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**COMMISSION STAFF WORKING DOCUMENT**

**Assessment of the 2013 national reform programme and convergence programme for  
UNITED KINGDOM**

*Accompanying the document*

**Recommendation for a COUNCIL RECOMMENDATION**

**on United Kingdom's 2013 national reform programme and delivering a Council  
Opinion on United Kingdom's convergence programme for 2012-2017**

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## EXECUTIVE SUMMARY

### Economic Outlook

**The UK has experienced a subdued and stuttering recovery from the financial crisis.** In 2012 as a whole the economy grew at a meagre 0.3%, after recovering from a double dip recession in the first half of the year. The Commission's spring 2013 forecast predicts GDP growth of 0.6% in 2013 and 1.7% in 2014. Unemployment, which has been relatively low given the weakness of GDP, is projected to remain relatively stable, at around 8.0% in 2013. Inflation, which peaked at 5.2% in September 2011, is set to average at 2.8% in 2013, before falling back through 2014 to 2.5%.

**Progress in reducing the fiscal deficit stalled in 2012-13 in a context of weak GDP growth, although the UK government has stuck to its fiscal consolidation strategy.** According to the Commission's spring 2013 forecast, the headline budget deficit is expected to be 6.9% of GDP in 2013-14 and 6.1% in 2014-15. The average annual structural effort (excluding one-off and temporary measures) made by the UK since 2010-11 is 1.1% of GDP a year, which is lower than the 1.34% recommended by the EU and will be insufficient to correct the excessive deficit by the 2014-15 deadline. Meanwhile, government debt has been increasing steadily for more than a decade, with the Commission predicting an increase to 98.7% of GDP by 2014-15 (up from 90.7% in 2012-13).

### Key Issues

**In the last year, the UK government has made significant progress in designing and legislating for an extensive reform agenda in financial regulation, spatial planning, education and welfare.** The reforms are relevant and ambitious in their stated aims, but in most cases, it is not yet fully clear how effective they will be. Indicators on housing, access to finance and infrastructure have been either stagnant or deteriorating, linked in large part to the challenging economic environment.

**In the short to medium term, the UK faces considerable challenges and tensions in reconciling needs for deleveraging, maintaining financial stability and avoiding compromising investment and growth.** Fiscal consolidation remains a pressing challenge for the UK, and needs to be balanced with fairness and growth-promoting investment. To provide the conditions for sustainable, investment- and export-led growth, the UK also needs to address the economy's structural weaknesses, including a lack of housing supply, skills gaps, and the need to renew and upgrade transport and energy infrastructure. These and other shortcomings also contribute to the UK's consistently weak net export position. The current account deficit grew to 3.7% of GDP in 2012 and the UK has a large goods trade deficit (-6.9% of GDP).

- **Public finances:** While the UK government has continued to implement its fiscal consolidation strategy, the deficit is now expected to fall more slowly than previously envisaged, due to weaker medium-term growth prospects, while government debt is on the rise. The UK deficit for 2013-14 is forecast to be 6.9% of GDP, one of the highest in the EU. Total public investment remains low, following sharp cuts in 2011, and the UK has a challenge to correct its excessive deficit while achieving differentiated, growth-friendly fiscal tightening and structural reforms. In this context, the potential revenue contribution from tax reforms, for example extending the standard VAT rate, remains relatively under-exploited.

- **Private debt and housing:** Household and corporate debt is relatively high (206% of GDP at the end of 2011, above the euro area average of 164%) and has been identified by the Commission as a macroeconomic imbalance. At the same time there is not enough housing to meet the demands of a growing population and to help bring down house prices relative to incomes, and the level of residential construction remains low.
- **Unemployment and skills:** Unemployment stood at 7.8% at the start of 2013, but youth unemployment is considerably higher at 20.7%. There are too many low-skilled workers, for whom demand is falling, and a shortage of workers with high-quality vocational and technical skills. This is a particular problem amongst the young, where the numbers of early school leavers and those not in employment, education or training (NEET) are high.
- **Welfare reform and childcare:** At 17.3%, the proportion of UK children living in workless households is the second-highest in the EU, which has a significant impact on child poverty. A lack of access to suitable, affordable childcare still discourages many parents from working, or from increasing the number of hours they work. In 2011, 22.7% of the population was at risk of poverty, slightly below the EU average. The UK Government aims to increase employment through welfare reform measures, such as Universal Credit, which will provide clearer work-incentives, but successful implementation and monitoring will be essential.
- **Access to finance and the banking sector:** Net lending to the corporate sector remained negative in 2012 and corporate investment is very low (gross fixed capital formation fell to 14.2% of GDP in 2012). While larger firms with strong balance sheets are able to borrow at a historically low cost, many other firms, particularly SMEs, are having difficulty accessing credit, and there are signs of less-than-viable companies being kept in business through low interest rates and bank forbearance. Access to non-bank lending remains largely restricted to bigger firms, and competition in the banking industry is still limited.
- **Energy and transport infrastructure:** The UK needs substantial investment in new electricity generation capacity by 2020, and has a low share of energy from renewable sources (only 3.8% in 2011). Shortcomings in transport networks are a problem for the whole economy, especially goods producers, distributors and exporters, and there is a significant gap between investment needs and committed funding. The costs of transport infrastructure construction and maintenance also remain high in the UK.

## 1. INTRODUCTION

In May 2012, the Commission proposed a set of country-specific recommendations (CSRs) for economic and structural reform policies for the United Kingdom. On the basis of these recommendations, the Council of the European Union adopted six CSRs in the form of a Council Recommendation in July 2012. These CSRs concerned growth-friendly fiscal consolidation, housing, youth employment, education and training, welfare reform and childcare, access to finance and infrastructure. This Staff Working Document (SWD) assesses the state of implementation of these recommendations in the UK.

The SWD assesses policy measures in light of the findings of the Commission's Annual Growth Survey 2013 (AGS)<sup>1</sup> and the second annual Alert Mechanism Report (AMR)<sup>2</sup>, which were published in November 2012. The AGS sets out the Commission's proposals for building the necessary common understanding about the priorities for action at national and EU level in 2013. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth-friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising public administration. The AMR serves as an initial screening device to determine whether macroeconomic imbalances exist or risk emerging in Member States. The AMR found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a complete and durable rebalancing is achieved, the UK and 12 other Member States were selected for a review of developments in the accumulation and unwinding of imbalances<sup>3</sup>.

Against the background of the 2012 Council Recommendation, the AGS and the AMR, the UK presented updates of her national reform programme (NRP) and of her convergence programme on 30 April 2013. These programmes provide detailed information on progress made since July 2012 and on the future plans of the government. The information contained in these programmes provides the basis for the assessment made in this Staff Working Document.

The NRP and the convergence programme outline in an integrated manner the UK's fiscal consolidation efforts, key structural reforms and reforms that underpin macroeconomic stabilisation. The NRP does not include the national targets envisaged under the Europe 2020 framework, except for the target on renewable energy, in line with Directive 2009/28/EC. Instead, it describes indicators of performance in areas connected to the Europe 2020 headline targets and records their current level<sup>4</sup>. The lack of quantitative targets makes it difficult to assess reforms, in particular whether policy efforts are adequate and whether they will be implemented promptly enough.

The policy content of the UK NRP and convergence programme is drawn exclusively from previous announcements and publications, mainly the Autumn Statement 2012, Budget 2013, and the Office for Budget Responsibility's (OBR) Economic and fiscal outlook, as well as other publicly available documents and data. In parliamentary debates on the convergence

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<sup>1</sup> COM (2012) 750 final

<sup>2</sup> COM (2012) 751 final

<sup>3</sup> SWD (2013) 125 final. 13 in-depth reviews were published on 10 April 2013. While selected for an in-depth review in the AMR, Cyprus was ultimately not reviewed under the Macroeconomic Imbalance Procedure in view of the advanced preparations for a financial assistance programme

<sup>4</sup> As regards social inclusion, last year's NRP referred to numerical targets of the Child Poverty Strategy 2011. There is no such reference in this year's NRP

programme, the government underlined that it contained no new information and that no additional costs were incurred. The government defended its decision not to fully align the convergence programme with guidance provided by the Commission, noting timetable constraints related to the UK financial year and Budget.

Stakeholder engagement events were held in Scotland and Wales, attended by representatives of the UK government, the European Commission, devolved administrations and other stakeholders. However, there is no evidence of significant stakeholder input in the development of the NRP itself. Since the NRP draws on publicly available information, it is not subject to formal consultation. The NRP is illustrated with examples of how stakeholders are involved in the delivery of policies. The UK NRP includes information on the policy programmes of the devolved administrations in addition to UK-level information. As in previous years, the Scottish Government also submitted a separate NRP to set out its policy strategy in more detail.

The House of Commons debated the country-specific recommendations addressed to the UK on 25 June 2012. The convergence programme was approved by the UK Parliament following debates in the House of Commons and the House of Lords. The 2013 NRP has not been debated by Parliament. The House of Lords EU Committee has asked that the NRP be covered in the annual debate on the convergence programme, but the government has rejected this on the basis that there is no legal obligation and no precedent. The House of Commons European Scrutiny Committee and the House of Lords debated the AGS.

### ***Overall assessment***

The analysis in this SWD leads to the conclusion that the UK has made some progress on measures taken to address the CSRs of the Council Recommendation. To date, these reforms have only been partially implemented and progress in improving relevant outcomes has been limited.

While the UK government has stuck to its fiscal consolidation strategy, progress in reducing the structural deficit has stalled in 2012-13 in a context of weak GDP growth. The UK deficit for 2013-14 is forecast to be 6.9%, one of the highest in the EU. Fiscal consolidation therefore remains a pressing challenge for the UK, and needs to be balanced with fairness and growth-promoting investment.

The challenges identified in July 2012 and reflected in the AGS remain valid. To provide the conditions for sustainable, investment-led growth, the UK needs to both maintain macroeconomic stability and succeed in reforms to address the UK economy's structural weaknesses.

The policy plans submitted by the United Kingdom address almost all the challenges identified in last year's Staff Working Document, and broad coherence between the two programmes has been ensured. The national reform programme confirms the United Kingdom's commitment to address shortcomings in the areas of the financial sector and the labour market. The NRP sets out the significant progress the government has made in designing and legislating for an extensive reform agenda across financial regulation, spatial planning, education and welfare. The reforms are relevant and ambitious in their stated aims, but in most cases it is not yet clear how far they are likely to be effective in addressing difficult challenges. Successful implementation will be key and many of the impacts will be gradual. To date, indicators related to the CSRs on housing, access to finance and infrastructure show stagnant or deteriorating investment. These trends are largely linked to the challenging economic environment, but in the cases of capital investment and welfare reform, other government spending cuts run counter to the stated aim of headline policy initiatives.

Necessary reforms to secure financial stability are also constraining access to credit. Employment has been surprisingly resilient, but skills gaps remain. Working age poverty rates could increase due to real terms benefit cuts.

The convergence programme demonstrates the United Kingdom's commitment to improving the budgetary position and ensuring the long-run sustainability of public finances.

## **2. ECONOMIC DEVELOPMENTS AND CHALLENGES**

### **2.1. Recent economic developments and outlook**

#### ***Recent economic developments***

The UK has experienced a subdued and stuttering recovery from the financial crisis. As of the first quarter of 2013, the level of real UK GDP was nearly 3 % below the pre-crisis peak five years earlier in the first quarter of 2008 (real per capita GDP is approximately 6 % lower). Over the course of 2012, the picture for growth in the UK was bleak, and the economy entered recession in the first half of the year. Growth was markedly volatile, with an extra bank holiday in the second quarter of the year being offset by the boost from the London Olympics contributing to growth of +0.9 % in the third quarter. This was followed by negative growth of -0.3 % in the final quarter of 2012 but the UK avoided a ‘triple dip’ recession by posting growth of 0.3 % in the first quarter of 2013. Overall, the UK economy is suffering from a lack of investment and extremely weak exports coupled with quite resilient imports. The UK’s net investment income also fell sharply in 2012. Growth in 2012 came entirely from domestic demand, namely, household consumption, with some help from government expenditure. Investment growth showed positive signs in the first half of the year but this petered out in the second half, when annual growth was positive, but very weak.

The government’s on-going fiscal consolidation plan continues to attract much focus as despite an adherence to departmental expenditure limits (DELs), borrowing has not fallen by as much as expected, linked in part to weaker growth. Consequently, the fiscal deficit remains high. Tax receipts over 2012 were less buoyant than anticipated, and there was higher spending from the part of government spending that allows the automatic stabilisers to operate, Annually Managed Expenditure (AME).

Inflation has generally been on a downward trend since September 2011, when it peaked at 5.2 %, but in recent months, the trend has been reversed. Inflation was 2.8 % in both February and March 2013, up from 2.7 % in each of the previous four months and 2.2 % in September 2012. However, the increase in October was due to a rise in university tuition fees in England, and utility prices kept inflation from falling in December. Increases in utility prices were also the main source of the further rise in inflation in early 2013. Higher inflation curtails household consumption and increases inflation-linked government expenditure items, thereby leading to rises in AME. Inflation has now been above the Bank of England’s target of 2 % continuously for three years, implying negative real interest rates on 10-year government bonds.

Unemployment has been falling in each quarter since the end of 2011, when it peaked at 8.3 %, to reach 7.8 % in early 2013<sup>5</sup>. Overall, the rate of unemployment for 2012 was 7.9 %. The strength of the labour market has been surprising, given the weakness in GDP. It can be explained partly by a strong rise in self-employment and part-time work, and also under-employment. Labour hoarding is less likely to be the cause the longer this phenomenon continues although the lower price of labour relative to the price of capital may play a role. Nominal wage growth was weak throughout 2012, with stubbornly high inflation, so real wage growth remained negative.

Productivity growth has been very weak in the UK since the start of the financial crisis. As well as weak investment, there is evidence of a lack of the economic restructuring needed to

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<sup>5</sup> November 2012 – January 2013, Eurostat definition. On the national definition unemployment was 7.9 % in December 2012 – February 2013



foster competition and innovation in the economy, and it is important that this does not become entrenched.

### ***Economic outlook***

According to the 2013 Commission spring forecast, UK GDP growth is forecast at 0.6% in 2013 and 1.7% in 2014. Private consumption and investment should improve gradually over the year, into 2014, as uncertainty fades and credit constraints ease further. Inflation is set to remain high through 2013, averaging 2.8%, before falling back through 2014 to 2.5%. The fall in inflation is likely to occur later and to be smaller than previously forecast, due mainly to higher utility prices. Private consumption is forecast to grow by 0.8% and 1.3%, and investment is expected to rise by 1.8% and 4.5% in 2013 and 2014 respectively. Net exports are not expected to contribute positively to growth in 2013, as growth in the UK's main export markets remains weak. Net exports are expected to contribute 0.4pp. to GDP growth in 2014, with UK exports expanding at a modest rate as economic activity in the UK's main trading partners picks up and the value of sterling remains low. Unemployment may have bottomed out and it is expected to remain relatively stable over the forecast horizon, averaging 8.0% in 2013 and 7.9% in 2014.

The Commission's estimates for overall GDP growth are similar to those of the Office for Budget Responsibility (OBR) outlined in the Convergence Programme (0.6% and 1.8% for 2013 and 2014 respectively). The Commission's forecast of the expected drivers of growth is similar to that of the OBR, although in 2013 the Commission forecasts a slightly larger contribution from private consumption, and a smaller contribution from investment.

The UK NRP does not directly quantify the likely impact of structural reforms on economic growth. The macroeconomic scenario in the NRP is based on the forecast produced by the independent OBR, which does incorporate the OBR's assessment of the likely impact of government policies on growth<sup>6</sup>. The OBR has tended to note the upside potential of the government's structural reform agenda on growth, but has been cautious about changing its growth forecast significantly until the impact of reforms is seen in the data. The government has an extensive reform agenda across financial regulation, spatial planning, education and welfare, which is relevant and ambitious in its stated aims, but in most cases, it is not yet fully clear how effective the reforms will be. As headline indicators related to the CSRs on housing, access to finance and infrastructure are either stagnant or deteriorating, the approach that the OBR has taken is appropriate.

