2480th Council meeting

- ECONOMIC AND FINANCIAL AFFAIRS -

Brussels, 21 January 2003

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- *The documents whose references are given in the text are available on the Council's Internet site http://ue.eu.int.*
- *Acts adopted with statements for the Council minutes which may be released to the public are indicated by an asterisk; these statements are available on the above mentioned Council Internet site or may be obtained from the Press Office.*

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PARTICIPANTS

The Governments of the Member States and the European Commission were represented as follows:

Belgium:	
Mr Didier REYNDERS	Minister for Finance
Denmark:	
Mr Thor PEDERSEN	Minister for Finance
Germany:	
Mr Hans EICHEL	Federal Minister for Finance
Mr Caio Kai KOCH-WESER	State Secretary, Federal Ministry of Finance
Greece:	
Mr Nikos CHRISTODOULAKIS	Minister for the National Economy and Finance
Spain:	
Mr Rodrigo DE RATO Y FIGAREDO	Second Deputy Prime Minister and Minister for Economic Affairs
Mr Luis de GUINDOS	State Secretary for Economy
Mr Estanislao RODRÍGUEZ-PONGA Y SALAMANCA	State Secretary for Finance
France:	
Mr Francis MER	Minister for Economic Affairs, Finance and Industry
Ireland:	
Mr Charlie McCREEVY	Minister for Finance
Italy:	
Mr Giulio TREMONTI	Minister for the Economy and Finance
Luxembourg:	
Mr Jean-Claude JUNCKER	Prime Minister, Minister for Finance
Mr Luc FRIEDEN	Minister for the Treasury and the Budget
Mr Henri GRETHEN	Minister for Economic Affairs
Netherlands:	
Mr Hans HOOGERVORST	Minister for Finance
Mr Steven van EIJCK	State Secretary for Finance
Austria:	
Mr Karl-Heinz GRASSER	Federal Minister for Finance
Portugal:	
Ms Manuela FERREIRA LEITE	Ministra de Estado, Minister for Finance
Finland:	
Mr Sauli NIINISTÖ	Minister for Finance
Sweden:	
Mr Bosse RINGHOLM	Minister for Finance
Mr Claes LJUNGH	State Secretary to the Minister for Finance
Ms Karin RUDEBECK	State Secretary to the Minister for Finance
United Kingdom:	
Mr Gordon BROWN	Chancellor of the Exchequer

* * *

Commission:	
Mr Frits BOLKESTEIN	Member
Mr Pedro SOLBES	Member

* * *

Other participants:	
Mr Philippe MAYSTADT	President of the European Investment Bank
Mr Johnny ÅKERHOLM	Chairman of the Economic and Financial Committee
Ms Dawn PRIMAROLO	Chair of the Code of Conduct Group

ITEMS DEBATED

PRESIDENCY AND COMMISSION WORK PROGRAMMES

The Council was informed of the content of the Presidency and the Commission work programmes relating to economic and financial affairs. The Presidency work programme is to be found in the Public Register of the Council (doc 5186/03).

STABILITY AND GROWTH PACT - EXAMINATION OF UPDATED STABILITY AND CONVERGENCE PROGRAMMES - COUNCIL OPINIONS ON FINLAND, SWEDEN, GREECE, ITALY, GERMANY AND FRANCE

The Council examined the updated Stability and Convergence Programmes for Finland, Sweden, Greece, Italy, Germany and France in the context of the Stability and Growth Pact. The Council agreed the following Opinions and decided to place them in the public domain:

– ***FINLAND - Council Opinion on the updated Stability Programme, 2002-2006***

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[2], and in particular Article 5 (3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 21 January 2003 the Council examined Finland's updated stability programme, which covers the period 2002-2006. The Council notes with satisfaction that the general government balance, which exceeded projections in 2001, is expected to remain clearly in surplus throughout the programme period. Furthermore, in spite of the higher than expected outcome in 2001, the general government debt to GDP ratio is projected to continue to decline, unlike in the previous programme, virtually every year during the programme period. The Council considers that the updated programme is consistent with the Broad Economic Policy Guidelines (BEPG).

The macroeconomic scenario presented in the 2002 updated stability programme projects a strengthening of economic activity in 2002 and 2003 which appears warranted on the back of most recent data. Subsequently, GDP growth is expected to decelerate slightly to below its trend rate, in the face of constraints on labour supply. Given the assumption of a favourable external environment, the projected deceleration of GDP growth in the later years of the programme represents a rather cautious view.

[2] OJ L 209, 2.8.1997.

The Council notes that the programme projects a substantial decline in the general government surplus from 4.9% of GDP in 2001 to just above 2% in 2004[3] and a return to close to 3% is expected for the later years of the programme owing to assumed expenditure control. The Council notes, that all levels of government appear to be responsible for the weakening of the financial position between 2002-04, with only the social security funds, preparing for the coming age-related expenditure pressures, upholding the surplus at the general government level. The projected decline in the cyclically adjusted balance by 1½ percentage points of GDP between 2002-04 is also partly due to the decline from the exceptionally high level recorded in 2000 in corporate taxes; however, the decline in the cyclically adjusted surplus seems to come at the time when the economy should be strongly gathering momentum, suggesting, thus, a pro-cyclical stance of fiscal policy.

The Council notes that, apart from the cyclical adjustment from exceptionally high starting point of 2000, the expected decline in the government surplus is mainly due to higher than originally planned income tax cuts between 2000-03 and higher than planned discretionary spending at central government level in 2001-02. Even though the previous high surpluses have created some additional room (for fiscal manoeuvre), the Council takes note of the apparent customary tendency of deviating from the medium-term spending guidelines which represent the governments´ key fiscal policy instrument. These slippages raise some concern, since, in order to maintain high surpluses in coming years, the programme assumes tight restraints on spending - but also a decline in the revenue-to-GDP ratio. Therefore, the Council renews its recommendation from last year – along also the lines of 2002 BEPGs - that the Finnish government reinforces its commitment to firmly control central government outlays over the medium-term.

The Council also notes the somewhat slow pace of debt reduction over the programme period, in the light of the comfortably high primary surpluses, but recognises that this follows mainly from net accumulation of financial assets and, furthermore, that the general government financial assets appear to exceed the sectors´ gross debt. Nevertheless, in light of Finland's above-average exposure to expenditure pressures related to the ageing of the population, the Council encourages the Finnish government to maintain the current high surpluses over the medium term to allow a continuous decline in the government gross debt ratio.

The Council notes that the projected surplus in the government accounts throughout the programme period is fully in line with the requirements of the Stability and Growth Pact. This is almost entirely due to a surplus in the accounts of statutory social security institutions preparing for the age-related expenditure pressures. In addition, in spite of expected deficit in central and local government finances, the estimated cyclically adjusted government surplus of at least 2% of GDP should provide a sufficient safety margin against a breach of the 3% of GDP reference value for the government deficit in normal cyclical fluctuations.

The Council welcomes the measures recently adopted to improve financial stability at the local government level over the medium term. The Council recommends, in line with the 2002 Broad Economic Policy Guidelines and the updated stability programme, to ensure that the envisaged aims are achieved; in this respect, the introduction of a surveillance mechanism underpinning legislation requiring local governments to balance their budgets within a three year period would be welcome.

The Council welcomes the attention given in the stability programme to the sustainability of public finances. The Council considers that on the basis of current policies, public finances appear to be on a sustainable footing to meet the budgetary costs of ageing populations, benefiting from the sustained running of budget surpluses, and a reformed pension system that has a high degree of pre-funding.

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[3] Excluding 2004, this represents an upward revision of the budgetary targets compared with the previous programme, due also to surplus in 2001 having been higher than targeted.

The Council also takes note of reforms, both planned and underway, which aim at raising employment rates of older workers, and encourages the Finnish authorities to proceed with their implementation according to the time frame indicated in the stability programme.

The Council notes that the tax ratio in Finland is high compared with other industrialised countries. A major challenge will be to carry out the planned tax reforms, while safeguarding the achievements of the past decade of placing public finances on a sustainable path.

– ***SWEDEN - Council Opinion on the updated Convergence Programme, 2002-2004***

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[4], and in particular Article 9 (3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 21 January 2003 the Council examined Sweden's updated convergence programme, which covers the period 2002 - 2004. This update provides detailed information, including the analysis of the long-term sustainability of public finances, which is broadly in line with code of conduct. The lack of detailed information for 2005 in the programme is not in line with the code of conduct. However, the Council recognises that the government's Budget Bill for 2003 did not include budgetary plans for 2005 as a result of prolonged negotiations with respect to forming a government in autumn 2002.

