COUNCIL OF
THE EUROPEAN UNION

**Brussels, 19 June 2013**

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**NOTE**

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| from: | Permanent Representatives Committee |
| to: | Council |
| No. Cion prop.: | 10028/13 UEM 111 ECOFIN 399 SOC 368 COMPET 353 ENV 455 EDUC 169 RECH 198 ENER 219 - COM(2013) 378 final |
| Subject: | Recommendation for a COUNCIL RECOMMENDATION on the United Kingdom's 2013 national reform programme and delivering a Council opinion on the United Kingdom's convergence programme for 2012-2017 |

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2013) 378 final.

**ANNEX**

Recommendation for a

**COUNCIL RECOMMENDATION**
**on the United Kingdom's 2013 national reform programme**

**and delivering a Council opinion on the United Kingdom's 2013 convergence programme for 2012-13 to 2017-18**

THE COUNCIL OF THE EUROPEAN UNION,

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

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

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

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

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

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

After consulting the Economic Policy Committee,

1 OJ L 209, 2.8.1997, p. 1.
2 OJ L 306, 23.11.2011, p. 25.
3 COM(2013)378 final.
4 P7_TA(2013)0052 and P7_TA(2013)0053.

Whereas:

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

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States[5], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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

(4) On 10 July 2012, the Council adopted a recommendation on the United Kingdom's national reform programme for 2012 and delivered its opinion on the United Kingdom's 2012 convergence programme for 2011/12-2016/7.

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[5] Council Decision 2013/208/EU of 22 April 2013.

(5) On 28 November 2012, the Commission adopted the Annual Growth Survey[6], marking the start of the 2013 European Semester of economic policy coordination. Also on 28 November 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the Alert Mechanism Report[7], in which it identified the United Kingdom as one of the Member States for which an in-depth review would be carried out.

(6) On 14 March 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 10 April 2013, the Commission published the results of its in-depth review[8] for the United Kingdom, under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that the United Kingdom is experiencing macroeconomic imbalances, which deserve monitoring and policy action. In particular, macroeconomic developments in the area of household debt, linked to the high levels of mortgage debt and the characteristics of the housing market, as well as unfavourable developments in external competitiveness, especially as regards goods exports and weak productivity growth, continue to deserve attention.

(8) On 30 April 2013, the United Kingdom submitted its 2013 convergence programme covering the period 2012-13 to 2017-18 and its 2013 national reform programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

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6 COM(2012) 750 final.
7 COM(2012) 751 final.
8 SWD(2013) 125 final.

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

(10) Based on the assessment of the 2013 Convergence Programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. The objective of the budgetary strategy outlined in the Convergence Programme is to achieve a cyclically-adjusted Current balance at the end of a five-year rolling period. The general government deficit peaked at 11.5% of GDP in 2009-10[9] and was reduced to 5.6% of GDP in 2012-13, thanks to one-off measures that reduced the deficit by 2 pp. in 2012-13. However, the Convergence Programme shows that the government is projected to miss the deadline of 2014-15 for correction of the excessive deficit set by the Council as the deficit is estimated at 6.0% of GDP that year. According to programme projections, the year in which the excessive deficit will be corrected is in 2017-18 at 2.3% of GDP, three years after the deadline set by the Council in December 2009. The programme implies that the structural general government deficit, as recalculated by the Commission, improving marginally from 5.6% of GDP in 2013-14 to 5.1% of GDP in 2014-15. Over the period 2010-11 to 2012-13, the average non-adjusted fiscal effort is estimated at 1.1% of GDP, well below the 1¾% of GDP recommended by the Council, before correcting for the impact of any revisions to potential output growth, or revenue windfalls or shortfalls. The main risks to the budgetary projections stem from lower-than-expected growth due to persistently high inflation curtailing private consumption and a potential deterioration in the international environment that could affect trade and investment.

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[9] 2009-10 refers to the financial year which starts on 1 April and ends on 31 March.

