



EUROPEAN COMMISSION

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Proposal for a

COUNCIL IMPLEMENTING DECISION

lifting the suspension of commitments from the Cohesion Fund for Hungary

EXPLANATORY MEMORANDUM

1. RECENT COUNCIL DECISION TO SUSPEND COMMITMENTS FROM THE COHESION FUND

On 13 March 2012, by Implementing Decision 2012/156/EU¹, the Council decided to suspend EUR 495.2 million of commitments from the Cohesion Fund for Hungary, taking effect from 1 January 2013 and representing 0.5% of GDP and 29% of the country's Cohesion Fund allocation for 2013. This decision was based on Council decision 2012/139/EU² of 24 January 2012, establishing that Hungary had not taken effective action in response to the Council Recommendation of 7 July 2009 to correct the excessive deficit in a credible and sustainable manner by 2011.

Conditions apply to accessing Cohesion Fund assistance and make access to this assistance conditional on the avoidance of an excessive government deficit in line with Article 126 of the Treaty on the Functioning of the European Union (TFEU)³. These conditions aim to increase the incentives for national governments to conduct sound fiscal policies, thus helping to put in place the right macroeconomic conditions that are needed to ensure an efficient use of Cohesion Fund resources. Specifically, Article 4(1) of Council Regulation (EC) No 1084/2006 of 11 July 2006 establishing a Cohesion Fund and repealing Regulation (EC) No 1164/94 establishes that the Council may decide, on a proposal from the Commission, to suspend part or the totality of commitment appropriations from the Fund for the Member State concerned when: (i) this Member State is in an excessive deficit procedure (EDP), and (ii) has not taken effective action in response to a Council recommendation under Article 126(7) TFEU⁴ to correct it by the established deadline. The trigger point for suspension of commitment appropriations is therefore a Council decision adopted on the basis of Article 126(8) TFEU⁵.

The decision on the amount of Cohesion Fund commitments to be suspended was aimed to ensure that the suspension was both effective and proportionate, whilst taking into account the current overall economic situation in the European Union and the relative importance of the Cohesion Fund for the economy of the Member State concerned.

2. CONDITIONS FOR LIFTING THE SUSPENSION OF COHESION FUND COMMITMENTS FOR HUNGARY

According to Article 4(2) of Regulation (EC) No 1084/2006, the Council shall decide, without delay, to lift the suspension of the commitments concerned if it establishes that the Member State concerned has taken the necessary corrective action.

At the time of adoption of Council Implementing Decision 2012/156/EU, the Commission issued the following statement: *"In order to facilitate the decision of the Council, the Commission is committed to present to the Council without delay its assessment of whether*

¹ OJ L 78, 17.03.2012, p. 19.

² OJ L 66, 6.3.2012, p. 6.

³ Replacing Article 104 of the Treaty establishing the European Community (TEC) as referred to in Article 4 of Regulation (EC) No 1084/2006.

⁴ Replacing Article 104(7) TEC as referred to in Article 4 of Regulation (EC) No 1084/2006.

⁵ Replacing Article 104(8) TEC as referred to in Article 4 of Regulation (EC) No 1084/2006.

effective action has been taken, following adoption by the Hungarian Government of corrective measures fulfilling the Council Recommendation of 13 March 2012 under Article 126(7) TFEU.". Moreover, in response to the commitment by the Hungarian government that the necessary correction action would be reflected in Hungary's convergence programme due in April 2012 and in other related publicly available documents and decisions, the Council indicated that it would return to this matter at its meeting of 22 June 2012 with a view to lifting the suspension if the conditions are met.

2.1. The Council Recommendation under Article 126(7) TFEU of 13 March 2012 to durably correct the excessive government deficit by 2012

In its new (the fifth) recommendation to Hungary under Article 126(7) TFEU, the Council established a postponed deadline of 2012 for bringing the situation of an excessive deficit to an end in a credible and sustainable manner. Specifically, the Council asked the Hungarian authorities to: (i) ensure the attainment of the 2012 deficit target of 2.5% of GDP, which based on the Commission Services' February Interim Forecast would require an additional fiscal effort of at least 0.5% of GDP that should be reached through the further specification and implementation of already planned as well as further consolidation measures of a structural nature as necessary; (ii) allocate possible windfall gains for improving the headline balance; (iii) take necessary additional measures of a structural nature as needed to ensure that the deficit in 2013 remains well below the 3% of GDP threshold even after the full phasing-out of one-off revenues of close to 1% of GDP; and (iv) incorporate sufficient reserve provisions in the forthcoming budget laws. At the same time, the Council underlined that the budgetary adjustment should contribute to bringing the government debt ratio onto a declining path and that it also needed to be supported by the proposed improvements in the fiscal governance framework.

