



Brussels, 31 October 2008

BACKGROUND¹
ECONOMIC AND FINANCIAL AFFAIRS COUNCIL
Tuesday 4 November 2008, Brussels

*The Council meeting will be preceded by a meeting of the **Eurogroup** on Monday 3 November, starting at 17.30, which will discuss among other items the economic situation, in the light of the Commission's autumn forecast, and developments on the financial markets.*

Also on Monday (at 12.15) the Council Troika will meet a delegation of the European Parliament and at 14.30 a dialogue on macroeconomic questions will be held with the social partners (employers and trade unions at EU level).

On Tuesday, at a working breakfast starting at 8.30, Ministers will discuss the economic situation, including the follow-up of national measures implemented in response to the financial crisis, and the macroeconomic situation in Hungary.

*Starting at 9.30, the Council will discuss follow-up to the October European Council, and, in particular, preparations for the **global summit on the financial crisis**, to be held in Washington on 15 November, and the European response to the economic situation, with a presentation by the Commission of its proposals of 29 October. The Council should also approve an EUR 6,5 billion loan to **Hungary**, in coordination with the financial assistance provided by the IMF, in order to support Hungary's balance of payments in the medium term.*

*Among the other items on the agenda, the Council will discuss a proposal for **reduced VAT rates** and will seek to reach agreement on measures to tackle **VAT fraud** and on new **general excise duty arrangements**. It will also review progress in the negotiations with **Liechtenstein** on an anti-fraud agreement.*

Ministers will have lunch with representatives of three sovereign wealth funds (Abu Dhabi, Norway and Qatar) and will discuss the application of IMF standards to this type of fund.

At 15.00, Ministers will meet their counterparts from EFTA (Iceland, Liechtenstein, Norway and Switzerland) to discuss the financial crisis, international financial cooperation and combating fraud.

Press conferences

- after the Eurogroup meeting (Monday, from 21.00)
- at the end of the Council meeting, before lunch (Tuesday, from 13.00)

Press conferences and public events 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.

Preparations for the Washington Summit on the financial crisis

The Presidency will brief the Council on the international initiatives launched in response to the financial crisis following the European Council meeting on 15 and 16 October 2008. The Council will discuss the principles of a future reform of the international financial system ahead of the Summit of the main countries and institutions concerned by the crisis, to be held in Washington on 15 November.

The Washington Summit will be the first of a series aimed at reforming the international financial system and ensuring that, through better regulation and more effective supervision of market operators, the errors which led to the current crisis are not repeated. The global economic situation and its impact on emerging economies and developing countries are also on the agenda.

The President-in-office of the European Council, Mr Nicolas Sarkozy, who had mooted the idea of an international summit in his address to the United National General Assembly on 23 September, discussed the matter in depth with the United States President, together with the President of the European Commission, during a visit to Camp David on 18 October.

At a meeting in Paris on 12 October, the Heads of State or Government of the Euro Area countries agreed, as a matter of urgency, on a concerted action plan to address the persistent problems of the interbank market and the contagion from the financial crisis to the real economy (14239/08).

The European Council on 15 and 16 October endorsed the principles of the action plan, which aims at:

- ensuring appropriate liquidity conditions for financial institutions;
- facilitating the funding of banks;
- providing financial institutions with additional capital resources so as to continue to ensure the proper financing of the economy;
- allowing for an efficient recapitalisation of distressed banks;
- ensuring sufficient flexibility in the implementation of accounting rules given current exceptional market circumstances;
- enhancing cooperation procedures among European countries.

The European Council's conclusions state: "*The European Union must work with its international partners on a genuine, all-encompassing reform of the international financial system based on the principles of transparency, sound banking, responsibility, integrity and world governance. The aim is to take early decisions on transparency, global standards of regulation, cross-border supervision and crisis management, to avoid conflicts of interest and to create an early warning system, so as to engender confidence among savers and investors in every country. The Union will quickly take appropriate initiatives in consultation with its main partners and the relevant international financial institutions. These initiatives will be carefully prepared within the EU.*"

The Council's discussion, which will be based on a Presidency note (14838/08), will enable the Union's initiatives to be prepared thoroughly and will prepare the ground for an informal meeting of EU Heads of State and Government in Brussels on 7 November, with a view to the Summit on 15 November.

