POLAND

Highlights

- **GDP growth remains robust.** The economic expansion was underpinned by continuously robust household consumption and improved investment, in particular in the public sector. In contrast, gross fixed capital formation by domestic private sector companies has remained low.
- **Public spending on healthcare is being reformed.** In June 2018 the government approved an amendment to the healthcare legislation to gradually increase public spending on health from the current 4.7 per cent to 6.0 per cent of GDP by 2024.
- **Special economic zones have been extended to cover the entire country.** In order to incentivise investment, companies will benefit from tax breaks for 10 to 15 years. The size of the relief will depend on the site of the investment, its nature and the quality of employment created.

Key priorities for 2019

- **Controversies relating to the ongoing judicial reform should be resolved to ensure the proper functioning of judicial bodies and the independence of the judiciary.** A satisfactory resolution of these issues would have a positive effect on business sentiment and could help attract private sector investment.
- **More measures to tackle high air pollution should be introduced.** Poland is home to 7 out of 10 cities in the European Union (EU) with the highest levels of particulates.
- **The efficiency and effectiveness of the social benefits system should be improved.** Among other measures, steps should be taken to expand access to long-term care and childcare in order to relieve bottlenecks and further increase employment.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
DP growth	3.3	3.8	3.0	4.6	4.7
Inflation (average)	0.1	-0.7	-0.2	1.6	1.7
Government balance/GDP	-3.6	-2.6	-2.3	-1.7	-1.4
Current account balance/GDP	-2.1	-0.6	-0.5	0.2	-0.7
Net FDI/GDP [neg. sign = inflows]	-2.4	-2.1	-0.9	-1.3	-2.0
External debt/GDP	72.7	71.8	76.5	67.1	n.a.
Gross reserves/GDP	18.4	19.9	24.3	22.6	n.a.
Credit to private sector/GDP	49.8	51.1	52.5	52.2	n.a.

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Macroeconomic performance

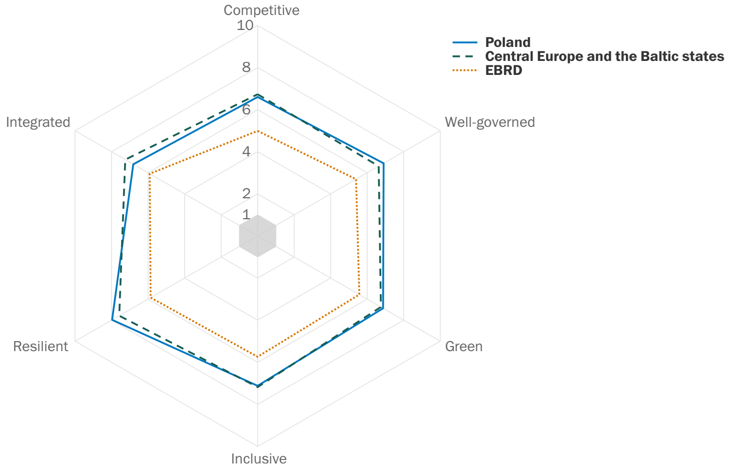
GDP growth has remained strong. The economy grew by 4.8 per cent in 2017 and the economic expansion accelerated further to 5.1 per cent year-on-year in the first half of 2018, amid continuously robust household consumption and improved investment, the latter rising by 3.4 per cent in 2017 and accelerating to 6.0 per cent year-on-year growth in the first half of 2018. Public investment has been expanding for some years, while private sector investment has finally showed early signs of recovery since the second quarter of 2018, driven mainly by foreign-owned companies and in sectors such as machinery, technical equipment, tools and transport. The expansionary fiscal policy and improving labour conditions underpinned the solid household consumption growth. Export demand has been strong, although its positive impact on GDP growth was markedly offset by consumption- and investment-led imports.

Labour shortages are increasing. The employment rate grew to 72 per cent in the first quarter of 2018, slowly approaching the EU average of 72.9 per cent. At the same time, the unemployment rate dropped to 3.7 per cent in mid-2018, the third lowest in the EU. The shrinking pool of labour, induced mainly by ageing, the decreased retirement age and higher social benefits, has resulted in decreased labour force participation, especially of women, and constitutes a limiting factor by almost 50 per cent of companies in Poland, according to the third quarter of 2018 European Commission business survey. While difficulties in employing new workers may be a factor in favour of greater automatisation in about 16 per cent of companies, according to a local employment agency, the shortage of workers has already delayed investment plans. This is especially visible in the construction sector.

Fiscal policy remains pro-cyclical, despite the booming economy. The budget deficit declined to 1.7 per cent of GDP in 2017, benefiting from strong GDP growth and improved tax collection, including higher VAT compliance. Public debt is forecast to remain at 53 per cent of GDP by the end of 2018, according to the European Commission, but the increased number of additional fixed expenditure positions introduced in the past two years constitutes a significant fiscal risk in case of a cyclical economic slow-down.