The Convergence Programme does not include a medium-term budgetary objective as foreseen by the Stability and Growth Pact. The government has continued with its fiscal consolidation strategy but, because of higher-than-expected expenditure due to the operation of automatic stabilisers and lower-than-expected tax revenues, the deficit is higher than forecast. Also, the consolidation measures taken so far have not been sufficient in attaining the annual average fiscal effort recommended to correct the excessive deficit. Moreover, the potential revenue contribution from structural reform, e.g. aiming to increase the efficiency of the tax system through revisions of the VAT rate structure, remains relatively under-exploited. Government debt as a percentage of GDP rose from 56.1% in 2008-09 to 90.7% in 2012-13. According to the programme, the general government debt ratio is projected to increase to 100.8% in 2015-16 and 2016-17 before falling back 99.4% in 2017-18.

(11) Household deleveraging continued in 2012, but at 96% of GDP, UK household debt remains well above the euro area average and deleveraging may not be sustained once the economy improves and housing transactions return to more normal levels. House prices remain high and volatile in the context of a housing shortage. Because of a combination of high house prices and the widespread use of variable-rate mortgages, households are particularly exposed to interest rate changes, as well as to rises in unemployment. The government has taken action to reform the spatial planning laws but residential construction remains at a low level and the planning system, including green belt restrictions, continues to be an important constraint on the supply of housing. Government interventions that stimulate housing demand more than supply, including the recently announced Help to Buy scheme could potentially exacerbate this situation by increasing house prices and household debt. The UK property tax system combines a regressive recurring tax (Council Tax) with a progressive transaction tax (Stamp Duty Land Tax). A combination of high house prices, stretched household finances and more responsible lending criteria are likely to continue to prevent many middle-income households from becoming home owners. In this context, private renting could be made a more attractive and viable long-term alternative to home ownership.

(12) The UK faces the challenges of both unemployment and underemployment, especially among the young. Unemployment stood at 7.8 % at the beginning of 2013, compared with the EU average of 10.9% and is expected to remain broadly flat through 2013 and 2014. Youth unemployment is much higher, at 20.7% and it has steadily increased since 2007, when it stood at 14.3 %. The proportion of young people not in education, employment or training is 14.0 %. Private sector employment has grown strongly in the last year, given the slow GDP growth, but productivity and wage growth have been weak. The UK also has an oversupply of low-skilled workers for whom demand is falling. At the same time the UK has a shortage of workers with high-quality vocational and technical skills which contributes to a lack of external competitiveness. Despite some progress in recent years, a significant proportion of young people do not have the skills and qualifications they need to compete successfully in the labour market. The unemployment rate of low skilled 15-25 year olds is 37.2%, significantly above the EU average. Existing vocational education and training policy has been too focused on basic skills and level 2 qualifications, while the economy increasingly demands more advanced qualifications. While there have been efforts to improve the quality of apprenticeship programmes, further efforts are needed. In particular, the qualifications system remains very complex, which may negatively impact on businesses' involvement in apprenticeship programmes. The UK could build on the current Youth Contract to implement a Youth Guarantee and address the problem of youth unemployment and those not in education, employment or training.

(13) Weak work incentives have been a persistent problem in the UK. The authorities plan to address this with the introduction of the Universal Credit, which will allow individuals to keep more of their benefit income as they move into work. Whilst Universal Credit could have a positive impact on employment much will depend on effective implementation and support services, including the interaction with other benefits. In parallel, many working-age benefits and tax credits will be increased by 1 % a year until 2016 which is below the projected inflation rate but should also improve work incentives. A range of other reforms to welfare benefits were also introduced in April 2013 There is a risk of increased poverty, including more child poverty for those in households that do not find employment. In contrast, the scope, level and uprating of both universal and means-tested payments to pensioners have been largely exempt from cuts. Early results from the Work Programme suggest scope to improve the delivery and outcomes. The UK also faces ongoing challenges to increase parental employment and improve access to high-quality, affordable childcare. At 17.3%, the proportion of UK children living in workless households is the second highest in the EU. Currently, childcare costs in the UK are among the highest in the EU, which poses particular problems for second earners in couples, and for single parents. In 2010, only 4 % of children under three used formal childcare on a full-time basis, well below the EU average of 14 %.

