EUROPEAN COMMISSION

Brussels, 30.5.2012
SWD(2012) 309 final

COMMISSION STAFF WORKING DOCUMENT

Assessment of the 2012 national reform programme and convergence programme for the UNITED KINGDOM

Accompanying the document

Recommendation for a

COUNCIL RECOMMENDATION

on United Kingdom's 2012 national reform programme and delivering a Council opinion on United Kingdom's updated convergence programme, 2012-2015

{COM(2012) 309 final}

CONTENT

1. EXECUTIVE SUMMARY

In 2012, UK economic activity is expected to remain subdued, with growth of 0.5 %, before regaining momentum in 2013. Unemployment is forecast to reach 8.5 %.

The UK is delivering its planned programme of fiscal consolidation measures, but the deficit is now projected to fall more slowly than previously expected, due to a weaker growth outlook in the medium term. The government has an extensive legislative reform agenda across financial regulation, planning, education and welfare.

Several structural challenges remain. Fiscal consolidation remains a pressing need and must be balanced with more investment, in particular to improve essential network infrastructure. Financing conditions remain tight, particularly for SMEs. Private debt levels are high and further deleveraging is necessary. Skills mismatches translate into higher unemployment levels, especially for young people, and the lack of high-quality and affordable childcare also contributes to the high proportion of workless households. There is a significant shortage of housing and house prices remain too high, which is linked to high levels of mortgage debt. The UK's persistently negative net export position calls for a strengthening of the non-cost competitiveness of the UK economy.

2. INTRODUCTION

In June 2011, the Commission proposed five country-specific recommendations[1] (CSRs) for economic and structural reform policies for the United Kingdom. In July 2011, the Council of the European Union adopted these recommendations which concerned fiscal consolidation, public finances, housing, education and training, employment and access to finance.

In November 2011, the Commission published its Annual Growth Survey for 2012[2] (AGS 2012) in which it set out its proposals for building the necessary common understanding about the priorities for action at national and EU level in 2012. It focused on five priorities — growth-friendly fiscal consolidation, restoring normal lending to the economy, promoting growth and competitiveness, tackling unemployment and the social consequences of the crisis, and modernising public administration — and encouraged Member States to implement them in the 2012 European Semester.

Against this background, the UK presented updates of its national reform programme (NRP) and convergence programme (CP) in April 2012. These programmes give details on progress made since July 2011 and plans going forward. The UK government recognises the challenges facing the economy, and the NRP sets out a comprehensive economic strategy based on five pillars: fiscal consolidation, monetary activism, financial sector reform, reform of the tax system, and microeconomic reforms to rebalance the economy towards greater exports and investment.

This Staff Working Document assesses the state of implementation of the 2011 Council recommendations in the UK and identifies the UK's current policy challenges in light of the AGS 2012 and the country's latest policy plans.

Overall assessment

Overall, the UK has made significant progress on developing reforms relating to the 2011 recommendations, but most have not yet been fully implemented. Although the government has started to make progress on reducing the deficit, this is still forecast to stand at 6.1% in 2012-13, one of the highest levels in the EU, and fiscal consolidation remains a pressing challenge for the UK. To date, the government has delivered its planned programme of fiscal consolidation measures, but the UK is only part of the way through an ambitious multi-year fiscal consolidation plan.

Wider reforms are also needed to promote the conditions for sustainable, investment-led growth. The government has an extensive and ambitious legislative reform agenda across financial regulation, planning, education and welfare. It is not yet fully clear to what extent these reforms will be successful and effective; final policy design and implementation will be key and many of the effects will be gradual. To date, progress on indicators related to the recommendations on housing, employment and access to finance has been limited, linked in large part to the challenging economic environment. In this respect, the challenges identified in July 2011 and reiterated in the AGS 2012 remain valid.

[1] SEC(2011) 827 final of 7 June 2011.
[2] COM(2011) 815 final of 23 November 2011.

3. ECONOMIC DEVELOPMENTS AND CHALLENGES

3.1. Recent economic developments and outlook

Recent economic developments

The UK's economic growth prospects deteriorated rapidly in the second half of 2011 with a contraction of -0.3% in the final quarter. However, the economy grew by 0.7% for the year as a whole. Growth was largely driven by external demand, as domestic disposable income was squeezed by a combination of high inflation, public expenditure cuts and tax rises, low nominal wage growth and rising unemployment. The level of investment remained low throughout 2011.

In the latter months of 2011, inflation began falling rapidly after peaking at 5.2% year-on-year in September, which equalled the highest rate since the introduction of the Harmonised Index of Consumer Prices in 1997. The latest figures show a drop to 3.0% in April 2012, driven in part by base effects as the 2.5 percentage point (pp) VAT rise in January 2011 dropped out of the calculations. The fall in inflation should continue during the year, owing to continuing subdued internal demand and greater price stability in imports. Inflation expectations of both business and households for 2012 are significantly lower than in 2011. Inflation is expected to decrease to an average of 2.9 % in 2012.

After remaining below 8% through the first half of 2011, unemployment rose to 8.4% in the final quarter of 2011 and is projected to peak at 8.5 %[3] in 2012. High unemployment should continue to weigh down on nominal wage growth, domestically-generated inflation and private consumption. Given that UK output remains below its pre-crisis peak, weak productivity and wage growth, and possible labour hoarding, appear to have cushioned the rise in unemployment since the onset of the crisis.

Outlook

There had been signs of improvement in the business surveys for the first quarter of 2012. However the preliminary estimate of GDP is for a further contraction of -0.2%, putting the UK economy into recession. Growth is likely to remain subdued in 2012 as the fiscal consolidation continues, the outlook for the European economy remains weak, and UK consumers remain squeezed, despite gaining some benefit from falling inflation. After a negative effect from there being fewer working days than usual in the second quarter of 2012, GDP growth is likely to pick up in the second half of the year, with the positive momentum continuing into 2013. This growth is expected to come from an uptick in both consumption and corporate investment, which will be aided by the London Olympics in the third quarter of 2012. The private consumption and investment outlook for 2013 is for growth of 1.0% and 3.2 % respectively. The Commission's forecast of the expected drivers of growth is similar to that of the Office for Budget Responsibility outlined in the Convergence Programme. However, the Commission's estimate for overall GDP growth for 2012 (0.5 %) and 2013 (1.7 %) is slightly less optimistic than that of the Office for Budget Responsibility (0.8% and 2.0% respectively).

Procedural and governance issues

The UK submitted its NRP and CP to the Commission on the 30 April 2012. They outline in an integrated manner the UK's fiscal consolidation efforts, key structural reforms and reforms that underpin macroeconomic stabilisation. The NRP does not contain the national targets envisaged under the Europe 2020 framework, except for the target on renewable energy, in line with Directive 2009/28/EC. Instead, it describes

[3]Commission estimate stems from Eurostat computation of the unemployment rate.

indicators of performance in areas connected to the Europe 2020 headline targets and records their current level. As regards social inclusion, the NRP refers only to the existing numerical targets of the Child Poverty Act 2010. The lack of quantitative targets makes it difficult to assess reforms, in particular whether policy efforts are adequate and whether they will be implemented promptly enough.

The policy content of the UK NRP and CP is primarily drawn from previous announcements and publications, mainly Budget 2012 and Autumn Statement 2011, as well as various other policy papers covering specific aspects. While stakeholder engagement events were held in Scotland and Wales, there is no evidence of significant stakeholder input in the development of the NRP itself, although the initiatives described were subject to separate public consultation.

The CP was approved by the UK Parliament following debates in the House of Commons and the House of Lords, but the NRP 2012 has not been debated by Parliament. The House of Commons EU Scrutiny Committee debated the AGS 2012. The UK NRP includes information on the policy programmes of the devolved administrations as well as at UK level. The Scottish Government also submitted a separate NRP to set out their policy strategy in more detail.

3.2. Challenges

The UK economy faces a number of challenges to achieve sustainable and balanced growth that were already reflected in the 2011 CSRs, plus a challenge to deliver adequate investment in energy and transport infrastructure.

Fiscal consolidation remains a pressing challenge for the UK. Government debt as a percentage of GDP rose from 58.7% in 2008-09[4] to 86.8% in 2011-12.[5] The government is implementing a fiscal consolidation plan which has already reduced the deficit from 11.6% in 2009-10 to 8.4% in 2011-12. Over this period the structural balance has improved by an average of 1.35 pp[6] of GDP per year. Although the government has started to make progress on reducing the deficit, it is still forecast to stand at 6.1% in 2012-13 after including a one-off pension fund transfer which reduces the deficit by 1.8 pp of GDP. The deficit is now expected to fall more slowly than previously envisaged, due to weaker medium-term growth prospects.

The UK has a considerable challenge ahead in reconciling a need for further deleveraging with the need for more investment across the economy to support sustainable and balanced growth. Total private debt stood at 207% of GDP at the end of 2011.[7]

The debt of non-financial corporations has been stable since 2008, while business investment has remained at very low levels. An unprecedented drop in business investment after 2007 saw the UK level of gross fixed capital formation as a share of GDP fall to 14.3% in 2011, the third lowest level in the EU-27. In 2011, there was a further reduction of 1.2% in investment.

Financing conditions remain tight, particularly for SMEs. Net lending to the corporate sector was negative in 2011, while survey evidence shows that a significant number of SMEs are credit constrained. Additionally, access to non-bank lending remains largely restricted to bigger firms, and competition in the banking industry is

[4] 20xx-xx refers to the financial year which starts on the 1st April and ends on the 31st March.
[5] Eurostat-validated EDP data.
[6] Based on the cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.
[7] Eurostat data.

limited. The Breedon task force on alternative debt markets estimated a substantial ongoing financing gap over the next five years, especially for SMEs.

There is a continued challenge to reform the spatial planning system and housing market so that they deliver the housing supply the population needs and are not a source of macroeconomic instability. The run-up to the crisis saw the housing market overheat, with house price-to-income ratios reaching historic highs and the accumulation of high levels of mortgage debt. An in-depth review of the UK has concluded that this constitutes an internal imbalance in the UK economy, as set out in Box 1. Household debt, which is mainly in the form of mortgages, has fallen modestly, as mortgage issuance has remained at unusually low levels. A sustained and significant fall in household debt is only likely if house prices fall relative to disposable income; however, rapid house price falls would risk pushing many households into negative equity. Residential construction remains at record lows and the housing market is stuck in a low transaction equilibrium. The UK property tax system combines a regressive recurring tax (Council Tax) with a progressive transaction tax (SDLT).

The UK's net export position has been persistently negative and underperformance in goods exports appears structural, reflecting a lack of external competitiveness. As discussed in Box 1, the UK's current account position saw a gradual and structural deterioration from the late 1990s, but in the past three years there has been some rebalancing of the economy towards external demand, which is forecast to continue.

The UK has growing challenges of unemployment and labour market attachment. Unemployment in the UK rose to 8.4% in the final quarter of 2011 and is projected to peak in 2012 at 8.5%. Youth unemployment is much higher, at 22.2%, and is continuing to rise. Private sector employment has been growing modestly, but not by enough to offset reductions in public sector employment and the growth of the workforce. Many people, especially young workers, are in precarious jobs (part-time and temporary workers). Long-term unemployment almost doubled between 2007 and 2011, from 1.3% to 2.7% of the workforce.

The UK also faces ongoing challenges to increase parental employment and improve access to high quality, affordable childcare. The UK has adopted a reform to introduce a Universal Credit, intended to improve work incentives and consequently employment; this reform will be implemented in autumn 2013. However, considerable risks remain that poverty will continue to increase, particularly for families with children. Lack of access to suitable and affordable childcare still discourages women with children from working, or from increasing their hours..

Raising skill levels remains important for the UK's employment and productivity prospects. The UK has an oversupply of low-skilled workers, for whom demand is falling, and a shortage of workers with high-quality vocational and technical skills. The main focus in vocational education and training (VET) policy is on basic skills and level 2 qualifications, while the economy increasingly demands more advanced vocational education and training qualifications. The UK also continues to have a relatively high number of adults with very poor basic literacy and numeracy skills, who are not well placed to benefit from vocational training. Having increased by 3.3 pp since 2005, early school leaving (ESL) is, at 14.9%, above the EU average.

The UK has a challenge to improve its energy and transport infrastructure, which is linked to the AGS priorities of achieving fiscal consolidation in a growth-friendly way and laying the foundations for long-term growth and competitiveness. The UK needs substantial investment to upgrade its electricity generation capacity, both because a large part of the UK's existing generating capacity will close over the next decade and needs to be replaced, and due to the need to meet the renewables obligation and tighter carbon emissions standards. The UK's transport sector faces shortcomings in the capacity and quality of its networks, which could work against the government's aim of rebalancing the UK economy towards investment and exports. As part of the government's fiscal consolidation strategy, public sector net investment will fall sharply by 2014-15, which risks exacerbating existing shortcomings in transport infrastructure unless alternative funding sources can be secured.

