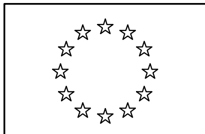

EUROPEAN COMMISSION

Brussels, 30.5.2012
COM(2012) 276 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of action taken by Hungary

in response to the Council Recommendation of 13 March 2012 with a view to bringing an end to the situation of excessive government deficit

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of action taken by Hungary

in response to the Council Recommendation of 13 March 2012 with a view to bringing an end to the situation of excessive government deficit

1. EXCESSIVE DEFICIT PROCEDURE AND MOST RECENT RECOMMENDATIONS

On 5 July 2004, by Decision No 2004/918/EC[1], the Council established, in accordance with Article 104(6) of the Treaty establishing the European Community (TEC), that an excessive deficit existed in Hungary and adopted a recommendation in accordance with Article 104(7) TEC with a view to bringing the excessive deficit situation to an end by 2008.

On 18 January 2005, by Decision No 2005/348/EC[2] in accordance with Article 104(8) TEC, the Council decided that Hungary had not taken effective action in response to its recommendation and, on 8 March 2005, issued a second recommendation in accordance with Article 104(7) TEC, confirming the 2008 deadline for the correction of the excessive deficit. On 8 November 2005, by Decision No 2005/843/EC[3] in accordance with Article 104(8) TEC, the Council established that Hungary had for a second time failed to comply with the recommendations in accordance with Article 104(7) TEC. Accordingly, on 10 October 2006, the Council addressed a third recommendation to Hungary in accordance with Article 104(7) TEC postponing the deadline for the correction of the excessive deficit to 2009. On 7 July 2009, the Council in its recommendation adopted in accordance with Article 104(7) TEC (henceforth Council Recommendation of 7 July 2009) concluded that the Hungarian authorities could be considered to have taken effective action in response to the recommendations of 10 October 2006 and, against the background of the severe economic downturn issued revised (fourth) recommendations in accordance with Article 104(7) TEC, setting a further new deadline of 2011 for Hungary to correct the situation. On 27 January 2010, the Commission adopted a Communication to the Council[4] concluding that Hungary had taken effective action in response to the Council Recommendation of 7 July 2009, but it nevertheless drew the attention to considerable risks.

On 24 January 2012, by Decision No 2012/139/EU[5], the Council established in accordance with Article 126(8) Treaty on the Functioning of the European Union (TFEU) that Hungary had not taken effective action in response to the Council Recommendation of 7 July 2009 within the period laid down therein. While the 3% of GDP reference value for the deficit was not breached in 2011, this was not based on a structural and sustainable correction, but hinged upon substantial one-off revenues. At the same time, there was a structural deterioration in 2010 and 2011 of over 2% of GDP, as compared to a recommended cumulative fiscal improvement of 0.5% of GDP. Moreover, while the authorities were implementing structural

[1] OJ L 389, 30.12.2004, p. 27.
[2] OJ L 110, 30.4.2005, p. 42.
[3] OJ L 314, 30.11.2005, p. 18.
[4] COM(2010) 10 final.
[5] OJ L 66, 6.3.2012, p. 6.

measures in 2012, which were expected to largely offset the previous deterioration, the 3% of GDP reference value for the deficit would again be respected in 2012 only thanks to one-off revenues of close to 1% of GDP and the Treaty reference value would be breached again in 2013 once all one-off measures would be phased out. Following that Council Decision, on 13 March 2012, by Implementing Decision No 2012/156/EU[6], the Council decided to suspend part of the commitments from the Cohesion Fund for Hungary with effect from 1 January 2013 in line with Article 4 of Council Regulation (EC) No 1084/2006 of 11 July 2006 establishing a Cohesion Fund[7].