(14) The stock of UK corporate debt is fairly high, yet some firms are having difficulty accessing credit, and business investment remains at very low levels. An unprecedented drop in business investment after 2007 caused gross fixed capital formation to fall to 14.2 % of GDP in 2012. This is the third lowest level in the EU. The UK has a low level of business expenditure on R&D, which fell from 1.17 % of GDP in 2001 to 1.09 % in 2011. Business investment has started to pick up slightly, with an annual increase of 4.9 % in 2012, but remains low. Net lending to the corporate sector remained negative in 2012. While larger firms with strong balance sheets are able to borrow at a historically low cost, many other firms, particularly SMEs, are having difficulty accessing credit. This is exacerbated by limited competition in the banking industry. Proper implementation of the Financial Policy Committee's recommendations on prudent reckoning of bank capital requirements and on addressing identified capital shortfalls without hindering lending to the economy should help reinforce the financial stability of the UK banking system.

(15) The UK has a challenge to renew and upgrade its energy and transport infrastructure. The UK needs substantial investment in new electricity generation capacity by 2020, both to replace old plants that are due to close, and to meet the renewables obligation and tighter carbon emissions standards. At 3.8 %, the share of renewable energy sources in final energy consumption ranks 25$^{th}$ out of 27 Member States (EU average 13.0 %). Regulatory certainty will be required to facilitate adequate and timely investment. Shortcomings in the capacity and quality of the UK's transport networks are a structural problem for the economy, especially for goods producers, distributors and exporters. There is currently a significant gap between committed funding, public and private, and the pipeline of transport investment needs which the government is seeking to address by prioritising public spending towards infrastructure and by attracting additional private investment. Unit costs in transport construction and maintenance also remain high in the UK.

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

(17) In the light of this assessment, the Council has examined the United Kingdom's convergence programme, and its opinion[10] is reflected in particular in recommendation (1) below.

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

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

HEREBY RECOMMENDS that the United Kingdom should take action within the period 2013-2014 to:

1. Implement a reinforced budgetary strategy, supported by sufficiently specified measures, for the year 2013-14 and beyond. Ensure the correction of the excessive deficit in a sustainable manner by 2014/15, and the achievement of the fiscal effort specified in the Council recommendations under the EDP and set the high public debt ratio on a sustained downward path. A durable correction of the fiscal imbalances requires the credible implementation of ambitious structural reforms which would increase the adjustment capacity and boost potential growth. Pursue a differentiated, growth-friendly approach to fiscal tightening, including through prioritising timely capital expenditure with high economic returns and through a balanced approach to the composition of consolidation measures and promoting medium and long-term fiscal sustainability. In order to raise revenue, make greater use of the standard rate of VAT.

2. Take further action to increase housing supply, including through further liberalisation of spatial planning laws and an efficient operation of the planning system. Ensure that housing policy, including the Help to Buy scheme does not encourage excessive and imprudent mortgage lending; and promote greater supply to avoid higher house prices.. Pursue reforms including to land and property taxation to reduce distortions and promote timely residential construction. Take steps to improve the functioning of rental markets, in particular by making longer rental terms more attractive to both tenants and landlords.

3. Building on the Youth Contract, step up measures to address youth unemployment, for example through a Youth Guarantee. Increase the quality and duration of apprenticeships, simplify the system of qualifications and strengthen the engagement of employers, particularly in the provision of advanced and intermediate technical skills. Reduce the number of young people aged 18-24 who have very poor basic skills, including through effectively implementing the Traineeships programme.

4. Enhance efforts to support low-income households and reduce child poverty by ensuring that the Universal Credit and other welfare reforms deliver a fair tax-benefit system with clearer work incentives and support services. Accelerate the implementation of planned measures to reduce the costs of childcare and improve its quality and availability.

5. Take further steps to improve the availability of bank and non-bank financing to the corporate sector, while ensuring that the measures primarily target viable companies, especially SMEs. Reduce barriers to entry in the banking sector, lower switching costs and facilitate the emergence of challenger banks through a divestiture of banking assets. Effectively implement the Financial Policy Committee's recommendations on prudent assessment of bank capital requirements and on addressing identified capital shortfalls.

6. Take measures to facilitate a timely increase in network infrastructure investment, especially by promoting more efficient and robust planning and decision-making processes. Provide a stable regulatory framework for investment in new energy capacity, including in renewable energy. Improve the capacity and quality of transport networks by providing greater predictability and certainty on planning and funding and by harnessing the most effective mix of public and private capital sources.

Done at Brussels,

*For the Council*
*The President*