Box 1. Summary of the results of the in-depth review of the UK under the macroeconomic imbalances procedure

The in-depth review took a broad view of the UK economy to identify actual and potential imbalances and the possible macroeconomic risks which they may entail. The main findings of the review are:

• The high levels of household debt cumulated over the past decade mean that highly indebted households are vulnerable to rises in interest rates and unemployment. This could potentially have destabilising knock-on effect on the economy as a whole, namely via the financial sector. Households are now undergoing a deleveraging process which may not be sustained if house prices stay high or increase again, especially in relation to disposable income. While housing market activity currently remains depressed, the insufficient and rigid supply of housing in the UK exposes the country to higher and volatile house prices.

• While the UK is noticeably underperforming as regards external competitiveness and export developments, potential associated macroeconomic risks appear less pressing than those arising from internal developments. The UK continues to run a trade surplus in services but has a negative current account balance due to a large trade deficit in goods, which gradually opened up from the late 1990s. However the depreciation that took place at the end of 2007 appears to have gradually fed through to an improvement in exports. The UK's export market share has stabilised in the past three years and there has been some rebalancing of the economy towards external demand, which is forecast to continue.

In this context, relevant policy responses include increasing housing supply, improving the functioning of the housing market and discouraging excessive and risky lending. The government is reforming the planning system with the aim of supporting an increase in housing supply, which should help to reduce house prices and with it the future level of associated mortgage debt. Further simplifying the planning system or altering the property taxation system could improve the functioning of the housing market and provide better incentives for labour mobility and efficient capital allocation. Fostering prudent lending, reducing incentives for households to take on excessive levels of debt, and improving their financial information and risk awareness, would lower the demand for mortgages at high loan-to-values or high income multiples, which both raise house prices and leave households and the financial system most vulnerable.

Although developments in external competitiveness are not characterised as a macroeconomic imbalance, improving export performance would boost UK growth. Given the poor external performance in trade in goods, as well as a history of low public investment, there is a case for targeted investment in infrastructure aimed at meeting the needs of the manufacturing and distribution sectors. Given a shortage of workers with high-quality vocational and technical skills, addressing skill mismatches faced by goods producing and exporting sectors could also prove beneficial. Finally, improving access to finance can support the expansion of the export sector, while fiscal consolidation can help the economy rebalance away from non-tradable sectors.

4. ASSESSMENT OF THE POLICY AGENDA

4.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

The goal of the UK's fiscal strategy is to have the cyclically-adjusted current balance in balance by the end of a five-year rolling period, currently ending in 2016-17. This fiscal mandate is supplemented by a target that debt should be falling by 2015-16. The UK does not set an explicit medium term objective (MTO), but the new fiscal framework, set up in 2010, is a step towards compliance with the Stability and Convergence Programmes (SCP) code of conduct since it sets a target designed to bring the fiscal position close to balance over the medium term. In the UK 2011-12 convergence programme, over the six-year period from 2010-11 to 2016-17, the forecast improvement in the cyclically-adjusted primary balance averages just over 1 pp per year. Regarding the Treaty deficit, the programme projections miss the excessive deficit procedure (EDP) target of 2014-15 by one year, with the deficit in the EDP year estimated at 4.4% of GDP.[8]

In 2011-12, the UK government continued its fiscal consolidation strategy and delivered the planned tax increases and spending cuts. The 2011-12 deficit was 8.4%,[9] higher than the 8.0% envisaged in the 2010-11 convergence programme. The main reason for this difference is the substantial downward revision to GDP growth, not expenditure slippages. In the 2010-11 convergence programme, the UK authorities had anticipated growth of 1.7% in 2011 and 2.5% in 2012, now revised down to 0.8% for both years in the 2011-12 convergence programme.

Box 2 sets out the new main fiscal policy measures due to come into force from 2012-13 to 2016-17.[10] In the Autumn Statement published in November 2011, the government made some minor changes to taxation and spending which alter the timing and composition of the government's fiscal consolidation plans, but do not change their overall size. Additional cuts to current spending were made, including capping public sector wage increases by an average of 1% for a further two years after the current pay freeze ends in 2013. The cuts were offset by spending on a new Youth Contract to incentivise hiring young people, subsidies to limit the increase of regulated transport fares, extra spending on childcare, and a new fund of GBP 6.3 billion (EUR 7.9 billion) for infrastructure over the next three years. The consolidation plans were also extended for a further two years after the end of the 2010 Spending Review period, until 2016-17, in order to adhere to the national fiscal targets.

[8] This would imply an average annual improvement in the Treaty deficit of 1.25 pp over the four years to the deadline.
[9] Eurostat-validated EDP data.
[10] Note that Box 2 does not include the fiscal effect of planned reductions in the budgets of government departments.

Box 2. Main budgetary measures

Revenue	Expenditure
2012-13	
Corporation tax decrease (-0.03% of GDP)	Alteration to child tax credit (-0.07% of GDP) New infrastructure funding (+0.05% of GDP)
2013-14	
Increase in personal income tax allowance (-0.23% of GDP) Corporation tax decrease (-0.05% of GDP) Freeze in age-related allowances (0.03% of GDP)	Alteration to child tax credit (-0.07% of GDP) Cap on public sector pay (-0.04% of GDP) New infrastructure funding (+0.13% of GDP)
2014-15	
Increase in personal income tax allowance (-0.24% of GDP) Corporation tax decrease (-0.06% of GDP) Freeze in age-related allowances (0.05% of GDP)	Alteration to child tax credit (-0.07% of GDP) Cap on public sector pay (-0.08% of GDP) New infrastructure funding (+0.15% of GDP)
2015-16	
Increase in personal income tax allowance (-0.25% of GDP) Corporation tax decrease (-0.06% of GDP) Freeze in age-related allowances (0.07% of GDP)	Alteration to child tax credit (-0.07% of GDP)
2016-17	
Increase in personal income tax allowance (-0.25% of GDP) Corporation tax decrease (-0.07% of GDP) Freeze in age-related allowances (0.09% of GDP)	Alteration to child tax credit (-0.07% of GDP)

Note: The degree of detail reflects the type of information made available in the convergence programme and, where available, of a multiannual budget. A positive sign implies that revenue / expenditure increases as a consequence of this measure.

The 2012 Budget was broadly fiscally neutral and focused on simplifying the tax system and attracting business investment. The measures included a rise in the personal income tax allowance to GBP 9 205 (EUR 11 500), a reduction in the top rate of income tax to 45%, a new 7% Stamp Duty Land Tax for houses worth more than GBP 2 million (EUR 2.5 million), a further reduction to 24% of the corporation tax rate with an offsetting increase in the Bank Levy to 0.105%, and increased tax allowances and R&D credits for certain industries.

The UK government will continue to implement its fiscal consolidation strategy in 2012-13. The deficit is forecast to fall to 5.9% in 2012-13, but the large decline is mainly due to the effect of a one-off measure (1.8 pp) whereby the assets of the Royal Mail pension fund are taken on by the government, together with its long-term liabilities. This measure allowed the government to attain the deficit target stipulated in the 2011 CSRs which was for a deficit of 6.2% of GDP that year. The UK authorities' 2012-13 deficit forecast is 5.9%, slightly lower than the Commission spring 2012 forecast of 6.1%. The difference is largely due to the Commission's lower growth forecast, which envisages GDP growth of 0.5% in 2012, compared with the UK Office for Budget Responsibility's (OBR) estimate of 0.8%. The main risks to the UK's forecast are a deterioration of the situation in the euro area, which would affect the UK via the trade, financial and confidence channels, externally-driven inflationary pressures, namely oil price rises, and uncertainty over spare capacity in the economy and the medium-term rate of potential output growth.

The UK also has a challenge to deliver the AGS 2012 priority of differentiated growth-friendly fiscal consolidation. Despite the slight increases to planned capital spending made in the Autumn Statement, public sector net investment is still forecast to fall from GBP 38.1 billion (EUR 47.6 billion) in 2010-11 to GBP 23.4 billion (EUR 29.3 billion) in 2013-14.

Almost 40% of the annual fiscal consolidation planned for the Spending Review 2010 period (from 2010-11 to 2014-15) was achieved by the end of 2011-12, with 30% of the spending cuts and two-thirds of the tax consolidation already in place. The government plans a total consolidation of GBP 155 billion (EUR 194 billion) by 2016-17 which consists of more than 80% in the form of expenditure cuts and the remainder in net tax increases.[11]

The one-off measure involving the transfer of the Royal Mail pension fund to the government sector has a significant effect on the deficit in 2012-13 to the tune of 1.8 pp of GDP as the assets of GBP 28 billion (EUR 35 billion) are transferred immediately. However, the long term liabilities outweigh the assets and have a total cost estimated at GBP 37.5 billion (EUR 47 billion); GBP 0.2 billion (EUR 0.25 billion) per year of the costs fall in the current Spending Review period, which the government has offset by reducing Departmental Expenditure Limit (DEL) reserves.

The Council recommendation to the UK to adhere to the EDP was for a fiscal effort of 1.75% of GDP between 2010-11 and 2014-15. The UK OBR estimates the treaty deficit to fall from 9.4% to 4.4% thus implying an annual average fiscal effort of 1.25%. The original consolidation plans had been thought sufficient to adhere to the EDP deadline but given a large deterioration in the growth prospects, their estimated impact on the deficit has declined significantly. At the time of the Autumn Statement, the OBR revised downwards its growth forecasts and the estimate of potential growth. This increased the estimated amount of fiscal effort required to eliminate the (recalculated) structural balance. The OBR did not make significant further changes to its estimate of potential growth at Budget 2012.

UK general government debt almost doubled between 2007-08 and 2011-12, from 43.5% to 86.8% of GDP.12 This is projected to increase in the short term, with the Commission forecast estimating 91.8% and 94.7% in 2012-13 and 2013-14, respectively. The government introduced a supplementary debt target as part of its fiscal rules package when it took office in 2010. This target envisages net debt as a percentage of GDP

[11]Table III in the Annex refers to the Expenditure benchmark of the UK. This is a theoretical assessment based on the minimum MTO established in 2009 as the UK has not set an MTO and is still in EDP. Nonetheless, the projections show that the UK net public expenditure growth plans are generally lower than the reference rate and thus are in line with the expenditure rule.

[12]The debt figures have been amended by Eurostat to take account of differing treatment of financial defeasance structures.

peaking in 2014-15. The 2011 recommendation stipulates that public debt should be on a downward path when the excessive deficit is corrected which would theoretically coincide with the national target. However, this year is not as yet included in the Commission forecast. The slightly higher debt estimate from the Commission stems from both a weaker growth outlook and the adjustments made by Eurostat to the UK's official figures based on differing treatments of financial defeasance structures.[13]

The risks to the debt ratio stem mainly from lower-than-expected growth. The government has been so far sticking to their fiscal consolidation plans, with departments respecting the DELs. However, should the economy deteriorate further, Annual Managed Expenditure (AME), which includes welfare benefits, may increase by more than estimated thereby putting the deficit and subsequently the debt ratio at risk.

The average maturity of UK gilts is relatively long at more than fourteen years. 31.2% of gilts are in the hands of foreign investors, but the high level of foreign ownership does not necessarily pose a problem to the UK, given that the majority of maturities are long-term. Furthermore, given the historically low levels of interest currently available to the government, the UK is actively considering the issuance of bonds with a longer, or possibly indefinite, duration than its current longest-maturity 50-year bonds.

Long-term sustainability

The long-term change in age-related expenditure is below the EU average. The initial budgetary position compounds the long-term costs. Assuming no policy change, debt would increase to 104% of GDP by 2020. Additional fiscal consolidation beyond the forecast horizon would be needed to make progress towards the reference value for government debt beyond the short-term. However, full implementation of the programme would be enough to put debt on a downward path by 2020, but it would still be above the 60% of GDP reference value. Ensuring sufficient primary surpluses over the medium-term, as planned in the 2012 programme and beyond, would improve the sustainability of public finances.

Over the last decade, the UK has made significant progress in tackling the adequacy and long-term fiscal sustainability of the state pension system. The state pension age is being equalised for men and women by 2020. It will rise to 67 between 2026 and 2028, and to 68 between 2044 and 2046, subject to Parliamentary approval. In Budget 2012, the government announced plans to automatically align the state pension age with life expectancy. Employment rates for older workers are already among the highest in Europe,14 and the default retirement age was phased out in 2011 to enable and encourage people to work longer.

Pensioner poverty decreased from 27.3% to 21.4% between 2008 and 2010 as benefits for pensioners rose faster than average earnings. However, occupational pension coverage and private pension saving have been declining in the UK for years, increasing the risk of future pensioner poverty. The UK is making a staged introduction of automatic enrolment in a workplace pension to address inadequate private pension provision. From October 2012, workers will automatically be enrolled into occupational pension schemes (with a possibility to opt out), with full implementation by 2018. As part of this reform, the government has introduced a low-cost, defined contribution pension scheme into which employers can enrol their employees, namely the National Employment Savings Trust (NEST). In a separate reform, significant reductions were

---

[13]Table IV in the Annex refers to the debt benchmark which only applies to the years after the EDP deadline. Given the information available, the UK's plans appear to ensure sufficient progress towards compliance with the debt criterion.
[14]In 2010, the employment rate for people aged 50-64 was 64.8% compared to an EU average of 56.7%.

made to pension tax relief for high earners in April 2011, saving GBP 4 billion (EUR 5 billion).