On the same day, the Council also issued new (the fifth) recommendations to Hungary, in accordance with Article 126(7) TFEU and Article 3 of Regulation (EC) No 1467/97[8] (henceforth Council Recommendation of 13 March 2012), establishing a new deadline of 2012 for bringing the situation of an excessive deficit to an end. Furthermore, the Council made the following specific recommendations:

- The Hungarian authorities should bring the general government deficit below the 3% of GDP reference value in a credible and sustainable manner in accordance with the multi-annual path outlined in the updated convergence programme as endorsed by the opinion expressed by the Council on 12 July 2011. Specifically to this end, the Hungarian authorities should:

  (a) Ensure the attainment of the 2012 deficit target of 2.5% of GDP, which based on the macroeconomic framework after the 2012 February Interim Forecast of the Commission services would require an additional fiscal effort of at least 0.5% of GDP on top of the 1.9% of GDP that is already foreseen. In particular, this should be done through a further specification and rigorous implementation of the deficit-decreasing measures included in the Széll Kálmán Plan and the updated convergence programme as well as the adoption of further consolidation measures of a structural nature as necessary.

  (b) Allocate possible windfall gains for improving the headline balance, including possible one-off revenues stemming from the step back of beneficiaries from the private to the public pension pillar.

  (c) Take necessary additional measures of a structural nature as needed to ensure that the deficit in 2013, estimated to exceed the 3% of GDP reference value by 0.6% of GDP based on the macroeconomic framework after the 2012 February Interim Forecast of the Commission services, remains well below the threshold even after the expected and recommended full phasing out of one-off revenues of close to 1% of GDP. These measures could include a further specification and implementation of the planned structural reforms included in the Széll Kálmán Plan.

  (d) Incorporate sufficient reserve provisions in the forthcoming budget laws (on top of the general reserve prescribed by the Public Finance Act), to ensure the achievement of the budgetary targets even in case of unforeseen events.

[6] OJ L 78, 17.3.2012, p. 19.
[7] OJ L 210, 31.7.2006, p. 79.
[8] OJ L 209, 2.8.1997, p. 6.

- That budgetary adjustment should contribute to bringing the government gross debt ratio onto a declining path. In particular, sufficient progress toward compliance with the debt reduction benchmark should be ensured for a period of three years from the correction of the excessive deficit, in accordance with paragraph 1a of Article 2 of Regulation (EC) No 1467/97.

- According to the Council Recommendation in 12 July 2011, the Hungarian authorities should operationalise the key constitutional fiscal rules by adapting the cardinal law on economic stability. The numerical rules should ensure that the budget process is within the context of a truly binding medium-term framework and the analytical remit of the Fiscal Council should be broadened.

The Council established the deadline of 13 September 2012 for the Hungarian government to take effective action and to specify the measures that will be necessary to progress towards ensuring a durable correction of the excessive deficit. At the same time, it committed to assess whether Hungary took necessary corrective action already in the context of its meeting on 22 June 2012 with a view to lifting the partial suspension of the Cohesion Fund commitments in 2013 if the conditions are met[9]. In order to facilitate the decision of the Council, the Commission committed to present the Council without delay its assessment whether effective action has been taken, following the adoption by the Hungarian government of corrective measures fulfilling the Council Recommendation of 13 March 2012 under Article 126(7) TFEU. These commitments and the actions undertaken by the Hungarian authorities provide the background for this Communication.

It is worth noting that the Council also invited the Hungarian authorities to make the necessary structural effort to reach its budget target of a deficit of 2.2% of GDP for 2013 in a way that ensures that the medium-term objective is sustained alongside the durable correction of the excessive deficit.

2. ASSESSMENT OF EFFECTIVE ACTION TAKEN

According to Regulation (EC) No 1467/97 and the revised Code of Conduct[10] a Member State should be considered to have taken effective action if it has acted in compliance with the Article 126(7) recommendation. The Code of Conduct states that the assessment of effective action should in particular take into account whether the Member State concerned has achieved the annual budgetary targets initially recommended by the Council and the underlying improvement in the cyclically adjusted balance net of one off and other temporary measures.

---

[9] Recital 12 of Council Implementing Decision 2012/156/EU concerning the partial suspension of the Cohesion Fund commitments in 2013 reads: "In accordance with Article 4(2) of Regulation (EC) No 1084/2006, if by 22 June 2012, or at a later date, the Council establishes that Hungary has taken the necessary corrective action, it will decide, without delay, to lift the suspension of the commitments concerned."

