Council of the European Union

PRESS
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BACKGROUND[1]
Brussels, 1 December 2017

ECONOMIC AND FINANCIAL AFFAIRS COUNCIL
Tuesday 5 December in Brussels

Ministers will hold a breakfast meeting, starting at 9.00, to discuss the ***economic situation****. They will also discuss the annual report of the* ***European Fiscal Board****, a newly created advisory body that assesses implementation of the EU's fiscal rules. The Council is scheduled to start at 10.00.*

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The Council will be called on to approve an ***EU list of non-cooperative jurisdictions*** *in taxation matters, aimed at preventing tax fraud and promoting good governance worldwide.*

It is expected to adopt conclusions on the taxation of profits in the ***digital economy****, with a view to discussions at international level. Proposals related to* ***electronic commerce****, making it easier for online businesses to comply with VAT obligations, are also scheduled for adoption.*

Ministers will take note of progress on work aimed at reducing risk in the ***banking industry*** *and on a proposed* ***European deposit insurance scheme****. They will be informed of developments with regard to* ***non-performing loans*** *in the banking sector.*

The Council is due to close the excessive deficit procedure for the ***United Kingdom****. It is expected to find that* ***Romania*** *has failed to take effective action to correct a significant budgetary deviation, and to issue a revised recommendation under the 'significant deviation procedure'.*

The 2018 ***European Semester*** *is amongst other items on the agenda.*

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The ***Eurogroup*** *will hold two meetings on Monday 4 December. The first will start at 13.00 and the second is scheduled for 18.00, in an extended format (27 member states), to prepare for the Euro Summit on 15 December.*

The Eurogroup will be called on to elect a new president. It will discuss the ongoing third review of Greece's macroeconomic adjustment programme, post-programme surveillance in Cyprus and Spain, and the member states' draft budgetary plans for 2018. It will hold a thematic discussion on the 'tax wedge' on labour. In extended format, the Eurogroup will discuss the further development of the EU's economic and monetary union.

Press conferences:

- after the first Eurogroup meeting *(Monday afternoon)*;
- after the second Eurogroup meeting *(Monday evening)*;
- at the end of the Council *(Tuesday afternoon).*

Eurogroup agenda highlights

Press conferences and public events by video streaming

Video coverage in broadcast quality (MPEG4) and photo gallery

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

Banking union - Risk reduction measures - Non-performing loans

The Council will take note of progress on:

- a package of measures aimed at reducing risk in the banking industry;
- a proposal for a European deposit insurance scheme (EDIS).

The banking package sets out to strengthen the EU's rules on capital requirements and on the recovery and resolution of banks in difficulty. The EDIS proposal is part of plans for strengthening the EU's banking union.

Furthermore, the Commission will report on work to implement the Council's July 2017 action plan on non-performing loans (NPLs) in the banking sector.

- November 2017 presidency note on EDIS, the banking package and NPLs

Reducing risk

Presented in November 2016, the proposed package builds on EU banking rules with the aim of reducing risk in the industry.

Progress has been achieved on the package, and preliminary agreement has been reached on a broad range of issues. The presidency has prepared compromise proposals on all of the main elements. A number of political issues remain to be resolved, however, and these are identified in a progress report.

Implementing reforms agreed at the international level following the 2007-08 financial crisis, the package is aimed at ensuring that any outstanding challenges to financial stability are correctly addressed.

It incorporates into EU law remaining elements of a regulatory framework agreed by the Basel Committee on Banking Supervision and the Financial Stability Board (FSB).

The package covers:

- bank capital requirements (amendments to regulation 575/2013 and directive 2013/36/EU on the activities and supervision of banking institutions);
- the recovery and resolution of banks in difficulty (amendments to directive 2014/59/EU on bank recovery and resolution and regulation 806/2014 on the EU's single resolution mechanism).

The proposals on bank capital requirements include a binding leverage ratio to prevent banks from excessively increasing leverage, and a binding net stable funding ratio. They establish more risk-sensitive capital requirements for banks that trade largely in securities and derivatives. And global systemically important institutions ('G-SIIs') would be required to have more loss-absorbing and recapitalisation capacity in case of resolution.