Fiscal framework

The UK government introduced a new fiscal framework after taking office in May 2010. The three key pillars are: (i) the setting of a new 'fiscal mandate' targeting the cyclically-adjusted current balance; (ii) the setting of a net debt target; and (iii) the establishment of the Office for Budget Responsibility (OBR), an independent body tasked with producing the official forecasts. The fiscal mandate requires that the cyclically-adjusted current budget be on track to be in balance by the end of a rolling five-year forecast period, currently ending in 2016-17. This is supplemented by a debt sustainability target which requires the public sector net debt target as a percentage of GDP to be falling by 2015-16. The OBR has to assess whether the chances of the government meeting the fiscal mandate and debt sustainability rule are greater than 50%. Its latest assessment of the government's budgetary plans, in March 2012, the OBR agreed that this was the case.

Government spending is set out in the Spending Review, which is published every three to four years. This sets out multi-annual limits for predictable spending in every department through Departmental Expenditure Limits (DELs). The remainder of spending, mainly social security, debt interest payments, public sector pensions and EU contributions, is classified as Annually Managed Expenditure (AME) and is not capped in advance.

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

Tax system

The UK's implicit tax rate on labour is relatively low by EU standards. The average effective corporate tax rate was relatively high, but is on a declining trend following the cuts in the headline statutory rate. The country has sizeable property and environmental tax revenues relative to GDP, although environmental taxes as a proportion of GDP have fallen over the last decade. Tax compliance costs are relatively low (110 hours for a typical medium-sized business, compared to a weighted EU average of 189 hours). Tax administrative costs as a percentage of net revenue collections have been relatively stable since 2005 and stood at 1.14% in 2009, similar to the EU average. The government has set up an independent Office of Tax Simplification and announced in Budget 2012 that they are consulting on a new General Anti-Abuse Rule (GAAR), recommended in the Aaronson Report, to tackle artificial and abusive tax avoidance.

The UK has now implemented most of the net tax rises planned as part of its fiscal consolidation strategy. To promote investment, the standard corporate income tax rate has been gradually reduced by 4 pp to 24% as from April 2012, and will be further reduced in stages to 22% by 2014, although capital allowances have also been reduced. The small profits rate of corporation tax has also been reduced to 20%. Additionally, the system of capital gains tax has been reformed to exempt gains that are invested in Seed Enterprise Investment Schemes. A Bank Levy was introduced in January 2011, based on bank balance sheets. The full rate was increased from 0.078% to 0.088% in January

2012 and will rise further to 0.105% from January 2013 to counteract the impact of lower corporation tax on banks.

The current system of property taxation is made up of a Stamp Duty Land Tax (SDLT) and a Council Tax. SDLT is charged on land and property transactions at increasing rates by bands based on the transfer price and rates vary between 0% and 7%.[15] Council Tax is recurrent, paid by the residing tenant or landlord, where the amount due is set according to property price bands. UK property taxation revenues as a proportion of GDP are the highest in the EU-27 (4.23% in 2010, of which 3.42% is recurrent). However, there are two main problems with Council Tax relevant to the 2011 recommendation on housing that property taxation could help to prevent excessive volatility of prices. First, the system is based on old valuation bands, linked to the price of housing in 1991. This does not capture current absolute or relative house price levels. Second, the tax structure is regressive, as the properties in the top band are at least eight times as valuable as those in the bottom band, but pay only three times as much tax. In the UK, with its rigid housing supply, any change in property tax is likely to be largely capitalised into house prices. SDLT suffers from 'cliff-edge' effects and also acts to discourage transactions and labour mobility. Some adjustments were made to SDLT rates in Budget 2012, but overall only minor changes have been made in this field in response to the 2011 recommendation on property taxation.

The standard VAT rate was increased by 2.5 pp to 20% in January 2011, and several environment-related taxes were increased in recent years, such as air passenger duty and landfill taxes. The UK VAT Revenue Ratio[16] of 46.3% is more than 8 pp below the arithmetic EU average of 54.4% in 2010. The reduced VAT rate of 5% is applied to domestic fuel and power (among others), reducing incentives to lower domestic energy consumption through measures to improve energy efficiency, and leading to increased CO_2 emissions and pollution.[17] Zero-rated goods include food, the construction of new dwellings, domestic passenger transport and water. Exemptions from VAT include rent on domestic dwellings, health services, and finance and insurance. Based on results for the year 2006, relatively low VAT compliance in the UK also contributes to low overall VAT efficiency.[18] Budget 2012 announced a set of measures to close some loopholes in the VAT system to prevent avoidance and ensure compliance.

4.2. Financial sector

Financial stability

The UK banking sector underwent a large-scale government intervention aimed at guaranteeing its liquidity and solvency in the wake of the 2008 financial crisis. Government support has gradually unwound as the UK banking sector has stabilised. Credit default swap rates on UK banks remained contained in 2011. No UK financial institutions were identified as needing recapitalisation in the context of the temporary bank recapitalisation exercise launched by the European Council of October 2011 and coordinated by the European Banking Authority. However, interbank lending spreads

[15]The tax placed on houses above GBP 2 million (EUR 2.5 million) is 7% since 22 March 2012.

[16]The VAT Revenue Ratio measures actual VAT revenues as a percentage of theoretical revenue if the standard rate were applied to all final consumption.

[17]See Annex 2: *Case studies for the energy sector* in *Environmentally Harmful Subsidies: Identification and Assessment*. A study led by IEEP, with Ecologic, IVM and Claudia Dias Soares for the European Commission, DG Environment http://www.ieep.eu/assets/466/EHS-case-studies-Energy.pdf.

[18]See Reckon (2009), *Study to quantify and analyse the VAT gap in the EU-25 Member States*. The study compares accrued VAT receipts with a theoretical net liability accounting for reduced rates and exemptions. The compliance gap for the UK is estimated at 17%, compared to an EU average of 11%.

reflect the significant tensions that remain, and the transmission of monetary policy has been impaired, with market rates partially decoupling from official rates since 2007.

The current financial supervision and regulation model is being overhauled and the Financial Services Authority (FSA) will be abolished during the course of 2012. The responsibilities of the FSA are to be partitioned and passed on to the Financial Conduct Authority and the Prudential Regulation Authority, under the auspices of the Bank of England. A Financial Policy Committee of senior economists is also being established as a macro-prudential complement to the Bank of England's existing Monetary Policy Committee.

The Independent Commission on Banking (ICB) was set up to consider reforms to the UK banking sector to promote financial stability and competition, and to draft recommendations to the government on these issues. In September 2011, the ICB delivered its report on financial stability and competition, in which it advocated the ring-fencing of retail banks from their investment counterparts so as to permit their separate liquidation in case of failure, as well as a number of measures to increase competition in the banking market.

The ICB's call for more competition in banking has been generally welcomed by the government. The UK banking industry experienced a strong wave of consolidation in the wake of the financial crisis, largely driven by government interventions in the sector. As noted in the ICB report, the forthcoming divestiture of Lloyd's assets in line with EU state aid rules creates the opportunity for the emergence of a strong challenger bank that can help to promote competition in the UK banking system. To this end, it is essential that the resulting bank be both sufficiently large and financially sound to act as an effective competitor. Competition can also be increased within the current market structure by decreasing switching costs and increasing transparency for consumers. This can be achieved, in particular, by the timely introduction of a seamless bank account redirection service, as recommended by the ICB, or more fundamentally, by implementing full account portability. Some limited progress has been made on improving market structure, namely through the sale of Northern Rock to Virgin Money, but developing stronger banking competition remains an important challenge.[19]

Access to finance

The UK has partially addressed the 2011 country-specific recommendation on banking and access to finance, the objective of which is to re-establish the flow of credit to the real economy, particularly to SMEs, and to promote non-bank lending channels. However, major challenges remain, including the re-establishment of a normal level of credit flows to the real economy, particularly to SMEs, and promoting non-bank lending channels.

The gross lending targets agreed between the government and the major UK banks as part of Project Merlin, aimed at restoring lending to the real economy, were almost met, but the impact of the programme was affected by the specification of the targets.[20] In fact, according to Bank of England data, net lending to the private sector remained negative over the course of 2011, while data from the British Banking Association showed that loans to small firms continued to fall in the second half of 2011. While credit rationing is partially explained by the weakness of corporate balance sheets and prospects, supply-side tensions and constraints have also played an important role. The

[19]See *Independent Commission on Banking, Final Report Recommendations* (September 2011).
[20]The Project Merlin targets were set in terms of gross, rather than net lending flows, and included undrawn amounts and credit loaned to public non-financial corporations.

latest Eurostat Survey on access to finance showed that a significant share of SMEs remain credit constrained, while spreads with respect to the official rate remain high.

The Breedon task force's report on alternative debt markets, published in March, estimated a substantial ongoing financing gap over the next five years, especially for SMEs.[21] The government has accepted the need to take further action to build alternative 'non-bank' markets and unlock new pools of capital for firms that cannot meet their financing needs from the banking sector alone, namely by promoting access to wholesale debt markets, peer-to-peer lending, private equity and venture capital. It has already undertaken a number of initiatives to promote access to equity and venture capital funding, such as the extension of the Enterprise Capital Funds programme and the Business Angel Co-Investment Fund. Initiatives in the area of non-bank lending are still embryonic, and the difficult question of how to improve access to non-bank lending channels, particularly for smaller companies, has not yet been resolved. However, the expansion of the Enterprise Finance Guarantee Scheme and the introduction of the National Loan Guarantee Scheme in March 2012 will provide some limited assistance to SMEs in need of credit. As well as central government actions, the three devolved administrations have also set out policies to improve access to finance for SMEs.

4.3. Labour market, education and social policy

Labour market policies

The UK has growing challenges of unemployment and labour market attachment. Unemployment in the UK increased to 8.4% (2.67 million) in the final quarter of 2011 and is projected to peak in 2012 at 8.5%. Youth unemployment is much higher at 22.2%, and continues to rise. In all, 17.7% of young people (18-24 year olds) are NEET (not in employment, education or training).[22] Private sector employment has been growing modestly, but not by enough to offset a reduction of more than 4% in public sector employment in 2011. Many people, especially young workers, are in precarious jobs (part-time or temporary). In 2010, almost a quarter of 15 to 24 year-olds (23.1%) worked part-time because they could not find a full-time job, up from 15.6% in 2007. Long-term unemployment almost doubled between 2007 and 2011, from 1.3% to 2.7% of the workforce. Real wages have been falling since 2009, as inflation has exceeded average nominal wage growth. Productivity growth has remained weak.

Although the UK has not set a national employment target, it recognises the urgency of developing effective labour market policies and promoting business creation and self-employment. In April 2011, the UK launched the Work Programme, which delivers customised job search and job preparation support to jobseekers and replaces a range of previous programmes. The Youth Contract, launched in April 2012, is a new tailored programme designed to combat youth unemployment by providing 160 000 wage incentives to employers recruiting 18-24 year-olds from the Work Programme, and 40 000 incentive payments for small firms who take on young apprentices. The New Enterprise Allowance has also been launched to encourage people in receipt of the Jobseeker's Allowance (JSA) to try self-employment.

Weak work incentives have been a long-running problem for the UK, particularly the high marginal withdrawal rates for those moving off benefits into low-paid jobs. Under the current system, in nearly 1.1 million workless households, someone taking a job with 10 hours of work a week would lose more than 70% of their earnings, due to benefit

[21] *Boosting Finance Options for Business* (March 2012), http://www.bis.gov.uk/assets/biscore/enterprise/docs/b/12-668-boosting-finance-options-for-business.pdf.

[22] 2010 Eurostat data, the latest available for the UK as a whole.

withdrawal and taxes. The incentives to raise the number of hours worked once in a job can also be very weak. At present, around 0.7 million households in low-paid work would lose more than 80 % of any increase in their earnings. In addition, the complexity of the benefits and tax credits system makes it difficult for benefit recipients to assess the financial gains of working, and administrative delays in the system can cause gaps in payments and short-term financial difficulties for people who move into work.

To tackle these problems and help ensure that work is rewarded, the government will introduce a Universal Credit in autumn 2013. Most means-tested benefits and tax credits for working adults (Income Support, income-related Jobseeker's Allowance and Employment and Support Allowance) will be replaced by a single benefit. The reform aims to increase work incentives through a lower withdrawal rate (65 %) in future, and stricter rules on benefit loss if an individual refuses a job offer. From May 2012, lone parents will be required to actively seek work when their youngest child begins full time education. This is a continuation of the approach to increasingly require workless adults with caring responsibilities to seek employment. Some progress has been made despite a weak labour market, but the overall employment rate for lone parents (57 %) remains relatively low. This is a major reason for the proportion of children in workless households in the UK standing at 17.9 %, which is the second highest rate in Europe.