[10] "Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes", of 24 January 2012. See http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/code_of_conduct_en.pdf

2.1. Assessment of action taken regarding the 2012 and 2013 budgetary outcome

The underlying macroeconomic environment has weakened slightly compared to the Commission services' 2012 February forecast underpinning the Council recommendation of 13 March 2012, which projected real GDP to contract by 0.1% in 2012 and to recover to a modest 1.6% in 2013. This weakening is mainly linked to the worse–than-expected performance in the construction industry in the first quarter. In addition, recent new measures (see details below) further deteriorated the short- and medium-term growth outlook and, according to the Commission services' 2012 spring forecast and based on information available until the cut-off date[11], real GDP is expected to decrease by 0.3% in 2012 and to rise only by 1.0% in 2013. The 2012 convergence programme (CP) contains a somewhat more optimistic growth outlook (0.1% in 2012 and 1.6% in 2013) mainly on account of (i) higher private consumption expenditure driven by more sanguine assumptions regarding employment growth in the private sector and (ii) more dynamic gross fixed capital formation.

The 2011 general government budget reached a surplus of 4.3% of GDP, thanks to one-off revenue of 9.7% of GDP stemming from the de facto elimination of the earlier compulsory private pension fund[12]. Excluding one-off factors, however, the budget was in deficit by 5¼% of GDP. Although this outcome is broadly in line with the estimation included in the Commission Staff Working Document accompanying the Commission recommendation for a Council recommendation under Article 126(7) TFEU of March 2012, it is better than foreseen by the government in their excessive deficit procedure (EDP) progress report of December 2011 and by the Commission services in early January 2012[13] and mainly reflects the better-than-expected budgetary balance of the local government sector.

2.1.1. Deficit correction in 2012 based on Commission services' 2012 spring forecast and use of windfall revenues

In 2012, according to the Commission Services' 2012 spring forecast, the budget deficit is expected to reach 2.5% of GDP, which is in line with the official deficit target and lower by 0.5% of GDP than the deficit estimate included in the 2012 March assessment. This improved outlook mainly reflects three elements.

1. It incorporates the base effect of the better-than-expected outcome of the 2011 budget (0.1% of GDP).

2. The government announced new saving measures of 0.3% of GDP in the 2012 CP affecting the 2012 budgetary developments. These contain revenue increasing measures of

[11] On 15 May, the Hungarian Statistical Office published its flash estimate for Q1 2012. On seasonally and calendar adjusted terms, real GDP declined by 1.3%, taking also analysts by surprise, in comparison with the 0.5% decline expected in the 2012 spring forecast published on 11 May, i.e. a few days before this flash estimate became available.

[12] In 2011 the government made it possible for the members of the earlier compulsory private pension funds to switch back to the public pension pillar and incentivised them to do so. Against this background, 97% of the members decided to switch back, which resulted in (i) a one-off budgetary revenue in light of the transfer of their accumulated assets to the general government and (ii) permanently higher pension contribution revenues to the public pension pillar.

[13] Commission Staff Working Document accompanying the Commission recommendation for a Council decision under Article 126(8) of the Treaty. See: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/other_documents/2012-03-06_hu_126-7_commission_swd_en.pdf

more than 0.1% of GDP, including the introduction of a new tax on telecommunication services and the reverse charge VAT in agriculture. On the expenditure side, savings of 0.2% of GDP consist of the cut of the appropriations of line ministries and a further reduction of pharmaceutical subsidies. In light of the implementation risk related to the expenditure side measures, the calculations in the Commission services' 2012 spring forecast incorporate savings of 0.2% of GDP (out of the total 0.3% of GDP).

3. Beyond the new saving measures, the deficit outlook is affected by newly emerged one-off developments. These new one-off revenues of 0.4% of GDP include (i) the impact of a new wave of stepping back of the remaining final beneficiaries from the private to the public pension pillar in response to government incentives with deadline of end March 2012 (0.2% of GDP)[14] and (ii) a one-off revenue of 0.2% of GDP related to the fact that some EU structural funds were received only in January 2012 whereas the government made the related payments to final beneficiaries already in December 2011, which was communicated to the Commission services in the context of the April 2012 forecast mission[15]. They are expected to be partly counterbalanced by new one-off expenditure of 0.15% of GDP related to the transport sector (this decision was communicated to the Commission services also in April). Thus, net one-offs are expected to increase by around 0.25% of GDP to around 0.9% of GDP. Without these temporary factors the budget deficit would be above the 3% of GDP reference value (notably at 3.4% of GDP).

