

BACKGROUND¹

ECONOMIC and FINANCIAL AFFAIRS COUNCIL

Tuesday 11 July in Brussels

*The Council will be preceded as usual by a meeting of the **eurogroup**, on Monday 10 July starting at 19.00, which will examine, in particular, budgetary developments in the member states in 2006, budgetary prospects for 2007 and IMF multilateral consultations on global imbalances.*

The president of the eurogroup will hold a press conference at the end of the meeting, which can be followed by video streaming.

*Starting at 10.00 on Tuesday, the Council is expected to adopt a decision allowing **Slovenia to join the euro area as from 1 January 2007**, making it the first to adopt the euro out of the ten member states that joined the EU on 1 May 2004, with six months to prepare for the changeover. The Council will also approve the permanent exchange rate of the Slovenian tolar to the euro.*

*On excessive deficits, the Council is due to abrogate the procedure it opened in July 2004 with regard to **Cyprus** and will assess action taken by **Portugal** following the recommendation it issued in September 2005.*

*It is also expected to adopt conclusions on funding of the **International Accounting Standards Board** and will hold a debate on renewal of the **EIB**'s external lending mandates.*

At lunch, ministers will discuss preparations for the IMF's annual meeting in Singapore on 19 and 20 September, in particular as regards reform of IMF governance.

The president of the Council will hold a press conference at the end of the meeting, which can be followed by video streaming.

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Public events that can be followed by video streaming:
<http://www.consilium.europa.eu/videostreaming>

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

Presidency work programme

- *public debate*

Finland will present its work programme for the Economic and Financial Affairs Council, updating, for the duration of its presidency during the second half of 2006, the joint Austrian and Finnish programme presented in January. (10789/06)

The item will be taken in public deliberation and can be followed by video streaming.

The work programme focuses on the following issues:

- Strengthening the coordination framework for economic policy, on the basis of the 2005 revisions of the EU's stability and growth pact and Lisbon strategy for growth and jobs.
- Stability of financial markets, in particular financial markets crisis management.
- Integration of financial markets.
- Alcohol taxation.
- Value-added tax: reform of provisions on the place of taxation for services and simplifying VAT obligations for businesses.
- Enlargement of the euro area.
- Renewal of the European Investment Bank's mandate for external lending.
- Implementation of the EU's budgetary framework for 2007-13.
- Regulatory reform.
- Global competition, innovation and productivity.
- Energy: energy efficiency and security of supply.

EIB external lending

- *public deliberation*

The Commission will present a proposal for a decision aimed at renewing, for the 2007-13 period, the mandates given, under guarantee from the EU budget, to the European Investment Bank for lending for projects outside the EU. It will also present a report on the EIB's activities under its current mandates.

The Council will hold a policy debate, on the basis of a questionnaire prepared by the presidency, with the aim of providing guidance for work on the proposal. (11252/06)

The item will be taken in public deliberation and can be followed by video streaming.

The questionnaire covers the main political issues raised by the proposal, except the total amount of external lending and the regional distribution of that lending. The Council will discuss these in greater depth at its meeting on 10 October, with a view to reaching an agreement on the proposal by the end of the year.

The EIB's general external lending mandate and specific mandates for projects in Russia, Ukraine, Moldova and Belarus, established by Council decisions 2000/24/EC and 2005/48/EC, will normally expire in January 2007.

Activities outside the EU generally make up 10% of the EIB's total activities, amounting to EUR 5,1 billion in 2005, of which 72,5% were under EU guarantee. The guarantee prevents the bank's operations, which often bear a significantly higher level of risk than the EIB's operations within the EU, from affecting the bank's credit standing, thus allowing it to maintain attractive lending rates.

The Commission's proposal would allow lending on a single legal basis for loans and guarantees in all regions, up to a total amount of EUR 33 billion over seven years with a 65% blanket guarantee coverage. It provides for a new geographical breakdown in order to ensure better linkage with the EU's external relations policies and objectives, as well as a reserve mandate to be activated in cases of natural disasters, post-conflict reconstruction and strategic developments.