The proposal on bank recovery and resolution sets out to implement the FSB's November 2015 'total loss-absorbing capacity' (TLAC) standard. It integrates the TLAC requirement into the EU's 'minimum requirement for own funds and eligible liabiltiies' (MREL) rules, in order to avoid duplication in two parallel requirements. Whereas the TLAC standard covers G-SIIs, the MREL covers the entire EU banking industry; the proposal therefore addresses this and other differences between the two.

The proposal on the single resolution mechanism (SRM) integrates the TLAC into the MREL under the SRM regulation.

Two other elements of the package were fast-tracked during 2017 and already await adoption by the European Parliament and the Council. These relate to the ranking of unsecured debt instruments in insolvency proceedings and a phase-in of the regulatory capital impact of the IFRS 9 international accounting standard.

- November 2017 progress report on the banking package
- November 2017 press release on bank creditor hierarchy, IFRS 9/large exposures rules
- Basel Committee on Banking Supervision
- Financial Stability Board

European deposit insurance scheme

Presented in November 2015, the EDIS proposal is aimed at establishing an EU-level insurance scheme to strengthen the protection of bank deposits.

A progress report assesses the outcome of work within the Council working group. It is intended to facilitate further work during 2018.

Whereas deposit guarantee schemes provide protection at national level in the event of bank failure, they remain vulnerable to local shocks. In remedying this, EDIS is foreseen as a third ‘pillar’ of the EU’s banking union, alongside the single supervisory mechanism for the banking sector and the single resolution mechanism for unviable banks.

According to the Commission's original proposal, EDIS would be established in three stages.

In June 2016, the Council agreed that negotiations at political level would start as soon as progress has been made on measures to reduce risk in the financial sector (see sub-item above).

Since June 2017, the Council working group has met three times to discuss the proposal. Work was of a technical nature because political discussions were held off pending sufficient progress on reducing risk.

To address diverging views, the Commission made some suggestions in a communication issued in October 2017.

It suggested a more gradual introduction of EDIS, with only two phases:

- during a more limited reinsurance phase than in its original proposal, EDIS would provide liquidity coverage to national deposit guarantee schemes (DGSs). It would temporarily provide the means for full pay-outs in the event of bank being in crisis. National DGSs would pay back this support, ensuring that any losses would continue to be covered at national level;
- during a coinsurance phase, EDIS would also progressively cover losses.

- November 2017 progress report on the EDIS proposal (14808/17)
- October 2017 Commission communication on completing the banking union
- June 2016 Council conclusions on a roadmap to complete the banking union

Non-performing loans

The Commission is preparing a package of measures to implement the Council's July 2017 action plan on NPLs.

The aim is to reduce levels of NPLs and to prevent their build-up in the future.

Non-performing loans are bank loans that are subject to late repayment or are unlikely to be repaid without requiring the sale of collateral.

High NPL levels can drag heavily on investment, and hence on the economy. A legacy of the financial crisis, they remain at historically high levels within the EU.

In July 2017, the Council approved an action plan in the light of a report prepared by a sub-group of the Council's financial services committee (FSC). The group, established to look into the problem, recommended a mix of policy actions at national and European level.

On 4 October, the ECB launched a public consultation on an addendum to its guidance on NPLs. The new guidance provides for measures that are stricter than the Council's action plan.

On 24 November, the European Banking Authority published a report showing progress made by EU banks in cleaning up their balance sheets.

The report shows overall NPL levels to have dropped from nearly €1 trillion at the end of 2016 to €893 billion. The ratio of NPLs in proportion to total bank loans has decreased from 5.4% in June 2016 to 4.5%. However, the ratio remains above 10% in around one third of member states, and there are large variations between countries and between sectors.

In its July 2017 conclusions, the Council highlighted the need for action as regards:

- bank supervision;
- the reform of insolvency and debt recovery frameworks;
- the development of secondary markets for NPLs ('distressed assets');
- restructuring of the banking industry.

The Commission's package of measures includes:

- a 'blueprint' for national asset management companies;
- legislative measures to facilitate the development of secondary markets for NPLs and enable creditors to recover value from secured loans;
- a report on the feasibility of a legislative proposal to introduce statutory prudential backstops against the under-provisioning of new NPLs;
- a suggested way forward to foster transparency on NPLs.

The Commission plans to approve the measures in spring 2018. The Council is expected to take stock at a meeting on 23 January.

