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**Assessment of the 2014 national reform programme and convergence programme for
UNITED KINGDOM**

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION

**on United Kingdom's 2014 national reform programme and delivering a Council
opinion on United Kingdom's 2014 convergence programme**

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EXECUTIVE SUMMARY

In 2014, the UK's economic growth is expected to become firmly established. GDP growth is projected to strengthen further and rise to 2.7% in 2014 compared with 1.7% in 2013 and 0.3% in 2012. Strengthening growth is expected to be maintained at 2.5% in 2015. To date, growth has been driven predominantly by strong rises in private consumption but the composition of growth is projected to broaden in 2014, in particular to investment, while the external contribution will remain subdued. Inflation is projected to fall to 1.9% and the unemployment rate is expected to decrease to 6.6% in 2014.

Overall, the United Kingdom has made some progress in addressing the 2013 country-specific recommendations. In certain areas, such as boosting youth employment and the skills base, the authorities are implementing appropriate policies but need to remain vigilant to any challenges that may arise during implementation. Challenges remain in relation to the housing market, including the need to increase the supply of houses to help dampen rapid rises in house prices, and the need to raise investment in infrastructure. The 2014 national reform programme and 2013-14 convergence programme set out details of policies that address most of the 2013 country-specific recommendations and Europe 2020 priorities but some policies have yet to be fully implemented or take full effect and, therefore, it is too early to definitively assess their effectiveness in addressing the policy challenges.

The strong macroeconomic outlook in 2014 and 2015 needs to be secured over the medium term through effective policies to address long-standing structural challenges, particularly in relation to the supply of housing, infrastructure investment and skills and education. The analysis in this staff working document leads to the conclusion that challenges identified in the 2013 country-specific recommendations and the 2014 Annual Growth Survey remain valid:

- **Public finances:** The UK government is continuing with its fiscal consolidation strategy and the deficit is now expected to fall more quickly than foreseen in the previous convergence programme, mainly as a result of higher-than-expected growth. However, the debt ratio, though lower than estimated in the previous convergence programme, is forecast to continue rising and peak in 2015-16. The deficit for 2014-15 is forecast to be 5% of GDP thereby not consistent with the EDP deadline. Total public investment remains low but has increased somewhat, thereby responding in some measure towards the challenge of differentiated, growth-friendly fiscal tightening.
- **Housing:** Housing demand and house prices are growing strongly. Additional action to further boost the supply of houses, including by creating appropriate incentives at the local level, could better align supply and demand in the short and medium terms. Continued close monitoring of house prices, credit conditions in the housing market and mortgage indebtedness, and clarification of the use of appropriate macro-prudential measures, would ensure that the authorities remain vigilant to the risks associated with the potentially destabilising impact of rapid house price rises. The risks are particularly pronounced in certain regions, including London. There is a case to update cadastral values (the property value roll), which was last updated in 1991, and associated measures relating to the rates/bands on which property tax is applied, to reduce distortions in the property taxation system.
- **Unemployment and skills:** The labour market is performing well overall. However, labour market outcomes are less positive for the young in relative terms; the UK has a shortage of workers with high-quality vocational and technical skills, which creates a

demand/supply mismatch in the job market. Employer engagement in bridging any skill gaps remains crucial.

- **Welfare reform and childcare:** There are ongoing challenges to address poverty, in particular, among children and people in jobless households. The introduction of the Universal Credit has potential to streamline the benefits system and improve work incentives. The supply of childcare has risen in recent years and the government has introduced significant extensions to tax incentives for childcare.
- **Financial sector:** The banking sector continued to stabilise in 2013 and banks raised capital to address capital shortfalls. Although the supply of credit to households picked up, the supply of credit to corporates, in particular to small and medium-sized enterprises (SMEs), continues to fall. The government responded with initiatives such as adjusting the Funding for Lending Scheme to focus it solely on businesses and establishing the 'Business Bank', which is designed to provide an additional source of non-bank finance to SMEs. Steps have also been taken to boost competition in the banking sector and encourage the formation of new 'challenger' banks.
- **Infrastructure:** The UK published a new national infrastructure plan in December 2013, which takes a long-term approach to the planning, funding and delivery of infrastructure and sets out a 'pipeline' of capital investment of GBP 375 billion to 2020 and beyond. While the plan is ambitious, it is crucial to ensure that stringent mechanisms are in place to monitor progress and delivery and mitigate significant risks, including risks that the substantial amount of private sector funding (three-quarters of the total) required to deliver the infrastructure investment may not fully materialise. There are also risks related to regulatory certainty and the efficient operation of the planning system.

1. INTRODUCTION

In May 2013, 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 2013. These CSRs concerned growth-friendly fiscal consolidation, the housing market, youth unemployment, support to low income households, access to finance for businesses and investment in 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 2014 Annual Growth Survey (AGS)¹ and the third annual Alert Mechanism Report (AMR)², which were published in November 2013. 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 2014. 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 15 other Member States were selected for a review of developments in the accumulation and unwinding of imbalances. These in-depth reviews were published on 5 March 2014 along with a Commission Communication.³

Against the background of the 2013 Council Recommendations, the AGS, the AMR and the in-depth review, the United Kingdom presented updates of its national reform programme and of its convergence programme on 30 April 2014. These programmes provide detailed information on progress made since July 2013 and on the plans of the government. While most of the 2013 CSRs and Europe 2020 priorities are addressed, some policies have yet to take full effect and implementation can be subject to risks. The information contained in these programmes provides the basis for the assessment made in this staff working document.

The programmes submitted went through a consultation process involving the national parliament, devolved administrations and other interested stakeholders.

2. ECONOMIC SITUATION AND OUTLOOK

Economic situation

Economic growth rose throughout 2013 although it was driven mainly by growth in household consumption, the labour market performed strongly and inflation pressures abated. Growth picked up in 2013, to 1.7%, the highest rate of growth since 2010 and an increase from 0.3% in 2012. Growth in private consumption outstripped growth in household disposable income resulting in a fall in the household saving rate from 7.3% in 2012 to 5.1% in 2013. Although increasingly buoyant, growth remained unbalanced; gross fixed capital formation declined by 0.6% in 2013 and net exports contributed only slightly to growth (by 0.2 pps.), compared to a brisk rise in household consumption of 2.2%. The unemployment rate fell to 7.5% in 2013 from 7.9% in 2012 while employment growth remained steadily

¹ COM(2013) 800 final

² COM(2013) 790 final

³ Aside from the 16 Member States identified in the AMR, Ireland was also covered by an in-depth review, following the conclusion by the Council that it should be fully integrated into the normal surveillance framework after the successful completion of its financial assistance programme.

positive at a little over 1% in 2013. The resilience in employment has, however, been accompanied by weak productivity growth as, in aggregate, firms elected to increase employment rather than raise the productivity of existing workers. Thus, productivity remains below the level before the international economic crisis (i.e. in 2008). Low productivity is matched by weak growth in the compensation of employees per head which grew by 2.1% in 2013. Inflation fell from 2.8% in 2012 to 2.6% in 2013 reflecting lower rises in energy prices than previously seen, subdued commodity price rises, a modest appreciation of the exchange rate and an absence of upstream price pressures.

The overall positive trends in 2013 continued into early 2014. Brisk output growth was maintained while resilience in the labour market remained and inflation continued to abate.

Economic outlook

Growth is projected to become firmly established in 2014 and 2015 and with some rebalancing towards investment. Strong growth in private consumption is expected to continue and investment is projected to increase. However, the contribution of the external sector to growth is expected to remain weak. Robust employment growth is expected and the unemployment rate is projected to continue declining. Inflation is expected to remain at, or close to, its target of 2%.

The outlook in the convergence programme (CP) is realistic and consistent with the Commission's analysis as reported in its spring 2014 economic forecast.⁴ The CP projects GDP growth of 2.7% in 2014 and 2.3% in 2015, in line with that of the Commission of 2.7% and 2.5%. Consumption will continue to be a strong driver of growth but the household saving rate will continue to fall under the CP's projections but stabilise under the Commission's projections. Investment growth is projected to pick up markedly following a slight decline in 2013. Although exports are projected to grow modestly in the CP, and by the Commission, growth is matched by increasing imports so that net trade contributes only slightly to growth in 2014 and 2015.

In addition, the CP and the Commission expect that the labour market will remain resilient with continued employment growth and falls in the unemployment rate and, moreover, that productivity growth will pick up while inflation pressures are projected to remain subdued. The CP's projections for inflation are consistent with those of the Commission. Inflation is projected at, or very close to, 2% in 2014 and 2015, that is, at the Bank of England's target for annual growth in inflation. For the labour market, again, the CP's projections are in line with those of the Commission. The unemployment rate is projected to continue its downward trajectory to 6.8% and 6.5% in 2014 and 2015, respectively; very close to that projected by the Commission. Employment is projected to reach 30.9 million by 2016. The CP forecasts a pick-up in labour productivity from its current low levels, again consistent with the Commission's projections.

3. CHALLENGES AND ASSESSMENT OF POLICY AGENDA

3.1. Fiscal policy and taxation

The aim of the UK's convergence programme is to balance the cyclically-adjusted current budget by the end of a five-year rolling period, currently ending in 2018-19; the fiscal mandate. Alongside this, there is a supplementary debt target which dictates that public sector net debt should be falling as a share of GDP in 2015-16. However, the programme's plans do not reduce the deficit below the 3% of GDP reference value by the deadline in 2014-15. Also, the UK does not specify a medium-term objective (MTO) in the convergence

⁴ European Economic Forecast, Spring 2014, European Economy 3/2014 and 2013-14 Convergence Programme for the United Kingdom, HM Treasury

programme and is therefore not in line with the legislation. However, the fiscal framework, set up in 2010, is a step towards compliance with the Stability and Growth Pact objectives, as it is designed to bring the fiscal position close to balance over the medium term.

The headline balance for 2013-14 is 6.0% of GDP; an improvement of 0.8 pp. compared with plans of the previous year's programme. This was mainly due to the substantial upward revision to GDP growth in 2013 and 2014, by 1.2 pp. to 1.8% and 0.9 pp. to 2.7%, respectively. For 2014-15, the planned deficit is also revised markedly downwards by 1 pp. to 5.0%. In both years, tax receipts are higher than forecast in the previous convergence programme and current spending is lower, with investment spending increased slightly.

The two major fiscal announcements since the last convergence programme were the Autumn Statement, published in December 2013, and the Budget 2014 published in March. Both continued with the trajectory of the fiscal consolidation strategy with policy changes at the margin. In the Autumn Statement, the main taxation measures were a scrapping of the fuel duty rise due in 2014, a discount for two years in business rates for small retailers, a removal of employer National Insurance Contributions for employees under 21 years, an increase in the bank levy and an extension of Capital Gains Tax to property sales by non-residents. The main spending announcements were further reductions in departmental spending of 1.1% in 2014-15 and 2015-16 and details on the cap on overall welfare spending from 2015-16, which excludes the basic state pension and job seekers allowance. In the Budget, the Personal Income Tax allowance was increased from April 2015 and the threshold for the higher income tax rate was raised in April 2014 and further in April 2015. Further measures were introduced to tackle tax avoidance with extra powers being given to the Revenue and Customs department (HMRC). The 10% savings tax rate was abolished on the first GBP 5 000 of savings and a single new Individual Savings Account (NISA) was introduced from July 2014. Regarding pensions, all tax restrictions on access to pensions were removed thereby ending the requirement of buying an annuity and the withdrawal tax rate on pensions was also reduced. On spending, the government provided details of the permanent cap on welfare spending with the cap being set at GBP 119 billion in 2015-16 allowing for increases with inflation thereafter; additional increases will need parliamentary approval.

The headline deficit forecast by both the Commission and convergence programme are very similar with both estimating a deficit of 5.0% in 2014-15 and only a 0.1 pp. difference the following year; the convergence programme marginally lower at 4.0%. The debt ratios are also consistent in 2014-15 and 2015-16; the former year being 91.8% of GDP for both estimates and the latter being 93.1% in the CP and 93.4% in the Commission estimates.

Box 1: Main budgetary measures

Revenue	Expenditure
2013-14	
<ul style="list-style-type: none"> • Increase in personal income tax allowance to GBP 9 440 (EUR 11 500) (-0.07% of GDP) • Corporation tax decrease to 23% (-0.05% of GDP) 	<ul style="list-style-type: none"> • Reductions in departmental spending (0.07% of GDP)
2014-15	
<ul style="list-style-type: none"> • Increase in personal income tax allowance to GBP 10 000 (EUR 12 200) (-0.07% of GDP) • Corporation tax decrease to 21% (-0.05% of GDP) 	<ul style="list-style-type: none"> • Reductions in departmental spending (0.16% of GDP)
2015-16	
<ul style="list-style-type: none"> • Increase in personal income tax allowance to GBP 10 500 (EUR 12 800) (-0.1% of GDP) • Corporation tax decrease to 20% (-0.05% of GDP) 	
2016-17	
<ul style="list-style-type: none"> • Changes to public and private sector pensions (+0.4% of GDP) 	
<p><i>Note:</i> 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>	

There are a number of one-off and transitory items included in the deficit out-turns for the UK. In April 2012, there is a transfer of the Royal Mail pension fund (GBP 28 billion, EUR 34 billion) to the general government accounts. In February 2013, the sale of 4G mobile phone licences (GBP 2.3 billion, EUR 2.8 billion) is included along with the one-off receipt of GBP 0.9 billion (EUR 1.1 billion) from the Swiss capital tax agreement in May that year. Furthermore, the deficit figures benefit from 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 in the short term but a potential increase in the deficit in the medium term. As quantitative easing is unwound, the government would be liable for capital losses related to its bond holdings. In 2012-13, the deficit is reduced by GBP 6.4 billion and by GBP 12.2 billion in 2013-14. The estimated reduction, determined by the OBR, is for the deficit to fall by GBP 11.6 billion in 2014-15, by GBP 6.9 billion in 2015-16 and by GBP 2.9 billion in 2016-17. In subsequent years, the transfers are projected to become negative and increase the deficit.

