Brussels, 8 July 2008

BACKGROUND[1]

ECONOMIC and FINANCIAL AFFAIRS COUNCIL

Tuesday 8 July in Brussels

The Council will be preceded as usual by a meeting of the ***eurogroup****, on Monday 7 July starting at 17.00, which will examine the economic situation, the situation of the financial markets, economic and monetary union ten years after its launch, and the eurogroup work programme for the second half of this year.*

Starting at 9.30 on Tuesday, the Council is due to take decisions to enable ***Slovakia to adopt the euro with effect from 1 January 2009*** *and definitively to determine the exchange rate between the Slovak koruna and the euro.*

The Council is due to close the ***excessive deficit procedure for Poland*** *and at the same time to open a procedure for the* ***United Kingdom****. It will also adopt opinions on* ***Belgium's*** *stability programme and Poland's convergence programme.*

Among other items on its agenda, the Council will hold an exchange of views on ***the rise in the price of oil*** *and is due to adopt conclusions on the reform of governance concerning international* ***accounting standards****, and on initiatives taken in relation to the financial markets, particularly concerning transparency and* ***rating agencies****.*

At lunch, the president of the eurogroup will report on the previous evening's deliberations. The Presidency will report on the meeting of G8 finance ministers held in Osaka on 14 June and will provide an update on the summit for the Mediterranean to be held in Paris on 13 July.

Press conferences

- President of the eurogroup: after the eurogroup meeting *(Monday, as from 20.00)*
- President of the Council: at the end of the Council, before lunch *(Tuesday, as from 12.00).*

Press conferences and public events can be followed by video streaming:
http://www.consilium.europa.eu/videostreaming

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[1] This note has been drawn up under the responsibility of the press office.

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Presidency work programme

– ***Public debate***

The French Presidency will present a work programme in the area of economic and financial affairs for the duration of its term in office (from July to December 2008) and the Council will hold an exchange of views *(11204/08).*

This item will be the subject of a public debate and may be followed by video streaming on the internet.

The work programme puts the emphasis in particular on the following issues:

- suggest responses to Europeans' concerns regarding the economic situation against a background of high oil prices and risks to the environment;

- strengthen confidence in the European financial system, adapt it to the reality of financial integration in Europe and organise effective supervision of pan-European financial groups;

- ensure proper functioning of Economic and Monetary Union;

- press on with the integration of the internal market, in particular in the area of financial services and taxation;

- as far as budgetary matters are concerned, finalise the EU budget for 2009.

In a word, help to assert a strong Europe which is an economic player at the service of its citizens in a globalised world.

Stability and convergence programmes

– **Belgium and Poland**

The Council is due to adopt opinions on the annual updates:
- o by Belgium, on its stability programme;
- o by Poland, on its convergence programme.

Under the EU's stability and growth pact, Member States having the euro as their currency are required to present stability programmes; those not participating in the single currency are required to present convergence programmes. They update them every year, and each time the Council adopts an opinion.

This year, the Council evaluated the updated programmes of most of the Member States at its meetings on 12 February and 4 March, but because they were forming new governments, Belgium and Poland were late in presenting their programmes.

Based on Article 99(5) of the Treaty, the opinions require a simple majority within the Council for adoption.

Excessive deficit procedures

– **Poland**

The Council is due to adopt a decision closing the procedure which it opened in July 2004 concerning the existence of an excessive deficit in Poland.

The aim of the draft Decision is, by virtue of Article 104(12) of the treaty, to abrogate a decision taken under Article 104(6) of the Treaty on the existence of an excessive government deficit, since Poland has reduced its deficit to below 3 % of gross domestic product (GDP), which is the threshold set by the Treaty.

The procedure was initiated following a general government deficit in 2003 of 4,1 % of GDP, excluding the cost of an ongoing pension reform. In July 2004, a few weeks after Poland's accession to the EU, the Council adopted its decision under Article 104(6), together with a recommendation under Article 104(7), in which it put forward the measures needed to bring the deficit below 3 % of GDP by 2007 at the latest.

In November 2006, the Council adopted a decision under Article 104(8) of the Treaty, establishing that the action taken by Poland was proving inadequate to reduce the deficit in accordance with its recommendation. It noted that despite an improvement in the government financial position in Poland, the 2007 deficit would again exceed the 3 % threshold, if the budgetary cost of the pensions reform were taken into account.

Given that Poland is not a member of the euro area, the stages in the excessive deficit procedure provided for in Article 104(9) and (11) of the Treaty do not apply. This is why, in February 2007, the Council adopted a new recommendation under Article 104(7) in which it confirmed that Poland had to bring its deficit below 3 % of GDP by 2007 at the latest.

In 2007, despite a 3,4 % forecast in its convergence programme of November 2006, the Polish deficit was only 2 % of GDP owing to a higher level of growth than expected, reflected in greater revenue than expected, and to restrictions on expenditure.

In December 2007 the Council took the view that the measures taken by Poland were, up to that time, in accordance with its second recommendation. It asked the Polish authorities to submit – as soon as possible after the formation of a new government following the elections in October 2007 – an updated convergence programme for the period 2008-10 together with a medium-term budget strategy. The new programme was submitted at the end of March.

