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Republic of Poland: Report on Observance of Standards and Codes—Fiscal Transparency Module—Update

This update to the Report on the Observance of Standards and Codes on Fiscal Transparency for the **Republic of Poland** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **June 2004.** The views expressed in this document are those of the staff team and do not necessary reflect the views of the government of the **Republic of Poland** or the Executive Board of the IMF.

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REPORT ON THE OBSERVANCE OF STANDARDS AND CODES
POLAND—FISCAL TRANSPARENCY MODULE: AN UPDATE
JUNE 2004

The Report on the Observance of Standards and Codes (ROSC) in Poland was issued in February 2001, and was updated in June 2003. The original report identified a number of areas where progress had been made in recent years in meeting the requirements of the Code of Good Practices in Fiscal Transparency, while flagging areas where transparency could still be improved. This note reports on developments since the 2003 update. For a full description of institutions, practices, and IMF staff recommendations, this note should be read in conjunction with the original report and the update.[1] *Poland joined the European Union (EU) on May 1, 2004 and number of changes in the area of fiscal transparency were prompted by the harmonization of Poland's practices and standards with those of the EU.*

I. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

The original ROSC concluded that fiscal transparency could be enhanced by eliminating a number of extrabudgetary funds and by bringing gross privatization flows into the central budget. It also recommended simplification of the tax system and improvements in tax administration.

The progress has been mixed. Moving in the direction of greater transparency and efficiency:[2]

- Three state offices were consolidated with the government.[3] Also, the Alimony Fund, an extrabudgetary fund, was liquidated and its functions were shifted to the local governments as of May 1, 2004. The medium-term fiscal reform plan under consideration envisages further consolidation of some extrabudgetary entities and

[1] The original report *Republic of Poland—Report on the Observance of Standards and Codes (ROSC)—Fiscal Transparency Module,* and its 2003 update are available on the IMF internet web site at: www.imf.org./external/np/rosc/rosc.asp.

[2] The numbers in the parentheses following the paragraphs refer to the most relevant elements of the IMF's *Code of Good Practices on Fiscal Transparency*.

[3] These were: the Technical Supervision Office, the Transport Technical Supervision Office, and the Accreditation Center.

elimination of certain overlapping functions between the central and local governments. (1.1.1)

- The use of "special means" (earmarked off-budget accounts in the budgetary units mainly used for bonus payments to civil servants) was curtailed in 2004, and 40 percent of these resources were consolidated with the state (central government) budget. (1.1.3)

- Efforts were also made to decentralize fiscal activity and increase the efficiency of public spending. A new law on local government revenue increased the share of local governments in central income taxes, while reducing the earmarked state subsidies to them by a similar amount. This increases the flexibility of local governments to spend these resources in line with their own requirements and priorities. (1.1.2)

- Important progress was made in simplifying the tax system as, effective 2004, a large number of exemptions and allowances in personal and corporate income taxes were eliminated. At the same time, VAT exemptions granted to enterprises employing disabled workers were eliminated and were replaced by direct subsidies. Special offices for large taxpayers were created in January 2004 to help improve tax administration. (1.2.2)

However, complicating transparency and impairing efficiency:

- Privatization receipts continued to be earmarked for off-budget expenditure, mostly for enterprise restructuring.[4] Moreover, the non-transparent practice of using government shares in listed companies to recapitalize ailing state-owned enterprises continued in 2003 and 2004. (1.1.4)

- Amendments to the law on public highways increased the scope of resource earmarking and quasi-fiscal activities. Specifically, a fuel surcharge—collected at the pump and earmarked for the National Road Fund (NRF)—was introduced in 2004. The NRF which finances the public highway program is managed by the state-owned Domestic Economy Bank (BGK). The law also opens the door to the possibility of government using its equity holdings in listed companies to augment NRF resources. (1.1.4)

[4] Despite continued earmarking, there was some improvement in transparency as gross privatization receipts and their off-budget uses are presented in the state budget financing table beginning with the 2004 budget.

