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to : Delegations
Subject : **EUROPEAN COUNCIL BRUSSELS
22 and 23 MARCH 2005**

PRESIDENCY CONCLUSIONS

Delegations will find attached the Presidency conclusions of the Brussels European Council (22 and 23 March 2005).

1. The meeting was preceded by a presentation given by Mr Josep Borrell, President of the European Parliament, followed by an exchange of views. The President of the Commission took the opportunity to present the Commission's strategic objectives for 2005-2009. The Heads of State or Government took note and welcomed the close agreement between the Council, the European Parliament and the Commission on the Union's priorities, particularly with regard to legislative activity for the coming years.

2. The European Council discussed the following matters:
 - I. Stability and Growth Pact
 - II. Mid-term review of the Lisbon Strategy
 - III. Sustainable development
 - IV. Climate change
 - V. ITER
 - VI. Preparations for the UN Summit in September 2005
 - VII. Lebanon



I. STABILITY AND GROWTH PACT

3. The European Council endorses the report of the Council (ECOFIN) of 20 March 2005 (see Annex II) entitled "Improving the implementation of the Stability and Growth Pact" and approves its findings and proposals. The report updates and complements the Stability and Growth Pact, which consists of the European Council Resolution of Amsterdam and Council Regulations Nos 1466/97 and 1467/97. The Commission is invited to bring forward rapidly proposals for amending the Council Regulations.

II. RELAUNCHING THE LISBON STRATEGY: A PARTNERSHIP FOR GROWTH AND EMPLOYMENT

A. A STRATEGY FOR TODAY'S WORLD

4. Five years after the launch of the Lisbon Strategy, the results are mixed. Alongside undeniable progress, there are shortcomings and obvious delays. Given the challenges to be met, there is a high price to pay for delayed or incomplete reforms, as is borne out by the gulf between Europe's growth potential and that of its economic partners. Urgent action is therefore called for.
5. To that end, it is essential to relaunch the Lisbon Strategy without delay and re-focus priorities on growth and employment. Europe must renew the basis of its competitiveness, increase its growth potential and its productivity and strengthen social cohesion, placing the main emphasis on knowledge, innovation and the optimisation of human capital.
6. To achieve these objectives, the Union must mobilise to a greater degree all appropriate national and Community resources – including the cohesion policy – in the Strategy's three dimensions (economic, social and environmental) so as better to tap into their synergies in a general context of sustainable development. Alongside the governments, all the other players concerned – parliaments, regional and local bodies, social partners and civil society – should be stakeholders in the Strategy and take an active part in attaining its objectives.
7. At the same time, the financial perspective for 2007-2013 will have to provide the Union with adequate funds to carry through the Union's policies in general, including the policies that contribute to the achievement of the Lisbon priorities. Sound macroeconomic conditions are essential to underpin the efforts in favour of growth and employment. The amendments to the Stability and Growth Pact will contribute to this and at the same time enable Member States to play a full role in relaunching long-term growth.

8. The European Council welcomes the Commission communication *Working together for growth and jobs – A new start for the Lisbon Strategy* submitted for the mid-term review. It welcomes the important contributions in this context by the European Parliament, the Committee of the Regions, the Economic and Social Committee and the social partners. In the light of these proposals, the European Council asks the Commission, Council and Member States to relaunch the Strategy without delay on the basis of the following elements centred on growth and employment.

9. The European Council welcomes the commitment expressed by the social partners at the Tripartite Summit on 22 March. It calls on the social partners to submit a common work programme for growth and employment in the context of their respective areas of competence.

In addition, it urges the European Economic and Social Committee to set up with Member States' economic and social committees and other partner organisations an interactive network of civil society initiatives aimed at promoting the implementation of the strategy.

B. VITAL STRANDS OF THE RELAUNCH

Knowledge and innovation – engines of sustainable growth

10. The European area of knowledge should enable undertakings to build new competitive factors, consumers to benefit from new goods and services and workers to acquire new skills. With that in mind, it is important to develop research, education and all forms of innovation insofar as they make it possible to turn knowledge into an added value and create more and better jobs. Moreover, in the years to come, a genuine dialogue must be encouraged among those directly involved in the knowledge-based society in the public and private sectors.

11. In the field of R&D, the overall objective of 3% investment is maintained, with an adequate split between private and public investment. Specific intermediate levels need to be set out at national level. This objective will be obtained *inter alia* by tax incentives for private investment, a better leverage effect of public investment and by a modernised management of research institutions and universities.
12. The 7th Framework Programme for Research and Development will lend fresh impetus to a European research area for the benefit of all Member States by enhancing European cooperation, mobilising private investment in areas crucial to competitiveness and helping to fill the technology gap. The programme should act as a lever on national research budgets. The attraction which Europe holds for researchers should be enhanced by an effective improvement in the conditions under which they move and practise their profession. The creation of a European Research Council to support cutting-edge research and basic research would be significant in this context. Work on the European space programme will make it possible to exploit the capacity for innovation and the considerable potential in this sector.
13. Member States should develop their innovation policies in the light of their specific characteristics and *inter alia* with the following objectives: establishing support mechanisms for innovative SMEs, including high-tech start-ups, promoting joint research between undertakings and universities, improving access to risk capital, refocusing public procurement on innovative products and services, developing partnerships for innovation and innovation centres at regional and local level.
14. The new Community Competitiveness and Innovation Programme should, for its part, lend great impetus to innovation throughout the European Union by establishing a new mechanism for financing innovative SMEs with a high growth potential, by streamlining and strengthening the technical support network for innovation in undertakings, and by supporting the development of regional centres and European networks for innovation.

15. The European Council notes the Commission's intention to submit a proposal on the establishment of a European Technology Institute.
16. Europe needs a solid industrial fabric throughout its territory. The necessary pursuit of an active industrial policy means strengthening the competitive advantages of the industrial base while ensuring the complementarity of the action at national, trans-national and European level. This objective will be pursued *inter alia* by means of technological initiatives based on public-private partnerships and the organisation of technological platforms aimed at setting long-term research agendas. The Commission will report back on its preparatory work on the subject by June.
17. The European Investment Bank will have to extend its Structured Finance Facility to R&D projects and, together with the Commission, explore new ways of using Community funds as levers for EIB loans.
18. It is essential to build a fully inclusive information society, based on widespread use of information and communication technologies (ICTs) in public services, SMEs and households. To that end, the i2010 initiative will focus on ICT research and innovation, content industry development, the security of networks and information, as well as convergence and interoperability in order to establish a seamless information area.