- Press release on 2017 Council action plan on non-performing loans
- 2017 report of the FSC subgroup on non-performing loans

Background

All the proposed regulations and directives require a qualified majority for adoption by the Council, in agreement with the European Parliament. (Legal basis: articles 53(1) and 114 of the Treaty on the Functioning of the European Union.)

An ad hoc Council working group was established in January 2016 to examine all issues related to the strengthening of the EU's banking union. In June 2016, the Council adopted conclusions setting out priorities and milestones for further work.

The banking union is aimed at placing Europe's banking industry on a sounder footing, whilst ensuring that unviable banks are resolved without recourse to taxpayers' money. Launched in 2012 to address the bank-sovereign nexus in Europe, it involves a transfer of responsibility to the EU level. It currently comprises the 19 countries of the euro area, whilst 7 other member states have also indicated their intention to join.

Taxation - Non-cooperative jurisdictions

The Council will be called on to approve an EU list of non-cooperative jurisdictions in taxation matters.

Part of the EU's external strategy for taxation, the list is intended to contribute to ongoing efforts to prevent tax fraud and promote good governance worldwide. Work has been conducted in parallel with the OECD global forum on transparency and exchange of information for tax purposes.

Work on the list started in July 2016 within the Council's working group responsible for implementing an EU code of conduct on business taxation.

In November 2016 the Council agreed on the process to be followed, setting the end of 2017 as a deadline for finalising the list.

It laid down criteria for screening third country jurisdictions, namely:

- criteria that a jurisdiction should fulfil to be considered compliant on tax transparency;
- criteria that a jurisdiction should fulfil to be considered compliant on fair taxation;
- criteria related to implementation of anti-BEPS (tax base erosion and profit shifting) measures agreed by the OECD.

Since then, the working group has overseen a 'screening' that included a technical dialogue with a number of third country jurisdictions. The screening enabled the situation in those jurisdictions to be determined with regard to the EU's criteria.

In the light of the outcome of that screening, the group has prepared draft Council conclusions. Annexes to the draft conclusions contain the draft EU list and measures envisaged with regard to jurisdictions on the list.

- November 2016 conclusions on the establishment of a list of non-cooperative jurisdictions
- Code of conduct group on business taxation
- OECD webpage on BEPS

Stability and Growth Pact - Romania and the United Kingdom

Decisions are expected under the Stability and Growth Pact, the EU’s fiscal rulebook.

The Council is due to:

- close the excessive deficit procedure for the United Kingdom, under the corrective arm of the Pact;
- find that Romania has failed to take effective action to correct a significant fiscal deviation, issuing a revised recommendation under the ‘significant deviation procedure’.

As concerns the UK, the Council will abrogate its 2008 decision on the existence of an excessive deficit. The UK has reduced its government deficit below 3% of GDP – the EU's reference value for government deficits – and the Council's decision will acknowledge this.

As a result, only two of the EU's 28 member states (France and Spain) will remain subject to excessive deficit procedures. This continues an improvement observed since 2010-11 when, during a 12-month period, procedures were open for 24 member states.

United Kingdom

The UK has been subject to an excessive deficit procedure since July 2008, when the Council called for its deficit to be corrected by the 2009-10 financial year.

The 2008 economic downturn, however, as well as stimulus measures adopted in response to the downturn, led to a substantial deterioration in the UK's budgetary position.

In April 2009, the Council extended the deadline for correcting the deficit by four years, to the 2013-14 financial year. In December 2009 it extended it by an additional year, to 2014-15, in the light unexpected adverse events. The contraction in economic activity in the UK had worsened to 3.3% of GDP, and the projected government deficit had been revised upwards to 13% of GDP for 2009-10.

In June 2015, the Council granted the UK a further two years to correct its deficit. It recommended headline deficit targets of 4.1% of GDP in 2015-16 and 2.7% of GDP in 2016-17, consistent with an improvement in the structural balance of 0.5% of GDP in 2015-16 and 1.1% in 2016-17.

Over the period, the Council found twice, in April 2009 and June 2015, that the UK had not taken effective action in response to its recommendations. But as the UK is not in the eurozone, fines couldn't be imposed.