The Council considers that the updated programme is consistent with the previous Council Opinion[5] and the Broad Economic Policy Guidelines.

The Council notes with satisfaction that the updated Programme envisages continued government surpluses throughout the period to 2004 as Sweden maintains its medium term objective of a budget surplus of 2% of GDP on average over the business cycle. The strategy of maintaining sound public finances is supported by a commitment to continue to adhere to the ceilings for central government expenditure, which has been instrumental in strengthening the credibility of sound public finances in recent years, and a balanced budget constraint for local governments. This has been accompanied by tax cuts, of which the third step out of four was implemented in 2002. The Council further notes with satisfaction that the debt ratio remains below the reference value of 60% of GDP, and is projected to continue on a downward trend over the remainder of the programme period.

[4] OJ L209, 2.8.1997
[5] OJ C 33, 6.2.2002.

The macroeconomic scenario presented in the programme, with GDP growth of 2.1% in 2002 and 2.5% in 2003 appears somewhat optimistic and the Council considers that there are downside risks to growth. Indeed, the Commission's autumn forecast is for growth of 1.6% in 2002 and 2.2% in 2003, suggesting a more subdued economic recovery, as there are signs of some fragility both externally and domestically. Economic growth can therefore be expected to return only gradually to the potential growth rate.

The Council considers that Sweden continues to fully respect the Stability and Growth Pact's requirement of a fiscal position 'close to balance or in surplus' over the programme period. Indeed, continued surpluses in the underlying budgetary position in each year over the period underpin that the public finances should remain sound. However, the Council notes that, on the basis of the Commission's analysis, the underlying budgetary position is expected to remain in surplus but below Sweden's 2% of GDP fiscal rule in the years to 2004. This results from the fact that the considerable fiscal stimulus in 2001 and 2002 is only partially reversed in the following years. Moreover, some restraining measures may be necessary in order to ensure adherence to the expenditure ceilings.

The Council welcomes the attention paid to the sustainability of public finances in the convergence programme, and considers that prudent assumptions should be used as regards the potential evolution of non-age related spending. The Council considers that on the basis of current policies, public finances appear to be on a sustainable footing to meet the budgetary costs of ageing populations, benefiting from the sustained running of budget surpluses and the ambitious reform of the pension system implemented during the 1990s. The Council welcomes the budgetary objective of running budget surpluses of 2% of GDP up to 2015 with a view to running down public debt at a fast pace. This may however prove difficult for such a sustained period. A challenge will be to complete the tax reform while safeguarding the achievements of the past decade of placing public finances on a sustainable path.

Inflation in Sweden fell back towards the inflation target of 2% in the spring of 2002. The Council notes that Sweden continues to fulfil the convergence criterion on price stability and is expected to continue do so in the years to 2004. Long-term interest rates in Sweden over the past year have been in line with the trend in the international bond and equity markets. Sweden continues to fulfil the long-term interest rate convergence criterion. Regarding the exchange rate, the krona has not participated in the ERM2 and it has exhibited some volatility since the submission of the previous update. Hence, Sweden does still not fulfil the exchange rate convergence criterion. The Council considers, as stated in its previous Opinion[6], that "Sweden needs to demonstrate its ability to stay in line with an appropriate parity between the krona and the euro over a sufficient period of time without severe tensions. To this end, the Council expects Sweden to decide to join the ERM2 in due course."

In order to obtain high and sustainable economic growth, the strategy of previous programmes is continued and structural measures in this regard have been implemented and proposed, in line with the Broad Economic Policy Guidelines. To this end, the Council considers that completing the tax reform and efforts to reach the key policy objectives regarding employment, social security recipients and days of sick-leave should be given high importance within the framework of sound public finances.

[6] OJ, C 33, (2002/C 33/04), 6.2.2002

– ***GREECE - Council Opinion on the updated Stability Programme, 2002-2006***

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[7], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission, after consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 21 January 2003 the Council examined the 2002 update of the stability programme of Greece, which covers the period 2002-2006. The programme conforms with the requirements of the Code of Conduct on the content and format of the programmes endorsed by the ECOFIN Council on 10 July 2001. The programme partly conforms with the recommendations of the BEPGs.

In 2002, real GDP growth decelerated somewhat, as a result of deteriorating external environment, but remained robust, at 3.8%, as projected in the 2001 stability programme. Inflation pressures under the impact of second round effects from the oil prices hike and other transitory factors, such as bad weather conditions, although easing in recent months, are still persisting with the inflation rate remaining high: the HICP was increasing by an annual rate of 3.9% in November 2002.

The 2002 update of the stability programme projects annual real GDP growth at around 3.8% in yearly average for the period 2003-2006, and marginally lower rates than the 2001 update for the period until 2004. The Council considers the projected real GDP growth as attainable, particularly until 2004 as economic activity will be underpinned by high private and public investment related to the preparation of the Olympic Games and sustained by the inflow of financial resources from the 3rd Community Support framework. However, for growth to be sustained it is essential that fiscal policy remains tight and wage increases are based on labor productivity changes.

The Council notes that the general government accounts deteriorated in 2000 and 2001, when compared with the estimates of the 2001 update, due to a large extent to the revisions of the government accounts figures, in order to ensure compliance with ESA national accounting rules. As a consequence, the starting point of the budgetary projections changed considerably as compared with the 2001 update: according to the 2002 updated stability programme a general government deficit of 1.1% of GDP is estimated for 2002 instead of a surplus of 0.8% of GDP as projected in the 2001 update. Similarly, the government debt ratio is estimated at 105.3% of GDP in 2002 in the current update, to be compared to 97.3% of GDP in the previous update.

The Council considers that the budgetary developments as portrayed in the revised data, in particular the slow pace of reduction in the government debt ratio, in a period when the Greek economy has been growing at high rates, is a matter of serious concern.

[7] OJ L 209, 2.8.1997

The Council notes that the 2002 update projects the government balance to turn from a deficit equal to 1.1% of GDP in 2002 to a surplus of 0.6% of GDP in 2006; at the same time, the government debt ratio is expected to decline from 107% of GDP in 2001 to 87.9% of GDP in 2006; in particular, during the period 2001-2004, from a higher initial level, the debt ratio is projected to decline by 10.9 percentage points of GDP instead of 9.6 percentage points as projected in the 2001 update.

The Council notes that the improvement in the government balance in the period from 2002 to 2006 relies both on the reduction in interest payments and on the retrenchment in current primary expenditure. However, the Council considers that, taking into consideration recent experience, fast and continuous reductions in primary current expenditure are difficult to achieve. Up to now, the programme does not include clear binding norms for current primary expenditure. The Council takes note of the initiative of the Greek government to introduce a code of fiscal stability, in response to the recommendation in the Council opinions on the 2000 stability programme[8] and on the 2001 update[9]. The Council urges the Greek authorities to accompany this new law by the introduction of appropriate mechanisms to ensure expenditure control. Setting binding norms for some categories of current public expenditures, such as the public sector wage bill, will contribute to the effective implementation of this code.

The Council considers that further budgetary adjustment effort is needed. Since the budgetary adjustment projected in the 2002 update is back-loaded, a heavy burden falls on later years of the programme. In 2006 there may still be a small cyclically adjusted government deficit. However, the Council considers that the level and recent developments in the government debt ratio require a stronger and more robust medium term budgetary adjustment, by at least 0.5% of GDP per year in underlying terms. This is also required given the perspective of increasing budgetary costs stemming from the ageing population. The Council urges the Greek government to take advantage of the current favourable macroeconomic situation to undertake determined effort in order to implement a durable budgetary adjustment leading to an improvement in the underlying budgetary position and a satisfactory pace of debt reduction.

The Council notes that strengthening structural reforms is a key economic policy objective of the updated programme; it considers that although progress has been made in recent years in this area, implementation of structural reforms must continue in the product, services and labour markets in order to ensure the efficiency in the markets and the competitiveness of the economy; the Council encourages the government to proceed to the necessary reforms rapidly and welcomes the intention of the government to implement reforms in the area of budgeting and management of expenditure in the public sector.

