COUNCIL OF THE EUROPEAN UNION

Brussels, 20 June 2012

11010/1/12
REV 1

UEM 174
ECOFIN 534
SOC 522
COMPET 390
ENV 483
EDUC 174
RECH 234
ENER 260

NOTE

from:	Permanent Representatives Committee
to:	Council
No. Cion prop.:	10542/12 UEM 125 ECOFIN 460 SOC 443 COMPET 337 ENV 425 EDUC 134 RECH 186 ENER 212 - COM(2012) 317 FINAL
Subject:	Draft Council Recommendation on Hungary's 2012 national reform programme and delivering a draft Council opinion on Hungary's convergence programme for 2012-2015

Delegations will find attached the above Draft Council Recommendation, as considered and, where indicated *in italics*, revised by COREPER, based on the Commission proposal COM (2012) 317 final.

The text in **bold** indicates the recommendations which have been considered in COREPER 1 and to be approved by the EPSCO Council on 21 June.

ANNEX

DRAFT COUNCIL RECOMMENDATION

on Hungary's 2012 national reform programme

and delivering a draft Council opinion on Hungary's convergence programme for 2012-2015

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 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission[3],

Having regard to the resolutions of the European Parliament,[4]

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

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1 OJ L 209, 02.08.1997, p. 1
2 OJ L 306, 23.11.2011, p. 25
3 COM(2012)317 final
4 P7_TA(2012)0048 and P7_TA(2012)0047

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, 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 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[5], 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 12 July 2011, the Council adopted a recommendation on Hungary's national reform programme for 2011 and delivered its opinion on Hungary's updated convergence programme for 2011-2014.

(4) On 23 November 2011, the Commission adopted the second Annual Growth Survey, marking the start of the second European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy. On 14 February 2012, the Commission, on the basis of Regulation (EU) 1176/2011, adopted the Alert Mechanism Report[6], in which it identified Hungary as one of the Member States for which an in-depth review would be carried out.

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[5] Council Decision 2012/238/EU of 26 April 2012
[6] COM(2012) 68 final

(4 a) On 1 December 2011, the Council adopted conclusions calling the Social Protection Committee, in co-operation with the Employment and other Committees, to present its views on actions recommended within the Europe 2020 policy cycle. These views form part of the opinion of the Employment Committee.

(5) On 2 March 2012, 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.

(6) On 29 February 2012, the European Parliament and Hungary exchanged views under Article 2a of 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.

(7) On 2 March 2012, the European Council also invited Member States participating in the Euro Plus Pact to present their commitments in time for inclusion in their stability or convergence programmes and their national reform programmes.

(8) On 23 April 2012, Hungary submitted its convergence programme covering the period 2012-2015 and its 2012 national reform programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time. The Commission has also assessed, in an in-depth review under Article 5 of Regulation (EU) No 1176/2011, whether Hungary is affected by macroeconomic imbalances. The Commission concluded in its in-depth review[7] that Hungary is experiencing external and internal Imbalances, although not excessive.

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[7] SWD(2012)157 final

(9) Based on the assessment of the 2012 Convergence Programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is somewhat optimistic. The Hungarian authorities' growth projections for 2012 and 2013 are higher by around half a percentage point compared to the Commission's 2012 spring forecast on the account of the more optimistic official assumptions regarding domestic demand, particularly in 2013. The objective of the budgetary strategy outlined in the programme is to ensure the sustainable correction of the excessive deficit by the 2012 deadline set by the Council in line with the Council Recommendation of March 2012. The official deficit targets and the planned fiscal efforts comply with the March 2012 Council recommendations based on Article 126(7). The programme confirms the previous medium-term budgetary objective (MTO) of 1.5% of GDP, which it plans to achieve by 2013. The MTO adequately reflects the requirements of the Stability and Growth Pact. Based on the (recalculated) structural budget balance[8], progress towards the MTO does not appear to be adequate in 2013 against the assessment of the Commission's 2012 spring forecast, which takes into account the implementation risks related to selected saving measures and a less optimistic macroeconomic scenario. The growth rate of government expenditure, taking into account discretionary revenue measures, is in line with the expenditure benchmark of the Stability and Growth Pact in 2013, but not in 2014 and in 2015. According to government plans, the public debt is continuously reduced throughout the programme period to below 73% of GDP in 2015, but will remain above the 60% of GDP reference value. Regarding the debt reduction benchmark, Hungary will be in transition period in 2013-2014 and the programme would ensure sufficient progress towards compliance with the benchmark. According to the programme, the debt reduction benchmark would be met at the end of the transition period, in 2015, and thereby should help to reduce the accumulated external and internal indebtedness.

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8 Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology.

(10) New regulations have been adopted for the implementation of the constitutional fiscal governance framework, but some of its features remain weak. The medium-term budgetary planning is only indicative, the resources of the Fiscal Council are not commensurate with its newly-granted strong veto power, and the availability of budgetary information remains insufficient. Strengthening the medium-term budgetary planning dimension and widening the analytical remit of the Fiscal Council would help to ensure that the new constitutional fiscal governance framework can play its role.

(11) Policy responses to address the impact of tax reform on low wage earners (minimum wage increase, wage subsidy scheme) have not contributed to enhancing employment, whereas measures to encourage women's participation in the labour market are a small step in the right direction. Making labour taxation more employment-friendly and further strengthening measures to encourage the participation of women in the labour market, particularly by expanding childcare and pre-school facilities, would help to improve the employment rate.