19. The European Council reiterates the important contribution of environment policy to growth and employment, and also to the quality of life, in particular through the development of eco-innovation and eco-technology as well as the sustainable management of natural resources, which lead to the creation of new outlets and new jobs. It emphasises the importance of energy efficiency as a factor in competitiveness and sustainable development and welcomes the Commission's intention of producing a European initiative on energy efficiency and a Green Paper in 2005. Eco-innovation and environmental technology should be strongly encouraged, particularly in energy and transport, with particular attention paid to SMEs and to promoting eco-technology in public procurement. In addition to its growth in the internal market, this sector has considerable export potential. The European Council invites the Commission and the Member States to implement the action plan for eco-technology as a matter of urgency, including by specific actions on a time scale agreed with economic operators. The European Council reaffirms the importance of the objective of halting the loss of biological diversity between now and 2010, in particular by incorporating this requirement into other policies, given the importance of biodiversity for certain economic sectors.

An attractive area in which to invest and work

20. In order to encourage investment and provide an attractive setting for business and work, the European Union must complete its internal market and make its regulatory environment more business-friendly, while business must in turn develop its sense of social responsibility. There is also a need for efficient infrastructure aimed *inter alia* at the problem of missing links, high-standard, affordable general-interest services and a healthy environment based on sustainable consumption and production and a high quality of life.
21. The European Council calls on Member States to spare no effort in honouring the commitments given in Barcelona in March 2002 as regards – among other things – the transposition of Directives.

22. For the completion of the internal market, the European Council has identified the following priority areas:

In order to promote growth and employment and to strengthen competitiveness, the internal market of services has to be fully operational while preserving the European social model. In the light of this ongoing debate which shows that the directive as it is currently drafted does not fully meet these requirements, the European Council requests all efforts to be undertaken within the legislative process in order to secure a broad consensus that meets all these objectives.

The European Council notes that effective services of general economic interest have an important role to play in a competitive and dynamic economy.

Any agreement on REACH must reconcile environmental and health protection concerns with the need to promote the competitiveness of European industry, while paying particular attention to SMEs and their ability to innovate.

23. In addition to an active competition policy, the European Council calls on Member States to continue working towards a reduction in the general level of State aid, while making allowance for any market failures. This movement must be accompanied by a redeployment of aid in favour of support for certain horizontal objectives such as research and innovation and the optimisation of human capital. The reform of regional aid should also foster a high level of investment and ensure a reduction in disparities in accordance with the Lisbon objectives.

24. The European Council reiterates the importance it attaches to improving the regulatory environment and urges that work press ahead – as envisaged by, among other things, the initiative of the six Presidencies and the Operational Programme of the Council for 2005 – in preparation for an overall assessment at one of its forthcoming meetings. It notes the communication submitted by the Commission and stresses the need for firm action along these lines at both European and national level. The European Council requests the Commission and the Council to consider a common methodology for measuring administrative burdens with the aim of reaching an agreement by the end of 2005. That agreement should take advantage of the results of the Commission's pilot projects which are due in the course of 2005. It calls on the Commission to develop its impact-analysis system in accordance with its communication, to work together with the Council to ensure faster progress in the context of simplification and, lastly, to take initiatives to encourage the participation of all players directly concerned by this process. It stresses that initiatives taken in the context of improving the regulatory environment must not themselves turn into administrative burdens.
25. Small and medium-sized enterprises play a key role for growth and employment and participate in developing the industrial fabric. Member States should therefore continue with their policies to cut red tape, introduce one-stop contact points and provide access to credit, micro-loans, other forms of financing and accompanying services. Access by SMEs to Community programmes is also of major importance. The Commission and Member States are also called on to make best use of support networks for SMEs; to this end, they should swiftly identify, with national and regional social partners and, as far as possible, with chambers of commerce, the rationalisation and cooperation measures required.

26. The European Council would urge the European Investment Fund to diversify its activities, in particular towards the financing of innovative SMEs through individual-investor (business-angel) and technology-transfer networks. Flexible funding suited to such activities should be found, together with the Commission. This action should also be supported by the new Community competitiveness and innovation programme.

27. The single market must in addition be based on a physical internal market free of interoperability and logistical constraints. Deployment of high-speed networks in poorly served regions is a prerequisite for the development of a knowledge-based economy. In general, infrastructure investment will boost growth and bring greater economic, social and environmental convergence. Under the growth initiative and quick-start programmes, the European Council emphasises the importance of carrying out the priority projects in the field of transport and energy networks and calls on the Union and the Member States to keep up their investment efforts and to encourage public-private partnerships.

28. The open global economy offers new opportunities for stimulating growth, competitiveness and redeployment in Europe's economy. The European Council recognises the importance of reaching an ambitious, balanced agreement in the Doha negotiations and the value of developing bilateral and regional free-trade agreements; pursuit of that objective must be accompanied by a sustained effort to ensure international convergence of standards, including as regards respect for intellectual property rights.

Growth and employment making for social cohesion

29. The European Council welcomes the Commission communication on the social agenda, which will help to achieve the Lisbon Strategy objectives by reinforcing the European social model based on the quest for full employment and greater social cohesion.

30. Raising employment rates and extending working life, coupled with reform of social protection systems, provide the best way of maintaining the present level of social protection.

The Commission will reflect in the context of its ongoing work on the relaunch of Lisbon on issues arising about how to ensure sustainable funding of our social model and will report to the European Council in the autumn.