The success of this strategy will be dependent on getting benefit recipients into stable jobs, mainly though clearer work incentives. The government believes that as many as 350 000 children and 500 000 working age adults could be moved out of poverty due to these changes by 2020-21, largely due to expected employment benefits. The success of the Universal Credit will also depend on its successful administration, which will be a challenge. A cap on the total amount of benefit that can be claimed could boost incentives to work, as well as generating savings, although high housing costs will still mean that households in many areas will continue to face high marginal withdrawal rates up to a relatively high point in the income distribution. The Universal Credit will be focused on supporting a sole breadwinner family model. The emphasis is on the first earner in a family. On average, couples with children will gain more than couples without children, who in turn will gain more than single adults without children. Second earners and single parents will, on average, lose in the long run. They will see the Universal Credit withdrawn more quickly if they enter work than currently happens with tax credits, according to the Institute for Fiscal Studies (IFS).[23]

The welfare bill faces reductions of GBP 18 billion (EUR 22.5 billion) by 2014-15, the highest share in government departmental cuts. This is a necessary part of the government's fiscal consolidation strategy, but in an October 2011 report,[24] the IFS concluded that the government would miss its targets for reducing child poverty, as set down in the Child Poverty Act. The IFS estimates that relative poverty among children will rise by 600 000 by 2012-13, and by 800 000 for adults of working age, and that by 2020-21 absolute child poverty will be at its highest level since 2001-02. The most significant policy change is that benefits will now be indexed in line with the consumer price index (CPI) measure of inflation, which is on average lower than the retail price index (RPI) measure that was previously used.

The UK government's plan for growth includes a focus on further reducing employment regulation, an area in which the UK economy is already relatively flexible. The government has focused in particular on helping small businesses through targeted measures, such as exempting micro businesses from new regulation, and lower taxes for

[23] http://www.ifs.org.uk/comms/comm121.pdf.
[24] Ibid.

smaller businesses.[25] These have the potential to help stimulate employment and growth, although the government may want to monitor the effect of targeted deregulation to ensure it does not unintentionally create incentives for firms to stay small, as has happened in some EU countries.

Childcare

The government has taken some steps to improve access to childcare for disadvantaged children, and the UK has a high rate of participation in early education. New plans include extending these free places to around 40% of two year-olds by 2013, and an additional investment of GBP 300 million (EUR 375 million) to support around 80 000 families with the cost of childcare within the Universal Credit when it is introduced. There is, however, much to be done to apply a life-cycle approach to employment policies and to lift more families out of poverty. Full-time pre-school childcare is still rare, insufficiently flexible and expensive, which is a constraint on single parents and second earners entering the labour market. Alongside Ireland, childcare costs in the UK are higher than in any other EU country and the net costs of childcare are especially high for second earners in couples.[26] Until these problems are alleviated, there will continue to be substantial failings in the quantity, quality and affordability of childcare. The government has trimmed demand subsidies for childcare users, and some local authorities are reducing subsidised childcare provision to help deliver spending reduction targets.

Overall, the 2011 recommendation on workless households has to date been partially implemented. The UK is engaged in ambitious welfare reforms that should bring employment benefits over time, but there remain significant challenges to effective implementation, particularly in the context of a weak labour market. Under current policy, the overall availability and affordability of childcare does not look set to significantly improve.

Skills

The UK continues to have too many people with low skills, resulting in inequality and skills mismatches. The economic costs of this problem are likely to increase over time if it is not effectively addressed. Recent research from the European Centre for the Development of Vocational Training (Cedefop)[27] estimates that, between 2010 and 2020, low-skilled jobs will decline by approximately 51%, while medium and high-skilled jobs will increase by 16% and 21% respectively. There is a persistently large number of functionally illiterate and innumerate adults in the UK,[28] usually with no qualifications. The country could gain significant economic and social benefits from doing more to address the needs of this group, including increasing their capacity to benefit from vocational training.

The UK has higher levels of early school leavers than the EU average for all subgroups except for migrants.[29] The UK has not established a national target for reducing early school leaving, but has taken steps to improve education and training systems, and to tackle youth unemployment. In November 2011, the government published a strategy designed to maximise the participation of 16-24 year-olds in education, training and employment named Building Engagement, Building Futures.[30] The government is also

[25]For example more favourable treatment of small business in corporation tax, business rates and VAT.
[26]OECD *Going for Growth 2012*. See Figure 2.8A and 3.9A.
[27]http://www.cedefop.europa.eu/en/Files/3052_en.pdf.
[28]*Skills for Life survey 2011*, http://www.bis.gov.uk/assets/biscore/further-education-skills/docs/0-9/11-1367-2011-skills-for-life-survey-findings.pdf. See also www.nrdc.org.uk/download2.asp?f=4690&e=pdf.
[29]Here migrants are respondents who report being born abroad. In the UK, 11.66% of 18-24 year olds are in this group.
[30]http://www.dwp.gov.uk/docs/building-engagement-building-futures.pdf.

raising the age for leaving compulsory education in England from 16 to 17 in 2013 and to 18 from 2015. Those who have left school without basic skills in literacy and numeracy will continue to have access to state-funded training. Those without a first full Level 2 (intermediate) or Level 3 (advanced or A-Level) qualification will be eligible for fully-funded training until the age of 24. In Scotland the government aims to offer post-16 learning for every young person who wants it, and the Welsh government has highlighted learner attainment at age 15 as a priority. However, some reforms risk exacerbating the problem of early school leaving, particularly the withdrawal of the Educational Maintenance Allowance (EMA) in England to be replaced by a smaller discretionary fund. The government draws on research by the National Foundation for Education Research saying that 90 % of students who receive EMA would still continue with their education without the payment. However, IFS research shows that the EMA has raised participation as well as boosted grades.[31] The Scottish government has retained the EMA in Scotland.

In the long term, successful schools reform will be key to addressing the UK's basic skills problem, as remedying the problem at a later stage has proven difficult. However, the requirement for all apprenticeship providers to support training in Maths and English up to GCSE (intermediate) standard for those who have not already achieved this could have significant benefits.

When the government set out its fiscal consolidation plans, with the exception of Higher Education, the education and training budget was relatively protected in comparison to other policy areas. The government prioritised areas that support long-term growth (including schools, early years provisions and apprenticeships), core universal frontline services, and services that protect the most disadvantaged. However, schools and other frontline services have to make significant savings, and education capital spending is being sharply reduced.

Vocational training

The government is reforming the vocational training system to give greater control to students and abolish the central direction of training available, so as to match skills provision and labour market needs more effectively. The government accepted all recommendations of the Wolf Review[32] in May 2011 and plans to complete its implementation by September 2012. If implemented effectively, there is significant scope for these reforms to increase the average labour market value of vocational training and ensure vocational courses complement rather than replace core academic education.

Young people can access the Apprenticeship programme from the age of 16, where on-the-job training (by employers) as well as school-based education (by the government) are fully funded. After the age of 19, only half the training cost is funded by the state and SMEs receive an incentive payment. The programme expanded by 140 % in the period 2006-07 to 2010-11, with new apprenticeship starts rising from 184 400 to 457 200. Additional funding will be provided for up to 250 000 more apprenticeships over the next four years.

Expanding the number of apprenticeships is welcome, but the government also needs to ensure they are well-targeted and are providing high-level skills. Apprenticeships are offered at intermediate level (level 2) and advanced level (level 3 or A-level). First assessments by the National Audit Office (NAO)[33] suggest that the Apprenticeship Programme is good value for money, but that most apprenticeships in England are at

[31] http://readingroom.lsc.gov.uk/lsc/National/nat-emaevaluationadministrativedata-jan2008.pdf.
[32] https://www.education.gov.uk/publications/eOrderingDownload/The%20Wolf%20Report.pdf.
[33] http://www.nao.org.uk/publications/1012/adult_apprenticeships.aspx.

lower skill levels, with only 33 % recorded as advanced level in 2010-11. Furthermore, a high proportion of apprentices are adults (71 %) rather than young jobseekers (29 %). Work-based apprenticeships are still in limited supply, and there is relatively little tradition among UK employers of commitment to providing vocational training opportunities for young people. In 2010, only 5 % of employers employed apprentices, according to the NAO.

Work-based academies for young people have been launched to equip them with skills matching the requirements of employers. Twenty-four university technical colleges (UTCs) will be opened by 2014 in collaboration with employers and universities, at a cost of GBP 150 million (EUR 188 million). The UTCs will train up to 50 000 young unemployed people to work in particular sectors, such as engineering, business and other practical skills.

Tertiary education

The current UK tertiary attainment rate of 43 % (2010) is well above the EU average of 33.6 %. The UK has not set a national target for tertiary attainment. As the government is expecting universities to rely more and more on the income they receive from students, it is reducing direct funding accordingly. Tuition fees paid by students are increasing to up to GBP 9 000 per year (EUR 11 250) (excluding Scotland). In its place, the government will provide institutions with up-front loans of GBP 3.6 billion (EUR 4.5 billion) in 2012-13, rising to GBP 5 billion (EUR 6.25 billion) in 2013-14. The premium that universities receive for taking in students from poorer backgrounds remains unchanged. The government may wish to monitor the effect of increased tuition fees on enrolment and graduation, as well as the way in which the mix of graduate skills fits with the needs of the economy.

The 2011 recommendation on skills has also been partially implemented. The UK has introduced a large number of relevant and ambitious reforms, particularly in vocational training. While there is much potential in the current reforms, implementation is only starting and it is too early to make a full assessment of their effectiveness. The expansion of apprenticeships is positive, but too many of them are currently at a low level and not enough are genuinely work-based. Given the long-term trends in demand for higher skills, the UK has not yet addressed its basic skills problems sufficiently. Many challenges remain, and there is no certainty that the UK can ensure that enough of the young people entering the labour market will have adequate skills in the short to medium term. Youth unemployment is high and has continued to increase.

4.4. Structural measures promoting growth and competitiveness

To address the challenges identified in the European Semester 2011 and the AGS 2012, it is important to take action to improve long-term investment and growth. UK investment and productivity have been weak since the onset of the crisis, and there is significant scope for the UK to raise productivity relative to the best performing countries. The UK government published The Plan for Growth alongside the 2011 Budget, setting out a wide-reaching programme of structural reforms.

The UK performs well in surveys on the business environment and market regulation. For example, a recent study showed that the UK had the second lowest level of market regulation in professional services,[34] notably because the UK is not regulating the access to professions but the use of professional titles. The UK has implemented the Services Directive, but some restrictions still remain. For example the justification and

[34]*Product Market Regulation Database*, OECD (2011), using data from 2008.

proportionality of shareholding and legal form requirements in certain professional services in parts of the UK could be examined.

However, a combination of relatively high prices and margins, low capital stock and low productivity suggests that parts of the UK economy suffer from weak effective competition and underinvestment. The UK economy has a high profit share and the second lowest share of investment in GDP in the EU. In both manufacturing and services, gross operating margins in the UK are among the highest in the EU.[35] The causes of this are complex, but may include high costs and entry barriers created by the restrictive planning system. There is considerable scope to improve the UK's infrastructure, and while the government has set out its aims in the National Infrastructure Plan, it is not yet clear where the financing will come from to deliver a real improvement.

Spatial planning

The UK has a rather rigid planning system, and the poor functioning of the land market is at odds with its generally flexible market economy. According to the NAO, planning laws create the highest regulatory costs of any type of regulation in the UK. This constitutes a barrier to investment, growth and efficiency, as it has put tight restrictions on the supply of land for development and imposed inflexibility in land use.[36] The planning system delays, discourages or distorts construction investment and modernisation (in houses, plants, offices,[37] transport infrastructure, and both renewable and non-renewable energy capacity).[38] This raises the cost of new and existing property, and can also affect market entry and competition, as well as labour mobility. Moreover, as discussed below, the UK has relatively poor transport infrastructure as compared to the EU-15, and high land costs. Together, these factors cause problems, particularly for the efficiency of capital-intensive, land-intensive and transport-intensive sectors, such as manufacturing, retail[39] and distribution.[40]

Housing and planning policy are devolved responsibilities. The government is in the process of undertaking a major, controversial reform of the planning system for England. The reforms affect the control of residential, commercial and infrastructure development. They aim to devolve more power to local authorities and simplify the process for securing planning consent. The National Planning Policy Framework (NPPF),[41] published in March, confirmed the government's plans with some amendments, following an extensive national debate. It is not yet clear how significant the outcome will be in terms of facilitating more, and more timely, construction activity in England. In March 2012, the Scottish government published a progress update on Scotland's National Planning Framework 2, which was launched in 2009.[42]

[35] Commission analysis of Eurostat data.

[36] See *Barker Review of Planning* (2006) for a comprehensive analysis http://www.ukcip.org.uk/wordpress/wp-content/PDFs/Barker_review_landuse.pdf.

[37] Gross costs of regulation associated with building office property are estimated to be 12 times higher in the City of London than in Brussels, and higher in Manchester than Milan, Paris, Barcelona or Amsterdam. See Cheshire and. Hilber (June 2008), Economic Journal vol. 118.

[38] A survey by the Killian Pretty Review (2008) found that only 3 out of 64 planning applications went ahead without difficulties, while over half encountered substantial problems.