## **2.2. Challenges**

**The UK faces tensions between a need for deleveraging, maintaining financial stability, and the need to avoid compromising investment and growth.** In the short to medium term, fiscal consolidation needs to be balanced with fairness and growth-promoting investment. To provide the conditions for sustainable, investment- and export-led growth, the UK also needs to address the economy's structural weaknesses, including a lack of housing supply, a persistently weak net export position, skills gaps, and a need to renew and upgrade transport and energy infrastructure.

**Fiscal consolidation remains a priority for the UK.** Government debt as a percentage of GDP rose from 56.2% in 2008-09<sup>7</sup> to 90.7% in 2012-13<sup>8</sup>. The government is implementing a fiscal consolidation plan that has reduced the deficit from 11.5% in 2009-10 to 5.6% in 2012-

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<sup>6</sup> See for example Office for Budget Responsibility (2013), *Economic and Fiscal Outlook, March 2013*

<sup>7</sup> 20xx-xx refers to the financial year which starts on 1 April and ends on 31 March

<sup>8</sup> Eurostat-validated EDP data

13, although the 2012-13 deficit would have been approximately 7.6% without one-off revenues. The one-offs are a transfer of the Royal Mail pension fund worth 1.8pp. of GDP, and the sale of the 4G mobile phone licence spectrum. While the UK government has stuck to its fiscal consolidation strategy, the structural deficit only improved by 0.3 pp. between 2011-12 and 2012-13. The deficit is now expected to fall more slowly than previously envisaged, due to weaker medium-term growth prospects. The deficit is forecast at 6.9% in 2013-14 and 6.1% in 2014-15. Total public investment remains low, following sharp cuts in 2011, and the UK has a challenge to achieve differentiated, growth-friendly fiscal tightening.

**Corporate debt remains quite high, but investment is low, and many firms are having difficulty accessing adequate funding for investment.** Total private debt stood at 206% of GDP at the end of 2011, above the euro area average of 164%. The stock of UK corporate debt is rather high yet some firms are having difficulty accessing credit and business investment remains at very low levels. An unprecedented drop in business investment after 2007 caused gross fixed capital formation to fall to 14.2% of GDP in 2012. This is the third lowest level in the EU-27. More specifically, the UK has a low level of business expenditure on R&D, which fell from 1.17% of GDP in 2001 to 1.09% in 2011<sup>9</sup>. Business investment has started to pick up slightly, with an annual increase of 4.9% in 2012, but remains low. Net lending to the corporate sector remained negative in 2012. While larger firms with strong balance sheets are able to borrow at a historically low cost, and there are signs of less-than-viable companies being kept in business through low interest rates and bank forbearance, many other firms, particularly SMEs, are having difficulty accessing credit. Access to non-bank lending remains largely restricted to bigger firms, and competition in the banking industry is still limited.

**There is a continued challenge to deliver the housing that people need, and to ensure that the housing market and household debt are not a source of macroeconomic instability.** As set out in Box 1, the high level of household debt constitutes an internal imbalance in the UK economy. Household deleveraging continued in 2012, but it may not be sustained once the economy improves and housing transactions return to more normal levels, given that house prices remain high in the context of a housing shortage and low levels of residential construction.

**The UK's persistently weak net export position reflects a lack of external competitiveness.** The UK's current account position saw a gradual and structural deterioration from the late 1990s until the onset of the financial crisis. A large goods trade deficit persisted despite the depreciation of sterling in 2008, and the net trade outturn for 2012 was surprisingly poor, driven by weaker net exports and a fall in net investment income. As set out in Box 1, while some rebalancing of the economy towards external demand is forecast over the next few years, to make sustained improvements to its goods trade balance, the UK needs to do more to successfully confront structural challenges in the areas of transport infrastructure, skills and access to finance.

**The UK has significant unemployment and underemployment, especially among the young.** Unemployment stood at 7.8% at the start of 2013<sup>10</sup> and is expected to remain broadly flat through 2012 and 2013. Youth unemployment, at 20.7%<sup>11</sup>, and the NEETS rate, 14.0%<sup>12</sup>, are much higher. Growth in private sector employment was surprisingly strong in the last

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<sup>9</sup> Eurostat (2013). Provisional figure

<sup>10</sup> November 2012 – January 2013, Eurostat definition

<sup>11</sup> Eurostat data, 2012 Q4

<sup>12</sup> Eurostat data, 2012 Q4

year, given the weakness of GDP growth. Productivity and real wages have remained weak. Many people, especially young workers, are in precarious part-time or temporary jobs. Long-term unemployment was 2.8% of the working-age population in Q4 2012<sup>13</sup>.

**The UK also faces on-going challenges to improve access to high quality, affordable childcare, to increase parental employment and to combat poverty.** At 17.3%<sup>14</sup> the proportion of UK children living in workless households is the second highest in the EU. A lack of access to suitable, affordable childcare still discourages many parents from working, or from increasing the number of hours they work. It is likely that poverty among those of working age will increase in coming years, due to cuts in the real value of benefits.

**The UK has too many low-skilled workers, and a shortage of workers with high-quality vocational and technical skills.** Despite some progress in recent years, a significant minority of young people continue to leave secondary education without the skills and qualifications they need to compete successfully in the labour market. Early school leaving remains slightly above the EU average. Vocational education and training policy has been too focused on basic skills and relatively low-level qualifications, while the economy increasingly demands more advanced qualifications.

**The UK needs to renew and upgrade its energy and transport infrastructure.** The UK needs substantial investment in new electricity generation capacity by 2020, and has a low share of energy from renewable sources. Regulatory certainty will be required to facilitate adequate and timely investment. Shortcomings in the capacity and quality of the UK's transport networks are a structural problem for the economy, especially for goods producers, distributors and exporters. There is currently a significant gap between committed funding, public and private, and the pipeline of transport investment needs. Unit costs in transport construction and maintenance also remain high in the UK. The UK also has a challenge ahead if it is to deliver additional hub airport capacity.

#### **Box 1. Summary of the 2013 in-depth review (IDR) under the Macroeconomic Imbalances Procedure (MIP)**

The second in-depth review of the UK economy concluded that the UK is experiencing macroeconomic imbalances, which deserve monitoring and policy action. In particular, macroeconomic developments in the areas of household debt, linked to the high levels of mortgage debt and the characteristics of the housing market, as well as unfavourable developments in external competitiveness, especially as regards goods exports and weak productivity growth, continue to deserve attention.

The main findings of the review were the following:

- The UK is confronted with the twin challenge of sustaining pre-crisis dynamism in service exports and boosting the underlying drivers of productivity in the industrial sectors to regain the external competitiveness that was partly eroded in the pre-crisis years. The UK experienced a large drop in export market shares from 2007 to 2010 and the trade balance has been negative since 1997, mainly as a result of a chronic deficit in goods trade. Nevertheless, export volumes have been a modest net driver of growth in the UK economy in the crisis period. External performance in 2012 was worse than anticipated, driven by weaker net exports and a fall in net investment income. The current account is, however, expected to move towards a more balanced position in the medium term.

<sup>13</sup> Eurostat definition, 2012 Q4

<sup>14</sup> Children aged 0-17 years living in jobless households, Eurostat definition

- Many of the drivers of the UK's persistent trade deficit relate to structural weaknesses that have a disproportionate impact on capital-intensive sectors and goods producers. As regards transport infrastructure, there is evidence of shortages in airport and seaport capacity. Road congestion is a problem, and there are identified investment needs in the rail network. As regards technical skills, evidence suggests that gaps and recruitment difficulties persist in manufacturing sectors. Finally, access to finance is crucial for UK firms seeking to enter or expand in exporting sectors. Difficulties in accessing finance are a cross-cutting problem at present, particularly for smaller and younger companies.
- The UK faces tensions between the needs for deleveraging, maintaining financial stability and the need to avoid compromising investment and growth. Household debt is currently falling, largely due to low levels of new mortgage lending, but it is likely to remain at a high level. Low interest rates and forbearance mask risks associated with a minority of over-indebted households. The stock of UK corporate debt is quite high and there are signs of less-than-viable companies being kept in business through low interest rates and bank forbearance, while other firms are having difficulty accessing adequate funding for investment.
- A shortage of housing in the UK increases the risk of persistent imbalances related to high house prices and household debt. There have been attempts to liberalise the spatial planning laws but the planning system continues to be an important constraint on the supply of housing, including through tight restrictions on development in many parts of the country. The UK property tax system combines a regressive recurring tax (Council Tax) with a progressive transaction tax (Stamp Duty Land Tax). Council Tax is based on outdated valuations and undeveloped land with planning permission is not currently subject to recurrent taxes. This system may not provide adequate incentives to release land and properties onto the market in a timely way. Most tenants do still not see long-term private renting as an attractive option, and rental contracts do not typically offer much security. The preference for home ownership increases the pressure on households to take on high levels of mortgage debt.

### 3. ASSESSMENT OF POLICY AGENDA

#### 3.1. Fiscal policy and taxation

##### *Budgetary developments and debt dynamics*

The UK is continuing to implement its fiscal consolidation programme, which is designed to have the cyclically-adjusted current balance in balance by the end of a five-year rolling period, currently ending in 2017-18. This fiscal mandate is supplemented by a debt target whereby the rate as a percentage of GDP should be falling by 2015-16. The UK does not set an explicit medium term objective (MTO) in its convergence programme, but its fiscal framework, set up in 2010, is a step towards compliance with the Stability and Convergence Programmes (SCP) code of conduct, as it is designed to bring the fiscal position close to balance over the medium term.

The improvement in the headline balance foreseen in the 2012-13 convergence programme, which covers the period 2011-12 to 2017-18, is insufficient for correcting the excessive deficit by the deadline set by the Council on 2 December 2009. The programme, based on forecasts carried out by the UK's OBR, envisages an average improvement of approximately 0.9 pp per annum over the six-year period. The programme projects that the excessive deficit procedure (EDP) deadline set by the Council on 2 December 2009 of 2014-15 would be missed by three years and estimates a deficit of 6.0% of GDP in the deadline year. The convergence programme envisages that the deficit will fall

below 3 % only in 2017-18, three years after the deadline previously recommended by the Council. On its current estimates, the deficit would fall to 5.2 % in 2015-16, 3.5 % in 2016-17 and 2.3 % in 2017-18.

**The planned deficit path is less favourable in the 2012-13 convergence programme than it was in the 2011-12 programme.** The difference between the deficit forecasts of the two programmes is accounted for by certain classification changes, one-off measures and a lower GDP forecast. Growth had been estimated at 0.8 % in 2012, 2.0 % in 2013 and 2.7 % in 2014. These numbers were revised to 0.2 %<sup>15</sup>, 0.6 % and 1.8 %, respectively.

**The improvement in the structural balance foreseen in the 2012-13 convergence programme is also lower than what was recommended by the Council on 2 December 2009.** The Council recommended an annual average improvement in the structural balance<sup>16</sup> of 1¾ % of GDP to the UK between 2010-11 and 2014-15. By contrast, the adjusted fiscal effort undertaken so far since the opening of the EDP (i.e. the three-year period between 2010-11 and 2012-13) averaged at just 1.0 % of GDP per annum. The UK's nominal deficits imply an annual average structural effort of 0.7 % over the final two years of the deadline to 2014-15.<sup>17</sup>

**In the Autumn Statement, published in December 2012, the government announced fiscally neutral measures over the current parliamentary period (to 2015-16) with increases in capital spending being offset by decreases in current expenditure.** A subsequent year of fiscal consolidation to 2017-18 was also added, following the previous addition of extra years. The main spending measures introduced in the Autumn Statement were a GBP 5.5 billion (EUR 6.5 billion) capital package and support for long-term private investment to fund new roads, science infrastructure and free schools, funded by savings from welfare and departmental expenditure cuts, the creation of a Business Bank to allocate GBP 1 billion (EUR 1.18 billion) of additional capital for small firms, mainly those involved in exporting, and an increase of 2.5 % in the basic state pension. The main taxation measures were a further 1 pp. cut in the main rate of corporation tax to 21 % from April 2014, an increase in the personal income tax allowance by GBP 235 (EUR 275) to GBP 9 440 (EUR 11 110) from April 2013, and a cancellation of the 3.02p per litre fuel duty increase that had been planned for January 2013.

**The 2013 Budget, published in March 2013, was also fiscally neutral as the government continued with its consolidation strategy.** The main expenditure items announced were an increase in capital spending by GBP 3 billion (EUR 3.5 billion) per year from 2015-16, funded by reductions in current spending, GBP 1.6 billion (EUR 1.9 billion) of funding to support 11 sectors, including aerospace technology, cars and agri-technology, as part of an industrial strategy, the introduction of a new housing scheme, 'Help to Buy', designed to support those with small deposits who aspire to purchase a property, the introduction of a single-tier state pension in 2016-17, the cancellation of the fuel duty increase planned for September 2013 and a reduction in beer duty by 1p on a pint of beer. The key taxation measures were an additional 1 pp. cut in the corporation tax rate to 20 % from April 2015, a GBP 2 000 (EUR 2 350) employment allowance to reduce employer national insurance contributions, an increase in the personal income tax allowance of GBP 560 (EUR 660) to

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<sup>15</sup> Subsequent revisions to 2012 now estimate growth at 0.3 %

<sup>16</sup> Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology

<sup>17</sup> Idem

GBP 10 000 (EUR 11 800) in April 2014, and the introduction of a new tax-free childcare scheme to support working families.

Box 2. Main measures	
Main budgetary measures	
Revenue	Expenditure
2013-14	
<ul style="list-style-type: none"> <li>Corporation tax decrease to 23 % (-0.05 % of GDP)</li> <li>Increase in personal income tax allowance to GBP 9 440 (EUR 11 100) (-0.07 % of GDP)</li> <li>Duty changes overall (-0.15 % of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>Capital package (+0.2 % of GDP)</li> <li>Help to Buy scheme (+0.07 % of GDP)</li> </ul>
2014-15	
<ul style="list-style-type: none"> <li>Corporation tax decreases to 21 % (-0.05 % of GDP)</li> <li>Increase in personal income tax allowance to GBP 10 000 (EUR 11 800) (-0.07 % of GDP)</li> <li>Employment allowance (-0.09 % of GDP)</li> <li>Tax avoidance (+0.07 % of GDP)</li> </ul>	
2015-16	
<ul style="list-style-type: none"> <li>Corporation tax decrease to 20 % (-0.05 % of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>Capital spending (+0.2 % of GDP)</li> </ul>
2016-17	
	<ul style="list-style-type: none"> <li>Capital spending (+0.2 % of GDP)</li> </ul>
2017-18	
	<ul style="list-style-type: none"> <li>Capital spending (+0.2 % of GDP)</li> </ul>
<p>Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

**The convergence programme shows that the deficit is estimated to increase from 5.6 % in 2012-13 to 6.8 % in 2013-14.** This increase is due to the fact that two one-off items appear in the fiscal figures of 2012-13 that account for a reduction of almost 2 pp. in the deficit. These are the transfer of the Royal Mail pension fund (GBP 28 billion, EUR 33 billion) to the government accounts and the sale of 4G mobile phone licences (GBP 2.3 billion, EUR 2.7 billion). The deficit for 2014-15 is estimated at 6.0%. Both deficits in the convergence programme are similar to the Commission's 2013 spring forecast, in which the deficits are estimated at 6.9% and 6.1%, respectively. The difference is due to the slightly lower growth rate in 2014 of 1.7%, compared with the convergence programme's 1.8%. The outturns for the deficits in 2011-12 and 2012-13 were both lower than in the previous year's convergence programme, due to somewhat lower-than-expected borrowing and, for the latter year, the transfer of the Asset Purchase Facility (APF) from the Bank of England to the government accounts. The decision to transfer the APF to the general government accounts entails a reduction in the deficit over a number of years, but a potential increase in the deficit in subsequent years. As quantitative easing is unwound, the government would be liable for capital losses related to its bond holdings.