31. The objectives of full employment, job quality, labour productivity and social cohesion must be reflected in clear and measurable priorities: making work a real option for everyone, attracting more people into the labour market, improving adaptability, investing in human capital, modernising social protection, promoting equal opportunities *inter alia* between men and women, and fostering social inclusion.
32. It is essential to attract more people into the labour market. This aim will be achieved by following the course of an active employment policy, of making work pay and of measures to reconcile working life and family life, including the improvement of child care facilities; priority must also be given to equal opportunities, active ageing strategies, encouraging social integration and converting undeclared work into lawful employment. New sources of jobs must also be developed in services to individuals and businesses, in the social economy, in town and country planning and environmental protection and in new industrial occupations, partly through promotion of local growth and employment partnerships.
33. New forms of work organisation and greater diversity of contractual arrangements for workers and businesses, better combining flexibility with security, will contribute to adaptability. Emphasis should also be placed on better anticipation and management of economic change.

34. Human capital is Europe's most important asset. Member States should step up their efforts to raise the general standard of education and reduce the number of early school-leavers, in particular by continuing with the Education and Training 2010 work programme. Lifelong learning is a *sine qua non* if the Lisbon objectives are to be achieved, taking into account the desirability of high quality at all levels. The European Council calls on Member States to make lifelong learning an opportunity open to all in schools, businesses and households. Particular attention should be paid to the availability of lifelong learning facilities for low-skilled workers and for the staff of small and medium-sized enterprises. The European Council therefore calls for the early adoption of the programme which the Commission will shortly be submitting in this connection. Availability should also be facilitated by means of working time organisation, family support services, vocational guidance and new forms of cost-sharing.
35. The European education area should be developed by encouraging geographical and occupational mobility. The European Council would point to the importance of disseminating the Europass and of adopting the Directive on recognition of professional qualifications in 2005 and a European qualifications framework in 2006.
36. Social inclusion policy should be pursued by the Union and by Member States, with its multifaceted approach, focusing on target groups such as children in poverty.
37. A return to sustained and sustainable growth requires greater demographic dynamism, improved social and vocational integration and fuller utilisation of the human potential embodied by European youth. To this end, the European Council has adopted the European Youth Pact set out in Annex I as one of the instruments contributing to the achievement of the Lisbon objectives.

C. IMPROVING GOVERNANCE

38. It is important that EU and Member States' action should make a bigger and more practical contribution to growth and employment. Accordingly, a simplified arrangement will be introduced. Its aim is threefold: to facilitate the identification of priorities while maintaining the overall balance of the strategy and the synergy between its various components; to improve the implementation of those priorities on the ground by increasing the Member States' involvement; and to streamline the monitoring procedure so as to give a clearer picture of national implementation of the strategy.
39. This new approach, based on a three-year cycle which starts this year and will have to be renewed in 2008, will comprise the following steps:
- (a) The starting-point of the cycle will be the Commission's synoptic document ("strategic report"). This report will be examined in the relevant Council configurations and discussed at the spring European Council meeting, which will establish political guidelines for the economic, social and environmental strands of the strategy.
 - (b) In accordance with the procedures laid down in Articles 99 and 128 of the Treaty and on the basis of the European Council conclusions, the Council will adopt a set of "integrated guidelines" consisting of two elements: broad economic policy guidelines (BEPGs) and employment guidelines (EGs). As a general instrument for coordinating economic policies, the BEPGs should continue to embrace the whole range of macroeconomic and microeconomic policies, as well as employment policy insofar as this interacts with those policies; the BEPGs will ensure general economic consistency between the three strands of the strategy.

(c) On the basis of the "integrated guidelines":

- Member States will draw up, on their own responsibility, "national reform programmes" geared to their own needs and specific situation. Consultations on these programmes will be held with all stakeholders at regional and national level, including parliamentary bodies in accordance with each Member State's specific procedures. The programmes will make allowance for national policy cycles and may be revised in the event of changes in the situation. Member States will enhance their internal coordination, where appropriate by appointing a Lisbon national coordinator;
- on its side, the Commission will present, as a counterpart to the national programmes, a "Community Lisbon programme" covering all action to be undertaken at Community level in the interests of growth and employment, taking account of the need for policy convergence.

(d) The reports on follow-up to the Lisbon Strategy sent to the Commission by Member States each year – including the application of the open method of coordination – will now be grouped in a single document clearly distinguishing between the different areas of action and setting out all measures taken during the previous twelve months to implement the national programmes; the first such document will be submitted in the autumn of 2006.

(e) The Commission will report on the implementation of the three strands of the strategy each year. On the basis of the Commission's assessment, the European Council will review progress every spring and decide on any necessary adjustments to the integrated guidelines.

(f) For the BEPGs, the existing multilateral surveillance arrangements will apply.

40. At the end of the third year of each cycle, the integrated guidelines, the national reform programmes and the Community Lisbon programme will be renewed in accordance with the procedure described above, taking as the starting-point a strategic report by the Commission, based on an overall assessment of progress during the previous three years.
41. In 2005 the cycle will begin in April, with the Commission submitting integrated guidelines drawn up on the basis of these conclusions. Member States are asked to draw up their national reform programmes in autumn 2005.

III. SUSTAINABLE DEVELOPMENT

42. On the occasion of the relaunch of the Lisbon Strategy, the European Council reaffirms that the Lisbon Strategy itself is to be seen in the wider context of the sustainable development requirement that present needs be met without compromising the ability of future generations to meet their own needs. The European Council agrees to adopt a declaration on guiding principles for sustainable development at its next meeting, in June 2005; that declaration will serve as a basis for renewing the sustainable development strategy adopted at the European Council meeting in Göteborg in 2001. The new, more comprehensive and more ambitious strategy, comprising targets, indicators and an effective monitoring procedure, should be based on a positive long-term vision and should fully integrate the internal and the external dimensions. The new strategy will be adopted by the end of 2005 and the Commission will be submitting the appropriate proposals in due course.

