.

Moreover, the payment of a one-off additional annual monetary benefit for the pensioners i.e. the so called 14th pension is planned in 2021. For this purpose, the total amount of approx. PLN 10.6 billion from the Solidarity Fund and from the State Budget will be allocated.

Public investments

Public investment constitutes a key element of the strategy for counteracting the negative effects of the COVID-19 pandemic due to their impact on the economic growth. It is assumed that the general government investment in 2021 shall increase their level relative to GDP up to approx. 4.8% and will support the economy in its return towards the economic growth path.

The estimated investment spending-to-GDP ratio in 2022-24 will be maintained at the average level of 4.5%. The level of investment in the sector will be influenced by multi-annual government programmes as well as implementation of the existing financial perspective for 2014-20 and of the new perspective for the years 2021-27.

The investment tasks in the central sub-sector will be implemented, among others, under:

- National Road Construction Programme until 2030 (NRCP) being the continuation of the National Road Construction Programme for 2014-2023 (with perspective until 2025) financed mainly by the National Road Fund, EU funds and the State Budget. NRCP until 2030 covers also various road infrastructure programmes, namely:
    - Programme for the Construction of 100 Ring Roads for 2020-2030, which defines objectives and investment priorities with respect to construction of city ring roads within the national road network,
    - Safe Road Infrastructure Programme for 2021-2024,
    - National Road Maintenance Programme for 2020-2030,
    - National Road Traffic Safety Programme;
- National Railway Programme until 2023 covering investment expenditure on the construction and modernisation of railway lines carried out by the company PKP Polskie Linie Kolejowe S.A., and financed by the Railway Fund, the State Budget, EU funds and own funds of PKP PLK S.A. as well as supplementary programmes including:

- ➢ Railway Station Investment Programme for 2016-2023,
- ➢ Programme to Supplement Local and Regional Railway Infrastructure - Railway + until 2028,
- ➢ Programme for construction/modernisation of railway stops for 2020–2025;

- Solidarity Transport Hub Investment Programme. Stage I. 2020-2023. This stage shall include the preparatory works and purchase of lands intended for this investment. In the following years, the Solidarity Transport Hub and auxiliary investments: new railway network, including high speed rail, and road investments will be implemented;
- Construction of a Waterway Connecting the Vistula Lagoon with the Gulf of Gdansk Programme;
- Government Programme to Supplement Local and Regional Railway Infrastructure – Bridges for the Regions.

Local investments will be supported by the Government Local Investment Funds (GLIF) financed by the COVID-19 Counteracting Fund. Non-refundable support for the local governments investment spending will cover approx. PLN 13 billion in total, of which nearly PLN 10 billion was already allocated to the local governments' budgets in the fourth quarter of 2020. The GLIF measures are addressed to all local governments with particular focus (a separate financial envelope within the GLIF to be allocated) on the communes, in which the liquidated state agricultural enterprises have been operated, as well as the investment in the "mountainous" communes in public tourist infrastructure and municipal infrastructure related to tourist services. Supporting the local governments from the GLIF will stimulate their investment expenditure under new projects and should mitigate the risk of postponing or withdrawing from already scheduled investments due to lack of financing.

Other current expenditure

The general government expenditures within the forecast horizon will also be affected by covering all planned groups of employers with the Employee Capital Plans - PPK (cf. Chapter IV.1). The PPK-related expenditure will result from introducing the incentive mechanism in the form of a welcome bonus and a yearly bonus both paid from the Labour Fund to the PPK participants, followed by contributions paid by public institutions for their employees, after the programme is extended to include this group in early 2021. Total annual cost for the sector amounts to PLN 1.4 – 1.5 billion within the forecast horizon.

Factors determining the general government revenues

In 2021-24, the general government revenues relative to GDP will decrease from 41.5% to 41.0%.

Taxes

Tax revenues are determined by the development of their base, including primarily the nominal levels of: private consumption, public investment, revenue from work, retirement and disability pension benefits and profits of enterprises. Within the forecast horizon, tax revenues shall be affected by the implemented in the previous years and continued changes aiming at further tightening of the tax system – mainly in the CIT and VAT area. These include:

- extending the scope of application of the online cash registers and implementation of virtual cash registers,
- effects of implementation of the split payment mechanism,
- changes to the rules for collecting withholding tax – CIT,
- introduction of the provisions governing the effects on corporate tax with regard to mismatches in qualification of hybrid structures into the legal order,

— measures aiming at counteracting the aggressive tax planning in CIT.

Within the forecast horizon, the PIT revenues will also be affected by the increased revenue cap for a lump-sum as the form of taxation from EUR 250 thousand to 2 million. In addition, the PIT revenues in 2021 will depend on the solutions provided for in the *Anti-Crisis Shield,* including contributions write-off, job retention subsidies as well as the withholding of personal income tax on wages for October – December 2020. Revenues will be also determined by the writing off of the losses suffered in 2020 or covering the limited partnerships with CIT. In addition, since 2020, the PIT revenues will be affected by the limited use of abolition, housing and robotisation relief.

Tax revenues in the upcoming years will be also determined by:

— the introduction of the so called Estonian CIT model and enabling the recognition as tax deductible expenses of write-downs to a fund set aside in reserve capital for investment purposes (special investment fund),

— covering the limited partnerships with CIT,

— increasing the current revenue threshold entitling to apply 9% CIT rate from EUR 1.2 million to 2 million,

— enabling the entrepreneurs to deduct losses incurred in 2020 from 2019 earnings,,

— introducing the option of online invoicing,

— implementation of e-commerce VAT package – remote sales,

— commencing the collection of retail sales tax in 2021.

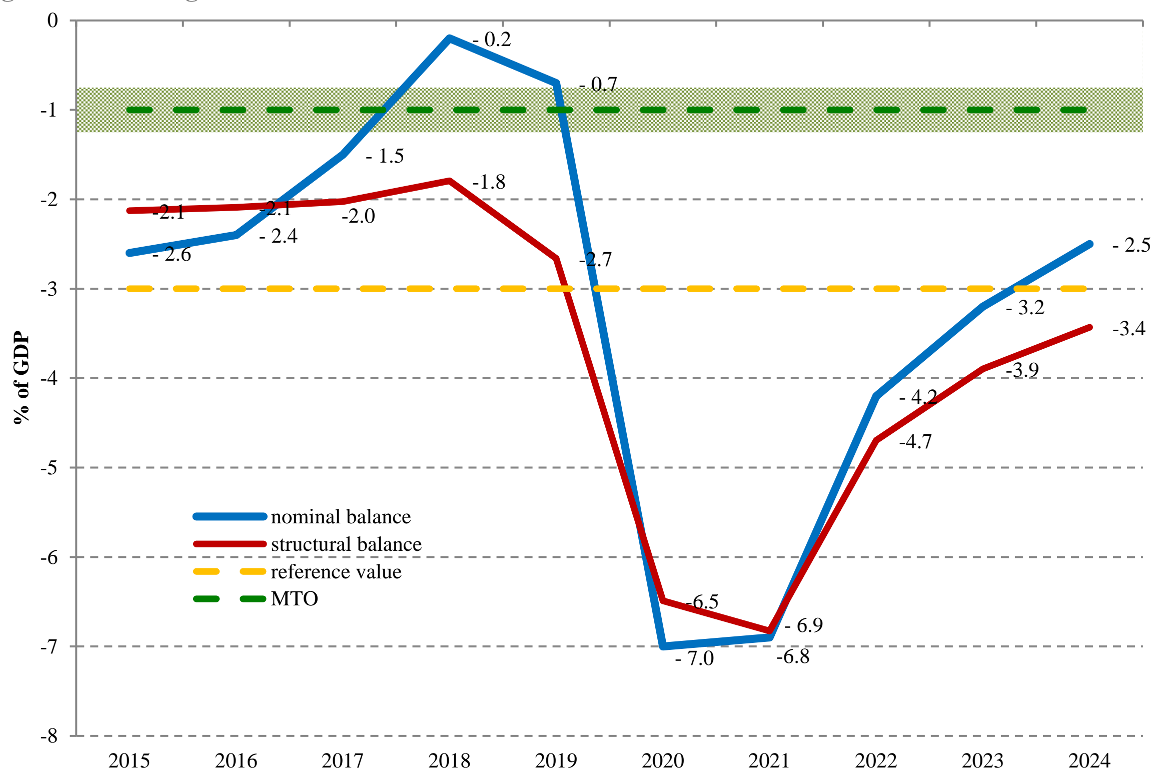
In addition, tax revenues will be affected by the planned tax exemption (PIT, CIT) of PDF subsidy write-off.

Social security contributions

In the period of forecast, the contributions will be determined by macroeconomic factors, including in particular by the situation on the labour market and measures taken by the government, mainly under the *Anti-Crisis Shield.*

In addition, the government draft act amending certain other acts in connection with the transfer of funds from open pension funds to individual pension accounts currently proceeded in the Polish Parliament (cf. more in Chapter IV.1) stipulates that the contributions which are currently being transferred to the Open Pension Funds will be redirected to the Social Insurance Fund. This will generate additional contributions of approx. PLN 1.9 billion for the social insurance sub-sector in 2021 and nearly PLN 3.4 billion, 3.8 billion and 4.9 billion in 2022-24, respectively. The revenue of the Social Insurance Fund will include also the conversion fee in the amount of 15% of net transferred assets. According to the preliminary statement of Eurostat, it will not be recorded as a one-off revenue, since it should be registered in the general government accounts as a revenue at the time of withdrawals from the Individual Pension Accounts (IKE) by the future pensioners i.e. be spread over time. Considering the above as well as given the scale of the potential revenues in terms of the EU methodology, no related revenues were estimated within the forecast horizon.

