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Recommendation for a

COUNCIL RECOMMENDATION

on Poland's 2014 national reform programme

and delivering a Council opinion on Poland's 2014 convergence programme

{SWD(2014) 422 final}

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THE COUNCIL OF THE EUROPEAN UNION,

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

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

Having regard to the recommendation of the European Commission[2],

Having regard to the resolutions of the European Parliament[3],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States, which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full

[1] OJ L 209, 2.8.1997, p. 1.
[2] COM(2014) 422 final.
[3] P7_TA(2014)0128 and P7_TA(2014)0129.

commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on Poland's national reform programme for 2013 and delivered its opinion on Poland's updated convergence programme for 2012-2016.

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[4], marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[5], in which it did not identify Poland as one of the Member States for which an in-depth review would be carried out.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 24 April 2014, Poland submitted its 2014 national reform programme and on 30 April 2014 its 2014 convergence programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(8) The objective of the budgetary strategy outlined in the 2014 Convergence Programme is to bring the deficit below the 3% of GDP reference value of the Treaty by 2015 and reach the medium-term objective by 2018. The medium-term objective (-1% of GDP in structural terms) is more stringent than what the Stability and Growth Pact requires. The targets for the headline deficit presented in the 2014 Convergence Programme are consistent with a timely correction of the excessive deficit. Moreover, while the (recalculated) structural adjustment in 2014 is in line with the Council recommendation under the Excessive Deficit Procedure, it is below the required improvement in 2015. In the years after the planned correction of the excessive deficit, the planned (recalculated) annual progress towards the medium-term objective is lower than the requirement of the Stability and Growth Pact. Therefore, the programme objectives are partly in line with the requirements of the Stability and Growth Pact. The general government debt is projected to remain below 60% of GDP over the programme period. The Polish authorities project it to fall sharply from 57.1% of GDP in 2013 to 49.5% in 2014, mainly due to the large, one-off transfer of pension fund assets, and remain at this level in 2015. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible for 2014 and optimistic for 2015 with a higher rate of real GDP growth of 3.8% compared to 3.4% in the Commission 2014 spring forecast. Based on its assessment of the programme and the Commission forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that while Poland is expected to stay within the ceiling of the headline deficit recommended by the Council for 2014, there are risks to a sustainable correction of the excessive deficit in 2015 and, thereafter, to the appropriate adjustment path towards the medium-term objective.

[4] COM(2013) 800 final.
[5] COM(2013) 790 final.

(9) To ensure the success of the fiscal consolidation strategy, it is important that the fiscal consolidation is backed by comprehensive structural reforms. A low share of growth-enhancing expenditure (education, research and innovation) hampers long-term growth prospects. Healthcare spending is expected to grow considerably in the medium to long term because of an aging society. The burden on public finances could be lowered and the access to healthcare improved through strengthening primary care and referral systems and exploiting the potential for cost-efficiency gains in hospital care. Low tax compliance remains an issue, in particular in terms of efficiency of tax administration and in the level of administrative burden on taxpayers. Poland has an extensive system of reduced VAT rates which contributes to the highest VAT policy gap in the EU. It leads to revenue losses and increased tax compliance costs. The level of energy taxation is relatively low. Steps have been taken in the recent past to improve the Polish fiscal framework. Nevertheless, the framework would benefit from the introduction of a fully-fledged independent fiscal council, responsible for ex-ante checks of compliance with fiscal rules, an assessment of macroeconomic and budgetary forecasts and an analysis of the long term sustainability of public finances as well as an ex-post assessment of compliance with fiscal rules.

(10) Youth unemployment has been gradually increasing over the last year, which partly results from the ongoing mismatch between education outcomes and labour market needs as well as the growing proportion of young people that are not in education, employment or training. Despite ongoing efforts to reform the vocational education and training system, there is a need to further facilitate access to good quality apprenticeships and work-based learning, to strengthen cooperation between schools and employers and to reach out non-registered youth, in line with the objectives of a youth guarantee. Adjustment of skills to labour market requirements is also particularly important in the context of lifelong learning, where participation remains very low, especially with regard to older workers, whose competencies are often outdated. Labour market segmentation persists with the extensive use of fixed-term employment, including civil law contracts. The incidence of fixed-term employment is particularly high among the young. While fixed-term contracts are often argued to be an instrument for the unemployed to enter the labour market with a view to later moving on to a permanent contract, this seems not to be the case for the majority of workers in Poland, given that the transition rate from fixed-term employment to permanent employment is low, which tends to negatively influence productivity and the quality of human capital.

(11) Female labour market participation remains low. Poland has taken several measures to enhance female employment, including an increase in the availability of early childcare services (nurseries), and an increase in public funding for kindergartens to encourage parents to enrol their children in pre-school education. Nevertheless, availability of early childcare services is still low, especially in rural areas, and disparities in access to pre-school education remain. Labour market participation of older workers in Poland remains low. Early retirement possibilities have been reduced significantly but further efforts are needed to increase the employability of older workers and the effective duration of working life. Reforming the special pension schemes for miners and farmers remains a challenge. The farmers' scheme (KRUS) creates incentives for small-scale farmers to remain in the agricultural sector, resulting in hidden unemployment in rural areas and stimulating the informal economy. Miners continue to enjoy privileges in terms of pension rights and

minimum work record required. Both pension schemes impede sectoral and territorial labour mobility.

