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NOTE

from:	General Secretariat of the Council
to:	Delegations
Subject:	Draft Key Issues Paper

Delegations will find attached a draft Key Issues Paper for the Ecofin Council as a contribution to the Spring European Council, as prepared by the Economic Policy Committee and the Economic and Financial Committee.

This text includes as an attachment the views of the Council (Ecofin and Competitiveness) on the implementation report for the Community Lisbon Programme.

Encl.:

Draft Key Issues Paper

1. Introduction: 2009 - A difficult year with high uncertainties

The EU, along with the world economy, has been hit by a severe global financial crisis that continues to take its toll on the real economy. While measures undertaken in response are starting to come into force, the EU is confronted with the impact of the crisis on economy and jobs.

As the crisis intensified last autumn, global growth slowed down considerably. Many countries are now in recession. While Member States are hit differently, there is an overall picture of sharp growth deceleration or negative growth accompanied by historically low consumer and business confidence. The outlook for 2010 is highly uncertain. Feedback loops between the real economy and the financial markets are aggravating the situation. Financial markets remain volatile and credit channels are not yet functioning properly. Unemployment rates are expected to rise sharply in most Members States in 2009 and 2010.

On the other hand, inflation is declining substantially as import prices have dropped sharply and underlying inflationary pressures are diminishing, thus having a positive effect on purchasing power and also leaving more room for manoeuvre for macroeconomic policies. This has allowed interest rates to be cut sharply. Decisive actions have been taken by central banks and governments to restore financial stability. In addition, substantial fiscal stimulus actions undertaken by the Member States in line with the European Economic Recovery Plan eventually will bear fruit and contribute to improving the economic prospects.

2. Financial markets: Resuming stability and modernising rules

2.1. EU financial markets: Restoring confidence and proper functioning

In October 2008 Member States approved a package of necessary and timely coordinated measures to restore the proper functioning of financial markets in the face of the financial crisis. They agreed on the need to act within a commonly agreed framework, in view of ensuring financial stability, level playing field, and sustainability of public finances. The agreed guarantee and early recapitalisation measures have averted a financial meltdown, although economic and financial distress continues to hamper credit flows. To complement existing measures, a framework based on common principles for possible asset relief measures has been developed in line with the above mentioned objectives.

The Council (Economic and Financial Affairs) reiterates that restoring the functioning of the credit market is a shared priority and coordination within the EU is needed to minimise the risk of negative spillovers between countries and financial-market participants. It is crucial that any further actions remain consistent with single market principles, avoid protectionism tendencies and take into account a credible exit strategy for public sector liabilities in the financial sector.

2.2. Preventing future financial crises

2.2.1. EU financial markets: Future design

The magnitude of the ongoing global financial and economic crisis, and its underlying causes, shows a need for reshaping of the financial markets' regulatory framework in the EU. Any fundamental changes to the design of the EU financial markets must therefore be based on a thorough examination of lessons of the crisis.

The Council (Economic and Financial Affairs) underlines that key policy measures should focus on reviving the EU financial markets. The ECOFIN roadmaps on financial turmoil, financial stability arrangements and supervision have been broadly implemented but further steps are needed to enhance financial stability. Prudential rules, crisis management arrangements and the supervisory framework must be strengthened in a clear and consistent manner.

The Council (Economic and Financial Affairs) agrees that the key priorities in the regulatory and prudential field are the following:

- As a guiding principle, market structures and practices, and prudential requirements borne to them, must be enhanced to minimise the risks of future systemic financial crisis. Public authorities must be in a position to effectively and efficiently manage the financial crisis while limiting public sector involvement.

- To this aim, the scope of regulation should be extended to actors that are relevant for financial stability and have so far not been sufficiently regulated, in particular hedge funds and other alternative investment vehicles.

- Credit rating agencies should be subject to registration and oversight.
- Financial regulation and prudential rules must be adapted to limit potential pro-cyclical effects of capital requirements.
- This should be complemented with a strong EU initiative in reviewing international accounting standards, continuing to work towards the objective of creating a single high-quality global standard, as well as the governance of standard-setting bodies, which should involve all stakeholders. Finally, early intervention mechanisms at the EU level should be enhanced.

