Council Decision of 28 November 2006 establishing, in accordance with Article 104(8), that the action taken by Poland in response to the Recommendation of the Council in accordance with Article 104(7) of the Treaty establishing the European Community is proving to be inadequate (2006/1014/EC)

COUNCIL DECISION

of 28 November 2006

establishing, in accordance with Article 104(8), that the action taken by Poland in response to the Recommendation of the Council in accordance with Article 104(7) of the Treaty establishing the European Community is proving to be inadequate

(2006/1014/EC)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(8) thereof,

Having regard to the recommendation from the Commission,

Whereas:

(1) According to Article 104 of the Treaty, Member States are to avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The Stability and Growth Pact includes Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[(1)] which was adopted to further the prompt correction of excessive general government deficits.

(3) The Resolution of the Amsterdam European Council of 17 June 1997[(2)] solemnly invited all parties, namely the Member States, the Council and the Commission, to implement the Treaty and the Stability and Growth Pact in a strict and timely manner.

(4) The Eurostat Decision of 2 March 2004 on the sectoral classification of pension schemes[(3)] established that a defined-contributions funded scheme cannot be classified as a social security scheme. This scheme cannot therefore be considered as part of general government. This was a framework decision which required bilateral discussions with Member States before implementation. In the context of those discussions, Eurostat acknowledged that 'some Member States might need a transitional period to implement the decision and to avoid disruptions in the conduct of their budgetary policies'[(4)]. The transitional period, allowed by Eurostat, will expire with the first fiscal notification of 2007, due by 1 April 2007. Poland decided to avail itself of this transitional period. Therefore, social contributions and other revenue collected (and expenditure incurred) by funded defined-contribution schemes have been recorded as

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government revenue (and expenditure), which result in deficit and debt figures being smaller than otherwise.

(5) By Decision 2005/183/EC[(5)] of 5 July 2004, it was decided, in accordance with Article 104(6) of the Treaty, that an excessive deficit existed in Poland.

(6) In accordance with Article 104(7) of the Treaty and Article 3(4) of Regulation (EC) No 1467/97, on 5 July 2004 the Council also adopted a recommendation to the Polish authorities to bring the existence of an excessive deficit to an end as rapidly as possible and to take action in a medium-term framework to achieve the objective of bringing the deficit below 3 % of GDP by 2007 in a credible and sustainable manner, in accordance with the path for deficit reduction specified in the convergence programme submitted by the authorities in May 2004 and endorsed in the Council opinion of 5 July 2004, with the following annual targets: 5,7 % of GDP in 2004, 4,2 % of GDP in 2005, 3,3 % in 2006 and 1,5 % of GDP in 2007. The Council established the deadline of 5 November 2004 to take effective action 'regarding the measures envisaged to achieve the 2005 deficit target'.

(7) The deficit-reduction path endorsed by the Council on 5 July 2004 did not include the cost of the pension reform implemented in 1999. About 20 % of the revenue from pension contributions has been redirected from the pay-as-you-go system to the fully-funded defined-contribution pension schemes. At the time of the recommendation under Article 104(7), the Council took explicitly into account the fact that the deficit targets would have to be revised upwards, with an estimated annual cost of the Polish pension reform of around 1,5 % of GDP. In view of this, and also of the prevailing negative risks attached to the budgetary consolidation strategy, the Council pointed out in its opinion on the May 2004 convergence programme that 'the budgetary stance in the programme may not be sufficient to reduce the deficit below 3 % of GDP during the programme period' (i.e. by 2007).

(8) After the expiry of the deadline of 5 November 2004 set in the Council recommendation under Article 104(7), the Commission concluded, in its Communication to the Council of 14 December 2004, that no further steps were necessary under the excessive deficit procedure for Poland as the Polish government had taken effective action regarding the measures envisaged to achieve the 2005 deficit target.

(9) On 17 February 2005, the Council delivered its opinion on the November 2004 update of the convergence programme of Poland. The update revised the 2007 deficit target upwards to 2,2 % of GDP in 2007 (from 1,5 % in the May 2004 convergence programme), i.e. about 3,7 % of GDP including the cost of pension reform. This upward revision occurred in spite of continued strong growth (projected in the programme to average more than 5 % per annum), while deficit outcomes/projections for the years 2004 to 2006 were all lowered, due to measures taken by the government, stronger economic growth as well as statistical revisions. The Council noticed a risk of a delayed or incomplete implementation of the fiscal adjustment measures. Referring to the negative risks attached to the budgetary consolidation strategy, the Council invited Poland *inter alia* to strengthen the fiscal adjustment beyond 2005 and lower the deficit

target for 2007. In effect, only a small number of measures was implemented. The fiscal outcome for 2005 was nevertheless better than expected at 2,5 % of GDP.