Although the 2012 deficit target is foreseen to be reached, according to the Commission services' 2012 spring forecast, it would require the elimination of the full amount of extraordinary reserve buffer (contingent expenditure cuts)[16] of close to 1½% of GDP, which was created to compensate for unforeseen developments while the deficit target can be met[17]. In contrast, the 2012 CP calculates with a still available extraordinary reserve buffer of 0.4% of GDP in 2012. This difference is on account of the expenditure slippages of close to ½% of GDP expected by the Commission services related to pharmaceutical subsidies, the transport sector and a lack of sufficient detail about the cuts in budgetary appropriations as well as the somewhat lower tax revenues in light of the lower economic growth forecast.

According to the Council Recommendation of 13 March 2012, any windfall revenue, including possible one-off revenues stemming from the step back of beneficiaries from the private to the public pension pillar, is to be allocated to improve the headline balance. Whereas the 2012 CP did not incorporate these revenues, they were incorporated in the 2012 spring forecast with the effect that the deficit is projected to reach (but not outperform) the target.

---

[14] Albeit the deadline was 31 March 2012 for stepping back from the private to the public pension pillar and it was known that around one-fourth of the remaining members had chosen to switch to the public pillar with a corresponding one-off revenue transfer of 0.2% of GDP, the 2012 CP did not incorporate any revenue from this operation.

[15] The same accounting in cash-flow and in ESA terms applied by the government is subject to verification by Eurostat.

[16] The same accounting in cash-flow and in ESA terms applied by the government is subject to verification by Eurostat.

[17] The submitted budget contained an extraordinary reserve buffer of 0.7% of GDP, which was increased by 0.4% to 1.1% of GDP in the adopted budget. Saving measures of close to 0.4% of GDP in 2012 incorporated in the 2012 CP, according to the government's calculation, aim at re-establishing some extraordinary reserve buffer since the budgeted extraordinary reserve buffer of 1.1% of GDP serve as an off-set of already evident revenue shortfalls and expenditure slippages.

2.1.2. *Deficit correction in 2013 based on Commission services' 2012 spring forecast and reserve provisions*

In the Commission services' 2012 spring forecast, the budget deficit is projected to rise to 2.9% of GDP in 2013, which means that the budget deficit is expected to be below the 3% of GDP reference value both in 2012 and in 2013, even though in the first year this depends on one-off measures. The 2013 deficit forecast is lower by 0.7% of GDP than the deficit estimate incorporated in the 2012 March assessment of 3.6% of GDP but higher by 0.7% of GDP than the official target of 2.2% of GDP. The improvement of the fiscal outlook reflects numerous additional saving measures announced in the 2012 CP. According to the estimation of the government, these measures can reduce the 2013 budget deficit by around 1.7% of GDP The 2012 CP, mainly based on the more favourable than earlier expected 2011 data, also counts with a lower deficit in the local government sector by 0.2% of GDP in 2012 and 0.3% of GDP in 2013. The gross deficit improving impact (of around 1.7% of GDP) of the saving measures is calculated with the revenue indicated in the 2012 CP as a minimum (0.4% of GDP) from the financial transaction levy. This approach is supported by the decision of the Government on 9 May, which aims at collecting this minimum revenue. At the same time, it includes saving of close to 0.2% of GDP from the strict control of expenditure on purchase of goods and services in the public sector, which was implicit in the 2012 CP and became public on 16 May 2012.