Box 2: Excessive deficit procedure for the United Kingdom

The United Kingdom is currently subject to the corrective arm of the Stability and Growth Pact. 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 at the latest.

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. The United Kingdom should ensure that its revised fiscal framework limits the risks to the adjustment and, after the excessive deficit has been corrected, underpins sustained budgetary consolidation.

An overview of the current state of excessive deficit procedures is available on: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm.

The programme, based on a growth forecast carried out by the UK's Office of Budget Responsibility (OBR), envisages an improvement in the headline balance of of 2.6 pp. between 2011-12 and 2014-15 to 5.0%. However, the programme projects that the excessive deficit procedure (EDP) deadline, set by the Council on 2 December 2009 of 2014-15, will be missed by two years, with the deficit falling to 2.4% in 2016-17. The Commission's 2014 spring forecast has similar fiscal projections to the programme with the deficit also estimated at 5.0% in 2014-15.

The improvement in the (recalculated) structural balance⁵ foreseen in the 2013-14 convergence programme is lower than the Council recommendation of 2 December 2009. The Council recommended an annual average improvement in the structural balance of 1¾% of GDP between 2010-11 and 2014-15. However, the average adjusted fiscal effort undertaken between 2013-14 and 2014-15 averaged at just 0.9% of GDP. This dips to an annual structural effort of 0.8% in 2015-16 before climbing back to at least 1% in each of 2016-17, 2017-18 and 2018-19. The Commission's 2014 spring forecast estimates an adjusted improvement of 1.1% over the entire 5-year period.

The time profile for correcting the excessive deficit between 2010-11 and 2014-15 is relatively front-loaded and will be almost 80% based on spending cuts. The headline deficits have been falling almost constantly over the period, with the exception of 2012-13 in which two one-off items cause the headline balance the following year to be higher. The

⁵ 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.

annual structural balances have also fallen over the entire period but the rate of decline was lower in the latter years of the EDP period.

The general government debt ratio has been increasing steadily for more than a decade. The convergence programme projects that the ratio will peak in 2015-16 at 93.1% before declining in the subsequent two years. The Commission's 2014 spring forecast also estimates that the debt ratio will also increase until 2015-16 but is unable to determine the turning point as this is the last point on the forecast period. In that year, the forecasts are very similar as the Commission's estimate is 93.4%. The maturity profile of gilts and treasury bills is quite long with almost 60% of these maturing after seven years. Only 20% of gilts and treasury bills are ultra-short and due for repayment within three years.⁶

Long-term sustainability

Government debt, at 89.6% of GDP in 2013-14 and expected to rise to 93.4% in 2015-16, is currently above the Treaty threshold of 60% of GDP and is projected to rise further by 2030.⁷ However, the full implementation of the convergence programme would put debt on a decreasing path reaching the 60% of GDP reference value in 2030.

The UK appears to face high fiscal sustainability risks in the medium-term. The medium-term sustainability gap, showing the adjustment effort up to 2020 required to bring debt ratios to 60% of GDP in 2030, is at 4.3% of GDP, and is primarily related to the high level of government debt (93.4% of GDP in 2015-16) and the structural primary deficit in 2015-16. In the long-term, the UK appears to face medium fiscal sustainability risks, primarily related to the structural primary balance in 2015-16 and the projected ageing costs over the very long run. The long-term sustainability gap shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at 4.9% of GDP.

Risks would be higher in the event of the structural primary balance reverting to lower values observed in the past, such as the average for the period 2004-2013. It is therefore appropriate for the UK to reduce government debt and to further contain age-related expenditure growth to contribute to the sustainability of public finances in the long term.

Fiscal frameworks

The government introduced a new framework for fiscal policy setting in May 2010. 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 target are greater than 50%. In its latest assessment, March 2014, the OBR concluded that the government remains on course to meet the fiscal mandate. However, the OBR forecasts that the government will miss the debt sustainability target by one year.

While the UK's fiscal framework is generally sound and benefits from well-established domestic good practice, no specific efforts have been undertaken to align it with EU developments which impact the UK. The UK does not set an explicit medium-term objective (MTO) as recommended by the code of conduct on the Stability and Growth Pact (SGP) and the Stability and Convergence Programmes (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

⁶ Debt Management Office (February 2014), *Quarterly Review*

⁷ Methodology based on Fiscal Sustainability Report 2012; government debt ratio in financial years corresponds to 90.6% in 2013 and 92.7% in 2015 on a calendar year basis.

from swaps and forward rate agreements. The national authorities' debt target is public sector net debt excluding financial interventions which is defined in net terms and includes the debt of non-financial public corporations but excludes that of public sector banking groups. The EDP definition refers to general government gross debt thereby excluding both the debt of non-financial public corporations and public sector banking groups, and being a gross measure of debt.

The UK's most recent Spending Round was published in June 2013 and it set out the government's spending plans for 2015-16. The previous Spending Review⁸, which covered multiple years, was set to end in 2014-15. Spending plans beyond 2015-16 will be set out by the new government following elections likely to be held in May 2015. Spending Rounds in general set out multi-annual limits for predictable spending in every department through Departmental Expenditure Limits. The remainder of spending, mainly social security, debt interest payments, public sector pensions and EU contributions, is classified as Annually Managed Expenditure (AME). The government introduced a cap on a significant proportion of AME from 2015-16, including many welfare payments but excluding pensioner benefits and jobseekers allowance. Spending rounds/reviews focus solely on spending, not taxation.

Tax systems

The overall tax system in the UK reflects the priorities of the Annual Growth Survey. The tax composition is relatively growth-friendly with consumption and recurrent taxes on property accounting for 43.3% of total taxation; a share which is among the highest in the EU. At 35.4% in 2012-13 (latest available year), the UK's total tax-to-GDP ratio is below the EU-28 weighted average (39.4%). The UK has a very competitive regime for the taxation of employment income, including personal taxation and social contributions, by EU standards, which at 46% of the total tax burden is significantly lower than other large Member States. The UK also has the second lowest implicit rate of income tax on employees in the EU (25.2% of average income). Since 2008, the corporation tax rate has decreased from 28% to 20%, as of April 2015. The UK is a strong supporter of initiatives on tax compliance, such as the OECD's global standard on automatic exchange of information. Ongoing actions on tax simplification and the reduction of administrative burdens include its HMRC digital strategy initiative and the report on the taxation of employee benefits and expenses.

In 2013, the country-specific recommendations to the UK included tax recommendations on property taxation and VAT base broadening. Overall, the analysis in this SWD leads to the conclusion that UK has made only limited progress to address these recommendations and the challenges which were identified in 2013 remain relevant. The areas of property taxation and consumption taxes offer scope for greater efficiencies and a higher proportion of growth-friendly taxes.

In general terms, there has been little reform in the field of land and property taxation to either reduce distortions or to promote timely residential construction. However, measures include a 7% rate of Stamp Duty Land Tax (SDLT) introduced in March 2012 for the purchase of residential properties costing over GBP 2 million (EUR 2.5 million) (increased to 15% if purchased by certain non-natural persons). Further tax charges are being introduced to discourage people from using corporate structures to invest in housing and a capital gains tax on profits made by non-residents disposing of UK residential property, from April 2015. Property taxation as a proportion of GDP was 4.1% in 2012, of which 3.4% was recurrent. Further discussion on housing is in Section 3.4.

⁸ "Spending Reviews" give details for multiple years; the "Spending Round" is for one year only.

There were no reforms of the VAT base in 2013. The UK average VAT policy gap⁹, at 47% between 2000 and 2011, is amongst the highest in the EU, and well above the average of 36%. The VAT compliance gap stood at 12% during the same period. The policy gap captures the revenue loss due to the various tax expenditures¹⁰. The UK applies a zero-percent rate to a broad range of goods and services including many foodstuffs, books, domestic transport, pharmaceutical products, the supply of water, certain construction services and supplies of new housing. The UK applies a reduced rate of 5% to certain supplies of home heating oil and LPG, electricity and natural gas. HMRC has estimated, in its analysis of the main tax expenditures, that the cost of the zero and reduced rates was GBP 44.8 billion (EUR 54.5 billion) in 2013-14.¹¹

Negative social impacts from VAT base broadening can be mitigated by gradual reform and targeted compensation measures. In respect of the zero-percent rates, the UK also has the option to avail of the provisions in Article 113 of the VAT Directive, which allows a Member State to tax goods and services previously taxed below 5% at one of two reduced rates even if such goods and services are not included in Annex III of the Directive. Such a policy choice would minimise any inflationary effects of an immediate move to the standard VAT rate, as well as lessen the impact on the most vulnerable in society. Many of the applied zero- and reduced rates are sensitive as they are deemed to address social impacts.¹² Although the UK VAT compliance gap at 12% is at the EU average, there should be scope to narrow this rate. It is relevant that each 1% decrease in the compliance gap in the UK would yield approximately EUR 1.5 billion (GBP 1.22 billion) in revenues.

In terms of the direct tax base, the UK avails of high levels of tax expenditure (both in numbers and amounts) in relation to personal income tax (PIT) and corporate income tax (CIT)¹³, which should be evaluated on a regular basis to ensure the allowance is targeted correctly and meets its objective. In 2013-14, GBP 32.8 billion (EUR 40 billion) was claimed in tax expenditures in direct income tax alone¹⁴ while the UK provides generous allowances for business investment in plant and machinery. A patent box was introduced in 2013 with an estimated cost of GBP 1.1 billion (EUR 1.4 billion) per year by 2017.¹⁵

3.2. Financial sector

The banking sector continued to stabilise and return to health in 2013 as the sector raised capital to address capital shortfalls. Credit supply to households picked up but supply to corporates, including SMEs, continued to decline. Scope remains to reduce concentration in the banking sector. The availability of finance, particularly for SMEs, remains constrained although policy action has been taken to address the issue.

In 2013, the United Kingdom received a CSR concerning the availability of finance, competition in the banking sector and the need to implement prudent capital requirements.

⁹ See page 36 of the Study to quantify and analyse the VAT Gap in the EU-27 Member States

http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf

¹⁰ Tax expenditures are deviations from a benchmark tax system where no allowances, exemptions, reduced rates, deferrals or tax credits exist. These tax reliefs, which reduce the taxpayer's obligations and represent a transfer of public resources through the taxation system, may reduce its efficiency and entail distortions.

¹¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253142/table1-5.pdf

¹² Zero-rates and reduced rates are often not the most suitable instrument for ensuring redistribution to poor households and they translate into significant subsidies to higher rate taxpayers. If VAT base broadening was to be undertaken it may need to be accompanied by a compensation payment to disadvantaged groups e.g. the poor, families with children, the elderly, students etc, as argued in the Mirlees Review.

¹³ OECD (2010a), Tax expenditures in OECD Countries, Paris.

¹⁴ <http://www.hmrc.gov.uk/statistics/expenditures/table1-5.pdf>

¹⁵ <http://www.ifs.org.uk/bns/bn112.pdf>

Box 3: Potential impact of structural reforms on growth – a benchmarking exercise

Structural reforms are crucial for boosting growth. It is therefore important to know the potential benefits of these reforms. Benefits of structural reforms can be assessed with the help of economic models. The Commission uses its QUEST model to determine how structural reforms in a given Member State would affect growth if the Member State narrowed its gap vis-à-vis the average of the three best EU performers on key indicators such as the degree of competition in the economy and female labour market participation. Improvements on these indicators could raise the GDP of the United Kingdom by about 4.8% in a 10-year period. Some reforms could have an effect even within a relatively short time horizon. The model simulations corroborate the analysis of Section 3.3, according to which large gains would likely stem from reducing skills gaps, albeit in the long term. In this respect, the simulations support the priority placed by the authorities on apprenticeships and traineeships.

Table: Structural indicators, targets, and potential GDP effects¹⁶

Reform areas		UK	Average 3 best EU performers	GDP % relative to baseline	
				5 years	10 years
Market competition	Final goods sector markups (price-cost margin)	0.19	0.13	1.5	1.8
Market regulation	Entry costs	0.70	0.13	0.0	0.0
Tax reform	Implicit consumption tax rate	19.5	28.6	0.3	0.4
Skill enhancing reforms*	Share of high-skilled	8.6	10.7	0.1	0.1
	Share of low-skilled	22.1	7.5	0.0	0.0
Labour market reforms	Female non-participation rate (25-54ys):			0.6	1.2
	- low-skilled	39.5	26.4		
	- medium-skilled	19.8	10.5		
	- high-skilled	12.5	4.3		
	Low-skilled male non-participation rate (25-54ys)	18.0	7.7	0.1	0.2
	Elderly non-participation rate (55-64ys):			0.2	0.4
	- low-skilled	15.3	13.4		
	- medium-skilled	7.5	4.8		
- high-skilled	5.7	3.3			
	ALMP (% of GDP over unemployment share)	1.0	37.4	0.4	0.5
	Benefit replacement rate**	61.4	52.6	0.2	0.3
Total				3.2	4.9

Source: Commission services. Note: Simulations assume that all Member States undertake reforms which close their structural gaps by half. The table shows the contribution of each reform to total GDP after five and ten years. If the country is above the benchmark for a given indicator, we do not simulate the impact of reform measures in that area; however, the Member State in question can still benefit from measures taken by other Member States. * The long run effect of increasing the share of high-skilled population would be 0.5% of GDP and of decreasing the share of low-skilled would be 2.9%. ** EU average is set as the benchmark.