Figure 3. General government balance



Source: Ministry of Finance

II.4. Structural balance

The Stability and Growth Pact requires EU Member States to formulate and achieve the so-called medium-term budgetary objective (MTO) within a specified time frame. Poland has adopted the general government structural balance at the level of 1% of GDP as its medium-term budgetary objective.

The leading tool for assessing progress towards the MTO is the expenditure benchmark. It represents the maximum annual growth rate of the general government expenditure, compliance with which ensures achievement and maintenance of the MTO. In the spring 2020, the European Commission identified significant deviation of expenditure growth rate from the expenditure benchmark recommended for 2019.[4] However, with regard to activation of the general escape clause (cf. Chapter II.1), the Commission has not launched the significant deviation procedure.

In accordance with the EU Council Recommendation for 2020[5], the annual nominal growth rate of the general government expenditure should not exceed 4.4%. Compliance with this benchmark was supposed to lead to improved structural balance by 0.6% of GDP. The activation of the general escape clause in the EU translated into withdrawal from the requirement of compliance with the expenditure benchmark in 2020. This enabled increasing the general government expenditure to support the economy and counteract the pandemic effects. This has led to higher structural deficit. According to the estimations of the Ministry of Finance, it amounted to 6.5% of GDP. In comparison to 2019, this means a deterioration by 3.8 percentage points of GDP.

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[4] European Commission - Assessment of the 2020 Convergence Programme for Poland, 20 May 2020 .

[5] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Poland and delivering a Council opinion on the 2019 Convergence Programme of Poland.

Table 5. General government structural balance

	% of GDP					
1.	**Real GDP growth (%)**	-2.7	3.8	4.3	3.7	3.5
2.	**Net lending of general government**	-7.0	-6.9	-4.2	-3.2	-2.5
3.	**Interest expenditure**	1.3	1.2	1.1	1.0	1.0
4.	**One-offs and temporary measures**	0.3	0.2	0.2	0.0	0.0
4.1	One-offs on the revenue side: general government	0.3	0.2	0.2	0.0	0.0
4.2	One-offs on the expenditure side: general government	0.0	0.0	0.0	0.0	0.0
5.	Potential GDP growth (%)	2.6	3.0	2.9	2.9	3.0
6.	Output gap	-1.4	-0.6	0.7	1.5	1.9
7.	Cyclical budgetary component	-0.7	-0.3	0.3	0.7	1.0
8.	Cyclically-adjusted balance	-6.2	-6.6	-4.5	-3.9	-3.4
9.	Cyclically-adjusted primary balance	-5.0	-5.4	-3.4	-2.9	-2.4
10.	**Structural balance**	-6.5	-6.8	-4.7	-3.9	-3.4

Source: Ministry of Finance.

Since the general escape clause has been in force, the recommendations of the EU Council of 20 July 2020[6] contained no recommendations on the required annual growth rate of the general government expenditure for the upcoming year. With regard to budgetary policy, the EU Council recommended that Poland shall:

- take all necessary steps to effectively tackle the effects of pandemic and foster economic recovery,
- along with improvement of economic situation – take the budgetary measures towards improving the medium-term budgetary situation and ensuring debt sustainability, while enhancing investments.

As a result, in 2021-22, the EU Member States carry out their budgetary policies without any restrictions by the EU pertaining to the expenditure growth rate of the general government. No annual improvement of the general government structural balance on the path towards MTO is required. The estimated structural balance presented in the Table take these conditions into account. Given the commencement of consolidation in 2023, reducing the structural balance to 3.4% of GDP in 2024 is estimated.

The forecast takes into account the impact of sales of greenhouse gas allowances on the general government revenues (one-off measure). Its revenues from such measure in 2020-22 will amount to PLN 5.9 billion, 5.3 billion and 5.3 billion, respectively.

At the same time, with regard to activation of general escape clause in 2020, the escape clause in the stabilising expenditure rule was adjusted accordingly. As a consequence, it enables temporary suspension of SER, when the government announces the state of pandemic at the nationwide level and the economic situation deteriorates significantly. It also allows for automatic and gradual return to the amount of expenditure specified under the conventional SER formula from the budgetary year in which these criteria are no longer fulfilled (cf. Chapter V).

In the Act amending the budgetary act for 2020, with regard to fulfilment of the above-mentioned criteria in 2020, the SER has been temporarily suspended. At the same time, the existing provisions of the Act

[6] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Poland and delivering a Council opinion on the 2020 Convergence Programme of Poland.

on public finance and macroeconomic projections would entail the return to full application of the SER in the second budgetary year from its suspension i.e. in 2022, according to the following path: PLN 986 574 million, (with consideration to discretionary measures referred to below) and in 2023-24 PLN 1 018 432 million and 1 060 172 million, respectively.

Given the planned extension of the general escape clause in the EU to 2022, adequate adjustment of the national budgetary framework is assumed (cf. Chapter V). Taking the proposed amendments of the return clause and extension of the scope of SER, the initial amount of expenditure under SER in 2022 is estimated at PLN 1 084 608 million (41.3% of GDP). This amount includes the 1/3 of total financial consequences resulting from discretionary measures addressing directly the prevention and tackling the effects of pandemic and direct support of the affected entities referred to in Article 112d and the discretionary revenue measures of approx. PLN 15 billion, presented in the budgetary act. These measures include, in particular, the effects of:

- implementation of directives of so-called e-commerce VAT package,
- discontinuation of paying contributions to the Open Pension Funds,
- transformation fee (cf. Chapter II.3),
- withdrawal from collection of tax on the value of written-off PDF subsidies (cf. Chapter II.3),
- solutions aiming at elimination of so called aggressive tax optimization,
- changes to withdrawing tax collection rules.

II.5. General government debt

In the period covered by the Programme, debt management will focus on the achievement of the objective set out in the Public Finance Sector Debt Management Strategy i.e. minimizing the long-term debt servicing costs in long-time perspective, subject to the adopted risk constraints.

Debt management will take place in a context of high primary general government deficit. This results mainly from the performance of tasks related to the COVID-19 pandemic, with nominal deficit of 6.9% of GDP in 2021, decreasing to 2.5% in 2024. Continuing uncertainty on the financial markets resulting among others from the subsequent development of the pandemic, growth rate of global economy, including in Europe, as well as monetary policy of the major central banks can be expected.

The changes of the debt to GDP ratio in 2021 will result primarily from development of the borrowing needs of the State Budget and of the entities involved in actions related to counteracting the COVID-19 pandemic i.e. the COVID-19 Counteracting Fund established in the Bank Gospodarstwa Krajowego and Financial Shield 1.0 and 2.0. implemented by the Polish Development Fund. In the following years of the forecast, the changes of debt to GDP ratio will result mainly from the level of the borrowing needs of the State Budget and of the GDP growth rate.

The changes in debt of the remaining general government entities will be mainly a consequence of increasing debt of the National Road Fund associated with incurring the liabilities for implementation of road investments.

It is estimated that the general government debt-to-GDP ratio will increase in 2021 to 60.0%, and then will gradually decline, reaching 57.9% by the end of 2024.

The developments of the average general government debt interest rate will result mostly from the expectations as to the level of interest rates within the time horizon of the Programme and pace of redemption of debt issued in the past at the higher yields.

Table 6. General government debt (end of the year)

	% PKB	ESA Code	2020	2021	2022	2023	2024
1.	**Gross debt**		57.5	60.0	59.2	58.7	57.9
2.	**Change in the gross debt ratio**		11.9	2.5	-0.7	-0.5	-0.8
	Contributions to changes in gross debt						
3.	**Primary balance***		5.7	5.7	3.1	2.1	1.4
4.	**Interest expenditure**	EDP D.41	1.3	1.2	1.1	1.0	1.0
5.	**Stock-flow adjustment**		5.0	-4.4	-4.9	-3.6	-3.3
	of which: difference between cash and accruals		0.1	0.0	-0.6	-0.2	-0.1
	net accumulation of financial assets		5.0	-0.9	-0.6	-0.4	-0.3
	effect of change in GDP		-0.6	-3.3	-3.7	-3.1	-3.0
	valuation effects and others		0.5	-0.2	-0.1	0.0	0.1
	p.m. implicit interest rate on debt (%)		2.8	2.2	1.9	1.8	1.9
	Other relevant variables						
6.	Liquid financial assets		8.0	5.9	5.6	5.3	5.1
7.	Net financial debt (=1-6)		49.4	54.0	53.6	53.4	52.9
8.	Debt amortisation (existing bonds) from the end of the previous year**		4.9	4.3	5.7	3.3	5.6
9.	Percentage of debt denominated in foreign currency (%)		23.4	21.6	20.9	19.9	18.3
10.	Average maturity***		4.6	4.8-5.0	4.8-5.1	4.7-5.1	4.7-5.1

Source: Ministry of Finance.
* Impact of primary balance on debt: (-) means primary surplus.
** In the case of public finance units' debt other than the State Treasury – estimate based on available reports.
*** Interval forecast for State Treasury debt.