**The consolidation programme outlined in the Spending Review 2010 and implemented since then front-loads the taxation measures.** At the end of 2012-13, approximately 70% of the annual fiscal consolidation planned for the Spending Review 2010 period (from 2010-11 to 2014-15) had been implemented, including 90% of the planned tax increases and 65% of the planned expenditure reductions. For the last two years of the Spending Review period, over 90% of the further net consolidation planned is in the form of spending cuts. By 2015-16, the share of spending reductions in the total of consolidation measures that have been undertaken is foreseen at 80%.

### **Box 3. Excessive deficit procedure for the United Kingdom**

*On 8 July 2008, the Council decided that an excessive deficit existed in the United Kingdom. The most recent Council Recommendation under Art. 126(7) TFEU in conjunction with Article 126(13) thereof was adopted on 2 December 2009. The Council recommended that the UK authorities should put an end to the present excessive deficit situation by 2014-15.*

*The United Kingdom authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the United Kingdom authorities should: (a) implement the fiscal measures in 2009-10 as planned in the 2009 Budget, avoiding further measures contributing to the deterioration of public finances, and start consolidation in 2010-11 in order to bring the deficit below the reference value by 2014-15; (b) to this end ensure an average annual fiscal effort of 1¾% of GDP between 2010-11 and 2014-15, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus; (c) further specify the additional measures that are necessary to achieve the correction of the excessive deficit by 2014-15, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected. In addition, the United Kingdom authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value and ensure that its revised fiscal framework limits the risks to the adjustment and, after the excessive deficit has been corrected, underpins sustained budgetary consolidation. Finally, the Council invited the United Kingdom authorities to implement reforms with a view to raising potential GDP growth, including reforms conducive to enhancing the quality of public finances, in particular those consistent with achieving expenditure efficiency savings.*

*An overview of the current state of excessive deficit procedures, including additional steps adopted after this finalisation of this Staff Working Document, is available on: [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/deficit/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm) (please refer to country sections at the bottom of the page).*

**The general government debt ratio has been increasing steadily for more than a decade, with the largest annual jump taking place between 2008-09 and 2009-10 due to financial interventions in the banking sector.** The convergence programme envisages that the debt ratio will peak above 100% in 2015-16 and 2016-17 before reversing the trend. The Commission's spring forecast also predicts an increasing debt ratio to 2014-15, reaching 98.7% that year. The slightly higher debt rate of the Commission forecast is due to the marginally lower than expected growth rate. This means that the supplementary debt target that was introduced as part of the new government's fiscal rules, based on public sector net debt, is now set to be breached, according to the OBR forecast. The rule aimed to put debt on a downward trajectory in 2015-16, but it is now unlikely to start declining until 2017-18.

Medium-term debt projections (see Graph below Table V in annex) indicate that full implementation of the programme could put debt on a downward path by 2020, although it would still be above the 60 % of GDP reference value.

### ***Long-term sustainability***

**The United Kingdom does not appear to face a significant risk of fiscal stress in the short term, but there are some indications of future fiscal sustainability challenges.** Sustainability risks appear to be high in the medium and long term. The latter is influenced by the costs implied by an ageing population. It is therefore appropriate for the UK to continue to implement measures that reduce risks to fiscal sustainability in the short term, and to enable government debt to be reduced. Moreover, containing age-related expenditure growth further would contribute to the sustainability of public finances in the long term. In January 2013, the government published a bill to introduce a single-tier pension in 2016-17. This will end contracting out of the State Second Pension so that everyone has access to the same pension and pays the same rate of National Insurance Contributions (NICs). In addition, private social care costs for the elderly are to be capped at GBP 72 000 (EUR 85 000) per person from April 2016.

**Long-term expenditure projections for healthcare indicate an expected increase in healthcare expenditure of 1.1 pps of GDP by 2060.** In addition, while UK life expectancy is slightly above the EU average, infant mortality and the share of people reporting a long-standing illness or health problem are above the EU average. The UK has seen a large increase in healthcare funding in recent years, but the outlook for health spending is tighter in coming years<sup>18</sup>. Efforts could therefore be pursued in the healthcare sector to improve the productivity and cost-effectiveness of the system, to avoid reductions in access and to improve the quality of healthcare. The government's current plans for health service reform (in NHS England) entail ambitious targets for efficiency gains that the government plans to attain via reductions in management and administration staff, encouraging greater involvement of the private sector and devolving budgets and decisions down to local areas. Further action could include improving e-health mechanisms for monitoring activity and quality, performance-related payment, stepping up information to promote health, and disease prevention<sup>19</sup>.

### ***Fiscal framework***

**The UK government introduced a new fiscal framework after taking office in May 2010, and is currently off-track against its own debt sustainability target.** The independent Office for Budget Responsibility (OBR) is tasked with producing official economic and fiscal forecasts and assessing whether the chances of the government meeting the fiscal mandate and debt sustainability rule are greater than 50%. In its latest assessment (March 2013 Economic and Fiscal Outlook), the OBR concluded that the government remains on course to meet the fiscal mandate. This requires the cyclically-adjusted current budget to be on track to be in balance by the end of a rolling five-year forecast period, currently ending in 2017-18. However, the OBR forecasts that the government will miss the debt sustainability target by two years. The debt sustainability target requires public sector net debt as a percentage of GDP to be falling by 2015-16.

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<sup>18</sup> See Office for Budget Responsibility (July 2012) *Fiscal Sustainability Report Table 3.6*

<sup>19</sup> See OECD (2013), *OECD Economic Surveys – United Kingdom*, and European Commission (2010), *Joint Report on Health Systems*



**The UK does not set an explicit medium-term objective to comply with the code of conduct of the Stability and Convergence Programme (SCP).** Furthermore, the UK authorities' definitions of national debt and deficit targets differ from those in the Maastricht Treaty. The national deficit target refers to the cyclically-adjusted current account balance, excluding financial interventions, whereas the excessive deficit procedure (EDP) deficit is defined as general government net borrowing, including investment expenditure and interest from swaps and forward rate agreements. The national authorities' debt target is defined in net terms, whereas the EDP refers to gross debt.

**The UK's most recent Spending Review was published in 2010 and it set out its spending plans until 2014-15; the next Review will be in June 2013.** The Spending Review sets out multi-annual limits for predictable spending in every department through Departmental Expenditure Limits (DELs). The remainder of spending, mainly social security, debt interest payments, public sector pensions and EU contributions, is classified as Annually Managed Expenditure (AME) and has not historically been capped in advance. In its 2013 Budget, the government announced that in future, it will introduce a firm limit on a significant proportion of AME, including some welfare payments.

### *Tax system*

**Since the 2012 European Semester, tax measures have been taken in the direction of the AGS priorities and a 2012 Council Recommendation for the UK to deliver differentiated, growth-friendly fiscal consolidation.** The standard corporate income tax rate has already been reduced by a total of 5 pp. from 28% to 23% since 2010, and will be reduced by a further 3 pp. to 20% by April 2015. In order to promote investment by SMEs, the Annual Investment Allowance for plant and machinery has been increased for two years from April 2013, although this follows earlier cuts to investment allowances. Recent increases in the annual allowance in the personal income tax mean that 2.4 million people have now been taken out of the income tax system. The government has also introduced measures to combat tax evasion and fraud, including the UK's first General Anti-Abuse Rule.

**No significant reforms have been carried out in relation to the property taxation element of the 2012 Council Recommendation on housing.** UK property tax revenues as a share of GDP (4.2%) are double the EU average. The UK system combines a regressive recurring tax (Council Tax) with a progressive transaction tax (Stamp Duty Land Tax or SDLT). There are two problems with the current Council Tax system. First, the system is based on outdated property valuations (which are linked to the price of housing of 1991), and second, it is regressive as households owning property in the lower valuation bands pay more tax in proportion to the value of their house than properties in higher valuation bands. Undeveloped land with planning permission is currently taxed on sale or transfer, but not recurrently on its annual economic value, which can encourage land value speculation, rather than timely residential construction.

**The UK's total tax-to-GDP ratio (36.1% in 2011) is slightly below the EU-27 weighted average, and there is scope to raise revenue by broadening the base of existing taxes.** While taxation of labour as a share of GDP and the implicit tax rate on labour are relatively low by EU standards, the UK has high levels of tax expenditure in relation to personal income tax<sup>20</sup>. In 2010-11, over half of the GBP 33 billion (EUR 39 billion) allowances for savings into pension schemes were claimed by higher-rate taxpayers.

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<sup>20</sup> OECD (2010), *Tax expenditures in OECD Countries*

**The UK standard VAT rate was increased to 20 % in April 2011 but there is significant scope for reducing the number of goods and services to which non-standard VAT rates apply.** While total UK revenues from VAT are around the EU average, the UK ranks 22<sup>nd</sup> in the EU in terms of actual VAT revenues collected as a percentage of theoretical revenues at standard rates (46.5 % in 2011). The VAT base was widened very marginally in Budget 2012. The UK currently has a reduced rate of 5 % for domestic gas and electricity and a limited number of other goods and services. A zero rate applies to a broad range of goods such as food, books, children's clothes, water supply and sewerage services to domestic customers. Though overall UK environmental tax revenues are above the EU average, the reduced VAT rate for domestic energy consumption provides a substantial subsidy to fossil fuel consumption, which is not targeted at low-income households. This has the effect of lessening pressure to reduce domestic energy consumption (mostly home heating) through energy efficiency measures. The Mirrlees Review<sup>21</sup> concluded that a comprehensive broadening of the VAT base would benefit the economy and could raise a net GBP 3 billion (EUR 5 billion) of tax revenue<sup>22</sup>, even after using the tax-benefit system to compensate households, especially poorer households, for the increase in their cost of living. The Mirrlees Review also proposes an alternative reform which is redistributional (i.e. compensates only poorer households) which would raise a net GBP 10 billion (EUR 11.8 billion). However, the report points out that this reform could reduce incentives to work.

### **3.2. Financial sector**

**The UK banking and financial sector has returned to relative stability, but has not yet fully recovered from the impact of the crisis.** The UK financial sector underwent a period of turmoil because of the 2008 financial crisis, which led the government to inject public funds into a number of systemically important UK banks to guarantee their solvency and liquidity. Despite higher bank capitalisation levels, the flow of credit to the corporate sector remained negative in 2012, and many SMEs are facing credit constraints. In 2012, the Council Recommendations for the United Kingdom included a CSR concerning improvements needed in the availability of financing, especially for SMEs, promoting the non-bank lending channel, and increasing competition in the banking sector.

**The UK has made some progress on measures taken to address the 2012 CSR on improving access to finance, non-bank lending and bank competition.** The challenge for the financial sector to support private sector investment and growth more effectively remains. Although the government has put in place a number of schemes designed to increase lending, net lending to firms continued to be negative in 2012, while net lending to households remained depressed<sup>23</sup>. Many firms, especially SMEs, are still having trouble obtaining credit to finance investment. Post-crisis loan rejection rates for SMEs have increased markedly compared to the pre-crisis period<sup>24</sup>. It is not clear when and to what extent private investment will pick-up, so the flow of credit may remain constrained until broader economic conditions improve. Corporate credit conditions have improved somewhat since the second half of 2012, but less so for smaller companies<sup>25</sup>.

<sup>21</sup> Mirrlees et al (2011), *Tax by Design: the Mirrlees Review. Chapter 9 – Broadening the VAT base*

<sup>22</sup> Based on the old 17.5 % rate of VAT. The authors state that the welfare gain would increase under the new VAT standard rate of 20 %

<sup>23</sup> Bank of England (2013), *Trends in Lending, April 2013*

<sup>24</sup> See Federation of Small Business (2013) *Voice of Small Business Index Quarter 1, 2013*. This recent survey on SME access to bank loans puts loan rejection rates at approximately 40 %

<sup>25</sup> Bank of England (2013), *Credit Conditions Survey 2013 Q1*

**Monetary policy has struggled to re-establish the flow of credit, even as it continues to venture into unconventional territory.** In 2012, the Bank of England activated the Extended Collateral Term Repo Facility, expanded the quantitative easing programme by GBP 50 billion (EUR 59 billion) to GBP 375 billion (EUR 440 billion) and introduced the Funding for Lending Scheme (FLS) which seeks to incentivise lending by reducing the funding costs of banks and building societies. In April 2013, the FLS was extended by one year to 2015, and partially redesigned to incentivise lending to SMEs. Preliminary evidence suggests that the FLS has contributed to an increase in mortgage lending, but has so far been less successful in boosting corporate lending, particularly to SMEs.

**The government has announced or put in place a range of initiatives to promote access to finance.** In December 2012, it pledged GBP 1 billion (EUR 1.18 billion) in capital to a new Business Bank to support the provision of long-term loans to SMEs via existing financial institutions. While plans are still under development, the Business Bank will enable the consolidation of numerous existing initiatives promoting access to finance under a single institution, which should raise the awareness of SMEs and help them navigate through the various schemes. The government also published its progress report on the implementation of the recommendations of the Breedon review on SME access to non-bank finance in November 2012. Peer-to-peer lending is expanding, as is supply-chain financing by larger companies and platforms that allow the exchange of receivables for cash. All these alternatives to bank lending are, however, still small-scale, and SME funding continues to rely extensively on bank lending and internal sources.

**The difficulties for many firms in accessing finance appear to be due in part to the persistent lack of competition in the banking sector.** The four main players cover more than 80% of the market, and there are only tentative signs of other players increasing their presence in the corporate credit market. The Independent Commission on Banking recommended the creation of a strong challenger bank through the divestiture of assets belonging to Lloyds Bank, which is partly owned by the government. However, the planned divestiture of 632 branches, which is also required to comply with state aid decisions, has yet to take place. Also, the government-controlled Royal Bank of Scotland has yet to reach an agreement with potential buyers that would allow it to meet the branch divestiture deadline set by state aid rules. The UK authorities have sought to decrease barriers to entry by easing capital requirements for bank start-ups and accelerating the authorisation process. Further options to help to increase bank competition include facilitating access to shared databases and standard risk models, so as to lower costs for smaller banks, and to introduce full bank account portability to decrease switching costs.

**Current bank capitalisation levels, though nominally adequate, may not reflect a sufficiently prudent calculation of risk weights and provisions for expected losses.** The aggregate core tier 1 capital ratio of the UK banking sector compares favourably with other EU countries, the share of non-performing loans is relatively small, and credit default swap spreads on UK banks remain contained. There is, however, evidence of continued bank forbearance in the post crisis-period, with respect to both corporate and household debt. Corporate insolvencies have remained low in the UK although many more companies are making losses. Also, R3, the insolvency industry trade body, found that a large and rising number companies are only able to pay the interest on their debt but do not see a prospect of being able to pay back the principal. Though this provides some immediate support to the economy, it could store up hidden risks in banks' balance sheets and delay necessary structural adjustments in the economy. Proper implementation of the Financial Policy

Committee's recommendations<sup>26</sup> on prudent reckoning of bank capital requirements and on addressing identified capital shortfalls without hindering lending to the economy should help reinforce the financial stability of the UK banking system.