The Council welcomes the information provided in the updated programme on long-term sustainability of public finances. The Council considers that on the basis of current policies there is a serious risk of budgetary imbalances emerging in the future due to the ageing population. In this context the Council notes the information provided in the updated programme on the "second phase" of the reform of the social security system introduced in 2002 as recommended in its opinion on the 2001 updated stability programme[10]. If debt reduction is to make a noticeable contribution towards meeting the budgetary cost of ageing populations, then reaching a balanced budget position by 2006 is essential; this should be part of an ambitious three-pronged strategy to meet the long-term budgetary consequences of ageing and may have to include the running of surpluses. Running sound public finances over the long run will allow to achieve a significant reduction in the debt ratio prior to the budgetary impact of ageing populations taking hold. The Council considers that further reforms are required to the pension system to avoid an unsustainable increase in public spending.

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8 OJ C 77, 9.3.2001
9 OJ C 51, 26.2.2002
10 OJ C 51, 26.2.2002

Furthermore, the Council encourages the Greek authorities to promote supplementary privately-funded pension schemes and to take measures to raise participation rates and to control the evolution of age related expenditures.

– ***ITALY - Council Opinion on the updated Stability Programme, 2002-2006***

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[11], and in particular Article 5 (3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 21 January 2003 the Council examined Italy's updated stability programme, which covers the period 2002-2006.

The new update broadly complies with the data requirements of the revised Code of Conduct on the content and format of stability and convergence programmes. However, the lack of Information on the additional measures foreseen to achieve the budgetary targets beyond 2003 is not in line with the requirements of the code.

The Council considers that the economic policies as reflected in the planned measures in the updated programme complies partly with the recommendations of the 2002 Broad Economic Policy Guidelines.

The Council welcomes Italy’s goal of keeping high primary surpluses throughout the programme period, while allowing for some easing in the tax burden. The Council notes that according to Commission forecasts, the cyclically-adjusted deficit improved by 0.6 percent of GDP in 2002, largely due to one-off measures. It notes that, following a much worse deficit in 2001 than estimated in last year’s programme and the delayed recovery in the economy, and in spite of corrective measures adopted in the course of the year, the projected deficit for 2002 significantly exceeds the original objectives. In turn, this implies that the “close-to-balance” position would be reached, according to the government’s own projections, in 2004 rather than in 2003. The Council regrets that the decline in the debt ratio has slowed down considerably since 2001, in a context of weak growth and slower-than-envisaged progress in the privatisation programme due to the conditions in financial markets. The reduction of the debt ratio below 100% of GDP is now envisaged by the government to occur in 2005 two years later than in the commitment made by Italy in 1998.

[11] OJ L209 of 2.8.1997.

The programme's macroeconomic scenario assumes a pick-up in economic activity, which in the short term reflects the expected recovery of the world economy and in domestic demand and then the assumption that the output gap will be closed. However, in light of the more recent developments, the recovery is likely to be slower than anticipated, and growth assumptions, both nominal and potential, appear to be optimistic. Also, in the medium-term, a growth assumption of 2½% per year seems to be more plausible, which, together with a downward revision of the potential growth rate to 2%, would result in an underlying deficit of 1.1% in 2006. This would imply that, under this scenario, the medium-term objective of close to balance or in surplus would not be reached in the programme period. However, the Council takes note of the commitment of Italy to reach the objective of close to balance in 2004.

The programme projects the cyclically-adjusted budget position in 2003 to improve by 0.7%. The Council observes that the budgetary target for 2003 relies heavily, as in the previous year, on one-off measures. According to Commission calculations based on the Italian programme update, the cyclically-adjusted deficit will remain at 0.9% of GDP in 2003, still not complying with the requirement of the Stability and Growth Pact to achieve a budget position close to balance or in surplus. Even assuming that such one-off measures yield the expected results, the cyclically-adjusted budget position may fail to improve as planned on account of the risks to the trend budgetary projections, thus putting in jeopardy the attainment of the minimum adjustment of 0.5% of GDP. While the Council welcomes the recently introduced measures for stricter control on public expenditures, it urges Italy to ensure the full implementation of the measures planned for 2003, so that, as a minimum, an improvement in the underlying balance of 0.5% of GDP is ensured. The Council notes that attainment of the budgetary targets for 2004 and beyond, including the achievement of the close-to-balance objective, hinges strongly on the replacement of the main one-off measures implemented in 2003 by measures of a more permanent character together with corrections in order to achieve the reduction of at least 0.5% in underlying terms.

The Council considers that, in order to implement a sustained path of consolidation, Italy should replace one-off measures with structural ones on the expenditure side. The Council notes that Italy undertakes to set out as a matter of urgency in its 2003 medium-term budgetary planning process the broad measures of a permanent nature that would ensure that a minimum improvement in the cyclically-adjusted balance of 0.5% of GDP per year until the close-to-balance objective can be considered achieved. More in general, the Council invites Italy to clarify its fiscal strategy, particularly in the light of the goal of reducing the tax burden, which the Council shares, but which can be safely and effectively achieved only within a comprehensive reform plan on both the expenditure and the revenue side.

The Council considers that in the light of Italy's very high debt ratio the pace of its reduction should be significantly faster than is the experience of the past years. It notes the slowdown in the rate of debt reduction projected toward the end of the programme period also in connection with some "below the line" operations. The Council is especially concerned that the risks to the programme deficit targets might imply too slow a pace of reduction in the debt ratio. The Council therefore urges Italy to act on all the factors under the government's control to ensure that debt is sufficiently diminishing. In this respect, it recommends that measures of transitory nature, particularly sales of assets through securitisation operations, be considered as a means to accelerate the reduction of the debt and not as a substitute for corrective action on the deficit side.

The Council recalls that the achievement of a position of underlying budget balance in the medium term is critical to placing public finances on a sustainable footing. On the basis of current policies, the risk of unsustainable public finances in light of ageing populations cannot be excluded. Given Italy's high debt, primary surpluses in the order of 5% of GDP will have to be maintained for many years.

The Council notes that Italy's ability to cope with the budgetary consequences of ageing is based on implementation of the major pension reforms adopted in the 1990s and a large increase in the participation rate. In line with its Opinion on the previous updated programmes and the Broad Economic Policy Guidelines for 2002, the Council encourages Italy to adopt further measures to promote supplementary privately-funded pension schemes and to address the outstanding critical issue in the public pension system, namely, the long transition period to the new contributions-based system. This should be coupled with the measures necessary to raise participation rates and to control the evolution of age-related expenditures.

– ***GERMANY - Council Opinion on the updated Stability Programme, 2002-2006***

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council regulation (EC) No. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[12], and in particular Article 5(3) thereof;

Having regard to the recommendation of the Commission;

After consulting the Economic and Financial Committee;

HAS DELIVERED THIS OPINION:

On 21 January 2003 the Council examined the updated stability programme for Germany, which covers the period 2002-2006. The updated programme projects general government finances to improve from a deficit of 3 ¾% of GDP in 2002 to a balanced position in 2006. Government gross debt is expected to decrease from 61% of GDP in 2002 to 57 ½% in 2006.

The Council notes that the new update broadly complies with the requirements of the revised "code of conduct on the content and format of stability and converge programmes", although there is still some need for improvement, notably concerning the degree of precision of the quantitative information provided. While the deficit targets set in the Broad Economic Policy guidelines (BEPGs) have not been achieved, the adjustment path planned in the programme is broadly consistent with the Broad Economic Policy Guidelines (BEPG).

The Council notes that the projected deficit outcome for 2002 (3¾% of GDP) is clearly higher than projected in the lower-growth scenario of the December 2001 update (2½ % of GDP). The Council regrets that it has proved not to be possible for the German authorities to fulfil their commitment of 12 February 2002 and the BEPG Recommendation for 2002 not to breach the 3% of GDP reference value for the general government deficit in 2002. The Council notes that the rise in the nominal deficit from 2001 to 2002 cannot be explained only by the unexpected slowdown in growth, and that there have once more been expenditure overruns in the health sector which contributed to a deterioration of the underlying balance.

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12 OJ L209/1, 2.8.1997

The Council decided on 21 January that an excessive deficit exists in Germany and issued a recommendation to Germany according to Art. 104(7) of the Treaty. According to this recommendation, *(i)* the German government should put an end to the excessive deficit situation as rapidly as possible in accordance with Article 3(4) of Council Regulation (EC) No 1467/97; *(ii)* the German authorities should implement with resolve their budgetary plans for 2003 which, on the basis of a GDP growth projection of 1 ½ % in 2003, aim at reducing the general government deficit in 2003 to 2 ¾% of GDP. In addition, the Council noted the commitment of the German authorities to ensure that the momentum of budgetary consolidation is maintained throughout the period covered by the updated stability programme, namely through a reduction of the underlying budgetary deficit by more than 0.5% of GDP per year which in turn requires the introduction of structural reforms.