[39] In the UK it has been estimated that the planning restriction that encourages smaller shop formats (including through Town Centre First), reduces productivity in the sector by up to 16%. See for example Cheshire, Hilber and Kaplanis (2011) http://eprints.lse.ac.uk/31757/1/sercdp0066.pdf.

[40] Distribution accounts for the largest part of the UK's productivity gap with the US — about a fifth. See for example http://www.aimresearch.org/uploads/pdf/Academic%20Publications/rgbrief.pdf.

[41] http://www.communities.gov.uk/documents/planningandbuilding/pdf/2116950.pdf.

[42] http://www.scotland.gov.uk/Topics/Built-Environment/planning/National-Planning-Policy/npf.

Housing supply

In the UK, housing supply is relatively unresponsive to demand.[43] This has led to low investment in residential construction and the UK housing market impairs labour mobility and distorts household incentives and behaviour. A lack of housing supply has contributed to high house prices and a lack of affordability, and as discussed in Box 1 is a potential source of macroeconomic instability.[44] As set out in section 3.3, high house prices also mean that large numbers of households are reliant on Housing Benefit, which both reduces work incentives and living standards for younger and poorer households, and imposes a large fiscal cost on the government.[45] In November 2011, the government published its housing strategy for England.[46] This argues that the housing market is currently not working, as the supply of housing is not sufficient to satisfy current demand, and that without effective action, the housing shortage is likely to worsen over time. The housing strategy did not mention the issue of property taxation, where, as set out in section 3.1, the UK system combines a regressive recurring Council Tax with a progressive transaction tax (SDLT). The Scottish government published its housing strategy in February 2011 and the Welsh government will publish a housing strategy in 2012 to inform a Housing Bill in 2013.

The government's reforms aim to increase housing supply through a range of measures, including a presumption in favour of sustainable development in the planning system. While streamlining the planning decision process is clearly positive, local authorities' response to the abolition of national house building targets has contributed to a record low volume of house building. A lack of confidence, financing constraints and regulatory uncertainty currently continues to restrict housing investment. To address this issue, the government has taken time-limited action to increase the housing supply via financial incentives such as the New Build Indemnity Scheme, the New Homes Bonus, the Community Infrastructure Levy and the Growing Places Fund.

If the new planning system is ultimately more supportive of development, it could deliver better-functioning UK land and housing markets, promote macroeconomic stability, support the rebalancing of the UK economy away from debt towards investment, and help to revitalise output and employment in the construction sector. However it is currently still not clear how far the new system will achieve these aims in practice. The government made some revisions to the final version of the National Planning Policy Framework that are likely to reduce the extent to which the reforms meet the stated goals of delivering a more streamlined planning system and increased housing development. Many groups who benefit from high house prices and restrictions on development are strongly opposed to liberalisation, and implementation could face further challenges from a lack of administrative capacity and local political opposition. The planning aspect of the 2011 recommendation on housing has therefore been partially implemented.

Energy, climate and resource efficiency

The UK is well on track to meet its carbon emission reduction target without the need to design additional policies or use additional flexibilities. The UK is committed to reducing its greenhouse gas emissions by 16 % (compared to 2005 and only for emissions not covered by the EU Emission Trading System) by 2020. According to 2011

---

[43]The response of housing supply to demand in the UK has been among the lowest in OECD countries over the last 20 years, *OECD UK country survey 2011*.

[44]House prices in an average local planning authority in England in 2008 would have been 21.5 % to 38.1 % lower if the planning system had been completely relaxed. Hilber, and Vermeulen (2010) *The impact of restricting housing supply on house prices and affordability*.

[45]Real Housing Benefit spend has nearly doubled in the last 20 years; just over half is on households in the bottom third of the income distribution. IEA (2012) *Abundance of land, shortage of housing*.

[46]http://www.communities.gov.uk/documents/housing/pdf/2033676.pdf.

projections taking into account existing measures, the UK is expected to overachieve its national target by 6 pp, and part of the reason is the low share of manufacturing in the economy. If the UK succeeds in its aim of reducing economic imbalances through growing manufacturing and exports, this margin may be reduced. The current complex framework of climate policies in the UK has led to variations of the implicit carbon price across sectors, and there is scope to streamline the system and make it more efficient.

Under Directive 2009/28/EC on the promotion of the use of energy from renewable sources, the UK is committed to reaching a target of 15% of renewable energy sources in final energy consumption and a 10% share of renewable energy in the transport sector by 2020. A large part of the UK's total existing electricity generation capacity is also nearing the end of its life or needs upgrading over the next 10 years.[47] The UK needs to install adequate new generation capacity and meet its obligations while avoiding excessive rises in energy costs.[48] In July 2011, the UK came forward with a White Paper on Electricity Market Reform proposing a range of new policy measures, as well as a Renewable Energy Roadmap to ensure that it achieves its target of 15% renewables. If the UK clarifies the support regime to be applied in both the heating and electricity sectors this, together with the Electricity Market Reform, should ensure the creation of a stable regulatory environment that promotes the development of new green goods and services markets.

The Green Deal is a market mechanism to improve energy efficiency in commercial and residential buildings, expected to be operational from late 2012. The programme aims to contribute to energy efficiency retrofits by connecting financing to savings on energy bills, with no upfront costs. The government's independent advisor on climate change, the Committee on Climate Change, has suggested that there may be a gap between the likely achievements of the Green Deal and associated emissions targets set out in the UK's carbon budgets. This gap may arise from insufficient market incentives for private sector investment, or the way in which energy company obligations are framed. Thus uptake and emissions savings, to be set in relation to the Green Deal, will require careful tracking against targets. The Green Investment Bank, with funding of EUR 17 billion, is a potentially significant initiative. However, it will not be operational until after 2015. Almost half of UK municipal household waste still goes to landfill, which some EU countries have almost completely eliminated. To address this issue, the UK plans to raise its landfill tax. Beyond the environmental benefits, full implementation of existing waste legislation could create around 64,000 jobs in the UK and increase the annual turnover of the waste sector by over EUR 6.7 billion.[49]

Transport

The UK faces a challenge to improve its transport infrastructure, which is characterised by capacity constraints on critical parts of its networks, sustained low levels of investment[50] and high costs. The OECD Country survey of the UK 2009 concluded that 'improvements in public infrastructure are required, particularly in transport where airport and road congestion and continuing problems with the rail system constrain productivity'.[51] The World Economic Forum (WEF) Global Competitiveness report

[47]http://www.decc.gov.uk/assets/decc/11/policy-legislation/EMR/2210-emr-white-paper-full-version.pdf.
[48]The UK currently has among the lowest domestic electricity prices in Europe (DECC 2010 energy price statistics) but industrial electricity is 6% above the EU-15 median price. DECC estimate an increase of around 40% in electricity bills if the UK's carbon and renewable electricity targets are met in full.
[49]European Commission, *Implementing EU waste legislation for green growth*, 2012.
[50]Crafts (2009) demonstrates that, in particular, road investment levels have been relatively low for the UK for decades, suggesting relative neglect.
[51]http://www.oecd.org/dataoecd/4/59/43037700.pdf.

ranks the UK as 12th among the EU-15 as regards 'quality of overall infrastructure'.[52] Reforms to stimulate increased investment and lower regulatory barriers in the UK's transport networks would support the government's aim of rebalancing the UK economy towards investment and exports. Improved infrastructure could generate positive spillovers, lower costs and improved productivity in the wider economy.

The UK government acknowledges the challenge, and set out its plans in the 2011 National Infrastructure Plan. The government is investing over GBP 1 billion (EUR 1.25 billion) to tackle areas of congestion and improve the national road network. Projects include upgrades to major trunk road routes to improve safety and remove bottlenecks, and an additional GBP 170 million (EUR 213 million) for local public transport. However, the new funding committed is low, given the size of the challenge and relative to the cuts made in the 2010 Spending Review. McKinsey estimate there will be a substantial public sector funding gap for road and rail of around GBP 100 billion (EUR 125 billion) between 2010 and 2030, the equivalent of GBP 5 billion (EUR 6.25 billion) per year.[53]

Particular problems for the **road network** include congestion on the major highways (especially those in the London area and the Midlands),[54] regulatory barriers to new infrastructure, and relatively high costs in construction and maintenance. On average, for each kilometre of motorway, 113 million passenger vehicle kilometres are driven nationally each year, against 47 million in Germany, 39 million in France and 36 million in the United States. In addition, the UK's roads carry more freight per kilometre of motorway than any major economy apart from Japan. The congestion problem has eased in the short term with the economic downturn, largely because of a drop in heavy goods traffic, but is likely to resume with economic recovery.

In tight fiscal circumstances, it is important to focus on road maintenance, not just new road building. The evidence suggests that cutting maintenance could threaten short- and longer-term growth prospects, as well as reducing safety and raising congestion levels. This holds in particular for local road networks maintained by local authorities with falling budgets. Neglecting maintenance implies higher maintenance costs in the future, reducing funds available for new infrastructure and lessening the overall growth impact of transport infrastructure spending. New models of ownership of the roads network are currently under discussion. Their possible introduction could have a significant impact and could also serve as an opportunity to introduce a 'user-pays' element to the financing of road infrastructure.

In the **rail sector,** the recent McNulty Report[55] called for more effective incentives and increased competition to improve efficiency and quality of services, lower costs for regional railways to make regional and urban travel more affordable, increased capacity for the West Coast Main Line and urban rail, and separating local lines from long distance lines on congested tracks. The total cost per passenger-kilometre of the rail network in the UK is around 70% higher than the average cost in a sample of four comparable rail systems. The report concluded that achieving a 30% efficiency improvement by 2019 was a realistic target.[56] More than GBP 1.4 billion (1.75 billion) is to be invested in railway infrastructure, and the go-ahead has been given to the HS2, a new high-speed rail link between London, the West Midlands and the North West. However, rail fares continue to be raised from already high levels, and the UK railway

[52]http://www3.weforum.org/docs/WEF_GCR_Report_2011-12.pdf.
[53]McKinsey (2011), *Keeping Britain moving: The United Kingdom's transport infrastructure needs*.
[54]The Eddington Study (2006) estimated the economic costs of road congestion at GBP 7-8 billion (EUR 9-10 billion) per year excluding reliability and costs for non-business users (vol. 1 p. 12 and vol. 2 p. 100).
[55]http://www.dft.gov.uk/publications/realising-the-potential-of-gb-rail/.
[56]Civity (2010) Background analysis for the McNulty report.

system continues to suffer from relatively high costs and growing congestion, which could limit its viability as an effective alternative to road transport.

Aviation is a major UK industry, carrying over 235 million passengers per year and over 2.3 million tonnes of freight. The UK is home to Europe's busiest airport, London Heathrow, which handled just under 70 million passengers in 2011. However, air travel has been hit by the economic downturn and aviation is taxed more than in other Member States via air passenger duty. Moreover, there is a growing shortage of airport capacity in the South East, where demand is concentrated.[57] To date, the government does not have a policy to deliver the increased capacity needed for long-haul connections and London risks losing out to other European capitals with spare capacity. However the government is undertaking an aviation policy review.

UK **ports** handle about 95% of the total volume of UK trade and 75% of its value, and the private sector operates around two thirds of this traffic.[58] The sector could benefit from better transport connections with its hinterland through multi-modal transport networks to reduce costs and delays associated with international trade and distribution within the UK. For example, the government is supporting the development of the London Gateway Port terminal, but road links to the UK's largest port, Felixstowe, are congested. Planning applications for strategic rail freight interchanges have been rejected in the past. In October 2011 the government announced a range of measures to address these issues in the National Policy Statement for Ports.

Research and innovation

For 2000-2010, the share of R&D spending in GDP was little changed, from 1.81% to 1.77%, following a period of decline from the mid-1980s. The long-term fall and relatively low level of R&D intensity is partly but not wholly a function of the increasingly service-focused structure of the economy, and raises challenges for the UK's long-term competitiveness.

The UK government's objective is to maintain and strengthen returns from accumulated investments in the science base as a driver of innovation and growth. The UK's public research base is a national strength, producing a significant share of highly cited publications. In terms of doctoral graduates, international scientific co-publication, percentage of employment in knowledge-intensive activities and contribution of medium and high tech goods to the trade balance, the UK outperforms the EU average and the US. It is therefore an important element of delivering the AGS 2012 goal of growth-friendly fiscal consolidation that the UK's academic and research base is in a position to retain these strengths.

Over the current spending review period, the core science budget is being frozen in cash terms, while cuts in other government departments will result in lower expenditure on defence and other R&D. Overall, research spending is therefore likely to fall in real terms, though by less than many other items. The UK has not set a national target for R&D intensity as part of the Europe 2020 objectives.