Support for economic activity in Europe

The Commission will present to the Council an action plan which it approved on 29 October in the context of the current economic downturn (14938/08).

The Council will discuss the options to be explored and the coordinated action to be taken, between now and its meeting on 2 December, to enable economic activity in Europe to recover as quickly as possible.

This follows the request, made by the European Council on 15 and 16 October, for the Commission to submit proposals to this end. The Commission has announced further measures for 26 November.

Support for Hungary to deal with financial crisis

The Council is expected to adopt, without discussion, a decision on the grant of a loan of EUR 6,5 billion to Hungary to enable it to deal with the country's current financial crisis.

The loan will be granted in coordination with the EUR 12,5 billion financial assistance package from the International Monetary Fund and EUR 1 billion from the World Bank in order to support Hungary's balance of payments in the medium term.

The loan should enable Hungary to cope with the heavy pressures on its financial markets; in return, the Hungarian authorities have undertaken to apply a programme of accompanying measures, which will be included in an update of Hungary's convergence programme under the EU Stability and Growth Pact.

The Hungarian authorities have pledged to accelerate the consolidation of the national budget this year and in 2009 and to reform Hungary's budgetary governance. With support from the European Central Bank, measures have also been taken to improve liquidity on the markets and to strengthen financial stability. For its part, the Hungarian Central Bank, the *Magyar Nemzeti Bank*, has raised its interest rates in order to halt the depreciation of the forint.

The Council decision will be based on Article 119 of the Treaty and on Regulation (EC) No 332/2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments. This will be the first time that the Regulation has been used; it provides for Community loans up to a total, set in 2002, of EUR 12 billion.

Reduced VAT rates

The Council will examine a proposal for a directive on the reduced rates of VAT (value added tax), following an exchange of views at its meeting on 7 October on the impact and usefulness of reduced rates.

The proposal provides for a limited amendment to the current rules, pending an in-depth review of the entire structure of reduced VAT rates at a later date. It is intended in particular to allow Member States to apply reduced rates – indefinitely – to certain locally provided services for which there is no risk of unfair competition in the internal market, including catering services.

At its meeting on 2 December 2008, the Council will be required to reach agreement on the basis of a draft compromise prepared by the Presidency.

The present VAT rules (Directive 2006/112/EC) require Member States to apply a normal rate of VAT to most goods and services. A normal minimum rate of 15 % is applicable until the end of 2010.

The Member States may apply a reduced minimum rate of 5 % to one or two categories in a list of essential goods and services, such as food products, energy products for heating and lighting and pharmaceutical products. The list is given in Annex III to Directive 2006/112/EC.

Furthermore, the present rules provide for derogations in certain cases and/or for certain Member States, namely:

- provisional derogations for Member States which before 1992 (when the general VAT rates system was introduced) applied rates lower than the present reduced rates. These are "super-reduced" rates, "parking" rates and zero rates. Thirteen Member States currently apply these;
- reduced minimum rates of 5 % applied on a temporary basis to certain highly labour-intensive locally-provided services (small repair services, renovation of private dwellings, window cleaning and private household cleaning, domestic care services, hairdressing). These derogations, which have been extended until the end of 2010 under Directive 2006/18/EC, are listed in Annex IV to Directive 2006/112/EC. Eighteen Member States currently apply them;
- other derogations with a limited timeframe, provided for in the Acts of Accession of those Member States which acceded to the EU in 2004. Those derogations were extended until the end of 2010 under Directive 2007/75/EC. Three Member States apply them.

In January 2006, the Commission was requested to commission an independent body to produce a study on reduced VAT rates.

