EUROPEAN
COMMISSION

Brussels, 20.11.2019
COM(2019) 921 final

Recommendation for a

COUNCIL DECISION

establishing that no effective action has been taken by Hungary in response to the Council Recommendation of 14 June 2019

{SWD(2019) 941 final}

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular the fourth subparagraph of Article 10(2) thereof,

Having regard to the Recommendation from the European Commission,

Whereas:

(1) In June 2018, the Council found in accordance with Article 121(4) of the Treaty that in 2017, there had been a significant observed deviation from Hungary's medium-term budgetary objective. In view of that established significant deviation, the Council issued a Recommendation on 22 June 2018[2], recommending that Hungary take the policy measures necessary to address that deviation. The Council subsequently found that Hungary had not taken effective action in response to that Recommendation and issued a revised Recommendation on 4 December 2018[3]. The Council subsequently found that Hungary had not taken effective action in response to that Recommendation either.

(2) On 14 June 2019, the Council found that in 2018 a significant observed deviation from the adjustment path toward the medium-term budgetary objective had again occurred in Hungary and issued a Recommendation for Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure[4] does not exceed 3.3% in 2019 and 4.7% in 2020, corresponding to an annual structural adjustment of 1.0% of gross domestic product (GDP) in 2019 and 0.75% of GDP in 2020.[5] The recommended effort for 2020 was deemed appropriate, contingent on compliance with the requested adjustment in 2019. It also recommended that Hungary uses any windfall gains for deficit

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1 OJ L 209, 2.8.1997, p. 1.

2 OJ C 223, 27.6.2018, p. 1.

3 OJ C 460, 21.12.2018, p. 4.

4 Net primary government expenditure is comprised of 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 four-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.

5 OJ C 210, 21.6.2019, p. 4.

reduction, while budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner. The Council established a deadline of 15 October 2019 for Hungary to report on the action taken in response to that Recommendation.

(3) On 26 September 2019, the Commission undertook an enhanced surveillance mission in Hungary for the purpose of on-site monitoring under Article -11(2) of Regulation (EC) No 1466/97. After having transmitted its provisional findings to the Hungarian authorities for comments, the Commission reported its findings to the Council on 20 November 2019. Those findings were made public. The Commission report finds that the Hungarian authorities intend to maintain the 2019 headline deficit target of 1.8% of GDP as set in the 2019 Convergence Programme. For 2020, the authorities revised the deficit target to 1% of GDP, making it more ambitious than the 1.5% of GDP target indicated in the 2019 Convergence Programme. Thus, the Hungarian authorities plan to act upon the Recommendation of 14 June 2019 only with respect to the year 2020.

(4) On 15 October 2019, the Hungarian authorities submitted a report on action taken in response to the Council Recommendation of 14 June 2019.[6] In the report, despite the more favourable macroeconomic and fiscal developments so far in 2019, the authorities maintain the general government deficit target from the 2019 Convergence programme of 1.8% of GDP in 2019. For 2020, the authorities confirm the target of a headline deficit of 1.0% of GDP, in line with the 2020 budget, and 0.5% of GDP better than the target included in the 2019 Convergence Programme. The report recalls the high reserve (1% of GDP) included in the 2020 deficit target, which is aimed at managing external risks and which could be spent only if the deficit target is expected to be met. The report lists the deficit-increasing measures contained in the “Economic Protection Action Plan” that the government adopted on 30 May 2019, which aim to sustain growth in the years to come at a rate of 2 percenage points higher than the EU average. The broad range of economic programmes listed in the report remain largely unquantified; nor does the report include any budgetary projection for 2019 and 2020. Thereby, the report does not comply with the reporting requirement recommended by the Council.

(5) In 2019, based on the Commission 2019 autumn forecast, the growth of net primary government expenditure is projected at 6.8%, well above the recommended rate of 3.3% (deviation of 1.3% of GDP). The structural balance is set to improve by 0.5% of GDP, against the recommended improvement of 1.0% of GDP (deviation of 0.5% of GDP). Therefore, both pillars point to a deviation from the recommended adjustment. The reading of the expenditure benchmark is negatively impacted by the use of a lower GDP deflator underlying that indicator compared to current estimates. Also the smoothing of nationally-financed investment impacts marginally and negatively the reading of the expenditure benchmark. The structural balance, in turn, is positively impacted by the higher potential growth estimate underlying that indicator but negatively impacted by revenue shortfalls. Taking into account these factors, the overall assessment confirms a deviation from the recommended adjustment in 2019.

(6) In 2020, based on the Commission 2019 autumn forecast, the growth of net primary government expenditure is projected to be 7.5%, well above the recommended rate

[6] https://ec.europa.eu/info/files/hungary-report-council-recommendations-under-significant-deviation-procedure_en

of 4.7% (deviation of 1.0% of GDP). The structural balance is set to improve by 1.2% of GDP, 0.4 percentage points above the effort of 0.75% of GDP recommended by the Council. Therefore, the expenditure benchmark points to a risk of a deviation from the required adjustment while the structural balance points to compliance, with a relatively large discrepancy. Public investment has been steadily increasing in recent years to reach a level of 6.4% of GDP in 2019, by far the highest in the EU. In this context, the planned reduction in 2020 is seen as a longer lasting normalization of the public investment rate. While the reduction in investment is fully reflected in the change of the structural balance, the smoothened profile of investment in the expenditure benchmark results in an overly negative indication of the fiscal effort given by the expenditure benchmark. The expenditure benchmark is also negatively impacted by the use of a lower GDP deflator compared to current estimates. When taking into account these factors, the expenditure benchmark would point to compliance with the requirement. At the same time, the structural balance is positively influenced by a higher point estimate of potential GDP growth underlying its calculation compared to the medium-term average underlying the expenditure benchmark. Taking into account these considerations, the overall assessment concludes that Hungary would deliver the recommended adjustment in 2020.

(7) The above findings lead to the conclusion that Hungary's response to the Council Recommendation of 14 June 2019 has been insufficient. The fiscal effort falls short of ensuring that the nominal growth rate of net primary government expenditure does not exceed 3.3% in 2019, corresponding to an annual structural adjustment of 1.0% of GDP, whereas in 2020 the planned fiscal effort is overall consistent with the recommended adjustment,

HAS ADOPTED THIS DECISION:

Article 1

Hungary has not taken effective action in response to the Council Recommendation of 14 June 2019.

Article 2

This Decision is addressed to Hungary.

Done at Brussels,

For the Council
The President