IV. CLIMATE CHANGE

43. The European Council acknowledges that climate change is likely to have major negative global environmental, economic and social implications. It confirms that, with a view to achieving the ultimate objective of the UN Framework Convention on Climate Change, the global annual mean surface temperature increase should not exceed 2°C above pre-industrial levels.
44. The European Council notes with great satisfaction the entry into force of the Kyoto Protocol. In this respect, it wishes in particular to congratulate the Russian Federation on having ratified the Protocol.
45. The European Council welcomes the Commission communication entitled "Winning the battle against global climate change" and calls on the Commission to continue its cost-benefit analysis of CO₂ reduction strategies.
46. The European Council emphasises the EU's determination to reinvigorate the international negotiations by:
 - exploring options for a post-2012 arrangement in the context of the UN climate change process, ensuring the widest possible cooperation by all countries and their participation in an effective and appropriate international response;

- developing a medium and long-term EU strategy to combat climate change, consistent with meeting the 2°C objective. In view of the global emission reductions required, global joint efforts are needed in the coming decades, in line with the common but differentiated responsibilities and respective capabilities, including significantly enhanced aggregate reduction efforts by all economically more advanced countries. Without prejudging new approaches for differentiation between parties in a future fair and flexible framework, the EU looks forward to exploring with other parties strategies for achieving necessary emission reductions and believes that, in this context, reduction pathways for the group of developed countries in the order of 15-30% by 2020, compared to the baseline envisaged in the Kyoto Protocol, and beyond, in the spirit of the conclusions of the Environment Council, should be considered. These reduction ranges will have to be viewed in the light of future work on how the objective can be achieved, including the cost-benefit aspect. Consideration should also be given to ways of effectively involving major energy-consuming countries, including those among the emerging and developing countries;

- promoting cost-efficient measures to cut emissions.

The European Council will keep this issue under regular review.

V. ITER

47. The European Council stresses the need to begin building the international thermonuclear experimental reactor on the European site by the end of 2005 and calls on the Commission to make every effort to achieve that aim, in particular by finalising the international agreement by July 2005.

VI. PREPARATIONS FOR THE UN SUMMIT IN SEPTEMBER 2005

48. The European Council welcomes the presentation by the United Nations Secretary-General on 21 March 2005 of his report entitled "In larger freedom: towards development, security and human rights for all", which makes a prime contribution to preparations for the United Nations summit in September 2005 on follow-up to the 2000 Millennium Declaration and to major United Nations conferences and summits. The European Council reaffirms that the Union is firmly resolved to play a major role within the United Nations in general and in preparations for the summit in particular. The European Union is determined that this process should result in the devising of common responses to the main development, security and human rights problems.

49. The European Council calls on the Commission and the Council to step up their work, particularly on the various development components, so as to finalise our positions on the various topics and enable the European Union to play an active part in the discussions ahead.

The European Council underlines the particular importance of Africa in 2005. It welcomes the Commission's intention to submit early proposals designed to make a substantial contribution to the review of the Millennium Development Goals and to reinforce the Union's support for the African continent. It also takes note in this context of the recent report of the Commission for Africa.

50. The European Council would like to see a process of dialogue continued and stepped up at all levels with those country groupings and countries with which the Union maintains structured relations, in order to help drive forward convergence of positions with a view to achieving ambitious, balanced results at the summit in September 2005.

VII. LEBANON

51. The European Council endorses the conclusions adopted by the Council on 16 March 2005 concerning Lebanon. It reaffirms its commitment to a sovereign, independent and democratic Lebanon. It recalls the importance of UN Security Council Resolution 1559 and expresses its full support for the mission of the United Nations Secretary-General's Special Envoy.

52. The European Council calls on Syria to implement rapidly the pledges made by President Bashar al-Assad on 12 March 2005 to withdraw all Syrian troops and intelligence services from Lebanon. That withdrawal must be complete and must be carried out in accordance with a precise timetable.

53. The European Council hopes that a new government will be formed at an early date and that it can act in the interests of all Lebanese. That government will have to be able to organise free, fair and transparent elections on schedule, in accordance with the Lebanese constitution, without any outside interference or meddling. The European Union will keep a careful watch on the electoral process and stand ready to provide its assistance.

European Youth Pact

Against the background of Europe's ageing population, the European Council sees a need for young Europeans to benefit from a set of policies and measures forming a fully integrated part of the Lisbon Strategy. The Youth Pact aims to improve the education, training, mobility, vocational integration and social inclusion of young Europeans, while facilitating the reconciliation of working life and family life. The Pact should ensure the overall consistency of initiatives in these areas and provide the starting point for strong, ongoing mobilisation on behalf of young people. Its success depends on the involvement of all parties concerned, first and foremost national, regional and local youth organisations as well as the European Youth Forum, regional and local authorities and the social partners.

The European Council calls on the Union and Member States, each within the limits of its own powers and in particular under the European employment strategy and under social inclusion strategy, to draw upon the following lines of action:

Employment, integration and social advancement

- specifically monitoring policies for the sustained integration of young people into the labour market, in the context of the mutual learning programme on employment;
- endeavouring to increase employment of young people;
- giving priority under national social inclusion policy to improving the situation of the most vulnerable young people, particularly those in poverty, and to initiatives to prevent educational failure;
- inviting employers and businesses to display social responsibility in the area of vocational integration of young people;

- encouraging young people to develop entrepreneurship and promoting the emergence of young entrepreneurs.

Education, training and mobility

- ensuring that knowledge matches the needs of a knowledge-based economy and, to this end, encouraging the development of a common set of core skills; in this context, concentrating primarily on the problem of drop-outs from the school system;
- expanding the scope for students to undertake a period of study in another Member State;
- encouraging mobility of young people by removing obstacles for trainees, volunteers and workers and for their families,
- for researchers, stepping up ongoing initiatives under the Marie Curie programme;
- developing, between Member States, closer cooperation on transparency and comparability of occupational qualifications and recognition of non-formal and informal education.

Reconciliation of working life and family life

- promoting the reconciliation of working life and family life by sharing the responsibility between partners, particularly by expanding the child care network and developing innovative forms of work organisation;
- considering child-friendly policies, in the light of discussions on the Commission Green Paper on demographic change.

Improving the implementation of the Stability and Growth Pact

– Council Report to the European Council –

This report presents proposals for strengthening and clarifying the implementation of the Stability and Growth Pact, with the aim of improving the coordination and monitoring of economic policies according to Article 99 of the Treaty and of avoiding excessive deficits as required by Article 104(1) of the Treaty.