The proposed breakdown by region is as follows:

- EU pre-accession countries: EUR 9 billion;
- neighbourhood and partnership countries: EUR 15 billion (of which EUR 10 billion for Mediterranean countries and EUR 5 billion for eastern Europe, the southern Caucasus and Russia);
- development and economic cooperation countries: EUR 7,5 billion (of which EUR 4 billion for Latin America, EUR 2 billion for Asia and EUR 1,5 billion for South Africa);
- reserve mandate: 1,5 billion.

The proposal is based on article 181A of the EU treaty, requiring qualified majority within the Council for adoption.

Briefing on the eurogroup

The president of the eurogroup will brief the Council on the eurogroup meeting held on 10 July.

Enlargement of the euro area - Slovenia

The Council is expected to adopt:

- a decision allowing Slovenia to adopt the euro as its currency as from 1 January 2007;
- a regulation fixing a permanent conversion rate between the Slovenian tolar and the euro, amending regulation 2866/98 accordingly.

Admission of Slovenia will make it the first to join the euro area out of the ten member states that joined the EU on 1 May 2004, with six months to prepare for the changeover. Adoption of the euro as Slovenia's currency will occur at the same time as the issuing of euro notes and coins.

The permanent conversion rate will be set at 239.64 Slovenian tolar to the euro, which corresponds to the current central rate of the tolar within the EU's ERM II exchange rate mechanism.

Heads of state/government discussed the draft decision at a Council meeting on 16 June in the margins of the European Council. They also took note of the presentation of reports by the European Central Bank and the Commission on fulfilment by Slovenia and Lithuania of their convergence obligations regarding economic and monetary union. They welcomed the proposal on Slovenia and commended Lithuania for the convergence it has achieved so far.

Twelve of the EU's 25 member states currently use the euro as their currency: Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Austria and Finland. Euro notes and coins were introduced in all twelve countries on 1 January 2002.

The draft decision allowing Slovenia to adopt the euro abrogates what is considered as a derogation. Based on article 122(2) of the EU treaty, it requires a qualified majority within the Council for adoption. The two draft regulations are based on article 123(5), requiring the unanimity of euro area member states plus Slovenia.

Article 122(2) requires convergence reports from the Commission and the ECB once every two years on all member states with a derogation, or at the request of one of those member states. The two-yearly convergence reports are due in October; Slovenia submitted a request on 2 March for an earlier assessment, so as to allow sufficient time for preparations for introduction of the euro on 1 January 2007.

Excessive deficit procedure

- **Cyprus**
- **Portugal**

The Council will adopt a decision abrogating its July 2004 decision on the existence of an excessive government deficit in Cyprus.

The Commission will present a communication assessing action taken by Portugal in order to correct its excessive government deficit following a recommendation issued by the Council in September 2005 under article 104(7) of the EU treaty. The Council is expected to share the Commission's view that no further action is necessary under the excessive deficit procedure at this stage.

Cyprus

Cyprus in 2003, the year before it joined the EU, had a government deficit amounting to 6.25% of GDP, well above the 3% of gross domestic product (GDP) reference value set by the EU treaty for deficits. It had a government debt amounting to 72,25% of GDP and further deviating from the 60% reference value for debt. In 2004, it had a deficit of 4,1%.

In a recommendation accompanying its July 2004 decision, issued under article 104(7) of the treaty, the Council called on Cyprus to take action in order to bring its deficit below 3% in 2005, and to ensure that the rise in the debt ratio is brought to a halt in 2004 and reversed thereafter.

Figures notified in April 2006 estimate Cyprus's deficit at 2,4% of GDP in 2005 and, according to the Commission's spring forecast, it is due to remain just above 2% in 2006. In 2005, government debt decreased to 70,25% of GDP and, according to the spring forecast, it is due to further decline to 69% in 2006. The Commission considers the deficit to have been brought below the 3% ceiling in a credible and sustainable manner and the debt to be sufficiently diminishing towards the 60% reference value.

The draft decision on Cyprus is based on article 104, paragraph 12 of the EU treaty, requiring two thirds of the weighted votes of 24 delegations, excluding Cyprus, for adoption.