### **3.3. Labour market, education and social policies**

**Employment has risen despite the lack of significant GDP growth, productivity growth is weak, and skills gaps persist.** The UK's flexible labour market has few large collective bargaining arrangements outside the public sector, which has seen widespread pay freezes, and very little automatic wage indexation. Real wages have been falling for three years, which has had a negative impact on household consumption, but helped to support employment. The overall unemployment rate is 7.8%<sup>27</sup> though youth unemployment and the NEETs<sup>28</sup> rate remain substantially higher. Many people, especially young workers, are in precarious and often involuntary part-time or temporary jobs. The challenge of providing sustainable employment, especially for young people, is complicated by two factors: the UK has too many low-skilled workers, for whom demand is falling, and a shortage of workers with high-quality vocational and technical skills. The UK also faces on-going challenges to improve access to high-quality, affordable childcare, raise parental employment and combat poverty. The percentage of the population at risk of poverty or social exclusion fell from 23.1% in 2010 to 22.7% in 2011, slightly below the EU average, but this fall was partly explained by a fall in the poverty threshold due to falling real median income. In 2012, the Council Recommendations for the United Kingdom contained CSRs concerning welfare reform, poverty and childcare, youth employment, and improving vocational education and skills provision.

#### ***Employment, welfare reform and social inclusion***

**The UK has made some progress on measures taken to address the 2012 CSR on welfare reform, poverty and childcare.** Early evidence on the impact of the new Work Programme for the unemployed is disappointing, but the programme is still at an early stage, and it is essential to provide appropriate support for those who are likely to find it particularly difficult to gain employment. The UK authorities have introduced a wide range of policies to address unemployment, especially youth unemployment, including the Work Programme and the Youth Contract (discussed below). The Work Programme was launched in April 2011 and seeks to provide people further from the labour market with relevant work experience and skills. Early results from the Work Programme<sup>29</sup> show that the total number of jobs gained by participants is below target, many of these jobs are part time, and a significant proportion has not turned out to be sustainable. While the early evidence is not definitive, it does suggest there is scope for refining the design and contracting of the Work Programme to improve outcomes for harder-to-help clients.

**The introduction of Universal Credit in place of existing working age benefits should be a positive step, with its focus on simplifying benefits and improving work incentives.** Weak work incentives have been a long-running problem for the UK, particularly the high marginal benefit withdrawal rates for those moving off benefits into low-paid jobs. Most means-tested out-of-work benefits and in-work tax credits for working adults (Income Support, income-related Jobseeker's Allowance and Employment and Support Allowance) are

<sup>26</sup> See the Financial Policy Committee's statement from its policy meeting of 19 March 2013

<sup>27</sup> November 2012 – January 2013, Eurostat definition

<sup>28</sup> 'NEET' refers to a young person who is not in education, employment, or training

<sup>29</sup> Department for Work and Pensions (2012), *Work Programme evaluation: Findings from the first phase of qualitative research on programme delivery*

to be replaced by a single benefit, Universal Credit, as set out in the Welfare Reform Act 2012. The new system will allow individuals to keep more of their income as they move into work, and will introduce a slower withdrawal rate (65%) of benefits when they increase their earnings.

**However, the net impact of Universal Credit on employment will depend on effective implementation and support services.** While improved incentives for households to accept some work should help to reduce the high level of workless households, the structure of the new system could induce some second earners to reduce their hours or to stop work. The government's stated intention is to introduce more work search conditionality into Universal Credit in future, to mitigate these risks, but as yet there are no clear plans for when or how this might be done. It will also be important to get the delivery of Universal Credit payments right, as delays and errors could cause severe short-term poverty and lead to scepticism and risk aversion among people looking to move off benefits and into work. Universal Credit is currently being piloted and is due to be rolled out for new claimants in stages from late 2013, with all existing claimants being transferred to the new system by the end of 2017. The government recognises the implementation risks and has indicated that it is willing to adapt the timetable if necessary.

**Poverty, including child poverty, is likely to increase due to cuts in real terms in welfare payments for those of working age.** As set out in the Welfare Benefits Up-rating Act, many working-age benefits and tax credits will be increased by 1% a year from 2013 until 2016. This is below the projected inflation rate so it means three years of cuts in real terms. Most working-age households receiving state support will be affected, but the poorest households will see the biggest proportionate fall in their incomes. A range of other reforms to welfare benefits were also introduced in April 2013. One element is a benefit cap, being rolled out from April 2013, which limits maximum weekly benefit payments to GBP 500 (EUR 590) for families, or GBP 350 (EUR 410) for single adults who do not have children or whose children do not live with them. This will primarily affect larger families living in areas with high housing costs. For disabled people who face additional living costs, Personal Independence Payments will gradually replace working age Disability Living Allowance. The main reason for cutting benefits is to make fiscal savings, but these cuts are likely to lead to an increase in poverty among those of working age. In contrast, the scope, level and uprating of both universal and means-tested payments to pensioners have been largely exempt from cuts.

**The decentralisation of Council Tax Benefit from April 2013 has added complexity to the benefits system by creating a range of different systems, which conflicts with the simplification rationale for Universal Credit<sup>30</sup>.** As total funding for working age claimants has been reduced this reform is likely to contribute to increasing poverty. Local authority administrative burdens and financial losses associated with Council Tax Benefit administration and rent collection could also rise.

**The UK's Social Justice Strategy emphasises a more multi-dimensional approach to measuring and tackling child poverty, with more focus on enabling services and prevention.** In October 2012, the government also published the Social Justice Outcomes Framework<sup>31</sup>. This strategy includes an ambitious set of measures to complement those launched in 2011, the Child Poverty Strategy (on the basis of the Child Poverty Act 2010),

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<sup>30</sup> Institute for Fiscal Studies (2012), *Reforming Council Tax Benefit*, IFS Commentary C123

<sup>31</sup> This framework aims to support future policy by highlighting priorities, identifying where good progress is being made and where more work needs to be done

and the Social Mobility Strategy<sup>32</sup>. This approach, with a focus on prevention, is positive in principle. However, income poverty remains an important issue, and budgets for wider support services provided at local level are being reduced.

### ***Childcare and parental employment***

**Although the supply of childcare places has risen in recent years, the cost and availability of childcare remain as barriers to parental employment.** Childcare poses particular problems for second earners in couples, and for single parents<sup>33</sup>. Currently, childcare costs in the UK are among the highest in the EU. In 2010, only 4% of children under the age of three had full-time places in formal childcare, well below the EU average of 14%<sup>34</sup>. The overall employment rate for single parents, 59.9%<sup>35</sup>, remains relatively low, and is the main reason why the proportion of children in workless households in the UK (17.3%) is the second highest rate in Europe. In 2012, the employment rate was 19.2 pp. higher for single women aged 25-49 who had no children (80.6%) than for single women who had children (61.4%)<sup>36</sup>. Since May 2012, single parents are required to actively seek work when their youngest child begins full-time education.

**The government is improving the availability of childcare for preschool children, but recognises that there is still a need to improve access to affordable, high-quality and adequate childcare services.** In January 2013, it published *More Great Childcare*<sup>37</sup>, which sets out a plan of action for delivering high-quality early childhood education and childcare, with a strong focus on child development to help break the cycle of disadvantage. In February 2013, the government presented the Children and Families Bill to Parliament, proposing reforms to boost the number of high-quality, affordable childcare places. It also aims to introduce child minder agencies to reverse a decline in registered child minders and to offer more support and quality control. Budget 2013 announced that tax-free childcare vouchers will be introduced from autumn 2015, supporting 20% of childcare costs up to a limit of GBP 1 200 (EUR 1 410) per child per year. Budget 2013 also announced an additional GBP 200 million (EUR 235 million) of support, to be phased in from April 2016, which is equivalent to 85% of childcare costs, for qualifying households in which a single parent or both earners in a couple pay income tax. It remains important to ensure that the benefits of these additional resources are not offset by the impact of other tax-benefit reforms, in particular for low income households.

### ***Employability of young people, education and skills***

**The UK has made some progress on measures taken to address the CSR on improving the employability of young people, vocational education and basic skills provision.** Despite some progress in recent years, a significant proportion of young people still leave secondary education without the skills and qualifications they need to compete in the labour market<sup>38</sup>. As a result of this persistent record of underachievement, the UK has a large number of functionally illiterate and innumerate adults, usually with no qualifications. Young low-

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<sup>32</sup> HM Government (2012), *Opening Doors, Breaking Barriers: A Strategy for Social Mobility. Update on progress since April 2011*

<sup>33</sup> OECD (2012), *OECD Family Database*

<sup>34</sup> Eurostat (Formal child care by duration and age group)

<sup>35</sup> Eurostat (Employment rate by sex, age groups, highest level of education attained and household composition)

<sup>36</sup> Eurostat (Employment rate by sex, age groups, highest level of education attained and household composition)

<sup>37</sup> Department for Education (2013), *More Great Childcare – Raising Quality and Giving Parents More Choice*

<sup>38</sup> Harding, C et al. (2011), *2011 BIS Research Paper Number 57, Skills for Life Survey: Headline Findings*. 28% of 16-18 year olds are functionally innumerate and 14% are functionally illiterate. The figures for 16-65 year olds are 24% and 15% respectively

skilled workers have seen their job prospects disproportionately affected by the economic crisis. The unemployment rate of low-skilled 15-24 year-olds is significantly above the EU average (37.2% in the UK compared to an EU average of 30.3% in 2012). Skills mismatches are also likely to become more serious in the medium term. The European Centre for the Development of Vocational Training projects that low skilled posts could represent only 11% of total jobs in the UK in 2020, down from 21% in 2010 (compared with an EU average of 18% in 2020 and 23% in 2010). Although the UK performs well above the EU average with regard to the tertiary attainment rate, university applications declined slightly in England for the academic year 2012-2013, following an increase in tuition fees to up to GBP 9 000 (EUR 10 600) per year in England<sup>39</sup>. The government is in the midst of a number of significant education reforms, whose effects on the economy will be primarily long term.

**It is too early to judge the effectiveness of the Youth Contract.** The Youth Contract supports tailored measures addressing youth unemployment by providing additional apprenticeships, giving financial incentives to employers taking on young people, and increasing support for the public employment service, Jobcentre Plus. The Youth Contract will be subject to an independent evaluation in 2013. The Youth Employment Initiative will deliver measures targeting young people, including by implementing a Youth Guarantee<sup>40</sup> and using ESF funding, and will need to build on the Youth Contract. The Scottish government has developed a package of measures to support youth unemployment and SME growth, including a recruitment incentive for employers taking on job-ready young people aged 16-24 who have had difficulty in securing employment.

**A number of recent reforms to the apprenticeships system may increase the labour market relevance of apprenticeships, but there is more to be done.** The government has announced or enacted changes to improve the quality of apprenticeship programmes, including their level and duration, but their impact will depend on effective implementation. The number of apprenticeships continues to grow and there is some evidence of a shift to high-level qualifications. There were 520 600 apprenticeship starts in the 2011-12 academic year (compared to 457 200 in 2010-11), of which 291 300 were taken up by young people (compared to 275 100 in 2010-2011). There was a 22% growth in advanced level (Level 3) apprenticeships and a 68% increase in higher-level (Levels 4 and 5) apprenticeships<sup>41</sup>. To make apprenticeships more focused on high-level skills, from 2013, Level 6 (graduate) and Level 7 (postgraduate) apprenticeships will be available in subjects including law, accountancy and advanced engineering. In addition, 24 University Technical Colleges (UTCs), a new type of school, set up in cooperation with employers and universities, will be opened by 2014. These colleges will teach engineering, business and other practical skills.

**Recent moves to increase employer and local control over skills provision have the potential to improve the responsiveness of the system to the needs of the labour market.** The Employer Ownership Pilot seeks to raise business engagement and investment in skills provision by routing public money directly to employers rather than via providers. Businesses are invited to set out the public funding they need to support their own investment in skills, training and apprenticeship opportunities. For 2013-14, the government has increased the size of the Employer Ownership Pilot from GBP 250 million (EUR 295 million) to GBP 340 million (EUR 400 million). A recent report from an independent ad-hoc commission, the

<sup>39</sup> See UCAS (2012), *How have applications for full-time undergraduate higher education in the UK changed in 2012?*

<sup>40</sup> Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (2013/C 120/01)

<sup>41</sup> In 2011/2012, advanced-level apprenticeships represented 36.1% of the total, compared with 33.7% in 2010/2011, while higher-level apprenticeships were 0.7% of the total, as against 0.5% in 2010/2011

Richard Review<sup>42</sup>, called on the government to improve the quality of apprenticeships and make them more focused on the needs of employers. The government endorsed the Richard Review's recommendations, which appear to have potential to strengthen the role of employers in designing an effective apprenticeships system. However, the qualifications system remains very complex, and this may have an adverse effect on business involvement in the apprenticeships programme.

**Raising the age of compulsory participation in education and training to 18 by 2015 should help address the UK's high early school leaving rate, but this alone will not necessarily endow pupils with the right skills for the labour market.** The UK continues to have slightly higher levels of early school leavers than the EU average, 13.5 % vs. 12.8 % in 2012, although the proportion has declined by 3.5 pp. since 2007. In England, the government is raising the age of compulsory participation in education or training, currently 16, to 17 in 2013 and 18 in 2015. This may significantly reduce early school leaving, but it remains to be seen how far additional time in education and training alone will give young people the right skills for the labour market. To deal with the basic skills issue, the government plans to introduce a new Traineeships programme in England by September 2013. This will provide 16-24 year-olds lacking the skills and experience they need for the labour market with a tailor-made package of support to enable them to take up apprenticeships or other jobs. Traineeships could have a positive impact in the relatively short term, but will require effective implementation and monitoring. In Scotland, through the 'Opportunities for All' commitment, the Government aims at offering a place in education or training to all 16-19 year olds not already in learning, training or employment.

**The government is also reforming the education system, and this includes reviewing the national curriculum<sup>43</sup>. At school level, the focus is more on system reform than discrete measures or initiatives.** The government is providing schools with a Pupil Premium worth GBP 1.25 billion (EUR 1.47 billion) from 2012–13 to boost the attainment of pupils from deprived backgrounds. A survey by the official school inspection body (Ofsted) expressed some concern that many schools were not using the extra funding to target disadvantaged children as envisaged<sup>44</sup>. The measures in the education system to improve the skills of young people have a long-term nature, so it is too early to assess their impact.

### **3.4. Structural measures promoting growth and competitiveness**

**There is significant scope for the UK to raise productivity relative to the best performing countries.** Although UK labour and product markets are among the least regulated in the EU, and its business environment is generally favourable, the UK economy has significant structural weaknesses. The UK's capital stock and investment rate are low. As set out in Box 1, the UK's persistently weak net export position reflects a lack of external competitiveness. Recent productivity growth has been very weak, and there is evidence of a lack of restructuring, competition and innovation in the economy. The UK has a challenge to put the regulatory and financing conditions in place to renew and upgrade its energy and transport infrastructure, using a mix of public and private funding sources. Government attempts to boost access to finance and investment are complicated by high levels of private debt, linked in large part to the after-effects of a house price boom that occurred in a context of restricted housing supply. In 2012, the Council Recommendations for the United Kingdom included CSRs concerning housing supply, and transport and energy infrastructure.

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<sup>42</sup> Richard (November 2012), *The Richard Review of Apprenticeships*

<sup>43</sup> The Department for Education proposed more demanding programmes in English, mathematics and science

<sup>44</sup> See Ofsted (2012), *The Pupil Premium*



### ***Spatial planning reform and housing supply***

**The UK has made some progress on measures taken to address the CSR on housing, but housing completions remain at historic lows and there remains a challenge to deliver the housing supply the population needs.** Residential investment remains low at 3.2% of GDP. Overall construction output (not just residential) fell by 5.9% in the year to 2013 Q1 and is nearly 20% lower than the pre-recession peak<sup>45</sup>. Some of the government's earliest commitments led to further reductions in housing supply. Government funding for social housing was cut sharply in the 2010 Spending Review. When top-down housing supply targets in Regional Spatial Strategies were abolished, the number of new dwellings targeted for construction across the country fell by 272 720<sup>46</sup>. In contrast, the new National Planning Policy Framework (NPPF), introduced in 2012, aims to increase residential construction through simplifying the spatial planning system and creating a presumption in favour of sustainable development. The measures announced in the 2011 Housing Strategy for England<sup>47</sup> are also being implemented. These include freeing up public sector land and various financial incentives such as the New Homes Bonus, Community Infrastructure Levy, Growing Places fund and a Get Britain Building investment fund. The government also recently announced the liberalisation of planning rules to allow offices, which have high vacancy rates in much of the country, to be converted for residential use.