The supervisory framework must be enhanced by introducing a macro-prudential approach. High priority should be given to ensuring that both central banks and the relevant supervisory authorities are in a position to assess cross-border and systemic risks in a timely and comprehensive manner. The supervisory framework at the EU level should be based on effective and efficient supervisory arrangements at national level. Enhancements to supervisory practices and cooperation should also be introduced to improve the supervision of all major cross border financial institutions. The setting up of colleges of supervisors represents an important progress in this respect. Finally, a more efficient functioning of the EU Committees of Supervisors should be ensured.

The de Larosière report is an important step to enhance this process. The Council (Economic and Financial Affairs) stands ready to examine the Commission's analysis and proposals and to report to the European Council in June 2009.

The framework for managing financial crises should be developed both with a view to ensuring maximum involvement of the private sector in bearing the costs of financial crisis and to improving the efficiency of public sector intervention tools and co-operation. Enhancements to the deposit guarantee schemes and to insolvency and winding-up procedures for financial institutions need to be urgently implemented. The above areas should be of key significance in the design of a new EU financial market policy strategy for 2010-2015, and the updated roadmap foreseen in the course of 2009. Moreover, the establishment of "Cross-Border Stability Groups" among relevant Member States is important for ensuring effective cooperative arrangements among authorities, both in the short and longer term.

2.2.2. International financial architecture: Time for reform

The Council (Economic and Financial Affairs) stresses that the EU should play a leading role in the design of regulatory reform in international financial markets, in close cooperation with its key partners at multilateral and bilateral levels, by presenting a set of important and ambitious proposals to tackle the existing regulatory gaps. Global standards, mutual recognition and openness of markets must remain fundamental principles. In this context the EU will come forward with common positions on these issues in the G20, and express the need for the IMF to enhance its activities in the financial area in close cooperation with the Financial Stability Forum (FSF).

The EU should aim at a comprehensive and ambitious regulatory reform, including the development of macro-prudential oversight and ensuring appropriate supervision of all financial markets, products and participants, in particular those that pose systemic risk or can access public crisis management tools. Issues of particular importance include the need to mitigate pro-cyclicality, the treatment of hedge funds, the oversight of credit rating agencies and better resilience of OTC derivative markets. To ensure level playing fields, and that the integrity and stability of international financial markets is not endangered by activities in non-transparent, non-cooperative and loosely regulated jurisdictions that do not obey international standards, concrete measures should be taken against such jurisdictions, in particular in the areas of prudential supervision, anti-money laundering, terrorism financing and taxation. To this end a list of uncooperative jurisdictions should be submitted by the relevant international organisations (FSF, FATF and OECD) and a toolbox of sanctions must be devised as soon as possible.

Transparency, integrity and accountability of international financial markets must be substantially enhanced. Top priorities are: adjusting the prudential rules, in respect of the level, quality and harmonisation of regulatory capital and risk management capacities; refining the accounting standards and their interaction with prudential rules and establishing sound common principles concerning compensation schemes in the financial sector. The focus should remain on strengthening cooperation between financial authorities at the global level. The Council (Economic and Financial Affairs) takes the view that the IMF requires a substantial increase in its resources to assist countries particularly affected by the financial crisis and should play a key role in multilateral surveillance and crisis prevention.

3. Real economy: Facilitating swift and steady recovery

3.1. European Economic Recovery Plan: Effective implementation

As agreed in December 2008, Member States have taken substantial coordinated stimulus actions in line with the European Economic Recovery Plan which provide an important support to the EU economy and contribute adequately to the global macro-economic response. Recovery measures are country-specific and differentiated, reflecting different room for budgetary manoeuvre. The Council (Economic and Financial Affairs) is committed to ensuring a level playing field, avoiding distortions of competition and sustaining the benefits of the internal market.

The total amount of support provided by fiscal policies in 2009 and 2010 is estimated between 3 and 4% of EU GDP measured by the change in net public budget positions. In addition to the large automatic stabilisers at work, this includes measures at the EU level (encompassing an increased support via the EIB) and discretionary measures at national level of around 1% of GDP in 2009 as well as additional stimuli foreseen for 2010 by a number of Member States. These significant measures both on the expenditure and revenue side will increasingly bear fruit. Member States have thereby fully responded to the objective stated by the European Council in December 2008. The fiscal stimulus undertaken is timely, temporary and targeted and is followed up by specified consolidation to ensure fiscal sustainability. Furthermore, structural reforms should bolster the credibility and complement the impact of the fiscal stimulus. The Council (Economic and Financial Affairs) stands ready to report back to the European Council in June 2009 with an assessment of the effectiveness of recovery measures.