For 2008, the relevant Commission departments indicated in their spring forecasts that the deficit would grow and reach 2,5 % of GDP, which was still in line with the target set by the new convergence programme. In 2009, assuming no change in policies, it should rise to 2,6 % of GDP, according to the same forecasts, while the convergence programme is counting on a deficit of 2 %.

Poland reduced its government debt to 45,2 % of GDP last year, having peaked at 47,6 % in 2006 while remaining well below the reference value of 60 % of GDP laid down in the Treaty. The debt is expected to continue to fall.

The Council should conclude that Poland has brought its budget deficit below the level of 3 % of GDP in a credible and sustainable manner.

Adoption of the decision requires a majority of two-thirds of the weighted votes of 26 delegations (excluding the Polish delegation);

– **United Kingdom**

The Council should open a procedure concerning an excessive government deficit in the United Kingdom.

It should adopt a decision under Article 104(6) of the Treaty on the existence of an excessive government deficit and a recommendation under Article 104(7) advocating corrective measures.

According to information received from the UK authorities, the deficit should reach 3,2 % of GDP in 2008-09 – i.e. above the 3 % threshold set by the Treaty – while an amendment of the 2008-09 budget announced in May indicates a further rise of 0,2 %. For its part, the Commission expects that the deficit will remain above the 3 % level during the 2009-10 financial year, as the economic situation is giving rise to a slow-down in growth.

The Council recommendation should give the United Kingdom a period of six months to take corrective measures and request it to put an end to its excessive deficit by the 2009-10 financial year at the latest. The recommendation would accordingly call on the United Kingdom to improve its structural balance by at least 0,5 % of GDP during the 2009-10 financial year.

However, although the trend is upwards, the United Kingdom's government debt, i.e. 43 % of GDP in 2007-08 – remains below the 60 % reference value specified in the Treaty.

Adoption of the decision requires a qualified majority in the Council; adoption of the recommendation requires a majority of two-thirds of the weighted votes of 26 delegations (excluding the United Kingdom delegation).

Adoption of the euro by Slovakia

The Council should adopt a decision authorising Slovakia to adopt the euro as its currency as from 1 January 2009 and repealing its derogation concerning its participation in the Economic and Monetary Union. It will also adopt Regulations setting permanent conversion rates between the Slovak koruna and the euro and adjusting certain technical provisions on the introduction of the euro.

Fifteen of the 27 EU Member States currently have the euro as their currency: Belgium, Cyprus, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Austria, Slovenia and Finland. Euro notes and coins were introduced in 12 of these countries on 1 January 2002, in Slovenia on 1 January 2007 and in Cyprus and Malta on 1 January 2008.

The Heads of State and Government discussed the proposal to authorise Slovakia to adopt the euro at a Council meeting on 19 June (in the margins of the European Council) on the basis of reports from the Commission and the European Central Bank and a letter from the President of the Economic and Financial Affairs Council (ECOFIN).

Noting that Slovakia fulfilled all the convergence criteria and the legal conditions for adopting the euro, the Council agreed to the Commission's proposal and asked the ECOFIN Council to adopt it.

The decision will thus expand the euro area from 15 to 16 Member States as from 1 January 2009, leaving Slovakia six months to prepare for the change.

The reports by the Commission and the ECB consider whether the legislation of the country concerned is compatible with the provisions of the Treaty and with the Statute of the European System of Central Banks (ESCB). They also look at progress in complying with the convergence criteria – i.e. price stability, the situation of public finances, the stability of exchange rates, and long-term interest rates – and several other factors.

Adoption of the draft decision, which is based on Article 122(2) of Treaty, requires a qualified majority in the Council with the support of at least 14 Member States. The draft Regulations are based on Article 123(5), requiring unanimity among the Member States in the euro area and Slovakia.

The letter from the President of the ECOFIN Council sets out his analysis in the following terms, in the light of an initial discussion that took place at the ECOFIN Council's meeting on 3 June:

– Slovakia's general government deficit has seen a credible and sustainable reduction from 8,2 % in 2002 to 2,2 % of GDP in 2007. Likewise, the general government debt to GDP ratio has been reduced since 2002 and reached 29,4 % of GDP in 2007. The ECOFIN Council has adopted a decision abrogating the excessive deficit procedure for Slovakia[2].

– The average HICP[3] inflation rate in Slovakia in the year ending March 2008 was 2,2 %, which is below the reference value for the price stability criterion[4]. The 12-month average inflation is expected to remain below the reference value in the months ahead, albeit with a narrowing margin.

  After several years of trend appreciation of the Slovak currency, operating under conditions of irrevocably fixed exchange rates will create new challenges for the Slovak economy. Insisting on the importance of the sustainability of inflation convergence, the ECOFIN Council underlined the need for Slovakia to be vigilant and to implement budgetary and structural policies supportive of price stability.

