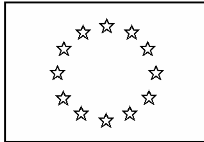

EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 28 January 2003
ECFIN/631/02- EN

2002 UPDATE OF THE CONVERGENCE PROGRAMME OF THE UNITED KINGDOM (2001-02 TO 2007-08)

AN ASSESSMENT

TABLE OF CONTENTS

SUMMARY AND CONCLUSIONS 2
1. INTRODUCTION 4
2. IMPLEMENTATION OF THE PREVIOUS UPDATE 5
3. MACROECONOMIC ASSESSMENT 6
   3.1 External economic assumptions 6
   3.2. Macroeconomics developments 6
4. MEDIUM TERM MONETARY POLICY OBJECTIVES AND THEIR RELATIONSHIP TO PRICE AND EXCHANGE RATE STABILITY 9
   4.1 Inflation developments 9
   4.2. Exchange rate developments 9
   4.3. Interest rate developments 10
5. BUDGETARY TARGETS AND MEDIUM-TERM PATH OF PUBLIC FINANCES 10
   5.1 Programme overview 10
   5.2. Public finances in 2003-04 12
   5.3. 2004-05 and beyond 14
   5.4. Debt ratio 14
   5.5. Sensitivity analysis 15
6. SUSTAINABILITY OF PUBLIC FINANCES 15
7. STRUCTURAL MEASURES AND OTHER REFORMS WITH LIKELY BUDGETARY IMPACT . 16
8. OVERALL ASSESSMENT OF COMPLIANCE WITH THE SGP 16

ANNEX 1 : SUMMARY TABLES DERIVED FROM THE 2002 UPDATED CONVERGENCE PROGRAMME 18

ANNEX 2 : THE QUANTITATIVE ASSESSMENT OF THE SUSTAINABILITY OF PUBLIC FINANCES 22

SUMMARY AND CONCLUSIONS

The fourth update of the convergence programme, called "Sustainability for the Long Term", is a clear, comprehensive, statement of UK economic and budgetary policy and prospects. It broadly conforms to the Code of Conduct agreed for stability and convergence programmes. The economic policies as reflected in the planned measures in the convergence programme update comply in part with the 2002 Broad Economic Policy Guidelines.

It is appropriate that the programme stresses, as did the previous programme, the importance of securing macro-economic stability supported by sound monetary and fiscal policies and continued structural reform. These policies have delivered low and stable inflation in recent years; close to the lowest in the EU in recent months. The programme considers that the macro-economic policy framework leaves the UK better placed than on previous occasions to cope with instability in the global economy.

The UK has enjoyed steady growth in recent years. The public finances have shown surpluses in the years 1998-99 to 2000-01 and the gross debt to GDP ratio is one of the lowest in the EU. Unemployment rates are around the lowest since the 1970s; again, among the lowest in the EU. GDP growth has been lower than expected in 2002 in a framework of a weak global environment but has been sustained by strong household consumption and growth in public expenditure, both current and fixed investment. The government finances moved into a small deficit in 2001-02 and the deficit is expected to rise substantially, to 1.8% in 2002-03. This is largely due to the effects of the global slowdown and especially its effects on financial company profits and associated tax revenues. But it also rises due to planned increases in discretionary expenditure.

The economic projections reported in the programme to 2005 (the last year for detailed economic projections) suggest a closing of the negative output gap by 2005 as the global environment recovers with GDP growth centred on 2¾% in 2003 – around trend growth. Growth is expected to rise to 3¼% (centre of the range) in 2004 and 3% in 2005. Inflation is projected to be a little below target of 2½% (RPIX measure) in 2003 and on target thereafter.

This outlook in 2003 and 2004 is more positive than that of the Commission services' Autumn forecasts, though the latter also see a substantial acceleration in GDP in 2003 as the global outlook improves. The programme sees a more rapid closing of the negative output gap and, in particular, a more rapid rise in fixed investment. In the short run, to 2004, the programme's economic projections appear to be on the optimistic side.