The Council is expected to find that the UK has now met the recommended deficit targets. After peaking at 10% of GDP in 2009-10, its nominal general government deficit has followed a steadily declining trend. The deficit fell to 4% of GDP in 2015-16 and 2.3% of GDP in 2016-17, in line with the Council's June 2015 recommendation. Fiscal consolidation has been largely expenditure-based.

In its autumn 2017 economic forecast, the Commission projects deficits of 2.5% of GDP in 2017-18, 1.8% of GDP in 2018-19 and 1.3% of GDP in 2019-20, on the basis of a no-policy-change assumption. The UK's deficit is therefore set to remain below the 3% of GDP reference value over the forecast horizon.

The autumn 2017 forecast estimates the UK's structural balance to have improved by 3.2% of GDP between 2008-09 and 2016-17.

General government gross debt ratio has increased significantly. From 41% of GDP in 2007-08, it increased to 86.8% of GDP in 2016-17, reflecting higher nominal deficits as well as financial sector interventions during this period. But according to the autumn 2017 forecast, the debt-to-GDP ratio is expected to have peaked in 2016-17 and to decrease to 82.9% of GDP in 2019-20.

The Council is expected to conclude that the UK's deficit has been corrected and that its July 2008 decision should therefore be abrogated.

- 2017 draft decision abrogating the 2008 decision on an excessive deficit in the UK

Romania

In July 2017, the Council issued a recommendation to Romania under the EU's 'significant deviation procedure'.

The significant deviation procedure is part of the preventive arm of the Stability and Growth Pact, the EU's fiscal rulebook.

The Council found a significant deviation in 2016 from the adjustment path set towards Romania's medium-term budgetary objective. The country's structural balance had deteriorated from a position above -1% of GDP – its medium-term objective – to -2.6% of GDP. And a 2.0% of GDP deviation was observed in relation to the expenditure benchmark set under the Pact's preventive arm.

The Council recommended measures to ensure a nominal growth of net primary government expenditure of no more than 3.3% in 2017, representing an annual structural adjustment of 0.5% of GDP. It set a deadline of 15 October 2017 for Romania to report on action taken.

In a report submitted on 13 October 2017, the Romanian authorities set a headline deficit of 3% of GDP as their target for 2017.

In the light of the Commission's autumn 2017 economic forecast, Romania's structural balance is expected to deteriorate by 1.1% of GDP in 2017. This is contrary to the 0.5% of GDP structural improvement recommended by the Council, and will generate a deficit of 3.3% of GDP in 2017. And the growth of net primary government expenditure has amounted to 4.9% of GDP, well above the expenditure benchmark of 3.3% set by the Council.

The Council is expected to call for measures ensuring a nominal growth of net primary government expenditure of no more than 3.3% in 2018, representing an annual structural adjustment of at least 0.8% of GDP. It will recommend that any windfall gains be used for deficit reduction, and that budgetary consolidation measures secure a lasting improvement in the general government structural balance.

It will set a 15 April 2018 deadline for Romania to report on action taken in response to its revised recommendation.

- November 2017 draft decision on Romania under the significant deviation procedure
- November 2017 draft recommendation to Romania on a significant deviation procedure

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The decisions and recommendations require a qualified majority amongst 27 of the EU's 28 member states. The member state concerned does not vote.

(Legal bases: article 121(4) of the Treaty on the Functioning of the European Union for the decision and recommendation to Romania; article 126(12) TFEU for the decisions on the UK.)

Economic governance - 2018 European Semester

The Council will initiate the annual 'European Semester' process for the monitoring of the member states' economic, employment and fiscal policies.

The Commission will present three documents:

- an annual growth survey, highlighting the main conclusions for 2018;
- an 'alert mechanism report', marking the starting point of the annual macroeconomic imbalances procedure;
- a draft Council recommendation on the economic policies of the euro area.

The Council will hold an exchange of views.

It is scheduled to approve the recommendation and conclusions on the two reports at a meeting on 23 January 2018.

The 2018 European Semester will conclude in July with the adoption of country-specific recommendations.

Annual growth survey

The Commission's survey is the starting point of the 2018 European Semester. It outlines the most pressing priorities on which the EU and the member states should focus in the economic and social field.

For 2018, the Commission calls on member states to continue efforts along the lines of the previous annual growth survey:

- boosting investment;
- pursuing structural reforms;
- ensuring responsible fiscal policies.