On the revenue side those include (i) the introduction of the financial transaction duty (at least 0.4% of GDP), (ii) the higher tax rates on the insurance services and on the energy and the public utility sector (0.2% of GDP), (iii) the full yearly impact of the tax on the telecommunication sector and the reverse charge VAT in agriculture (0.2% of GDP) as well as (iv) the introduction of the electronic road toll as of July 2013 (0.25% of GDP). On the expenditure side, measures include (i) the cut of the appropriations of the budgetary chapters and the state-owned enterprises, (ii) the nominal freezing of the expenditure on purchase of goods and services in the central government sub-sector as well as (iii) the reduction in subsidies to the public transport sector and the pharmaceuticals, altogether with a gross budgetary improving effect of more than 0.6% of GDP.

Taking into account the lack of specific information available at the cut-off date of the Commission services' 2012 spring forecast (26 April 2012) and implementation risks related mainly to some expenditure cuts, only two-thirds of this deficit improving effect of 1.7% of GDP (i.e. 1.1% of GDP) could be incorporated in the forecast. Whereas the 2012 CP forecasts that the deficit target of 2.2% of GDP will be achieved while preserving an extraordinary reserve buffer of 0.2 – 0.5% of GDP (depending on revenue raised from the financial transaction tax), the Commission services' 2012 spring forecast projects a deficit just below the reference value of 3% of GDP without any extraordinary reserve buffer left (and assuming no one-offs and temporary measures for that year). This higher deficit forecast mainly reflects the implementation risks associated with the earlier and recently announced saving measures (¼% and ½% of GDP, respectively) as well as a worse macroeconomic outlook (resulting in a higher deficit by ¼% of GDP)[18].

The recommendation also asks the government to incorporate sufficient reserve provisions in the forthcoming budget laws. While the Commission services' 2012 spring forecast does not

[18] It is worth highlighting that some details of the measures have not yet been specified on the revenue side either, which creates uncertainty for the assessment of their budgetary impact.

foresee that reserve buffer is left in 2013 to compensate for possible slippages, it has taken into account some implementation risk. Moreover, the authorities still have the opportunity to include such reserve buffer in the forthcoming budget laws. This, as well as the use of one-off revenues to improve the structural budget, will be monitored based on the semi-annual EDP Progress Report expected to be continuously delivered by the government until the abrogation of the EDP.

2.1.3. New information after the cut-off date of the spring forecast

Following the cut-off date of the Commission services' 2012 spring forecast, the government provided further details related to the cut of the appropriations of the budgetary chapters amounting to 0.15% of GDP, of which only one third was taken into account in the Commission services' 2012 spring forecast due to lack of sufficient details. New information clarified the extent to which the budgets of the various ministries and appropriations are affected and that the intended savings are based on a cancellation of selected tasks and improvement of efficiency, which can ensure their sustainability. Based on this information, the Commission services can now include the full 0.15% of GDP effect of this measure into their updated projection. Moreover, by Government Decision No. 1152/2012 of 16 May 2012 amending the Government Decision No. 1122/2012 (IV.25.), the government made public its decision to nominally freeze the expenditure of the central budgetary sub-system as well as to contain it at the half of the inflation rate for the local government sub-system on purchase of goods and services in 2013 (these were only implicitly assumed in the 2012 CP). The government also clarified that this saving of close to 0.2% of GDP would be implemented based on the same principles applied for the cut of the appropriations of the budgetary chapters. This decision improves the Commission services' updated budgetary assessment by only 0.1% of GDP as there are some implementation risks, also in view of the fact that the central government has limited impact on the budgetary planning of the local governments.

On 9 May 2012 the authorities adopted some key parameters of a tax package (draft laws were submitted to Parliament on 11 May), which contained a number of elements that differed from the description in the 2012 CP. In general, the subject of the new taxes will consistently be the companies and not the consumers as previously anticipated, which may further deteriorate the investment climate as exemplified by the statements of the concerned business organisations. As to the specific numerical changes, the government decided on ceilings on the telecom tax monthly payments and a lower-than-planned tax hike for the surcharge on energy and public utility companies with combined revenue loss of close to 0.1% of GDP. This is planned to be compensated by correspondingly higher receipts from the financial transaction duty as the removal of the originally foreseen capping would not be fully counterbalanced by a narrower list of taxable transactions. On the basis of information available at the time of finalising this assessment, this new information did not have an impact on the overall revenue expected from the tax package.

