Brussels, 16 June 2014

BACKGROUND[1]
ECONOMIC and FINANCIAL AFFAIRS COUNCIL
Friday 20 June in Luxembourg

Proceedings will begin on Thursday 19 June (13.00) with the annual meeting of the board of governors of the European Stability Mechanism.

*The **Eurogroup** will also meet on Thursday, starting at 15.00.*

On Friday at 9.00, ministers will hold a breakfast meeting to discuss the economic situation. The Council meeting is scheduled to start at 10.00.

*The Council will discuss **country-specific recommendations** to the member states on their economic and fiscal policies. It is expected to endorse a proposal to allow **Lithuania to adopt the euro** as its currency as from 1 January 2015.*

Both the country-specific recommendations and the proposal on Lithuania will be referred to the European Council before decisions are taken.

*The Council is expected to close excessive deficit procedures for **Belgium**, the **Czech Republic**, **Denmark**, the **Netherlands**, **Austria** and **Slovakia**.*

*It will be called on to agree an amendment to EU tax rules to prevent **double non-taxation** for corporate groups with parent companies and subsidiaries in different countries.*

*The Commission will brief the Council on the preparation of implementing legislation on contributions to be paid by banks to resolution funds established under recently-agreed rules on **bank resolution**.*

*The EU's **budget for 2015** is amongst other items on the agenda.*

Press conferences:

- after the ESM board of governors meeting *(Thursday +/-14.30)*;
- after the Eurogroup meeting *(Thursday evening)*;
- at the end of the Council *(Friday lunchtime).*

Press conferences and public deliberations: **http://video.consilium.europa.eu/**
Video coverage: **http://tvnewsroom.consilium.europa.eu**
Photographic library: **www.consilium.europa.eu/photo**

[1] This note has been drawn up under the responsibility of the press office.

EU draft budget for 2015

The Commission will present its draft for the EU's general budget for 2015.

The draft provides for payments totalling EUR 142.1 billion (+ 4.9% compared with the 2014 budget as adopted last year) and commitments at the level of EUR 145.6 billion (+ 2.1%). The detail is as follows:

APPROPRIATIONS BY HEADING	billion EUR		% change from 2014	
	COMMITMENTS	PAYMENTS	COMMITMENTS	PAYMENTS
1. Smart and inclusive growth:	66.7	67.2	+4.2	+7.7
a) Competitiveness	*17.4*	*15.6*	*+5.8*	*+36.2*
b) Cohesion	*49.2*	*51.6*	*+3.6*	*+1.3*
2. Sustainable growth: natural resources:	59.3	56.9	+0.0	+0.8
of which market related expenditure and direct aids	*43.9*	*43.9*	*+0.3*	*+0.3*
of which rural development, environment and fisheries	*15.3*	*12.9*	*-0.8*	*+2.7*
3. Security and citizenship:	2.1	1.9	-1.9	+12.2
4. Global Europe	8.4	7.3	+1.1	+18.3
5. Administrative expenditure (for all EU institutions):	8.6	8.6	+2.5	+2.5
Special instruments	0.5	0.2	+13.0	-35.7
Total appropriations	145.6	142.1	+2.1	+4.9
In % of EU-28 GNI	1.04	1.02		

The Council established its priorities for the 2015 budget in conclusions adopted at its meeting on 18 February (*doc. 5852/14*). These will be used by the incoming Italian presidency as the basis for negotiations with the European Parliament and the Commission later in the year.

In its conclusions, the Council emphasised the need to maintain budgetary discipline at all levels, given that, despite an improvement of the economic outlook, many member states continue to face considerable budget constraints. It called for a balance to be struck between fiscal consolidation and investments to boost growth, to be achieved through the prioritisation of objectives and the allocation of resources to measures that contribute the most to those aims.

The Council is expected to agree its position on the draft budget in July and formally adopt its position early September, before the Parliament will vote on its position in late October. If their positions diverge, a three-week conciliation process will start on 28 October.

Company taxation - Parent-subsidiary directive

The Council will be called on to agree an amendment to EU tax rules in order to prevent the double non-taxation of corporate groups deriving from hybrid loan arrangements[2] (*doc.* *10419/14*).

The aim is to close a loophole that currently allows corporate groups to exploit mismatches between national tax rules so as to avoid paying taxes on some types of profits distributed within the group.

The proposal was discussed by the Council on 6 May, though concerns were raised by Malta and Sweden that prevented them from agreeing the text. Sweden has since indicated that it could lift its reservation, given that the Commission would be willing to provide assurances about application of the amending directive. Malta however still objects to wording that it views as implying an obligation to tax.