The report notes that Europe's economy is strengthening. Growth is up, surpassing expectations; unemployment is down, investment is recovering and public finances are improving. In both the EU28 and the euro area, the economy has grown over the past 18 quarters. The recovery has now reached all member states.

This momentum presents the EU with a window of opportunity for strengthening economic and social convergence. Nearly 19 million people are still without a job, investment levels are still too low, wage growth is subdued, slack persists on the labour market, and core inflation is forecast to stay low. In some member states, high debt levels remain a drag on growth.

The Commission sees scope for supporting a continuation of the recovery. Structural reforms can create the conditions for boosting investment and increasing real wage growth in support of domestic demand, supporting internal and external rebalancing in the euro area. Fiscal policies should strike the appropriate balance between ensuring sustainability, in particular reducing debt ratios where they are high, and supporting the economic recovery. And the economic crisis underscored the importance of strengthening the structure of the EU's economic and monetary union.

The 2018 annual growth survey also focuses on the EU's 'pillar of social rights' endorsed at a November 2017 informal meeting of EU heads of state and government in Gothenburg.

- 2018 annual growth survey
- November 2017 press release on the European pillar of social rights

Alert mechanism report

The Commission's report identifies 12 member states that may have a macroeconomic imbalance. For these, it will present in-depth reviews in February 2018.

The 12 figure amongst 13 countries identified under the previous European Semester. They are Bulgaria, Croatia, Cyprus, France, Germany, Ireland, Italy, the Netherlands, Portugal, Slovenia, Spain and Sweden.

They do not include Greece, which is subject to enhanced surveillance under a macroeconomic adjustment programme. The 13th member state (Finland) exited the macroeconomic imbalances procedure in February 2017.

Macroeconomic imbalances risk hindering the smooth functioning of the European economy and the EU's monetary union. They were amongst factors that contributed to the sovereign debt crisis in the euro area.

The macroeconomic imbalances procedure was introduced in 2011 as an annual process aimed at preventing and correcting such imbalances. Fines can be imposed on eurozone countries if they repeatedly fail to comply with the Council's recommendations.

To identify imbalances, the Commission applies the following "scoreboard" of economic indicators:

- External imbalances and competitiveness: current account balance; net international investment position; real effective exchange rate; export market share; nominal unit labour cost index.
- Internal imbalances: house price index; private sector credit flow; private sector debt; general government gross debt; unemployment rate; total financial sector liabilities.
- Employment indicators: activity rate; long-term unemployment rate; youth unemployment rate.

- 2018 alert mechanism report

Recommendation on the economic policies of the euro area

This annual recommendation is a key part of the European Semester. It enables a focus on eurozone priorities when preparing country-specific recommendations in the spring.

In its draft, the Commission recommends a broadly neutral fiscal stance and a balanced policy mix. This will enable a balance between ensuring sustainable public finances and supporting the economic recovery.

The draft recommendation calls for policies to support sustainable and inclusive growth, and improve resilience, rebalancing and convergence. Member states with current account deficits or high external debt should aim at containing growth in unit labour costs. Those with large current account surpluses should promote wage growth, foster investment and support domestic demand.

As regards labour markets, the Commission recommends reforms to promote the creation of quality jobs, equal opportunities, access to the labour market and fair working conditions. It recommends reforms to support social protection and inclusion, and to shift taxes away from labour, particularly for low-income and second earners.

The Commission calls for work to press ahead in completing the EU's banking union, in relation to both the sharing of risk and reducing risk. It calls for swift progress on completing the EU's economic and monetary union.

The Employment, Social Policy, Health and Consumer Affairs Council will approve contributions on the social and employment aspects of the recommendation at a meeting on 7 and 8 December 2017. The Economic and Financial Affairs Council is due to approve the economic and financial aspects on 23 January 2018.

- 2018 draft recommendation on the economic policies of the euro area

Taxation of the digital economy

The Council is expected to adopt, without discussion, conclusions on the taxation of profits in the 'digital economy'.

The conclusions will serve both as the EU's contribution to discussions at international level and a reference for further work at EU level.

Current tax rules were designed for the traditional economy and do not apply to activities that require no physical presence in the country where goods and services are sold. As a result, businesses active in the digital economy are perceived not to pay their fair share of taxes in all countries where they are active.