(12) The public employment service has been reorganised resulting in an overall downsizing, pointing in the opposite direction of what was recommended in 2011. In the field of active labour market policies some measures aiming to provide tailor-made services for disadvantaged groups, for instance, under ESF programmes, appear credible and relevant. However, other measures aimed at disadvantaged groups (e.g. public works) are unlikely to be effective in improving the placement of participants in the open job market. Serious steps to strengthen the capacity of the public employment service should be taken without delay, while keeping the right balance of funding between public works and other active labour market policies, to help to improve the functioning of the labour market and raise the participation rate. Raising the growth potential through structural reform in the labour market would also be important for a sustained reduction of the vulnerabilities stemming from the large stock of external and internal debt. Furthermore, the National Social (Roma) Inclusion Strategy has not been mainstreamed in other policies.

(13) Measures to improve the business environment largely go in the right direction, but there is significant room for further progress. Efforts to improve access to non-bank funding are also going in the right direction, but a comprehensive assessment of SME policies is still missing. Hungary ranks very low on many indicators measuring the transparency and quality of public administration, where progress would also help in improving the stability of the institutional and policy environment. This, in turn, could improve conditions for foreign direct investment and would support the reduction of the significant imbalance in the net international investment position: in particular, the ratio of reinvested profits fell dramatically in 2009 and 2010 partly on account of the crisis but also as a result of a number of controversial and unpredictable changes in the policy and fiscal environment and in the legal and institutional system. The recent trend in public funding for research and innovation (since mid-2010) is not in line with the 2012 Annual Growth Survey priority of differentiated growth-friendly fiscal consolidation.

(14) The Hungarian government carried out a higher education reform that introduced changes in the structure and funding of higher education. In addition, elements of the new legislation on school education risk increasing the number of early school leavers and segregation in the Hungarian school system. The equally important issue of lifelong learning is not sufficiently addressed. Improving education at all levels will be important to raise the competitiveness of the Hungarian labour force.

(15) The lack of progress in restructuring public transport has been an important reason for budget slippages in recent years. The vast majority of the rolling stock of public transport companies have reached the limits of their utility. Increasing the cross-border capacity of the electricity network could facilitate a potential increase in trade with neighbouring countries. The national energy regulator is not empowered to organise its structures autonomously and lacks exclusive competence to set network tariffs including the rate of return that network operators are allowed to earn. Regulated prices should only apply to vulnerable customers.

(16) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Hungary's economic policy. It has assessed the convergence programme and national reform programme, and has presented an in-depth review. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Hungary, 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 (7) below.

(17) In the light of this assessment, the Council has examined Hungary's convergence programme, and its opinion[9] is reflected in particular in recommendation (1) below.

(18) In the light of the results of the Commission's in-depth review and this assessment, the Council has examined Hungary's 2012 national reform programme and Hungary's convergence programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in particular in recommendations (1), (3), (4) and (5) below;

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

HEREBY RECOMMENDS THAT HUNGARY SHOULD TAKE ACTION WITHIN THE PERIOD 2012-2013 TO:

1. Correct the excessive deficit by 2012 in a durable manner, by implementing the 2012 budget and the subsequently approved consolidation measures, while reducing the reliance on one-off measures. Thereafter, specify all structural measures necessary to ensure a durable correction of the excessive deficit and to make sufficient progress towards the medium-term budgetary objective (MTO), including meeting the expenditure benchmark, and ensure sufficient progress towards compliance with the debt reduction benchmark. Also to help mitigate the accumulated macroeconomic imbalances, put the public debt ratio on a firm downward path.

2. Revise the cardinal law on economic stability by putting the new numerical rules into a binding medium-term budgetary framework. Continue to broaden the analytical remit of the Fiscal Council, with a view to increasing the transparency of public finances.

3. Make the taxation of labour more employment-friendly by alleviating the impact of the 2011 and 2012 tax changes on low earners in a sustainable, budget-neutral manner, for example by shifting part of the tax burden to energy taxes and recurrent taxes on property. Strengthen measures to encourage women's participation in the labour market, particularly by expanding childcare and pre-school facilities.

4. Strengthen the capacity of the Public Employment Service to increase the quality and effectiveness of training, job search assistance and individualised services, with particular regard for disadvantaged groups. Strengthen the activation element in the public work scheme through effective training and job search assistance. Implement the National Social (Roma) Inclusion Strategy, and mainstream it with other policies.

5. Implement measures envisaged to reduce the administrative burden. Ensure that public procurement and the legislative process support market competition and ensure a stable regulatory and business-friendly environment for financial and non-financial enterprises, including foreign direct investors. Reduce tax compliance costs and establish a stable, lawful and non-distortive framework for corporate taxation. Remove unjustifiable restrictions on the establishment of large-scale retail premises. Provide specific well-targeted incentive schemes to support innovative SMEs in the new innovation strategy.

6. **Prepare and implement a national strategy on early school-leaving by ensuring adequate financing. Ensure that the implementation of the higher education reform improves access to education for disadvantaged groups.**

7. Reform the public transport system to make it more cost efficient. Increase the cross-border capacities of the electricity network, ensure the independence of the energy regulator and gradually abolish regulated energy prices.

Done at Brussels,

For the Council
The President