Council of the
European Union

Brussels, 13 June 2016
(OR. en)

9217/16

ECOFIN 459
UEM 206
SOC 323
EMPL 220
COMPET 293
ENV 339
EDUC 194
RECH 186
ENER 202
JAI 450

NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
No. Cion doc.:	9134/16 ECOFIN 425 UEM 175 SOC 289 EMPL 185 COMPET 262 ENV 306 EDUC 162 RECH 154 ENER 167 JAI 412 - COM(2016) 337 final
Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2016 national reform programme of Hungary and delivering a Council opinion on the 2016 convergence programme of Hungary

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2016) 337 final.

COUNCIL RECOMMENDATION

of …

on the 2016 National Reform Programme of Hungary

and delivering a Council opinion on the 2016 Convergence Programme of Hungary

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,

Having regard to the resolutions of the European Parliament,

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,

---

[1] OJ L 209, 2.8.1997, p. 1.

Whereas:

(1) On 26 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council[2], the Commission adopted the Alert Mechanism Report, in which it identified Hungary as one of the Member States for which an in-depth review would be carried out.

(2) The 2016 country report for Hungary was published on 26 February 2016. It assessed Hungary's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and Hungary's progress towards its national Europe 2020 targets. It also included the in-depth review under Article 5 of Regulation (EU) No 1176/2011. On 8 March 2016, the Commission presented the results of the in-depth review. The Commission's analysis leads it to conclude that Hungary is experiencing no macroeconomic imbalances. In particular, although high external debt rollover needs and the share of non-performing loans remain a concern, risks linked to external and internal liabilities have been reduced.

(3) On 29 April 2016, Hungary submitted its 2016 National Reform Programme and its 2016 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

---

[2] 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 (OJ L 306, 23.11.2011, p. 25).

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[3], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance.

(5) The Convergence Programme indicates that the budgetary impact of the exceptional inflow of refugees is significant and an addendum of 6 May provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission's assessment, the eligible additional expenditure amounted to 0,04 % of GDP in 2015 and currently no further incremental costs are expected in 2016. The provisions set out in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees is an exceptional event, its impact on Hungary`s public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2015 has been reduced to take into account these costs. Regarding 2016, a final assessment, including on the eligible amounts, will be made in spring 2017 on the basis of observed data as provided by Hungary's authorities.

[3] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

(6) Hungary is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2016 Convergence Programme, the Government plans the headline deficit to increase to 2,4 % of GDP by 2017 and then to decrease gradually to 1,2 % by 2020. The Government plans a gradual improvement of the structural balance in order to reach its revised medium-term budgetary objective – a deficit of 1,5 % of GDP in structural terms – by 2019. However, the recalculated[4] structural deficit would remain higher than the medium-term budgetary objective. According to the Convergence Programme, the government debt-to-GDP ratio is expected to decline gradually from 75,3 % in 2015 and to below 65% in 2020. The macroeconomic scenario underpinning these budgetary projections is broadly plausible until 2017 and becomes increasingly favourable thereafter. The measures needed to support the planned deficit targets from 2017 onwards have not been sufficiently specified, in particular for after 2017. Based on the Commission 2016 spring forecast, there is a high risk of a significant deviation from the required adjustment in 2016 as well as, under unchanged policies, in 2016 and 2017 taken together. At the same time, Hungary is forecast to comply with the debt reduction benchmark in 2016 and in 2017. Based on its assessment of the Convergence Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that there is a risk that Hungary will not comply with the provisions of the Stability and Growth Pact. Therefore further measures will be needed in both years to ensure compliance.

(7) Internal financial imbalances have been reduced and the banking system has become less vulnerable, but challenges remain. Considerable progress has been made in reducing private sector debt, previously mostly denominated in foreign currencies. Lending to households showed signs of recovery but a turnaround in corporate lending has yet to take place. The profitability of the banking sector has started to recover, helped by the improving economic environment and by a moderation in the previous policies towards taxes on banks. Nevertheless, banks remain cautious in their lending, even though they are well capitalised and highly liquid. The main remaining challenge for banks is to reduce the still high share of non-performing loans that hinder new lending and put pressure on profits. The contingent liability risks linked to the increased ownership of the state in the banking sector are still high.

---

[4] The structural balance as recalculated by the Commission based on the information in the Convergence Programme, following the commonly agreed methodology.

(8) Despite considerable recent improvements in tax policies and the tax administration, Hungary's reliance on sector-specific taxes remains a potential barrier to investment. The selective design of these taxes causes distortions across sectors. While several other sector-specfic taxes remain in place, the levy on credit institutions has been reduced significantly and the progressive rates in the food inspection fee have been repealed. The labour tax wedge for low-income earners is still high, especially for those without children. This can have a negative impact on their employability and can also hamper investment. Steps have been taken to reduce the tax wedge (including a one percentage point cut in the uniform tax rate of the personal income tax and an increase of the family tax allowance for earners with two children). However, measures are not sufficiently well targeted to have a significant effect for low-income earners. There is a potential for shifting tax away from labour to areas less distortive to growth. Several measures have been taken to improve compliance and reduce compliance costs, although tax compliance costs remain high. Despite improvements in recent years, Hungary still faces challenges regarding the efficiency of tax collection. The Government announced a major institutional reform, to be launched in 2016, targeting efficiency in the tax administration.