The proposed amendment to the EU's parent-subsidiary directive[3] would enable member states to avoid losses in tax revenues from corporate groups. Furthermore, it would help create a level playing field between groups with parent companies and subsidiaries located in different countries and those that have all entities based in a single member state.

If agreed, the amending directive would be split from a broader proposal in order to allow early adoption of the new rule on hybrid loans, whilst allowing work to continue on another aspect, namely the introduction of a common anti-abuse provision.

The European Council in December called for rapid progress on the proposal as part of on-going efforts at both EU and global levels to counter tax fraud and tax evasion, aggressive tax planning and tax base erosion and profit shifting.

The parent-subsidiary directive is intended to ensure that profits made by cross-border groups are not taxed twice, and that such groups are thereby not put at a disadvantage compared to domestic groups. It requires member states to exempt from taxation profits received by parent companies from their subsidiaries in other member states.

However, this currently applies even if profit distribution is treated as a tax-deductible payment in the country where the paying subsidiary is based. Some member states classify payments from hybrid loan arrangements as tax deductible "debt".

The amending directive would prevent cross-border companies from planning their intra-group payments in such a manner as to benefit from this provision in order to enjoy double non-taxation. The member state of the parent company would henceforth refrain from taxing profits from the subsidiary, but only to the extent that such profits are not tax deductible for the subsidiary.

Member states would have until 31 December 2015 to transpose the amending provision into national law.

Based on article 115 of the Treaty on the Functioning of the European Union, the proposal requires unanimity for adoption by the Council.

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[2] Hybrid loan arrangements are financial instruments that have characteristics of both debt and equity.

[3] Directive 2011/96/EU

Bank resolution - Contributions by banks

The Commission, under "other business", will brief the Council on the preparation of implementing legislation that will determine the contributions to be paid by banks to resolution funds[4] established under a recently-agreed directive on bank recovery and resolution directive (BRRD) and a draft regulation on the single resolution mechanism (SRM).

Under the new rules, banks will have to make annual contributions; these will be calculated on the basis of their liabilities, excluding own funds and covered deposits, and adjusted for risk. The Commission is due to adopt a delegated act and a proposal for an implementing act according to article 94(7) of the BRRD and article 66(3a) of the SRM regulation, respectively. These acts will specify how to calculate banks' contributions, in particular how to account for risk and what the ratio should be between the flat rate, i.e. that which all banks must pay, and the risk-adjusted rate.

In a recent letter to the President of the Council, commissioner Michel Barnier confirmed the Commission's commitment to concluding its work on the two acts in September.

Once it has done so, the delegated act will enter into force only if no objection has been expressed by the European Parliament or by the Council within three months (extendable by a further three months at the initiative of the Parliament or the Council). It can however enter into force earlier than that if both institutions inform the Commission that they will not object. As for the implementing act, it will be adopted by the Council on the basis of a proposal by the Commission.

The Commission is already consulting with member states and the Parliament to ensure that the delegated act can enter into force rapidly once adopted.

The directive on bank recovery and resolution was adopted by the Council on 6 May. Member states have until 31 December 2014 to transpose it into national law[5]. The SRM regulation is scheduled for adoption by the Council in early July and publication in the Official Journal in mid-July. The regulation will be applicable from 1 January 2016[6].

Country-specific recommendations on economic and fiscal policies

The Council is due to approve, under this year's *European Semester*:

- draft recommendations to 26 member states[7] on the economic policies set out in their national reform programmes, including draft opinions on the fiscal policies set out in their stability/convergence programmes; and
- a specific draft recommendation on the economic policies of the member states of the euro area.

The texts will be forwarded to the General Affairs Council on 24 June, with a view to endorsement by the European Council meeting on 26 and 27 June. Similar preparations will be made by the Employment, Social Policy, Health and Consumer Affairs Council on 19 June as concerns the member states' employment policies, and the whole package is due to be adopted in July.

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[4] The single resolution fund for member states participating in the banking union; national funds in other EU countries.

[5] See press release *9510/14*.

[6] See press release *8273/14*.

[7] All except Cyprus and Greece, which are subject to macroeconomic adjustment programmes. To avoid duplication, there are no country-specific recommendations for these two countries.

The *European Semester* is an annual process that involves simultaneous monitoring of the member states' economic and fiscal policies.

In the light of policy guidance given by the European Council annually in March, the member states present each year in April:

- national reform programmes, setting out a macroeconomic scenario for the medium term, national targets for implementing the "Europe 2020" strategy for jobs and growth, identification of the main obstacles to growth, and measures for concentrating growth-enhancing initiatives in an early period;
- stability or convergence programmes[8], setting out medium-term budgetary objectives, the main assumptions about expected economic developments, a description of fiscal and economic policy measures, and an analysis of how changes in assumptions will affect fiscal and debt positions.

