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To:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
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Recommendation for a

COUNCIL RECOMMENDATION

on the United Kingdom's 2014 national reform programme

and delivering a Council opinion on the United Kingdom's 2014 convergence programme

{SWD(2014) 429 final}

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Recommendation for a

COUNCIL RECOMMENDATION

on the United Kingdom's 2014 national reform programme

and delivering a Council opinion on the United Kingdom's 2014 convergence programme

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission[3],

Having regard to the resolutions of the European Parliament[4],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2014) 429 final.
4 P7_TA(2014)0128 and P7_TA(2014)0129.

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States, which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

(4) On 9 July 2013, the Council adopted a recommendation on the United Kingdom's national reform programme for 2013 and delivered its opinion on the United Kingdom's updated convergence programme for 2012-13 to 2017-18.

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey[5], marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[6], in which it identified the United Kingdom as one of the Member States for which an in-depth review would be carried out.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 5 March 2014, the Commission published the results of its in-depth review for the United Kingdom[7], under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that the United Kingdom continues to experience macroeconomic imbalances, which require monitoring and policy action. In particular, developments in the areas of household debt, linked to the high levels of mortgage debt and structural characteristics of the housing market, as well as unfavourable developments in export market shares, continue to warrant attention. The risks in the housing sector relate to a continuing structural undersupply of housing; intrinsic supply constraints, particularly in London, and the relatively slow response of supply to increases in demand continues to drive house prices higher, particularly in London and the southeast, and also leads to buyers taking on high mortgages. While the declining export market share is unlikely to pose short-term risks, taken together with the current account deficit, it still points to structural

[5] COM(2013) 800 final.
[6] COM(2013) 790 final.
[7] SWD(2014) 91 final.

challenges. These are related to skills gaps and infrastructure deficiencies. As regards public finances, the United Kingdom has missed its headline deficit targets and its structural adjustment targets.

(8) On 30 April 2014, the United Kingdom submitted its 2014 national reform programme and its 2014 convergence programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(9) Pursuant to paragraph 4 of the Protocol (No 15) on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, the obligation in Article 126(1) of the Treaty on the Functioning of the European Union to avoid excessive general government deficits does not apply to the United Kingdom. Paragraph 5 of the Protocol provides that the United Kingdom is to endeavour to avoid an excessive government deficit. On 8 July 2008 the Council decided, in accordance with Article 104(6) of the Treaty establishing the European Community that an excessive deficit exists in the United Kingdom.

(10) The objective of the budgetary strategy outlined in the 2014 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 Convergence Programme does not include a medium-term objective as foreseen by the Stability and Growth Pact. The general government deficit is estimated at 5.0% of GDP in 2014-15, having fallen from a peak of 11.4% of GDP in 2009-10. This does not comply with the deadline for correcting the excessive deficit set by the Council. According to the programme, the excessive deficit will be corrected in 2016-17 at 2.4% of GDP, two years after the deadline set by the Council. The programme implies that the (recalculated) general government structural deficit will improve by 0.3 pp. to 4.4% of GDP over the year to 2014-15. The budgetary plans are not sufficient in attaining the annual average fiscal effort recommended to correct the excessive deficit. Thereafter, the programme foresees an annual improvement of the (recalculated) structural balance of 0.8 pp. in 2015-16 and 1.3 pp. in 2016-17. Overall, the programme is only partly in line with the requirements of the Stability and Growth Pact. The consolidation has until now been heavily skewed towards expenditure cuts, therefore the potential revenue contribution from a broadening of the tax base could be considered. The United Kingdom has a high level of foregone taxes, particularly with regard to indirect taxation. According to the Convergence Programme, the debt-to-GDP ratio is projected to increase to 93.1% in 2015-16 before falling back to 86.6% in 2018-19. The United Kingdom's macroeconomic scenario underpinning the budgetary projections in the programme is plausible. Potential risks to the budgetary projections stem from lower-than-expected growth due to constrained wages curtailing private consumption and uncertainty hindering investment. Nevertheless, the projections are consistent with the Commission 2014 spring forecast, which also does not foresee that the excessive deficit will be corrected by the deadline set by the Council. Furthermore, based on the Commission forecast, the (corrected) change in the structural balance over 2010-2014 falls short by on average 0.6% of GDP per year compared to the requirement and is projected to fall short in 2015 as well. Based on its assessment of the programme and the Commission forecast, pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that additional measures are needed to ensure compliance with the recommendation under the excessive deficit procedure.

(11) The United Kingdom has taken both demand and supply side measures in the area of housing. Although the supply of new properties has risen, it remains low and has fallen short of demand by a considerable margin. This has combined with low interest rates and easier terms for mortgage lending (such as higher loan-to-income multiples) to push up house prices in certain parts of the United Kingdom particularly in London. A shortage of supply has long been a structural phenomenon and is likely to extend into the medium term. Action is needed to further boost the supply of houses - by creating appropriate incentives to raise supply at the local level. The authorities should continue to monitor house prices and mortgage indebtedness and stand ready to deploy appropriate measures, including adjusting the Help to Buy 2 (loan guarantee) scheme, if deemed necessary. There is a need to increase the transparency of the use and impact of the macro-prudential regulation of the housing sector by the Financial Policy Committee that could be deployed to address excessive house price rises and increases in mortgage indebtedness. Reforms to the taxation of land and property should be considered to alleviate distortions in the housing market. At the moment, increasing property values are not translated into higher property taxes as the property value roll has not been updated since 1991 and taxes on higher value property are lower than on lower value property in relative terms due to the regressivity of the current rates and bands within the council tax system.

