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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Recommendation for a

COUNCIL RECOMMENDATION

**on the 2019 National Reform Programme of the United Kingdom and delivering a
Council opinion on the 2018-2019 Convergence Programme of the United Kingdom**

Recommendation for a

COUNCIL RECOMMENDATION

on the 2019 National Reform Programme of the United Kingdom and delivering a Council opinion on the 2018-2019 Convergence Programme of the United Kingdom

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 policies¹, and in particular Article 9(2) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it did not identify the

¹ OJ L 209, 2.8.1997, p. 1.

United Kingdom as one of the Member States for which an in-depth review would be carried out.

- (2) The 2019 country report for the United Kingdom² was published on 27 February 2019. It assessed the United Kingdom's progress in addressing the country-specific recommendations adopted by the Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and the United Kingdom's progress towards its national Europe 2020 targets.
- (3) On 23 April 2019, the United Kingdom submitted its 2019 National Reform Programme and its 2018-2019 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (4) On 29 March 2017, the United Kingdom notified the European Council of its intention to leave the European Union. When the United Kingdom leaves the European Union, it will become a third country. As there is uncertainty over the date and terms of the United Kingdom's withdrawal, as well as the United Kingdom's future relations with the EU, this document does not speculate on the possible economic implications of different scenarios. In the instance that the United Kingdom leaves the European Union on the basis of the Withdrawal Agreement, which has been agreed by the government of the United Kingdom and which the European Council (Article 50) endorsed on 25 November 2018, Union law, including the European Semester, will continue to apply to and in the United Kingdom, for the duration of the transition period established by that Agreement.
- (5) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council³, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance⁴.
- (6) The United Kingdom is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule until 2019-2020. In its 2018-2019 Convergence Programme, the government expects the headline deficit to increase from 1.2% of GDP in 2018-2019 to 1.4% of GDP in 2019-2020 and to fall to 1.1% of GDP in 2020-2021. The Convergence Programme does not include a medium-term budgetary objective. According to the Convergence Programme, the general government debt-to-GDP ratio is expected to fall from 85.5% in 2018-2019 to 83.3% in 2019-2020 and to 82.9% of GDP in 2020-2021. The macroeconomic scenario underpinning those budgetary projections is plausible. While the measures needed to

² SWD(2019) 1027 final.

³ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

⁴ COM(2014) 494 final.

support the planned deficit targets are overall well specified, growing pressures on government expenditure⁵ in a number of areas pose a risk to the achievement of the planned deficit path.

- (7) On 13 July 2018, the Council recommended the United Kingdom to ensure that the nominal growth rate of net primary government expenditure does not exceed 1.6% in 2019-2020, corresponding to an annual structural adjustment of 0.6% of GDP. Based on the Commission 2019 spring forecast, there is a risk of a significant deviation from the requirements of the preventive arm in 2019-2020.
- (8) In 2020-2021, in view of the United Kingdom's general government debt ratio above 60% of GDP and projected output gap of 0.3%, the nominal growth rate of net primary government expenditure should not exceed 1.9%, in line with the structural adjustment of 0.6% of GDP stemming from the matrix of requirements under the Stability and Growth Pact. Under unchanged policies, there is a risk of a significant deviation from the requirement in 2020-2021. The United Kingdom is projected to comply with the transitional debt rule in 2019-2020, as a result of the allowed annual deviation of 0.25%, and with the debt rule in 2020-2021. Overall, the Council is of the opinion that the United Kingdom needs to stand ready to take further measures as of 2019-2020 to comply with the provisions of the Stability and Growth Pact.
- (9) The United Kingdom has long been the G7 economy with the lowest capital investment as a share of GDP. Investment also fell particularly sharply in the financial crisis, and a post-crisis recovery in private investment has stalled. The United Kingdom's research and development investment intensity has been around 1.7% of GDP for the past decade, below the EU average. Research and development investment is concentrated in a limited number of companies and regions. These broad-based shortfalls in both physical and human capital are a root cause of the United Kingdom's relatively low and stagnant labour productivity.
- (10) The United Kingdom has a persistent housing shortage. A post-crisis recovery in house building has lost momentum. Capacity constraints are emerging while residential construction remains below what is required to meet estimated demand. House prices and rents remain high, especially in areas of high housing demand, with signs of overvaluation. Significantly fewer young adults now own their own homes. The government is implementing a range of measures to boost housing supply. At the same time, the amount and location of land available for new housing remains limited by tight regulation of the land market, particularly around big towns and cities.
- (11) Major investment is needed to modernise and expand infrastructure networks while bringing down project costs and greenhouse gas emissions. There are growing capacity pressures in road, rail and aviation networks. The United Kingdom needs to deliver significant new and greener energy generation and supply capacity. The United Kingdom's infrastructure development has tended to be costly and slow. After decades

⁵ Net primary government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

of public under-investment, the government is starting to deal with the infrastructure deficit, but it will be challenging to secure the amount of outside funding required in the government's projections in a cost effective manner.

- (12) Although unemployment is low, real wages remain below their pre-crisis peak. The high proportion of low-skilled employees has limited career progression prospects, weighing on productivity and contributing to high levels of in-work poverty. There is scope to improve the effectiveness of the education and training systems in basic and technical skills. The government is making reforms to both classroom and work-based training, but overall registrations for the new twin-track system are far fewer than expected.
- (13) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of the United Kingdom's economic policy and published it in the 2019 country report. It has also assessed the 2018-2019 Convergence Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to the United Kingdom in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in the United Kingdom, but also their compliance with Union rules and guidance. This reflects the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (14) In the light of this assessment, the Council has examined the 2018-2019 Convergence Programme and its opinion⁶ is reflected in particular in recommendation (1) below.

HEREBY RECOMMENDS that the United Kingdom take action in 2019 and 2020 to:

1. Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.9% in 2020-2021, corresponding to an annual structural adjustment of 0.6% of GDP.
2. Focus investment-related economic policy on research and innovation, housing, training and improving skills, sustainable transport and low carbon and energy transition, taking into account regional diversity.

Done at Brussels,

*For the Council
The President*

⁶ Under Article 5(2) of Council Regulation (EC) No 1466/97.