III. Sensitivity analysis and comparison with the previous update

III.1. Risk factors

The forecast presented in the Programme assumes that the economic growth in the EU, which is the largest trade partner of Poland, will be consistent with the scenario presented by the European Commission in the edition of forecasts published in February 2021. According to the Commission experts, increased level of uncertainty as to the economic perspective persists, however risk factors for this forecast are more balanced in comparison to the autumn 2020 scenario. These are mostly associated with the evolution of the pandemic situation and the progresses in vaccination programmes. A slower pace of gaining population immunity to the pathogen accompanied with a potential occurrence and expansion of its more infectious and lethal mutations could force a delay in lifting the pandemic restrictions. This would have a negative impact on the level of trust in the economy, which in turn would translate into maintaining higher preventive savings in the households and postponement of investment decisions by the enterprises.

Furthermore, long-term effects of the protracted crisis – visible upon the discontinuation of support measures under the economic policy – could be more negative (e.g. larger scale of bankruptcies and higher unemployment rate). On the other hand, greater progress in vaccinations could contribute to the accelerated economic recovery. Post-crisis optimism may result in greater dynamics of pent-up demand generated by historically high savings of households and an investment boom, supported in turn by low costs of financing. Rapid implementation of the Recovery plan for Europe (NextGenerationEU) would also provide a strong growth incentive.

The subsequent development of the COVID-19 pandemic is also the key risk factor for the economic activity in Poland. Similarly as in the EU, the progresses in mitigating the virus transmission, including the rapidity of vaccination programme implementation, determine the pace of return of the Polish economy towards the path of economic growth and the scale of potential decrease in the production capacity of the economy.

A risk factor related to structural changes in the labour market in Poland is the size of labour supply in the forecast horizon. On the one hand, increased demand for labour, including the less qualified and less well paid, supported by low replacement rates, may translate into postponing retirement. In addition, a greater inflow of workers from Ukraine may increase the labour supply in the country. Currently strong ‘push factors’ in the migration processes affect also the Poles working abroad, while intensification of these processes in the post-pandemic period may cause significant flows of population in working age. On the other hand, in case of shortages on the supply side, it can be expected that the space for increasing production and expansion of enterprises will be limited and competition for employees through higher wages will translate into an increase in core inflation. As a result, it is possible to slow down the GDP growth rate and increase prices faster than in the Programme scenario.

Demographic changes constitute a challenge for the long-term sustainability of public finance of the vast majority of European countries, including Poland. They are of key importance for the situation on the labour market. The population ageing observed in recent years, stemming from the increasing life expectancy, low fertility and the current age structure of population, are expected to persist. As a result, the demographic dependency ratio shall deteriorate, and the total age-related public finance expenditure shall increase. In response to the challenges posed by population ageing, the government takes the actions aimed at increasing the long-term savings and rise in assets of the future pensioners (among others by implementation of the Employee Capital Plans, cf. Chapter IV.1).

Risk factors for the fulfilment of the inflation forecast also include a possibility of other developments in prices in world markets of energy and food commodities than assumed, which will directly translate into the path of price changes in Poland. This is particularly true for oil prices, which have a significant impact on fuel prices in Poland and consequently on transport costs. Higher inflation can be indirectly caused by growing dynamics of the producer prices resulting from lack of raw materials and components for production, accompanied by growing demand on the production means once the economy recovers.

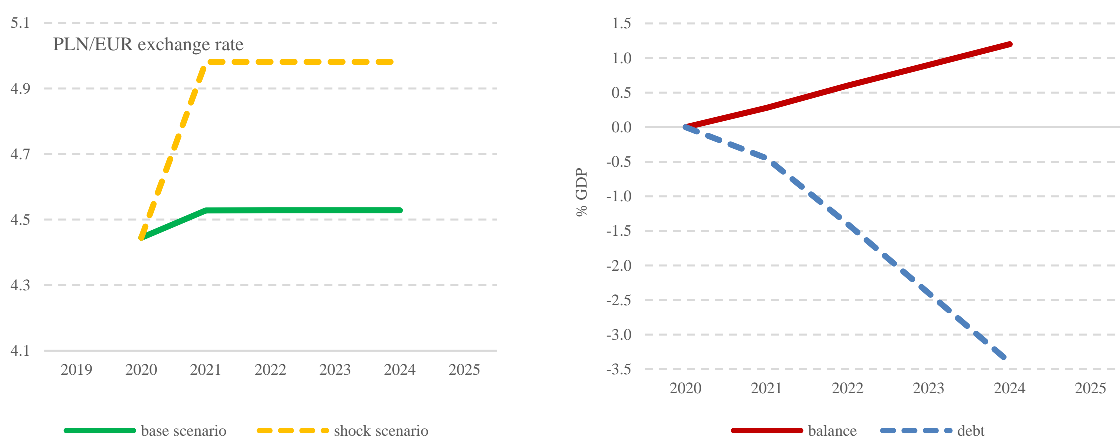
Implementation of the National Recovery Programme assuming the use of funds from the EU’s Recovery and Resilience Facility in the amount of EUR 34.6 billion (EUR 23.9 billion from grants and

EUR 10.8 billion from loans) is a positive risk factor against the baseline scenario. The results will increase the internal demand and external demand among our key trade partners which will lead to increase in the level of GDP along with long-term increase in productivity and activity on the labour market.

III.2. Sensitivity analysis

The sensitivity of the general government balance and debt in the years 2020-2024 to a depreciation of the zloty exchange rate and the increase in the domestic interest rate is presented below. The analysis was performed on the basis of the econometric Model of Public Finance (eMPF) developed by the Ministry of Finance. Simulation results are based on the historical elasticities estimated for the assumed forms of behavioural equations.

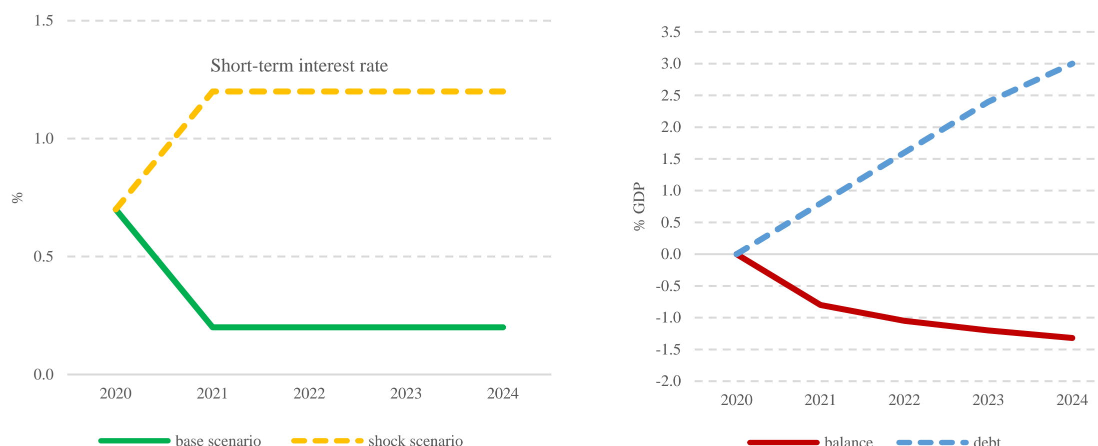
Figure 4. EUR/PLN exchange rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The exchange rate impulse (cf. graph 4) was introduced as a permanent 10% depreciation of the PLN/EUR exchange rate. The weakening of the zloty improves the competitiveness of domestic products, which directly results in an increase in the volume of exports. The increase in exports due to its high import-intensiveness is accompanied by an increase in imports. An increase in demand for Polish goods fosters the improvement of labour market conditions and an acceleration of investment activity, which supports the GDP growth in the horizon of the forecast. Higher economic growth leads to an increase in government revenue which exceeds the increase in expenditure on debt servicing denominated in foreign currency, ultimately leading to an improvement in the government balance. As a consequence, in the shock scenario, the general government debt in 2024 is lower in relation to GDP than in the baseline scenario.

Figure 5. Short-term interest rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The interest rate impulse (cf. graph 5) has been defined as an increase in the nominal short-term interest rate of 1 percentage point for the entire horizon covered by the analysis. A rise in short-term interest rates results in an increase in long-term interest rates and leads to a higher cost of capital acquisition, which causes limiting of the investment level against the baseline scenario and higher debt financing. As a result of a shift in consumption over time due to inter-temporal substitution and tightened conditions for granting loans, the level of private consumption is also decreasing. As a consequence, the impulse triggering the enhancement of monetary policy restrictiveness leads to a decrease in GDP volume in the forecast horizon. Parallel to the growing debt servicing costs and a relatively lower GDP level, the general government balance to GDP ratio deteriorates and the share of the general government debt in GDP grows against the relation in the baseline scenario.

III.3. Comparison with previous update

The European Commission decided to reduce informational requirements for the stability and convergence programmes prepared by the Member States in 2020. Because of this, no comparison with the forecasts for 2021-23 can be made.

In 2020, as a result of the outbreak of the COVID-19 pandemic, GDP growth declined by 2.7% i.e. by 0.7 percentage points less than projected in the previous update. This resulted from, among others, the protection programmes for enterprises implemented by the government in the *Anti-Crisis Shields.*

The general government deficit in 2020 amounted to 7.0% of GDP and was by 1.4% percentage points better than expected. The lower general government deficit in comparison to the forecast presented in the previous update was the result of higher than projected revenues – by 1.7 percentage points – primarily in the area of social insurance contributions and taxes and higher expenditures (by 0.3 percentage points). Higher revenues from taxes and social insurance contributions stemmed from the economic recovery in the third quarter and limited impact of the second pandemic wave in November and December 2020.