The Council notes that in the light of the weakening of economic indicators in recent months, the 1½ % growth rate expected for 2003 appears optimistic. It requires an early restoration of economic confidence, not least through implementation of a consistent budgetary adjustment programme. Furthermore, the average growth rates of 2¼ % assumed for the years 2004 to 2006 are above the estimated long-term growth potential of the German economy, which reflects the programme assumption that the output gap will be closed.

However, the level of growth potential in Germany is currently low. It is in the hands of the German government to raise it significantly through coherent reforms, notably of the labour market. The Council strongly urges the German government to undertake the necessary steps.

The Council considers that there is a non-negligible risk that the general government deficit in 2003 may again exceed the 3% of GDP reference value. Therefore, the German authorities should ensure a rigorous budgetary execution and a thorough implementation of the measures announced in the budget for 2003.

The Council acknowledges the projected improvement in the underlying balance by more than 0.5% of GDP per year up to the new programme's horizon, with the exception of 2005 due to the introduction of tax reforms; it notes that in underlying terms the government accounts would at least be close to balance by 2006. It is recalled, however that this adjustment path hinges on the full implementation of the announced measures, the respect of agreed expenditure targets for 2003 and 2004 and an agreement on ambitious expenditure targets for 2005 and 2006. The Council urges the German authorities to ensure that the implementation of the next steps of tax reform in 2004 and 2005 is compatible with a continuous adjustment path towards overall budget balance.

The Council notes that this should lead to a balanced budget by 2006, although this is two years later than planned in last year's update of the stability programme. The Council welcomes the confirmation of the 2006 target by the German *Finanzplanungsrat* (financial planning council) of 27 November 2002. It urges the federal and regional authorities to agree on ambitious expenditure targets for 2005 and 2006 and to ensure strict budgetary implementation at all levels of government. As shown by budgetary developments in the past, this will be crucial in order to attain the projected deficit targets, especially once growth recovers. While the Council welcomes the recent (advanced) implementation of the revised law on budgetary procedures *('Haushaltsgrundsätzegesetz')*, the Council reiterates its view that the mechanism enshrined therein is not yet sufficient to guarantee compliance with mutually agreed objectives by all levels of government.

The Council takes note of the German authorities' intentions to bring the debt level down below the Treaty's reference value by 2005 but notes that these intentions are subject to a number of risks. Therefore the development of the debt ratio remains a source of concern given the need to ensure the sustainability of public finances. On the basis of current policies, the risk of unsustainable public finances in light of ageing populations cannot be excluded. If debt reduction is to make a noticeable contribution towards meeting the budgetary cost of ageing populations, then reaching a balanced budget position by 2006 is essential; this should be part of an ambitious three-pronged strategy to meet the long-term budgetary consequences of ageing and may have to include the running of surpluses. Running sound public finances over the long run will allow to achieve a significant reduction in the debt ratio prior to the budgetary impact of ageing populations taking hold.

The Council considers it to be indispensable that fiscal consolidation, in order to prove sustainable, should be underpinned by far-reaching reforms to raise Germany's very low growth potential. The Council stresses again that the German economy, despite its large size, remains highly vulnerable to external shocks and unable to generate an endogenous and durable growth process. While acknowledging that this still partially reflects the economic consequences of German unification, the Council reiterates the need for urgent reforms not only in the labour market, but also in social security and benefit systems in general, and for a reduction in the regulatory burden of the economy.

– ***FRANCE - Council Opinion on the updated Stability Programme, 2004-2006***

The Council, with France abstaining, adopted the following Opinion:

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[13], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission, after consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 21 January 2003 the Council examined the updated stability programme of France which covers the period 2003-2006. This update is the first programme prepared by the new government, which took office in June 2002; it provides a budgetary strategy designed to support a strong and lasting improvement in economic and employment growth. The programme complies with the requirements of the revised Code of Conduct on the content and format of stability and convergence programmes. The Council considers that the programme complies partly with the recommendations of the 2002 Broad Economic Policy Guidelines.

[13] OJ L 209, 2.8.1997

The Council, having identified a significant divergence in 2002 budgetary developments from the projections of the 2001 update of the stability programme, and considering that this divergence is not corrected in the plans for 2003, adopted on 21 January 2003 a recommendation with a view to giving early warning to France in order to prevent the occurrence of an excessive deficit. According to this recommendation: (i) The French government should take all the appropriate measures in order to ensure that the general government deficit does not breach the 3% of GDP threshold in 2003; (ii) Adopting measures apt to improve the cyclically-adjusted budgetary position by at least 0.5 percentage point of GDP would not only reduce the risk for the general government deficit to breach the 3% of GDP threshold in 2003, but also contribute to resuming a budgetary consolidation path towards a close to balance position as from 2003; (iii) Continuous adjustment in the underlying budgetary position by at least 0.5% of GDP per year should be pursued also in subsequent years in order to achieve the medium-term budgetary position of close to balance or in surplus by 2006.

General government finances deteriorated markedly in 2002. The updated stability programme estimates the 2002 general government deficit at 2.8% of GDP, a level higher than that recommended in the early warning and well above the 1.4% of GDP planned in the previous update. The Council notes that a large part of the slippage in 2002 is due to a deterioration in the underlying balance, which mainly reflects an overrun in expenditures. The budget for 2003 projects the general government deficit at 2.6% of GDP; this projection is consistent with a decrease in the cyclically-adjusted by 0.2% of GDP in 2003 to 2.6% of GDP[14].

The macroeconomic assumption underlying the budget of an increase in real GDP by 2.5% in 2003 is to be considered as optimistic. Therefore, there is a danger for the government deficit to breach the reference value in 2003. A further deterioration in the 2002 position, which cannot be excluded, or an eventual slippage in the 2003 budget could also bring the general government deficit above 3% of GDP in 2003. In its Autumn forecast, the Commission projected an increase in the government deficit by 0.2 percentage point between 2002 and 2003 under the assumption of real GDP growth at 2.0%. Finally, a risk exists that the government debt breaches the 60% of GDP reference value in 2003.

For the period 2004-2006, the macroeconomic projections of the 2002 update are based on two scenarios: a "cautious" scenario, with real GDP growth at 2.5% a year over the period, and a "favourable" scenario where real GDP growth reaches 3% per year. The projections of the "favourable" scenario encompass downside risks, and the "cautious" scenario should be taken as the reference one for assessing budgetary developments. In the "cautious" scenario, the government deficit is projected to decline by 0.5 percentage point of GDP per year as from 2004 to reach 1.0% of GDP in 2006, which implies that the medium-term objective of close to balance or in surplus would not be reached in the programme period. In the "favourable" scenario, the government deficit would reach a close to balance position in 2006.

The Council notes that the budgetary consolidation mainly takes place from 2004 onwards. The effort planned for 2003 reaches 0.2 percentage point of GDP, and between 2004 and 2006, the underlying budgetary position improves by 0.5 percentage point a year. The Council urges the French authorities to seek an improvement in the underlying budgetary position of at least 0.5% each year in order to reduce the risk for the general government deficit to breach the 3% of GDP threshold and to reach a close to balance position by 2006.

The slow budgetary adjustment is partly due to the implementation of tax cuts from 2003 worth 0.2/0.3 percentage point of GDP per year, in a context where expenditures are projected to increase at the same rate as in the 2001 update. Although considering that a reduction in the tax burden is to be welcomed in so far as it contributes to strengthen potential output growth, the Council regrets that the current update does not confirm that any reduction in the tax burden after 2003 is conditional on the attainment of a close to balance budgetary position.

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14 These calculations are based on the production function method approved by the Council.

The budgetary strategy of the 2002 updated stability programme remains based on defining norms for general government expenditure increases in real terms. This strategy has already been commended by the Council in its opinions on the previous updated programmes. Over the period 2004-2006, real expenditures are planned to increase by 3.9% in real terms. The Council considers, in particular in view of recent economic and budgetary developments, that ambitious reforms should be rapidly implemented in order to ensure that this objective is achieved. The Council welcomes the structural measures designed to curb expenditures in the health sector taken recently and the actions aiming at improving the control of budgetary execution in the State sector. It also welcomes the commitment to implement corrective infra-annual measures in the social security sector in the event of an evidence of overspending. The Council considers that these reforms should lead to a better adherence to the ex ante defined pluri-annual expenditure norms.