The Council then approves country-specific recommendations and opinions and, after endorsement by the European Council annually in June, these are adopted each year in July. The Council provides explanations in cases where the recommendations do not comply with those proposed by the Commission.

Based respectively on articles 121(2) and 148(4) of the Treaty on the Functioning of the European Union, the recommendations and opinions require a qualified majority for adoption by the Council.

Excessive deficit procedure

- **Closure of procedures: Belgium, Czech Republic, Denmark, Netherlands, Austria and Slovakia**

The Council will be called on to adopt decisions closing the excessive deficit procedures for Belgium, the Czech Republic, Denmark, the Netherlands, Austria and Slovakia. It will thereby confirm that these countries have reduced their deficits below 3% of GDP, the EU's reference value for government deficits.

The decisions will be adopted under article 126(12) of the Treaty on the Functioning of the European Union. They will abrogate decisions the Council took in December 2009 and July 2010, under article 126(6) of the treaty, on the existence of excessive deficits in the six countries.

As a consequence, 11 of the EU's 28 member states will remain subject to the excessive deficit procedure, down from 24 during a 12 month period in 2010-11.

A large number of procedures were opened subsequent to the global financial crisis and recession of 2008 and 2009, and the Council's recommendations under the excessive deficit procedure have set out to support a return by governments to sound fiscal positions.

[8] Euro area member states present stability programmes, those member states that don't use the euro present convergence programmes.

Belgium

Belgium has been subject to an excessive deficit procedure since December 2009, when a deficit amounting to 5.9% of GDP was planned for 2009 and its general government gross debt was expected to reach 97.6 % of GDP.

The Council issued a recommendation calling for the deficit to be corrected by 2012.

In January 2012, the Commission estimated that Belgium's deficit would reach 2.9% of GDP that year. In May 2013 however, it found Belgium to have run a deficit totalling 3.9% of GDP in 2012, thus missing the deadline set by the Council.

This was partly due to the recapitalisation of the Dexia banking group at the end of 2012, which had an impact of 0.8% of GDP on the government deficit, but even without this the 2012 deadline would have been missed.

Consequently in June 2013 the Council stepped up the excessive deficit procedure, adopting a decision, under article 126(8) of the Treaty on the Functioning of the European Union, establishing that Belgium had not taken effective action in response to its December 2009 recommendation. It also adopted a decision, under article 126(9) of the TFEU, giving notice to Belgium to take measures to correct the deficit in 2013.

The Council called on Belgium to reduce its headline deficit to 2.7% of GDP in 2013, consistent with an improvement in the structural balance of 1% of GDP in 2013. It required Belgium to fully implement consolidation measures foreseen in its 2013 budget, to take additional measures of a structural nature to achieve the recommended structural effort for that year, and to stand ready to adopt further measures if necessary.

According to Eurostat, Belgium's general government deficit amounted to 2.6 % of GDP in 2013, in line with the Council's June 2013 decision. The improvement was driven by significant fiscal consolidation, as well as an improvement in cyclical conditions.

On the basis of a no-policy-change scenario, the Commission's spring economic forecast projects deficits of 2.6 % of GDP also in 2014, and 2.8 % of GDP in 2015, thus remaining below the 3 % of GDP reference value over the forecast horizon.

Belgium's debt-to-GDP ratio rose by about five percentage points between 2009 and 2013, reaching 101.5%, in part due to its financial assistance to other eurozone countries. Its gross government debt is forecast to remain around this level in 2014 and 2015.

The Council will be called on to conclude that Belgium's deficit has been corrected.

Czech Republic

The Czech Republic has subject to an excessive deficit procedure since December 2009, when it planned a deficit for 2009 amounting to 6,6 % of GDP.

The Council issued a recommendation calling for an average annual budgetary effort of at least 1 % of GDP over the 2010-13 period, in order to bring the deficit below 3 % of GDP by 2013.

According to Eurostat, the Czech Republic's general government deficit amounted to 1.5 % of GDP in 2013, in line with the Council's recommendation.

On the basis of a no-policy-change scenario, the Commission's spring economic forecast projects deficits of 1.9 % of GDP in 2014 and 2.4 % of GDP in 2015, thus remaining below the 3 % of GDP reference value over the forecast horizon.

The Czech Republic's debt-to-GDP ratio increased by 11.5 percentage points between 2009 and 2013, reaching 46 %. The Commission projects the general government gross debt to fall to 44.4 % of GDP in 2014 and to increase to 45.8 % of GDP in 2015, remaining below the EU's 60 % of GDP reference value.