**It is not yet clear to what extent the government's reforms will increase housing supply in the medium to long term.** Many of the major housing developers have made it clear to investors that they are currently focused more on expanding margins than volumes<sup>48</sup>. This could limit the positive impact of policies designed to boost housing supply in the short to medium term. There is also a lack of effective competition in the residential construction industry. Much of the impact of the new planning system will depend on local implementation, and the reforms that have been made seem to amount to moderate liberalisation overall. There continue to be tight restrictions on construction around most of the UK's major cities and economic growth poles.

**The capacity, efficiency and financial incentives in the planning system could also be a continuing constraint on residential development.** Whether or not decisions on planning applications are timely and efficient can make a large difference to developers' risks and returns on potential residential construction projects. This in turn has an impact on the quantity and cost of new housing. Planning approvals had been at very low levels since mid-2008, although there were signs of a pick-up in late 2012<sup>49</sup>. Local authorities are sharply cutting spending on administering the planning system in response to cuts in their overall budgets, and the government has decided against allowing local authorities to increase user charges for planning- and housing-related services to reflect the full cost of the system. Some 70% of local authorities now have a plan under the new system but there is still strong local political opposition to new housing in areas where house prices are high, and the financial incentives available to local authorities may not be strong enough to overcome this. The government has threatened to take decision-making powers away from local authorities that are too slow to make planning decisions or take an excessively anti-development approach, and this measure may be needed as a last resort.

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<sup>45</sup> Office for National Statistics (2013), *GDP Preliminary Estimate, Q1 2013*

<sup>46</sup> Morton (2012), *Planning for Less: the impact of abolishing regional planning*

<sup>47</sup> HM Government (November 2011), *Laying the Foundations: A housing strategy for England*

<sup>48</sup> Deutsche Bank (2013), *UK Building Sector – What to expect from the Q4 2012 results*

<sup>49</sup> Home Builders Federation (2013). *New Housing Pipeline, Q4 2012 Report*

**There is also a risk that government interventions that stimulate housing demand more than supply, in particular Help to Buy, could reflate a housing bubble and consequently household debt.** The level of housing transactions and loans for new mortgages remains low, held back by a weak domestic economy, impaired credit markets and a continued lack of affordability. Early results from the Funding for Lending Scheme, discussed in Section 3.2, suggest that to date it has largely led to an increase in lending against existing property<sup>50</sup>. In Budget 2013 the government announced the introduction of Help to Buy, which has two elements, both available for houses costing up to GBP 600 000 (EUR 705 000). First, from April 2013, the government will provide an equity loan worth up to 20% of the value of a new-build house, repayable once the home is sold. Second, from January 2014, the government will provide a mortgage guarantee to lenders who offer high loan-to-value mortgages (80-95%) on any house, new or existing. By facilitating loans for potential buyers who could not otherwise afford to buy a house, Help to Buy risks leading to the return of imprudent and excessive mortgage lending and generating a rise in house prices due to state subsidy, which would further worsen the underlying problem of housing being unaffordable<sup>51</sup>. It could also lead to contingent liabilities for the Exchequer. However, the details of how the guarantees will operate and be priced have not yet been announced. The Scottish government's National Housing Trust initiative also provides guarantees to stimulate both public and private sector funding for the provision of rental accommodation.

**The private rented sector in the UK is dominated by short-term, insecure tenancies<sup>52</sup>.** Tenancy agreements tend to be set for a relatively short fixed period, after which they revert to a rolling basis (running on a week-to-week or month-to-month basis). The notice period for terminating a tenancy is usually one to six months. One reason for the flexibility and dominance of short-term tenancies in the private rental market is that in recent decades, private renting has been seen as a temporary solution. Most people aim to buy their own house at some point in the future. However, a combination of high house prices, stretched household finances and more responsible lending criteria are likely to continue to prevent many middle-income households from becoming home owners. Private renting could be made a more attractive and viable long-term alternative to home ownership through the use of legal frameworks that make longer and more secure rental terms more appealing to both tenants and landlords, and if the sector became more professional. The Welsh government will bring forward legislation in 2013 to develop more secure tenancy arrangements in the rental sector.

### ***Infrastructure***

**The UK has made some progress on measures taken to address the CSR on improving transport and energy infrastructure, but continues to have substantial infrastructure investment needs.** The UK has shortcomings in its infrastructure<sup>53</sup> and, while the government recognises the potential for infrastructure improvements to drive both short- and longer-term growth, the UK continues to have a significant challenge to secure adequate and cost-effective infrastructure investment. Around GBP 310 billion (EUR 365 billion) of investment is needed in energy, roads and the rail network over the duration of the current parliament and beyond<sup>54</sup>.

<sup>50</sup> Bank of England (2013), *Trends in Lending, April 2013*

<sup>51</sup> See oral evidence from the Office of Budget Responsibility to the House of Commons Treasury Committee hearing on Budget 2013, 26 March 2013

<sup>52</sup> Shelter (2012), *A better deal: Towards more private renting*

<sup>53</sup> According to the World Economic Forum, the UK currently ranks 24th on quality of its overall infrastructure, while France ranks fifth and Germany ninth. World Economic Forum (2012), *The Global Competitiveness Report 2012-13*

<sup>54</sup> HM Treasury (2012), *National Infrastructure Plan: update 2012*

However, in 2012, total infrastructure spending (public and private) fell<sup>55</sup>. Significant cuts to publicly-funded infrastructure construction and maintenance have been made as part of the 2010 Spending Review. The government plans to partially reverse these cuts. It announced in Budget 2013 that it would increase capital spending plans by GBP 3 billion (EUR 3.5 billion) a year from 2015-16. The government also indicated that in Spending Review 2013, it would set out long-term plans up to 2020-21 for the most economically valuable areas of capital expenditure. While the cuts made to date have had a negative impact and are not due to be fully reversed, the government is now taking some positive steps on public infrastructure spending, though the increases will not come in immediately. Giving greater certainty and predictability on future capital spending plans could help to bring down the high unit costs in UK infrastructure, especially in the transport sector.

**Most infrastructure spending is privately funded, and the government is also seeking to stimulate increased private investment.** In the 2012-15 infrastructure pipeline 65 % of spending is private, 13 % public, and 22 % public/private<sup>56</sup>. The government has introduced a GBP 40 billion (EUR 47 billion) infrastructure guarantee fund to assist large privately-funded infrastructure projects that are currently struggling because of adverse credit conditions. The projects can come from a range of sectors including transport, energy, utilities and communications. The scheme has received 75 enquiries from project sponsors to date. Projects with a capital value of around GBP 10 billion (EUR 11.8 billion) have so far prequalified as potentially eligible for a guarantee. The government has also stated that it wants to access pension funds and other private capital to fund infrastructure improvements, including new road developments and replacements for ageing electricity generating capacity. In the Autumn Statement 2012, a successor to the Private Finance Initiative (PFI) initiative was also announced. This will be called PFI 2. The UK needs to be careful not to repeat the mistakes of past PFI projects and to ensure that the most cost-effective funding model is used for each project. Audit evidence suggests the PFI model was a costly way of procuring public infrastructure, largely because long-term projects were funded at a (higher) private rate of return than the cost of public borrowing. These initiatives may be beneficial if they can provide additional investment cost-effectively, which requires careful design, but few funds have been committed to date and it is too early to make a clear assessment of their likely impact.

### ***Transport***

**Transport infrastructure is of particular importance for the goods-producing sector, an area in which the UK trade balance is in a persistent and significant deficit.** Across different transport modes, the UK has a challenge to identify additional sources of funding, to bring down high unit costs, and to address practical regulatory barriers to timely investment. According to the ITF, investment in transport infrastructure building (all modes) is average at 0.89% of GDP. In Spending Review 2010, transport investment was relatively protected in a context of sharp cuts to overall capital spending.

**The UK's roads are among the most congested in the EU, and the UK's ratio of average road traffic speed to free-flow speed is also one of the lowest in the EU<sup>57</sup>.** According to a recent McKinsey report<sup>58</sup>, road spending had fallen to 50% of its 1975 levels by 2000, though

<sup>55</sup> Office for National Statistics (2013), *Output in the Construction Industry, December and Q4 2012*

<sup>56</sup> HM Treasury (2013), *Infrastructure Pipeline Data 2012*

<sup>57</sup> European Commission (2012), *Key areas: comparing Member States' performances, Network industries — transport*

<sup>58</sup> McKinsey (2011), *Keeping Britain moving — The United Kingdom's transport infrastructure needs*

it has since increased again and is currently 75 % of 1975 levels. On average roads in England are only resurfaced once every 58 years, much less frequently than is ideal<sup>59</sup>. The Government has announced priorities for alleviating congestion and improving the national road network, but overall road construction and maintenance spending is being squeezed. There is a particular risk that local authorities, whose overall budgets are being reduced, will cut spending on highways significantly. Road maintenance and small projects to deal with bottlenecks are important and should not be neglected. There is evidence that they tend to have relatively high economic payoffs compared to other spending, and they have relatively short lead times if the government can identify additional funding. McKinsey estimate that the UK will need to find up to an extra GBP 2.7 billion (EUR 3.2 billion) annually to fund its road network over the next 20 years if it is to avoid a rise in congestion. There is a case for reprioritising existing public spending towards roads. The UK could also consider options for generating additional revenue, for example, through user charging for lorries.

**Rapid growth in rail passenger traffic is leading to congestion on some routes and there is a need for increased capacity.** UK rail passenger numbers have increased by 70 % since the 1990s (compared to increases of 20 % in Germany, 10 % in Italy and 8 % in France)<sup>60</sup>. Rail freight also moves a substantial proportion of goods to and from the UK's sea ports, which could benefit from better transport connections. In July 2012<sup>61</sup>, the Government announced that over the period 2014-2019, more than GBP 9.4 billion (EUR 11 billion) is to be invested in railway infrastructure, including improvements to stations, routes (electrification, reopening of routes), rolling stock and ticketing systems. This represents a decrease from the GBP 11.8 billion (EUR 13.9 billion) earmarked by Government for improvements from 2009-2014. Including running costs, Network Rail plans to spend GBP 37.5 billion (EUR 44 billion) on operation and expansion of railways for the period 2014-2019. Network Rail intends to increase capacity, improve connections, especially for cities in the North of England, and reduce greenhouse gas emissions per passenger, but their plans are dependent on passenger demand, government fare policy and efficiency savings. There have been some difficulties with the process of reletting rail operating franchises, which also need to be resolved to give the industry the clarity it needs to plan and invest effectively. The government also announced the construction of a new high-speed rail line between London and Birmingham and on to Manchester and Leeds. Construction is due to start in 2017, with a view to services starting in 2026. There remains considerable scope for the UK rail industry to cut costs and improve efficiency<sup>62</sup>. The government has recognised this in setting an ambition for the rail industry to reduce running costs by GBP 3.5 billion (EUR 4.1 billion) by 2019<sup>63</sup>. This could help mitigate the extent to which high fares rise yet further.

**The UK currently has no clear plan to address looming constraints in airport capacity.** As in most other EU countries, aviation has been hit by the economic downturn and traffic growth and passenger numbers have all but stalled. Aviation is taxed more in the UK than in other EU Member States, through Air Passenger Duty, and UK airline passenger services have some of the worst market performance indicators<sup>64</sup>. There is, however, a growing need for additional airport capacity in the South East of the UK. To date, the government does not have a policy to deliver the additional capacity needed for London to maintain its hub status

<sup>59</sup> Asphalt Industry Alliance (2012), *Annual Local Authority Road Maintenance Survey 2012*

<sup>60</sup> European Commission (2013), *Commission Staff Working Document, Impact assessment SWD(2013) 10*

<sup>61</sup> Department for Transport (2012), *High Level Output Specification (HLOS) 2012: Railways Act 2005 statement*

<sup>62</sup> McNulty (2011), *Realising the potential of GB rail – Report of the rail value for money study*

<sup>63</sup> Department for Transport (2012), *Reforming our Railways: Putting the Customer First*

<sup>64</sup> European Commission (December 2012), *8th Consumer Markets Scoreboard, DG SANCO*

for long-haul connections. In September 2012, the government established an Airports Commission<sup>65</sup> to conduct an independent assessment of the future of aviation capacity in the South East, including the possibility of building a third runway at Heathrow. However, the final report is not due until 2015 and there is scope for the government to make progress in the interim, given the pressing need for additional capacity.

### *Energy, climate and resource efficiency*

**The UK is making good progress towards meeting its Europe 2020 target for greenhouse gas emissions not covered by the EU-wide EU Emissions Trading Scheme (ETS).** In 2011 emissions were 14% below 2005 levels. Projections based on existing measures suggest that the UK emissions from non-ETS sectors will be 19% below 2005 levels by 2020, exceeding the 16% cut by 2020 required under Europe 2020. The long-term legally binding framework established under the 2008 Climate Change Act, including statutory carbon budgets, continues to drive emissions reductions and a focus on green growth. In October 2012, a Green Investment Bank was launched with GBP 3 billion (EUR 3.5 billion) to invest in the transition to a green economy. The UK housing stock is relatively old and the government estimate that 38% of GHG emissions in the UK come from energy inefficient buildings. The government's main programme to improve energy efficiency is the Green Deal, launched in January 2013. It provides households and landlords with the option of paying back investment costs over time through energy bills, rather than paying costs upfront.

**The UK ranks 25th out of 27 EU Member States regarding the share of renewable energy sources in final energy consumption.** Under Directive 2009/28/EC on the promotion of the use of energy from renewable sources, the UK is committed to reaching a target of 15% of renewable energy sources in final energy consumption and a 10% share of renewable energy in the transport sector by 2020. Currently, performance on energy from renewable sources is significantly short of the target. In 2011 the share of renewable energy in gross final energy consumption was 3.8%, below the first interim target set for 2011-2012 (4.1%). The National Renewable Energy Action Plan outlines the current and future measures to be deployed to follow the trajectory for developing renewable energy sources laid down in the Directive and sets sectoral targets. Over the 2007-2013 programming period, around EUR 433 million or 4.2% of the ERDF in the UK has been devoted to renewable energy and energy efficiency. The Commission's position on the development of the Partnership Agreement and programmes in the United Kingdom for the period 2014-2020 states that ESI Funds should support an increase in the use of all types of renewable energy.

**The UK has an increasingly urgent need for new electricity generating capacity, but there has been a lot of uncertainty over the prospects for energy investment, due mainly to regulatory risks.** The Energy Bill, submitted to Parliament in 2012, includes a number of policies intended to set a clearer long-term framework for investments in low carbon energy generation and to stimulate green growth. In view of potential generation capacity shortages in Great Britain in the latter part of this decade, the Energy Bill introduces an explicit capacity mechanism to address this concern. Electricity market reform should make a difference in helping to stimulate the GBP 110 billion (EUR 130 billion) of investment needed to renew the UK's electricity infrastructure<sup>66</sup>. The Energy Bill also proposes a new long-term feed-in tariff for renewable electricity generation to replace the existing renewables obligation. Other changes to support for renewables proposed in 2012 included reduced tariffs for some renewable generation, and the addition of a new domestic renewable heat incentive. Given the

<sup>65</sup> See <https://www.gov.uk/government/organisations/airports-commission>

<sup>66</sup> Ofgem (2012), *Electricity capacity assessment* (Ref: 126/12)

importance of an effectively-functioning internal energy market for delivering new investment, it will be very important for the UK to ensure that detailed measures implemented under the Energy Bill to attract new investment are fully in line with State aid and internal market rules.