On the basis of current policies, the risk of unsustainable public finances in light of ageing populations cannot be excluded. If debt reduction is to make a noticeable contribution towards meeting the budgetary cost of ageing populations, then reaching a balanced budget position by 2006 is essential; this should be part of an ambitious three-pronged strategy to meet the long-term budgetary consequences of ageing and may have to include the running of surpluses. Running sound public finances over the long run will allow to achieve a significant reduction in the debt ratio prior to the budgetary impact of ageing populations taking hold. The Council welcomes the intentions of the French authorities to reform pension and health care systems in light of ageing populations and urges them to proceed rapidly with these reforms given the limited window of opportunity.

IMPLEMENTATION OF THE EXCESSIVE DEFICIT PROCEDURE FOR GERMANY

The Council adopted the following ***Decision*** on the existence of an excessive deficit in Germany:

THE COUNCIL OF THE EUROPEAN UNION

Having regard to the Treaty establishing the European Community, and in particular Article 104(6) thereof,

Having regard to the recommendation from the Commission under article 104(6) of the Treaty,

Having regard to the observations made by Germany,

Whereas:

(1) In stage three of Economic and Monetary Union (EMU), according to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The Amsterdam Resolution of the European Council on the Stability and Growth Pact of 17 June 1997 solemnly invites all parties, namely the Member States, the Council and the Commission, to implement the Treaty and the Stability and Growth pact in a strict an timely manner.

(4) The excessive deficit procedure under article 104 provides for a decision on the existence of an excessive deficit. The Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the excessive deficit procedure. Council Regulation (EC) 3605/93[15], as last amended by Commission Regulation (EC) 351/2002[16] lays down detailed rules and definitions for the application of the provision of the said Protocol.

(5) Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. The Commission has addressed such an opinion on Germany to the Council on 8 January 2003. According to this opinion:

- Following the publication of its own Autumn forecast on 13 November 2002, which showed a government deficit of 3.8% of GDP in 2002 for Germany, the Commission, in accordance with Article 104(3) of the Treaty, prepared in November 2002 a report on Germany which takes account of the relevant factors;

- In accordance with Article 104(4) of the Treaty, the Economic and Financial Committee has formulated an opinion on the report of the Commission;

- Germany has submitted an updated Stability Programme in accordance with Article 3 of Council Regulation (EC) No. 1466/97, which had been adopted by the Federal government on 18 December 2002. According to the update, the government deficit in 2002 amounted to 3 ¾% of GDP;

[15] OJ No L332, 31.12.1993, p.7.
[16] OJ No L 055, 26.02.2002 p. 23.

- The Commission considers that there exists an excessive deficit in Germany.

(1) Article 104(6) of the Treaty lays down that the Council should consider any observations which the Member State concerned may wish to make before the Council decides after an overall assessment whether an excessive deficit exists.

(2) The overall assessment leads to the following conclusions: in the late 1990s, when Germany enjoyed relatively strong economic growth, progress in fiscal consolidation was limited, with the general government deficit remaining at around 1 ½% of GDP. Thus, there had been little budgetary leeway to accommodate for the effects of a cyclical slowdown or for any unexpected revenue shortfalls from a tax reform implemented in 2001. From a low of 1.4% of GDP in 2000, the deficit rose to 3.7% of GDP in 2002, significantly exceeding the reference value of 3% in that year. While general economic conditions have weakened in Germany as elsewhere, the overrun in budgetary expenditure and the shortfall in revenue can only partially be explained by cyclical factors. Moreover, government debt is projected to rise to 60.9% of GDP by the end of 2002, a level also exceeding, albeit slightly, the respective reference value of 60% of GDP.

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment it follows that an excessive deficit exists in Germany.

Article 2

This decision is addressed to the Federal Republic of Germany.

The Council also adopted the following ***Recommendation*** to Germany with a view to bringing an end to the situation of an excessive government deficit - Application of Article 104(7) of the Treaty:

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof,

Having regard to the recommendation from the Commission under Article 104(7) and Article 104(13),

Whereas in stage three of Economic and Monetary Union (EMU), Member States according to Article 104 of the Treaty shall avoid excessive government deficits.

Whereas the Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

Whereas the Amsterdam Resolution of the European Council on the Stability and Growth Pact of 17 June 1997 solemnly invites all parties, namely the Member States, the Council and the Commission, to implement the Treaty and the Stability and Growth Pact in a strict and timely manner.

Whereas the Council has decided, in accordance with Article 104 (6), that an excessive deficit exists in Germany.

Whereas having decided on the existence of an excessive deficit in Germany, the Council, in accordance with Article 104(7) of the Treaty and Article 3(4) of Regulation EC 1467/97, shall adopt a Recommendation establishing a deadline of four months at the most for effective action to be taken by Germany to correct the excessive deficit position; whereas the Council takes note of the budgetary measures announced in November 2002, which aim at reducing the deficit level to 2 ¾% of GDP in 2003, as well as those planned for 2004; whereas the Council welcomes the measures announced by the German authorities but shall establish a deadline of 21 May 2003 at the latest for the German government to take measures to bring the existence of an excessive deficit to an end within the deadline established by this Council Recommendation.

Whereas Article 3(4) of Regulation EC 1467/97 requires that the Recommendation adopted by the Council in accordance with Article 104(7) also establishes a deadline for the correction of the excessive deficit, which should be completed in the year following its identification.

Whereas the German government adopted a federal budget aiming at a general government deficit of 2 ¾% for 2003; whereas on 18 December, the German government adopted an updated Stability Programme aiming at a balanced budget in 2006 in a central scenario.

Whereas, in accordance with Article 104(12) of the Treaty, a Council decision under Article 104(6) on the existence of an excessive deficit will only be abrogated if the excessive deficit, in the view of the Council, has been corrected; whereas the Council will take into account compliance with the recommendation made under Article 104(7) when taking decisions in accordance with Article 104(12),

HEREBY RECOMMENDS:

- the German government to put an end to the present excessive deficit situation as rapidly as possible in accordance with Article 3(4) of Council Regulation (EC) No 1467/97;

- the German authorities to implement with resolve their budgetary plans for 2003 which, on the basis of GDP growth projections of 1 ½% in 2003, aim at reducing the general government deficit in 2003 to 2 ¾% of GDP; in particular, the German authorities should ensure a rigorous budgetary execution and a thorough implementation of the measures announced for 2003 amounting to 1% of GDP. The Council establishes a deadline of 21 May 2003 at the latest for the German government to take such measures. If some of these measures are not implemented, the German government should adopt and implement compensatory measures to ensure a reduction of the government deficit in 2003 as planned. In addition, the Council recommends the German authorities to ensure that the rise in the debt ratio is brought to a halt in 2003 and reversed thereafter.

In addition, the Council notes the commitments of the German authorities:

- to implement structural reforms which should vigorously address the need to raise the growth potential of the German economy and, in this way, also be conducive to the achievement of a medium-term budgetary position of close to balance or in surplus, and to a debt ratio brought back to a declining path;

- to ensure that the momentum of budgetary consolidation is maintained throughout the period covered by the December 2002 update of the Stability Programme, namely through a reduction in the underlying budgetary deficit by more than 0.5% of GDP per year, with the exception of 2005 due to the introduction of tax reforms, which in turn requires the introduction of structural reforms;

- to reinforce the co-ordination mechanisms of budgetary policy in Germany and to secure the process of budgetary consolidation. In this regard, the Council notes with satisfaction the approval and implementation of the new §51a *Haushaltsgrundsätzegesetz* ('law on budgetary procedures') aimed at strengthening budgetary co-ordination and fiscal discipline among the constituent sectors of general government, thereby assisting in the management of fiscal policy; the Council welcomes the efforts that are being made by the German government to reduce the government deficit on a permanent basis and encourages the German government to implement these policies with determination.

This recommendation is addressed to the Federal Republic of Germany.

Germany decided that the Recommendation should be made public.