The Council confirms that the Stability and Growth Pact, built on Treaty Articles 99 and 104, is an essential part of the macroeconomic framework of the Economic and Monetary Union. By requesting Member States to coordinate their budgetary policies and to avoid excessive deficits, it contributes to achieving macroeconomic stability in the EU and plays a key role in securing low inflation and low interest rates, which are essential contributions for delivering sustainable economic growth and job creation.

The Council recalls the Declaration on Article III-184 (annexed to the Final Act of the Constitution), which reaffirmed the European Council's commitment to the goals of the Lisbon Strategy - job creation, structural reforms, and social cohesion – and which stated on budgetary policy: "The Union aims at achieving balanced economic growth and price stability. Economic and budgetary policies thus need to set the right priorities towards economic reforms, innovation, competitiveness and strengthening of private investment and consumption in phases of weak economic growth. This should be reflected in the orientations of budgetary decisions at the national and Union level in particular through restructuring of public revenue and expenditure while respecting budgetary discipline in accordance with the Constitution and the Stability and Growth Pact."

The two nominal anchors of the Pact - the 3% of GDP reference value for the deficit ratio and the 60% of GDP reference value for the debt ratio - have proven their value and continue to be the centrepiece of multilateral surveillance. However, the European Council noted in June 2004 the need to strengthen and to clarify the implementation of the Stability and Growth Pact, in order to foster transparency and national ownership of the EU fiscal framework and to improve enforcement of its rules and provisions.

The Pact has to be applied across countries in a fair and consistent way and be understood by public opinion. The Council reaffirms that a rules-based system is the best guarantee for commitments to be enforced and for all Member States to be treated equally. In strengthening and clarifying the Pact it is essential to secure a proper balance between the higher degree of economic judgement and policy discretion in the surveillance and co-ordination of budgetary policies and the need for keeping the rules-based framework simple, transparent and enforceable.

However, in a European Union of 25 countries, characterised by considerable heterogeneity and diversity and given the experience of 5 years in EMU, an enriched common framework with a stronger emphasis on the economic rationale of its rules would allow to better cater for differences in economic situations across the EU. The objective is therefore to enhance the economic underpinnings of the existing framework and thus strengthen credibility and enforcement. The aim is not to increase the rigidity or flexibility of current rules but rather to make them more effective.

On this basis, the reform aims at better responding to the shortcomings experienced so far through greater emphasis to economic developments and an increased focus on safeguarding the sustainability of public finances. Also, the instruments for EU economic governance need to be better interlinked in order to enhance the contribution of fiscal policy to economic growth and support progress towards realising the Lisbon strategy.

Following the Commission Communication of 3 September 2004 on "Strengthening economic governance and clarifying the implementation of the Stability and Growth Pact", the Council has worked in order to make concrete proposals for a reform of the Stability and Growth Pact.

The Council, in reviewing the Stability- and Growth-Pact provisions, detected mainly five areas where improvements could be made:

- (i) enhance the economic rationale of the budgetary rules to improve their credibility and ownership;
- (ii) improve "ownership" by national policy makers;
- (iii) use more effectively periods when economies are growing above trend for budgetary consolidation in order to avoid pro-cyclical policies;
- (iv) take better account in Council recommendations of periods when economies are growing below trend;
- (v) give sufficient attention in the surveillance of budgetary positions to debt and sustainability.

In making the proposals for a reform of the Stability and Growth Pact, the Council gave due consideration to enhance the governance and the national ownership of the fiscal framework, to strengthen the economic underpinnings and the effectiveness of the Pact, both in its preventive and corrective arms, to safeguard the sustainability of public finances in the long run, to promote growth and to avoid imposing excessive burdens on future generations.

In accordance with the Luxembourg Resolution on economic policy coordination, the Council confirms that enhanced coordination of fiscal policies must adhere to the Treaty principle of subsidiarity, respecting the prerogatives of national Governments in determining their structural and budgetary policies, while complying with the provisions of the Treaty and the Stability and Growth Pact.

Ministers indicate in the present report the necessary legislative changes in order to make operational their views on the reform of the Stability and Growth Pact. They intend to keep changes to a minimum and look forward to proposals of the Commission to put their views into effect.

1. Improving governance

In order to increase the legitimacy of the EU fiscal framework and to strengthen support for its goals and institutional arrangements, the Council considers that Member States, the Commission and the Council, while avoiding any institutional shift, must deliver on their respective responsibilities, in particular:

- (1) The Commission and the Council respect the Member States' responsibility to implement the policies of their choice within the limits set by the Treaty, in particular by Articles 99 and 104, while the Member States have to comply with the recommendations of the Council;
- (2) The Commission has to exercise its right of initiative in a timely manner and apply the rules effectively, while the Council and the Member States respect the Commission's responsibility as guardian of the Treaty and its procedures;
- (3) The Council has to exercise responsibly its margin of discretion, while the Member States and the Commission respect the Council's responsibility for the coordination of economic policies within the European Union and its role for the proper functioning of economic and monetary union;
- (4) The Member States, the Council and the Commission should reaffirm their commitment to implement the Treaty and the Stability and Growth Pact in an effective and timely manner, through peer support and peer pressure, and to act in close and constructive cooperation in the process of economic and fiscal surveillance, in order to guarantee certainty and effectiveness to the rules of the Pact.

The Council emphasises the importance of improving governance and strengthening national ownership of the fiscal framework through the proposals outlined hereafter.

1.1. Cooperation and communication

The Council, the Commission and the Member States should apply the Treaty and the Stability and Growth Pact in an effective and timely manner. Parties should act in close and constructive cooperation in the process of economic and fiscal surveillance in order to guarantee certainty and effectiveness to the rules of the Pact.

In the spirit of transparency and accountability, due consideration should be given to full and timely communication among institutions as well as with the general public. In particular, in order to foster a frank and confidential exchange of views, the Council, the Commission and the Member States should commit to exchange advance information on their intentions at all stages of the budgetary monitoring and excessive deficit procedure, without prejudice to their respective prerogatives.

1.2. Improving peer support and applying peer pressure

The Council agrees that increasing the effectiveness of peer support and peer pressure is an integral part of a reformed Stability and Growth Pact. The Council and the Commission should commit to motivate and to make public their positions and decisions at all appropriate stages of the procedure of the Pact.