The study, which was carried out by the firm of *Copenhagen Economics ApS*, evaluates the possible impact – on job creation, economic growth and the proper functioning of the internal market – of reduced rates applied to highly labour-intensive locally-provided services. The findings are set out in a communication issued by the Commission in July 2007 (11695/07 + ADD 1).

On the basis of that study, the Commission considered that a new framework would be needed to rationalise and simplify the rules currently in force, while leaving a degree of latitude to the Member States in the use of reduced rates.

Last December, the Council agreed that in 2008 it would conduct a policy debate on the economic impact of reduced rates and whether they were an appropriate instrument to achieve sectoral policy objectives. At the same time, it took note of the Commission's intention to submit a proposal for a Directive concerning the most urgent matters, notably the provisions relating to local services which will expire at the end of 2010.

That proposal was approved by the Commission in July.

The Presidency announced its intention to close the debate at the Council meeting on 7 October 2008 and to examine the proposal at the November Council.

The proposal, which amends the provisions of Directive 2006/112/EC, is intended to:

- guarantee equality of treatment between Member States with regard to the options offered for applying reduced VAT rates;
- allow all Member States to apply reduced rates to certain highly labour-intensive locally-provided services, including catering services, regarding which there is no risk of unfair competition in the internal market, without any set end-date for this regime. The proposal also aims to allow Member States to apply permanent reduced rates to renovation and repair work which improves energy efficiency and saving. Annex III to Directive 2006/112/EC (permanent derogations) would include these different categories, among which are all the services currently in Annex IV (temporary derogations expiring at the end of 2010);
- make technical improvements to the provisions in force and remove certain inconsistencies, in particular by permitting the application of reduced rates to babies' nappies as for other absorbent hygiene products, as well as to audio books, CDs, CD-ROMs and other carriers giving the same information as that contained in printed books.

However, the preparatory work has confirmed the differences between delegations concerning the room for manoeuvre that Member States should have in setting reduced VAT rates. Many delegations underline the positive effects of applying reduced rates to certain sectors in terms of job creation and action to counter the underground economy; they ask for more flexibility for Member States than that currently allowed. Conversely, other delegations argue for a reduction in the scope of reduced rates to facilitate greater harmonisation and administrative simplification.

The draft Presidency compromise is aimed at reconciling these positions. It provides for the following:

- a focus on application of reduced rates to highly labour-intensive services which do not distort competition;
- restriction of the scope of reduced rates in certain cases as compared with the Commission's original proposal;

- Member States which decide to apply a reduced rate must conduct an impact assessment before implementing their decision and again after a three-year period;
- taking into account the environmental aspect in the case of the supply of certain services;
- accommodating some old requests by certain Member States, inasmuch as they do not interfere with the operation of the internal market (places of worship, school buildings, tolls on domestic road bridges);
- improvements of a technical nature (nappies, audio books, equipment for the disabled);
- the inclusion in Annex III to Directive 2006/112/EC of those provisions on reduced rates which currently appear in the body of the Directive.

The proposal is based on Article 93 of the Treaty, which lays down that the Council should act unanimously, after consulting the European Parliament.

Fight against VAT fraud

On the basis of a compromise proposed by the Presidency, the Council will be asked to work out a general approach on the proposals for improving the fight against VAT (value-added tax) fraud connected with cross-border transactions, and particularly "carousel" fraud.

The proposals amend Directive 2006/112/EC on the common system of value added tax and Regulation No 1798/2003 on administrative cooperation in tax matters so that information on cross-border operations can be more quickly collected and exchanged between Member States.

Each year VAT fraud costs Member States billions of euros. It most frequently takes the form of circuits known as "VAT carousels", which target cross-border transactions. In November 2006, the Council agreed to establish a strategy to supplement on an EU scale the efforts made at national level to combat fraud. In June 2007, it asked the Commission to propose legislative measures to strengthen the VAT system and decided to give those measures a high priority.