The UK has made substantial progress in addressing the financial sector CSR. Implementation of the Financial Policy Committee's (FPC) recommendation of March 2013, relating to a prudent assessment of bank capital requirements and the need to address immediate capital shortfalls - is close to completion. The FPC reported, in March 2014, that most UK large banks and building societies had met the 7% target for capital ratios by the end of 2013. Capital has been raised by equity issuance, asset disposals and retained earnings. The

¹⁶ Final goods sector mark-ups are the difference between the selling price of a good/service and its cost. Entry cost refers to the cost of starting a business in the intermediate sector. The implicit consumption tax rate is a proxy for shifting taxation away from labour to indirect taxes. The benefit replacement rate is the % of a worker's pre-unemployment income that is paid out by the unemployment scheme. For a detailed explanation of indicators see Annex.

FPC also noted that funding and liquidity risks had diminished. The Prudential Regulation Authority (PRA) has agreed to ease the requirements related to liquid asset holdings for the major banks and building societies that have adequate capital requirements. Major banks have also reduced exposure to riskier assets. They need to plan for the implementation of the Basel III requirements in relation to leverage and capital ratios by 2019.¹⁷ However, vulnerabilities remain. The Royal Bank of Scotland (RBS) continues to report heavy losses (a pre-tax loss of GBP 8 billion was reported for 2013 taking combined losses since 2008 to GBP 46 billion) and it remains majority-owned by the government. The government sold two tranches of shares in Lloyds, which raised GBP 3.2 billion in September 2013 and GBP 4.2 billion in March 2014, and reduced its share-holding to 25%.

The supply of finance to the corporate sector, especially SMEs, remains constrained although the government is taking positive steps to ease funding constraints. As set out in the 2014 In-depth Review, the stock of outstanding credit to the corporate sector and SMEs continued to decline throughout 2013. However, survey measures indicate that the availability of credit is expected to improve, alongside an increase in demand for credit, although the extent to which this translates into large increases in net credit supply, particularly for SMEs, remains to be seen. It would appear that corporates are, in aggregate, continuing the process of deleveraging which began in 2010.

Moreover, the authorities are implementing policies which should, in time, further increase the availability of bank and non-bank finance. In November 2013, the Funding for Lending Scheme (FLS), which provides incentives to banks and building societies to expand lending by reducing their funding costs, was restricted to corporates effective from January 2014. The move is appropriate and should encourage banks to boost lending to firms rather than households. Most importantly, plans to establish a 'Business Bank'¹⁸ are well advanced and it is expected that the bank will become fully operational during 2014. It is to be noted that the Business Bank will need to comply with the EU State Aid regime. The establishment of the Business Bank is a positive step forward as it specifically addresses gaps in the market provision of finance. It should eventually help SMEs obtain non-bank finance to expand and invest. However, design and implementation will need to proceed carefully given the complexities of the issue so that the bank gains the confidence of SMEs and potential niche providers of funds. In addition, the Scottish Investment Bank has been established to deliver risk capital and debt finance support to technology-based companies and exporting SMEs, and Finance Wales plc, a Welsh government subsidiary, provides debt and equity finance to Welsh businesses.

The UK's experience in the establishment of Financial Engineering Instruments (FEIs) is positive. This scheme is part of the UK European Regional Development Fund (ERDF) programmes, which amounted to a total investment of around EUR 1 167 million (GBP 960 million) out of which 47% were covered by the ERDF (EUR 550 million, GBP 450 million). In general, the take-up of ERDF-supported SME investment funds has been good, especially in view of the fact that there remains another two years to complete their implementation. Although there was a slow start-up, recent experience suggests a strong pipeline and a full investment by the end of 2015.

¹⁷ Note that the UK will not be a participant in EU Banking Union including the Single Supervisory Mechanism and the Single Resolution Mechanism.

¹⁸ Despite its name, the Business Bank is not a bank in the conventional sense of the term 'bank' (i.e. a privately-owned deposit taking institution). Rather, the Business Bank is a government-backed 'bank' that supports economic development by making targeted loans to selected corporates. The bank will deploy capital to address gaps in the provision of finance for SMEs. It has been provided with GBP 1 billion of new capital which will be levered up through the involvement of the private sector. In addition, a number of existing schemes to support access to finance (a total value of GBP 2.9 billion) of both a debt and equity nature will be rolled into the bank.

Some steps to boost competition in the banking sector have been taken. The banking sector is characterised by a small number of large national banks and relatively few regional banks or building societies with a presence limited to a narrow geographical area. However, a number of small and new so-called 'challenger banks' have commenced operation in recent years. An increase in competition may follow from the divestiture of bank branches and other assets following the provision of support from the government in 2008-09. As a condition of EU approval for State Aid, the Lloyds Banking Group was required to divest retail banking business of at least 600 branches (approximately 20% of the branch network), a share of 4.6% of the personal current account market and up to 19% of mortgage assets. Following the divestiture, a new bank, TSB, was established in 2013, although it is not yet fully independent. RBS is also required to divest assets including around 300 branches which will be facilitated by the formation of a new bank, Williams and Glyn, and which is currently being established. The Financial Conduct Authority (FCA) and PRA are implementing measures, including significantly lowering capital and liquidity requirements for new banks and an improved authorisation process, to increase competition and a new Payments System Regulator is being established. It is unclear, however, whether new/challenger banks will be able to gain significant market share and, where relevant, expand activities to the SME sector.

A number of other actions to address competition in the banking sector are underway. The government is consulting on proposals to require banks to share information on their SME customers with other lenders through credit reference agencies. In September 2013, steps were taken to ease the ability of customers to switch current accounts but results are mixed. The Competition and Markets Authority is collecting evidence on the anti-competitive practice of banks potentially requiring SMEs to open or maintain a business current account in order to qualify for a loan. A decision is pending on whether to undertake a more detailed investigation of the retail banking sector. The former Office of Fair Trading provided an update on its banking study of the SME sector in March 2014 in which it expressed concern about the level of competition in the sector.

3.3. Labour market¹⁹, education and social policies

The labour market is performing well overall. Employment growth was a healthy 1.2% in 2013, the fourth consecutive year of growth, while the unemployment rate continued to fall. Further growth in employment and falls in the unemployment rate are projected in 2014 and 2015. Growth in private sector employment was positive in 2013, thus continuing a trend that began in 2010.

Nonetheless, the UK faces several challenges in specific areas. While there is still relatively significant unemployment and underemployment among young people, the youth unemployment and NEET rates decreased between 2012 and 2013.²⁰ In addition, the UK has a shortage of workers with high-quality vocational and technical skills and issues with basic skills. Also, lifelong learning provision decreased between 2009 and 2012 but improved between 2012 and 2013, when it was 16.1%.²¹ If the negative trend resumes, it may have an impact on the skills and productivity of the age group which benefits from lifelong learning.

¹⁹ For further details, see the 2014 Joint Employment Report, COM(2013)801, which includes a scoreboard of key employment and social indicators.

²⁰ Youth unemployment was at 20.5% in 2013 according to the Eurostat measure (age 15-24) and 19% in the three months to March 2014 according to the UK measure, which is based on a different age band (16-24) and has a different in classification of people who are not seeking work because they have already found a job which they are due to start in the future. The NEET rate (not in education, employment, or training) was 13.3% in 2013 according to the Eurostat measure (age 15-24) and 13.5% in the three months to March 2014 according to the ONS measure (age 16-24).

²¹ Eurostat. Lifelong learning refers to persons aged 25 to 64 who stated that they received education or training in the four weeks preceding the survey

There are also ongoing challenges in tackling the share of children in jobless households and child poverty. Despite a decreasing trend, at 16.5%²² (2012), the proportion of UK children living in workless households is one of the highest in the EU. The 'at-risk of poverty or social exclusion' rate is considerably higher for people with disability.²³ Further continuing challenges include material deprivation²⁴, in-work poverty²⁵, and affordable, high-quality, childcare.

In 2013, the United Kingdom received a CSR concerning youth unemployment, improving vocational education and skills provision and a second one covering welfare reform, poverty and childcare.

Labour market

The UK has achieved some progress in addressing the CSR on youth unemployment. It has put a wide range of measures in place, such as the Work Programme and the Youth Contract, with a focus on providing apprenticeships and getting people into work. Despite initial difficulties, the performance of the Work Programme has improved significantly with 22 000 individuals remaining in employment. On the Youth Contract, the government made substantial progress in providing work experience placements and launching more and better quality apprenticeships. Recent figures show that the employer take-up has been low and fewer wage incentive payouts than expected have been made.²⁶ To respond better to employer requirements, the government increased the duration of apprenticeships to a minimum of 12 months. The government also introduced an assessment at the end of an apprenticeship to ensure higher levels of competence. Employers will also be given more responsibility for developing the standards that will replace the current apprenticeship framework and will have greater control over which training providers receive funding. This will ensure a better matching of training provision to employers' needs. The government decided to increase business engagement and investment in skills provision by routing public money directly to employers rather than via training providers.²⁷ Through the Employer Ownership Pilot businesses are invited to set out the public funding they need to support their own investment in skills, training and apprenticeships. All these measures are likely to ensure more effective apprenticeships. However, whilst the number of higher apprenticeships has been increasing steadily, they still make up a very small proportion of apprenticeships (2%) when compared to intermediate (57%) and advanced apprenticeships (41%).²⁸ The predominant intermediate apprenticeships do not convey the advanced vocational and technical skills lacking in the UK, therefore the increase in funding for higher apprenticeships announced in the Autumn Statement and Budget 2014 is a welcome contribution towards a rebalancing of the apprenticeship programme towards higher skills.

Education

The UK has made some progress on measures taken to address the 2013 CSR on skills. However, there is still a lack of basic skills among young people, especially early school

²² Eurostat. Share of persons aged 0-17 who are living in households where no-one works. ONS data for end of 2013, based on a 0-16 age band, confirm the decreasing trend.

²³ 38% of persons aged 16-64 with disabilities were at risk of poverty or social exclusion, according to 2011 EU-SILC data.

²⁴ The severe material deprivation rate rose from 2008 to 2012 according to the latest available data from Eurostat. However, it is subject to break in the series in 2012.

²⁵ In-work poverty (of the working age population 18-64) has risen from a low of 6.3% in 2009 to 7.8% in 2011 (8.8% in 2012 but subject to break in series).

²⁶ House of Commons Library, Apprenticeship statistics, 10 February 2014.

²⁷ The Autumn Statement 2013 announced that the new funding mechanism should be in place by 2016.

²⁸ The three levels of apprenticeships in England are Higher, Advanced and Intermediate.

leavers. Recent evidence from the OECD Survey of Adult Skills in England shows that a relatively high proportion of young people with lower secondary education lack basic skills in numeracy and literacy. In response, the new Traineeship Programme was launched in England in August 2013. It targets 16-24 year olds who want to work but lack the necessary skills to find either a job or an apprenticeship. The programme combines work preparation training, study of English and maths, and a high-quality work placement lasting at least six weeks. However, the size of the programme is yet to be determined and the absence of specific quality requirements may inhibit its success. Through the 'Opportunities for All' commitment, the Scottish Government aims to offer a place in education or training to all 16-19 year olds who are not already in learning, training or employment. Finally, increasing the age of compulsory participation in education and training to 17 in 2013 and to 18 in 2015 should help reduce the UK's early school leaving rate.

The government is also reforming the education system, including reviewing the national curriculum. The measures in the education system to improve young people's skills are likely to have a positive long-term impact. In order to address the lack of ICT skills, the government recently overhauled the school ICT curriculum, introducing coding as a compulsory subject from primary school onwards.

Despite measures to reform it, the qualifications system remains complex.²⁹ Many qualifications in the initial and continuous vocational education and training system are not linked to occupations. They therefore do not achieve an occupational standard that employers recognise and associate with knowledge and skills applicable to a particular sector. To tackle this issue, and following the Wolf Report, Tech Levels are being introduced from September 2014 as an equivalent of A levels for those who want to take a vocational route. Although it adds more qualifications to the system, this is a positive step. The government has published a reform plan for vocational qualifications³⁰ to simplify the qualifications regime and improve its quality. More clarity in the system will ease the transition from school to further education and lead to better recognition of qualifications by employers.

Varying skills levels can be explained by educational disadvantages linked to the effect of socio-economic backgrounds on educational achievement. In 2011, the government published a Social Mobility Strategy announcing several measures to narrow the gaps in attainment between children from different backgrounds. Besides measures to raise standards across the overall schooling system, the government introduced the Pupil Premium³¹ to help raise the educational attainment of disadvantaged pupils. Academies and Free Schools, with more autonomy than most state schools also received support in disadvantaged areas. An Education and Employers Taskforce has been given the task of encouraging graduates to offer career advice in their old schools and the Education Endowment Fund has been set up to promote innovative ways of helping disadvantaged pupils. However, despite the increased funding through the Pupil Premium for pupils from deprived backgrounds who risk becoming NEETs, there is evidence to suggest that the measure is not promoting innovative solutions and often not targeting individual disadvantaged children as planned.³²

²⁹ The current system has over 19 000 regulated vocational qualifications available through 176 awarding organisations, out of which 1 780 qualifications account for over 90% of achievement.

³⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286749/bis-14-577-vocational-qualification-reform-plan.pdf

³¹ GBP 488 per eligible pupil was allocated in 2011-12, rising to GBP 623 in 2012-13. In 2013-14, the sums are GBP 900 per eligible pupil in secondary education and GBP 953 in primary school. Budget 2014 announced in addition the Early Years Pupil Premium which will provide nurseries, schools and other providers of government funded early education with extra money for disadvantaged 3 and 4 year olds.

³² Department of Education (July 2013), Evaluation of Pupil Premium: Research Report, at <https://www.gov.uk/government/publications/evaluation-of-pupil-premium>

Box 4: The delivery of a Youth Guarantee in the UK³³

Important challenges to deliver a Youth Guarantee in the UK³⁴ are:

- equipping young people, particularly NEETs with the skills and work experience required by the labour market, through employer engagement in skills provision and by providing more and higher-level quality apprenticeships. Despite current progress in implementing apprenticeship reform there is a need to increase the supply of higher apprenticeships for young people under 25 as well as to ensure sufficient employer demand for them;
- insufficient take-up of wage subsidies provided by the Youth Contract. In order to make up for this, the Youth Contract, in particular its work experience component, and the apprenticeship reform now need to better incentivise employers to employ young people and to target a larger group of young people;
- to achieve a sufficient high number of young people, especially NEETs, who successfully and quickly transition from school to work and remain on the labour market in the long term.

Social policies

The UK has made some progress on measures taken to address the 2013 CSR on welfare reform, poverty and childcare. The introduction of Universal Credit has the potential to streamline the benefits system and improve work incentives. The benefit will replace six existing benefits; although a positive development that will cover most social issues, there are some potentially significant issues of delays in its rollout, complexity and overlaps. The major improvement in work incentives is due to a tapering effect that allows individuals to keep more of their income as they move into work by introducing a slower withdrawal rate of benefits when their earnings increase. In certain instances, this may provide weaker incentives for the second earner in couples to move into work. The effectiveness of the Universal Credit on employment and poverty reduction will depend on implementation and support services.

The poverty implications of the new provisions relating to the up-rating of certain social security benefits and tax credits need to be closely monitored. The government's benefit cap, introduced on a national scale from October 2013, may affect larger families living in areas with high housing costs and disabled people with additional living costs to pay. Many working-age benefits will be adjusted below the projected inflation rate. The Welfare Benefits Up-rating Act provides that such benefits will be increased by 1% per year in the period from 2013 to 2016. Changes to the conditions for receiving in-work benefits mean that couples with children have to work at least 24 hours a week between them (and one member of the couple has to work at least 16 hours) to qualify for working tax credits.

The availability of affordable, high-quality, full-time childcare remains a key issue. Although the supply of childcare has increased in recent years, its costs in the UK are high on an internationally comparable basis³⁵, and children from disadvantaged backgrounds are the least able to use childcare facilities. The availability of childcare is improving for pre-school

³³ The UK presented a plan entitled "Youth Guarantee Implementation Plans: The UK Response" in March 2013.

³⁴ Pursuant to the Council Recommendation of 22 April 2013 on establishing a Youth Guarantee (2013/C 120/01): "ensure that all young people under the age of 25 years receive a good-quality offer of employment, continued education, an apprenticeship or a traineeship within a period of four months of becoming unemployed or leaving formal education".

³⁵ See, for example, European Commission Report: "Barcelona Objectives: the development of childcare facilities for young children in Europe" (2013), p. 13.

children, although there is still a need to make childcare easily accessible to the disadvantaged as the current system involves restricted hours, part-payment or retrospective funding. To the extent that the cost and availability of childcare results in women taking involuntary part-time employment, there is a risk that the declining trend in the gender pay gap is reversed and the gender gap in pensions widens. The government has announced measures that include free hours of childcare, vouchers and tax breaks. Under Universal Credit, the government has pledged to increase childcare support for households where both earners earn enough to pay income tax (i.e. GBP 833.33 per earner); these households will be able to claim 85% of childcare costs. Eligibility is dependent on savings, capital and household income, and is determined on a case-by-case basis. Families that earn less will only receive the 70% level of support, up to the monthly limits.³⁶ However, intervention from the demand side rather than the supply side might increase prices rather than availability. Moreover, the system remains complex as it consists of several support arrangements, each with different rules.³⁷

3.4. Structural measures promoting sustainable growth and competitiveness

While the UK's economy is dynamic and relatively flexible overall, there is scope to boost competitiveness.³⁸ On the external side, its export market share has persistently declined. This can be partly attributed to the restructuring of industrial sectors and to increases in unit labour cost in recent years. More specifically, wage costs have outstripped productivity since 2008; labour productivity declined following the crisis and has continued to stagnate since. Increases in infrastructure investment, particularly energy and transport infrastructure, are likely to boost productivity. The link between structural reform and growth is discussed in Box 3. Over the medium term, this is essential to sustain rises in household and corporate incomes, and living standards.

In 2013, the United Kingdom received a CSR concerning infrastructure, and another one dealing with the housing market.

The UK has made some progress on measures taken to address the 2013 CSR on infrastructure. In December 2013, it published an updated national infrastructure plan³⁹, a long-term and strategic approach to the planning, funding, finance and delivery of infrastructure. The plan is ambitious in its scale and scope and is a welcome initiative to address challenges relating to infrastructure. The plan sets out a 'pipeline' of capital investment to 2020 and beyond of GBP 375 billion (EUR 460 billion) in total. A large proportion of the 'pipeline' (GBP 340 billion) comprises investment in the energy and transport sectors. Around three-quarters of the funding is projected to be privately-sourced while the remainder is foreseen to be publicly funded. Although the plan is a welcome initiative, there are a number of concerns relating to funding and feasibility. First, there are significant risks surrounding the private sector element of financing. Greater detail is required on the sources of such funding and there is a risk that a substantial amount of private sector funding required to deliver the infrastructure investment may not materialise fully or within the required time-frames. Secondly, there are risks related to the need for high levels of regulatory certainty (especially in the energy sector) before large projects can proceed and certainty relating to the operation of the planning system, in particular, the need for

³⁶ Analysis by the Joseph Rowntree Foundation (2013) indicates that around 60% of households would not be eligible for reimbursement of childcare costs because not all adults in the household earn enough to pay tax.

³⁷ Institute for Fiscal Studies (2014), State support for early childhood education and care in England.

³⁸ A discussion of recent developments in competitiveness can be found in the In-Depth Review 2014

³⁹ HM Treasury (2013). The updated plan follows the first National Infrastructure Plan, published in 2010 and subsequent updates in 2011 and 2012. The government announced an updated approach to building public infrastructure through the Private Finance Initiative ('Private Finance Initiative 2') in December 2012 (HM Treasury (2012)). In addition, Scotland and Wales have published infrastructure plans.

developers to obtain timely planning permission (in this regard, the government announced positive measures to reform the planning system as they relate to judicial review, in February 2014⁴⁰). Thirdly, there is also a need for clarity in relation to investment for building new infrastructure as distinct from that targeted at improving the quality of infrastructure (i.e. existing infrastructure may have been insufficiently maintained due to under-spending in the past and at least some of the investment projected in the plan may be spending that was previously deferred). Fourthly, there is a need for high levels of transparency and accountability, for example the publication of clear and consistent data on previous and projected expenditure on infrastructure, detail on the progress of delivery for individual projects and the provision of funds, and amount spent, on each project. Provision of regular reports is essential to enable effective assessment and rigorous scrutiny of the flow of private finance and delivery of individual projects detailed in the plan. In this respect, the government published a useful methodological note on infrastructure spending following Budget 2014.

Box 5. Conclusions from the March 2014 In-depth Review of the United Kingdom

The 2014 In-depth Review (IDR) for the UK is the third IDR conducted as part of the Macroeconomic Imbalances Procedure and was published on 5 March 2014. On the basis of this review, the Commission concluded that the United Kingdom continues to experience macroeconomic imbalances, which require monitoring and policy action. More specifically:

- an imbalance exists in the housing market which, in the absence of policy action, is likely to persist and worsen. Demand for housing is increasing rapidly, outstripping the increase in supply. As a result, house prices and mortgage indebtedness are on the rise. Although moderately increasing, supply remains constrained. Demand is projected to continue to outstrip supply over the medium term;
- export share continues to decline but this is unlikely to pose short-term risks. However, it points to structural challenges for exporters over the medium term;
- the risks and challenges associated with high corporate indebtedness are low as corporate balance sheets are healthy although some SMEs report difficulties accessing finance.

The IDR also discusses the possible policy response:

- to address the imbalance between the supply and demand for housing, increasing supply by seeking solutions at the local level, reforming the planning system, providing greater detail and transparency in relation to macro-prudential regulation and updating the valuation of the property roll;
- to support exporters, delivering improvements in skills and infrastructure investment, particularly in the transport and energy sectors,
- to boost access to finance for SMEs, while corporate deleveraging should continue, continue the implementation of current policies.

The emphasis on investment in transport and energy infrastructure is considered appropriate. These issues were identified in the 2014 In-depth Review, in the context of addressing bottlenecks for exports. Plans for a new high-speed rail route, 'High Speed 2', connecting London and Birmingham in its first phase and then onwards to Manchester and Leeds in a second phase, are advancing and should ease congestion, address future capacity constraints and help address shortages of housing in London by facilitating easier access for

⁴⁰ Ministry of Justice, Written Ministerial Statement, Judicial Review, February 2012

commuters to the capital. The plan does not, however, provide certainty on increasing airport capacity in South East England, which is a long-standing and increasingly urgent challenge.

Recent energy infrastructure reforms have lowered the market risk for most low-carbon investments. In addition, they also address the political uncertainty that has surrounded the regulatory framework for investment in new energy capacity. The reforms include the adoption of the Energy Act and the Electricity Market Reform although the details of the relevant implementing legislation are still to be decided. These reforms could potentially have a major impact on types of investment; they could promote investments, for example, in renewables and new nuclear capacity but potentially diminish the viability of investments in areas such as gas fired power plants. The government is implementing measures to reduce the cost of energy and to provide greater security of supply. However, there remains a need to clarify the role of interconnection in terms of national infrastructure planning. In October 2013, the government announced the details of an agreement to build a new nuclear reactor, Hinkley Point C.⁴¹ Construction of the plant should boost energy supply and security (it is expected to produce 7% of the UK's total energy needs by the time it is completed in 2023). In relation to communications infrastructure, the UK is one of the leading countries in the EU regarding the rollout and take-up of high-speed, fixed and wireless broadband communications.

The need for the UK to better leverage its world-leading science base into a more innovation-intensive economy remains a key challenge. The relatively low and decreasing level of business R&D intensity⁴² reflects this need. In its strategy for innovation, the government identified four priority areas for policy development: strengthening the sharing and dissemination of knowledge; fostering the development and use of a more coherent innovation infrastructure; driving business innovation in all sectors of the economy; and transforming the public sector into a major driver of innovation. The choice of priorities is appropriate and in line with the dimension of the challenge.

Climate change and resource efficiency

The UK is currently on track to meet its Europe 2020 target for greenhouse gas emissions not covered by the EU Emissions Trading Scheme (ETS).⁴³ The UK continued to develop measures aimed at reducing emissions from both ETS and non-ETS sectors. Some challenges remain relating to the Green Deal and Energy Companies Obligation, support to promote low carbon heat and a rationalisation of policies aimed at enhancing energy efficiency in the commercial and industrial sectors. A significant role is played by emissions in the road transport sector, in particular emissions from passenger cars. The government aims to reduce emissions from transport by supporting ultra-low emission vehicles, the use of biofuels and the use of local transport projects. In Budget 2014, the government announced a cap to the Carbon Support rate⁴⁴, at GBP 18 from 2016-17 to 2019-20, and that it would

⁴¹ The Commission is currently examining the compatibility of the support which the UK government is providing to this project and has State aid procedures laid down in Article 108(2) of the Treaty on the Functioning of the European Union (C(2013) 9073 final).

⁴² R&D intensity decreased from 1.16% in 2001 to 1.09% in 2012. The EU average is 1.30%.

⁴³ In 2012 emissions increased slightly compared to the previous year, turning into a reduction of 8.6% from 2005 levels, just above the interim 2013 target of 8% set by the Effort Sharing Decision. Projections based on existing measures indicate that emissions from non-ETS sectors will be 19% below 2005 levels by 2020, over-achieving the 16% target under Europe 2020. See EEA, 15 January 2014 MS' submissions to Commission and EEA, MS' GHG projections submissions under Art. 3(2) of the EU MMD (19/03/2013).

⁴⁴ The Carbon Support rate is the amount levied by the UK on fossil fuels used for electricity generation above the EU ETS emissions price. This measure has been introduced in 2013 with the aim of providing further incentives for investments in low-carbon electricity generation, however, it is not expected to help achieve the national greenhouse gas emissions target under Europe 2020, which refers to emissions from non-ETS sectors,

extend compensation to energy-intensive industries for its cost and for the cost of the EU Emissions Trading Scheme. The government also announced that it would introduce a new compensation scheme to support energy-intensive industries with high electricity costs resulting from the renewables obligation and small-scale feed in tariffs for renewable generation from 2016-17.

The UK has made some progress towards meeting the 2020 renewable energy targets, namely, a share of 15% in final energy consumption and a 10% share in that of the transport sector. However, as the targets become progressively more demanding towards the end of the period 2005-2020, the timeframe to ensure the required investment is tight. Successfully meeting the 15% target by 2020 thus remains uncertain.