**UK energy networks are being improved to ensure the security of supply and to add flexibility and reliability to the grid.** There are significant developments in the power transmission grid across the UK to better integrate generation from renewable sources, such as both on and offshore wind farms. Further strengthening the electricity grid and interconnections, especially to mainland Europe, would allow the UK and EU to benefit from the UK's significant potential for wind power generation, especially offshore.

**Although the UK has taken reasonable first steps to improve resource efficiency, there is still room for improvement, especially as regards waste and water management.** The UK still landfills almost 50% of its municipal household waste, in contrast to most other EU countries, although the government plans to increase the landfill tax. The UK already recycles or composts almost 40% of waste, so reaching the 50% recycling target by 2020 may be possible. Full implementation of the existing waste legislation could reduce direct and indirect GHG emissions by an amount equal to 4% of total 2004 emissions. The current level of water abstraction is unsustainable, and water scarcity will have impacts not only on the population, but also on industry and agriculture.

### ***Research and innovation***

**Although the UK scores above the EU average on innovation indicators<sup>67</sup>, it has relative weaknesses in R&D investment by firms, the creation of intellectual assets, SMEs introducing product or process innovations, and sales of new-to-market or new-to-firm innovations.** Business expenditure on R&D fell from 1.17% of GDP in 2001 to 1.09% in 2011<sup>68</sup>. Furthermore, in the last decade, overall expenditure on R&D has averaged around 1.8% of GDP, lower than the EU average of 2.03%. The UK has not set a national R&D intensity target in response to the European Council's request regarding Europe 2020 headline targets. As part of the 2010 Spending Review, the budget for science was frozen in cash terms at just over GBP 4.6 billion (EUR 5.4 billion) for the next four years. This amounts to a cut of some 10% in real terms over the period. The capital expenditure budget for science was not protected, although additional commitments to research capital announced since Spending Review 2010 have reduced the initially planned 44% cuts considerably<sup>69</sup>. R&D tax credits continue to be the largest single source of government support for business R&D<sup>70</sup>.

### **3.5. Modernisation of public administration**

**The UK generally performs well in surveys on the quality and timeliness of public administration<sup>71</sup>.** The government itself has set ambitious targets to reduce the administrative burden on companies, and to use e-government tools as much as possible. Regarding regulatory burdens, the one in, one out target has been replaced by the even more ambitious one in, two out, to help stem the flow of new regulation. Regarding e-government, the digital

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<sup>67</sup> European Commission (2013), *Innovation Union Scoreboard 2013*

<sup>68</sup> Eurostat (2013). Provisional figure

<sup>69</sup> Campaign for Science and Engineering (CaSE) (2013), *Public Funding of UK Science and Engineering — March 2013 update*

<sup>70</sup> The UK authorities estimate that claims are made for some two-thirds of all business R&D expenditure and that each GBP 1 of foregone tax revenue from the R&D tax credit stimulates between GBP 0.47 and GBP 3.37 of R&D investment (UK National Reform Programme 2013)

<sup>71</sup> European Commission (2012), *Excellence in public administration for competitiveness in EU Member States*

by default principle is being implemented, meaning that online services will get priority unless there is a good reason to take a different approach<sup>72</sup>.

**The UK does, however, have scope to improve public procurement, particularly in facilitating the participation of SMEs.** The UK authorities estimate that only 12 % of central government procurement is currently from SMEs, against their target of 25 %. The government is aware of the issue, but is finding it difficult to overcome strong resistance to the centralisation of procurement across central government, and to reconcile its localism agenda with the streamlining and coordination needed to make public procurement more accessible.

**The UK lacks mechanisms of control and knowledge over state aid granted.** Other Member States have introduced relevant procedures such as transparency mechanisms and bodies in charge of checking eligibility of aid awards<sup>73</sup>. One of the UK's main challenges for the successful implementation of the European Regional Development Fund (ERDF) 2007-2013 Operational Programmes is the scarcity of funding to match EU funds, especially after the abolition of the Regional Development Agencies. However, despite these challenging circumstances, the absorption rate of ERDF in the UK is still acceptable. Around 80 % of resources had been contracted to operations by the end of 2012.

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<sup>72</sup> Cabinet Office (2012), *Government Digital Strategy*

<sup>73</sup> For instance, Estonia recently introduced a public registry of all State aid awards, including de minimis aid, on the homepage of the Ministry of Finance (<http://www.fin.ee/riigiabi>); in Hungary, the State aid Monitoring Office (<http://tvi.kormany.hu/home>) is in charge of checking eligibility under the General Block Exemption Regulation; Slovenia's Ministry of Finance has put in place a system of regular monitoring and evaluation of State aid measures ([http://www.mf.gov.si/en/areas\\_of\\_work/state\\_aid\\_monitoring/surveys\\_on\\_state\\_aid\\_in\\_slovenia/](http://www.mf.gov.si/en/areas_of_work/state_aid_monitoring/surveys_on_state_aid_in_slovenia/))

#### 4. OVERVIEW TABLE

2012 commitments	Summary assessment
Country-specific recommendations (CSRs)	
<p><b>CSR 1:</b> Fully implement the budgetary strategy for the financial year 2012-13 and beyond, supported by sufficiently specified measures, to ensure a timely correction of the excessive deficit in a sustainable manner and the achievement of the structural adjustment effort specified in the Council recommendations under the EDP and to set the high public debt ratio on a sustained downward path. Subject to reinforcing the budgetary strategy for the financial year 2013-14 and beyond, prioritise growth-enhancing expenditure to avoid the risk that a further weakening of the medium-term outlook for growth will negatively impact on the long- term sustainability of public finances.</p>	<p>The UK has made limited progress on measures taken to address the CSR.</p> <p>At 6.4 %, structural borrowing in FY 2012-13 was only 0.3 pp. lower than in 2011-12, despite the UK government sticking to its fiscal consolidation strategy. The deficit is forecast at 6.8 % in 2013-14 and 6.3 % in 2014.</p> <p>Some modest progress has been made on making the structure of consolidation more growth-friendly by shifting spending towards capital budgets.</p>
<p><b>CSR 2:</b> Address the destabilising impact of high and volatile house prices and high household debt by implementing a comprehensive housing reform programme to increase housing supply and alleviate problems of affordability and the need for state subsidisation of housing. Pursue further reforms to the housing market, including the mortgage and rental markets, financial regulation and property taxation to prevent excessive volatility and distortions in the housing market.</p>	<p>The UK has made some progress on measures taken to address the CSR.</p> <p>Government has reformed the planning system and put in place a number of regulatory and fiscal measures aimed at increasing residential construction, but it is not yet clear how effective these will be in boosting the supply of housing.</p> <p>Both residential construction and new mortgage lending remain low, affected by a weak economy and policy constraints. There is also a risk that recent government interventions that stimulate housing demand more than supply, in particular Help to Buy, could reflate a housing bubble and consequently household debt. This could also further decrease housing affordability.</p> <p>Limited changes to SLDT have been made but no wider reforms to property taxation have been made.</p>
<p><b>CSR 3:</b> Continue to improve the employability of young people, in particular those not in education, employment or training, including by using the Youth Contract. Ensure that apprenticeship schemes are taken up by more young people, have a sufficient focus on advanced and higher-level skills, and involve more small and medium-sized businesses. Take measures to reduce the high proportion of young people aged 18-24 with very poor basic skills.</p>	<p>The UK has made some progress on measures taken to address the CSR.</p> <p>If implemented effectively, with a proper focus on increasing the quality of apprenticeship programmes, including their level and duration, a number of measures taken may increase the labour market relevance of apprenticeships.</p> <p>The measures in the education system to improve the skill levels and employability of young people have a long-term nature and therefore it is too early to assess their impact.</p>
<p><b>CSR 4:</b> Step up measures to facilitate the labour market integration of people from jobless households. Ensure that planned welfare reforms do not translate into increased child poverty. Fully implement measures aiming to facilitate access to childcare services.</p>	<p>The UK has made some progress on measures taken to address the CSR.</p> <p>The introduction of Universal Credit will be a positive step, with its focus on benefits</p>



	<p>simplification and improving work incentives, although the employment impact is likely to depend in part on effective implementation.</p> <p>However reforms to Council Tax benefit appear likely to increase poverty and make the benefits system more complex, partially offsetting the simplification benefits of Universal Credit.</p> <p>Early evidence on the impact of the new flagship Work Programme for the unemployed is disappointing.</p> <p>Relative poverty, including child poverty, fell slightly from 2010 to 2011, due in part to falling real median income. However, poverty is likely to increase in future due to a range of real terms reductions to working age welfare payments that the government is making as part of its fiscal consolidation strategy.</p> <p>Some additions to early years provision are being made but childcare remains expensive and of variable quality.</p>
<p><b>CSR 5:</b> Further improve the availability of bank and non-bank financing to the private sector, in particular to SMEs. Support competition within the banking sector, in particular through measures to reduce barriers to entry, increase transparency and facilitate switching between banks as recommended by the Independent Commission on Banking and explore ways to improve access to venture and risk capital and other forms of non-bank lending.</p>	<p>The UK has made some progress on measures taken to address the CSR.</p> <p>The government has put in place a number of schemes aimed at increasing lending but net credit trends remained weak throughout 2012. Many firms, notably SMEs, are experiencing difficulties in obtaining credit to finance investment. More coordination and clarity among the different programmes would be beneficial for SMEs.</p> <p>The FLS has contributed to ease bank funding costs and credit conditions, but there is a risk of it being primarily channelled to sectors that are less in need of funding.</p> <p>The government is addressing a number of the recommendations put forth in the Breendon review, but access to non-bank lending remains largely restricted to bigger firms.</p> <p>There remains limited competition in the banking industry, but some actions to tackle barriers to entry have been announced. Lloyds bank and RBS are yet to divest of part of their assets to comply with state aid rules and to facilitate the creation of new challenger banks.</p>
<p><b>CSR 6:</b> Pursue a long-term strategy for improving the capacity and quality of the UK's network infrastructure, including measures to address pressures in transport and energy networks by promoting more efficient and robust planning and decision-making processes, and harnessing appropriate public or private financing arrangements.</p>	<p>The UK has made some progress on measures taken to address the CSR.</p> <p>Overall, public investment has fallen and remains relatively low, but there has been some prioritisation of higher value projects.</p> <p>Quality and congestion of transport infrastructure remains a structural weakness affecting the whole economy, and especially goods producing and</p>

	<p>exporting companies. The rail investment pipeline should help to accommodate the forecast continued increase in rail traffic. The government has announced a lot of initiatives to boost private investment in the road network but most remain aspirational and the UK needs to be careful not to repeat past mistakes. Limited progress has been made in addressing the need for additional hub airport capacity.</p> <p>There has been a lot of uncertainty over the prospects for energy investment, due in part to regulatory risks. UK assessments show an increasing need for new generating capacity, both renewable and non-renewable.</p> <p>The energy bill aims to put in place measures to attract the GBP 110 billion (EUR 130 billion) investment that is needed to replace current generating capacity and upgrade the grid by 2020.</p> <p>The UK should ensure that the detailed measures to attract new investments are fully in line with State aid and internal market rules.</p>
<b>Europe 2020 (national targets and progress)</b>	
Employment rate target: No target set in NRP	<p>73.6 % of the population aged 20-64 was employed in 2011 (unchanged from 73.6 % in 2010).</p> <p>Little progress has been made in contributing to this target in 2012, but the situation has not deteriorated. The UK employment rate is now marginally below the Europe 2020 target of 75 %.</p> <p>In 2012 private sector employment grew sufficiently to offset reductions in public sector employment and the growth of the workforce. To raise employment in the longer term, the UK also faces challenges to increase work incentives and parental employment, to improve access to high-quality, affordable childcare, and to raise skill levels.</p>
R&D target: No target set in NRP	<p>1.86 % (2009), 1.77 % (2010), 1.77 % (2011).</p> <p>The share of R&amp;D spending in UK GDP is below the EU average of 2.03 %. It has averaged around 1.8 % over the past decade. The trend since 2000 shows an initial fall, a mild recovery from 2005 (peaking in 2009), and a recent decline then stabilisation.</p>
Greenhouse gas (GHG) emissions target: -16 % (compared to 2005 emissions. ETS emissions not covered by this national target)	<p>Change in non-ETS greenhouse gas emissions between 2005 and 2011: -14 %.</p> <p>According to the latest national projections submitted to the Commission and when existing measures are taken into account, the target is expected to be reached: -19 % in 2020 compared to</p>

	2005 (with a margin of 3 pps).
Renewable energy target: 15 % Share of renewable energy in all modes of transport: 10 %	Share of renewable energy in gross final energy consumption was 3.8 % in 2011, and 2.9 % in transport <sup>74</sup> .  Progress to date was not sufficient to reach the 2011-12 interim trajectory target (4.1 %). To achieve the 2020 target, the UK should urgently finish developing and put in place a coherent, stable and predictable renewable energy support framework.
Indicative national energy efficiency target for 2020: final energy consumption in 2020 of 129.2 Mtoe. This implies reaching a 2020 level of 177.6 Mtoe primary consumption and 157.8 Mtoe final energy consumption.	The United Kingdom has set an indicative national energy efficiency target in accordance with Articles 3 and 24 of the Energy Efficiency Directive (2012/27/EU). It has also expressed it, as required, in terms of an absolute level of primary and final energy consumption in 2020 and has provided information on the basis on which data this has been calculated.
Early school leaving target: No target set in NRP	Early school leaving rate: 14.9 % in 2010; 15.0 % in 2011; 13.5 % in 2012.  The early school leaving rate is falling but remains slightly above the EU average (12.9 % in 2012). The government is introducing reforms which should have a significant effect in reducing early school leaving. The age of compulsory participation in education or training is increasing from 16 to 17 in 2013 and 18 in 2015.
Tertiary education target: No target set in NRP	Tertiary attainment rate: 43.0 % in 2010; 45.8 % in 2011; 47.1 % in 2012.  The UK tertiary attainment rate has increased significantly from 29 % in 2000, and is well above the EU average (35.5 % in 2012).
Risk of poverty or social exclusion target: Existing numerical targets in the 2010 Child Poverty Act and Child Poverty Strategy 2011-14	The percentage of the population at risk of poverty or social exclusion was 23.1 % in 2010 and 22.7 % in 2011 (slightly below the EU averages of 23.6 % and 24.2 % respectively).  The fall in the indicator from 2010 to 2011 is partly explained by a reduction in the poverty threshold due to falling real median income. Three other relevant social inclusion indicators rose from 2010 to 2011: risk-of-poverty or exclusion of elderly: +0.4 pp.; severe material deprivation: +0.3 pp.; in-work at-risk-of-poverty rate: +1 pp.  Although the latest figures show a reduction in the number of children living below the relative poverty

<sup>74</sup> Eurostat (April 2013). For 2011, only formally reported biofuels compliant with Art. 17 and 18 of Directive 2009/28/EC are included)

	threshold, linked to the drop in median income, absolute poverty remained unchanged. Planned real terms reductions in some working age welfare benefits are likely to increase poverty rates.
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## 5. ANNEX