Moreover, the Council (Economic and Financial Affairs) welcomes the progress that has been made in implementing the EU-level measures in the recovery plan, notably enhanced activities of the EIB, including for SMEs and the automotive sector. The Council (Economic and Financial Affairs) stresses the need for the EIB to continue to speed up its response, drawing on the €3bn flexibility reserve, while fully respecting best banking practices.

3.2. Fiscal policy: An anchor for the medium term

The Council (Economic and Financial Affairs) reaffirms its strong commitment to sound public finances and the Stability and Growth Pact framework. The flexibility foreseen in the Pact is used by Member States during these difficult times. The Council (Economic and Financial Affairs) will ensure that this flexibility will be used judiciously taking into account different starting positions and impacts of the crisis on Member States.

Member States´ average budget deficit is projected to reach more than 4% of GDP in 2009, the highest level in 15 years. Therefore, swift and credible reversal of the fiscal expansion should be ensured, keeping pace with the economic recovery. Some countries facing macroeconomic tensions and large imbalances are consolidating their public finances already this year. Most Member States will start their consolidation efforts in 2010, while those who have the most margin for manoeuvre will start in 2011. Thus, the EU will avoid potential long-term negative effects from high deficits and debts and government bond yield spreads. The Stability and Growth Pact provides the appropriate framework for a coordinated consolidation strategy to maintain sustainable public finances. The consolidation path and deadlines for correcting the excessive deficits should be sufficiently ambitious and take into account the different starting positions and economic situation of the countries. Moreover, where substantial overall risks to the economy exist, early consolidation should be a rule. Significant excess of public finance deficit needs to be accommodated by longer deadlines for correction, but faster annual average consolidation.

The improvement of long-term sustainability is evermore challenging in these times of declining growth potential and rising debt levels. The financial sector stability packages could have an impact on long-term sustainability if the costs of the financial support are not fully recouped. Furthermore, it is important to continue to address ageing through fiscal consolidation, reform of pension systems and enhancing employment and in most Member States, timely and concrete decisions are needed to ensure long-term sustainability. The Council (Economic and Financial Affairs) looks forward to the new set of long-term budgetary projections, which will provide an essential input for the assessment of long-term sustainability and medium-term objectives, in line with the reformed Stability and Growth Pact. The quality of public finances including strong national fiscal frameworks is of increased importance against the current worsening fiscal situation and the necessity to elaborate exit strategies, therefore work should be continued in this field.

3.3. Structural reforms: Keeping up with the Lisbon Strategy

Structural reforms are an important element of the European Economic Recovery Plan and it is essential that more attention be paid in coming months to the quality and effectiveness of measures. The renewed Lisbon Strategy including the Broad Economic Policy Guidelines remains the right framework in the current crisis. However, its focus has to be more than ever on growth and jobs. The crisis should be seen as an opportunity to increase the momentum for important reforms, in particular those supporting competitiveness and adjustment capacity including flexicurity principles for labour market policies. The implementation of the Community Lisbon Programme will reinforce and complement Member States' structural efforts (see Annex).

The existing multilateral surveillance exercise is important for strengthening coordination among Member States. The Council (Economic and Financial Affairs) considers of utmost importance to closely monitor the consistency of short-term actions with long-term reform objectives, such as facilitating moves towards a low-carbon economy. Furthermore, all measures taken by Member States must be in line with the Single Market principles. The Council (Economic and Financial Affairs) remains fully committed to avoiding protectionist measures which would only exacerbate the downturn and endanger future prosperity. To this end, consideration could be given to establishing guiding principles at EU level to help Member States frame decisive policy responses to the economic slowdown that take account of spill-overs. Measures should facilitate structural adjustment, be non-discriminatory, take full account of spill-over effects on other Member States, and be subject to regular reviews to ensure their reversibility.

The long-term challenges persist and increase pressure on the sustainability of public finances. A renewed and strong commitment to the solid medium and long-term framework of the Lisbon Strategy after 2010 should take into account these challenges and serve as a vital component of a credible exit strategy towards a sustainable economic recovery.