2.2. The Commission assessment of the action taken

Based on current information it appears that Hungary has taken action representing adequate progress towards the correction of the excessive deficit. In particular, despite the slight weakening of the underlying macroeconomic environment as shown in 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. The new measures announced in the context of the convergence programme imply additional structural measures of 0.3% of GDP and an improvement of the structural balance by ¼% of GDP in 2012 compared to the assessment underlying the Council's March 2012 recommendations. This is somewhat lower than the recommended additional fiscal effort of 0.5% of GDP but can be considered as broadly acceptable, taking into account the revisions to potential GDP growth and that projected revenues are lower than what could be usually expected based on standard tax elasticities. The use of windfall revenues to improve on the target and the incorporation of sufficient reserve provisions in the forthcoming budgets will yet need to be demonstrated. Based on the Spring 2012 forecast, the general government debt is expected to decrease to 78.5% of GDP in 2012 and slightly further in 2013. Finally, some progress has been made on enhancing the fiscal governance framework, but important reforms are still to be designed and adopted before the end of the Spring session of Parliament. 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 Stability and Growth Pact, 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.

3. PROPOSED LIFTING OF THE SUSPENSION OF COMMITMENTS FROM THE COHESION FUND FOR HUNGARY

The Commission, having taken into account its assessment of the action taken by Hungary in response of the Council Recommendation under Article 126(7) TFEU of 13 March 2012 with a view to bringing the situation of excessive government deficit to an end by 2012 is of the opinion that the conditions for lifting the suspension of commitments from the Cohesion Fund are met.

Accordingly, the Commission proposes to the Council to lift the suspension of commitments from the Cohesion Fund laid down in Council Implementing Decision 2012/156/EU.

The Commission will continue to closely monitor fiscal developments in Hungary, as foreseen under Article 10 of Council Regulation 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, including on the basis of the bi-annual EDP reports produced by the Government, and in the context of post-programme surveillance exercise after the expiry of the financial assistance made available pursuant to Council Decision 2009/102/EC of 4 November 2008 providing Community medium-term financial assistance for Hungary⁶ or under any new Union financial assistance programme for Hungary that the Council may approve. If at any moment in time, before abrogation under Article 126(12) TFEU, action taken is proving inadequate, the Commission will recommend to the Council to adopt a new Decision under Article 126(8) and may propose to the Council to adopt a decision to suspend Cohesion Fund commitments.

⁶ OJ L 37, 6.2.2009, p. 5.

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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 1084/2006 of 11 July 2006 establishing a Cohesion Fund and repealing Regulation (EC) No 1164/94⁷, and in particular Article 4(2) thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) Article 4 of Regulation (EC) No 1084/2006 sets out conditions applicable to Cohesion Fund assistance. According to Paragraph 1 of this article, the Council may decide to suspend either the totality or part of the commitments from the Fund for the Member State concerned with effect from 1 January of the year following the decision to suspend if it has established in accordance with Article 126(8) TFEU that the Member State concerned has not taken effective action in response to a Council recommendation made under Article 126(7) TFEU⁸.
- (2) On 5 July 2004, by Decision 2004/918/EC⁹ the Council decided in accordance with Article 104(6) of the Treaty establishing the European Community (TEC) that an excessive deficit existed in Hungary. The Council adopted a first recommendation on 5 July 2004, a second recommendation on 8 March 2005 and a third recommendation on 10 October 2006 addressed to Hungary in accordance with Article 104(7) TEC. On 7 July 2009 the Council adopted its fourth recommendation to Hungary in accordance with Article 104(7) TEC ('Council Recommendation of 7 July 2009'), with a view to bringing an end to the situation of an excessive government deficit by 2011 at the latest.
- (3) On 24 January 2012 the Council adopted Decision 2012/139/EU¹⁰ in accordance with Article 126(8) TFEU, establishing that Hungary had not taken effective action to correct the excessive government deficit in response to the Council Recommendation of 7 July 2009 within the period laid down therein.

⁷ OJ L 210, 31.7.2006, p. 79.

⁸ Replacing Article 104 of the Treaty establishing the European Community (TEC) as referred to in Article 4 of Regulation (EC) No 1084/2006.

⁹ OJ L 389, 30.12.2004, p. 27.