(12) Poland is among the EU countries with the lowest level of R&D expenditure and is one of the worst performers in broader innovation indicators. Private R&D expenditure is especially low. Low R&D spending is coupled with weak research and innovation activity by companies and an insufficiently innovation-friendly business environment. The innovation support system in Poland has been risk-averse, based mostly on grants, supporting technology absorption and transfer without a big impact on genuinely new innovation. Existing tax incentives for R&D are ineffective in promoting internal R&D by the private sector and are used only by big companies. Polish enterprises have relied largely on technology absorption. While this has been successful in ensuring productivity gains and economic growth, Poland now needs a transition towards a more indigenous innovation-based model. Raising the innovation capacity of Polish companies, improving links between science and industry and developing targeted instruments adapted to the whole innovation cycle remains a challenge.

(13) There are still very high potential gains from improvements in energy efficiency in all sectors of Poland's economy and such gains could support growth, improve competitiveness and contribute to reducing Poland's energy dependency. Domestic energy generation capacity is ageing and the electricity grid is still congested but projects to create more interconnection capacity to neighbouring Member States are advancing. The key problem in the natural gas market remains the lack of diversification and competition.

(14) Poland's underdeveloped transport and broadband infrastructure remains a major bottleneck to growth. In particular, significant investments are needed in the degraded railway network to increase the competitiveness of the rail sector and achieve a better balance between road and rail transport. Only around one third of the total of about 20000 km of operated railway lines is in a good technical condition. Problems with the timely implementation of railway projects continue. Resource efficiency can be increased by improving waste management.

(15) Contract enforcement in Poland is lengthy and the procedure to obtain construction permits is long and burdensome. Tax compliance costs are high, which is a major problem in the business environment. Poland has made substantial progress in implementing an ambitious reform facilitating access to regulated professions.

(16) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Poland's economic policy. It has assessed the convergence programme and the national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Poland but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (6) below.

(17) In the light of this assessment, the Council has examined Poland's convergence programme, and its opinion[6] is reflected in particular in recommendation (1) below.

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

HEREBY RECOMMENDS that Poland take action within the period 2014-2015 to:

1. Reinforce the budgetary strategy to ensure the correction of the excessive deficit in a sustainable manner by 2015 through achieving the structural adjustment effort specified in the Council recommendation under the Excessive Deficit Procedure. After the correction of the excessive deficit and until the medium-term objective is achieved, pursue an annual structural adjustment of 0.5% of GDP as a benchmark. A durable correction of the fiscal imbalances requires a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. In that regard, minimise cuts in growth-enhancing investment, improve the targeting of social policies and the cost effectiveness of spending and the overall efficiency of the healthcare sector, broaden the tax base by addressing the issue of an extensive system of reduced VAT rates, and improve tax compliance, in particular by increasing the efficiency of the tax administration. Establish an independent fiscal council.
2. Strengthen efforts to reduce youth unemployment, notably by further improving the relevance of education to labour market needs, increasing the availability of apprenticeships and work-based learning places and by strengthening outreach to unregistered youth and the cooperation between schools and employers, in line with the objectives of a youth guarantee. Increase adult's participation in lifelong learning in order to adjust skills supply to skills demand. Combat labour market segmentation by stepping up efforts to ensure a better transition from fixed-term to permanent employment and by reducing the excessive use of civil law contracts.
3. Continue efforts to increase female labour market participation, in particular by taking further steps to increase the availability of affordable quality childcare and pre-school education and ensuring stable funding. Include farmers in the general pension system, starting by speeding up the creation of the system for assessment and recording of farmers' incomes. Phase out the special pension system for miners with a view to integrating them into the general scheme. Underpin the general pension reform by stepping up efforts to promote the employability of older workers to raise exit ages from the labour market.
4. Improve the effectiveness of tax incentives in promoting R&D in the private sector as part of the efforts to strengthen the links between research, innovation and industrial policy, and better target existing instruments at the different stages of the innovation cycle.
5. Renew and extend energy generation capacity and improve efficiency in the whole energy chain. Speed up and extend the development of the electricity grid, including cross-border interconnections to neighbouring Member States, and develop the gas interconnector with Lithuania. Ensure effective implementation of railway investment projects without further delay and improve the administrative capacity in this sector. Accelerate efforts to increase broadband coverage. Improve waste management.
6. Take further steps to improve the business environment by simplifying contract enforcement and requirements for construction permits. Step up efforts to reduce

costs and time spent on tax compliance by businesses. Complete the ongoing reform aimed at facilitating access to regulated professions.

Done at Brussels,

For the Council
The President