(10) On 14 March 2006, the Council adopted its opinion on the January 2006 update of the convergence programme of Poland. The update aimed at a slow reduction of the general government deficit (by about 0,3 % of GDP annually on average in the period 2006 to 2008) in order to meet the budgetary convergence criteria by the end of the legislature (i.e. by the end of 2009). Also, while deficit outcomes and projections for the years 2004 to 2006 were again revised downward, due to measures taken by the government, stronger economic growth as well as statistical revisions, the programme confirmed the deficit target for 2007 at 2,2 % of GDP (with the cost of the pension reform not included). Given the upward revision of the pension reform cost to 2 %, due to better-than-expected labour market developments and higher participation in the new pension system, the 2007 deficit target including this cost was 0,4 percentage points of GDP higher than in the previous update (4,1 % of GDP compared to 3,7 % of GDP). The Council pointed to various risks attached to the budgetary consolidation strategy, such as relatively favourable growth assumptions in the last year of the programme period (2008), relatively optimistic assumptions about tax elasticities and possible difficulties with expenditure control in the face of social spending pressures. The Council concluded that ‘the convergence programme envisages some progress, but not the effective correction of the excessive deficit in 2007’. In addition, the Council mentioned that the planned adjustment in the structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures calculated by the Commission services on the basis of the information provided in the programme according to the commonly agreed methodology) was planned to improve on average by 0,25 % of GDP per year over the programme period.

(11) The draft budget for 2007, adopted on 27 September 2006, estimates the 2006 deficit at 2,1 % of GDP (pension reform cost not included), compared to 2,6 % of GDP targeted in the January 2006 update of the convergence programme (and 3,3 % underlying the July 2004 Council recommendation under Article 104(7)). The more positive outcome reflects higher revenues (especially personal income tax) owing to stronger-than-projected growth as well as more contained expenditure growth, notably lower-than-planned public investment. The draft 2007 budget presents the following deficit targets for the subsequent years: 1,7 % in 2007, 1,2 % in 2008 and 0,5 % in 2009.

(12) The assessment of the action taken by Poland to correct the excessive deficit by 2007 in response to the Council recommendation under Article 104(7) leads to the following conclusions:

- — The revised 2007 deficit target of 1,7 % of GDP (excluding pension reform costs), in the draft budget for 2007, is above the target of 1,5 % of GDP endorsed in the Council recommendation of 5 July 2004 for the correction of the excessive deficit. The revision of the 2007 deficit occurred against the background of much lower deficit outcomes in the period 2004 to 2006 than foreseen in the Recommendation.
- — The transition period for implementing the Eurostat Decision of 2 March 2004 on the classification of funded pension schemes will expire with the first

notification in 2007 due by 1 April. The inclusion of the higher than previously projected pension reform cost leads to a 2007 deficit target of around 3,7 % of GDP.

— Commission services' autumn 2006 forecast projects the 2007 deficit by 0,3 % of GDP higher than targeted by the Polish authorities. In particular, revenues from direct taxes are expected to be lower than planned by the authorities, while social expenditure and public investment are likely to be higher.

(13) This leads to the conclusion that, while there has been an improvement in the fiscal position and Poland has so far over-achieved its budgetary targets, on the basis of current information the 2007 deficit would clearly exceed the 3 % of GDP deficit reference value which is not in line with the recommendations of the Council for a correction of the excessive deficit by the 2007 deadline.

In line with the Resolution of the Amsterdam European Council on the Stability and Growth Pact, Poland agreed to make the Council Recommendation of 5 July 2004 public[(6)],

HAS ADOPTED THIS DECISION:

Article 1

The action taken by Poland in response to the Council Recommendation of 5 July 2004 under Article 104(7) of the Treaty is proving to be inadequate to correct the excessive deficit within the deadline fixed by the Recommendation.

Article 2

This Decision is addressed to the Republic of Poland.

Done at Brussels, 28 November 2006.

For the Council

The President

E. HEINÄLUOMA

(**1**) OJ L 209, 2.8.1997, p. 6, Regulation as last amended by Regulation (EC) No 1056/2005 (OJ L 174, 7.7.2005, p. 5).

(**2**) OJ C 236, 2.8.1997, p. 1.

(**3**) Eurostat News Releases No 30/2004 of 2 March 2004 and No 117/2004 of 23 September 2004 and Chapter I.1.3 — Classification of funded pension schemes and impact on government finance of the Eurostat Manual on government deficit and debt, available for download at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-BE-04-002/EN/KS-BE-04-002-EN.PDF

(**4**) See footnote 3.

(**5**) OJ L 62, 9.3.2005, p. 18.

(**6**) See http://register.consilium.eu.int/pdf/en/04/st11/st11220.en04.pdf

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