The UK government recognises the importance of enhancing the links between universities and industry to better address the needs of industry, as illustrated in the recent Innovation Union scoreboard, in which the UK is among a group of innovation followers. The UK has a new Innovation and Research Strategy for Growth, which includes a new elite national network of technology and innovation centres to foster links

[57] Heathrow airport is operating at 99% of its runway capacity compared to other European airports like Frankfurt (74.5%), Paris CDG (73.5%) and Amsterdam Schipol (70%). GLA(2011), *A new airport for London*.
[58] Eurostat (2012) *Transport Statistics in Focus.*

between academia and business, and support commercialisation of new technologies, as well as more R&D tax incentives for small companies.

4.5. Modernisation of public administration

As mentioned in section 3.4, the UK government generally performs well in surveys on the ease of doing business, and on the administrative burdens of the tax system. The value of public procurement is estimated to be between 4.5% and 6.5% of GDP. Collaborative procurement is widely used for the purposes of awarding contracts and framework agreements to enable the government to achieve savings, and overall, European procurement rules are applied correctly.

As part of the government's fiscal consolidation strategy, public sector employment is falling sharply, by over 4% in 2011. The government is taking action to increase the cost-effectiveness of the public sector workforce. Public sector pensions are being reformed to raise employee contributions and reduce costs. Following a period of pay restraint across the public sector, the government is looking into ways of making pay in the sector more responsive to local labour market conditions. The government is also committed to a programme of localism, which aims to give more discretion to local government over policy and budget allocations.

The decision of the UK government to abolish the Regional Development Agencies (RDAs) had a strong impact on the implementation of the European Regional Development Fund (ERDF) (2007-2013) programmes in England, both in terms of management and match funding. Scarce match funding is one of the main challenges for the successful implementation of operational programmes. Despite the challenging circumstances, absorption of the ERDF in the UK is still acceptable.

5. Overview table

2011 commitments	Summary assessment
Country specific recommendations (CSRs)	
CSR 1: Implement the planned fiscal consolidation aiming at a deficit of 6.2 % of GDP in 2012-2013, in line with Council recommendations on correcting the excessive deficit, and setting the high public debt ratio on a downward path when the excessive deficit is corrected by the end of the programme period. Ensure no slippage from the ambitious spending reduction targets, thereby strengthening long-term sustainability; and, subject to this, prioritise growth-enhancing expenditure.	The UK has implemented the CSR. However due to a slower growth path, the UK is likely to miss its EDP deadline of reducing the deficit below 3 % of GDP by 2014-15 by one year. The Office for Budget Responsibility forecasts that public debt will peak in 2014-15. The government has so far stuck to the fiscal consolidation strategy it announced in June 2010. The deficit fell from 9.5 % in 2010-11 to 8.4 % in 2011-12, though this still one of the highest levels in the EU. Due to weakening of the medium-term outlook for growth, the deficit will fall more slowly than previously projected and for 2012-13 is now forecast to be 6.1 % (and would be 7.9 % without an upcoming one-off pension fund transfer). Some adjustments were made to the government's existing fiscal plans in the 2011 Autumn Statement to prioritise growth-enhancing expenditure, but public sector investment is still set to fall sharply by 2014-15.
CSR 2: Develop a programme of reform which addresses the destabilising impact of the house price cycle on public finances, the financial sector and the economy, with a view to alleviating problems of affordability and the need for state subsidy for housing. A broad set of measures and policy instruments could be considered including reforms to the mortgage market, financial regulation, property tax and the planning system in order to prevent excessive volatility.	The UK has partially implemented the CSR. In November 2011, the government published its housing strategy for England. The government's reforms aim to deliver increased housing supply through a range of measures including a presumption in favour of sustainable development. If the new system is more supportive of housing development, it could substantially increase housing supply and, over time, alleviate the problem of high prices and strong housing cycles. However, significant uncertainty about the net impact of the new system remains. There could also be difficulties with a lack of administrative capacity and local political opposition to a more streamlined planning system. A lack of confidence, financing constraints and regulatory uncertainty currently continue to restrict housing investment. However, the housing strategy does not mention the issue of property taxation, where the UK system combines a regressive recurring tax (council tax) with a progressive transaction tax (SDLT), which may play a role in such cyclical developments and their impact on budget revenues and financial stability. Minor changes to SDLT in Budget 2012 did not deal with the main issue.
CSR 3: Take steps by 2012 to ensure that a higher share of young people enter the labour market with adequate skills and to improve the employability of 18 to 24-year-olds who left education or training without qualifications. Address skill shortages by increasing the numbers attaining intermediate skills, in line with labour market needs.	The UK has partially implemented the CSR. The UK undertook a series of measures to reduce youth unemployment in 2011, but it continues to rise. The Council Recommendation to address skills shortages at intermediate level has not yet been fully implemented and will take time. It remains a major challenge to reduce youth unemployment by meeting labour market needs. The Apprenticeships programme is the government's flagship initiative to address the challenge of improving the

	employability of 18 to 24-year-olds and equip them with adequate skills for the labour market. While the programme is expanding and has the right ambitions, it is still too focused on the lower skills level. The number of work-based apprenticeships is still low and the involvement of social partners could be improved. The Apprenticeships programme could target even more low achievers and NEETs. The success of school reform will largely determine whether the UK can reduce the number of young people lacking basic skills. Overall, the UK has introduced a large number of relevant and ambitious reforms, particularly in school education and vocational training. While there is a lot of potential in the current set of reforms, the implementation of many programmes, including raising the age for completing compulsory education, Free Schools, the Youth Contract and the expansion of Apprenticeships, has just started. Many challenges remain and there is no certainty that the UK can ensure that in the short to medium term a sufficiently high share of young people enter the labour market with adequate skills.
CSR 4: Take measures, within current budgetary plans, to reduce the number of workless households by targeting those who are inactive because of caring responsibilities, including lone parents.	The UK has partially implemented the CSR. The government has an active welfare reform agenda which, once fully implemented, should bring employment benefits over time. However, the introduction of the Universal Credit in autumn 2013 will be administratively challenging. In addition declining benefit amounts are likely to offset the positive impact of employment policies on incomes, particularly for families with children. Access to childcare still causes significant problems and the government has not yet come up with adequate plans on how to tackle this challenge. Cuts to support for supply of childcare alongside growing demand also risk exacerbating the problem.
CSR 5: Implement measures already announced and continue to work to improve the availability of bank and non-bank financing to the private sector and in particular to SMEs while recognising potential challenges on the demand side. Encourage competition within the banking sector and explore with the market ways to improve access to non-bank financing such as venture and risk capital and debt issued on public markets.	The UK has partially implemented the CSR. Net lending remained negative in 2011. Gross lending targets agreed between the government and the major UK banks aimed at restoring lending to the real economy as part of Project Merlin were broadly met. However, Project Merlin targets suffered from important issues which affected their effectiveness, such as including undrawn amounts and lending to public corporations. The UK continued the Enterprise Finance Guarantee scheme, and a National Loan Guarantee Scheme is also being introduced in 2012. Notwithstanding a number of positive initiatives in the area of access to finance, survey evidence shows that a significant share of businesses, in particular SMEs, remains credit constrained. The Independent Commission on Banking (ICB) recommended improving bank competition through the creation of a new bank. However, the details and the date for its creation by means of a divestiture of Lloyds' assets are still to be set. Other measures aimed at increasing competition in the banking industry, such as the account redirection service, are set to be implemented over an extended time period. The Enterprise Capital Funds programme and the newly-created Business Angel Co Investment Fund have supported

	equity investment in SMEs. The promotion of non-bank lending channels to the corporate sector has yet to lead to a significant improvement, notwithstanding the industry-led report commissioned by the government on the matter and the announced Business Finance Partnership. Significant challenges therefore remain in re-establishing the flow of credit to the real economy, and in particular to SMEs, in increasing competition in the banking industry, and in promoting the non-bank lending channel.
Europe 2020 (national targets and progress)	
Employment rate — no target in NRP	73.6 % of the population aged 20-64 was employed in 2010 (73.9 % in 2009). No progress has been made in contributing to this target. After remaining stable at 75.2 % from 2005-2008, the employment rate has dropped by 1.6 pp, reflecting rising unemployment. The UK employment rate is now marginally below the Europe 2020 target of 75 %. In the short term, private sector employment has been growing modestly, but not by enough to offset reductions in public sector employment and the growth of the workforce. To raise employment in the longer term, the UK also faces challenges to increase work incentives and parental employment, to improve access to high-quality, affordable childcare, and to raise skill levels.
R&D as a % of GDP — no target in NRP	1.86 % (2009), 1.77 % (2010). The share of R&D spending in UK GDP is slightly below the EU average and well below the Europe 2020 target of 3 %. Between 2000 and 2010 it was little changed, from 1.81 % to 1.77 %, following a period of decline from the mid-1980s.
Greenhouse gas emissions target: -16 % (compared to 2005 emissions, ETS emissions are not covered by this national target)	Change in greenhouse gas emissions between 2005 and 2010: -8 % (this estimate corresponds to the current ETS scope). This evolution is consistent with the 2020 greenhouse gas emissions target but it partially results from the economic crisis.
15 % of gross final energy consumption from renewable sources	Starting from 1.3 % in 2005, the share of renewable energy in gross final energy consumption rose to 2.9 % (in 2009). The UK set out its strategy to meet the target in the Renewable Energy Roadmap in July 2011 and acknowledges that further efforts are needed to reach the 2011-2012 interim target. Last year’s proposal on an electricity market reform will have to be substantiated and followed up. Support schemes in both the heating and electricity sector should be clarified to create the necessary stable investment framework.
Energy efficiency — reduction in primary energy consumption by 2020 (in Mtoe)	The UK has not yet specified its national target for energy efficiency. The energy efficiency objectives are set according to national circumstances and national formulations. As the methodology to express the 2020 energy consumption impact of these objectives in the same format was agreed only recently, the Commission is not yet able to present this overview.
Early school leaving — no target in NRP	No progress has been made to contribute to this target.

	Starting from 11.6 % in 2005, the share of early school leavers has increased by 3.3 pp to 14.9 % in 2010, well above the EU target of 10 %. In the meantime, the government has undertaken further steps to contribute to the EU target. The government plans include to raise the age for leaving compulsory education in England from 16 to 17 in 2013 and to 18 from 2015. Those who have left school without basic skills in literacy and numeracy will continue to have access to state funded training, with those without a first full Level 2 (intermediate) or Level 3 (advanced or A-Level) qualification eligible for fully funded training until the age of 24. However, some reforms risk exacerbating the problem of early school leaving, particularly the withdrawal of the Educational Maintenance Allowance.
Tertiary education — no target in NRP	Compared to the EU average, the UK has high and increasing tertiary completion rates. The UK has progressed significantly from 29 % in 2000 to a tertiary attainment rate of 41.5 % in 2009 and 43 % in 2010, well above the EU average (33.6 %).
Reduction of population at risk of poverty or social exclusion in number of persons — existing numerical targets of the 2010 Child Poverty Act	The percentage of the population at risk of poverty or social exclusion was 22 % in 2009 and 23.1 % in 2010 (according to the definition of the EU target). This is close to the EU average. So far the UK has not made progress towards meeting the EU 2020 poverty and social exclusion target. Between 2007 and 2010, the number of people at-risk-of-poverty and social exclusion has increased from 13.5 million to 14.2 million. Reductions in welfare spending are a necessary part of the government's fiscal consolidation strategy, but in an October 2011 report, the Institute of Fiscal Studies (IFS) concluded that the government would miss its targets for reducing child poverty, as set down in the Child Poverty Act. The IFS estimates that relative poverty among children will rise by 600 000 by 2012-13, and by 800 000 for adults of working age, and that by 2020-21 absolute child poverty will be at its highest level since 2001-02.