A higher general government debt to GDP ratio in 2020 against the forecast from the previous Programme resulted mainly from higher borrowing needs of the central government sub-sector as the effect of financing the measures adopted in response to pandemic, including the expenditure of the State Budget, COVID-19 Counteracting Fund and *Financial Shield 1.0* and *2.0,* followed by the depreciation of zloty and higher nominal GDP. Due to high uncertainty and the need to ensure predictable financing, part of borrowing needs for 2021 was pre-financed in 2020.

Table 7. Difference from the previous update

	ESA Code	2020	2021	2022	2023	2024
Real GDP growth (%)						
Previous update		-3.4	-	-	-	-
Current update		-2.7	3.8	4.3	3.7	3.5
Difference		0.7	-	-	-	-
General government net lending (% of GDP)	EDP B.9					
Previous update		-8.4	-	-	-	-
Current update		-7.0	-6.9	-4.2	-3.2	-2.5
Difference		1.4	-	-	-	-
General government gross debt (% of GDP)						
Previous update		55.2	-	-	-	-
Current update		57.5	60.0	59.2	58.7	57.9
Difference		-2.2	-	-	-	-

Source: Ministry of Finance, Statistics Poland

IV. Sustainability of public finances

IV.1. Long-term budgetary prospects, including the implications of ageing population

Sustainable public finance supports long-term economic growth and constitute a critical element of the macroeconomic stability. Therefore, monitoring of public finance sustainability in the short-, medium- and long-time perspective for early detection of the potential threats and implementation of preventive measures is necessary. In this context, it is crucial for the sustainability of public finance to have well-grounded fiscal framework.

The elements of the Polish budgetary framework include the fiscal rules, namely:

- public debt rules,
- stabilising expenditure rule, which has a stabilising effect on public finance in the medium and long term and corrects potential imbalances, minimising the risk of over-tightening of budgetary policy,
- rules limiting the growth in debt of local government units.

The outbreak of the COVID-19 pandemic required the allocation of supplementary budgetary measures in order to overcome the health crisis, maintain the functioning of the state during the pandemic and economic recovery in the post-pandemic period. Therefore, supporting the economy above the expenditure cap resulting from the fiscal rules, including in particular the stabilising expenditure rule, was reasonable. An amendment of the Act on public finance enabled the suspension of the stabilising expenditure rule due to the state of pandemic and slowdown of economic growth rate. Automatic return mechanism to the conventional formula of expenditure rule in the two to four years perspective was implemented (cf. Chapter V). According to the recommendation of the European Commission, the introduced fiscal impulse should pose no threat to sustainability of public finance in medium-term perspective.

The European Commission regularly assesses the situation in Member States in terms of public finance sustainability, based on fiscal gap ratios in the medium (S1 indicator), and long, infinite horizon (S2 indicator). The fiscal gap reflects the scale of the necessary adjustments to the primary structural balance adjusted by a cycle's impact, so that the public debt reaches a specific level (S1 indicator), or so that the solvency condition is satisfied in the infinite horizon (S2).

The indicators are derived assuming the no-policy change scenario. Fiscal gap indicators therefore illustrate whether current policies are sufficient to maintain fiscal sustainability and do not aim to show the most likely scenario. The increase of an indicator means that a greater improvement of the primary structural result adjusted by a cycle is required, while its decrease means that an improvement in public finance sustainability is taking place and that the required adjustments of the primary structural balance by a cycle will be lower.

Table 8. Fiscal sustainability indicators in the subsequent periods

% of GDP	base year 2021	base year 2024
S1	5.3 high risk	2.3 medium risk
S2	7.5 high risk	4.5 medium risk

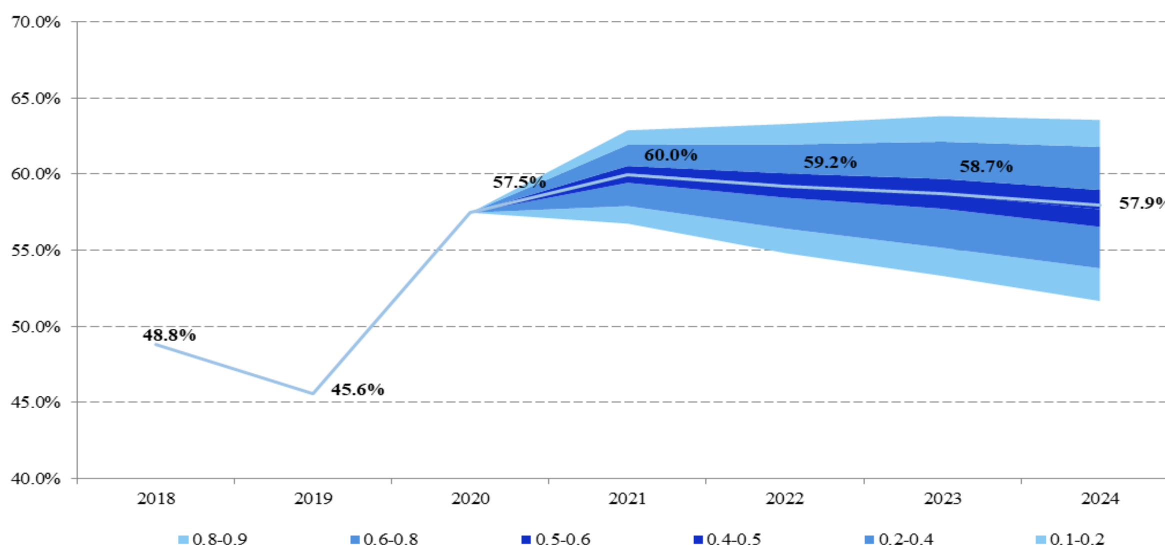
Source: Ministry of Finance

The S1 and S2 indices were estimated in two scenarios, adopting the first and last year of the *Programme* i.e. 2021 and 2024, respectively, as the baseline year. The estimates use the age-related cost projection published by the European Commission in 2018 (cf. Table 9) and macro-fiscal indices projections presented in the Programme. Update of the age-related cost projection taking the effects of the COVID-19 pandemic into account will be known after the publication of the Programme.

The fiscal effort made to overcome the health crisis and mitigate the negative economic effects of pandemic, including in particular supporting the economic entities by the state under extended restrictions in business activity, had a significant negative impact on the values of S1 and S2 indices for the baseline year of 2021. High values of S1 and S2 indices for this year result from a negative starting position caused by the effects of the COVID-19 pandemic and, in consequence, high primary deficit.

Assuming that the consolidation is carried out consistently with the forecast presented in this *Programme,* it can be expected that S1 and S2 indicators for Poland will improve in the coming years. Indicators will be decreased by the projected improvement of cyclically adjusted primary balance and forecasted decline in public debt. Fiscal consolidation will pursue towards lowering the risk to the sustainability of public finance of Poland in medium- and long-term perspective to a medium level.

Figure 6. Stochastic debt projections from 2021



Source: Ministry of Finance

A medium level of risk to the sustainability of public finances is indicated also by stochastic simulations of the debt based on the approach adopted by the European Commission and the International Monetary Fund[7]. The projections were derived based on the baseline scenario presented in the Programme and using the annual shocks obtained for the following variables: real GDP growth, real effective yield rate of general government debt, the primary balance and the exchange rate. The performed analysis of 80% of possible debt paths (paths below 10 and above 90 percentile were excluded) demonstrates that the general government debt would not be reduced below 60% of GDP only in presence of the most extreme set of shocks.

[7] Stochastic projections are developed using the Monte Carlo simulation based on 1000 draws .

Table 9. Long-term sustainability of public finances

% PKB	2016	2030	2040	2050	2060	2070
Total expenditure						
Of which **age-related expenditure**	20.3	20.4	20.6	21.4	22.1	21.4
Pension expenditure	11.2	11.0	10.8	11.2	11.1	10.2
Social security pension	11.2	11.0	10.8	11.2	11.1	10.2
Old-age and early pensions	9.9	10.2	10.0	10.4	10.4	9.5
Other pensions (disability. survivors)	1.3	0.8	0.8	0.8	0.7	0.7
Health care	4.3	4.5	4.8	5.0	5.2	5.2
Long-term care (previously as a component of health care)	0.5	0.7	0.9	1.0	1.2	1.3
Education expenditure	4.3	4.2	4.1	4.2	4.6	4.7
Other age-related expenditure						
Interest expenditure	0.0	0.0	0.0	0.0	0.0	0.0
Total revenue						
Of which: from pension contributions	7.9	8.3	8.4	8.3	8.3	8.3
Assumptions						
Labour productivity growth	2.1	2.7	2.2	1.9	1.7	1.5
Potential GDP growth	2.7	1.9	1.2	0.7	1.0	1.0
Participation rate males (aged 20-64)	73.9	72.9	71.7	68.2	68.7	71.0
Participation rate females (aged 20-64)	58.0	57.4	55.7	52.6	54.4	56.4
Total participation rate (aged 20-64)	65.8	65.1	63.7	60.4	61.6	63.8
Unemployment rate (aged 20-64)	6.0	5.5	5.5	5.4	5.4	5.4
Population aged 65+ over total population	16.3	23.3	26.1	30.9	34.1	33.3

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

The projections of long-term public expenditure presented in the table above are prepared in the framework of the work of the Ageing Working Group (AWG) of the Economic Policy Committee (EPC). They were published by the European Commission in 2018 in the Ageing Report 2018 on ageing effects foreseen up to 2070. Publication of the new long-term projections of long-term expenditure by the European Commission is expected this year.