Peer support and peer pressure at euro area level should be given in the framework of the coordination carried out in the Eurogroup and be based on a horizontal assessment of national budgetary developments and their implications for the euro area as a whole. Such an assessment should be done at least once a year before the summer.

1.3. Complementary national budgetary rules and institutions

The Council agrees that national budgetary rules should be complementary to the Member States' commitments under the Stability and Growth Pact. Conversely, at EU level, incentives should be given and disincentives removed for national rules to support the objectives of the Stability and Growth Pact. In this context, the Council points out disincentives stemming from the impact in the fiscal framework of certain ESA95 accounting and statistical rules.

The implementation of existing national rules (expenditure rules, etc.) could be discussed in stability and convergence programmes, with due caution and as far as they are relevant for the respect of EU budgetary rules, as Member States are committed at European level to respect the latter, and compliance with EU budgetary rules constitutes the focus of the assessment of the stability and convergence programmes.

The Council considers that domestic governance arrangements should complement the EU framework. National institutions could play a more prominent role in budgetary surveillance to strengthen national ownership, enhance enforcement through national public opinion and complement the economic and policy analysis at EU level.

1.4. A stability programme for the legislature

The Council invites Member States, when preparing the first update of their stability/convergence programme after a new government has taken office, to show continuity with respect to the budgetary targets endorsed by the Council on the basis of the previous update of the stability/convergence programme and - with an outlook for the whole legislature - to provide information on the means and instruments which it intends to employ to reach these targets by setting out its budgetary strategy.

1.5. Involvement of national Parliaments

The Council invites Member States' governments to present stability/convergence programmes and the Council opinions thereon to their national Parliaments. National Parliaments may wish to discuss the follow-up to recommendations in the context of the early warning and the excessive deficit procedures.

1.6. Reliable macroeconomic forecasts

The Council recognises that it is important to base budgetary projections on realistic and cautious macroeconomic forecasts. It also recognises the important contribution that Commission forecasts can provide for the coordination of economic and fiscal policies.

In their macroeconomic and budgetary projections, Member States, in particular euro area Member States and Member States participating in ERM II, should use the "common external assumptions" if provided by the Commission in due time. Member States are free to base their stability/convergence programmes on their own projections. However, divergences between the national and the Commission forecasts should be explained in some detail. This explanation will serve as a reference when assessing *a posteriori* forecast errors.

Given the inevitability of forecast errors, greater emphasis should be placed in the stability/convergence programmes on conducting comprehensive sensitivity analyses and/or developing alternative scenarios, in order to enable the Commission and the Council to consider the complete range of possible fiscal outcomes.

1.7. Statistical governance

The Council agrees that the implementation of the fiscal framework and its credibility rely crucially on the quality, reliability and timeliness of fiscal statistics. Reliable and timely statistics are not only essential for the assessment of government budgetary positions; full transparency of such statistics will also allow the financial markets to better assess the creditworthiness of the different Member States, providing an important signalling function for policy errors.

The core issue remains to ensure adequate practices, resources and capabilities to produce high quality statistics at the national and European level with a view to ensuring the independence, integrity and accountability of both national statistical offices and Eurostat. Furthermore, the focus must be on developing the operational capacity, monitoring power, independence and accountability of Eurostat. The Commission and the Council in the course of 2005 are dealing with the issue of improving the governance of the European statistical system.

Member States and EU institutions should affirm their commitment to produce high quality and reliable budgetary statistics and to ensure mutual cooperation to achieve this goal. Imposing sanctions on a Member State should be considered when there is infringement of the obligations to duly report government data.

2. Strengthening the preventive arm

There is broad consensus that periods of growth above trend should be used for budgetary consolidation in order to avoid pro-cyclical policies. The past failure to reach the medium-term budgetary objective of 'close to balance or in surplus' calls for a strengthening of the preventive arm of the Stability and Growth Pact, through a renewed commitment by Member States to take the budgetary action necessary to converge towards this objective and respect it.

2.1. Definition of the medium-term budgetary objective

The Stability and Growth Pact lays down the obligation for Member States to adhere to the medium term objective (MTO) for their budgetary positions of "close to balance or in surplus" (CTBOIS).

In light of the increased economic and budgetary heterogeneity in the EU of 25 Member States, the Council agrees that the MTO should be differentiated for individual Member States to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risk to the sustainability of public finances, also in the face of prospective demographic changes.

The Council therefore proposes developing medium-term objectives that, by taking account of the characteristics of the economy of each Member State, pursue a triple aim. They should firstly provide a safety margin with respect to the 3% deficit limit. They should also ensure rapid progress towards sustainability. Taking this into account, they should allow room for budgetary manoeuvre, in particular taking into account the needs for public investment.

MTOs should be differentiated and may diverge from CTBOIS for individual Member States on the basis of their current debt ratio and potential growth, while preserving sufficient margin below the reference value of -3% of GDP. The range for the country-specific MTOs for euro area and ERM II Member States would thus be, in cyclically adjusted terms, net of one-off and temporary measures, between -1% of GDP for low debt/high potential growth countries and balance or surplus for high debt/low potential growth countries.

The long-term sustainability of public finances would be supported by the convergence of debt ratios towards prudent levels.

Implicit liabilities (related to increasing expenditures in the light of ageing populations) should be taken into account, as soon as criteria and modalities for doing so are appropriately established and agreed by the Council. By the end of 2006, the Commission should report on progress achieved towards the methodology for completing the analysis by incorporating such implicit liabilities.

The Council stresses however that fiscal policy cannot be expected in the short term to cope with the full structural effects of demographic ageing and it invites Member States to pursue their efforts in implementing structural reforms in the areas related to the ageing of their populations as well as towards increasing employment and participation ratios.

Medium-term budgetary objectives could be revised when a major reform is implemented and in any case every four years, in order to reflect developments in government debt, potential growth and fiscal sustainability.

