COUNCIL OF
THE EUROPEAN UNION

EN

KEY ISSUES PAPER

(Preparation of the meeting of the European Council of 8 and 9 March)

2787th ECONOMIC and FINANCIAL AFFAIRS Council meeting
Brussels, 27 February 2007

The Council adopted a key issues paper to be submitted to the European Council on 8 and 9 March, outlining the main policy objectives relating to economy and finance:

"Contribution by the Council (ECOFIN) to the Spring Meeting of the European Council

In autumn 2006 the Member States presented their first progress reports on the implementation of their National Reform Programmes. The European Council should now give guidance on progress with structural reforms under the Lisbon Strategy for Growth and Jobs re-launched in 2005 and maintain the momentum for reforms within an improved economic context.

1. Favourable times for budgetary consolidation and further structural reforms

The Council (Economic and Financial) calls for fully taking advantage of growth conditions which are now better than they have been for many years to pursue structural reforms in line with the BEPGs, including their country-specific recommendations. The favourable overall conditions, as exemplified by an expected growth rate of 2.7% in 2007, should be also used to consolidate public finances, and improve their quality, thus contributing to sustainability. This is in accordance with the revised Stability and Growth Pact which has strengthened the consistency of budgetary and structural policies in the short and longer term. The positive development on the labour markets is reflected in the prospects of a falling unemployment rate, 7 million new jobs created during the 2007/2008 period, and an expected increase in the employment rate from 63¾% in 2005 to 65½% by 2008. However, the level of long-term unemployment remains high. Structural reforms that increase the potential for employment and growth therefore remain a top priority. While gains from past reforms start to show, the

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positive effects of many reforms will be felt only in the medium to long term, which make an effective communication boosting national "ownership" important.

2. Implementation of the Lisbon Strategy

The Council (Economic and Financial) welcomes the Annual Progress Report submitted by the Commission on 12 December 2006 on the Lisbon Strategy for Growth and Jobs. It broadly shares the Commission's diagnosis taking into account the work carried out by the Council under the Finnish Presidency and building upon the priorities identified by the Spring European Council 2006. Member States and the Commission have made a promising start in implementing National Reform Programmes and the Community Lisbon Programme. However, in most Member States there is scope for stronger action in areas such as long-term sustainability of public finances, adaptability of the labour market, R&D and innovation policy, unlocking the business potential especially of SMEs, improving the functioning of energy markets, and competition, particularly in network industries and services. At EU-level, in particular the Community Lisbon Programme has also a role to play in enhancing European competitiveness. Important are also measures in the field of better regulation as outlined in the conclusions of the Council (Economic and Financial), including an ambitious reduction target for administrative burdens arising from EU legislation.

The Council (Economic and Financial) takes note of the Commission Communication "An Energy Policy for Europe". A secure, sustainable and competitive energy supply is crucial for the Community. Climate change provides challenges to our economies and demands action at all levels, global, EU and national. In order to effectively address these challenges, the Council (Economic and Financial) emphasises the need for an Energy Policy for Europe based on careful assessment of the impact on cost effectiveness, security of supply and diversification of sources and routes of supply and subsidiarity, creating a positive framework for investment in the energy sector. Energy policy also needs to take full advantage of market mechanisms, in particular the European Emissions Trading Scheme.

A core element of the Lisbon Strategy is further strengthening of the Single Market and in this respect the Council looks forward to an ambitious review of the Single market. External openness should be developed further in the context of the Doha round.

Monitoring and assessing reforms is an important factor for the success of the Lisbon strategy. This calls for a clear and transparent approach based on suitable methods.

3. Specific areas for further implementation

The Council (Economic and Financial) recommends putting particular emphasis on the areas listed below when implementing the National Reform Programmes and the country-specific recommendations and the Community Lisbon Programme.

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3.1. Fostering the success of the European Economic and Monetary Union

The Council (Economic and Financial) recognises the special importance of sound and well-balanced fiscal policies and further structural reforms in the Member States of the euro area. The euro is a stable currency that enjoys great confidence worldwide benefiting citizens and investors. Currency conversion costs and the need to hedge against exchange-rate risk no longer apply within the euro area. The euro has ensured low inflation and low long-term interest rates. It is encouraging an intensification of trade and competition and has already cut the costs of money transactions considerably.