Strong economic growth will likely moderate. GDP growth may have peaked in mid-2018, but it is expected to remain robust over the forecast horizon. Amid increasing inflation, household consumption will likely soften to some extent, but the tightening labour market, noticeable largely in rising wages, will keep it at a high level. Investment is expected to continue its recovery, in particular in the public sector. Nevertheless, a possible delay in the recovery in private investment of domestic companies constitutes a downside risk to that scenario. Global trade disruptions contribute also to that uncertainty. As a result, GDP growth in 2018 is forecast to reach 4.7 per cent and to slow down to 3.6 per cent in 2019.

Assessment of transition qualities (1-10)



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Major structural reform developments

Judicial reform has raised controversy, seen as undermining the independence of the judiciary. The ongoing reform of the judiciary, including of the Supreme Court, the National Council for the Judiciary and the organisation of ordinary courts, has been seen by relevant international organisations as undermining the independence of the judiciary. The European Commission submitted in December 2017 a reasoned proposal to the Council inviting it to adopt a decision under Article 7(1) of the Treaty on European Union. The General Affairs Council (GAC) held two hearings under Article 7(1) TEU on the rule of law in Poland, in June and September 2018. The Commission also launched an infringement procedure against Poland concerning the law on ordinary courts (December 2017) and an infringement procedure regarding the law on the Supreme Court (July 2018). The United Nations, the Organisation for Security and Co-operation/Office of Democratic Institutions and Human Rights and the Council of Europe have also voiced their concerns, as have Polish judges. The Polish Supreme Court appealed to the European Court of Justice (ECJ) to rule on the legality of some of the changes adopted by the law on the Supreme Court. The government of Poland has, nevertheless, considered those concerns to be unjustified and has proceeded with the judicial reform.

New taxes are being introduced. The government plans to introduce several new taxes in 2019, such as a solidarity tax, an emissions charge on the fuel price, a removal of the limit on social security contributions and the so-called exit tax. The solidarity tax would be paid on any income over PLN 1 million (about €230 million) a year as a way to finance more spending on disabled persons, following protests by this group in early 2018. The emissions charge is expected to support the so-called Low Emission Transport Fund, which will finance environmentally friendly investments, largely aimed at reducing air pollution. The removal of the limit on social security contributions will force taxpayers to continue paying contributions even if their income exceeds 30 times the average. Lastly, the exit tax will be payable on unrealised capital gains on assets that would be transferred abroad.

Use of cohesion policy funds has been moderate. In the 2014-20 budget, Poland was allocated €86 billion of EU funds, which represents about 2.8 per cent of GDP annually. By the end of 2017, about 55 per cent of the funds had already been allocated to projects on the ground. About €3.4 billion is expected to be delivered via financial instruments, which is three times more than in the previous budget.

Public spending on healthcare is being reformed. In June 2018 the government approved an amendment to the healthcare legislation to gradually increase public spending on health from the current 4.7 per cent to 6.0 per cent of GDP by 2024. The amendment law was a pledge to resident doctors in order to end a strike over low pay in late 2017. The number of practising doctors and nurses relative to the population remains among the lowest in the EU, which has negative implications for access to healthcare. Without a significant increase in the tax wedge, a jump in healthcare spending of this scale will require a major change in the health funding system, which today is directly linked with tax-like contributions.

The new posted worker directive is expected to affect Poland the most among the EU member states. In June 2018, the European Council adopted posted worker rules, which will limit posted work to 12 months, with a possible extension by an additional six months. Afterwards, the posted workers will need to be hired under local conditions, including higher social insurance payments to the host country. Poland, together with Hungary, voted against that approval, which will come into effect after a two-year adjustment period. Out of the estimated 2 million posted workers in the EU, Poland accounts for some 22 per cent of them.

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Gas import dependence on Russia is falling. According to PGNiG, the state-controlled natural gas company, the reliance on imported natural gas from Russia was reduced from 90 per cent in 2015 to 70 per cent in 2017. The reduction was possible through increased liquefied natural gas (LNG) imports from Qatar via the new LNG terminal on the Baltic Sea, opened in late 2015. The expected additional LNG gas imports from the United States of America, together with the imports from Norway through the Baltic Pipe, to be ready in October 2022, are expected to cover all of the country's gas consumption needs by the end of 2022.

Measures to increase savings and pensions are being introduced. Following the initial declaration in mid-2016, the Employee Capital Plan (PPK) scheme was officially announced by the prime minister in February 2018. The main goal of the scheme is to increase the low domestic savings, as participants will put aside between 0.5 and 4.0 per cent of their income, topped up by an additional 1.5 per cent to 4.0 per cent by the employer, and some additional money by the state. The additional money saved by participants is aimed to partially offset the expected low pension replacement rates. The PPK was approved by parliament in October 2018 and it is expected to gradually enter into force from June 2019, starting with the biggest companies.

The government has introduced new incentives for investment. In May 2018 parliament approved a bill that simplifies the current system of 14 special economic zone tax incentives. Tax breaks will be given to investors for 10 to 15 years, and the size of the relief will depend on different factors, such as the site of the investment, its nature and the quality of employment created. The government wants to attract more investment, in particular related to know-how transfer, research and development and cluster development, mainly in less-developed regions.