The basis for projections included in the Ageing Report 2018 included the demographic assumptions developed by Eurostat, extrapolation of historical trends and technical assumptions on the convergence of the basic factors of economic growth i.e. labour, capital and labour productivity. It should be noted that the Act of 24 November 2017 amending the Act on healthcare services financed from public funds, which provides for a gradual increase in health care expenditure by 2025 to 6% of GDP, entered into force after the completion of the AWG on health care projections. The amended Act of 5 July 2018 shortened the increase in expenditure on healthcare by 1 year, i.e. until 2024.

According to AWG projections, pension expenditure shall remain stable over the long term and will fall from 11.2% GDP in 2016 to 10.2% GDP in 2070. Fluctuations in expenditure result mainly from changes in the demographic structure of the population. Compared to the previous forecasts, expenditure is slightly higher, as a result of the reduction in the retirement age for women (60) and men (65) from 1

October 2017 on. The forecast was also affected by the change in macroeconomic assumptions. However, demographic change continues to have the greatest impact on the level of expenditure. The AWG forecast is developed with a view to the statutory retirement age, while the Polish pension system defines only the minimum retirement age and it is possible to continue the professional activity, which is rewarded by a significant increase in future benefits.

The total age-related expenditure also increases slightly, from 20.3% GDP to 21.4% GDP. The main determinant of the increase in this type of expenditure is health and long-term care expenditure. Demographic changes constitute one of the major challenges for the long-term stability of public finance in most European countries. Against their background, the current situation in Poland appears to be favourable. It should be expected however that the ageing population phenomenon observed in recent years will continue, caused by the extension of life expectancy, low fertility and the current age structure of population. As a result, the demographic burden ratio shall deteriorate, i.e. the relationship between the number of population at post-productive age (65 and more) against the number of population at productive age (i.e. aged 15-64), expressed as percentage. According to the AWG forecast, this ratio will increase from 23.7% in 2016 to 62.2% in 2070.

As of 1 January 2019, Employee Capital Plans (PPK) were introduced as an instrument aimed at increasing the level of long-term savings and growth of future pensioners' assets. In 2019, the programme covered companies employing 250 people and more, while in 2020 the two other groups of companies joined the programme – those with employment falling within the range of 50 – 249 and 20-49 people. In 2021, the programme became available for all remaining employees paying the pension contributions (employed in the businesses employing up to 19 people) and the public finance units. The Employee Capital Plans are a system of voluntary savings based on contributions paid by the employee and the employer supported by financial incentives from the state. Participation rate for the groups covered with PPK in 2019 and 2020 amounted to 31.2%. The funds accumulated in the PPK are invested in the financial market and paid out when the PPK participant reaches the age of 60. The PPK is an element of the *Capital Building Programme*. One of the basic effects of the programme should be an increase in the long-term savings rate of Poles, which will serve to limit the effect of an expected decrease in replacement rates for pensions received under the participation in the first pillar of the pension system (pension savings under the PPK are, in fact, the transfer of consumption to future periods). To a certain extent, the PPK may contribute to the improvement of Poland's net international investment position, as well as to an increase in the investment rate and acceleration of the potential GDP growth rate.

The government proposed the changes in the functioning of the Open Pension Funds (OFE). These will include transformation of the Open Pension Funds into the Investment Fund Companies (IFC) and transfer of accumulated savings from OFE onto the private individual pension accounts (IKE). Changing the nature of contributions accumulated in OFE into fully private assets will become another impulse, alongside the PPK, to build pension savings in the third pillar. The draft act assumes entering new regulations into force on 1 June 2021.

The savings accumulated in OFE transferred to the individual pension accounts will be subject to a conversion fee of 15% of total value of net redirected assets. The fee will be paid in 2 instalments: in January and October 2022. There is also an option of submitting a statement by the Open Pension Fund member on transferring of savings from OFE into the Demographic Reserve Fund and adding their value to the assets accumulated on the individual account in the Social Insurance Fund. While choosing this option, the conversion fee will be not collected. Choosing IKE is a default option. Social contributions that are currently transferred to OFE as a second pillar, will remain in the compulsory public pension system and will be collected by the Social Insurance Fund.

IV.2. Contingent liabilities

The majority of potential contingent liabilities on account of sureties and guarantees results from guarantees granted by the State Treasury in connection with the consequences of the COVID-19 pandemic. They are guarantees of repayment of liabilities from bonds issued by:

- Bank Gospodarstwa Krajowego (BGK) for the purposes of the COVID-19 Counteracting Fund
- Polski Fundusz Rozwoju S.A. (PFR) for the purposes of supporting the economy under the *Financial Shield 1.0 and 2.0*.

In subsequent years, potential contingent liabilities on account of sureties and guarantees granted by the State Treasury may increase. The main reason will be a continued support for the economy with the use of so-called COVID guarantees. It is estimated that as a result potential liabilities in relation to GDP may grow in 2021 by 3.4 percentage points in comparison to the current state.

Furthermore, it is expected that granting Treasury sureties and guarantees in order to support investments fostering development in the area of road and rail infrastructure will continue. In addition, it is possible to grant sureties and guarantees for the other purposes permitted by the Act, in particular as regards support for: exports, environmental protection, job creation, innovation, corporate restructuring, regional development, entrepreneurship, and programmes or projects under the EU assistance programmes. These sureties and guarantees will be mainly granted for investments co-financed by EU funds (loans and bonds underwritten or guaranteed by the State Treasury should enable the acquisition of EU funds), as well as for other investment tasks arising from potential new support programmes stipulating granting sureties and guarantees. Long-term risk factor for the portfolio of sureties and guarantees granted by the State Treasury should be maintained at the low level.

The table presents only guarantees granted by the State Treasury. Maximum planned values for 2020 and 2021 and progress as of 18 March 2021 have been considered. So called ordinary guarantees consist of non-COVID guarantees, which are a standard support of investments not related to the COVID-19 pandemic.

Table 10. Government COVID-19-related guarantees and others

	Measures	Date of adoption	Maximum amount of contingent liabilities (% of GDP)	Estimated take-up (% of GDP)
	In response to COVID-19:			
1.	State Treasury guarantees related to the issue of bonds by the Polish Development Fund	April 2020	7.8	3.5
2.	State Treasury guarantees for BGK's liabilities incurred for the purposes of the COVID-19 Counteracting Fund	March 2020	8.1	5.4
3.	State Treasury guarantees for BGK's liabilities incurred for the purposes of the National Guarantee Fund*	March 2020	-	-
4.	State Treasury guarantees for BGK's liabilities incurred for the purposes of the Liquidity Guarantee Fund of BGK**	March 2020	-	-
	Subtotal		15.9	8.9
	Others:			
	Usual guarantees – contingent liabilities	-	6.7	5.1
	Subtotal			
	Total		**22.6**	**14.0**

Estimates of the Ministry of Finance

Remarks:

*In line with the Act of 8 May 1997 on sureties and guarantees granted by the State Treasury and some legal entities (Dz. U. 2021 item 442) expenditure of the National Guarantee Fund (Krajowy Fundusz Gwarancyjny) may be covered i.a. by the State Budget, as well as from proceeds from bond issuance by BGK. Bond repayment is, in turn, to be guaranteed by the State Treasury.

**BGK may, in accordance with the Act of 31 March 2020 amending the Act on special arrangements for the prevention, counteracting and combating of COVID-19, other infectious diseases and the crisis situations caused by them and certain other Acts (Journal of Laws of 2020 item 568), provide COVID-19-related guarantees on its own account. BGK expenditure stemming from theses guarantees are to be covered by the Liquidity Guarantee Fund of BGK, which, apart from the State Budget, may also be funded with proceeds from BGK bond issuance. Their repayment, in turn, is to be guaranteed by the State Treasury. The funds of the Liquidity Guarantee Fund may also be provided by the COVID-19 Counteracting Fund.

No general government expenditure for activation of guarantees presented in the table above is expected. With regard to the COVID-19 pandemic guarantees, the forecast expenditure is also zero. This is due to adopted mechanisms for ensuring that the PFR and COVID-19 Counteracting Fund in BGK have funds to repay the guaranteed liabilities. Such expenditure has not been realised so far.

V. Institutional features of public finances

The general escape clause (cf. Chapter II.1) proposed by the European Commission in March last year and approved by the Ecofin Council enabled the EU Member States to support their economies in the face of the pandemic. This required, however, a deviation from the recommendations of the EU Council on the budgetary policies. An analogical approach was presented in the Act on public finance[8] (APF) amended in May 2020.

As a result of this amendment, modified article 112d enables temporary suspension of SER and application of the escape clause, provided that the government declares a pandemic at the nationwide level and the economic situation will deteriorate significantly. It takes place, when the annual dynamics of GDP value in real terms forecasted in the draft Budget Act for a given year is lower by more than 2 percentage points from the average dynamics of GDP value for the past 6 years announced by the President of Statistics Poland.

In the budgetary year, in which the above-mentioned criteria are no longer fulfilled, the so-called return clause will be applied. This will enable automatic and gradual return to the amount of expenditure specified under the conventional SER formula the perspective of 2 to 4 years. The pace of return to the initial SER formula depends on the macroeconomic situation i.e. nominal GDP growth and economic growth rate in the year following the year in which the pre-conditions referred to above were fulfilled.