(12) The United Kingdom continues to address the challenges of unemployment and underemployment as well as the specific issues related to youth unemployment. There are important challenges with equipping young people with the skills and work experience required by the labour market and increasing the supply of apprenticeships. This helps to explain the fact that the take-up of wage subsidies provided for by the Youth Contract remains lower than forecast. The labour market suffers from skill mismatches and the authorities are attempting to re-skill the workforce to address both unemployment and a shortage of high-quality vocational and technical skills. While there have been efforts to improve the quality of apprenticeship programmes, further efforts are needed. Moreover, the qualifications system remains complex and needs to be streamlined to facilitate universal recognition and a higher level of engagement by employers.

(13) The authorities are addressing the problem of weak work incentives, especially for recipients of social benefits with the introduction of the Universal Credit, which will allow individuals to keep more of their benefit income as they move into work. Whilst Universal Credit could have a positive impact on employment much will depend on effective implementation and support services, including the interaction with other benefits. The focus on getting back into work has also been reflected in limiting the annual adjustment to many working-age benefits and tax credits to 1% per annum until 2016.

(14) The United Kingdom continues to tackle challenges to increasing parental employment by increasing access to high-quality, affordable childcare. It continues to introduce schemes to make childcare affordable for both part-time and full-time employed parents, taking into account different levels of earnings. Childcare costs, however, remain among the highest in the EU and continue to pose problems particularly for second earners and for single parents.

(15) In terms of access to finance, while conditions in credit markets have improved in 2013, credit growth remains weak and existing policies need more time to show that they have been successful. Particular challenges regarding access to credit remain for SMEs. While large firms can finance themselves directly in wholesale markets and profit from the well-developed financial services offer of the United Kingdom, SMEs largely rely on banks to obtain their external funding. Good progress has been made to address last year's recommendation on competition in banking by the creation of new banks, referred to as challenger banks (one such example is TSB, which, however, is not yet fully independent).

(16) In December 2013, the United Kingdom published an updated national infrastructure plan: a long-term and strategic approach to the planning, funding, finance and delivery of infrastructure. The plan sets out a 'pipeline' of forward-looking capital investment to 2020 and beyond of GBP 375 billion in total (approximately EUR 460 billion). A large proportion of the 'pipeline' (GBP 340 billion, i.e. approximately EUR 420 billion) concerns investment in the energy and transport sectors. Around three-quarters of the funding is projected to be privately-sourced, while the rest is projected to be publicly funded. Although the plan is an appropriate initiative, there remain concerns about the private sector element of financing, regulatory certainty and timely planning permission. There is a need for stringent mechanisms to mitigate financing and execution risks while ensuring transparency on projected and actual expenditure on infrastructure.

(17) In the context of the European Semester, the Commission has carried out a comprehensive analysis of the United Kingdom’s economic policy. It has assessed the convergence programme and the national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in the United Kingdom but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (6) below.

(18) In the light of this assessment, the Council has examined the United Kingdom's convergence programme, and its opinion[8] is reflected in particular in recommendation (1) below.

(19) In the light of the Commission's in-depth review and this assessment, the Council has examined the national reform programme and the convergence programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (2), (3), (5) and (6) below.

HEREBY RECOMMENDS that the United Kingdom take action within the period 2014-2015 to:

1. Reinforce the budgetary strategy, endeavouring to correct the excessive deficit in a sustainable manner in line with the Council recommendation under the Excessive Deficit Procedure. Pursue a differentiated, growth-friendly approach to fiscal tightening by prioritising capital expenditure. To assist with fiscal consolidation, consideration should be given to raising revenues through broadening the tax base.

[8] Under Article 9(2) of Council Regulation (EC) No 1466/97.

Address structural bottlenecks related to infrastructure, skills mismatches and access to finance for SMEs to boost growth in the export of both goods and services.

2. Increase the transparency of the use and impact of macro-prudential regulation in respect of the housing sector by the Bank of England's Financial Policy Committee. Deploy appropriate measures to respond to the rapid increases in property prices in areas that account for a substantial share of economic growth in the United Kingdom, particularly London, for example by adjusting the Help to Buy 2 scheme and mitigate risks related to high mortgage indebtedness. Remove distortions in property taxation by regularly updating the valuation of property and reduce the regressivity of the band and rates within the council tax system. Continue efforts to increase the supply of housing.

3. Maintain commitment to the Youth Contract, especially by improving skills that meet employer needs. Ensure employer engagement by placing emphasis on addressing skills mismatches through more advanced and higher level skills provision and furthering apprenticeship offers. Reduce the number of young people with low basic skills.

4. Continue efforts to reduce child poverty in low-income households, by ensuring that the Universal Credit and other welfare reforms deliver adequate benefits with clear work incentives and support services. Improve the availability of affordable quality childcare.

5. Continue efforts to improve the availability of bank and non-bank financing to SMEs. Ensure the effective functioning of the Business Bank and support an increased presence of challenger banks.

6. Follow up on the National Infrastructure Plan by increasing the predictability of the planning processes as well as providing clarity on funding commitments. Ensure transparency and accountability by providing consistent and timely information on the implementation of the Plan.

Done at Brussels,

For the Council
The President