EARLY WARNING PROCEDURE FOR FRANCE

The Council adopted, with France abstaining, the following ***Recommendation*** with a view to giving early warning to France in order to prevent the occurrence of an excessive deficit:

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99(4) thereof,

Having regard to the Council regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[17], and in particular Article 6(2) thereof,

Having regard to the recommendation of the Commission,

Whereas:

(1) Article 6(2) of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies as part of the Stability and Growth pact establishes an early warning system for alerting a Member State at an early stage to the need to make the necessary budgetary adjustment to prevent a government deficit becoming excessive. An early warning shall be given when the Council identifies actual or expected significant divergence of the budgetary position in a Member State from the medium-term budgetary objective, or the adjustment path towards it, set in the Member State's stability programme for the government balance.

(2) In the Resolution on the Stability and Growth Pact adopted in Amsterdam on 17 June 1997[18] the European Council invited all parties to implement the Treaty and the Stability and Growth Pact in a strict and timely manner.

(3) In the 2001 updated stability programme of France, on which the Council delivered an opinion on 12 February 2002[19], the French authorities aimed at a 1.4% of GDP general government deficit in 2002 and 1.3% of GDP in 2003. The projections for the 2002 general government deficit were rectified to 1.8% of GDP in February by the French authorities, when they revised the projections for the 2002 real GDP growth from 2.5% to 1.5%.

(4) The general government deficit in France in 2002 is now projected at 2.8% of GDP by the French authorities and at 2.7% of GDP by the Commission, thus 1.4 percentage point above the initial target set in the 2001 updated stability programme. According to Commission services calculations, less than one half, i.e. 0.5 percentage point of GDP, of the total slippage in the general government deficit in 2002 can be attributed to cyclical factors. The remaining part represents a deterioration in the cyclically-adjusted balance.

(5) As a consequence of this slippage, the French budgetary position in 2002 is far from close to balance, in actual and cyclically-adjusted terms. Indeed, the cyclically-adjusted deficit is estimated by the Commission services to have increased from about 2% of GDP in 2001 to 2.7% of GDP in 2002. This level is clearly too high to ensure that the general government deficit does not breach the 3% of GDP reference value under normal cyclical fluctuations.

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17 OJ L 209, 2.8.1997, p.1.
18 OJ C 236, 2.8.1997, p.1.
19 OJ C 51, 26.2.2002, p.4.

(6) The draft budget for 2003 presented in September projects a slight reduction in the general government deficit at 2.6% of GDP, in the context of an expected acceleration in real GDP growth to 2.5%. The Broad Economic Policy Guidelines for 2002 recommended that France should "aim at a sufficient decline of the 2003 deficit to ensure that a close to balance position in 2004 can be achieved". According to Commission calculations based on the French programme update, the cyclically-adjusted budgetary deficit will decline slightly by 0.2% to 2.6% in 2003.

(7) Taking also into account significant downward risks surrounding the macroeconomic perspectives, the budgetary position foreseen in the 2003 draft budget is at a level which could lead to the occurrence of an excessive deficit, should the recovery be less pronounced than assumed in the budget or in case further slippage in the 2003 budget would occur. The Commission Autumn forecasts project an increase in the general government deficit from 2.7% in 2002 to 2.9% of GDP in 2003, in a context where real GDP growth accelerates from 1.0% in 2002 to 2.0% in 2003.

(8) In view of these elements, the risk for the general government deficit to breach the 3% of GDP threshold has not been removed. Moreover, this divergence influences medium term commitments, as the attainment of a close to balance position is now postponed.

(9) On the basis of information provided by the French authorities and of the assessments made by the Commission, the Council identifies a significant divergence in terms of Article 6(2) of Council Regulation (EC) No 1466/97.

(10) There is a need for an early warning to be given alerting France in order to prevent the occurrence of an excessive deficit.

HEREBY RECOMMENDS:

1. The French government should take all the appropriate measures in order to ensure that the general government deficit does not breach the 3% of GDP threshold in 2003.

2. Adopting measures apt to improve the cyclically-adjusted budgetary position by at least 0.5 percentage point of GDP would not only reduce the risk for the general government deficit to breach the 3% of GDP threshold in 2003, but also contribute to resuming a budgetary consolidation path towards a close to balance position as from 2003.

3. Continuous adjustment in the underlying budgetary position by at least 0.5% of GDP per year should be pursued also in subsequent years in order to achieve the medium-term budgetary position of close to balance or in surplus by 2006.

This recommendation is addressed to the Republic of France.

The Council adopted a Decision making the early warning recommendation public.

TAX ISSUES

– ***TAX PACKAGE - Council conclusions***

"1. The Council reaches political agreement as follows and commits itself to formally adopt the Tax Package before the European Council in March 2003.

With regard to the Directive on the Taxation of Savings:

2. The Council sticks to the Feira European Council conclusions that the exchange of information, on as wide a basis as possible, is to be the ultimate objective of the European Union in line with international developments.

The Council recalls the conclusions of the Feira European Council that sufficient reassurances should be obtained from certain third countries on the application of "equivalent measures" to those provided for in the draft directive. Based on the Commission's report, as submitted to the ECOFIN of 3 December, the Council considers that this condition is effectively satisfied in the case of the United States of America and that it would be satisfied in the cases of Switzerland, Liechtenstein, Monaco, Andorra and San Marino if these countries offered to enter into agreements as outlined below.

3. The Council agrees that the EC should, on the basis of unanimity, enter into an **agreement with Switzerland** based on the following package:

- *Retention and Withholding:* Switzerland will apply the same rates of retention and withholding as Belgium, Luxembourg and Austria - 15% during the first three years of the transitional period starting on 1 January 2004, 20% as from 1 January 2007 and 35% as of 1 January 2010. The scope of the agreement shall also include, inter alia, the definition of the paying agent, definition of interest, including interest paid on fiduciary deposits and by Swiss investment funds. In cases where a taxpayer declares his interest income obtained from a Swiss paying agent to the tax authorities in his Member State of residence, that interest income should be subject to taxation there at the same rates as those applied to interest earned domestically. The 35% withholding rate will remain also after Switzerland has adopted exchange of information on the OECD standard.
- *Revenue sharing:* Switzerland will share the revenue of the retention tax and will accept the 75/25 division applied within the Community and may even be prepared to reduce the percentage of 25 depending on the "overall balance of the agreement". However the revenue sharing provisions will only apply to the new retention tax and not the existing withholding tax.
- *Voluntary disclosure of information:*
  Review clause stating that "The Contracting Parties shall consult with each other at least every three years or at the request of either Contracting Party with a view to examining and – if deemed necessary by the Contracting Parties – improving the technical functioning of the Agreement. In any event when Belgium, Luxembourg and Austria change from withholding tax to automatic exchange of information, in accordance with the Directive, the Contracting Parties shall consult each other in order to examine if changes to the agreement are necessary taking into account international developments.

Switzerland grants exchange of information on request for all criminal or civil cases of fraud or similar misbehaviour on the part of taxpayers. This part of the agreement may be implemented through bilateral agreements between Member States and Switzerland.

4. The Council agrees that the European Community should enter into similar agreements with Liechtenstein, Monaco, Andorra and San Marino.

5. The Council asks the Commission – in extension of its Council conclusions of 4 June 2002 – to continue negotiations, in close conjunction with the Presidency of the Council, with Switzerland and the other third countries, and to press for the exchange of information as the EU's ultimate objective and to report back to the Council before 2007.

   The Council invites the Commission to enter into discussions during the transitional period as provided for in the Directive with other important financial centres with a view to providing the adoption by those jurisdictions of measures equivalent to those to be applied within the EU.

6. The Council agrees that – in extension to its conclusions of 13 December 2001 – the **directive on the taxation of Savings based on exchange of information as the ultimate objective**, will contain provisions ensuring that:

   - *12 Member States* will implement automatic exchange of information from 1 January 2004, the date of implementation of the directive, and of the agreements with third countries as well as with the dependent or associated territories.

   - *Austria, Belgium and Luxembourg* will from the date of implementation of the directive and of the agreements with third countries as well as with the associated or dependent territories operate a (transitional) withholding tax, with 75/25 revenue sharing and will

   - implement *automatic* exchange of information,

     = if and when the EC enters into an agreement by unanimity in the Council with Switzerland, Liechtenstein, San Marino, Monaco and Andorra to exchange of information *upon request as defined in the OECD agreement*[20] , applying simultaneously the withholding tax rate defined for the corresponding period, for the purposes of the directive ; and,

     = if and when the Council agrees by unanimity that the USA are committed to exchange of information *upon request as defined in the OECD agreement*[1] for the purposes of the directive.

