EUROPEAN COMMISSION

Brussels, 11.1.2012
COM(2012) 5 final

Recommendation for a

COUNCIL DECISION

Establishing that no effective action has been taken by Hungary in response to the Council Recommendation of 7 July 2009

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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 Article 126(8) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 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 Council 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 in order to further the prompt correction of excessive general government deficits.

(3) The Council, acting upon a recommendation by the Commission, decided on 5 July 2004, in accordance with Article 104(6) of the Treaty, that an excessive deficit existed in Hungary[2]. On the same day, and also on the basis of a recommendation by the Commission, the Council adopted recommendations under Article 104(7) asking the Hungarian authorities to take action in a medium-term framework in order to bring the deficit below 3 % of GDP by 2008.

(4) In January 2005, in accordance with Article 104(8) TEC, the Council considered that Hungary had not taken effective action in response to its recommendation and issued another recommendation based on Article 104(7) TEC in March 2005, confirming the 2008 deadline for the correction of the excessive deficit. After a substantial deterioration of the budgetary outlook in Hungary, the Council decided in November

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1 OJ L 209, 2.8.1997, p. 6.

2 OJ L 389, 30.12.2004, p. 27. All EDP-related documents for Hungary can be found at the following website: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm.

2005 that Hungary had for the second time failed to comply with recommendations under Article 104(7) TEC. Accordingly, the Council addressed a third recommendation under Article 104(7) TEC to Hungary in October 2006, postponing the deadline for the correction of the excessive deficit to 2009. In July 2009 it concluded that the Hungarian authorities could be considered to have taken effective action in response to the recommendations from October 2006. Against the background of the severe downturn in the context of the economic and financial crisis, it issued a revised (the third) recommendations under Article 104(7) TEC.

(5) The Council recommendation of July 2009 called on the Hungarian authorities to put an end to the excessive deficit situation by 2011 at the latest. Specifically, Hungary was recommended to limit the deterioration of the fiscal position in 2009 by ensuring a rigorous implementation of the adopted and announced corrective measures to respect the target of 3.9 % of GDP. Additionally, starting from 2010, it was also recommended to rigorously implement the necessary consolidation measures to ensure a continued reduction of the structural deficit and a renewed decline of the headline deficit, with an increased reliance on structural measures, in view of warranting a lasting improvement of public finances. The Council also recommended to spell out and adopt in a timely manner the consolidation measures necessary to achieve the correction of the excessive deficit by 2011 and ensure, at least, a cumulative 0.5% of GDP fiscal effort over 2010 and 2011. The Hungarian authorities were also recommended to ensure that the government gross debt ratio was brought onto a firm downward trajectory.

(6) On 27 January 2010 the Commission adopted a Communication to the Council concluding that, based on information available at the time, it considered that Hungary had taken effective action in response to the Council recommendations of July 2009, in particular taking into account consolidation measures of 1½% of GDP to meet the 2009 deficit target of 3.9% of GDP, structural reforms in the pension and the social benefit system supporting the achievement of the 2010 deficit target of 3.8% of GDP, and progress regarding the implementation of the new fiscal framework but alerted about considerable risks.

(7) A new assessment of the action taken by Hungary to correct the excessive deficit by 2011 in response to the Council recommendation under Article 104(7) of the Treaty, based on, inter alia, the 9th EDP progress report submitted to the Commission and the Council on 15 December 2011, leads to the following conclusions:

- In 2010 the actual budget deficit exceeded the target by 0.4% of GDP while economic growth was stronger in 2010 than foreseen by the Commission services' 2009 Spring Forecast, which had served as the basis for the Council recommensations of July 2009. In 2011, the general government balance is expected (both by the government and the Commission services' Autumn 2011 Forecast) to turn into surplus, but only thanks to one-off revenues of 9 ¾% of GDP linked to the transfer of the pension assets from the private pension schemes to the state pillar and of 0.9% of GDP from sectoral levies (on telecom, energy, retail and financial sectors).Without one-off measures the deficit would have reached around 6% of GDP and by far surpassed the 3% of GDP reference value in the Treaty. In their 2011 autumn EDP notification, the Hungarian authorities projected a surplus of 3.9% of GDP. The Commission services' 2011 Autumn Forecast projected a somewhat lower surplus (3.6% of GDP), notably since it

included the assumption of part of the debt of public transport companies' (0.2% of GDP). Based on recent information on one-offs received after the cut-off date of the 2011 Autumn Forecast, the surplus may even be lower. As to the structural deficit, it deteriorated by 1½% in 2010 and by 1¼% in 2011, a cumulative 2¾% of GDP, contrary to the Council recommendation of ensuring, at least, a cumulative 0.5% of GDP fiscal effort over these two years as needed to correct the deficit by the 2011 deadline in a sustainable manner. This structural deterioration is a reflection of the fact that tax cuts amounting to over 2% of GDP were not suffiently compensated by structural measures.