Taking into account all of this new information received after the cut off date of the Commission services' 2012 spring forecast and notably the further details regarding expenditure which have a deficit reducing impact of 0.2% of GDP, the 2013 deficit would be projected to fall to 2.7% of GDP, which can be considered to be well below the threshold of 3% of GDP (see Table 1 for the evolution of the Commission's assessment at different stages).

2.1.4. *Fiscal effort underlying the deficit correction in 2012 and 2013*

In its Recommendation of 13 March 2012, the Council invited the government to ensure the attainment of the 2012 deficit target of 2.5% of GDP and a deficit well below the threshold of 3% of GDP in 2013. Based on the macroeconomic framework emerging from the Commission services' 2012 February forecast, this was expected to require an additional fiscal effort of at least ½% of GDP in 2012 (on top of the 1.9% of GDP already foreseen) and further efforts in 2013 (given a deficit forecast of 3.6% of GDP for that year).

According to the Commission services' 2012 spring forecast, following a deterioration of 1.4% of GDP in 2010 and an additional 0.7% of GDP in 2011, the structural balance is expected to improve by 2¼% of GDP in 2012, which exceeds the improvement expected in the 2012 March assessment by ¼% of GDP. While this is slightly below the additional fiscal effort recommended by the Council, this is partly explained by a (small) downward revision of potential growth between the Commission services' 2012 February forecast and the 2012 spring forecast (with a negative impact on the cyclically adjusted budget balance in 2012 of 0.1% of GDP).

Moreover, tax revenue (net of the impact of discretionary measures) in 2012 has been lower than suggested by GDP developments and standard tax elasticities, part of which may have contributed to the change in the structural balance falling slightly short of the required fiscal effort. Taking these factors into consideration, the fiscal effort for 2012 can be considered to be broadly in line with what was required under the Council Recommendation of 13 March 2012.

In 2013, a slight additional improvement of the structural budget balance (0.1% of GDP) was foreseen by the 2012 spring forecast. Taking into account the new information provided by the government following the cut-off date of the forecast, this would raise the additional improvement to over ¼% of GDP.

Table 1: Evolution of budgetary forecast

	2012	2013
Commission March 2012 assessment	-3.0	-3.6
Underlying macroeconomic developments	-0.05	-0.05
One-offs	0.25	0.0
revenue side (additional move of members from the private to public pension pillar, special accounting of EU Funds)	*0.40*	*0.0*
expenditure side (debt related expenditure in the transport sector)	*-0.15*	*0.0*
Other fiscal developments (e.g. change in the wage compensation system, adjustment to tax changes)	0.15	-0.10
Commission assessment before new measures were taken	-2.65	-3.75
Saving measures outlined in the 2012 convergence programme	0.20	1.10
revenue side (e.g. financial transaction duty, electronic road toll, extra tax on energy and telecom sector)	*0.15*	*0.90*
expenditure side (e.g. cut of expenditure at the budgetary chapters, reduction of pharmaceutical subsidies)	*0.05*	*0.20*
Second-round macroeconomic effects of the saving measures	-0.05	-0.25
2012 spring forecast (published on 11 May 2012)	-2.5	-2.9
Further information on expenditure side saving measures (after the cut-off date of the 2012 spring forecast)	0.10	0.20
Updated Commission assessment	-2.5[1]	-2.7

[1] Further information on saving measures created extraordinary reserve buffer of 0.1% of GDP

2.1.5. Overall assessment regarding deficit and debt correction

Overall, and also taking into account information that became available after the cut-off date of the Commission services' 2012 spring forecast, the budget deficit is expected to reach 2.5% of GDP in 2012 and remain well below the 3% of GDP reference value in 2013 as recommended by the Council in March this year. The improvement of the fiscal forecast mainly reflects the budgetary effect of new measures of 0.3% of GDP in 2012 and 1.3% of GDP in 2013 announced in the context of the 2012 CP and further explained thereafter, which also contribute to the improvement of the structural balance by ¼% of GDP in 2012 and an additional ½% of GDP in 2013 compared to the 2012 March assessment. Other factors, such as the base effect of the somewhat better-than-expected 2011 budget balance and higher one-off revenues, also contribute to the improving headline deficit outlook and make the deficit target of 2.5% of GDP in 2012 attainable.