The regulatory framework for renewable energy sources is becoming more stable. The adoption of the Energy Act with its Electricity Market Reform should help by providing clarity about rules for developers and investors in renewable projects, projected funding from consumer bills and support levels for the different technologies until 2019. Stabilising the regulatory framework concerning renewable energy generation represents a fundamental step in addressing uncertainties in the market, however, it is important to ensure a smooth transition from the existing Renewable Obligation (quota based) to the Contracts-for-Difference (CfD) regime, which relates to market prices. It is also difficult to ascertain, at this stage, whether the new CfD regime will be sufficient to increase the amount of electricity coming from renewables to 30% by 2020 in line with the UK plans to meet the overall renewable target.

The take-up of the Green Deal⁴⁵ has been disappointing. The low conversion rate of assessments into plans to make use of Green Deal finance has been attributed to the complexity of the system as well as the lack of flexibility in the application of the 'golden rule' (i.e. the charge attached to the bill should not exceed the expected savings). The government announced that the Green Deal will undergo a series of changes in order to become simpler and to provide stronger incentives. The design and implementation of such changes will affect the emission reduction potential of the building sector.

The management and prevention of floods could be more cost efficient. One in six properties is at risk of flooding from all types of floods across England and Wales. The latest climate change projections imply an increase in the risk of floods.⁴⁶ Further support for flood defences was announced in the Budget 2014.

Operation of the housing market

The UK has made limited progress on measures to address the 2013 CSR on the housing market. Demand for housing is rising rapidly. House prices are rising strongly by around 9% on an annual basis⁴⁷ and price rises are beginning to feed into a rise in household mortgage indebtedness as demand for housing continues to outstrip supply. Housing policy is contributing to demand. The Help to Buy 2 (loan guarantee) policy, for existing or new

nor to help achieving additional emission reductions in the EU ETS, since emissions from ETS-sectors are determined by the cap at EU level.

⁴⁵ The Green Deal is a market mechanism, operational from January 2013, that allows energy efficiency measures to be financed through energy bill savings. The energy efficiency of buildings is also addressed by the Building Regulation.

⁴⁶ Between 2002 and 2013, there were flood damages of about EUR 23 billion (approximately GBP 19 billion). An illustration of the inefficiency is provided by a study showing that investments in flood prevention could return benefits 6-8 times the cost. See Study on Economic and Social Benefits of Environmental Protection and Resource Efficiency Related to the European Semester, 2014.

⁴⁷ According to the Office for National Statistics, house prices increased in the UK by 8.0% in the year to March 2014 and by 17% in London.

properties, which aims to support households to obtain a loan that they may not otherwise be able to obtain due to credit constraints, is likely to boost demand relative to supply.⁴⁸ In the absence of a strong supply response, the predominant impact of Help to Buy 2 is likely to increase house prices. At a time when credit constraints are easing, the need for the Help to Buy 2 policy may diminish. In its Budget 2014, the government announced that Help to Buy 1 (equity loan), applicable only for new properties, would be extended to March 2020 which should further increase demand and supply. The requirements of the FCA's Mortgage Market Review came into operation in April 2014 and should help address risks associated with an excessive easing of credit constraints through mandatory requirements for affordability tests and interest rate stress tests prior to the granting of a mortgage⁴⁹. Nevertheless, the authorities need to remain vigilant to the potentially destabilising impact of rapid increases in housing market activity, house prices and mortgage indebtedness. The risks are particularly pronounced in certain regions, including London and the south east.⁵⁰

Macro-prudential regulation policy, which is the responsibility of the Financial Policy Committee, can address concerns relating to the stability of the housing sector. The FPC's determination of the trade-offs between the benefits, costs, risks and unintended side effects associated with the options for macro-prudential regulation in its tool kit could be developed further. A detailed, public assessment by the FPC of the merits of the various instruments available to it, and the situations in which they would be deployed, would boost not only transparency but also the effectiveness of the instruments at its disposal.

Supply is increasing, although it remains low, and lags behind demand; shortages of housing are likely to persist. A number of policies to stimulate supply have been announced in 2013 and 2014 including measures to strengthen the National Planning Framework to ensure that economic factors are at the heart of the planning decisions. The reforms to the planning system are appropriate and potentially far-reaching and should, in time, stimulate supply. In order to encourage the release of more land for development, an appropriate incentive structure for local authorities to increase and accelerate the release of such land would help facilitate local and regional solutions to increasing supply. In the 2014 Budget, the government announced a loan scheme to provide finance to spur construction on sites held by small and medium-sized builders. Changes to the taxation system, which include the extension of the Annual Tax on Enveloped Dwellings (and the related capital gains tax charge) to properties with a value of more than GBP 1 million from April 2015 and GBP 500 000 from April 2016, the related extension of SDLT at 15% to houses worth more than GBP 500 000 (EUR 615 000) from March 2014 when these properties are owned through companies, changes to the council tax treatment of empty homes and the introduction of Capital Gains Tax for non-residents disposing of UK property from 2015, may also have some impact on the demand and supply balance. Supply constraints are likely to be especially marked in certain regions, particularly London. In March 2014, the government announced further measures to boost supply near London, including support for a new garden city at Ebbsfleet to provide capacity for up to 15 000 new homes.

Scope to mitigate distortions in the taxation of property⁵¹ should be considered, in particular, an updating of the cadastre (the 'property valuation roll') could reduce distortions in the property taxation system. The cadastre, the basis for the assessment of

⁴⁸ Help to Buy 2, which came into effect in October 2013, enables households to purchase a property of up to GBP 600 000 (EUR 737 000) in value with a 5% deposit and with the government guaranteeing 5-15% of the loan. Further details can be found in the 2014 In-depth Review.

⁴⁹ It is noteworthy that, on 20 May 2014, one of the largest mortgage lenders, Lloyds Banking Group, announced that it would limit mortgage lending to a multiple of four times income for loans of more than £500,000.

⁵⁰ London and the south east account for a little more than one-third of total UK output.

⁵¹ Property taxation as a proportion of GDP at 4.1% in 2012, of which 3.4% is recurrent.

council tax, has not been updated since 1991.⁵² A revaluation could correct distortions resulting from property value developments in the intervening decades. The UK is one of more than one-third of EU Member States that levies property taxes on outdated cadastral values.⁵³ Use of an outdated property value roll may lead to distortions in property taxation between, and within, regions and a bias in the tax system towards over-investment in property. The degree of regression in the tax system may also increase. Moreover, regular revaluation of the roll would smooth property tax increases rather than result in a sudden increase in the annual council tax liabilities if only irregular updates are carried out. In addition, progressivity in rates and the number of bands could be re-evaluated as properties in the lower valuation bands pay proportionally more tax relative to properties in higher valuation bands. Furthermore, undeveloped land with planning permission is currently taxed on sale or transfer. Therefore, there is an incentive, for owners to hold on to land for speculation rather than for timely residential construction.

In relation to the rental market, greater security in rental agreements could be beneficial for tenants that seek it. The private rented sector in the UK is relatively unregulated compared to that in some other EU Member States. The rights of tenants and responsibilities of landlords are relatively limited. While some tenants and landlords may prefer short-term tenancy arrangements, other tenants might prefer greater stability in the form of longer-term tenancy arrangements that landlords may be unwilling to provide. The development of a model tenancy agreement to help tenants and landlords understand their rights and obligations could have provided greater impetus towards encouraging long-term tenancies.

3.5. Modernisation of public administration

In 2013, the UK did not receive a CSR on the modernisation of public administration.

The UK performs very well in surveys of the quality, efficiency and effectiveness of government. For most key measures of government effectiveness as measured by the European Commission (government effectiveness; tools for public administration; absence of corruption and fraud; ease of obtaining business starts and licences; public procurement; tax compliance and administration and the efficiency of civil justice), the UK is at or above the EU average.⁵⁴ Moreover, at 5.6% of GDP in 2010, spending on 'core administration' (excluding defence) is the second lowest of all EU Member States. The government publishes six-monthly progress updates on deregulation through its 'Red Tape Challenge'.⁵⁵ Along with the one-in-two-out rule, which aims to reduce the regulatory burden, in June 2013 the government announced a small and micro business assessment (SMBA) which aims to reduce disproportionate burdens of regulation on smaller businesses.⁵⁶ This is an extension and an increase in scope of a previous moratorium that exempted microbusinesses from burdensome new regulations. The SMBA will apply to new regulations that come into force after 31 March 2014. Such policies operate positively to keep the regulatory burden low.

An area of concern is the capacity of governance at the sub-regional level. In 2010, thirty-nine Local Enterprise Partnerships (LEPs) were established at the sub-national governance level in England following the abolition of the Regional Development Agencies. Although these newly created bodies are still gaining experience and building capacity, there remain

⁵² However, the cadastre was updated in Wales in 2003.

⁵³ See European Commission (2013) Tax Reforms in EU Member States 2013, European Economy 5/2013.

⁵⁴ See, for example, European Commission (2013) Excellence in public administration for competitiveness in EU Member States, or the World Bank's (2014) Ease of doing business index (the UK ranks 10th of 189 countries).

⁵⁵ It estimates that total annual savings to business were GBP 1.19 billion between January 2011 and December 2013. See UK government Red Tape Challenge <http://www.redtapechallenge.cabinetoffice.gov.uk/home/index/>

⁵⁶ Seventh Statement of New Regulation, December 2013, Department for Business, Innovation and Skills.

risks to delivery of policy, including EU policy, at the sub-regional level. For example, the effective and efficient use of 2014-20 European Structural and Investment Funds (ESIF programmes) could be adversely affected. Moreover, the process of designing a Smart Specialisation Strategy, under which priorities for the use of ESIF and other funds are set out, could be affected.

4. CONCLUSIONS

Economic growth is becoming firmly established, driven by increases in private consumption, and is projected to broaden as investment rises although the contribution of the external sector to growth is expected to remain subdued. Employment growth has been healthy and is expected to remain so. Productivity growth is expected to pick up although it currently remains below its 2008 level. The strong macroeconomic outlook in 2014 and 2015 needs to be secured over the medium term through effective policies to address long-standing structural challenges. In particular, increased investment in infrastructure and education should support and secure growth over the medium term. A shortage of housing has been a structural phenomenon afflicting the UK as rapid rises in demand result in high house price rises. Policies to boost supply can secure medium-term growth by mitigating the risk that rises in demand result in potentially destabilising and rapid house price rises, and increases in mortgage indebtedness. Policies are in place to boost the supply of finance to corporates, especially small and medium-sized enterprises, thus assisting the ability of corporates to expand and invest and contribute to growth. All of these issues were addressed in the 2013 country-specific recommendations.

The analysis in this staff working document leads to the conclusion that the UK has made some progress in addressing the 2013 country-specific recommendations. In some areas, policies have been announced and/or are being implemented, but further time is required before the effectiveness of these policies can be assessed. The need for both increased infrastructure investment and increased housing supply is likely to continue over the medium term. Similarly, on labour market policy and welfare policy, while labour market outcomes at the macroeconomic level are highly positive, policy is yet to take full effect on the quality of youth labour force participation and further action is required on childcare provision. The national reform programme and convergence programme set out details of policies that address most of the 2013 CSRs and Europe 2020 priorities but some policies have yet to take full effect and implementation can be subject to risk.

Challenges identified in July 2013 and reiterated in the Annual Growth Survey remain valid. Limited progress has been made in the area of housing. While action has been taken to fine-tune the National Policy Planning Framework, the supply of houses, although rising, remains low and well below demand, although a further period of time is required for the policies that have been announced and/or are being implemented to take full effect. There has been limited progress in reforming land and property taxation. Some progress has been made in the areas of employment and the labour market, welfare and infrastructure investment. There has been substantial progress in policies to strengthen the financial sector, for instance, the increase in capital ratios in the banking sector is almost complete. The government has introduced the National Infrastructure Plan 2013, which sets out an ambitious scale and scope for infrastructure investment to 2020 and beyond although further action is required to increase the clarity of some elements of the plan and ensure that mechanisms are in place to ensure effective delivery and scrutiny of the plan.