– Regarding 2012, the draft budget targets a deficit of 2.5% of GDP in line with the 2011 update of the Convergence Programme (CP). In order to achieve this, the budget proposal contains several measures, altogether amounting to close to 4% of GDP according to the authorities, while setting aside 0.7% of GDP as an extraordinary reserve buffer. In contrast, the Commission services' 2011 Autumn Forecast projects the 2012 general government deficit to reach 2.8% of GDP. Compared to the draft budget, this higher deficit number reflects, among other factors, a lower economic growth projection for 2012 by 1 pp. as well as a more prudent assessment of revenue and expenditure developments. At the same time, it assumes in line with the relevant legislation that the extraordinary reserve is not expected to be spent. Nevertheless, the 3% of GDP threshold is only respected on the back of a close to 0.9% of GDP one-off revenue stemming from the above-mentioned extraordinary levies.

– According to the Commission services' 2011 Autumn Forecast, and based on the usual no-policy-change assumption, the budget deficit was projected to deteriorate again to 3.7% in 2013. This is chiefly due to the fact that the phasing out of the extraordinary levies of around 0.9% of GDP is not expected to be counterbalanced by the additional savings from the structural reform programme for that year.

– Based on budgetary developments since the publication of the 2011 Autumn Forecast, the 2012 projection of 2.8% of GDP still appears to be plausible (without taking into the recent deterioration in the macroeconomic environment). This is explained by the fact that the deficit-decreasing impact of the new consolidation package of 0.4% of GDP adopted by the government on 15 December 2011 is broadly counterbalanced by the deficit-increasing amendments adopted to the draft budget as well as by the net budgetary costs of the agreement with the banking sector concluded on 15 December 2011 which are not yet appropriately offset by additional consolidation measures).

– For 2013, taking into account some further specifications of the structural reform programme (related government and Parliamentary decisions are detailed in the December 2011 progress report), the positive base effect from 2012 and the net cost stemming from the agreement with the banking sector, the 2013 deficit projection contained in the 2011 Autumn Forcast could be lowered from 3.7% of GDP to 3¼% of GDP, which is still clearly above the 3% deficit threshold. The difference between this updated assessment and the official target (2.2% of GDP) notably stems from the fact that in the absence of specific steps about half of the structural reform programme could not be taken into account. The remainder of the difference compared to the official target is related to a higher expenditure forecast notably in the area of state-owned transport enterprises and the

maintenance of roads and also incorporates some difference in growth assumptions.

– The risks to these updated medium-term projections are tilted to the downside. There is some positive risk, notably stemming from the continuation of better-than-expected revenue inflows into 2012 and 2013. However, it is expected to be more than offset by negative risks. In particular, interest rates for all maturities have increased, the exchange rate has weakened, and the medium-term economic outlook seems to have worsened since the 2011 Autumn Forecast was published on 10 November 2011. Overall, if these factors were taken into account, the deficit projections in both 2012 and 2013 would be further increased by ½% of GDP, leading to deficits of just above 3% of GDP and 3¾% of GDP, respectively.

– According to the 2011 Autumn Forecast, gross public debt, given both the forecast deficit numbers and the exchange rate assumptions, is expected to increase again to nearly 77% of GDP by 2013, following a temporary drop in 2011 due to the takeover of the private pension assets. If the medium-term budgetary projections were updated only on the basis of new measures adopted after the cut-off date of the forecast, the projected 2012 debt ratio would be largely unchanged and improve only slighly in 2013. However, further possible revisions in the budgetary projections, taking into account most notably the increased yields, the end-2011 HUF/EUR exchange rate of 311 (which is around 12% weaker than the technical assumption used in the Autumn Forecast), as well as the weaker macroeconomic environment would lead to a debt ratio of around 80% in 2011, after which it would stabilise at around 78.5% in both 2012 and 2013 whereas the Council recommended that the gross debt ratio should be brought onto a firm downward trajectory.

(8) The overall conclusion is while Hungary formally respects the 3% of GDP reference value by 2011 this is not based on a structural and sustainable correction. The budget surplus in 2011 hinges upon substantial one-off revenues of over 10% of GDP and is accompanied by a cumulative structural deterioration in 2010 and 2011 of 2¾% of GDP compared to a recommended cumulative fiscal improvement of 0.5% of GDP. Moreover, while the authorities are implementing substantial structural measures in 2012; the 3% of GDP reference value is again only respected thanks to one-off measures of close to 1% of GDP. Finally, in 2013, the deficit (at 3¼% of GDP) is expected to surpass the reference value in the Treaty again even after taking into account additional measures announced since the Commission services' 2011 Autumn Forecast). The higher deficit in 2013 is mainly linked to the fact that temporary one-off revenues are being phased out as planned while not all planned structural reforms are sufficiently specified. Overall, this supports the conclusion that the response by the Hungarian authorities to the Council recommendation according to Article 104(7) of the Treaty of 7 July 2009 has been insufficient,

HAS ADOPTED THIS DECISION:

Article 1

Hungary has not taken effective action in response to the Council recommendation according to Article 104(7) of the Treaty of 7 July 2009.

Article 2

This Decision is addressed to Hungary.

Done at Brussels,

For the Council
The President