The amount of adjustment (additional expenditure capacity) in the individual years following the suspension of SER depends on the total financial consequences related to pandemic suffered in the year of SER suspension. This includes loss in revenue and expenditure resulting from the actions taken by the government and aimed at counteracting and tackling the effects of the pandemic and direct support of the affected entities.

With regard to the fulfilment of criteria specified in Article 112d of APF, the amended Budget Act for 2020 temporarily suspended SER. In addition, due to the COVID-19 pandemic and the need for economic recovery, exceeding the expenditure cap under SER by the capital expenditures of local government units, investment expenditure of the State Budget and expenditure of funds established, entrusted or handed over to the Bank Gospodarstwa Krajowego[9] was permitted.

The existing provisions of APF and macroeconomic forecasts would imply the return to application of SER in line with the conventional formula under Article 112aa of APF in the second budgetary year from the suspension i.e. in 2022. With a view to the latest information on the course of pandemic and its impact on the economy, reducing the expenditure growth resulting from the application of the normal formula in the upcoming year might be premature. The European Commission encourages the continuation of anti-crisis measures and, following the progress in tackling the pandemic – to support economic recovery. Therefore, the adjustment of SER return clause to the extended application of general escape clause scheduled by the European Commission for 2022 (cf. Chapter II.1) is assumed. The planned amendments to the SER return clause will cover:

— revision of the criteria listed in Article 112d(4) of APF, which specify the pace of the return to the conventional SER formula – the new criteria will be based on a comparison of the economic growth pace in the years in which the escape and return clauses were in force, with the average economic growth rate from before the pandemic. The proposed amendment will enable the extension of the return clause and at the same time will ensure compliance with the general escape clause in the EU and will simplify this mechanism
— clearing the growth indicator specifying the amount of expenditure and adjustment mechanism from the pandemic impact – the amendment will consist in clearing the indicator of medium-term GDP dynamics, specifying the amount of expenditure, from the disturbances triggered by pandemic effects. The economic growth pace in the years in which the escape and return clauses applied will

[8] Act of 28 May 2020 amending the Act on public finance (Journal of Laws of 2020, item 1175).

[9] Act of 24 July 2020 amending the Act on the posting of workers as part of the provision of services and certain other acts (Journal of Laws of 2020, item 1423).

be replaced by average economic growth rate from before the suspension of SER. Absence of such adjustment would mean a permanent impact of shock triggered by the pandemic on the path of expenditure under SER

- deactivation of the correction mechanism in SER aiming at consolidation of public finance, in the period in which the escape and return clauses apply – in accordance with the recommendations of international institutions, including the European Commission, in the pandemic and direct post-pandemic period the macroeconomic policy should focus on the recovery of economic capacity. Consolidation should be started as the situation stabilises.

The legislative actions concerning the SER return clause will be taken after a package of documents on the European Semester, including the assessment of the deactivation or continued application the general escape clause in 2022 is published. This has been scheduled by the European Commission for the end of May. The National Recovery Plan has already proposed the extension of SER with the state special-purpose funds. The legislative actions in this area should be completed in the third quarter of 2021, which will enable application of the amended SER in the budgetary process for 2022.

The COVID-19 pandemic entailed also certain amendments to fiscal rules applied by the local government units[10]. These include:

- balancing the current part of the local government budget – when planning and executing the 2020 and 2021 budgets, a local government unit may exceed the indicator for balance of current revenue and expenditure by the amount of:
  - loss in revenue of this unit resulting from the COVID-19 pandemic
  - current expenditure incurred to implement the measures taken to tackle the COVID-19 pandemic – in the part, in which they are financed by property revenue or specific revenue
- individual debt repayment ratio for a local government unit – namely:
  - exclusion from the individual debt repayment ration of liabilities from loans, credits and issue of bonds incurred in 2020 and in 2021 by the local government units due to loss of revenues as a result of the COVID-19 pandemic. The exclusion has a long-term nature, i.e. repayment of credit (loan, credit, bonds) remains outside the limit throughout the entire repayment period
  - decreasing current expenditure by current expenditure incurred in 2020 and 2021 to implement the measures to tackle the COVID-19 pandemic – when setting the ratio reducing the amount of debt repayment for 2021 and the following years
  - increasing the debt repayment limit by the amount of current expenditure incurred for debt management.

In addition, the mechanism protecting the finance of local government units was introduced. This consists in reducing the debt of unit to 80% of its revenues. The limit applies in 2020-21 and does not apply to units which, not excluding the repayment of liabilities incurred due to loss of revenues, will meet the debt repayment limit referred to in Article 243(1) of APF.

The General Government Statistics Working Group continued its operation in the period after the 2019 Programme update. The works focused on the sectoral classification of entities and the new transactions, including in particular these resulting from the actions taken by the government with regard to pandemic. The Working Group also analysed the new edition of MDGG published by Eurostat in 2019[11] and their potential impact on the general government balance and debt. The Eurostat representatives visited

[10] The Act of 2 March 2020 on special solutions related to preventing, counteracting and combating COVID-19, other infectious diseases and the resulting crisis situations (Journal of Laws of 1942, as amended) and the Act of 19 November 2020 on special solutions to implement the Budget Act for 2021 (Journal of Laws of 2020, item 2400).

[11] Manual on Government Deficit and Debt. Implementation of ESA2010.

Poland in 11 and 12 February 2020 with the standard dialogue visit to discuss the selected methodological issues.

The Ministry of Finance continues the budget system reform (BSR). Its main objective – in accordance with the *Assumptions of the budget system reform* adopted on 26 July 2016 by the Council of Ministers – is to implement the budget system supporting the delivery of strategic objectives and development priorities in long-term perspective. Specific objectives include among others:

- introduction of a medium-term budgetary framework (MTBF) and integration of multiannual and annual planning processes,
- introduction of a new budget classification,
- improvement of data collection systems (budgetary reporting and financial reporting),
- institutionalisation and inclusion of spending reviews and other instruments enhancing the efficiency of public spending into the budget process.

The objectives and directions of the BSR address the recommendation of the EU Council of 9 July 2019, the so-called CSR 1 of 2019. The Council of European Union recommended taking further steps to increase the efficiency of public spending, including by improving the budget system in Poland. The conceptual and implementation works on the individual components are carried out within interlinked projects and initiatives. Cooperation between the Ministry of Finance and the International Monetary Fund (IMF) covers the classification system, public accounting and financial reporting as well as – on an as needed basis – the MTBF. In the area of spending reviews, the Ministry of Finance commenced cooperation with the Organisation for Economic Co-operation and Development (OECD). It aims at strengthening the public administration capacity to implement spending reviews, improving the methodology of reviews and presenting a proposal for including them into the budget process.

The BSR is financed from, among others, the EU funds, i.e. from Structural Reform Support Programme (SRSP) and in future from the Technical Support Instrument. At the same time, implementation of the reform is one of the measures envisaged in the RRP. The assumed effects of the BSR include increasing transparency and effectiveness of public expenditure by establishing stronger linkages with results, improving quality and availability of budgetary and financial data and enhancing the budget decision-making process as a result of inclusion of multi-annual perspective.

Given the interdependencies between the BSR components, the development of a standardised chart of accounts (SCoA) of the public finance sector integrated with budget classification was prioritised. This initiative is implemented in cooperation with the IMF. The first stage (December 2018 – October 2020) of technical cooperation covered the development of the SCoA concept including the segmentation and detailed structure of individual segments. The second stage of cooperation (18 months starting from November 2020) includes activities related to finalisation of works on the SCoA concept, testing of this tool and preparation for deployment. The subsequent stages of works shall cover:

- determination of structure of the new budget classification integrated with the chart of accounts in form of a report (business assumptions of the new system and deployment plan, since the new system requires an adequate IT tool) – 1Q 2022,
- pilot of the new classification system in selected entities in order to identify potential gaps in the new classification system, areas for improvement and a description of results of testing how the solutions designed are functioning – 1Q 2023.

Simultaneously, the conceptual works on the MTBF design and budget process are carried out. The first changes were introduced in 2019. The Regulation of the Ministry of Finance on budget planning, i.e. so-called budget note, incorporated the multi-annual perspective into the budget forms. The Regulation defined also the key elements of stance no-policy change scenario. In addition, so-called starting amount of expenditure were introduced. These are the indicative amounts of expenditure for 2 years following the planned year, communicated by the Ministry of Finance to the budget administrators along with the limits for the planned year. These solutions enabled to communicate the initial amounts of expenditure (for 2020) and starting amounts of expenditure for 2 following years to the budget administrators for the first time during budget planning for 2020. The conceptual works currently under way concern the institutionalisation of MTBF in the Act on public finance.

The legislative solutions for the new classification system and the new budget management model including the MTBF should be developed by 2025.