Portugal

In June 2005, Portugal announced a projected government deficit amounting to 6.2% of GDP in 2005, with plans to bring the deficit below 3% of gross domestic product (GDP), the reference value set by the EU treaty for deficits, no sooner than 2008. Government debt would remain in excess of the 60% of GDP reference value for debt, and continue rising until 2007.

In the September 2005 recommendation, issued under article 104(7) of the treaty, the Council stipulated measures to be taken by Portugal in order to bring its deficit below 3% in a credible and sustainable manner by 2008 at the latest, and to put its debt ratio onto a downward path. The Council established a deadline of 19 March 2006 for taking effective action, in particular as regards the 2006 deficit.

Portugal's budget law for 2006 set a deficit target of 4,6%, relying on corrective measures on both the expenditure and revenue side, including an increase in the standard VAT rate from 19 to 21%, and projecting a 1,6% reduction in the structural balance. In accordance with the December 2005 update of its stability programme, Portugal is aiming for a 3,7% deficit in 2007 and a deficit below 3% in 2008. Government debt, which stood at 63,9% at the end of 2005, is projected to peak at just over 69% in 2007 and to decline thereafter.

In April, Portugal reported a deficit of 6,0% in 2005, less than the 6,2% target set the previous June. The Commission however, in its spring forecast, projects a 5% deficit for 2006, higher than the 4,6% target.

The Commission considers that Portugal's action represents adequate progress within the time limits set by the Council, although correction of the excessive deficit by 2008 and the reduction in the debt ratio are subject to significant risks and uncertainties. Further corrective efforts may be needed. The Commission concludes that no further steps in the excessive deficit procedure are needed at present, although it will continue to monitor developments closely.

Public finances under the revised stability and growth pact

The Commission will present a communication on member state public finances one year after the revision of the EU's stability and growth pact, as well as its assessment of figures notified by the member states regarding their government budgets for 2005. The Council will hold an exchange of views and is due to adopt conclusions.

The stability and growth pact is aimed at ensuring sound government finances as a means of strengthening the conditions for price stability and for sustainable growth conducive to employment creation within the EU's economic and monetary union. The 2005 revision of the pact confirmed the ceilings for government deficit and debt set respectively at 3% and 60% of gross domestic product, whilst increasing flexibility and strengthening the system's economic rationale.

The revised pact pays greater attention to debt developments, the enhancement of growth potential and the long-term sustainability of government finances in line with the EU's Lisbon strategy for growth and jobs. It requires member states to ensure budgetary consolidation during economic good times so as to create the budgetary margins necessary for less favourable times. Medium-term objectives are more clearly linked to sustainability and country-specific situations. Decisions and recommendations under the pact's excessive deficit procedure are made in the light of an overall economic analysis, and an increased focus is put on structural fiscal consolidation efforts rather than merely on short-term nominal results.

The Commission considers experience so far under the revised pact to have been positive. It reports concerns, however, as regards implementation of the pact's preventive arm, as it is not yet clear whether the member states will step up fiscal consolidation in line with their improving growth prospects.

Dialogue with third countries on economic issues

- **EU-US summit on 21 June**
- **Dialogue with third countries**

The presidency and the Commission will brief the Council on the outcome of the EU-US summit held in Vienna on 21 June as regards economic, financial and regulatory issues.

The Commission will brief the Council on dialogue engaged with a number of third countries, including the EU-US financial markets regulatory dialogue and dialogue with China, Russia, Japan and India.

The Council will hold an exchange of views.

International accounting standards - Funding of the IASB

The Council will discuss the funding of the International Accounting Standards Board (IASB) and possible arrangements to succeed the current funding scheme which expires at the end of 2007. It is expected to adopt conclusions.

The Council briefly discussed the issue at its meeting on 7 June.

The IASB, based in London, is responsible for the development and approval of international financial reporting standards, as well as the interpretation of those standards. IASB standards are incorporated into EU law.

Funding of the IASB currently depends on voluntary contributions from a limited number of companies and institutions, and is considered to be unsustainable. Alternative arrangements have been discussed, in particular the idea of a voluntary company fee-based scheme. According to the Commission, global financing needs of the IASB will amount to EUR 23,5 million in 2008.

The draft Council conclusions highlight factors that should be taken into account in the IASB's future financing.