B. Public Availability of Information

The public availability and the coverage of fiscal information have improved significantly since the original ROSC was issued and many of the shortcomings identified in the report, including the provision of data on contingent liabilities and public debt and expenditure arrears, have been addressed. The Ministry of Finance (MoF) has also made progress in improving communication with financial markets as regards issuance of government securities.

- The range of fiscal information available on the MoF's web site (www.mf.gov.pl) was further expanded last year by including monthly data in the format of the IMF's Government Finance Statistics (GFS 1986), as well as analytical economic reviews prepared by the MoF staff. (2.1.1)

- With its accession to the EU, Poland has to comply with EU information requirements, including preparation of convergence programs with medium term fiscal projections and fiscal sensitivity analysis. The annual budget documents should be consistent with the framework of convergence reports. (2.1.2)

- The primary market dealership system for government securities introduced in 2003 has improved communication with the financial markets. With the aim of improving its efficiency, the government intends to open the primary dealer system to foreign participation in the coming years. It is also planned to harmonize the electronic platform for bond trading with EU standards. (2.1.4)

C. Open Budget Preparation, Execution and Reporting

The original ROSC suggested establishing a clear and comprehensive concept of fiscal deficit to remove incentives for creative accounting practices and pushing the state budget deficit to the outer layers of the general government.

- Limits on the state budget deficit continues to serve as the fiscal rule, while the fiscal stance is measured by wider concepts of general government deficit. Starting with the 2004 budget, the official definition of state budget deficit was modified by excluding transfers to the open pension funds from state expenditure—this reduced the deficit by more than 1 percent of GDP.[5] The treatment of these transfers is under discussion with the Eurostat. (3.1.2)

- Progress is being made in complying with international reporting standards. With technical support from the IMF, in 2003, and based on the available information, the

[5] The government's decision is based on the argument that these transfers are financed by privatization receipts, which are financing rather than revenue items.

MoF began compiling and disseminating fiscal data in the format of the accrual-based 2001 version of the IMF's *Government Finance Statistics Manual (GFSM 2001)*. The scope and coverage of accrual data is being expanded to enhance GFSM 2001 reporting. Progress is also being made to meet the EU reporting requirements according to the ESA 95 format, which is compatible with the *GFSM 2001.* The Central Statistical Office will start publishing historical data on government sector transactions on the ESA 95 basis later this year. With Poland's EU accession, the fiscal stance measured on the ESA 95 basis is gaining importance and will ultimately become the main fiscal indicator. Consideration is also being given to adopting the ESA 95 standards for public debt statistics. (3.2.1)

- The government also approved a new public procurement law compatible with EU standards and norms. The new law extends the coverage of the general government for procurement purposes to the broader ESA 95 definition, and abolishes the national preference in procurement. It also brings more transparency and scrutiny in large bids (exceeding €10 million in construction and €5 million in other areas), while reducing the administrative burden in the case of small bids (euro €30,000–60,000). (3.3.2)

II. IMF Staff Commentary

While fiscal transparency in Poland has improved in recent years, and is generally in line with international standards, there are still some outstanding issues which need to be addressed:

- The reporting standards should be harmonized across the general government. In this context, the progress in implementing the *GFSM 2001* and ESA 95 standards is encouraging and should be intensified. (3.2.1)

- There are various measurements of general government's fiscal stance. It is important to establish an official headline measure of the deficit that could serve as a policy target and be monitored and published regularly with a short time lag. This would provide clear market guidance with regard to the fiscal stance and developments. (3.2.3)

- Preparing a medium-term budget framework in the context of the convergence report, with a comprehensive assessment of fiscal risks, would also be an important step forward. Output-oriented budgeting, with ex-post "value-for-money" monitoring, would help in assessing the efficiency of public service delivery. (3.1.3/3.4.3)

- Efforts to reduce budget fragmentation should continue. Budget entities should be consolidated to the extent possible and the scope of nontransparent activities—such as recapitalization of ailing state enterprises, particularly by using government equity holdings in listed companies—should be eliminated. (1.1.1/1.1.4)

- Communication with the financial markets on the government securities market should remain a forces of policy-makers.

(2.1)