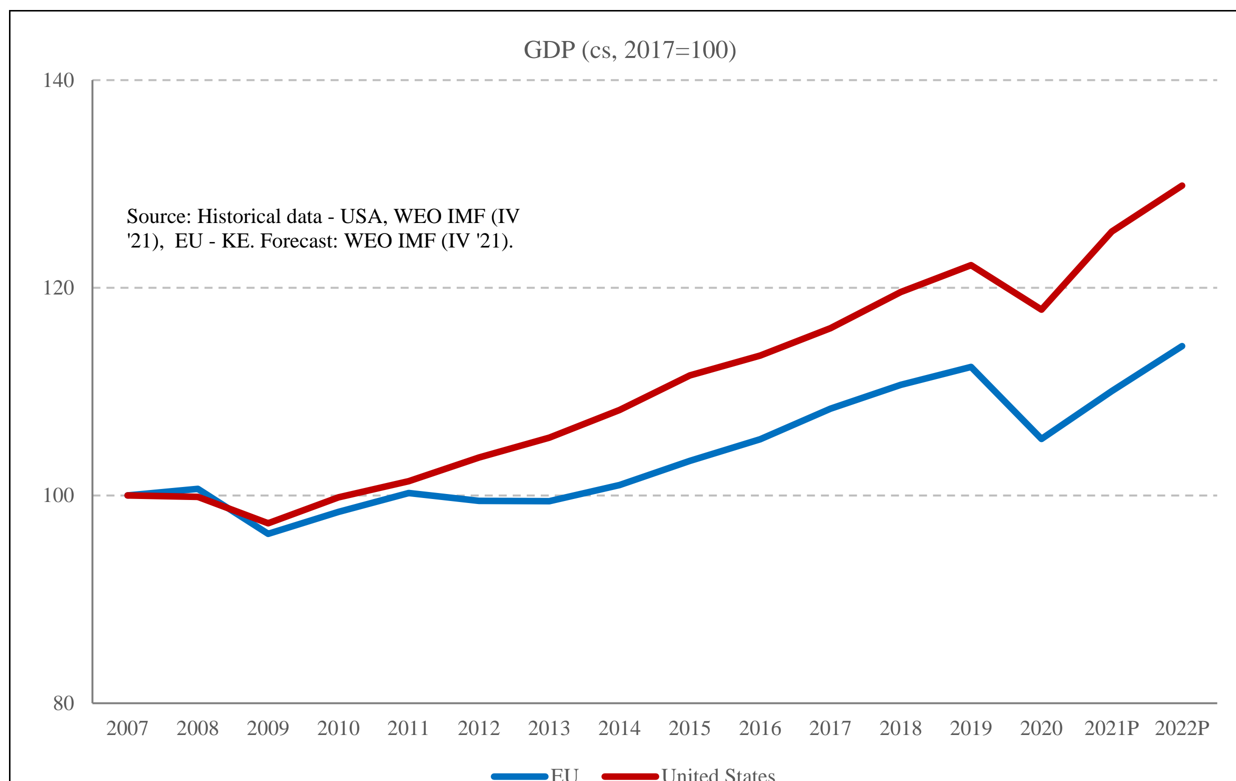
In 2020, the spending reviews were continued in the following areas: 1) determining the wages for the state budgetary employees – stage II, 2) prison systems. The review of spending for supporting employment and counteracting unemployment was initiated. Works concerning spending review are carried out in cooperation with the OECD. The OECD experts support Poland in, among others, developing the concept of spending reviews' institutionalisation and their inclusion into the budget process. They are also reviewing and verifying the methodological document concerning the process of spending reviews.

In addition, the works on public accounting are under way. Their key objective is to develop legal and institutional solutions enabling the preparation of the consolidated financial statement of the state. This statement should allow a consistent and reliable presentation of the financial situation of the public finance sector as a whole and facilitate the assessment of state resource management effectiveness. This activity is carried out in the long-term perspective. The first stage of preparing the reform concept was completed in 2020, while the activities related to development of legislative solutions are planned for the following years.

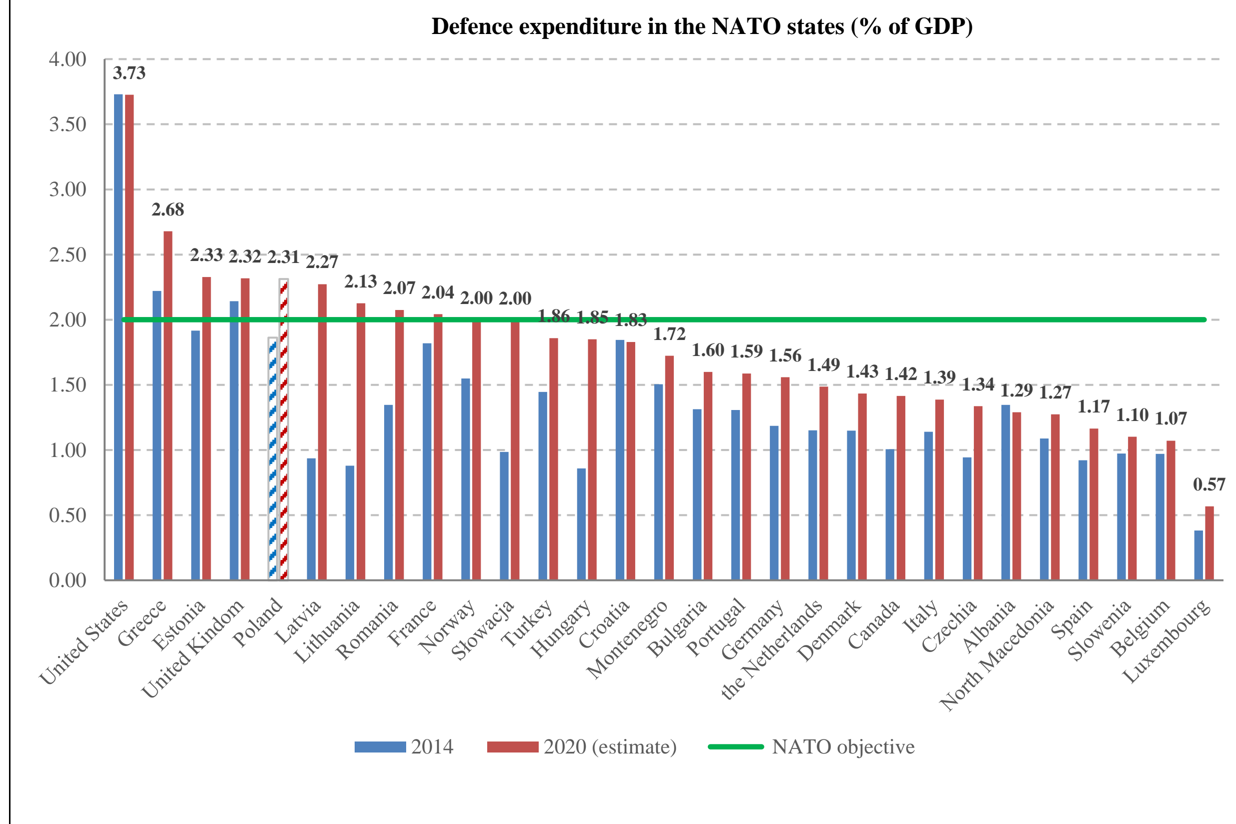
Furthermore, with regard to expected amendments of the EU fiscal framework, an assessment of the effectiveness of SER functioning is planned for 2024. This measure will constitute a part of the fiscal framework report under the RRP. Conclusions and recommendations from the review shall be published in the first quarter of 2025 at the latest and will form the basis for any potential adjustments of the domestic budgetary framework in future.

Box 1. Exemption of military (defence) expenditure from the EU fiscal framework

The economic crisis triggered by the pandemic requires a firm response by fiscal policy. Several years ago, in response to economic disturbances in the euro area, the EU Member States were forced to carry out excessively rapid budgetary consolidation, as a result of which some of them suffered from economic stagnation for years. Implementation of the general escape clause by the EC enables only temporary addressing the challenges related to recession triggered by the pandemic. It does not solve the problems associated with supporting the recovery of the economic capacity of the EU in the long-time perspective. **In order to avoid repeating the past errors, the discussion on amending the EU fiscal rules should begin right now.**



The debate on fiscal framework should not be limited only to the corrections of the existing regulations, but should also consider the strategic challenges faced by the Community. Taking care of common good, which constitutes widely-understood safety and security, requires special treatment of the Member States' defence expenditure. At present, there are significant differences in bearing the financial responsibility in this area throughout the EU, which even exceed 2% of GDP.



Exclusion of expenditure for military purposes from the debt and deficit indicators used in the EU's fiscal rules would enable partial elimination of imbalance that was formed in the EU as a result of application of the existing fiscal framework, which does not consider geopolitical challenges faced by the individual Member States and therefore by the European Community as a whole.

Table annex

Table 11. Macroeconomic prospects

	ESA Code	2020 Level	2020 Rate of change	2021 Rate of change	2022 Rate of change	2023 Rate of change	2024 Rate of change
1. Real GDP (PLN billion)	B1*g	2231.6	-2.7	3.8	4.3	3.7	3.5
2. Nominal GDP (PLN billion)	B1*g	2323.9	1.3	6.1	6.5	5.6	5.4
Components of real GDP							
3. Private consumption expenditure	P.3	1278.2	-3.1	4.3	4.4	4.0	3.3
4. Government consumption expenditure	P.3	431.2	4.4	3.4	3.7	4.9	3.5
5. Gross fixed capital formation	P.51	379.1	-9.6	2.0	3.9	2.2	5.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	14.8	0.5	0.4	0.6	0.7	0.8
7. Exports of goods and services	P.6	1267.9	-0.2	8.8	7.3	4.5	4.0
8. Import of goods and services	P.7	1139.6	-1.9	9.4	7.8	5.2	4.6
Contributions to real GDP growth							
9. Final domestic demand		-	-3.5	3.4	4.1	3.9	3.6
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-0.8	0.0	0.2	0.2	0.1
11. External balance of goods and services	B.11	-	0.8	0.2	0.1	-0.1	-0.1

Source: Ministry of Finance
Remark: the levels of real volumes are expressed in constant prices of 2019.