All Member States need to achieve and sustain dynamic growth and high employment, and the benefits outlined above clearly enhance the euro area's potential to accomplish these objectives. In addition, euro-area Member States need to observe closely issues arising from persistent differences in growth, inflation and competitiveness. Differences may occur within large monetary unions reflecting the processes of economic catch-up in Member States or cyclical effects. The observed divergences, however, may also reflect structural rigidities or a lack of productivity, or insufficient investment and innovation.

Enduring non-inflationary growth in line with the provisions of the EC treaty needs to be secured in the Member States by effectively coordinating economic policies, including country-specific recommendations within the context of the Broad Economic Policy Guidelines and in line with the Treaty. Effective policy co-ordination is particularly important at the euro-area level in order to ensure a smooth functioning of adjustment in monetary union. It would help to promote policy actions in Member States aiming to achieve structural reforms. In this respect, important priorities for the euro area include labour market reforms supporting labour cost developments that are conducive to stability, a deeper integration of financial, product and services markets, and further measures to facilitate flexible market adjustments and labour mobility as well as fostering competitiveness. Sound and well-balanced fiscal policies are also key elements of successful strategies. Sound fiscal policies require further budget consolidation to attain MTOs, thereby improving the sustainability of public finances. Well-balanced fiscal policies call for public expenditure and taxation to be reviewed by Member States to attain positive effects on the sustainability of growth.

3.2. Improving the future prospects of public budgets – sustainability and quality of public finance

Demographic change and advancing globalisation represent significant challenges for fiscal policy. It is important to set the right course today:

- Member States which have not reached their medium-term budgetary objective (MTO) should pursue efforts to reach it as soon as possible in line with the revised Stability and Growth Pact. Larger than expected revenues related to growth should be allocated to consolidate public budgets. National fiscal rules and institutions at different levels of government can play an important role in that respect.

- The long-term sustainability of public finances should be safeguarded by pursuing the three-pronged-strategy, i.e. by reforming pension- and health care systems, reducing public debt and raising employment rates and productivity. More flexible and secure employment systems ("flexicurity") can in a mutually reinforcing way improve labour markets but need to be sustainable in fiscal terms and create appropriate overall work incentives.

- The quality of public finances needs to be improved by raising efficiency and effectiveness of spending and restructuring public budgets in favour of measures that promote productivity and innovation and by strengthening human capital with a view to raising the long-term growth potential of the economy.

- Taxation and levy systems which promote growth and cope with globalisation help ensure government revenues. Furthermore, new ways of financing government tasks (e.g. public-private partnerships) should be explored. An exchange of best practices, will give the opportunity to learn from each other.

3.3. Tax policies in Europe – enhancing the internal market

National rules on taxation differ between Member States. The functioning of the internal market may be improved through co-operation on taxation among Member States and where appropriate at the European level, while respecting national competencies. The Council (Economic and Financial) has been informed of the ongoing work especially in the field of taxation and of action taken to tackle fiscal fraud and harmful tax practices.

3.4. Integrating financial markets to raise efficiency and international competitiveness

Further integrating the European financial markets will enhance their efficiency and global competitiveness. The Council (Economic and Financial) therefore calls for further development of the strategy to create an integrated and smoothly functioning European market for financial services, which was adopted in the Financial Services Action Plan and in the Commission "White Paper on Financial Services Policy 2005 to 2010". For this reason it is important to

- overcome the obstacles against the adoption of the Directive on Payment Services in order to create a legal framework for a uniform EU-wide payments system;

- create a risk-oriented financial-services supervision for insurance companies (Solvency II) which will contribute to stability in the financial markets, recognising the role of insurance companies in long-term investment;

- remain vigilant on potential systematic and operational risks associated with the activities of hedge funds, while acknowledging that they have contributed significantly to the efficiency of the financial system;

- continue working towards an improved supervision of the acquisition of significant holdings in the financial sector in the context of the "acquisition directive";

- thoroughly evaluate the existing measures on financial integration within the better regulation agenda and continue work in the field of clearing and settlement;

- enhance the convergence in supervisory practices and improve the efficiency of EU arrangements for financial stability and crisis management;

- enhance the efficiency of the investment funds market while assuring a high level of protection to investors.

4. Further steps

The Member States and the Commission are called upon to continue the implementation of their National Reform Programmes and of the Community Lisbon Programme and to report on further progress in autumn 2007. During the review and the adoption of a new three year cycle of the Integrated Guidelines planned for 2008 the overall policy orientation as well as the possibility of further streamlining the present planning and reporting system should be examined."