OVERVIEW TABLE⁵⁷

2013 commitments	Summary assessment
Country-specific recommendations (CSRs)	
<p>CSR 1: Implement a reinforced budgetary strategy, supported by sufficiently specified measures, for the year 2013-14 and beyond. Ensure the correction of the excessive deficit in a sustainable manner by 2014/15, and the achievement of the fiscal effort specified in the Council recommendations under the EDP and set the high public debt ratio on a sustained downward path.</p> <p>A durable correction of the fiscal imbalances requires the credible implementation of ambitious structural reforms which would increase the adjustment capacity and boost potential growth.</p> <p>Pursue a differentiated, growth-friendly approach to fiscal tightening, including through prioritising timely capital expenditure with high economic returns and through a balanced approach to the composition of consolidation measures and promoting medium and long-term fiscal sustainability.</p> <p>In order to raise revenue, make greater use of the standard rate of VAT.</p>	<p>The UK has made limited progress in addressing CSR 1:</p> <ul style="list-style-type: none"> • some progress in implementing a reinforced budgetary strategy; • some progress in ensuring the correction of the excessive deficit; The deficit is continuing to fall and the fiscal consolidation plans are continuing but the EDP deadline will not be reached; • some progress in the implementation of structural reforms; According to the OBR, the UK's debt rate will peak in 2015-16 and decline thereafter; COM's forecast does not go beyond 2015-16. The government has proposed a permanent welfare cap to curtail spending; • some progress in growth-friendly approach to fiscal tightening; The government have shifted focus from current to capital spending; • no progress in making greater use of the standard rate of VAT. The government has announced tax avoidance measures.
<p>CSR 2: Take further action to increase housing supply, including through further liberalisation of spatial planning laws and an efficient operation of the planning system. Ensure that housing policy, including the Help to Buy scheme does not encourage excessive and imprudent mortgage lending; and promote greater supply to avoid higher house prices.</p>	<p>The UK has made limited progress in addressing CSR 2:</p> <ul style="list-style-type: none"> • some progress in increasing housing supply – completions have increased and policies introduced to fine-tune the planning system but more time is needed for them to take full effect; • some progress in relation to policies that constrain excessive demand – the FLS

⁵⁷ The following categories are used to assess progress in implementing the 2013 country-specific recommendations: **No progress:** The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures. **Limited progress:** The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk. **Some progress:** The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. **Substantial progress:** The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR. **Fully addressed:** The Member State has adopted and implemented measures that address the CSR appropriately

<p>Pursue reforms including to land and property taxation to reduce distortions and promote timely residential construction.</p> <p>Take steps to improve the functioning of rental markets, in particular by making longer rental terms more attractive to both tenants and landlords.</p>	<p>was removed for lending to households and safeguards built into the Help to Buy 2 policy but the thrust of the policy is unchanged;</p> <ul style="list-style-type: none"> • limited progress in reforming land and property taxation; • limited progress in affecting the operation of rental markets and longer-term tenancies.
<p>CSR 3: Building on the Youth Contract, step up measures to address youth unemployment, for example through a Youth Guarantee.</p> <p>Increase the quality and duration of apprenticeships, simplify the system of qualifications and strengthen the engagement of employers, particularly in the provision of advanced and intermediate technical skills.</p> <p>Reduce the number of young people aged 18-24 who have very poor basic skills, including through effectively implementing the Traineeships programme.</p>	<p>The UK has made some progress in addressing CSR:</p> <ul style="list-style-type: none"> • some progress on apprenticeships, simplifying the qualifications and engaging employers. Provided effective implementation, a number of measures taken may increase the impact of the Youth Contract on the labour market; • some progress in the implementation of the traineeship program; however, it is too early to assess its impact.
<p>CSR 4: Enhance efforts to support low-income households and reduce child poverty by ensuring that the Universal Credit and other welfare reforms deliver a fair tax-benefit system with clearer work incentives and support services.</p> <p>Accelerate the implementation of planned measures to reduce the costs of childcare and improve its quality and availability.</p>	<p>The UK has made some progress in addressing CSR 4:</p> <ul style="list-style-type: none"> • some progress in supporting low-income households, reducing child poverty and the introduction of Universal Credit. The number of people in sustainable job as a result of the Work Programme is still low. Poverty, particularly in work-poverty is likely to increase; • some progress in supporting childcare, which still remains expensive (particularly full-time) and of variable quality. There is a need to continue implementation of planned measures to improve the quality and availability of childcare as well as its affordability.
<p>CSR 5: Take further steps to improve the availability of bank and non-bank financing to the corporate sector, while ensuring that the measures primarily target viable companies, especially SMEs.</p> <p>Reduce barriers to entry in the banking sector, lower switching costs and facilitate</p>	<p>The UK has made substantial progress in addressing CSR 5:</p> <ul style="list-style-type: none"> • substantial progress in facilitating an improved supply of finance to the corporate sector through the establishment of the Business Bank, and fine-tuning the FLS, although bank credit continues to

<p>the emergence of challenger banks through a divestiture of banking assets. Effectively implement the Financial Policy Committee's recommendations on prudent assessment of bank capital requirements and on addressing identified capital shortfalls.</p>	<p>decline;</p> <ul style="list-style-type: none"> • substantial progress in relation to boosting competition in the banking sector – TSB was set up as a new bank (although not yet fully independent) through divestiture of bank assets from Lloyds and reforms have been made to reduce switching costs. However, there is not a significant presence of challenger banks; • implementation of the Financial Policy Committee's recommendations has been fully addressed.
<p>CSR 6: Take measures to facilitate a timely increase in network infrastructure investment, especially by promoting more efficient and robust planning and decision-making processes.</p> <p>Provide a stable regulatory framework for investment in new energy capacity, including in renewable energy. -Improve the capacity and quality of transport networks by providing greater predictability and certainty on planning and funding and by harnessing the most effective mix of public and private capital sources.</p>	<p>The UK has made some progress in addressing CSR 6:</p> <ul style="list-style-type: none"> • some progress in strengthening the planning framework – although the measures have been announced they have yet to be implemented; • some progress in relation to regulatory stability for energy capacity – the Energy Act 2013 received royal assent – and detailed funding streams and proposals have been set out in the National Infrastructure Plan although implementation is partial to date; • some progress in relation to the quality and quantity of transport networks – a major new rail network (Crossrail) is underway and the National Infrastructure Plan sets out considerable detail on funding new projects although implementation is partial to date.

Europe 2020 (national targets and progress)	
Employment rate target: No target set in NRP	74.9% of the population aged 20-64 was employed in 2013 (an increase from 74.2% in 2012). The UK employment rate is now marginally below the Europe 2020 target of 75%. In 2013, 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 employability of young people not in education, employment or training (NEET) by reintegrating them into the education system or the labour market thus raising their skills level, work incentives and parental employment, to improve access to high quality, affordable childcare.
Early school leaving target: No target in NRP	Early school leaving rate: 14.9% in 2010; 15.0% in 2011; 13.5% in 2012 and 12.4% in 2013. The early school leaving rate is falling but remains slightly above the EU average (11.9% in 2013). Raising the age of compulsory participation in education or training from 16 to 18 in 2015 should have a significant effect on reducing early school leaving.
Tertiary education target: No target in NRP	Tertiary attainment rate: 43.0% in 2010; 45.8% in 2011; 47.1% in 2012 and 47.6% in 2013. The UK tertiary attainment rate has increased significantly from 29% in 2000, and is well above the EU average (36.6% in 2013).
Target on the reduction of population at risk of poverty or social exclusion in number of persons: Existing numerical targets in the 2010 Child Poverty Act and Child Poverty Strategy 2011-14	The at-risk of poverty rate remained with 16.2% unchanged between 2011 and 2012 ⁵⁸ . The percentage of the population at risk of poverty or social exclusion increased from 22.7% in 2011 to 24.1% in 2012 ⁵⁹ , slightly below the EU-28 average of 24.8%, driven mainly by the increase between 2011-2012 of

⁵⁸ Eurostat, at-risk of poverty rate.

⁵⁹ Break in time series. Eurostat estimations for 2012, published December 2013.

	<p>severe material deprivation (from 5.1% to 7.8%) and the share of people in low work intensity households (from 11.5% to 13.0%). Planned real terms reductions in some working age welfare benefits are likely to increase in-work-poverty rates.</p>
<p>R&D target: No target set in NRP.</p>	<p>1.86% (2009), 1.77% (2010), 1.77% (2011), 1.72% (2012)</p> <p>The share of R&D spending in UK GDP is below the EU average of 2.06%. 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.</p>
<p>2020 Greenhouse gas emissions target: -16% (compared to 2005 emissions in non-ETS sectors)</p>	<p>Change in non-ETS greenhouse gas emissions between 2005 and 2012: -8.6%.</p> <p>According to the latest national projections and taking into account existing measures, the target is expected to be achieved: -19% in 2020 compared to 2005 (with a margin of 3 percentage points).</p>
<p>2020 Renewable energy target: 15%</p> <p>2020 renewable energy target in transport: 10%</p>	<p>RES share in 2012: 4.2%</p> <p>RES share in transport in 2012: 3.7%</p> <p>The UK has made some progress towards meeting the 2020 renewable energy target, however the pathway gets more demanding towards 2020, and therefore success is not assured.</p>
<p>Energy Efficiency target: 129.2 Mtoe (final energy consumption on a net calorific value basis)</p> <p>By 2020: level of 177.6 Mtoe primary consumption and 157.8 Mtoe final energy consumption</p>	<p>The United Kingdom notified the policy measures it plans to adopt to implement Article 7 of the Energy Efficiency Directive</p> <p>Energy efficiency policy in the UK is integrated within the wider climate change policy. The UK is making good progress towards reaching its targets.</p>

ANNEX

STANDARD TABLES

Table I. Macro-economic indicators

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015
Core indicators								
GDP growth rate	3.7	3.0	0.4	1.1	0.3	1.7	2.7	2.5
Output gap ¹	n.a	n.a	n.a	n.a	n.a	-2.2	-0.8	0.3
HICP (annual % change)	1.6	1.5	2.7	4.5	2.8	2.6	1.9	2.0
Domestic demand (annual % change) ²	4.6	3.3	0.1	-0.1	1.2	1.8	2.5	2.4
Unemployment rate (% of labour force) ³	6.4	4.9	6.3	8.0	7.9	7.5	6.6	6.3
Gross fixed capital formation (% of GDP)	17.3	16.9	16.3	14.4	14.5	14.0	14.4	15.0
Gross national saving (% of GDP)	16.5	15.4	14.4	13.5	10.7	9.5	10.6	11.7
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	n.a	n.a	n.a	n.a	n.a	-6.0	-5.0	-4.1
Gross debt	45.6	39.0	56.8	84.3	89.1	90.6	91.8	92.7
Net financial assets	-28.0	-22.3	-35.6	-66.5	-67.7	n.a	n.a	n.a
Total revenue	n.a	n.a	n.a	n.a	n.a	40.5	40.2	40.0
Total expenditure	n.a	n.a	n.a	n.a	n.a	47.1	45.7	44.4
<i>of which: Interest</i>	n.a	n.a	n.a	n.a	n.a	3.0	2.9	2.8
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-1.3	2.5	6.2	5.8	0.7	1.3	1.4	1.2
Net financial assets; non-financial corporations	-169.4	-128.7	-130.9	-123.8	-135.5	n.a	n.a	n.a
Net financial assets; financial corporations	-45.0	-36.0	-15.2	10.8	-0.4	n.a	n.a	n.a
Gross capital formation	11.9	10.7	9.1	8.8	8.6	8.4	8.8	9.2
Gross operating surplus	23.0	20.9	22.0	20.7	19.4	19.4	20.7	21.7
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	0.0	-1.9	-1.6	1.0	1.6	-0.3	-0.5	-0.7
Net financial assets	230.1	176.3	172.8	180.1	193.8	n.a	n.a	n.a
Gross wages and salaries	45.5	46.2	45.0	44.2	44.6	44.4	44.0	43.6
Net property income	10.3	8.0	7.1	7.8	7.5	7.3	7.5	7.9
Current transfers received	21.9	21.6	22.3	23.6	24.9	23.7	23.6	23.0
Gross saving	4.5	2.9	3.0	4.6	5.2	3.6	3.6	3.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-1.2	-1.8	-1.8	-1.2	-3.6	-4.1	-3.5	-3.0
Net financial assets	12.8	11.0	9.5	0.6	11.1	n.a	n.a	n.a
Net exports of goods and services	-0.6	-2.5	-2.3	-1.5	-2.1	-1.6	-1.1	-0.6
Net primary income from the rest of the world	-0.3	1.2	1.2	1.3	-0.4	-1.2	-1.2	-1.1
Net capital transactions	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.2
Tradable sector	44.1	40.4	37.0	35.8	35.6	n.a	n.a	n.a
Non tradable sector	44.9	48.8	52.7	52.7	53.5	n.a	n.a	n.a
<i>of which: Building and construction sector</i>	5.2	5.9	6.0	5.6	5.4	n.a	n.a	n.a
Real effective exchange rate (index, 2000=100)	91.0	99.2	93.3	84.7	89.1	87.9	92.2	92.4
Terms of trade goods and services (index, 2000=100)	97.2	100.4	98.6	96.1	95.8	96.7	97.7	98.9
Market performance of exports (index, 2000=100)	108.1	100.0	98.3	95.9	97.1	97.4	96.5	94.7
Notes:								
¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
² The indicator on domestic demand includes stocks.								
³ 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 2014 spring forecast (COM); Convergence programme (CP).								

Table II. Comparison of macroeconomic developments and forecasts

	2013		2014		2015		2016	2017	2018
	COM	CP	COM	CP	COM	CP	CP	CP	CP
Real GDP (% change)	1.7	1.8	2.7	2.7	2.5	2.3	2.6	2.6	2.5
Private consumption (% change)	2.2	2.3	2.1	2.1	2.2	1.8	2.5	2.7	2.4
Gross fixed capital formation (% change)	-0.6	-0.5	6.6	8.6	7.1	8.2	7.8	7.9	6.8
Exports of goods and services (% change)	1.0	0.8	2.6	2.6	3.2	4.7	5.0	5.0	4.7
Imports of goods and services (% change)	0.5	0.4	2.0	3.0	2.8	4.3	4.8	4.8	4.7
<i>Contributions to real GDP growth:</i>									
- Final domestic demand	1.5	1.6	2.5	2.9	2.5	2.3	2.6	2.7	2.5
- Change in inventories	0.3	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.0
- Net exports	0.2	0.1	0.1	-0.2	0.1	0.1	0.0	0.0	-0.1
Output gap ¹	-2.2	-2.5	-0.8	-1.2	0.3	-0.7	0.1	0.4	0.5
Employment (% change)	1.2	1.3	1.6	1.6	1.0	0.8	0.9	0.9	0.7
Unemployment rate (%)	7.5	7.6	6.6	6.8	6.3	6.5	6.1	5.7	5.4
Labour productivity (% change)	0.5	0.5	1.1	1.1	1.5	1.5	1.6	1.7	1.8
HICP inflation (%)	2.6	2.6	1.9	1.9	2.0	2.0	2.0	2.0	2.0
GDP deflator (% change)	1.8	1.6	1.8	2.3	2.2	1.6	1.8	1.9	2.0
Comp. of employees (per head, % change)	2.1	1.6	2.1	1.8	2.8	3.2	3.9	3.7	3.8
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-4.1	-2.9	-3.5	-1.8	-3.0	-1.6	-1.4	-1.3	n.a.
<u>Note:</u>									
¹ 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.									
<u>Source:</u>									
Commission 2014 spring forecast (COM); Convergence programme (CP).									