**Table I. Macroeconomic indicators**

	1995- 1999	2000- 2004	2005- 2009	2010	2011	2012	2013	2014
<b>Core indicators</b>								
GDP growth rate	3.2	3.3	0.8	1.8	1.0	0.3	0.6	1.7
Output gap <sup>1</sup>	0.1	0.9	0.8	-2.6	-2.2	-2.5	-2.6	-1.8
HICP (annual % change)	2.0	1.2	2.5	3.3	4.5	2.8	2.8	2.5
Domestic demand (annual % change) <sup>2</sup>	3.7	3.7	0.3	2.3	-0.6	1.4	0.6	1.3
Unemployment rate (% of labour force) <sup>3</sup>	7.0	5.0	5.7	7.8	8.0	7.9	8.0	7.9
Gross fixed capital formation (% of GDP)	16.9	16.8	16.6	14.9	14.1	14.2	14.4	14.9
Gross national saving (% of GDP)	16.6	15.0	14.9	12.6	13.7	10.8	11.8	12.9
<b>General Government (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-2.3</b>	<b>-1.0</b>	<b>-5.1</b>	<b>-10.2</b>	<b>-7.8</b>	<b>-6.3</b>	<b>-6.8</b>	<b>-6.3</b>
<b>Gross debt</b>	<b>48.2</b>	<b>39.3</b>	<b>50.0</b>	<b>79.4</b>	<b>85.5</b>	<b>90.0</b>	<b>95.5</b>	<b>98.7</b>
<b>Net financial assets</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Total revenue	38.5	39.8	41.0	40.3	40.8	42.2	41.7	41.5
Total expenditure	40.7	40.7	46.1	50.5	48.6	48.5	48.5	47.8
<i>of which: Interest</i>	3.4	2.2	2.1	3.0	3.3	3.0	2.9	2.9
<b>Corporations (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>0.0</b>	<b>0.5</b>	<b>5.8</b>	<b>6.5</b>	<b>6.4</b>	<b>1.8</b>	<b>3.0</b>	<b>3.3</b>
<b>Net financial assets; non-financial corporations</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
<b>Net financial assets; financial corporations</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross capital formation	12.1	10.6	9.7	8.7	8.8	8.6	8.4	8.7
Gross operating surplus	23.6	20.4	22.4	21.8	21.4	20.3	24.7	19.4
<b>Households and NPISH (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>1.5</b>	<b>-1.7</b>	<b>-2.6</b>	<b>1.2</b>	<b>0.9</b>	<b>1.6</b>	<b>1.4</b>	<b>1.2</b>
<b>Net financial assets</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Gross wages and salaries	45.5	47.1	45.3	44.8	44.4	45.0	45.1	45.1
Net property income	10.5	8.4	7.2	7.7	7.9	7.6	7.5	7.4
Current transfers received	22.4	21.9	21.9	24.5	23.9	25.1	25.2	24.9
Gross saving	5.1	3.2	2.1	4.5	4.5	5.1	5.0	4.9
<b>Rest of the world (% of GDP)</b>								
<b>Net lending (+) or net borrowing (-)</b>	<b>-0.8</b>	<b>-2.1</b>	<b>-1.7</b>	<b>-2.3</b>	<b>-1.1</b>	<b>-3.5</b>	<b>-2.5</b>	<b>-1.8</b>
<b>Net financial assets</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>	<b>n.a</b>
Net exports of goods and services	-0.1	-2.4	-2.4	-2.1	-1.6	-2.3	-2.6	-2.6
Net primary income from the rest of the world	-0.4	0.7	1.3	0.9	1.6	-0.1	1.4	2.0
Net capital transactions	0.1	0.1	0.2	0.3	0.2	0.2	0.2	0.2
Tradable sector	44.3	41.0	37.5	37.1	37.1	37.0	n.a	n.a
Non tradable sector	44.8	47.9	52.0	52.2	51.2	51.5	n.a	n.a
<i>of which: Building and construction sector</i>	5.3	6.1	6.6	6.1	6.0	5.5	n.a	n.a
Real effective exchange rate (index, 2000=100)	86.6	98.7	95.9	83.8	83.2	88.3	86.5	87.4
Terms of trade goods and services (index, 2000=100)	96.5	100.0	99.0	97.4	95.1	95.5	94.8	93.9
Market performance of exports (index, 2000=100)	111.0	100.0	99.1	96.3	96.5	95.8	95.7	95.1
Notes:								
<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
<sup>2</sup> The indicator on domestic demand includes stocks.								
<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks.								
The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.								
Source:								
Commission services' 2013 spring forecasts (COM); Convergence programme (CP).								

**Table II. Comparison of macroeconomic developments and forecasts**

	2012		2013		2014		2015	2016	2017
	COM	CP	COM	CP	COM	CP	CP	CP	CP
Real GDP (% change)	0.3	0.2	0.6	0.6	1.7	1.8	2.3	2.7	2.8
Private consumption (% change)	1.2	1.0	0.8	0.5	1.3	1.2	1.7	2.4	2.8
Gross fixed capital formation (% change)	1.5	1.4	1.8	2.2	4.5	6.7	8.1	7.7	7.8
Exports of goods and services (% change)	-0.2	-0.3	1.3	1.5	3.9	4.4	5.1	5.3	5.3
Imports of goods and services (% change)	2.7	2.0	1.3	1.0	2.6	3.8	4.4	4.8	4.9
<i>Contributions to real GDP growth:</i>									
- Final domestic demand	1.5	1.4	0.9	0.7	1.4	1.6	2.2	2.5	2.7
- Change in inventories	-0.1	-0.2	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0
- Net exports	-1.0	-0.8	0.0	0.1	0.4	0.1	0.1	0.1	0.1
Output gap <sup>1</sup>	-2.5	-2.4	-2.6	-2.6	-1.8	-1.9	-1.2	-0.3	0.3
Employment (% change)	1.2	1.0	0.5	1.0	1.1	0.3	0.7	0.7	0.7
Unemployment rate (%)	7.9	7.9	8.0	7.9	7.9	8.0	7.9	7.4	6.9
Labour productivity (% change)	-0.9	-1.1	0.0	-0.3	0.6	1.5	1.7	1.8	2.0
HICP inflation (%)	2.8	2.8	2.8	2.8	2.5	2.4	2.1	2.0	2.0
GDP deflator (% change)	1.4	1.3	1.7	2.1	1.6	2.0	1.8	1.8	1.7
Comp. of employees (per head, % change)	2.3	1.4	2.6	1.7	2.8	2.6	3.6	4.3	4.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-3.5	-3.3	-2.5	-2.3	-1.8	-1.9	-1.6	-1.4	n.a.

Note:

<sup>1</sup>In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission services' 2013 spring forecasts (COM); Convergence programme (CP).

**Table III. Composition of the budgetary adjustment**

(% of GDP)	2012-13	2013-14		2014-15		2015-16	2016-17	2017-18	Change : 2012-13 to 2017-18
	COM	COM	CP	COM <sup>1</sup>	CP	CP	CP	CP	CP
<b>Revenue</b>	<b>42.6</b>	<b>41.5</b>	<b>38.0</b>	<b>41.4</b>	<b>37.8</b>	<b>37.7</b>	<b>38.0</b>	<b>37.9</b>	<b>-4.3</b>
<i>of which:</i>									
- Taxes on production and imports	13.4	13.9	13.6	14.5	13.6	13.6	13.5	13.4	0.1
- Current taxes on income, wealth, etc.	15.0	15.5	12.5	16.1	12.6	12.6	12.9	13.1	-2.0
- Social contributions	8.5	8.7	6.7	9.0	6.5	6.6	7.0	7.0	-1.5
- Other (residual)	5.7	3.5	5.2	1.8	5.1	4.9	4.6	4.4	-0.9
<b>Expenditure</b>	<b>48.3</b>	<b>48.5</b>	<b>44.9</b>	<b>47.5</b>	<b>43.8</b>	<b>42.8</b>	<b>41.5</b>	<b>40.2</b>	<b>-8.3</b>
<i>of which:</i>									
- Primary expenditure	45.3	45.5	41.7	44.4	40.6	39.4	37.9	36.4	-9.1
<i>of which:</i>									
Compensation of employees and intermediate consumption	23.0	23.7	n.a.	24.0	n.a.	n.a.	n.a.	n.a.	n.a.
Social payments	15.6	16.1	n.a.	16.4	n.a.	n.a.	n.a.	n.a.	n.a.
Subsidies	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7	0.1
Gross fixed capital formation	2.2	2.3	1.9	2.4	2.0	1.9	1.9	1.8	-0.3
Other (residual)	3.9	2.8	3.4	1.0	3.2	3.0	2.9	2.7	-1.2
- Interest expenditure	3.0	3.0	3.2	3.1	3.2	3.4	3.6	3.8	0.8
<b>General government balance (GGB)</b>	<b>-5.6</b>	<b>-6.9</b>	<b>-6.8</b>	<b>-6.1</b>	<b>-6.0</b>	<b>-5.2</b>	<b>-3.5</b>	<b>-2.3</b>	<b>4.0</b>
<b>Primary balance</b>	<b>-2.7</b>	<b>-4.0</b>	<b>-3.7</b>	<b>-3.2</b>	<b>-2.8</b>	<b>-1.8</b>	<b>0.1</b>	<b>1.5</b>	<b>4.9</b>
One-off and other temporary measures	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.8
<b>GGB excl. one-offs</b>	<b>-7.6</b>	<b>-6.9</b>	<b>-6.8</b>	<b>-6.1</b>	<b>-6.0</b>	<b>-5.2</b>	<b>-3.5</b>	<b>-2.3</b>	<b>5.9</b>
Output gap <sup>2</sup>	-2.5	-2.4	-2.6	-1.7	-1.9	-1.2	-0.3	0.3	2.7
Cyclically-adjusted balance <sup>2</sup>	-4.4	-5.8	-5.6	-5.3	-5.1	-4.6	-3.3	-2.4	2.7
<b>Structural balance (SB)<sup>3</sup></b>	<b>-6.4</b>	<b>-5.8</b>	<b>-5.6</b>	<b>-5.3</b>	<b>-5.1</b>	<b>-4.6</b>	<b>-3.3</b>	<b>-2.4</b>	<b>4.5</b>
<i>Change in SB</i>	<i>0.3</i>	<i>0.6</i>	<i>0.8</i>	<i>0.5</i>	<i>0.5</i>	<i>0.4</i>	<i>1.3</i>	<i>0.9</i>	<i>-</i>
<i>Two year average change in SB</i>	<i>1.0</i>	<i>0.5</i>	<i>0.6</i>	<i>0.6</i>	<i>0.7</i>	<i>0.5</i>	<i>0.9</i>	<i>1.1</i>	<i>-</i>
<b>Structural primary balance<sup>3</sup></b>	<b>-3.4</b>	<b>-2.8</b>	<b>-2.4</b>	<b>-2.2</b>	<b>-1.9</b>	<b>-1.2</b>	<b>0.3</b>	<b>1.4</b>	<b>5.4</b>
<i>Change in structural primary balance</i>		<i>0.6</i>	<i>1.1</i>	<i>0.6</i>	<i>0.5</i>	<i>0.6</i>	<i>1.5</i>	<i>1.1</i>	<i>-</i>
<b>Expenditure benchmark</b>									
Applicable reference rate <sup>4</sup>	0.09	0.09	0.09	0.04	0.04	0.04	0.04	n.a.	-
Deviation <sup>5</sup> (% GDP)	-2.6	1.4	n.a.	-0.2	n.a.	n.a.	n.a.	n.a.	-
Two-year average deviation (% GDP)	-2.3	-0.6	n.a.	0.6	n.a.	n.a.	n.a.	n.a.	-
<b>Notes:</b> <sup>1</sup> On a no-policy-change basis. <sup>2</sup> Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology. <sup>3</sup> Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures. <sup>4</sup> Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t. The reference rates applicable to 2014 onwards have been updated in 2013. <sup>5</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.  <b>Source:</b> Convergence programme (CP); Commission services' 2013 spring forecasts (COM); Commission services' calculations.									

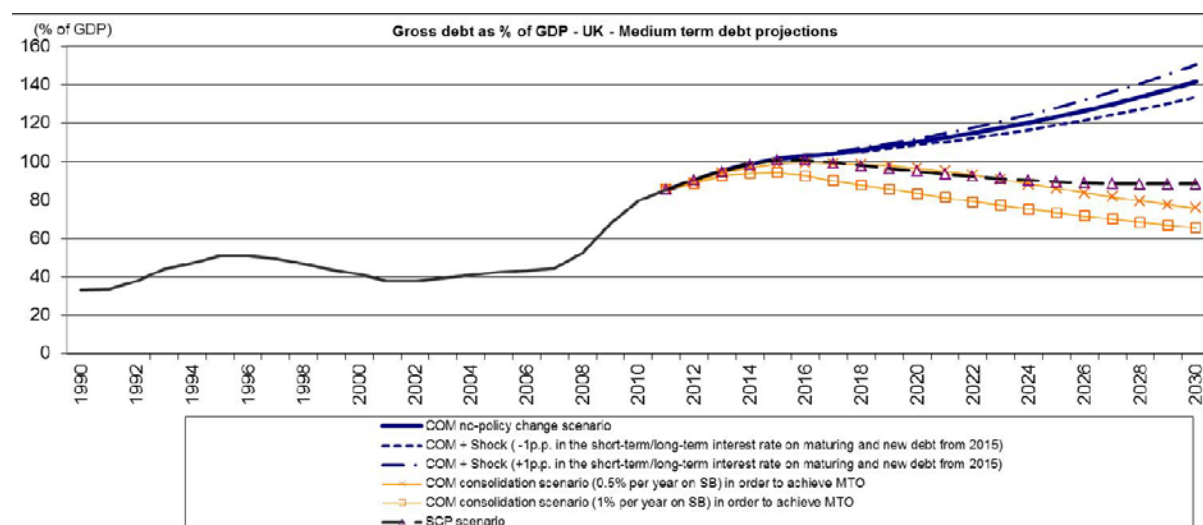
**Table IV. Debt dynamics**

(% of GDP)	Average 2007-08 to 2011-12	2012- 13	2013-14		2014-15		2015-	2016-	2017-
			COM	CP	COM	CP	CP	CP	CP
<b>Gross debt ratio<sup>1</sup></b>	<b>68.0</b>	<b>90.6</b>	<b>95.6</b>	<b>94.9</b>	<b>98.7</b>	<b>98.6</b>	<b>100.8</b>	<b>100.8</b>	<b>99.4</b>
Change in the ratio	8.7	4.3	5.0	4.3	3.0	3.7	2.2	0.0	-1.4
<i>Contributions<sup>2</sup>:</i>									
<b>1. Primary balance</b>	<b>5.2</b>	<b>2.7</b>	<b>4.0</b>	<b>3.7</b>	<b>3.2</b>	<b>2.8</b>	<b>1.8</b>	<b>-0.1</b>	<b>-1.5</b>
<b>2. "Snow-ball" effect</b>	<b>1.1</b>	<b>1.3</b>	<b>1.0</b>	<b>0.7</b>	<b>-0.6</b>	<b>-0.2</b>	<b>-0.5</b>	<b>-0.6</b>	<b>-0.6</b>
<i>Of which:</i>									
Interest expenditure	2.6	3.0	2.9	3.1	2.9	3.2	3.4	3.6	3.8
Growth effect	-0.2	-0.2	-0.8	-0.5	-1.7	-1.6	-2.2	-2.6	-2.7
Inflation effect	-1.3	-1.5	-1.2	-1.8	-1.8	-1.8	-1.8	-1.6	-1.7
<b>3. Stock-flow adjustment</b>	<b>2.4</b>	<b>0.3</b>	<b>0.0</b>	<b>-0.2</b>	<b>0.5</b>	<b>1.2</b>	<b>1.0</b>	<b>0.7</b>	<b>0.7</b>
<i>Of which:</i>									
Cash/accruals diff.									
Acc. financial assets									
Privatisation									
Val. effect & residual									
			<b>2013</b>		<b>2014</b>		<b>2015</b>	<b>2016</b>	<b>2017</b>
	<b>2012</b>		COM/ CP <sup>3</sup>	CP <sup>4</sup>	COM/ CP <sup>3</sup>	CP <sup>4</sup>	CP	CP	SP
<b>Gap to the debt benchmark<sup>5,6</sup></b>	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.
<b>Structural adjustment<sup>7</sup></b>	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	0.5	1.3	0.9
<i>To be compared to:</i>									
<b>Required adjustment<sup>8</sup></b>	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	1.0	1.3	1.3
<p><u>Notes:</u></p> <p><sup>1</sup>End of period.</p> <p><sup>2</sup>The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.</p> <p><sup>3</sup> Assessment of the consolidation path set in CP assuming growth follows the COM forecasts.</p> <p><sup>4</sup>Assessment of the consolidation path set in the CP assuming growth follows the CP projections.</p> <p><sup>5</sup>Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.</p> <p><sup>6</sup>Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.</p> <p><sup>7</sup>Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.</p> <p><sup>8</sup>Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.</p> <p><u>Source:</u></p> <p>Convergence programme (CP); Commission services' spring 2013 forecasts (COM); Commission services' calculations.</p>									



**Table V. Sustainability indicators**

	UK		EU27	
	No-policy change scenario	Programme (SCP) scenario	No-policy change scenario	Programme (SCP) scenario
S2	6.2	2.4	3.0	1.3
<i>of which:</i>				
Initial budgetary position (IBP)	3.6	-0.4	0.8	-0.9
Long-term cost of ageing (CoA)	2.6	2.8	2.2	2.2
<i>of which:</i>				
Pensions	1.2	1.5	1.0	1.1
Health care	0.8	0.8	0.9	0.8
Long-term care	0.5	0.5	0.6	0.6
Others	0.1	0.1	-0.4	-0.3
S1 (required adjustment)*	6.1	2.4	2.2	0.5
<i>of which:</i>				
Initial budgetary position (IBP)	3.4	-1.0	0.0	-1.8
Debt requirement (DR)	2.5	3.1	1.9	1.9
Long-term cost of ageing (CoA)	0.2	0.3	0.3	0.4
S0 (risk for fiscal stress)**	0.29		:	
Debt, % of GDP (2012)	90.0		87.0	
Age-related expenditure, % of GDP (2012)	22.3		25.8	
<b>Note:</b> The 'No-policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the Commissions' spring 2013 forecast until 2014. The 'Programme (SCP)' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented. * The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030. ** The critical threshold for the S0 indicator is 0.44.				
<b>Source:</b> Commission services; 2013 stability programme.				