The programme presents projections and analyses of the public finances to 2007-08. These are also presented in cyclically adjusted terms. The projections show a surplus on current balance, on average, to the end of the programme period in 2007-08 which would be in line with the government's "golden rule". Gross government debt relative to GDP falls to 37.9% in 2002-03 before rising a little to stabilise around 39% in 2003-04 to the end of the programme period in 2007-08. However, the general government balance is seen to move from a slight deficit of 0.2% of GDP in 2001-02 to one of 1.8% in 2002-03 and 2.2% in 2003-04 before falling to 1.7% in 2004-05 and

1.6% in the subsequent years to 2007-08. In cyclically adjusted terms, the deficit would rise from 0.2% in 2002-03 to 1.4% in 2003-04 and by the end of the programme to 1.6% of GDP in 2006-07 and 2007-08. Compared to the previous programme update, the projected deficit is now 0.7% of GDP higher in 2002-03 and 0.9% higher in 2003-04 for cyclical reasons especially that of lower receipts associated with depressed financial company profits which are expected to be transitory. However, the cyclically adjusted balance, at 1.6% of GDP in 2006-07 and subsequently, is now some 0.6 of a percentage point of GDP higher than in the previous update. This results from further rises in planned discretionary expenditure, especially investment expenditure, announced since the last programme.

The trend growth assumption of 2½% to 2006-07, for public finance purposes, while higher than the 2¼% assumed in the last update, is a little lower than the programme's neutral trend assumption of 2¾%. The latter is in line with Commission services calculations. For example, application of this trend growth, by the Commission services, yields a cyclically adjusted deficit that declines to 1.2% of GDP in 2005-06 compared to the 1½% of the programme. Moreover, the cyclically adjusted deficits would result, in very large part, from the welcome 'reversal' of the historic decline, to low levels - around the lowest in the EU - of net public investment relative to GDP, in line with the 2002 Broad Economic Policy Guidelines. This is projected to rise from 0.9% in 2001-02 to 2.2% in 2007-08.

In its recent Communication on *Strengthening the co-ordination of budgetary policies*[1], the Commission suggested that a small deviation from the 'close to balance or in surplus' requirement of a longer-term nature be envisaged for Member States where debt levels are well below the 60% of GDP reference value, and when public finances are on a sustainable footing. The projections in the UK updated convergence programme show a low and stable level of the general government gross debt-to-GDP ratio from 2003-04. It is also noted that on the basis of current policies and the assumptions in the programme, ageing populations are projected to have a limited impact on public spending on pensions as a share of GDP. Given these considerations, the UK could envisage running a small deviation from the 'close to balance or in surplus' requirement without jeopardising the sustainability of the public finances in the longer term. However, the deficits projected for the later years of the programme are at around 1½% of GDP, both actual and cyclically adjusted. It is also noted that the relatively high projected deficit of 2.2% of GDP in 2003-04 is based on an optimistic 2¾% GDP growth assumption. Such budgetary plans could lead to a deficit that could potentially approach the 3% of GDP threshold and, consequently, they would not be in line with the medium-term requirement of the Stability and Growth Pact. Consequently, the UK authorities should aim for a 'medium-term' budgetary deficit that is small enough to ensure that the 3% deficit ceiling is not breached in any year.

The attention paid to the sustainability of public finances in the convergence programme is welcome. The variety of indicators used to examine long-run budgetary challenges and issues related to intergenerational equity are very useful. It is considered that on current policies and the assumptions in the programme, the UK is well placed to meet the budgetary costs associated with ageing populations. Much of the financial sustainability of the pension system depends on the performance of

[1] COM (2002)668 final, 27.11.2002

private pension providers. If private provision produces significantly less than the anticipated coverage or level of pensions, future governments may face increased claims of means-tested benefits. However, a budgetary position of a limited deficit in the medium term would help avoid any risk of emerging budget imbalances in the context of ageing populations, and give greater assurance to the programme view that "the public finances, based on current policies, are sustainable in the long-term".