Table 12. Price developments

	ESA Code	2020 Level	2020 Rate of change	2021 Rate of change	2022 Rate of change	2023 Rate of change	2024 Rate of change
1. GDP deflator			4.1	2.4	2.2	1.8	1.9
2. Private consumption deflator			3.3	3.1	2.8	2.6	2.5
3. HICP			3.7	3.1	2.8	2.6	2.5
3a. CPI			3.4	3.1	2.8	2.6	2.5
4. Public consumption deflator			3.6	3.4	3.2	2.5	1.5
5. Investment deflator			2.2	2.0	3.7	3.5	2.5
6. Export price deflator (goods and services)			2.3	2.4	2.2	2.0	1.8
7. Import price deflator (goods and services)			-0.1	3.6	3.7	3.5	2.5

Table 13. Labour market developments

	ESA Code	2020 Level	2020 Rate of change	2021 Rate of change	2022 Rate of change	2023 Rate of change	2024 Rate of change
1. Employment (thousands of persons)*		16442	-0.1	0.1	0.0	0.0	0.0
2. Employment (hours worked)**		-	-	-	-	-	-
3. Unemployment rate (%)***		3.2	3.2	3.4	3.0	2.5	2.0
4. Labour productivity (PLN thousand)****		136.1	-2.8	3.6	4.3	3.7	3.5
5. Labour productivity (PLN thousand)*****		-	-	-	-	-	-
6. Compensation of employees (PLN billion)	D.1	939	3.7	6.3	6.4	5.8	5.3
7. Compensation per employee (PLN thousand)		72.1	4.3	6.1	6.4	5.8	5.3

Source: Ministry of Finance
* Average employment based on LFS (aged 15 and older).
** National accounts definition.
*** Harmonised unemployment rate, Eurostat definition, levels.
**** Real GDP per person employed.
***** Real GDP per hour worked.

Table 14. Sectoral balances

% of GDP	ESA Code	2020	2021	2022	2023	2024
1. Net lending / borrowing vis-à-vis the rest of the world*	B.9	6.0	3.9	3.2	1.9	0.0
of which: - balance on goods and services		6.9	6.3	5.4	4.3	3.6
- balance of primary incomes and transfers		-3.3	-4.1	-4.2	-4.2	-4.2
- capital account		2.4	1.7	2.0	1.8	0.7
2. Net lending/borrowing of the private sector	B.9	13.0	10.8	7.4	5.1	2.5
3. Net lending/borrowing of general government	EDP B.9	-7.0	-6.9	-4.2	-3.2	-2.5
4. Statistical discrepancies		-	-	-	-	-

Source: Ministry of Finance
* 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.

Table 15. Basic assumptions

	2020	2021	2022	2023	2024
Short-term interest rate (annual average)	0.7	0.2	0.2	0.2	0.2
Long-term interest rate (annual average)	1.5	1.5	1.5	1.5	1.5
Nominal effective exchange rate	-	-	-	-	-
Exchange rate vis-à-vis the EUR (annual average)	4.45	4.53	4.53	4.53	4.53
World excluding EU. GDP growth*	-3.4	5.2	3.8	-	-
EU GDP growth*	-6.1	3.7	3.9	-	-
Growth of relevant foreign export markets**	-8.3	6.1	6.6	4.0	3.8
World import volumes *	-9.4	7.5	4.9	-	-
Oil prices (Brent, USD/barrel) *	43.4	54.7	52.4	-	-

* Source: *European Commission*, *European Economic Forecast. Winter* 2021, February 2021. (years 2021-22).
** EU import as an indicator of the foreign export markets.

Table 16. General government budgetary prospects

	ESA Code	2020 PLN million	2020 % of GDP	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP
Net lending (EDP B9) by sub-sector							
1. General government	S.13	-161 544	-7.0	-6.9	-4.2	-3.2	-2.5
1a. General government corrected for national defence expenditure		-	*-4.7*	*-4.8*	*-2.0*	*-1.0*	*-0.2*
2. Central government	S.1311	-185 934	-8.0	-6.7	-2.9	-3.1	-2.5
3. State government	S.1312	-					-
4. Local government	S.1313	3 733	0.2	-0.1	-0.2	-0.1	0.0
5. Social security funds	S.1314	20 656	0.9	-0.1	-1.1	0.0	0.1
General government							
6. Total revenue	TR	969 275	41.7	41.5	41.2	41.0	41.0
7. Total expenditure	TE	1 130 820	48.7	48.4	45.4	44.2	43.5
8. Net lending/borrowing	EDPB.9	-161 544	-7.0	-6.9	-4.2	-3.2	-2.5
9. Interest expenditure	EDPD.41	29 128	1.3	1.2	1.1	1.0	1.0
10. Primary balance		-132 416	-5.7	-5.7	-3.1	-2.2	-1.5
11. One-off and other temporary measures*		5 900	0.3	0.2	0.2	0.0	0.0
Selected components of revenue							
12. Total taxes (=12a+12b+12c)		511 333	22.0	22.8	22.7	22.6	22.9
12a. Taxes on production and imports	D.2	326 107	14.0	14.7	14.6	14.3	14.3
12b. Current taxes on income, wealth, etc	D.5	184 913	8.0	8.0	8.0	8.3	8.6
12c. Capital taxes	D.91	313	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	341 538	14.7	14.3	14.3	14.4	14.3
14. Property income	D.4	12 363	0.5	0.4	0.3	0.3	0.3

	ESA Code	2020 PLN million	2020 % of GDP	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP
15. Other		104 041	4.5	4.0	3.8	3.7	3.4
16. Total revenue	TR	969 275	41.7	41.5	41.2	41.0	41.0
Tax burden (D.2+D.5+D.61+D.91-D.995)		849 670	36.6	36.9	36.9	36.9	37.1
Selected components of expenditure							
17 Compensation of employees + intermediate consumption	D1+P2	390 503	16.8	16.9	17.0	17.1	17.0
17a. Compensation of employees	D.1	252 879	10.9	10.9	10.7	10.6	10.5
17b. Intermediate consumption	P.2	137 624	5.9	6.1	6.3	6.5	6.5
18. Social payments (18=18a+18b)		434 751	18.7	19.3	18.5	18.5	18.4
***of which* Unemployment benefits**		7 039	0.3	0.1	0.1	0.1	0.1
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	44 696	1.9	2.1	2.1	2.2	2.2
18b. Social transfers other than in kind	D.62	390 055	16.8	17.2	16.4	16.3	16.2
19. Interest expenditure	EDP D.41	29 128	1.3	1.2	1.1	1.0	1.0
20. Subsidies	D.3	89 027	3.8	1.4	0.4	0.4	0.3
21. Gross fixed capital formation	P.51	102 963	4.4	4.8	4.8	4.3	4.3
22. Capital transfers	D.9	28 168	1.1	0.9	0.8	0.7	0.6
23. Other		56 280	2.6	3.9	2.8	2.2	1.9
24. Total expenditure	TE	1 130 820	48.7	48.4	45.4	44.2	43.5
p.m.: Government consumption (nominal)	P.3	446 903	19.2	19.4	19.5	19.8	19.8

Source: Ministry of Finance
* In the years 2020-22, revenues from the sale of additional CO_2 emission rights in the amount of PLN 5.9 bn, PLN 5.3 bn and PLN 5.3 bn, respectively, has been taken into account.

Table 17. No-policy change projections

	2020 PLN million	2020 % of GDP	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP
1. Total revenue at unchanged policies	973 907	41.9	41.1	41.1	40.8	41.0
2. Total expenditure at unchanged policies	-	-	-	-	-	-

Source: Ministry of Finance

Table 18. Amounts to be excluded from the expenditure benchmark

	2020 PLN million	2020 % of GDP	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	37 225	1.6	1.3	1.1	0.9	0.8
1a. of which investment fully matched by EU funds revenue	29 110	1.3	1.1	0.9	0.8	0.6
2. Cyclical unemployment benefit expenditure*	-1 514	-0.1	0.0	0.0	-0.1	-0.1
3. Effect of discretionary revenue measures	-4 632	-0.2	0.4	0.1	0.2	0.0
4. Revenue increases mandated by law	-	-	-	-	-	-

Source: Ministry of Finance
* 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.
The basis for calculating *cyclical unemployment expenditure* is the unemployment expenditure included in COFOG function, code 10.5. The European Commission has left it up to the Member States to exclude from this function expenditure which in their opinion does not reflect the unemployment expenditure resulting from the cycle. Such situation occurs in case of Poland. Labour Fund expenditure represents the vast majority of expenditure in the COFOG function, code 10.5. At the same time, due to the changing role and tasks of the Fund, there is no justification for using all expenditures included in the COFOG function, code 10.5 as a basis for estimating cyclical unemployment expenditure.

Table 19. General government expenditure by function

% of GDP	COFOG Code	2019	2024*
1. General public services	1	4.2	
2. Defence	2	1.6	
3. Public order and safety	3	2.1	
4. Economic affairs	4	4.8	
5. Environmental protection	5	0.5	
6. Housing and community amenities	6	0.5	
7. Health	7	4.9	
8. Recreation, culture and religion	8	1.3	
9. Education	9	5.0	
10. Social protection	10	16.7	
11. Total expenditure	TE	41.7	43.5

Source: Ministry of Finance
* expenditure's disaggregation by function is a part of the budgetary process.