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Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2017 National Reform Programme of Hungary and delivering a Council opinion on the 2017 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(2017) 516 final.

COUNCIL RECOMMENDATION

of …

on the 2017 National Reform Programme of Hungary

and delivering a Council opinion on the 2017 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,

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

Whereas:

(1) On 16 November 2016, the Commission adopted the Annual Growth Survey, marking the start of the 2017 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, 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 did not identify Hungary as one of the Member States for which an in-depth review would be carried out.

(2) The 2017 country report for Hungary was published on 22 February 2017. It assessed Hungary's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the country-specific recommendations adopted in previous years and Hungary's progress towards its national Europe 2020 targets.

(3) On 2 May 2017, Hungary submitted its 2017 National Reform Programme and its 2017 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

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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 (ESI Funds) for the 2014-2020 period. As provided for 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 that provision in guidelines on the application of the measures linking effectiveness of the ESI Funds to sound economic governance.

(5) Hungary is currently in the preventive arm of the Stability and Growth Pact and subject to the debt rule. In its 2017 Convergence Programme, the Government plans a deterioration of the headline deficit from 1,8 % in 2016 to 2,4 % in both 2017 and 2018 and a gradual improvement thereafter to 1,2 % of GDP by 2021. The medium-term budgetary objective — a structural deficit of 1,7 % of GDP until 2016 and revised to 1,5 % of GDP as of 2017 — is planned to be met by 2020. However, based on the recalculated[4] structural balance, the medium-term budgetary objective would not be reached over the programme horizon. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to decline gradually to close to 61 % by the end of 2021. The macroeconomic scenario underpinning those budgetary projections is favourable, which poses risks to the implementation of the deficit targets.

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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).

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

(6) The 2017 Convergence Programme indicates that the budgetary impact of the exceptional inflow of refugees and security-related measures in 2016 and 2017 is significant, and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure in 2015 amounted to 0,04 % of GDP for the exceptional inflow of refugees and there is no additional eligible expenditure in relation to refugee inflows in 2016. The eligible additional expenditure concerning security-related measures amounted to 0,04 % of GDP in 2016. In 2017, no further increase in expenditure is expected due to the exceptional inflow of refugees, whereas the additional budgetary impact of the security-related measures is currently estimated at 0,14 % of GDP. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees as well as the severity of the terrorist threat are unusual events, their 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 2016 has been reduced to take into account additional security-related costs. Regarding 2017, a final assessment, including on the eligible amounts, will be made in spring 2018 on the basis of observed data as provided by the Hungarian authorities.

(7) On 12 July 2016, the Council recommended Hungary to achieve an annual fiscal adjustment of 0,6 % of GDP towards the medium-term budgetary objective in 2017. Based on the Commission 2017 spring forecast, there is a risk of a significant deviation from that requirement in 2017.

(8) In 2018, in light of its fiscal situation and, in particular, of its debt level, Hungary is expected to further adjust towards its medium-term budgetary objective of a structural deficit of 1,5 % of GDP. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure[5] which does not exceed 2,8 % in 2018. It would correspond to a structural adjustment of 1,0 % of GDP. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2018. At the same time, Hungary is forecast to comply with the debt rule in 2017 and 2018. Overall, the Council is of the opinion that further measures will be needed as of 2017 to comply with the provisions of the Stability and Growth Pact. However, as foreseen in Regulation (EC) No 1466/97, the assessment of the budgetary plans and outcomes should take account of the Member State's budgetary balance in light of the cyclical conditions. As recalled in the Commission Communication accompanying these country-specific recommendations, the assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Hungary's public finances. In that context, the Council notes that the Commission intends to carry out an overall assessment in line with Regulation (EC) No 1466/97, in particular in light of the cyclical situation of Hungary.

(9) Hungary's competitiveness and potential growth is held back by low private investment and low productivity. Factors adversely affecting the business environment and corporate investment are linked particularly to weaknesses in institutional performance and governance. Frequent changes in the regulatory and tax environment are one of the biggest barriers to doing business in Hungary, with insufficient stakeholder engagement and evidence-based policy-making. Regulatory barriers in services also tend to limit market dynamics and hamper investment. Restrictive regulations, including in retail, limit competition in the services sector and weigh on the business climate.

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5 Net government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

(10) Hungary's total tax-to-GDP ratio remains well above those of its regional peers and challenges in the tax system remain. The Government has decreased employers' social security contributions by 5 percentage points in 2017, and a further 2 percentage points reduction is planned for 2018. This measure has significantly reduced the tax wedge for low-income earners but it remains high. This is particularly the case for low-income earners without children, where it is still among the highest in the Union. The tax system remains complex. Despite a declining trend since 2013, sector-specific taxes — some of which remain highly distortive — still tend to complicate the tax system and weaken investor confidence. The complexity and uncertainty of the tax system, associated with high compliance costs and administrative burdens, continue to weigh on investor confidence in Hungary.

(11) Weaknesses in institutional performance are weighing on the business climate and reducing the economy's growth potential. In particular, despite recent improvements and the amendment to the Public Procurement Act, progress on strengthening transparency and competition in public procurement is still limited. The current e-procurement strategy is a solid basis to enhance transparency, but its implementation and impact on efficiency and transparency need to be monitored. Corruption risks remain high, adversely impacting the business climate, and there are notable gaps in the measures taken to address the issue. Hungary is also experiencing delays in the implementation of its e-procurement strategy. This is slowing the timely introduction of e-procurement in Hungary, which is crucial for strengthening transparency and increasing competition.