It may be useful to note that the consolidation steps raise some questions in terms of quality, as they are mainly concentrated on the revenue side and may hinder economic growth also in light of the deteriorating business environment due to the de facto replacement of temporary sectoral levies that were supposed to be phased out by permanent sectoral taxes in largely the same sectors. As mentioned in the context of the Council Recommendation, in order to achieve a durable correction of the excessive deficit, Hungary could benefit from measures in the area of the universal child benefit (possibly in connection with the recently introduced

family tax allowances), a centralised, value-based property tax and from enhancing the progressive nature of the flat income tax scheme[19].

In 2011, the general government debt declined somewhat, to 80.6% of GDP, in the light of the sizeable primary surplus of 8¼% of GDP that was to a large extent offset by the depreciation of the forint of more than 10%. The debt is expected to decrease to 78.5% of GDP in 2012 and slightly further in 2013, based on the deficit outlook incorporated in the 2012 spring forecast and assuming that no public assets will be sold[20]. According to the CP update, the public debt is continuously reduced throughout the programme period to 77% of GDP in 2013 and below 73% of GDP in 2015. As to compliance with the debt reduction benchmark, Hungary will be in a transition period in the three years following the correction of its excessive deficit (i.e. 2013-2015). The planned fiscal adjustment would ensure sufficient progress towards compliance with the debt reduction benchmark. Based on the planned fiscal adjustment, the debt reduction benchmark will be met in 2015. According to Article 2(1a) of Regulation (EC) No 1467/97, for a Member State which was subject to an excessive deficit procedure on 8 November 2011 and for a period of three years from the correction of the excessive deficit, the requirement under the debt criterion shall be considered fulfilled if the Member State concerned makes sufficient progress towards compliance.

2.2. Assessment of action taken regarding fiscal governance

As regards fiscal governance, the Council asked the Hungarian authorities to adapt the law on economic stability, in particular by establishing a truly binding medium-term framework and broadening the analytical remit of the Fiscal Council. The 2012 CP announced that, following a review of the new regulatory framework in place, the Government will submit to Parliament the necessary amendment during the spring session. At the time of finalising this assessment, no information was provided on the planned amendments. In order to ensure full transposition of the Council directive of minimum requirements for national budgetary frameworks, a timetable was set up in the framework of the Government's database for the harmonisation of Hungarian law with EU law (managed by the Ministry of Public Administration and Justice); it starts with a decision on conceptual issues in June 2012 and foresees the completion of the legislative process by Autumn 2013. As regards the functioning of the Fiscal Council, in late March 2012, it was legislated that the President of this body would receive a salary and could set up a small secretariat within the Office of the Parliament (these aspects were missing before). While this constitutes a small step in the right direction, as some institutionalisation of the Fiscal Council appears to be more commensurate with its strong veto power over the annual budget, overall progress in this area can be considered to be slow, and developments on fiscal governance will need to be closely monitored.

3. CONCLUSIONS

On current information it appears that Hungary has taken action representing adequate progress towards the correction of the excessive deficit.

In particular, the 2012 deficit target of 2.5% of GDP is expected to be met and the 2013 budget deficit is foreseen to be well below the threshold of 3% of GDP against a slightly

---

[19] Recital 13 in the Council Recommendation of 13 March.

[20] A significant part of these public assets stem from the takeover of the assets in the framework of the de facto elimination of the earlier mandatory private pension pillar.

weakened underlying macroeconomic environment The 2012 deficit is expected to be reached based on structural measures of 0.3% of GDP and also builds on a small positive base effect from 2011 as well as some one-off developments Taking into account the effect of revisions to potential GDP growth and that tax revenue (net of the impact of discretionary measures) in 2012 falls short of what could be expected on the basis of GDP developments and standard tax elasticities, the fiscal effort in 2012 can be considered to be broadly in line with the requirement of the Council Recommendation of 13 March 2012.