ANNEX

Table I. Macroeconomic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012	2013
Core indicators								
GDP growth rate	3.3	3.3	1.8	-4.4	2.1	0.7	0.5	1.7
Output gap [1]	0.0	1.8	2.1	-4.3	-3.1	-3.3	-3.7	-3.1
HICP (annual % change)	2.0	1.2	2.6	2.2	3.3	4.5	2.9	2.0
Domestic demand (annual % change) [2]	3.8	3.7	1.6	-5.4	2.9	-0.8	-0.1	0.8
Unemployment rate (% of labour force) [3]	7.0	5.0	5.3	7.6	7.8	8.0	8.5	8.4
Gross fixed capital formation (% of GDP)	17.1	16.8	17.1	15.0	14.9	14.3	14.1	14.2
Gross national saving (% of GDP)	16.6	15.2	15.0	12.8	11.8	13.2	12.9	13.8
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.3**	**-1.0**	**-3.5**	**-11.5**	**-10.2**	**-8.3**	**-6.7**	**-6.5**
Gross debt	**48.5**	**39.2**	**46.3**	**69.6**	**79.6**	**85.7**	**91.2**	**94.6**
Net financial assets	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
Total revenue	38.7	39.6	41.5	40.1	40.2	40.8	40.8	40.8
Total expenditure	41.0	40.6	45.0	51.6	50.4	49.1	47.4	47.2
of which: Interest	3.4	2.2	2.2	2.0	2.9	3.2	3.4	3.5
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-1.0**	**0.4**	**4.3**	**7.0**	**5.0**	**5.4**	**3.7**	**4.2**
Net financial assets; non-financial corporations	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
Gross capital formation	12.3	10.8	10.2	8.2	9.1	8.6	8.1	8.3
Gross operating surplus	23.1	20.7	22.0	22.2	21.3	20.7	25.7	37.4
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**2.4**	**-1.3**	**-3.2**	**2.7**	**1.7**	**1.4**	**1.5**	**1.4**
Net financial assets	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	45.8	47.0	45.2	46.6	45.3	44.9	44.5	43.9
Net property income	10.9	8.8	7.8	8.4	7.9	8.3	8.4	8.5
Current transfers received	22.5	21.2	21.2	24.3	23.7	23.5	23.5	23.2
Gross saving	5.9	3.3	2.1	5.4	5.0	5.1	5.1	5.0
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.9**	**-1.9**	**-2.3**	**-1.2**	**-3.1**	**-1.7**	**-1.5**	**-0.8**
Net financial assets	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-0.3	-2.4	-3.1	-1.8	-2.5	-1.8	-1.1	0.2
Net primary income from the rest of the world	-0.2	0.9	1.5	1.4	0.4	1.3	0.9	0.3
Net capital transactions	0.1	0.1	0.2	0.3	0.3	0.2	0.2	0.2
Tradable sector	44.2	40.5	37.2	36.5	35.4	35.3	n.a	n.a
Non tradable sector	44.8	48.4	52.0	53.7	53.8	53.0	n.a	n.a
of which: Building and construction sector	5.5	6.2	6.7	6.3	6.2	6.1	n.a	n.a
Real effective exchange rate (index, 2000=100)	87.6	98.9	100.3	83.3	86.0	85.9	89.2	89.6
Terms of trade goods and services (index, 2000=100)	98.6	101.6	100.8	100.0	99.4	98.5	99.2	100.2
Market performance of exports (index, 2000=100)	110.8	100.7	98.8	99.5	97.2	97.8	99.3	99.7

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2000 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. Eurostat computation.

Source :

Commission spring 2012 forecast

Table II. Comparison of macroeconomic developments and forecasts

	2011		2012		2013		2014	2015	2016
	COM	**CP**	**COM**	**CP**	**COM**	**CP**	**CP**	**CP**	**CP**
Real GDP (% change)	0.7	0.8	0.5	0.8	1.7	2.0	2.7	3.0	3.0
Private consumption (% change)	-1.2	-0.8	0.3	0.5	1.0	1.3	2.3	3.0	3.0
Gross fixed capital formation (% change)	-1.2	-1.7	-0.6	-0.3	3.2	6.2	8.6	8.9	8.7
Exports of goods and services (% change)	4.6	4.8	3.1	2.9	4.7	5.3	5.7	5.5	5.3
Imports of goods and services (% change)	1.2	0.6	1.3	1.4	1.8	3.8	4.6	4.8	4.9
Contributions to real GDP growth:									
- Final domestic demand	-0.9	-0.7	0.2	0.4	0.9	1.5	2.3	2.8	2.9
- Change in inventories	0.1	0.0	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0
- Net exports	1.0	1.2	0.5	0.4	0.9	0.5	0.3	0.2	0.1
Output gap[1]	-3.3	-3.3	-3.7	-3.6	-3.1	-3.2	-2.2	-1.2	-0.5
Employment (% change)	0.4	0.6	0.4	-0.3	0.5	0.4	0.7	1.0	1.0
Unemployment rate (%)[2]	8.0	8.1	8.5	8.7	8.4	8.6	8.0	7.2	6.3
Labour productivity (% change)	0.2	0.3	0.1	1.1	1.2	1.6	2.0	2.0	2.0
HICP inflation (%)	4.5	4.5	2.9	2.8	2.0	1.9	1.9	2.0	2.0
GDP deflator (% change)	2.3	2.3	2.7	2.5	2.3	2.5	2.5	2.5	2.5
Comp. of employees (per head, % change)	1.9	0.9	2.4	2.9	2.6	3.2	4.3	4.5	4.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.7	-2.5	-1.5	-1.7	-0.8	-1.3	-1.2	-0.8	-0.6

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

[2]Commission estimate stems from Eurostat computation of the unemployment rate.

Source :

Commission spring 2012 forecast (COM); Convergence programme (CP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2011-12	2012-13		2013-14		2014-15	2015-16	2016-17	Change: 2011-12 : 2016-17
	COM	COM	CP	COM	CP	CP	CP	CP	CP
Revenue	**40.4**	**40.7**	**37.1**	**39.8**	**37.3**	**37.4**	**37.2**	**37.5**	**-3.3**
of which:									
- Taxes on production and imports	13.4	13.4	13.6	13.4	13.6	13.6	13.4	13.3	0.0
- Current taxes on income, wealth, etc.	15.7	16.1	12.8	16.2	12.8	13.1	13.0	13.3	-2.4
- Social contributions	8.5	8.3	6.7	7.3	6.7	6.7	6.8	6.9	-1.6
- Other (residual)	2.9	2.9	4.0	2.9	4.2	4.0	4.0	4.0	0.7
Expenditure	**48.9**	**48.6**	**43.0**	**46.9**	**43.3**	**41.8**	**40.2**	**38.7**	**-10.4**
of which:									
- Primary expenditure	45.6	45.1	40.1	43.4	40.5	38.7	36.9	35.4	-10.5
of which:									
Compensation of employees and intermediate consumption	23.6	23.6	n.a.	22.8	n.a.	n.a.	n.a.	n.a.	n.a.
Social payments	15.4	15.2	n.a.	14.7	n.a.	n.a.	n.a.	n.a.	n.a.
Subsidies	0.5	0.5	0.7	0.5	0.7	0.7	0.7	0.7	0.2
Gross fixed capital formation	2.1	2.2	1.9	2.0	1.8	1.8	1.6	1.6	-0.6
Other (residual)	4.0	3.6	1.6	3.4	3.4	3.2	2.9	2.7	-1.4
- Interest expenditure	3.3	3.5	2.9	3.5	2.8	3.1	3.3	3.3	0.1
General government balance (GGB)	**-8.4**	**-6.1**	**-5.9**	**-6.5**	**-6.0**	**-4.4**	**-2.9**	**-1.2**	**7.1**
Primary balance	**-5.1**	**-2.6**	**-3.0**	**-3.0**	**-3.1**	**-1.3**	**0.3**	**2.1**	**7.2**
One-off and other temporary measures	0.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-8.4**	**-7.9**	**-5.9**	**-6.5**	**-6.0**	**-4.4**	**-2.9**	**-1.2**	**7.1**
Output gap[2]	-3.3	-3.7	-3.6	-3.1	-3.2	-2.2	-1.2	-0.5	2.8
Cyclically-adjusted balance[2]	-6.9	-5.1	-4.4	-5.1	-4.6	-3.5	-2.4	-1.0	5.9
Structural balance[3]	**-6.9**	**-6.9**	**-4.4**	**-5.1**	**-4.6**	**-3.5**	**-2.4**	**-1.0**	**5.9**
Change in structural balance		*0.0*	*2.5*	*1.8*	*-0.3*	*1.2*	*1.1*	*1.4*	
Structural primary balance[3]	-3.7	-3.5	-1.5	-1.6	-1.8	-0.4	0.9	2.3	6.0
Change in structural primary balance		*0.2*	*2.2*	*1.9*	*-0.4*	*1.5*	*1.3*	*1.4*	
Expenditure benchmark[4]									
Public expenditure growth[5] (real)		-7.25	-4.33	0.67	2.78	-2.53	-1.53	n.a.	n.a.
Reference rate[6,7]		1.19	1.19	1.19	1.19	*1.19*	*1.19*	n.a.	n.a.
Lower reference rate[6,8]		0.09	0.09	0.09	0.09	*0.09*	*0.09*	n.a.	n.a.
Deviation in % GDP against applicable reference rate		-3.35	-1.87	0.25	1.06	*-1.04*	*-0.61*	n.a.	n.a.
Two-year average deviation in % GDP against applicable reference rate		n.a.	n.a.	-1.55	-0.40	*0.01*	*-0.82*	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 information in the programme; calendar year basis.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures; calendar year basis.

[4]This assessment is based on the minimum MTO established in 2009.

[5]Modified expenditure aggregate used for the expenditure benchmark, growth rates net of non-discretionary changes in unemployment benefit and of discretionary measures.

[6]The reference rates applicable to 2014 onwards will be available from mid-2012. For illustrative purposes, the current reference rates have also been applied to the years 2014 onwards.

[7]The (standard) reference rate applies starting in the year following which the country has reached its MTO.

[8]The lower reference rate applies as long as the country is adjusting towards its MTO, including the year in which it reaches the MTO.

Source :

Convergence programme (CP); Commission spring 2012 forecast (COM); Commission calculations.

Table IV. Debt dynamics

(% of GDP)	average 2006-07 : 2010-11	2011-12	2012-13		2013-14		2014-15	2015-16	2016-17
			COM	CP	COM	CP	CP	CP	CP
Gross debt ratio[1]	**59.7**	**86.8**	**91.8**	**89.0**	**94.7**	**91.9**	**92.7**	**91.4**	**n.a.**
Change in the ratio	7.7	6.5	4.9	5.0	3.0	2.9	0.8	-1.3	-2.8
Contributions [2] :									
1. Primary balance	**4.4**	**5.1**	**2.6**	**3.0**	**3.0**	**3.1**	**1.3**	**-0.3**	**-2.1**
2. "Snow-ball" effect	**0.9**	**1.0**	**0.5**	**0.2**	**-0.1**	**-1.0**	**-1.5**	**-1.6**	**-1.5**
Of which:									
Interest expenditure	2.3	3.3	3.5	2.9	3.5	2.9	3.1	3.2	3.3
Growth effect	-0.2	-0.2	-0.8	-0.7	-1.6	-1.7	-2.4	-2.6	-2.6
Inflation effect	-1.3	-2.1	-2.2	-2.0	-1.9	-2.2	-2.2	-2.2	-2.2
3. Stock-flow adjustment	**2.4**	**0.5**	**1.8**	**1.8**	**0.0**	**0.8**	**1.0**	**0.7**	**0.8**
Of which:									
Cash/accruals diff.									
Acc. financial assets									
Privatisation									
Val. effect & residual									
(% of GDP)		2011-12	2012-13		2013-14		2014-15	2015-16	2016-17
			COM/CP[3]	CP[4]	COM/CP[3]	CP[4]	CP[4]	CP[4]	CP[4]
Gap to the debt benchmark[3,4]	-	-	-	-	-	-	-	-	-
Structural adjustment[5]	-	-	-	-	-	-	-	1.1	3.8
To be compared to:									
Required adjustment[6]	-	-	-	-	-	-	-	0.4	0.0

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]Assessment of the consolidation path set in the CP assuming growth follows the COM forecasts.

[4]Assessment of the consolidation path set in the CP assuming growth follows the CP projections.

[5]Not relevant during EDP that were ongoing in November 2011 and in the three years following the correction of the excessive deficit.

[6]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.

[7]Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[8]Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections are achieved.

Source :

Convergence programme (CP); Commission spring 2012 forecast (COM); Commission calculations

Table V. Long-term sustainability indicators

	UK		EU-27	
	No policy change scenario	CP scenario	No policy change scenario	SCP scenario
S2	5.2	1.2	2.9	0.7
of which:				
Initial budgetary position (IBP)	2.6	-1.4	0.7	-1.6
Long-term change in the primary balance (LTC)	2.5	2.7	2.3	2.4
of which:				
Pension	1.1	1.4	1.1	1.2
Care (HC and LTC)	1.4	1.2	1.5	1.5
Others	0.1	0.1	-0.3	-0.3
S1 (required adjustment)*	5.1	0.6	2.2	-0.1
Debt, % of GDP (2011)	85.7		82.8	
Age-related expenditure, % of GDP (2011)	22.2		25.8	

Notes:

The 'no policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the spring 2012 forecast until 2013. The 'convergence programme' (CP) scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented.

* The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030.