The Council will be called on to conclude that the Czech Republic's deficit has been corrected.

Denmark

Denmark has been subject to an excessive deficit procedure since July 2010, when it planned a deficit for 2010 amounting to 5,4 % of GDP.

The Council issued a recommendation calling for an average annual budgetary effort of at least ½ % of GDP over the 2011-13 period, in order to bring the deficit below 3 % of GDP by 2013.

According to Eurostat, Denmark's general government deficit was below the 3 % of GDP reference value during the 2010-13 period, except in 2012 when it was negatively affected by a one-off reimbursement related to a pension reform in 2011, estimated to be equivalent to 1.6 % of GDP. Denmark's deficit amounted to 2.5 % of GDP in 2010, 1.9 % of GDP in 2011, 3.8 % of GDP in 2012 and 0.8 % of GDP in 2013.

The Commission's spring economic forecast projects deficits of 1.2 % of GDP in 2014 and 2.7 % of GDP in 2015, thus remaining below the 3 % of GDP reference value over the forecast horizon.

The Commission projects Denmark's general government gross debt to decrease to 43.5 % of GDP in 2014 and to increase to 44.9 % of GDP in 2015, remaining below the EU's 60 % of GDP reference value.

The Council will be called on to conclude that Denmark's deficit has been corrected.

Netherlands

The Netherlands have been subject to an excessive deficit procedure since December 2009, when a deficit amounting to 4.8% of GDP was planned for 2009.

The Council issued a recommendation calling for the deficit to be corrected by 2013.

In June 2013 however, it agreed to extend the deadline for correcting the deficit by one year, finding the Netherlands to have fulfilled the conditions for doing so.

The Council set headline deficit targets of 3.6% of GDP for 2013 and 2.8% of GDP for 2014, consistent with 0.6% and 0.7% of GDP improvements in the structural balance respectively. It called on the Netherlands to bring the deficit below 3 % of GDP by 2014.

According to Eurostat, the Netherlands' general government deficit amounted to 2.5 % of GDP in 2013, dropping below the 3 % of GDP reference value a year earlier than required by the Council's most recent recommendation.

The Commission's spring economic forecast projects deficits of 2.8 % of GDP in 2014 and 1.8 % of GDP in 2015, remaining below 3 % of GDP over the forecast horizon.

The Netherlands' debt-to-GDP ratio was planned to reach 59.7 % of GDP in 2009. It increased by about ten percentage points between 2010 and 2013, reaching 73.5 %. The Commission projects the general government gross debt to increase further to 73.8 % of GDP in 2014 and to decrease to 73.4 % of GDP in 2015.

The Council will be called on to conclude that the Netherlands's deficit has been corrected.

Austria

Austria has been subject to an excessive deficit procedure since December 2009, when a deficit amounting to 3.9 % of GDP was planned for 2009 and its general government gross debt was expected to reach 68.2 % of GDP.

The Council issued a recommendation calling for an average annual budgetary effort of at least ¾ % of GDP over the 2009-11 period, in order to bring the deficit below 3 % of GDP by 2013.

After peaking at 4.5 % of GDP in 2010, Austria's general government deficit amounted to less than 3 % of GDP in 2011 and 2012, but the Commission didn't recommend closure of the excessive deficit procedure because of looming risks related to financial sector repair operations. However, those risks have not materialised and Austria has notified the Commission of a deficit amounting to 1.5 % of GDP for 2013.

The Commission's spring economic forecast projects deficits of 2.8 % of GDP in 2014 and 1.5 % of GDP in 2015, remaining below 3 % of GDP over the forecast horizon.

Austria's debt-to-GDP ratio rose from 69.2 % to 74.5 % between 2009 and 2013. The Commission projects its gross government debt to increase to around 80 % of GDP in 2014, mainly due to the inclusion of liabilities incurred in connection with impaired assets of the Hypo Alpe Adria banking group.

The Council will be called on to conclude that Austria's deficit has been corrected.

Slovakia

Slovakia has been subject to an excessive deficit procedure since December 2009, when it planned a deficit for 2009 amounting to 6.3 % of GDP.

The Council issued a recommendation calling for an average annual budgetary effort of 1 % of its GDP over the 2010-13 period, in order to bring the deficit below 3 % of GDP by 2013.

According to Eurostat, Slovakia's general government deficit amounted to 2.8 % of GDP in 2013, in line with the Council's recommendation.

The Commission's spring economic forecast projects the deficit to increase to 2.9 % of GDP in 2014 and to return to 2.8 % of GDP in 2015, remaining below 3 % of GDP over the forecast horizon.