Table III. Composition of the budgetary adjustment

(% of GDP)	2013-14	2014-15		2015-16		2016-17	2017-18	2018-19	Change: 2013-14 to 2018-19
	COM	COM	CP	COM ¹	CP	CP	CP	CP	CP
Revenue	40.5	40.2	37.2	40.0	37.3	37.5	37.5	37.6	-2.9
<i>of which:</i>									
- Taxes on production and imports	13.5	13.5	13.6	13.6	13.6	13.5	13.4	13.3	-0.2
- Current taxes on income, wealth, etc.	14.9	14.6	12.3	14.3	12.6	12.8	13.0	13.2	-1.7
- Social contributions	8.4	8.3	6.4	8.2	6.4	6.7	6.7	6.8	-1.6
- Other (residual)	3.8	3.8	4.9	3.9	4.7	4.5	4.4	4.3	0.5
Expenditure	47.1	45.7	42.2	44.4	41.3	39.9	38.6	37.7	-9.4
<i>of which:</i>									
- Primary expenditure	44.1	42.8	39.2	41.6	38.0	36.4	34.9	34.0	-10.1
<i>of which:</i>									
Compensation of employees and intermediate consumption	22.4	21.6	n.a.	21.0	n.a.	n.a.	n.a.	n.a.	n.a.
Social payments	15.2	14.9	n.a.	14.4	n.a.	n.a.	n.a.	n.a.	n.a.
Subsidies	0.6	0.6	0.8	0.6	0.8	0.8	0.8	0.8	0.2
Gross fixed capital formation	2.0	2.0	2.0	2.0	1.8	1.8	1.7	1.7	-0.3
Other (residual)	3.9	3.8	3.2	3.6	3.2	2.9	2.8	2.8	-1.1
- Interest expenditure	3.0	2.9	3.0	2.8	3.3	3.5	3.7	3.7	0.7
General government balance (GGB)	-6.0	-5.0	-5.0	-4.1	-4.0	-2.4	-1.1	-0.1	5.9
Primary balance	-3.0	-2.1	-2.0	-1.3	-0.7	1.1	2.6	-3.6	-0.6
One-off and other temporary measures	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1
GGB excl. one-offs	-6.1	-5.0	-5.0	-4.1	-4.0	-2.4	-1.1	-0.1	6.0
Output gap ²	-2.2	-0.8	-1.2	0.3	-0.7	0.1	0.4	0.5	2.7
Cyclically-adjusted balance ²	-5.0	-4.4	-4.4	-3.9	-3.7	-2.4	-1.3	-0.3	4.6
Structural balance (SB)³	-5.0	-4.4	-4.4	-3.9	-3.7	-2.4	-1.3	-0.3	4.4
<i>Change in SB</i>	<i>0.6</i>	<i>0.6</i>	<i>0.3</i>	<i>0.5</i>	<i>0.8</i>	<i>1.3</i>	<i>1.1</i>	<i>1.0</i>	<i>-</i>
<i>Two year average change in SB</i>	<i>0.5</i>	<i>0.6</i>	<i>0.9</i>	<i>0.6</i>	<i>0.5</i>	<i>1.0</i>	<i>1.2</i>	<i>1.0</i>	<i>-</i>
Structural primary balance ³	-2.0	-1.5	-1.4	-1.1	-0.4	1.1	2.4	3.4	5.1
<i>Change in structural primary balance</i>		<i>0.5</i>	<i>0.3</i>	<i>0.5</i>	<i>1.1</i>	<i>1.5</i>	<i>1.3</i>	<i>1.0</i>	<i>-</i>
Expenditure benchmark									
Applicable reference rate ⁴	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Deviation ⁵ (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Two-year average deviation (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-
Notes:									
¹ On a no-policy-change basis.									
² 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.									
³ Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.									
⁴ 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.									
⁵ 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 negative sign implies that expenditure growth exceeds the applicable reference rate.									
Source:									
Convergence programme (CP); Commission 2014 spring forecast (COM); Commission calculations.									

Table IV. Debt dynamics

(% of GDP)	Average 2008-09 to 2012-13	2013- 14	2014-15		2015-16		2016-17	2017-18	2018-19
			COM	CP	COM	CP	CP	CP	CP
Gross debt ratio ¹	76.2	89.6	91.8	91.8	93.4	93.1	91.9	89.4	86.6
Change in the ratio	9.2	1.0	2.2	2.2	1.6	1.3	-1.2	-2.5	-2.8
<i>Contributions</i> ² :									
1. Primary balance	5.4	3.0	1.9	2.0	0.9	0.7	-1.1	-2.6	3.6
2. “Snow-ball” effect	1.5	-0.5	-0.8	-1.2	-1.2	-0.2	-0.4	-0.3	-7.3
<i>Of which:</i>									
Interest expenditure	2.7	3.0	2.9	3.0	2.8	3.3	3.5	3.7	-3.5
Growth effect	0.2	-1.9	-2.2	-2.3	-2.3	-2.0	-2.3	-2.3	-2.1
Inflation effect	-1.4	-1.5	-1.6	-1.9	-1.7	-1.5	-1.6	-1.7	-1.7
3. Stock-flow	2.3	-1.4	1.1	1.4	1.9	0.8	0.3	0.4	0.9
<i>Of which:</i>									
Cash/accruals diff.									
Acc. financial assets									
Privatisation									
Val. effect & residual									
		2013- 14	2014-15		2015-16		2016-17	2017-18	2018-19
			COM	CP	COM	CP	CP	CP	CP
Gap to the debt benchmark ^{3,4}	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Structural adjustment ⁵	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>To be compared to:</i>									
Required adjustment ⁶	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Notes:									
¹ End of period.									
² 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.									
³ 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.									
⁴ 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.									
⁵ Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.									
⁶ 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/CP) budgetary projections for the previous years are achieved.									
Source:									
Convergence programme (CP); Commission 2014 spring forecast (COM); Commission calculations.									

Table V. Sustainability indicators

	United-Kingdom			European Union		
	2013 scenario	No-policy-change scenario	Convergence programme scenario	2013 scenario	No-policy-change scenario	Convergence programme scenario
S2*	5.3	4.9	0.4	2.4	2.4	0.7
<i>of which:</i>						
Initial budgetary position (IBP)	2.7	2.3	-2.4	0.5	0.4	-1.3
Long-term cost of ageing (CoA)	2.6	2.7	2.8	1.9	2.0	2.0
<i>of which:</i>						
pensions	1.1	1.3	1.6	0.7	0.8	0.9
healthcare	0.9	0.8	0.7	0.9	0.9	0.8
long-term care	0.5	0.5	0.5	0.6	0.6	0.6
others	0.1	0.1	0.1	-0.4	-0.4	-0.3
S1**	4.5	4.3	0.0	1.5	1.7	-0.2
<i>of which:</i>						
Initial budgetary position (IBP)	2.5	1.8	-2.6	-0.2	-0.4	-2.0
Debt requirement (DR)	1.8	2.2	2.1	1.5	1.8	1.5
Long-term cost of ageing (CoA)	0.2	0.3	0.5	0.2	0.3	0.3
S0 (risk for fiscal stress)***	0.34	:	:	:	:	:
Debt as % of GDP (2013)	90.6			88.9		
Age-related expenditure as % of GDP (2013)	22.2			25.8		

Source : Commission; 2014 convergence programme.

Note : The 2013 scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2013 in line with the Commission's 2014 spring forecast. The 'no-policy-change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves until 2015 in line with the Commission's 2014 spring forecast. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented. Age-related expenditure as given in the 2012 Ageing Report.

* The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: (i) the initial budgetary position (IBP), which gives the gap vis-à-vis the debt-stabilising primary balance and (ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that, in an infinite horizon, the growth in the debt ratio is bound by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60 % debt threshold. The following thresholds were used for the S2 indicator: (i) if the value of S2 is lower than 2, the country is classed as low risk; (ii) if it is between 2 and 6, it is classed as medium risk; and (iii) if it is greater than 6, it is classed as high risk.

** The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance in the period to 2020 and then sustained for a decade, to bring debt ratios back to 60% of GDP in 2030, including financing for any additional expenditure by the target date, arising from population ageing. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is classed as low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 pp of GDP per year until 2020 after the last year covered by the 2014 spring forecast (2015) is required (indicating a cumulated adjustment of 2.5 pp), it is classed as medium risk; and (iii) if the S1 value is greater than 2.5 (i.e. a structural adjustment of more than 0.5 pp of GDP per year is necessary), it is classed as high risk.

*** The S0 indicator reflects up-to-date evidence on the role played by fiscal and financial competitiveness variables in creating potential fiscal risks. The methodology for the S0 indicator differs fundamentally from that for the S1 and S2 indicators. Unlike S1 and S2, S0 is not a quantification of the required fiscal adjustment effort, but a composite indicator which estimates the extent to which there might be a risk of fiscal stress in the short term. The critical threshold for the S0 indicator is 0.43.

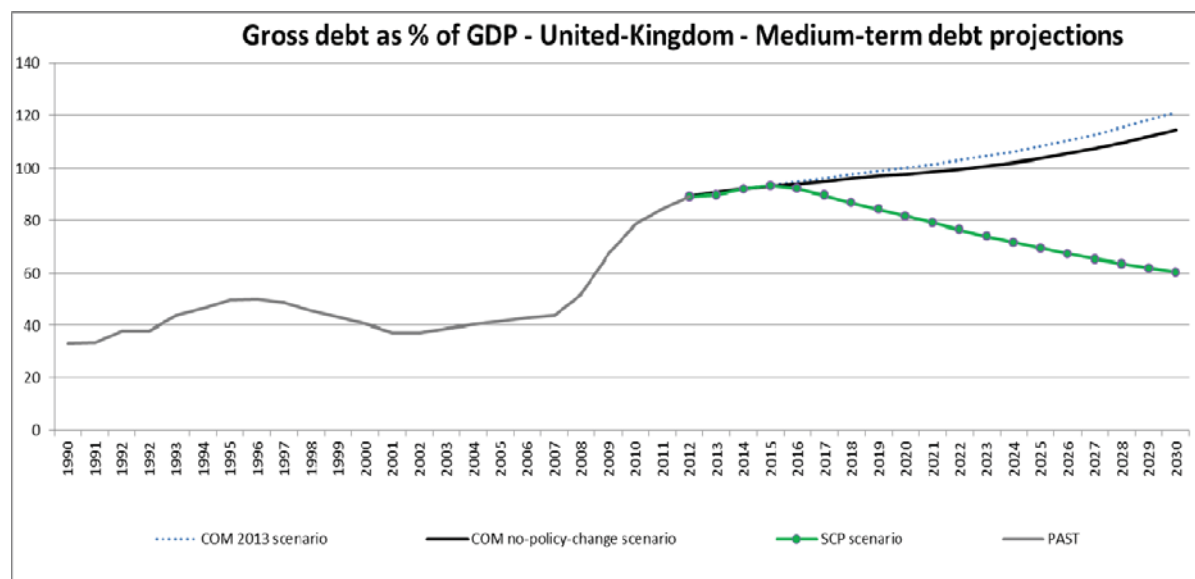


Table VI. Taxation indicators

	2002	2006	2008	2010	2011	2012
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	34.8	36.1	37.1	35.0	35.8	35.4
Breakdown by economic function (% of GDP) ¹						
Consumption	11.5	10.8	10.6	11.1	11.9	12.0
of which:						
- VAT	6.6	6.5	6.3	6.5	7.3	7.3
- excise duties on tobacco and alcohol	1.4	1.2	1.2	1.2	1.3	1.3
- energy	2.1	1.8	1.8	2.0	1.9	1.9
- other (residual)	1.3	1.2	1.3	1.4	1.5	1.5
Labour employed	13.2	13.8	13.9	13.9	13.8	13.6
Labour non-employed	0.2	0.2	0.2	0.2	0.2	0.2
Capital and business income	5.7	6.9	6.8	5.7	5.6	5.4
Stocks of capital/wealth	4.2	4.5	5.7	4.2	4.3	4.3
<i>p.m.</i> Environmental taxes ²	2.7	2.4	2.4	2.6	2.6	2.6
VAT efficiency ³						
Actual VAT revenues as % of theoretical revenues at standard rate	47.7	47.3	45.6	45.7	45.7	45.5
Note:						
1. Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.						
2. This category comprises taxes on energy, transport and pollution, and resources included in taxes on consumption and capital.						
3. The VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. 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'). It should be noted that the relative size of cross-border shopping compared to domestic consumption also influences the value of the ratio, notably for smaller economies. See European Commission (2012), Tax Reforms in EU Member States and OECD (2012), Consumption tax trends for a more detailed discussion.						
<i>Source: Commission</i>						

Table VII. Financial market indicators

	2009	2010	2011	2012	2013
Total assets of the banking sector (% of GDP)	563.1	529.8	549.5	494.6	465.5
Share of assets of the five largest banks (% of total assets)	34.1	39.8	44.1	40.6	-
Foreign ownership of banking system (% of total assets)	48.1	47.6	48.2	46.0	-
Financial soundness indicators:					
- non-performing loans (% of total loans) ^{1),2)}	3.5	4.0	4.0	3.7	...
- capital adequacy ratio (%) ^{1),2)}	14.8	15.9	15.7	16.4	...
- return on equity (%) ^{1),2)}	-0.1	6.9	6.1	5.8	...
Bank loans to the private sector (year-on-year % change)	3.2	4.6	-1.5	2.9	-4.7
Lending for house purchase (year-on-year % change)	24.1	18.0	3.9	4.4	-0.8
Loan to deposit ratio	110.0	106.2	104.0	102.6	99.3
CB liquidity as % of liabilities	-	-	-	-	-
Banks' exposure to countries receiving official financial assistance (% of GDP) ³⁾	14.3	12.5	10.9	9.2	9.1
Private debt (% of GDP)	195.4	183.0	179.5	179.1	-
Gross external debt (% of GDP)					
- Public	17.6	23.0	28.7	27.6	27.2
- Private	136.9	138.8	149.4	127.3	132.7
Long term interest rates spread versus Bund (basis points)*	13.7	62.1	26.1	24.9	45.7
Credit default swap spreads for sovereign securities (5-year)*	83.3	68.0	64.8	51.2	34.9
Notes:					
¹⁾ Latest data 2012 Q2.					
²⁾ Figures for the United Kingdom are based on the consolidated global operations of domestically controlled banks reporting in the UK, so may not be representative of the financial soundness of the subgroup of banks that account for the bulk of retail activity in the UK.					
³⁾ Covered countries are CY, EL, ES, LV, HU, IE, PT and RO.					
* Measured in basis points.					
Source:					
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).					