In 2013, based on all publicly available information also after the cut-off date of the 2012 spring forecast, the deficit is foreseen by the Commission services to reach 2.7% of GDP thanks to a series of consolidation measures and thus to remain well below the 3% of GDP Treaty reference value even after the full phasing-out of net one-off measures of 0.9% of GDP revenues. Based on this deficit forecast and additional information received since then, the general government debt is expected to decrease from 80.6% of GDP in 2011 to below 78.5% of GDP in 2012 and slightly further in 2013.

The baseline scenario incorporated in the 2012 spring forecast is surrounded by symmetric risks. On the one hand, a lower deficit may be attained by a more favourable than currently assumed balance of the local governments, or lower interest expenditure of the public sector. On the other hand, there are deficit increasing risks, for instance the higher-than-expected expenditure linked to the losses of the central bank. In addition, the recently announced new taxes could trigger a further deterioration in the investment climate in a non-linear manner, which may also suffer from the latest strong GDP decline in the first quarter that could not be integrated in the forecast and thus negatively affect the deficit.

As regards fiscal governance, the intention to submit legislative amendments to Parliament was announced in the 2012 CP. However, at the time of finalising this assessment, no public information on the content and ambition of the planned revision was available. From March 2012, the President of the Fiscal Council has become eligible for a competitive remuneration and setting up a small secretariat. Against the background of this slow progress, developments on fiscal governance will need to be closely monitored also as a follow-up of the 2012 country-specific recommendation on fiscal governance reform.

In view of the above assessment, the Commission considers that no further steps in the excessive deficit procedure of Hungary are needed at present. A rigorous implementation and swift progress with the specifications of all announced measures will be needed to keep the budget deficit safely below the 3% of GDP reference value. The design of consolidation measures could be further improved, in close and ex ante consultation with relevant stakeholders and international organisations. The fiscal governance framework still needs to be adjusted to be in line with the Council recommendation so that the country would benefit from the creation of a well-functioning institutional system. Against this background, and also in light of the recent worse-than-expected first quarter growth data, the Commission will continue to closely monitor budgetary developments in Hungary in accordance with the Treaty and the SGP, in particular in the light of the prolonged history of this Excessive Deficit Procedure. The bi-annual EDP reports by the government will be one of the sources of information for this purpose.

Table 2: Comparison of key macroeconomic and budgetary projections

		2011	2012	2013	2014	2015
Real GDP (% change)	COM	1.7	-0.3	1.0	n.a.	n.a.
	CP	1.7	0.1	1.6	2.5	2.5
Output gap[1] (% of potential GDP)	COM	-2.3	-2.7	-2.0	n.a.	n.a.
	CP	-2.4	-3.0	-2.6	-1.7	-1.2
General government balance[2] (% of GDP)	COM	4.3	-2.5	-2.9	n.a.	n.a.
	CP	4.3	-2.5	-2.2	-1.9	-1.5
Primary balance (% of GDP)	COM	8.3	1.5	1.2	n.a.	n.a.
	CP	8.3	1.6	2.0	2.2	2.2
Cyclically-adjusted balance[1,3] (% of GDP)	COM	5.3	-1.3	-2.0	n.a.	n.a.
	CP	5.4	-1.1	-1.0	-1.1	-0.9
Structural balance[4] (% of GDP)	COM	-4.3	-2.1	-2.0	n.a.	n.a.
	CP	n.a.- 4.0	-1.9	-1.2	-1.1	-0.9
Government gross debt (% of GDP)	COM	80.6	78.5	78.0	n.a.	n.a.
	CP	80.6	78.4	77.0	73.7	72.7

Notes:

[1] For CP, output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2] Based on information received after the cut-off date of the Commission services' 2012 spring forecast, the 2013 headline deficit forecast could be revised down to 2.7% of GDP.

[3] Cyclically-adjusted balance excluding one-off and other temporary measures.

[4] In line with the revision of the 2013 headline deficit forecast based on information received after the cut-off date of the Commission services' spring forecast, the corresponding structural balance also improved by ¼% of GDP in 2013.

Source: Commission services' 2012 spring forecast (COM) published on 11 May 2012 and 2012 convergence programme (CP)