  In this context, the Council welcomed the measures planned by the Slovak government aiming at containing inflationary pressures over the medium-term and the commitment to step up efforts towards achieving this goal should unexpected inflationary pressures arise, efforts which are supported by the recent upward re-alignment of the central rate of the Slovak currency within ERM [5] II.

– Slovakia has been participating in ERM II since November 2005. In that period, the Slovak koruna (SKK) has not been subject to severe tensions and Slovakia has not devalued, on its own initiative, the SKK bilateral central rate against the euro.

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[2] The Council adopted this decision at its meeting on 3 June.
[3] Harmonised Index of Consumer Prices.
[4] Value corresponding to the average in the three best-performing Member States plus 1,5 percentage points.
[5] Exchange-rate mechanism. The purpose of ERM II is to reduce exchange-rate variability and ensure monetary stability in preparation for the introduction of the euro.

- In the year ending in March 2008, the long-term interest rate in Slovakia was, on average, 4,5 %, which is below the reference value [6].

- Other relevant factors to which the Treaty refers, such as the integration of markets or the situation and the evolution of the balance of payments, also point to a high degree of sustainable convergence. Slovakia's national legislation, including the statutes of the Slovak national central bank, is compatible with the Treaty and the ESCB Statute requirements for Stage Three of Economic and Monetary Union.

Rising oil prices

The Presidency will describe the Council's role, in its Economic and Financial Affairs configuration, in implementing the conclusions of the European Council on 19 and 20 June 2008 on rising oil prices.

Among the subjects that it will examine are the operation of the market, with regard to such matters as the transparency of oil stocks, the role of financial incentives in the diversification of energy sources and in the promotion of energy efficiency, and measures likely to alleviate the impact of rising oil prices.

At its June meeting, the European Council expressed concern in regard to the continued surge in oil and gas prices and the social and economic consequences. The Presidency's conclusions stated that "*measures can be considered to alleviate the impact of higher oil and gas prices on the poorer sections of the population, but should remain short-term and targeted*". "*Distortionary fiscal and other policy interventions should be avoided as they prevent the necessary adjustment by economic agents*".

The European Council invited the French Presidency in cooperation with the Commission to examine the feasibility and impact of measures to smooth the effects of sudden oil and gas price increases and report before the October European Council.

It also stressed the need to:

- rapidly adopt the climate change and energy package;
- make further efforts to increase energy efficiency and energy savings and diversify the EU energy supply;
- rapidly examine other measures, in particular to promote competition in energy markets, promote modernisation of transport systems and increase the transparency of oil markets;
- enhance the dialogue with oil and gas companies, producing countries and importing developing countries in order to ensure better response of supply to market needs and to improve the framework conditions for investment in exploration, production, refining capacity and alternative energy sources.

The other Council configurations will also make their contribution to the work on oil during the six months of the French Presidency.

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[6] Value corresponding to the average interest rate in the three best-performing Member States in terms of price stability, plus 2 percentage points.

A Commission communication of last month provides a basis for discussion on the way in which Europe may be able to adapt itself in the years to come to higher oil prices (*10824/08*).

International accounting standards – IASB Governance

The Council should adopt the conclusions on the reform currently taking place in the International Accounting Standards Board (IASB), following the public consultation launched at the end of May (*11183/08*).

It has already considered the governance and financing of the IASB, and adopted conclusions on this subject in July 2006 and July 2007.

There are two reasons why conclusions must again be adopted this year:

- the IASCF, the foundation responsible for appointing the members and the financing of the IASB, launched a process of constitutional review last May with a view to enhancing its own governance and that of the IASB; it proposes inter alia to set up a Monitoring Committee within the IASCF which would be responsible for ensuring that the public interest and prudential concerns are better taken into account when accounting standards are being drawn up;
- recent financial turbulence has demonstrated the need for a reliable mechanism for drawing up international accounting standards.

Against this background, the Council aims to express a firm European position, focused in particular on the principles identified by the draft conclusions.

Financial markets – Implementation of current initiatives

The Council will review developments on current initiatives, in accordance with a "road map" adopted at its meeting last October in order to deal more effectively with the turmoil on financial markets since August 2007.

The Council should adopt conclusions on two issues in particular:

- progress in the transparency of banks and other financial institutions regarding the valuation of their risk assets;
- the line to be followed in Europe and at world level regarding rating agencies *(11229/08)*.

The draft conclusions stress that prompt and full disclosure by financial institutions of their exposure to distressed assets and off-balance sheet vehicles and of their write-downs and losses is essential to bring back confidence in the markets.

The Committee of European Banking Supervisors recently drew up recommendations to give guidance to banks in evaluating their assets. According to the draft conclusions, this is a very important factor in ensuring greater consistency in the practices of financial institutions, which is essential for restoring confidence in the real situation of the market.

With regard to rating agencies, the draft conclusions support the idea of better regulation, in particular by means of European registration of rating agencies.

It stresses the need to address the concerns that have been raised concerning the transparency of the rating process, risk of conflicts of interest relating to the remuneration models of the rating agencies, accountability and the quality of ratings.

Commissioner Charlie McCreevy has announced a regulatory initiative by the Commission along these lines for the autumn and the Presidency will continue to advance this dossier.