3.4. Economic and Monetary Union: Fostering the success in turbulent times

A decade after the introduction of the euro, the single currency contributes to macroeconomic stability and helps Member States weather the current crisis. However, the euro area has to address persistent divergences in competitiveness and current accounts. These divergences are mainly rooted in domestic factors. Competitiveness positions need to be adjusted through enhanced market flexibility and other measures to restore price competitiveness. In particular, responsiveness of wages to prices and productivity development is a critical driver for the competitiveness of an economy. Addressing this common challenge will provide further benefits, given the euro area's cross-border spillovers and interactions. For these reasons, the euro group will implement the agreed monitoring of competitiveness developments.

ANNEX

Views of the ECOFIN and Competitiveness Councils

on the Commission's Implementation Report for the Community Lisbon Programme (CLP) 2008-2010

In 2008 the EU economy was exposed to negative impacts of the global financial turmoil and its strong spill-over into the real economy. In response to the exceptionally strong economic slowdown the Council reacted promptly and approved a European Economic Recovery Plan with a number of concrete actions to be taken at Community level.

The Council (Ecofin and Competitiveness) considers particularly the increased financing to SMEs by the European Investment Bank and the speeding-up and improving of procedures of the European Social Fund and the European Globalisation Adjustment Fund as high priority measures. Priority measures should include investment in R&D, innovation, the energy sector, and infrastructure projects.

The Council (Ecofin and Competitiveness) agrees with the Commission's assessment that substantial progress has been made among others by adopting the Climate and Energy Package, the Goods Package and the Small Business Act Action Plan and the renewed Social Agenda. Nonetheless, further efforts and proper and prompt implementation of initiatives are needed inter alia to improve the functioning of the Internal Market and the competitiveness of SMEs, unlock research and innovation potential, strengthen competition notably in the service sector and the network industries, in particular transport, energy, and telecommunications, and further facilitate conditions for open international trade.

In view of an expected further worsening of the economic situation in 2009 the Council (Ecofin and Competitiveness) stresses the need to stick firmly to the CLP objectives, which provides a strategic reform agenda for the Community part of the renewed Lisbon Strategy and focus all the more on their implementation.

On the basis of the Commission's report, the Council (Ecofin and Competitiveness) assessed the progress in the first year of the Community Lisbon Programme implementation and highlights the following actions within the five priority areas.

Investing in people and modernising labour markets

Work on the **renewed Social Agenda**, adopted in July 2008 by the Commission, will be taken up by the Council in order to enhance employment opportunities, improve access to quality services and ensure solidarity. Further efforts are needed on a priority basis to reduce existing regulatory barriers to labour markets and to promote the development of skills and life-long learning in conjunction with businesses and social partners so that the skill mismatch can be reduced. The procedures of the European Globalisation Adjustment Fund should be improved and speeded up, so that it can intervene more rapidly in key sectors. The Council (Ecofin and Competitiveness) also welcomes the presentation of the "New skills for new jobs" initiative.

The implementation of the **European Pact on Asylum and Migration**, adopted in October 2008 with the main aim to define common goals in European immigration policy as well as to identify common means for achieving them, should continue. Both legal and illegal migration, spill-overs, economic and fiscal effects, skills requirements and national competences need to be considered. The Council (Ecofin and Competitiveness) supports adoption of the Blue Card scheme to attract highly-skilled workers by June 2009.

Unlocking business potential, especially of SMEs

The **Small Business Act Action Plan** endorsed by the Council in December 2008 should help SMEs through the economic downturn by improving access to finance, reducing administrative burden and helping SMEs benefit from the internal market and increase competitiveness in external markets. The Action Plan should be fully and rapidly implemented at both Community and national levels, respecting the principle of subsidiarity. The Commission should introduce common commencement dates for all new regulations; implement an "SME test" on all proposals affecting business in line with its impact assessment guidelines as soon as possible.

The Council (Ecofin and Competitiveness) recalls the importance of further improvement of the access to finance (credit, guarantees, mezzanine financing, etc.) and venture capital for innovative start-ups and for SMEs, bearing in mind the consequences of the current financial crisis. There is a need to enhance market access for SMEs, notably through greater use of market and sector monitoring, to identify and tackle barriers to the internal market. Accounting requirements and start-up procedures of business should be significantly simplified and accelerated.