Table VIII. Labour market and social indicators

	2008	2009	2010	2011	2012	2013
Labour market indicators						
Employment rate (% of population aged 20-64)	75.2	73.9	73.6	73.6	74.2	74.9
Employment growth (% change from previous year)	0.7	-1.6	0.2	0.5	1.2	1.3
Employment rate of women (% of female population aged 20-64)	68.8	68.2	67.9	67.9	68.4	69.4
Employment rate of men (% of male population aged 20-64)	81.8	79.6	79.3	79.4	80.0	80.5
Employment rate of older workers (% of population aged 55-64)	58.0	57.5	57.1	56.7	58.1	59.8
Part-time employment (% of total employment, 15 years and more)	25.3	26.1	26.9	26.8	27.2	26.9
Part-time employment of women (% of women employment, 15 years and more)	41.8	42.5	43.3	43.1	43.3	42.6
Part-time employment of men (% of men employment, 15 years and more)	11.3	11.8	12.6	12.7	13.3	13.2
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	5.4	5.7	6.1	6.2	6.3	6.2
Transitions from temporary to permanent employment	:	:	72.1	51.0	52.5	:
Unemployment rate ¹ (% of labour force, age group 15-74)	5.6	7.6	7.8	8.0	7.9	7.5
Long-term unemployment rate ² (% of labour force)	1.4	1.9	2.5	2.7	2.7	2.7
Youth unemployment rate (% of youth labour force aged 15-24)	15.0	19.1	19.6	21.1	21.0	20.5
Youth NEET rate (% of population aged 15-24)	12.1	13.3	13.7	14.3	14.0	13.3
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	17.0	15.7	14.9	15.0	13.6	12.4
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	39.7	41.5	43.0	45.8	47.1	47.6
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	31.0	31.0	31.0	30.0	24.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	4.0	4.0	4.0	5.0	3.0	:
Labour productivity per person employed (annual % change)	-1.5	-3.6	1.5	0.6	-0.9	0.5
Hours worked per person employed (annual % change)	-0.3	-1.3	0.3	-0.1	0.8	0.5
Labour productivity per hour worked (annual % change; constant prices)	-1.2	-2.3	1.1	0.7	-1.7	0.0
Compensation per employee (annual % change; constant prices)	-1.5	0.2	0.0	-0.3	0.5	0.3
Nominal unit labour cost growth (annual % change)	3.2	6.2	1.7	1.4	2.5	:
Real unit labour cost growth (annual % change)	0.0	3.9	-1.4	-0.9	0.8	:
Notes:						
¹ 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.						
² Long-term unemployed are unemployed persons for at least 12 months.						
Sources:						
Commission (EU Labour Force Survey and European National Accounts)						

Expenditure on social protection benefits (% of GDP)	2007	2008	2009	2010	2011
Sickness/Health care	7.5	7.7	8.7	8.3	8.3
Invalidity	2.5	2.7	2.9	2.4	2.4
Old age and survivors	10.4	10.7	11.8	11.4	11.4
Family/Children	1.6	1.7	1.9	1.8	1.7
Unemployment	0.5	0.6	0.8	0.7	0.7
Housing and Social exclusion n.e.c.	1.1	1.2	1.4	1.5	1.5
Total	23.8	24.8	27.8	26.4	26.3
of which: means tested benefits	3.5	3.6	4.2	3.8	3.8
Social inclusion indicators	2008	2009	2010	2011	2012
At-risk-of-poverty or social exclusion ¹ (% of total population)	23.2	22.0	23.2	22.7	24.1
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	29.6	27.4	29.7	26.9	31.2
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	28.5	23.1	22.3	22.7	16.9
At-Risk-of-Poverty rate ² (% of total population)	18.7	17.3	17.1	16.2	16.2
Severe Material Deprivation ³ (% of total population)	4.5	3.3	4.8	5.1	7.8
Share of people living in low work intensity households ⁴ (% of people aged 0-59)	10.4	12.7	13.2	11.5	13.0
In-work at-risk-of poverty rate (% of persons employed)	8.5	6.7	6.8	7.9	9.0
Impact of social transfers (excluding pensions) on reducing poverty	35.3	43.1	44.8	46.9	49.2
Poverty thresholds, expressed in national currency at constant prices ⁵	8 834	8 196	8 129	7 972	7 909
Gross disposable income (households)	921 444	954 247	999 828	1 027 025	1 072 184
Relative median poverty risk gap (60% of median equivalised income, age: total)	21.0	20.6	21.4	21.3	21.0
Notes:					
¹ 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).					
² At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.					
³ 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.					
⁴ 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.					
⁵ 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 market performance and policy indicators

Performance indicators	2004-2008	2009	2010	2011	2012	2013
Labour productivity ¹ total economy (annual growth in %)	1.4	-3.9	1.4	0.7	-0.9	n.a.
Labour productivity ¹ in manufacturing (annual growth in %)	3.2	-3.6	6.8	3.5	-2.8	n.a.
Labour productivity ¹ in electricity, gas, water (annual growth in %)	-5.9	-7.2	-4.1	-15.0	n.a.	n.a.
Labour productivity ¹ in the construction sector (annual growth in %)	-2.3	-9.2	14.3	4.6	-5.1	n.a.
Patent intensity in manufacturing ² (patents of the EPO divided by gross value added of the sector)	181.7	168.0	162.5	157.1	n.a.	n.a.
Policy indicators	2004-2008	2009	2010	2011	2012	2013
Enforcing contracts ³ (days)	404	399	399	399	437	437
Time to start a business ³ (days)	13.0	12	12	12	12	12
R&D expenditure (% of GDP)	1.7	1.8	1.8	1.8	1.7	n.a.
Tertiary educational attainment (% of 30-34 years old population)	36.6	41.5	43.0	45.8	47.1	47.6
Total public expenditure on education (% of GDP)	5.3	5.6	6.2	5.9	n.a.	n.a.
	2008	2009	2010	2011	2012	2013
Product market regulation ⁴ , Overall (Index; 0=not regulated; 6=most regulated)	1.2	n.a.	n.a.	n.a.	n.a.	1.1
Product market regulation ⁴ , Retail (Index; 0=not regulated; 6=most regulated)	n.a.	n.a.	n.a.	n.a.	n.a.	1.8
Product market regulation ⁴ , Network Industries ⁵ (Index; 0=not regulated; 6=most regulated)	1.1	n.a.	n.a.	n.a.	n.a.	0.8
Notes:						
¹ Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.						
² Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.						
³ The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology .						
⁴ The methodologies of the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html .						
⁵ Aggregate ETCR.						
Source:						
Commission, World Bank - <i>Doing Business</i> (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).						

Table X. Green Growth

		2003-2007	2008	2009	2010	2011	2012
Green Growth performance							
<i>Macroeconomic</i>							
Energy intensity	kgoe / €	0.12	0.11	0.11	0.11	0.10	0.10
Carbon intensity	kg / €	0.35	0.32	0.31	0.31	0.29	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	0.40	0.36	0.33	0.32	0.32	n.a.
Waste intensity	kg / €	n.a.	0.17	n.a.	0.14	n.a.	n.a.
Energy balance of trade	% GDP	-0.1%	-0.7%	-0.4%	-0.5%	-1.0%	-1%
Energy weight in HICP	%	6	7	8	9	9	10
Difference between change energy price and inflation	%	8.88	14.9	4.8	-6.1	5.4	5.2
Environmental taxes over labour taxes	ratio	17.9%	16.7%	18.1%	18.3%	18.1%	n.a.
Environmental taxes over total taxes	ratio	7.1%	6.5%	7.4%	7.4%	7.1%	n.a.
<i>Sectoral</i>							
Industry energy intensity	kgoe / €	0.12	0.12	0.11	0.11	n.a.	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.	0.10	0.10	0.10	0.10	0.11
Gas prices for medium-sized industrial users***	€/ kWh	n.a.	0.03	0.02	0.02	0.02	0.03
Public R&D for energy	% GDP	n.a.	0.00%	0.00%	0.01%	0.01%	0.01%
Public R&D for the environment	% GDP	n.a.	0.02%	0.02%	0.02%	0.02%	0.02%
Recycling rate of municipal waste	ratio	34.8%	46.7%	49.8%	53.1%	58.2%	58.1%
Share of GHG emissions covered by ETS*	%	n.a.	41.2%	39.3%	39.2%	39.2%	39.8%
Transport energy intensity	kgoe / €	0.47	0.46	0.44	n.a.	n.a.	n.a.
Transport carbon intensity	kg / €	1.09	1.04	1.00	n.a.	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	10.6%	26.2%	26.3%	28.2%	36.1%	42.2%
Diversification of oil import sources	HHI	n.a.	0.22	0.22	0.23	0.20	n.a.
Diversification of energy mix	HHI	0.30	0.31	0.30	0.31	0.29	0.27
Share renewable energy in energy mix	%	1.6%	2.5%	3.0%	3.2%	3.9%	4.1%
<u>Country-specific notes:</u>							
The year 2012 is not included in the table due to lack of data.							
<u>General explanation of the table items:</u>							
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 CO2 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							
* Commission and EEA.							
** For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.							
*** For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.							

List of indicators used in Box 3 on the potential impact on growth of structural reforms

Final goods sector mark-ups: price cost margin, i.e. the difference between the selling price of a good or service and its cost. Final goods mark-ups are proxied by the mark-ups in selected services sectors (transport and storage, post and telecommunications, electricity, gas and water supply, hotels and restaurants and financial intermediation but excluding real estate and renting of machinery and equipment and other business activities⁶⁰).

Source: Commission services estimation using the methodology of Roeger (1995) based on EUKLEMS 1996-2007 data.

Entry costs: cost of starting a business in the intermediate sector. The intermediate sector is proxied by the manufacturing sector in the model.

Source: starting business costs in % of income per capita, 2012 data. Doing Business Database. www.doingbusiness.org

Implicit consumption tax rate: defined as total taxes on consumption over the value of private consumption. In the simulations it is used as a proxy for shifting taxation away from labour to indirect taxes; the implicit consumption tax-rates are increased (halving the gap vis-à-vis the best performers) while labour tax-rates are reduced, so that the combined impact is ex-ante budget-neutral.

Source: European Commission, Taxation trends in the European Union, 2013 edition, Luxembourg, 2013, 2011 data.

Shares of high-skilled and low-skilled: share of high skilled workers are increased, share of low-skilled workers are reduced (halving the gap vis-à-vis the best performers). Skill definitions: Low-skilled correspond to ISCED 0-2 categories, high-skilled correspond to scientists (in mathematics and computing, engineering, manufacturing and construction). The remainder is medium-skilled.

Source: 2012 data or latest available, EUROSTAT.

Female non-participation rate: percentage of female that do not work/search for a job (non-active female population/female of a working age)

Source: 2012 data or latest available, EUROSTAT.

Low-skilled male non-participation rates: percentage of low-skilled male that do not work/search for a job (non-active low-skilled male population/ male of a working age)

Source: 2012 data or latest available, EUROSTAT.

Elderly non-participation rates (55-64 years): it is the percentage of the elderly population (55-64 years) that do not work/search for a job (non-active elderly population/55-64-year-old population)

Source: 2012 data or latest available, EUROSTAT.

ALMP: Active Labour Market Policy expenditures in % GDP over the share of unemployed in the population.

Source: 2011 or latest available data. EUROSTAT

⁶⁰ The real estate sector is excluded because of statistical difficulties of estimating a mark-up in this sector. The sector renting of machinery and equipment and other business activities is conceptually part of intermediate goods sector.

Benefit replacement rate: % of a worker's pre-unemployment income that is paid out by the unemployment scheme.

Source: average of net replacement rates over 60 months of unemployment, 2012 data, OECD, Benefits and Wages Statistics. www.oecd.org/els/benefitsandwagesstatistics.htm.