2.2. Adjustment path to the medium-term objective

The Council considers that a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in periods of economic recovery should be achieved, with the objective to avoid pro-cyclical policies and to gradually reach the medium term objective, thus creating the necessary room to accommodate economic downturns and reduce government debt at a satisfactory pace, thereby contributing to the long-term sustainability of public finances.

Member States should commit at a European level to actively consolidate public finances in good times. The presumption is to use unexpected extra revenues for deficit and debt reduction.

Member States that have not yet reached their MTO should take steps to achieve it over the cycle. Their adjustment effort should be higher in good times; it could be more limited in bad times. In order to reach their MTO, Member States of the euro zone or of ERM-II should pursue an annual adjustment in cyclically adjusted terms, net of one-offs and other temporary measures, of 0,5% of GDP as a benchmark. "Good times" should be identified as periods where output exceeds its potential level, taking into account tax elasticities.

Member States that do not follow the required adjustment path will explain the reasons for the deviation in the annual update of the stability/convergence programmes. The Commission will issue policy advice to encourage Member States to stick to their adjustment path. Such policy advice will be replaced by early warnings in accordance with the Constitution as soon as it becomes applicable.

2.3. Taking structural reforms into account

The Council agrees that, in order to enhance the growth oriented nature of the Pact, structural reforms will be taken into account when defining the adjustment path to the medium-term objective for countries that have not yet reached this objective and in allowing a temporary deviation from this objective for countries that have already reached it, with the clear understanding that a safety margin to ensure the respect of the 3% of GDP reference value for the deficit has to be guaranteed and that the budgetary position would be expected to return to the MTO within the programme period.

Only major reforms which have direct long-term cost-saving effects, including by raising potential growth, and therefore a verifiable positive impact on the long-term sustainability of public finances, will be taken into account. A detailed cost-benefit analysis of those reforms from the budgetary point of view would need to be provided in the framework of the annual update of stability/convergence programmes.

These proposals should be introduced into Regulation 1466/97.

Moreover, the Council is mindful that the respect of the budgetary targets of the Stability and Growth Pact should not hamper structural reforms that unequivocally improve the long-term sustainability of public finances. The Council acknowledges that special attention must be paid to pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar. Although these reforms entail a short-term deterioration of public finances during the implementation period, the long-term sustainability of public finances is clearly improved. The Council therefore agrees that Member States implementing such reforms should be allowed to deviate from the adjustment path towards the MTO, or from the MTO itself. The deviation from the MTO should reflect the net cost of the reform to the publicly managed pillar, provided the deviation remains temporary and an appropriate safety margin to the reference value is preserved.

3. Improving the implementation of the excessive deficit procedure

The excessive deficit procedure should remain simple, transparent and equitable. Nevertheless, the experience of recent years shows possible scope for improvement in its implementation.

The guiding principle for the application of the procedure is the prompt correction of an excessive deficit.

The Council underlines that the purpose of the excessive deficit procedure is to assist rather than to punish, and therefore to provide incentives for Member States to pursue budgetary discipline, through enhanced surveillance, peer support and peer pressure. Moreover, policy errors should be clearly distinguished from forecast errors in the implementation of the excessive deficit procedure. If nevertheless a Member State fails to comply with the recommendations addressed to it under the excessive deficit procedure, the Council has the power to apply the available sanctions.

3.1. Preparing a Commission report under Article 104(3)

In order to avoid excessive government deficits, as called for by Article 104(1) of the Treaty, the reports, prepared by the Commission according to Article 104(3) of the Treaty as a result of its monitoring, form the basis of the EFC opinion, the ensuing Commission assessment and ultimately the Council decision on the existence of an excessive deficit as well as on its recommendations, including on the deadlines for the correction of the deficit.

The Council and the Commission are resolved to clearly preserve and uphold the reference values of 3% and 60% of GDP as the anchors of the monitoring of the development of the budgetary situation and of the ratio of government debt to GDP in the Member States. The Commission will always prepare a report on the basis of Article 104(3) of the Treaty. The Commission shall examine in its report if one or more of the exceptions foreseen respectively in Article 104(2)(a) and (b) apply. The Council hereafter proposes revisions or clarifications to the scope of those exceptions.

As foreseen by the Treaty, the Commission shall moreover take into account in its report whether the Member State's government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State. The Council hereafter proposes clarifications to the concept of "all other relevant factors".

3.2. An "exceptional and temporary" excess of the deficit over the reference value

The Treaty provides, in Article 104(2)(a) second indent, for an exception if an excess over the reference value is only exceptional and temporary and if the ratio remains close to the reference value.

Whereas, in order to benefit from that exception, the ratio has always to remain close to the reference value, Regulation 1467/97 gives definitions as to when an excess over the reference value, but still close to it, shall be considered exceptional and temporary: in order to be considered as exceptional, the excess has to result from an unusual event outside the control of the Member State and with a major impact on the financial position of the general government, or it has to result from a severe economic downturn. In order for the excess to be temporary, the Commission's budgetary forecast must indicate that the deficit will fall below the reference value following the end of the unusual event or the severe economic downturn.

A severe economic downturn is presently defined - as a rule - as an annual fall of real GDP of at least 2%. Moreover, in the case of an annual fall of real GDP of less than 2%, Regulation 1467/97 still allows the Council to decide that no excessive deficit exists, in the light of further evidence, in particular on the abruptness of the downturn or on the accumulated loss of output relative to past trends.

The Council considers that the current definition of "a severe economic downturn" given in Article 2(2) of Regulation 1467/97 is too restrictive. The Council considers that paragraphs (2) and (3) of Article 2 in Regulation 1467/97 need to be adapted in order to allow both the Commission and the Council, when assessing and deciding upon the existence of an excessive deficit, according to paragraphs (3) to (6) of Article 104 of the Treaty, to consider as exceptional an excess over the reference value which results from a negative growth rate or from the accumulated loss of output during a protracted period of very low growth relative to potential growth.

3.3. "All other relevant factors"

Article 104(3) of the Treaty requests that, in preparing the report on the non-fulfilment of the criteria for compliance with budgetary discipline, the Commission "shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State". A balanced overall assessment has to encompass all these factors.