Slovakia's general government debt reached 55.4 % of GDP in 2013 and the Commission projects it to increase to 56.3 % of GDP in 2014 and 57.8 % of GDP in 2015, remaining below the EU's 60 % of GDP reference value.

The Council will be called on to conclude that Slovakia's deficit has been corrected.

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The decisions will require:

- for Belgium, the Netherlands, Austria and Slovakia (eurozone countries), a qualified majority amongst 17 of the 18 member states of the euro area;
- for the Czech Republic and Denmark (non-eurozone countries), a qualified majority amongst 27 of the 28 member states of the EU.

The member state concerned does not vote.

Excessive deficit procedure - Methodology for the assessment of "effective action"

The Council is expected to endorse terms of reference following a review of the methodology used under the EU's excessive deficit procedure for assessing "effective action" taken by member states in response to Council recommendations.

Under the excessive deficit procedure, the Council makes recommendations to member states whose general government deficit exceeds 3 % of GDP or whose general government debt is higher than 60 % of GDP and not diminishing at a satisfactory pace, with a view to correcting the deficit.

The instruments and methods that the Commission uses when assessing whether a member state has complied with the Council's recommendations have been reviewed. Improvements have sought, amongst other things, to improve transparency.

To this end, all relevant data used by the Commission, including data on the yields of discretionary fiscal measures, will be shared with the member states in a timely manner, enabling them to replicate the calculation underlying the Commission's assessments and recommendations in the context of the excessive deficit procedure.

The revised methodology will from now on be used by the Commission when assessing whether action taken by a member state can be deemed "effective action".

Enlargement of the euro area – Lithuania

The Commission and the European Central Bank will present reports assessing the readiness of eight member states to adopt the euro.

In the light of these reports, the eurozone countries (meeting within the Council) are expected to adopt a recommendation approving a proposal that would enable Lithuania to become the 19th member of the euro area.

The proposal will be referred to the European Council for discussion and to the European Parliament for an opinion before a decision is taken. If so agreed, Lithuania would adopt the euro as its currency on 1 January 2015.

Every two years[9], the Commission and the ECB issue reports assessing the fulfilment of convergence criteria by non-eurozone member states that have a derogation under the EU's economic and monetary union (EMU).

Of the ten member states that continue to use their own national currencies, eight have an EMU derogation, which implies that they have not yet fulfilled the conditions for adopting the euro. These are Bulgaria, the Czech Republic, Croatia, Lithuania, Hungary, Poland, Romania and Sweden. The other two – Denmark and the United Kingdom – are exempted from adopting the euro.

The Commission and ECB reports assess the compatibility of the eight countries' legislation with EU treaty provisions and with the statute of the European system of central banks. The reports examine their progress in fulfilling the convergence criteria – namely price stability, the government's budgetary position, exchange rate stability and long-term interest rates – and several other requirements that are a precondition for joining the euro.

As concerns Lithuania, the Council is expected to share the Commission's assessment that it has achieved a high degree of sustainable convergence and fulfils all the necessary conditions for adopting the euro as its currency.

This is the second time that Lithuania's accession to the euro area has been considered. In 2006, the Commission found that, despite meeting the criteria on public finances, exchange rate stability and long-term interest rates, Lithuania did not yet meet the criterion on price stability.

The reports and proposals are based on article 140 of the Treaty on the Functioning of the European Union, which requires a qualified majority of euro area member states for a decision by the Council.

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[9] Or when there is a specific request from a member state to assess its readiness to join the euro area.

Other issues

Over breakfast, ministers will discuss the **economic situation**.

Under "other business":

- the Commission will brief the Council on the preparation of implementing legislation on contributions to be paid by banks to resolution funds established under recently-agreed rules on **bank resolution** (see separate item above);
- the Council will take stock of on-going work on legislative dossiers.

Without discussion, the Council is expected to approve:

- a six-monthly report to the European Council on **tax issues** and a report on tax issues by finance ministers of countries participating in the *Euro Plus Pact*[10];
- conclusions on implementation of a code of conduct aimed at eliminating situations of **harmful tax competition**, in the light of a six-monthly report;
- conclusions and a report on progress on a draft directive aimed at introducing a **standard VAT return** (*doc.* *10276/14*);
- a report on progress on a draft directive on the **taxation of energy** products and electricity (*doc.* *10417/14*).

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[10] Concluded in March 2011 by 23 of the 27 member states, the *Euro Plus Pact* is aimed at strengthening economic policy coordination with a view to improving competitiveness and enabling a greater degree of convergence.