The contribution of the first package of proposals to the reduction of existing administrative burdens from EU legislation to the agreed target of 25 % by 2012 is estimated to amount to cost savings of approx. EUR 30 billions. On the EU level, the eleven new Fast Track Actions for **reducing administrative burdens** for businesses were presented by the Commission in 2008. The Council (Ecofin and Competitiveness) invites the Commission to propose new specific reduction measures for each of the 13 key priority areas in the Action Programme. The Commission and the Member States will implement jointly these measures. The Council (Ecofin and Competitiveness) considers it a priority to continue this important work to achieve the 25% reduction in administrative burden. The Commission is also invited to complete screening of all existing legislation as early as possible.

A well functioning **Internal Market** without barriers significantly strengthens the resilience and adjustment capacity of the EU economy, and makes it more attractive for investment. In times of the current extraordinary economic downturn, the Council (Ecofin and Competitiveness) stresses the significance of open markets, effective competition, and the continued application of state aid rules while respecting the need for speed and flexible action and compliance with the European framework. The Council (Ecofin and Competitiveness) notes that significant progress in completion of the Internal Market has been made mainly in the area of goods (the recently adopted Goods Package) and to some extent in cross-border financial supervision.

With regard to the latter, the Council (Ecofin and Competitiveness) considers that further progress is needed on global co-operation of financial supervision and crisis management, improving the flow of credit to businesses, and on strengthening the EU regulatory framework, as regards the accounting rules (IAS regulation), risks from derivatives and credit default swaps, etc. The Council (Ecofin and Competitiveness) welcomes the Commission's increased efforts in the field of market monitoring. Further effort is needed to strengthen the enforcement of competition policy, especially in the service sector and the network industries, in particular transport, energy, and telecommunications. Member States should ensure the precise and timely implementation of the Services Directive into their legislation by the December 2009 deadline, including a properly functioning Internal Market Information System (IMI).

Investing in knowledge and innovation

The knowledge triangle of research, education and innovation should be strengthened by developing the European Research Area (ERA) in order to make the **"fifth freedom"** a reality. The Council (Ecofin and Competitiveness) calls on a further development and coordination of the ERA partnership initiatives. Particular attention should be paid to better coordination of national research activities through both the Joint Programming initiative and by establishing pan-European research infrastructures, to the implementation of partnership between the Member States and the Community for international science and technology cooperation, and to the practical implementation of the Partnership on researcher careers and mobility. These measures should be complemented by the effective implementation of the Lead Markets Initiative and by cluster development.

As it is necessary to further improve private sector involvement and the framework conditions for **innovation** in Europe, efforts of the EU to create a Community Patent and a Patent litigation system should be intensified. The Council (Ecofin and Competitiveness) should react to the implementation of the broad-based innovation strategy by the end of 2009 and calls on the Commission to present by then its "European Plan for Innovation".

Energy and Climate Change

The adoption of the **Climate and Energy** Package enables the EU to take the lead and play an active role in forming an ambitious and comprehensive global agreement on further international action to tackle climate change impacts to be reached in Copenhagen later this year. The Council (Ecofin and Competitiveness) is committed to contributing to the necessary preparatory steps leading to a successful outcome of such agreement. The Council (Ecofin and Competitiveness) also underlines that a well-functioning, competitive, and interconnected internal energy market is fundamental for assuring a sustainable and secure supply of energy. Timely adoption of the internal energy market package remains top priority. The Council (Ecofin and Competitiveness) supports the implementation of the Action Plan on Sustainable **Industrial Policy** and Sustainable Consumption and Production. Furthermore, increasing EU energy security, improving energy efficiency and supporting innovative technologies should contribute to enhancing the competitiveness of European businesses.

External agenda

Policies supporting **free trade** and external openness have shown their positive effects on fostering economic growth, creating jobs, and improving consumer choice and the standard of living world-wide. The current economic downturn should not be an excuse for protectionism. Openness encourages European industry to strengthen innovation and productivity and thus promotes growth.

The Council (Ecofin and Competitiveness) calls for the successful conclusion of the Doha multilateral trade negotiations as soon as possible while negotiating bilaterally with key trading partners. Promoting cooperation and regulatory convergence with major trading partners and increasingly open markets, which should lead to reciprocal benefits, remains a priority.