(9) Limited progress has been made as regards promoting competition and transparency in public procurement (for example, by adopting the new Public Procurement Act, the compliance of which with EU law has still to be assessed), while unpredictable regulatory changes and administrative burden hamper private business and investment. The high number of negotiated procedures without publication, and contract awards with a single bid, show that a low level of competition in procurement persists. In May 2016, the Government presented an e-procurement strategy. Its implementation and impact on improving efficiency and transparency needs to be monitored and the risk of corruption remains. Changes would be needed to make the new National Anti-Corruption Action Programme (NAP) 2015-2018 more effective in preventing corruption in public institutions and applying dissuasive sanctions. The Government has not renewed its earlier commitment to revise the 2013 whistle-blower law, which lacks provisions that adequately protect whistle-blowers from retaliation. The NAP's plans to revise the asset declaration system lack ambition, and new legislative amendments passed in 2015 introduced some further restrictions to public access to information. The Government has taken steps to reduce the administrative burden, but Hungary's restrictive regulations in service sectors and a volatile regulatory environment remain concerns for businesses and thus create uncertainty for investors. Establishment and operational restrictions on the retail sector constitute significant barriers to entry and expansion. Mark-ups in the Hungarian retail sector are the third highest in the Union and have been increasing continuously for the last decade while the allocative efficiency indicator is among the lowest in the Union.

(10) Recent labour market developments are favourable in Hungary, with unemployment having fallen to pre-crisis levels. Employment creation in the private sector is picking up, but the public works scheme has also contributed to reducing unemployment. The scheme is the main active labour market policy in Hungary. Its budgetary cost has more than quadrupled over the last five years. However, the scheme does not seem sufficiently to improve the reintegration of participants into the open labour market. In the first half of 2015, the rate of successful exit from the scheme to regular employment was 13,1 %, but around 60 % of the participants who left it in that period returned to the scheme within 180 days. This significantly risks locking participants into the scheme, particularly low-skilled workers and people in disadvantaged regions. Although the scheme targets the long-term unemployed, the low-skilled and unemployed people living in disadvantaged areas, 47 % of participants in 2015 had secondary or tertiary education. The proportion of unemployed people involved in public works is also significant in counties with well-performing labour markets. The recent reform of the public employment service is likely to make it less effective. The administrative complexity of the management arrangements – currently the responsibility over the public employment service is spread between four ministries – may significantly compromise effective steering and an increased result orientation. The maximum duration of unemployment benefits (three months) is the lowest in the Union and is significantly shorter than the average time necessary to find a job. Poverty indicators are improving, but they remain high, especially among the most disadvantaged, in particular Roma and children. The adequacy and coverage of social assistance remains a challenge and recent reforms could further restrict the conditions for access to a number of benefits.

(11) The average performance of Hungarian students in basic skills was below the EU average in the 2012 OECD Programme for International Student Assessment (PISA) and the proportion of low-achievers increased between 2009 and 2012. The influence of the socioeconomic background and school location on educational performance is among the strongest in the Union. The selectivity of the education system deepens performance gaps among students in different school types and these gaps widen over time. The lack of equal access to quality mainstream education is particularly acute for Roma. With the exception of early childhood education, where there has been significant improvement in recent years, gaps remain wide between completion rates of Roma and non-Roma on all other educational levels, i.e. primary, secondary and tertiary education. Early school leaving remains high among Roma. Hungary has introduced a number of measures that aim to address low-achievement more effectively. However, important details on the implementation of these measures are not available, making it difficult to assess their potential impact. A systemic approach to promoting inclusive mainstream education has yet to be developed. The announced implementation plan for the early school leaving strategy has yet to be published. The transition between different forms and stages of education remains difficult and the implementation of recent reforms in vocational education should be targeted at facilitating transitions.

(12) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Hungary's economic policy and published it in the 2016 country report. It has also assessed the Convergence Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Hungary in previous years. 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 strengthen the overall economic governance of the European Union by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations (1) to (3) below.

(13) In the light of this assessment, the Council has examined the Convergence Programme, and its opinion[5] is reflected in particular in recommendation (1) below.

---

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

HEREBY RECOMMENDS that Hungary take action in 2016 and 2017 to:

1. In view of the high risk of a significant deviation, achieve an annual fiscal adjustment of 0,3 % of GDP towards the medium-term budgetary objective in 2016 and of 0,6 % of GDP in 2017, unless the medium-term budgetary objective is respected with a lower effort, by taking the necessary structural measures.

2. Further reduce sector-specific taxes and reduce the tax wedge for low-income earners. Strengthen transparency and competition in public procurement through e-procurement, increased publication of tenders and further improvement of the anti-corruption framework. Improve the regulatory environment in the services sector and in the retail sector by addressing restrictive regulations and ensuring predictability.

3. Facilitate the transition from the public works scheme to the primary labour market and reinforce other active labour market policies. Improve the adequacy and coverage of social assistance and unemployment benefits. Take measures to improve educational outcomes and to increase the participation of disadvantaged groups, in particular Roma, in inclusive mainstream education.

Done at Brussels,

For the Council
The President