For the time being there is no agreement at international level on how to respond to such challenges. The OECD is analysing business models of the digital economy and preparing a report to the G20, scheduled for April 2018. Some EU member states are already taking unilateral measures to address the problem, which could however create double taxation disputes and distortions within the EU's single market.

The presidency launched a discussion at EU level on the challenges for taxation of the digital economy in July 2017. In September, ministers discussed the issue at an informal meeting in Tallinn.

The Commission issued a communication in September 2017 outlining the challenges and possible solutions. It also announced a legislative proposal for spring 2018.

The challenges of the digital economy were discussed at an EU summit on digital issues held in Tallinn in September 2017. In October, the European Council highlighted the need for an effective and fair system of taxation for the digital era.

The draft Council conclusions note that the digital economy is challenging the agreed concepts of international tax rules. This leads in certain situations to a misalignment between where profits are taxable and where value is created.

The draft highlights the urgency of agreeing on a policy response at international level. It suggests that an "appropriate nexus" be explored in the form of a virtual permanent establishment, together with amendments to the rules on transfer pricing and profit attribution. The draft calls for close cooperation in this process between the EU, the OECD and other international partners.

As concerns action at EU level, it notes the interest of many member states for temporary measures, for instance an 'equalisation levy' based on revenues from digital activities. The draft calls on the Commission to thoroughly assess these measures.

- September 2017 Commission communication on taxation of the digital economy

VAT on electronic commerce

The Council is expected to adopt, without discussion, new rules aimed at making it easier for online businesses to comply with VAT obligations.

Part of the EU's 'digital single market' strategy, the proposals are aimed at facilitating the collection of VAT for goods and services bought online.

In October 2017, the European Council called for the digital single market to be prioritised and for "an effective and fair taxation system fit for the digital era".

At the Council's meeting on 7 November 2017, a presidency proposal received broad support though one member state still had reservations.

All remaining issues have now been resolved.

The new rules extend an existing EU-wide portal (mini 'one-stop shop') for the VAT registration of distance sales. And they establish a new portal for distance sales from third countries with a value below €150. This will reduce the costs of complying with VAT requirements for business-to-consumer transactions.

VAT will be paid in the member state of the consumer, ensuring a fairer distribution of tax revenues amongst member states.

Some measures are aimed at preventing VAT fraud, which for distance sales is estimated at €5 billion per year.

Additionally, the drafts make online platforms liable for collecting VAT on the distance sales that they facilitate. This was not foreseen in the Commission's proposals, but has become an essential provision of the package. Most goods that are imported for distance sales currently enter the EU VAT-free, resulting in unfair competition for EU businesses.

The Council requires unanimity to adopt the package (a directive and two regulations), after consulting the European Parliament. (Legal basis: article 113 of the Treaty on the Functioning of the European Union.) The Parliament gave its opinion in November 2017.

- November 2017 draft directive on VAT obligations for services and distance sales of goods (14126/17)
- November 2017 draft regulation on implementing measures for the common VAT system (14127/17)
- November 2017 draft regulation on VAT administrative cooperation and combating fraud (14128/17)

Other items

The Council will discuss the following under 'other business':

- **Financial services**: Ministers will be updated regarding work on legislative proposals;
  - November 2017 note on financial services legislative proposals
- **VAT fraud**: The Commission will present a proposal aimed at strengthening administrative cooperation in order to boost the prevention of VAT fraud;
  - November 2017 press release on preventing VAT fraud
- **European Development Bank**: The European Investment Bank will inform ministers of its initiative to establish a subsidiary dedicated to development.

Without discussion, the Council is expected to approve:

- conclusions on the **taxation of the digital economy** (see separate item above);
- new rules on **VAT on electronic commerce** (see separate item above);
- conclusions on implementation of directive 2008/118/EC on **excise duties**, providing guidance to the Commission for a possible forthcoming legislative proposal;
- conclusions and a six-monthly report on implementation of a code of conduct aimed at eliminating situations of **harmful tax competition**;
    - November 2017 report of the code of conduct group on business taxation
    - November 2017 draft conclusions on the code of conduct on business taxation
- a six-monthly report to the European Council on **tax issues**;
    - November 2017 report to the European Council on tax issues