¹⁰ OJ L 66, 6.3.2012, p. 6.

- (4) On 13 March 2012, by Implementing Decision 2012/156/EU¹¹, the Council decided to suspend part of the commitments from the Cohesion Fund with effect from 1 January 2013 in accordance with Article 4 of Regulation (EC) No 1084/2006. The decision on the amount of Cohesion Fund commitments to be suspended aimed to ensure that the suspension was both effective and proportionate, whilst taking into account the current overall economic situation in the European Union and the relative importance of the Cohesion Fund for the economy of the Member State concerned. The Council considered appropriate, in the case of a first application of Article 4(1) of Regulation (EC) No 1084/2006 to a given Member State, to set the amount at 50% of the allocation of the Cohesion Fund for 2013, without exceeding the maximum level of 0.5% of the nominal GDP of the Member State concerned as forecast by the Commission services. Accordingly, the Council decided to suspend EUR 495 184 000 commitments from the Cohesion Fund for Hungary with effect from 1 January 2013.
- (5) On the same day, the Council issued a revised recommendation to Hungary in accordance with Article 126(7) TFEU ('Council Recommendation of 13 March 2012'), setting 2012 as deadline for bringing the situation of an excessive government deficit to an end. Specifically, Hungary was recommended to: (i) undertake an additional fiscal effort of at least ½% of GDP, based on the further specification and implementation of consolidation measures of a structural nature, to ensure the attainment of the 2012 deficit target of 2.5% of GDP; (ii) allocate possible windfall gains for improving the headline balance; (iii) take necessary additional measures of a structural nature as needed to ensure that the deficit in 2013 remains well below the 3% of GDP threshold; and (iv) incorporate sufficient reserve provisions in the forthcoming budget laws. At the same time, the Council underlined that the budgetary adjustment should contribute to bringing the government debt ratio onto a declining path and that it also needed to be supported by the proposed improvements in the fiscal governance framework.
- (6) On 23 April 2012, Hungary submitted the annual update of its convergence programme outlining its budgetary strategy to ensure the sustainable correction of the excessive deficit by the 2012 deadline. The official deficit targets and the planned fiscal efforts comply with the Council Recommendation under Article 126(7) TFEU of 13 March 2012. The programme confirms the previous medium-term objective of 1.5% of GDP, which it plans to achieve by 2013. According to the 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 regards fiscal governance reform, the authorities announced that they will submit to the Parliament the necessary amendments during the spring session.
- (7) Based on publicly available information, the Commission concluded in its Communication of 30 May 2012¹² that Hungary has taken the necessary corrective action, representing adequate progress towards the correction of the excessive deficit. In particular, 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. Specifically, taking also into account all publicly available information provided by the government since mid-March, the 2013 deficit is foreseen by the Commission services to reach 2.7% of GDP. Considering also the effect of revisions

¹¹ OJ L 78, 17.3.2012, p. 19.

¹² COM(2012) XXXX **LINK TO BE INSERTED HERE AFTER THE 30TH OF MAY**

to potential GDP growth and the projected deviation from standard tax elasticities, the fiscal effort in 2012 can be considered to be broadly in line with what was required. The use of windfall revenues and the incorporation of sufficient reserve provisions in the forthcoming budgets will yet need to be demonstrated. Based on the Spring 2012 forecast, the general government debt is expected to decrease to 78.5% of GDP in 2012 and slightly further in 2013. Finally, some progress has been made on enhancing the fiscal governance framework, but important reforms are still to be designed and adopted before the end of the Spring session of Parliament. 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.

- (8) Overall, Hungary has taken the necessary corrective action in response to the Council Recommendation of 13 March 2012 to correct the excessive deficit by the deadline set by the Council. Therefore, Council Implementing Decision 2012/156/EU suspending part of the commitments from the Cohesion Fund should be abrogated.
- (9) If at any moment in time, before the abrogation of the decision on the existence of an excessive deficit in accordance with Article 126(12) TFEU, action taken is proving inadequate, the Council will, based on a recommendation by the Commission, adopt a new Decision under Article 126(8) TFEU. It may, on a proposal by the Commission, adopt a decision to suspend Cohesion Fund commitments,

HAS ADOPTED THIS DECISION:

Article 1

The partial suspension of commitments from the Cohesion Fund for Hungary laid down in Council Implementing Decision No 2012/156/EU is hereby lifted.

Article 2

This Decision is addressed to Hungary.

Done at Brussels,

*For the Council
The President*