The Council underlines that taking into account "other relevant factors" in the steps leading to the decision on the existence of an excessive deficit (Article 104, paragraphs (4), (5) and (6)) must be fully conditional on the overarching principle that - before other relevant factors are taken into account - the excess over the reference value is temporary and the deficit remains close to the reference value.

The Council considers that the framework to take into account "all other relevant factors" should be clarified. The Commission's report under Article 104(3) should appropriately reflect developments in the medium-term economic position (in particular potential growth, prevailing cyclical conditions, the implementation of policies in the context of the Lisbon agenda and policies to foster R&D and innovation) and developments in the medium-term budgetary position (in particular, fiscal consolidation efforts in "good times", debt sustainability, public investment and the overall quality of public finances). Furthermore, due consideration will be given to any other factors, which in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value. In that context, special consideration will be given to budgetary efforts towards increasing or maintaining at a high level financial contributions to fostering international solidarity and to achieving European policy goals, notably the unification of Europe if it has a detrimental effect on the growth and fiscal burden of a Member State.

Clearly no redefinition of the Maastricht reference value for the deficit via the exclusion of particular budgetary items should be pursued.

If the Council has decided, on the basis of Article 104(6), that an excessive deficit exists in a Member State, the "other relevant factors" will also be considered in the subsequent procedural steps of Article 104. However, they should not be taken into account under Article 104(12), i.e. in the decision of the Council as to whether a Member State has corrected its excessive deficit.

These proposals should be introduced into Regulation 1467/97.

3.4. Taking into account systemic pension reforms

The Council agrees that an excess close to the reference value which reflects the implementation of pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar should be considered carefully. Although the implementation of these reforms leads to a short-term deterioration of the budgetary position, the long-term sustainability of public finances clearly improves.

The Commission and the Council, in all budgetary assessments in the framework of the EDP, will give due consideration to the implementation of these reforms.

In particular, when assessing under Article 104(12) whether the excessive deficit has been corrected, the Commission and the Council will assess developments in EDP deficit figures while also considering the net cost of the reform to the publicly managed pillar. Consideration to the net cost of the reform will be given for the initial five years after a Member State has introduced a mandatory fully-funded system, or five years after 2004 for Member States that have already introduced such a system. Furthermore, it will also be regressive, i.e. during a period of five years, consideration will be given to 100, 80, 60, 40 and 20 percent of the net cost of the reform to the publicly managed pillar.

3.5. Increasing the focus on debt and sustainability

In line with the provisions of the Treaty, the Commission has to examine compliance with budgetary discipline on the basis of both the deficit and the debt criterion. The Council agrees that there should be increased focus on debt and sustainability, and reaffirms the need to reduce government debt to below 60% of GDP at a satisfactory pace, taking into account macroeconomic conditions. The higher the debt to GDP ratios of Member States, the greater must be their efforts to reduce them rapidly.

The Council considers that the debt surveillance framework should be strengthened by applying the concept of "sufficiently diminishing and approaching the reference value at a satisfactory pace" for the debt ratio in qualitative terms, by taking into account macroeconomic conditions and debt dynamics, including the pursuit of appropriate levels of primary surpluses as well as other measures to reduce gross debt and debt management strategies. For countries above the reference value, the Council will formulate recommendations on the debt dynamics in its opinions on the stability and convergence programmes.

No change to the existing Regulations is required to that effect.

3.6. Extending deadlines for taking effective action and measures

The Council considers that the deadline for adoption of a decision under Article 104(6) establishing the existence of an excessive deficit should be extended from three to four months after the fiscal notification deadline. Moreover, the Council considers that the timing for taking effective action following a recommendation to correct the excessive deficit under Article 104(7) could be extended from 4 to 6 months, in order to allow the Member State to better frame the action within the national budgetary procedure and to develop a more articulated package of measures. This could facilitate the adoption of corrective packages of structural (as opposed to largely temporary) measures. Furthermore, with longer deadlines it would be possible to take an updated Commission forecast into account, so that measures taken and significant changes in growth conditions that could justify an extension of the deadlines would be assessed together. For the same reasons, the one-month deadline for the Council to take a decision to move from Article 104(8) to Article 104(9) should be extended to two months, and the two-month deadline under Article 104(9) should be extended to 4 months.

These proposals would require changes to the relevant Articles of Regulation 1467/97.

3.7. Initial deadline for correcting the excessive deficit

The Council considers that, as a rule, the deadline for correcting an excessive deficit should be the year after its identification and thus, normally, the second year after its occurrence. The Council agrees however that the elements to be taken into account in setting the initial deadline for the correction of an excessive deficit should be better specified and should include, in particular, an overall assessment of all the factors mentioned in the report under Art. 104(3).

As a benchmark, countries in excessive deficit will be required to achieve an annual minimum fiscal effort of at least 0,5 percent of GDP in cyclically adjusted terms, net of one-off measures, and the initial deadline for the correction of the excessive deficit should be set taking into account this minimum fiscal effort. If this effort seems sufficient to correct the excessive deficit in the year following its identification, the initial deadline need not be set beyond that year.

However the Council agrees that in case of special circumstances, the initial deadline for correcting an excessive deficit could be set one year later, i.e. the second year after its identification and thus normally the third year after its occurrence. The determination of the existence of special circumstances will take into account a balanced overall assessment of the factors mentioned in the report under Article 104(3).

The initial deadline will be set without prejudice to the taking into account of systemic pension reforms and without prejudice to deadlines applying to new and future Member States.

3.8. Revising the deadlines for correcting the deficit

The Council agrees that deadlines for correcting the excessive deficit could be revised and extended if unexpected adverse economic events with major unfavourable budgetary effects occur during the excessive deficit procedure. Repetition of a recommendation under Article 104(7) or a notice under Article 104(9) of the Treaty is possible and should be used if effective action has been taken by the Member State concerned in compliance with the initial recommendation or notice. This should be specified in Regulation 1467/97.

Member States would be required to give evidence of having taken effective action following recommendations. If effective action was taken in response to previous recommendations and unforeseeable growth developments justify a revision of the deadlines for correcting the excessive deficit, the procedure would not move to the next step. The growth forecast contained in the Council recommendation would be the reference against which unforeseeable growth developments would be assessed.