In this framework the proposals provide for:

- a reduction from 3 months to 1 month of the period for declaring cross-border transactions and the deadlines for this information to be transmitted between the Member States;
- the harmonisation of the provisions governing liability for VAT on services, the aim of which is to ensure that such transactions are declared by the seller and by the buyer during the same tax period.

However, in order to prevent the administrative burden on undertakings becoming excessive, the Presidency compromise focuses in particular on supplies of goods, which are the principal conduit for "carousel" fraud.

The draft compromise provides that:

- in principle, with effect from 1 January 2010, transactions will be declared for VAT purposes on a monthly basis;
- Member States will nevertheless be able to authorise small-scale operators (threshold of cross-border deliveries worth EUR 50 000 exclusive of VAT per quarter) – in the case of supplies of goods – and the providers of services to continue to submit their recapitulative statements on a quarterly basis;

- the Commission will evaluate the impact of the new provisions on Member States' ability to combat fraud by 30 June 2012.

The proposals are based on Article 93 of the Treaty, which lays down that the Council must act unanimously, after consulting the Parliament; the Parliament's opinion is expected in December.

General arrangements for excise duty – introduction of a computerised control system

On the basis of a compromise proposed by the Presidency and pending the opinion of the European Parliament, the Council is expected to work out a general approach on a draft Directive laying down new arrangements for excise duty in the EU.

The aim of the proposal is to recast and replace Directive 92/12/EEC to permit the introduction of a computerised surveillance system for improving the fight against excise-duty fraud.

It provides for amendment of the provisions on product movements so they are subject to the procedures introduced by the computerised system, as laid down in Decision 1152/2003/EC. The aim is to provide a simplified paperless environment for trade, while promoting quicker and more integrated surveillance strategies. The text also seeks to simplify and modernise excise procedures in order to reduce the obligations on undertakings without compromising standards of surveillance.

Decision 1152/2003/EC, which was adopted in June 2003, required Member States and the Commission to establish a computer system within six years. Member States have meanwhile invested heavily in order to be ready to put it into operation. The Directive therefore needs to be adopted before the end of this year so that the computerised system can be introduced as soon as possible (on 1 April 2010).

Furthermore, some delegations maintain reservations, concerning for example the prohibition of tax-free sales at land borders with third countries and, secondarily, the procedure to follow if the computerised system is down.

The proposal is based on Article 93 of the Treaty, which provides that the Council must act unanimously, after consulting the Parliament; the Parliament's opinion is expected in November.

Anti-fraud agreement with Liechtenstein

The Commission will inform the Council of the progress of negotiations with Liechtenstein on an agreement to combat fraud.

Some delegations wish to increase the pressure on Liechtenstein in order to negotiate a more ambitious agreement than that which the Commission has managed to negotiate so far.

The draft agreement, negotiated on the basis of a mandate drawn up by the Council in 2006, covers fraud relating to both indirect and direct taxation. It is important for the EU that the agreement should apply to direct taxation given the absence of a convention with Liechtenstein on the exchange of information on taxation of savings.

There is also a link with Schengen provisions, because the negotiation of the anti-fraud agreement had been stipulated by the EU as a condition for Liechtenstein's entry into the Schengen area.

Finally, the EU would like, while remaining within the framework of the *acquis communautaire*, to obtain genuine administrative assistance from Liechtenstein, including as regards investment funds.

Climate change – Emissions Trading Scheme

The Polish Minister will explain to the Council his country's position concerning the trading scheme for CO₂ emissions proposed for the period 2012 to 2020.

Poland wishes to prevent excessive volatility in the allowance prices provided under the new scheme.

There may be an exchange of views, it being understood that the Environment Council alone is responsible for this issue, in the context of negotiations on a package of new measures to combat climate change.

Lisbon Strategy for Growth and Jobs

The Presidency and the Commission will inform the Council of progress on the Lisbon Strategy for Growth and Jobs.

It will essentially be a question of work by the Economic Policy Committee on the challenges of the strategy with a view to 2010 and beyond.