**Table VI. Taxation indicators**

	2002	2006	2008	2009	2010	2011
<b>Total tax revenues</b> (incl. actual compulsory social contributions, % of GDP)	35.2	36.6	37.6	34.6	35.4	36.1
<b>Breakdown by economic function</b> (% of GDP) <sup>1</sup>						
Consumption	11.6	10.9	10.7	10.3	11.2	11.9
of which:						
- VAT	6.7	6.6	6.4	5.7	6.5	7.3
- excise duties on tobacco and alcohol	1.4	1.2	1.2	1.3	1.3	1.3
- energy	2.2	1.8	1.8	1.9	1.9	1.9
- other (residual)	1.4	1.3	1.3	1.4	1.5	1.5
Labour employed	13.6	14.2	14.4	14.2	14.1	14.0
Labour non-employed	0.2	0.2	0.2	0.1	0.2	0.2
Capital and business income	5.5	6.8	6.6	5.6	5.7	5.7
Stocks of capital/wealth	4.3	4.6	5.8	4.4	4.3	4.4
<i>p.m.</i> Environmental taxes <sup>2</sup>	2.7	2.4	2.4	2.6	2.6	2.6
<b>VAT efficiency</b> <sup>3</sup>						
Actual VAT revenues as % of theoretical revenues at standard rate	48.2	47.9	46.3	46.7	46.3	46.5
<p><b>Note:</b></p> <p><sup>1</sup> Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2013) Taxation trends in the European Union, for a more detailed explanation.</p> <p><sup>2</sup> This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.</p> <p><sup>3</sup> The VAT efficiency is measured via the VAT revenue ratio. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). See European Commission (2012), Tax reforms in EU Member States, European Economy 6/2012 and Taxation Papers 34/2012 for a more detailed explanation.</p>						
<i>Source: Commission</i>						

**Table VII. Financial market indicators**

	2008	2009	2010	2011	2012
Total assets of the banking sector (% of GDP)	482.3	569.4	536.7	557.0	503.5
Share of assets of the five largest banks (% of total assets)	35.3	34.1	39.8	44.1	...
Foreign ownership of banking system (% of total assets)	50.9	45.8	...	...	...
Financial soundness indicators:					
- non-performing loans (% of total loans) <sup>1)</sup>	1.6	3.5	4.0	4.0	...
- capital adequacy ratio (%) <sup>1)</sup>	12.9	14.8	15.9	15.7	...
- return on equity (%) <sup>1), 2)</sup>	-10.3	2.6	3.9	2.2	...
Bank loans to the private sector (year-on-year % change)	-14.9	3.2	4.6	-1.5	2.9
Lending for house purchase (year-on-year % change)	-27.5	24.1	18.0	3.9	4.4
Loan to deposit ratio	117.1	110.0	107.1	104.0	102.6
CB liquidity as % of liabilities	...	...	...	...	...
Banks' exposure to countries receiving official financial assistance (% of GDP) <sup>3)</sup>	13.7	15.4	13.6	12.0	9.9
Private debt (% of GDP)	...	208.8	204.9	195.2	...
Gross external debt (% of GDP) <sup>4)</sup>					
- Public	13.0	17.8	23.3	29.0	28.8
- Private	111.7	138.4	140.6	151.4	156.7
Long term interest rates spread versus Bund (basis points)*	0.5	0.1	0.6	0.3	0.2
Credit default swap spreads for sovereign securities (5-year)*	48.0	84.8	72.8	72.4	59.1
<p>Notes:</p> <p><sup>1)</sup> Latest data (December 2011).</p> <p><sup>2)</sup> After extraordinary items and taxes.</p> <p><sup>3)</sup> Covered countries are CY, EL, ES, LV, HU, IE, PT and RO.</p> <p><sup>4)</sup> Latest data 2012Q3.</p> <p>* Measured in basis points.</p> <p>Source :</p> <p>Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).</p>					

**Table VIII. Labour market and social indicators**

<b>Labour market indicators</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Employment rate (% of population aged 20-64)	75.2	75.2	73.9	73.6	73.6	74.2
Employment growth (% change from previous year)	0.7	0.3	-1.7	-0.7	0.5	1.9
Employment rate of women (% of female population aged 20-64)	68.4	68.8	68.2	67.9	67.9	68.4
Employment rate of men (% of male population aged 20-64)	82.2	81.8	79.6	79.3	79.4	80.1
Employment rate of older workers (% of population aged 55-64)	57.4	58.0	57.5	57.1	56.7	58.1
Part-time employment (% of total employment, 15 years and more)	25.2	25.3	26.1	26.9	26.8	27.2
Part-time employment of women (% of women employment, 15 years and more)	42.2	41.8	42.5	43.3	43.1	43.4
Part-time employment of men (% of men employment, 15 years and more)	10.8	11.3	11.8	12.6	12.7	13.3
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	5.9	5.4	5.7	6.1	6.2	6.3
Transitions from temporary to permanent employment	:	:	:	1.6	1.7	:
Unemployment rate1 (% of labour force, age group 15-74)	5.3	5.6	7.6	7.8	8.0	7.9
Long-term unemployment rate2 (% of labour force)	1.3	1.4	1.9	2.5	2.7	2.8
Youth unemployment rate (% of youth labour force aged 15-24)	14.3	15.0	19.1	19.6	21.1	21.0
Youth NEET rate (% of population aged 15-24)	11.9	12.1	13.3	13.7	14.3	14.0
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	16.6	17.0	15.7	14.9	15.0	13.5
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	38.5	39.7	41.5	43.0	45.8	47.1
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	34.0	31.0	31.0	31.0	30.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	4.0	4.0	4.0	4.0	5.0	:
Labour productivity per person employed (annual % change)	2.9	-1.7	-2.4	1.6	0.4	-0.7
Hours worked per person employed (annual % change)	0.1	-1.3	-0.4	-0.6	0.8	-0.9
Labour productivity per hour worked (annual % change; constant prices)	2.8	-0.4	-2.0	2.2	-0.4	0.2
Compensation per employee (annual % change; constant prices)	2.9	-1.5	1.5	0.0	-0.5	1.0
Nominal unit labour cost growth (annual % change)	2.1	3.2	5.5	1.1	1.5	3.2
Real unit labour cost growth (annual % change)	-0.1	0.2	4.1	-1.6	-0.8	1.8

**Notes:**

<sup>1</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.

<sup>2</sup> Long-term unemployed are unemployed persons for at least 12 months.

**Sources:**

Commission (EU Labour Force Survey and European National Accounts)

<b>Expenditure on social protection benefits (% of GDP)</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Sickness/Health care	7.99	7.61	7.84	8.79	8.57
Invalidity	2.41	2.50	2.73	2.92	2.78
Old age and survivors	11.30	10.47	10.91	11.93	11.49
Family/Children	1.51	1.59	1.68	1.93	1.87
Unemployment	0.63	0.51	0.59	0.83	0.73
Housing and Social exclusion n.e.c.	1.44	1.15	1.22	1.46	1.51
<b>Total</b>	<b>25.45</b>	<b>24.05</b>	<b>25.15</b>	<b>28.09</b>	<b>27.15</b>
of which: means tested benefits	3.92	3.57	3.68	4.20	4.23
<b>Social inclusion indicators</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
At-risk-of-poverty or social exclusion <sup>1</sup> (% of total population)	22.6	23.2	22.0	23.1	22.7
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	27.6	29.6	27.4	29.7	26.9
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	27.9	28.5	23.1	22.3	22.7
At-Risk-of-Poverty rate <sup>2</sup> (% of total population)	18.6	18.7	17.3	17.1	16.2
Severe Material Deprivation <sup>3</sup> (% of total population)	4.2	4.5	3.3	4.8	5.1
Share of people living in low work intensity households <sup>4</sup> (% of people aged 0-59)	10.3	10.4	12.6	13.1	11.5
In-work at-risk-of poverty rate (% of persons employed)	8.0	8.5	6.7	6.8	7.9
Impact of social transfers (excluding pensions) on reducing poverty	37.4	35.3	43.1	44.8	46.9
Poverty thresholds, expressed in national currency at constant prices <sup>5</sup>	8682	8834	8196	8129	7973
Gross disposable income (households)	872401	904588	933599	972492	1002261
Relative median poverty risk gap (60% of median equivalised income, age: total)	22.4	21.0	20.6	21.4	21.1

Notes:

<sup>1</sup> People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).

<sup>2</sup> At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.

<sup>3</sup> Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour tv, or ix) have a telephone.

<sup>4</sup> People living in households with very low work intensity: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.

<sup>5</sup> For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)

Sources:

For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

**Table IX. Product markets performance and policy indicators**

<b>Performance indicators</b>	<b>2003-2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Labour productivity <sup>1</sup> total economy (annual growth in %)	2.1	-1.5	-2.3	1.3	0.6	-0.5
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	6.0	3.1	-5.4	6.4	3.6	n.a.
Labour productivity <sup>1</sup> in electricity, gas, steam and air conditioning supply (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	-0.5	-2.7	-10.8	13.1	7.6	n.a.
Total number of patent <sup>2</sup> applications per million of labour force	185.6	166.1	160.4	152.8	n.a.	n.a.
<b>Policy indicators</b>	<b>2003-2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Enforcing contracts <sup>3</sup> (days)	404	404	399	399	399	399
Time to start a business <sup>3</sup> (days)	13	13	13	13	13	13
R&D expenditure (% of GDP)	1.7	1.8	1.9	1.8	1.8	n.a.
Tertiary educational attainment (% of 30-34 years old population)	34.9	39.7	41.5	43.0	45.8	46.8
Total public expenditure on education (% of GDP)	5.32	5.37	5.67	n.a.	n.a.	n.a.
	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Product market regulation <sup>4</sup> , Overall (Index; 0=not regulated; 6=most regulated)	n.a.	0.8	n.a.	n.a.	n.a.	n.a.
Product market regulation <sup>4</sup> , Retail (Index; 0=not regulated; 6=most regulated)	n.a.	2.0	n.a.	n.a.	n.a.	n.a.
Product market regulation <sup>4</sup> , Network Industries <sup>5</sup> (Index; 0=not regulated; 6=most regulated)	0.9	n.a.	n.a.	n.a.	n.a.	n.a.
<p><b>Notes:</b></p> <p><sup>1</sup> Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.</p> <p><sup>2</sup> Total number of patent applications to the European Patent Office (EPO) per million of labour force</p> <p><sup>3</sup> The methodologies, including the assumptions, for this indicator are presented in detail on the website <a href="http://www.doingbusiness.org/methodology">http://www.doingbusiness.org/methodology</a>.</p> <p><sup>4</sup> The methodologies of the product market regulation indicators are presented in detail on the website <a href="http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html">http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html</a>. The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.</p> <p><sup>5</sup> Aggregate Energy, Transport and Communications Regulation (ETCR).</p> <p>* figure for 2007.</p> <p><b>Source :</b></p> <p>Commission, World Bank - <i>Doing Business</i> (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).</p>						

**Table X. Green Growth**

		2002-2006	2007	2008	2009	2010	2011
<b>Green Growth performance</b>							
<b>Macroeconomic</b>							
Energy intensity	kgoe / €	0.13	0.11	0.11	0.11	0.11	0.10
Carbon intensity	kg / €	0.37	0.33	0.32	0.31	0.31	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	0.42	0.38	0.36	0.34	n.a.	n.a.
Waste intensity	kg / €	n.a.	n.a.	0.17	n.a.	0.14	n.a.
Energy balance of trade	% GDP	0.1%	-0.4%	-0.7%	-0.4%	-0.5%	-1.0%
Energy weight in HICP	%	n.a.	8	7	8	9	9
Difference between change energy price and inflation	%	n.a.	4.9	14.9	4.8	-6.1	5.4
Environmental taxes over labour taxes	ratio	18.5%	17.2%	16.3%	17.9%	18.2%	n.a.
Environmental taxes over total taxes	ratio	7.3%	6.9%	6.3%	7.5%	7.3%	n.a.
<b>Sectoral</b>							
Industry energy intensity	kgoe / €	0.12	0.11	0.12	0.11	0.11	n.a.
Share of energy-intensive industries in the economy	% GDP	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.11	0.10	0.11	0.10	0.10
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.03	0.03	0.03	0.02	0.03
Public R&D for energy	% GDP	n.a.	0.00%	0.00%	0.01%	0.00%	0.00%
Public R&D for the environment	% GDP	n.a.	0.01%	0.02%	0.02%	0.02%	0.02%
Recycling rate of municipal waste	ratio	30.6%	42.9%	46.7%	49.8%	50.4%	n.a.
Share of GHG emissions covered by ETS*	%	n.a.	39.8%	42.1%	40.2%	40.0%	40.0%
Transport energy intensity	kgoe / €	n.a.	0.47	0.46	0.45	n.a.	n.a.
Transport carbon intensity	kg / €	n.a.	1.08	1.04	1.00	n.a.	n.a.
<b>Security of energy supply</b>							
Energy import dependency	%	n.a.	20.5%	26.2%	26.2%	28.1%	36.0%
Diversification of oil import sources	HHI	n.a.	0.22	0.22	0.22	0.23	n.a.
Diversification of energy mix	HHI	n.a.	0.30	0.31	0.30	0.31	0.29
Share renewable energy in energy mix	%	n.a.	2.1%	2.5%	3.0%	3.2%	3.9%

Country-specific notes:

The year 2012 is not included in the table due to lack of data.

General explanation of the table items:

Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: Greenhouse gas emissions (in kg CO<sub>2</sub> equivalents) divided by GDP (in EUR)

Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)

Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)

Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents

\*Provisional data (15 April 2013). Commission Services and EEA.

\*\* For 2007 average of S1 & S2 for DE, LU, NL, FI, SE & UK. Other countries only have S2.

\*\*\* For 2007 average of S1 & S2 for IT, NL, FI, SE & UK. Other countries only have S2.