Source : Commission, 2012 stability and convergence programmes

Figure I. Medium-term debt projection

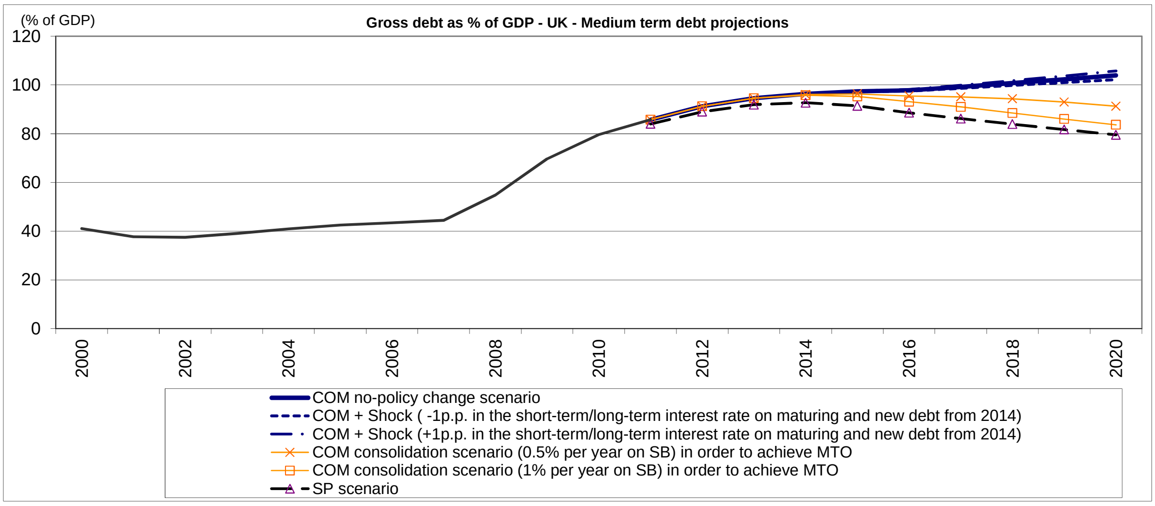

Table VI. Taxation indicators

	2001	2005	2007	2008	2009	2010
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	36.5	36.0	36.3	37.9	34.8	35.6
Breakdown by economic function (% of GDP)[1]						
Consumption	11.6	11.1	10.8	10.8	10.3	11.2
of which:						
- VAT	6.6	6.7	6.5	6.4	5.7	6.6
- excise duties on tobacco and alcohol	1.4	1.3	1.1	1.2	1.3	1.3
- energy	2.2	2.0	1.8	1.8	1.9	1.9
- other (residual)	1.4	1.3	1.3	1.3	1.4	1.5
Labour employed	14.2	14.2	14.3	14.5	14.3	14.1
Labour non-employed	0.2	0.2	0.2	0.2	0.2	0.2
Capital and business income	6.2	6.1	6.4	6.6	5.5	5.8
Stocks of capital/wealth	4.3	4.4	4.6	5.8	4.4	4.3
p.m. Environmental taxes[2]	2.8	2.5	2.5	2.4	2.6	2.6
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	47.9	47.7	47.8	46.2	46.7	46.3

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 (2012), 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. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). See European Commission (2011), Tax reforms in EU Member States, European Economy 5/2011, for a more detailed explanation.

Source: Commission

Table VII. Financial market indicators

	2007	2008	2009	2010	2011
Total assets of the banking sector (% of GDP)	485.3	484.7	572.6	537.7	555.6
Share of assets of the five largest banks (% of total assets)	40.7	36.5	40.8	42.5	…
Foreign ownership of banking system (% of total assets)	53.3	50.9	45.8	…	…
Financial soundness indicators:					
- non-performing loans (% of total loans)	0.9	1.6	3.5	4.0	...
- capital adequacy ratio (%) [1]	12.6	12.9	14.8	15.9	...
- return on equity (%) [2]	6.2	-10.3	2.6	1.0	...
Bank loans to the private sector (year-on-year % change)	7.9	-14.9	3.2	4.6	-1.6
Lending for house purchase (year-on-year % change)	-4.8	-27.5	24.1	18.0	3.9
Loan to deposit ratio	123.3	117.1	110.0	106.2	103.9
CB liquidity as % of liabilities	…	…	…	…	…
Banks' exposure to countries receiving official financial assistance (% of GDP)[4]	7.9	9.9	9.6	8.6	7.6
Private debt (% of GDP)	…	…	213.8	197.5	…
Gross external debt (% of GDP) [4]					
- Public	11.4	13.8	17.4	23.1	24.3
- Private	122.6	118.4	135.1	139.1	139.6
Long term interest rates spread versus Bund (basis points)*	84.3	51.7	13.7	62.1	43.8
Credit default swap spreads for sovereign securities (5-year)*	…	48.0	84.8	72.8	72.4

Notes:

[1] The capital adequacy ratio is defined as total capital devided by risk weigthed assets.

[2] The capital adequacy ratio is defined as total capital divided by risk weighted assets.

[3] Covered countries are IE, EL, PT, RO, LV and HU.

[4] Latest data 2011Q3.

* 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), ECB (all other indicators).

Table VIII. Labour market and social indicators

Labour market indicators	2006	2007	2008	2009	2010	2011
Employment rate (% of population aged 20-64)	75.2	75.2	75.2	73.9	73.6	73.6
Employment growth (% change from previous year)	0.9	0.6	0.8	-1.5	0.1	0.5
Employment rate of women (% of female population aged 20-64)	68.6	68.4	68.8	68.2	67.9	67.9
Employment rate of men (% of male population aged 20-64)	82.0	82.2	81.8	79.6	79.3	79.4
Employment rate of older workers (% of population aged 55-64)	57.3	57.4	58.0	57.5	57.1	56.7
Part-time employment (% of total employment)	25.8	25.7	25.9	26.7	27.6	27.6
Part-time employment of women (% of women employment)	43.2	42.9	42.5	43.4	44.3	44.2
Part-time employment of men (% of men employment)	10.8	11.0	11.6	12.1	13.0	13.1
Fixed term employment (% of employees with a fixed term contract)	5.8	5.9	5.4	5.7	6.1	6.2
Unemployment rate[1] (% of labour force)	5.4	5.3	5.6	7.6	7.8	8.0
Long-term unemployment[2] (% of labour force)	1.2	1.3	1.4	1.9	2.5	2.7
Youth unemployment rate (% of youth labour force aged 15-24)	14.0	14.3	15.0	19.1	19.6	21.1
Youth NEET[3] rate (% of population aged 15-24)	8.5	11.9	12.1	13.3	13.7	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	11.3	16.6	17.0	15.7	14.9	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	36.9	37.9	38.6	40.1	41.2	:
Labour productivity per person employed (annual % change)	1.7	2.8	-1.8	-2.8	1.9	-0.1
Hours worked per person employed (annual % change)	-0.3	0.1	-1.3	-0.4	-0.6	-1.1
Labour productivity per hour worked (annual % change; constant prices)	2.0	2.6	-0.6	-2.5	2.5	1.0
Compensation per employee (annual % change; constant prices)	1.6	2.6	-1.4	1.0	0.7	-1.7
Nominal unit labour cost growth (annual % change)	2.8	2.1	3.6	5.7	1.7	1.6
Real unit labour cost growth (annual % change)	-0.4	-0.2	0.5	4.0	-1.2	-0.7

Notes:

[1] According to ILO definition, age group 15-74.
[2] Share of persons in the labour force who have been unemployed for at least 12 months.
[3] NEET are persons that are neither in employment nor in any education or training.

Sources:
Commission (EU Labour Force Survey and European National Accounts)

Table VIII. Labour market and social indicators (continued)

Expenditure on social protection benefits (% of GDP)	2005	2006	2007	2008	2009
Sickness/Health care	7.96	8.02	7.65	7.88	8.67
Invalidity	2.30	2.42	2.46	2.75	2.98
Old age and survivors	10.76	10.52	8.51	10.82	12.00
Family/Children	1.60	1.51	1.60	1.68	1.82
Unemployment	0.68	0.63	0.51	0.59	0.84
Housing and Social exclusion n.e.c.	1.44	1.45	1.15	1.23	1.47
Total	26.3	26.0	23.3	26.3	29.2
of which: Means tested benefits	3.99	3.94	3.59	3.70	4.23
Social inclusion indicators	**2006**	**2007**	**2008**	**2009**	**2010**
Risk-of-poverty or exclusion[1] (% of total population)	23.7	22.6	23.2	22.0	23.1
Risk-of-poverty or exclusion of children (% of people aged 0-17)	30.1	27.6	29.6	27.4	29.7
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	27.5	27.9	28.5	23.1	22.3
At-risk-of-poverty rate[2] (% of total population)	19.0	18.6	18.7	17.3	17.1
Value of relative poverty threshold (single household per year) - in PPS	10578	11267	11126	10250	10241
Severe material deprivation[3] (% of total population)	4.5	4.2	4.5	3.3	4.8
Share of people living in low work intensity households[4] (% of people aged 0-59 not student)	12.0	10.3	10.4	12.6	13.1
In-work at-risk-of poverty rate (% of persons employed)	7.8	8.0	8.5	6.7	6.8

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 households with zero or very low work intensity (LWI).

[2] At-risk-of poverty rate: 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 work less than 20% of their total work-time potential during the previous 12 months.

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

Table IX. Product market performance and policy indicators

Performance indicators	2002-2006	2007	2008	2009	2010	2011
Labour productivity[1] total economy (annual growth in %)	**1.8**	**2.8**	**-1.8**	**-2.8**	**1.5**	**1.4**
Labour productivity[1] in manufacturing (annual growth in %)	**4.6**	**2.5**	**1.9**	**-5.4**	**6.9**	**n.a.**
Labour productivity[1] in electricity, gas, water (annual growth in %)	**6.2**	**-11.7**	**-6.6**	**n.a.**	**n.a.**	**n.a.**
Labour productivity[1] in the construction sector (annual growth in %)	**0.2**	**0.6**	**-0.2**	**-5.9**	**11.9**	**n.a.**
Patent intensity in manufacturing[2] (patents of the EPO divided by gross value added of the sector)	**2.5**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Policy indicators	**2002-2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Enforcing contracts[3] (days)	**n.a.**	**404**	**404**	**399**	**399**	**399**
Time to start a business[3] (days)	**n.a.**	**13**	**13**	**13**	**13**	**13**
R&D expenditure (% of GDP)	**1.7**	**1.8**	**1.8**	**1.9**	**1.8**	**n.a.**
Tertiary educational attainment (% of 30-34 years old population)	**33.5**	**38.5**	**39.7**	**41.5**	**43.0**	**n.a.**
Total public expenditure on education (% of GDP)	**5.3**	**5.4**	**5.4**	**n.a.**	**n.a.**	**n.a.**
	2005	**2006**	**2008**	**2009**	**2010**	**2011**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	**n.a.**	**n.a.**	**0.8**	**n.a.**	**n.a.**	**n.a.**
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	**n.a.**	**n.a.**	**2.0**	**n.a.**	**n.a.**	**n.a.**
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	**3.1**	**2.9**	**0.9***	**n.a.**	**n.a.**	**n.a.**

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 for 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. The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.

[5] Aggregate ETCR.

*figure for 2007.

Source :

Commission, World Bank - Doing Business (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).

Table X. Indicators on green growth

		2001-2005	2006	2007	2008	2009	2010
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.13	0.12	0.12	0.11	0.11	0.12
Carbon intensity	kg / €	0.38	0.34	0.32	0.32	0.31	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	0.43	0.39	0.38	0.36	0.34	n.a.
Waste intensity	kg / €	n.a.	0.18	0.17	0.17	n.a.	n.a.
Energy balance of trade	% GDP	0.2%	-0.4%	-0.4%	-0.7%	-0.4%	-0.5%
Energy weight in HICP	%	6	7	8	7	8	9
Difference between change energy price and inflation	%	3.44	22.5	4.9	14.9	4.8	-6.1
Environmental taxes over labour taxes	ratio	19.2%	16.8%	17.2%	17.0%	18.5%	n.a.
Environmental taxes over total taxes	ratio	7.5%	6.5%	6.8%	6.4%	7.4%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.12	0.11	0.11	0.12	0.13	n.a.
Share of energy-intensive industries in the economy	% GDP	10.2	n.a.	n.a.	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users	€ / kWh	0.06	0.08	0.10	0.09	0.11	0.09
Public R&D for energy	% GDP	n.a.	0.00%	0.00%	0.00%	0.01%	n.a.
Public R&D for the environment	% GDP	n.a.	0.01%	0.01%	0.02%	0.02%	n.a.
Recycling rate of municipal waste	ratio	26.6%	39.5%	42.9%	46.7%	49.8%	n.a.
Share of GHG emissions covered by ETS	%	n.a.	39.0%	40.5%	42.7%	41.0%	n.a.
Transport energy intensity	kgoe / €	0.46	0.47	0.48	0.47	0.45	n.a.
Transport carbon intensity	kg / €	1.10	1.08	1.09	1.05	1.01	n.a.
Change in the ratio of passenger transport and GDP	%	-1.3%	-1.4%	-1.7%	-1.1%	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	-2.1%	21.2%	20.0%	26.0%	26.6%	n.a.
Diversification of oil import sources	HHI	n.a.	0.42	0.45	0.42	0.44	n.a.
Diversification of energy mix	HHI	0.30	0.29	0.30	0.31	0.30	n.a.
Share of renewable energy in energy mix	%	1.3%	1.8%	2.1%	2.5%	3.0%	n.a.

Country-specific notes:
The year 2011 is not included in the table due to lack of data.
General explanation of the table items:
Source: Eurostat unless indicated otherwise; ECFIN explanations given 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 EUR)
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
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 (in kgoe) divided by gross value added of industry (in EUR)
Transport carbon intensity: greenhouse gas emissions in transport divided by gross value added of the transport sector
Passenger transport growth : measured in %-change in passenger kilometres
Energy import dependency: net energy imports divided by gross inland energy consumption incl. of 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 of renewable energy in energy mix: percentage-share in gross inland energy consumption, expressed in tonne oil equivalents