(12) The situation in the services sector including retail remains particularly challenging in Hungary. Over the past year, the Government continued to intervene on markets previously open to competition and adopted tighter requirements for passenger transport services operated by independent dispatching centres. The Government took no substantial step to ease the regulatory environment in the services sector, in particular regarding retail, public waste-management services, textbook publishing and distribution or mobile payment systems. In the retail sector, clear guidelines on the granting of authorisation to open new shops larger than 400 m^2 are missing. This adds to the lack of transparency and predictability in the sector. The continuing existence of the regulatory barriers in services, including in retail, is limiting market dynamics and hampering investment, while also generating uncertainty for investors, in particular international investors.

(13) To support Hungary's competitiveness and potential growth in the medium term, structural reforms to promote investment in human capital, particularly in education and healthcare, and to continue improving the functioning of the labour market will be key. Enhancing social fairness will be also essential to deliver more inclusive growth.

(14) Performance in providing basic skills remains weak by international standards. The 2015 OECD Programme for International Student Assessment (PISA) survey of educational systems showed significantly worsening results and the impact of pupils' socioeconomic background on education outcomes is one of the highest in the Union. The impact of the school type on education outcomes is very significant. The reduction in teaching hours for science subjects in vocational grammar schools since 2016 is likely to amplify Hungary's backlog in science skills. The share of early school leavers has been stagnating for the last 5 years and remains especially high among Roma people. The distribution of disadvantaged pupils between schools is uneven, and Roma children increasingly attend Roma-majority schools and classes. Measures are in place to support teacher training, early education and school achievement and to combat early school leaving among Roma. Although steps have been taken to address segregation, they are insufficiently comprehensive and systemic to address the challenge. The growing demand for a highly skilled workforce is not matched by a sufficiently large pool of applicants to tertiary education and adequate completion rates. The modification of the Act on higher education adopted in 2017 may cause the situation to deteriorate further.

(15) The labour market has developed favourably in recent years, with unemployment returning to its pre-crisis level. Employment reached historical high levels thanks to private-sector job creation and the public work scheme, which is still the largest active labour market policy in Hungary with over 200 000 participants. In recent years, a set of measures have been adopted to facilitate the transition from the scheme to the primary labour market. However, the scheme is still not sufficiently targeted and its effectiveness in reintegrating participants into the open labour market continues to be limited. At the same time, certain sectors face increasing labour shortages. Other active labour market policies are being reinforced, partly with the support of Union funds, but further efforts are needed to facilitate transitions to the primary labour market effectively. The profiling system for the unemployed is operational but not yet fully effective. The gender employment gap has increased in recent years and the impact of parenthood on women's employment is one of the highest in the Union. Labour market participation is affected by comparatively weak health outcomes and unequal access to healthcare. The participation of social partners in policy-making is limited.

(16) Some poverty indicators are back down to pre-crisis levels but remain above the Union average. Poverty among children and Roma remains particularly high, although declining. A significant proportion of Roma in employment work in the public works scheme. Their effective integration into the open labour market remains limited so far.

(17) The adequacy and coverage of social assistance and unemployment benefits is limited. The duration of unemployment benefits is still the lowest in the Union at 3 months, below the average time required by jobseekers to find employment. The 2015 social assistance reform streamlined the benefits system but it does not seem to have guaranteed a uniform and minimally adequate living standard for those in need. With regards to the benefits administered by municipalities, there is a high degree of discretion in the eligibility criteria and the level of entitlements, which creates uncertainty for beneficiaries. The minimum income benefit remains frozen at a low level, but the Hungarian authorities are planning to gradually increase the level of the targeted cash benefits in the coming years. Already in 2017 three of these benefits were slightly increased. Additional targeted measures would help alleviate material deprivation of the most disadvantaged groups, in particular children and Roma.

(18) In the context of the 2017 European Semester, the Commission has carried out a comprehensive analysis of Hungary's economic policy and published it in the 2017 country report. It has also assessed the 2017 Convergence Programme, the 2017 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 socioeconomic policy in Hungary, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.

(19) In the light of this assessment, the Council has examined the 2017 Convergence Programme and its opinion[6] is reflected in particular in recommendation (1) below,

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

HEREBY RECOMMENDS that Hungary take action in 2017 and 2018 to:

1. Pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Hungary's public finances.

2. Complete the reduction of the tax wedge for low-income earners and simplify the tax structure, in particular by reducing the most distortive sector-specific taxes. Strengthen transparency and competition in public procurement, by implementing a comprehensive and efficient e-procurement system, and strengthen the anti-corruption framework. Strengthen regulatory predictability, transparency and competition in particular in the services sector, notably in retail.

3. Better target the public works scheme to those furthest away from the labour market and provide effective support to jobseekers in order to facilitate transitions to the labour market, including by reinforcing active labour market policies. Take measures to improve education outcomes and to increase the participation of disadvantaged groups, in particular Roma, in inclusive mainstream education. Improve the adequacy and coverage of social assistance and the duration of unemployment benefits.

Done at Brussels,

For the Council
The President