     By the end of the first full fiscal year following the entry into force of that agreement, Austria, Belgium and Luxembourg will cease to apply a withholding tax with revenue sharing,

   - set the withholding tax at 15% during the first three years of the transitional period starting on 1 January 2004, 20% as from 1 January 2007 and 35% as of 1 January 2010.

[20] The OECD Agreement on Exchange of Information on Tax Matters as developed by the OECD global forum working group on effective exchange of information (DAFFE/CFA(2002)24/final).

The Council assesses that sufficient reassurances have been obtained with regard to the application of the same measures applying the same procedures as the 12 Member States or as Austria, Belgium and Luxembourg, in all relevant dependent or associated territories (the Channel Islands, Isle of Man, and the dependent or associated territories in the Caribbean) and asks the Member States concerned to ensure that all relevant dependent or associated territories will apply those measures from the date of implementation of the Directive.

With regard to the Code of Conduct:

7. The Council takes note of the progress achieved by the Code of Conduct Group (Business Taxation) as set out in the report (14812/02 FISC 299).

8. Notes that the descriptions in Annex 1 to this report now form an agreed basis for the evaluation of rollback.

   Asks the Group to consider the proposed revised or replacement measures against the established criteria of the Code of Conduct and report back to Council in March 2003.

9. Agrees that, the Council, in March 2003, assesses all the measures of Member States and of dependent or associated territories listed in Annex C of SN 4901/99 and if any proposal for a revised or replacement measure is considered by the Council to be inadequate to achieve rollback of all the harmful features of a measure, then the Council will seek commitments from the Member States and the dependent or associated territories concerned that additional changes will be implemented as of 1 January 2004.

10. The Council agrees that, at the final adoption of the tax package and in the context of an agreement on the assessment of the results reached on the rollback of the harmful measures, extensions beyond the end of 2005 of benefits of the following measures are granted:

-	Belgium:	Co-ordination Centres,	extension to 31 December 2010,
-	Ireland:	Foreign Income,	extension to 31 December 2010,
-	Luxembourg:	1929 Holding Companies,	extension to 31 December 2010,
-	Netherlands:	International Financing,	extension to 31 December 2010,
-	Portugal:	Madeira's Free Economic Zone,	extension to 31 December 2011.

   At that stage, the Council will also consider the one further request which is being processed.

11. Asks the Group to monitor standstill and the implementation of rollback and report to Council before the end of the year.

With regard to the Directive on Interest and Royalties:

12. The Council confirms the agreement on all pending issues at its meeting on 26 and 27 November 2000 and the revised version of the proposal (8697/01 FISC 82) reflecting the conclusions of this meeting.

13. At the final adoption of the Tax Package the Council will agree that the length of the transitional period for Spain shall be extended to 31 December 2009.

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On that occasion, the following statement was made:

"Austria states that the implementation of an automatic exchange of information requires and the implementation of a withholding tax of 35% might require the modification of the Austrian Constitution. Therefore the agreement of Austria to the relevant provisions in the present conclusions is subject to an approval by the Austrian Parliament."

– ***ENERGY TAXATION AND VAT ADMINISTRATIVE COOPERATION***

The Council decided to postponing the discussion on this two matters at its next session.

ITEMS APPROVED WITHOUT DEBATE

ECOFIN

Special report n° 1/2002 of the Court of Auditors - Council conclusions

"The Council examined with interest the special report No 1/2002 by the Court of Auditors concerning macro-financial assistance (MFA) to third countries and structural adjustment facilities (SAF) in the Mediterranean countries. In total, direct budgetary and balance-of-payments aid in the form of loans and grants under these instruments of a macro-economic nature has reached significant proportions.

The Council welcomes the report and agrees that the Court's remarks on the 6 SAF-programmes and 23 MFA-operations reviewed should be recalled when considering future direct budgetary and balance-of-payments support in the context of MFA, SAF or any other instruments of a similar nature.

The Council notes that although the macro-economic impact which these instruments aim to achieve is similar, they follow different economic and financial principles and rules. Without calling into question the distinction between the provision of macro-financial support for short term financing needs (granted however only under the condition of medium and/or long term structural reforms) and budgetary support for medium term structural adjustment, the Council, in line with the recommendations of the Court of Auditors, sees a need for a more harmonized approach between the different available instruments for financial assistance with macro-economic purposes and for improved transparency and economic monitoring. Therefore, a proper co-ordination in the use of the different available instruments must be ensured to achieve maximum impact on the beneficiaries' economies.

The Council recalls that, in its Conclusions of 8 October 2002, it reviewed the provisions for extending EU macro-financial assistance to third countries and updated the "Genval" criteria applicable to EU macro-financial activities in order, inter alia, to ensure reinforced complementarity with the Bretton Woods Institutions. In line with the recommendations of the Court of Auditors the Council considered that the principles, conditions and implementation modalities for all EU instruments of a macro-economic nature need to be streamlined. The Council also agreed that a number of practical steps should be taken with the aim of improving the efficiency of the current decision-making process for EU macro-financial assistance.

The Council invites the Commission to evaluate the effectiveness of conditionality and assess the contribution of macro-financial assistance to the implementation of the economic and stabilisation programmes in the beneficiary countries, and to report on them in the annual report to the Council and Parliament on the implementation of macro-financial assistance. A similar assessment should be envisaged for the structural adjustment facilities in the Mediterranean countries or any other instruments of a similar nature.

With regard to the specific recommendations by the Court of Auditors, and taking into account the fungible nature of the funds provided, the Council agrees that:

- The design of the actions under both MFA and SAF should be carefully monitored, and should include clear and measurable conditionality consistent with adjustment and reform programmes agreed with the IMF or, where appropriate, the World Bank;
- The value added of the complementary EU contribution and additional conditionality should be clearly defined;
- The financial management capacities of the beneficiary countries should be strengthened and closely monitored;
- The support and assessment of the reform policy in the beneficiary countries should be strengthened by developing guidelines for financial assistance instruments of macroeconomic nature, in particular for untied budget support, with regard to the phases up to and after agreement with the beneficiary countries on the assistance, its objectives, conditionality and performance indicators.

In this context, the Council welcomes the fact that the Commission has taken note of the concrete recommendations of the Court and intends to:
- draft manuals of procedures and provide specific training on these manuals;
- guarantee effective evaluation of the performance indicators associated with implementation;
- ensure, in all cases, that reasons for granting waivers are adequately documented.

The Council invites the Commission to report on the follow-up of these conclusions and to establish the aforementioned guidelines for financial assistance instruments of macro-economic nature, in particular for untied budget support, by mid 2003."

TAXATION

6th VAT Directive - derogation submitted by the Danish and Swedish Governments

The Council adopted a Decision extending the application of Decision 2000/91/EC authorising the Kingdom of Denmark and the Kingdom of Sweden to apply a measure derogating from Article 17 of the Sixth Council Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes *(doc. 15300/02)*.

Excisable products *

Public deliberation

The Council adopted a Common Position with a view to the adoption of a Decision on computerising the movement and surveillance of excisable products *(doc. 15291/02 + COR 1 + ADD1 + 5120/03 ADD1)*.

ECONOMIC EUROPEAN AREA

EEA - employment/ public health

The Council adopted two Decisions for ulterior formal adoption by the EEA Joint Committee. The Decisions create the framework for co-operation and lay down the arrangements for full participation by the EEA-EFTA States in the Community programmes and actions in the relevant fields.

- A Decision aims to amend Protocol 31 to the EEA Agreement in order to extend co-operation in the field of employment, in particular concerning participation in the Community incentive measures in the field of employment *(doc. 14938/02)*.
- A second Decision aims to amend Protocol 31 to the EEA Agreement in order to extend co-operation in the field of public health, in particular concerning participation in the new Community framework programme in the field of public health (2003-2008) *(doc. 15223/02)*.

RELATIONS WITH THE CENTRAL AND EASTERN EUROPEAN COUNTRIES

Steel products from the Slovak Republic, the Czech Republic, Poland and Romania - double-checking system

The Council agreed on the adoption by the relevant Association Councils, by written procedure, of four Decisions concerning exports of certain steel products to the Community. These Decisions, concerning respectively the Slovak Republic *(doc. 2027/02)*, the Czech Republic *(doc. 1739/02)*, Poland *(doc. 1429/02)* and Romania *(doc. 1815/02)*, seek to extend the double-checking system applied to certain steel products, for the period from the dates of entry into force of the Decisions of the respective Association Council up to the dates of accession by the aforementioned countries to the European Union.

The Council also adopted four Regulations concerning respectively the Slovak Republic *(doc. 15164/02)*, the Czech Republic *(doc. 15165/02)*, Poland *(doc. 15162/02)* and Romania *(doc. 15163/02), with a view to* applying the Decisions of the respective Association Councils on the extension of the double-checking system for exports of certain steel products from the four aforementioned countries to the Community.

Lithuania - rules of origin

The Council agreed for the EU-Lithuania Association Council to adopt, by written procedure, a Decision amending Protocol 3 to the EU-Lithuania Agreement on the definition of the concept of "originating products" and methods of administrative co-operation *(doc. 913/02)*. The Decision is a "consolidated" text incorporating all successive amendments to the Protocol since the system introducing pan-European cumulation of rules of origin for the associated countries of Central and Eastern Europe (CCEE) and EFTA and EEA countries was adopted in the first half of 1997. The decision is applicable as from 1 January 2003.

Similar exercises have been and will be carried out for the other CCEE.

EXTERNAL RELATIONS

Mutual recognition agreement with the United States – Suspension of Community obligations

The Council adopted a Decision suspending the Community's obligations following the United States' failure to fulfil its obligations under the annex regarding electrical safety of the EU-US Mutual Recognition Agreement *(doc. 14926/02)*.

The United States has failed to respect the procedures to be followed for the recognition of conformity assessment bodies designated by the Community, resulting in the loss of market access for Community products covered by the annex on electrical safety. The decision requires the Commission to report within three years to the Council on continuing consultations with the United States on this issue.

TRADE

Textile - common rules for imports from third countries

The Council adopted a Regulation amending Regulation (EEC) No 3030/93 on common rules for imports of certain textile products from third countries *(doc. 11570/02)*. Its purpose is to insert changes into the latter Regulation concerning the following issues:

- treatment of samples for trade promotion purposes;
- proof of origin for textile and clothing products;
- safeguard provisions concerning the People's Republic of China.

ENVIRONMENT

Recreational craft

The Council decided to convene, in accordance with the co-decision procedure, the Conciliation Committee with a view to reaching an agreement with the European Parliament on the proposal for a Directive on the approximation of the laws, regulations and administrative provisions of the Member States relating to recreational craft *(doc. 5107/03)*. The meeting is due to take place on 28 February 2003.

The proposal modifies Directive 94/25/EC of 16 June 1994. It aims at covering recreational and personal watercraft, in particular as regards the exhaust, particle and noise emissions produced by their engines with a view to protecting human health and the environment.

It is also seen as an instrument to promote the proper functioning of the internal market, as the harmonisation of national laws in this area is expected to result in the elimination of trade obstacles and of unfair competition between Member States.

Dangerous substances

- *Conciliation Committee*

The Council decided to convene, in accordance with the co-decision procedure, the Conciliation Committee with a view to reaching an agreement with the European Parliament on the proposal for a Directive concerning restrictions on the marketing and use of certain dangerous substances and preparations classified as carcinogenic, mutagenic or toxic to reproduction (also known as "CMR substances") *(doc. 15845/02)*. The meeting is expected to take place on 28 February 2003.

The proposed Directive modifies for the twenty-third time Directive 76/769/EEC on the approximation of Member States laws, regulations and administrative provisions relating to restrictions on the marketing and use of "CMR substances". It adds two new "CMR substances" to those already listed in the appendix to Annex I to Directive 76/769/EEC.

It is recalled that the Council adopted its common position on 3 June 2002.

- *Common position (*Public deliberation)

The Council adopted a common position on the proposal for a Directive modifying for the twenty-fifth time Directive 76/769/EEC on the approximation of Member States laws, regulations and administrative provisions relating to restrictions on the marketing and use of "CMR substances" *(doc. 15703/02)*. In accordance with the co-decision procedure, the common position will be sent to the European Parliament for a second reading.

The proposed Directive adds new substances to those already listed in the appendix to Annex I to Directive 76/769/EEC, in harmony with Commission Directive 2001/59/EC (classification, packaging and labelling of dangerous substances). The proposal adds, in particular, two substances (category 1) and nineteen substances (category 2) newly classified as carcinogenic, five substances (category 2) newly classified as mutagenic, one substance (category 1) and sixteen substances (category 2) newly classified as toxic to reproduction.

The two proposed Directives fall within the Union's overall efforts to improve health protection and consumer safety.

Pollutant Release and Transfer Registers

The Council adopted a Decision on the participation of the Community in negotiations on a legally binding instrument on Pollutant Release and Transfer Registers (PRTRs) under the Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental matters. PRTRs relate to different systems to collect and disseminate data on environmental releases and transfers of toxic chemicals from industrial facilities.

AGRICULTURE

Non commercial movements of pets animals

The Council decided to convene, in accordance with the co-decision procedure, the Conciliation Committee with a view to reach an agreement with the European Parliament on the amended proposal for a Regulation on the animal-health requirements applicable to non-commercial movement of pets animals *(doc.15848/02)*.

The Council adopted a common position on the proposal on 27 June 2002 (7839/02 + ADD1). The European Parliament adopted a list of amendments to the proposal on 22 October 2002 and forwarded this list to the Council on 14 November 2002.

This Regulation lays down common vaccination requirements, principally for dogs and cats.

CUSTOMS UNION

Import duties on weapons and military equipment *

The Council adopted a Regulation suspending import duties on certain weapons and military equipment, aimed at enabling the Member States to procure the most technologically advanced weapons and equipment for their military forces *(doc. 5140/03)*.

The Regulation establishes a list of goods as well as parts and components for fitting or the repair, refurbishment or maintenance of those goods, and goods for use in training and testing, that are eligible for import free of customs duties. Imports of all military equipment not included on the list are subject to the appropriate duties provided for in the Common Customs Tariff. The Regulation will apply from 1 January 2003.

In order to protect confidentiality in the Member States, the Regulation lays down administrative procedures for the granting of the benefit of duty suspension, as well as rules on the provision of information on the quantity and value of goods imported under the new arrangements.

DECISION ADOPTED BY WRITTEN PROCEDURE

HAITI

The Council adopted on 10 January 2003 a Decision amending Council Decision 2001/131/EC of 29 January 2001 concluding the consultation procedure with Haiti under Article 96 of the ACP-EC Partnership Agreement *(doc. 15554/02)* and partially suspending financial aid to Haiti. It extends the validity of the Decision for a further one year up to the 31 December 2003 concluding that democratic principles, essential elements of the ACP-EC Partnership Agreement and the cornerstone of relations between both sides, are still not upheld in Haiti.

The European Union however recognises the international and local efforts being made in search of a solution to the political crisis and reaffirms its wish to support these efforts. It urges the Haitian government to translate the commitments made into concrete actions. The European Union also expresses its worries regarding the socio-economic situation in Haiti and reaffirms its wish to continue co-operation for the benefit of the Haitian people. The Council therefore decided to review the measures as follows: redirection of the remaining funds of the first 8th EDF tranche and provision of the second tranche under the 8th EDF for programmes that are of direct benefit to the Haitian people, to strengthen civil society and the private sector and to support democratisation, the strengthening of the rule of law and the electoral process. A decision on the gradual reactivation of the co-operation instruments affected would be taken on the basis of the advancement of the electoral process and in the light of the resumption of co-operation with the international financial institutions, the Union being ready to review its Decision if there are encouraging developments.

It is recalled that following the general elections in Haiti on 21 May and 9 July 2000, during which the observers' mission of the Organisation of American States noted various irregularities and frauds, the European Union decided on 2 August 2000 to invite the government of Haiti to enter into consultations under Article 96 of the Cotonou Agreement. The consultations were held in Brussels on 26 September 2000. With the Haitian authorities failing to take into account the concerns expressed by the European Union, the Council decided on 29 January 2001 to take appropriate measures with regard to co-operation with Haiti, in particular regarding the non-provision of the second tranche under the 8th EDF, suspension of direct budget aid and redirection of the remaining funds of the first 8th EDF tranche to projects of direct benefit to the Haitian people. A review of the situation by the Commission and the Council took place at the end of 2001. It recognised certain attempts being made although insufficient. The Council thus decided on 21 January 2002 to maintain the measures up to the end of 2002. The decision foresaw however a gradual reactivation of the co-operation instruments affected subject to the achievement of certain objectives as regards the electoral process.