The programme describes measures of economic reform intended to deliver high-quality public services. It also describes measures to achieve the goal of a higher proportion of people in work in 2010 than ever before and to achieve a higher sustainable rate of productivity growth. In view of the relatively low level of productivity in the UK, compared to its competitors, these measures are considered desirable.

The convergence criteria on inflation and interest rates are assessed to be fulfilled with some margin. On EMU, the programme refers to the policy set out in 1997 and the 'five tests' assessment that will be made by June 2003. The programme believes that exchange rate stability can only be achieved on the basis of sound economic fundamentals so it is considered as the outcome of, and not the target for, all other economic policies. While there may be problems in the internationally tradable goods sector, the UK economy seems to be living with an exchange rate that is higher than that seen in the mid 1990s. Though there is some evidence to suggest that exchange rate volatility has declined in recent years, a reversal of such a trend remains a possibility. If it occurs, this may result in a less stable macro-economic path and government finances than those projected in the programme. In this context, ERM2 membership, once a judgement on the appropriate parity between the pound and the euro has been made, could add another pillar of stability to the sound and effective fiscal and monetary framework in place.

1. INTRODUCTION

The fourth update of the convergence programme[2] was submitted to the Commission on 19 December 2002. It is based on the Pre-Budget Report (PBR) published on November 27. The programme contains no new policy initiatives other than those described in the PBR, and so is not subject to additional parliamentary approval. This update extends the period covered, by one year, to 2007-08. Detailed macro-economic forecasts are presented to 2005.

The update broadly conforms to the Code of Conduct agreed for stability and convergence programmes[3]. It is a clear and comprehensive description of economic and fiscal policy and prospects. The fiscal objectives are framed in terms of the public

[2] The first update covered the period 1998/99 to 2004/05 and was assessed by the Commission and the Council gave its opinion in February 2000 (OJ, C 98, (2000/C 98/05), 6.4.2000). The second update covered the period 1999/2000 to 2005/06 and was assessed by the Commission and the Council gave its opinion in February 2001 (OJ, C 77, (2001/C 77/02), 9.3.2001). The third update covered the period 2000/2001 to 2006/07 and was assessed by the Commission and the Council gave its opinion in February 2002 (OJ, C 51, (2002/C 51/06), 26.2.2002).

[3] Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

sector (including public corporations) but projections, though for financial years only, are also made for the general government finances. Projections are made over a sufficiently long period, to 2007-08, to assess compliance of the finances with the 'close to balance or in surplus' medium-term objective of the Stability and Growth Pact. A clear and plausible account of policies to secure sustainability of the finances in the longer term is contained along with projections to 2051-52 to demonstrate that the UK is well placed to meet the challenges of ageing populations. Indeed, "Sustainability for the Long Term" is the title of the programme.

The update, like its predecessors, appropriately focuses on the policies implemented by the government to achieve macro-economic stability and describes the success of such policies. The framework for these policies defines clear policy objectives and an allocation of responsibility that gives accountability. The co-ordination of monetary and fiscal policy is described and noted, appropriately, as playing an important role in delivering economic stability.

Fiscal rules are again noted:

- The golden rule – that is, over the economic cycle, the public sector will only borrow to invest and not fund current spending and
- The sustainable investment rule where public sector net debt as a proportion of GDP will be held, over the economic cycle, at a stable and prudent level.

The authorities stress that since the fiscal rules are set over the cycle, the automatic stabilisers are allowed to operate fully.

A trend GDP growth estimate of 2½% to 2006-07 and 2¼% in 2007-08, underpins the public finance projections and these are more cautious than the 2¾% neutral trend growth rate underpinning the economic forecasts. The caution is intended to take account of possible misjudgement about trend growth in the medium term. In addition, a public finance scenario is described where the level of trend output is 1 percentage point below the central case.

The main messages that come across from a reading of the programme are that the UK seems better placed than on previous occasions to maintain stability to cope with global instability. It has a sound macro-economic policy framework and economic position. Public finance projections show the government's fiscal rules being achieved. Debt levels are low. The programme's reading is that the (fiscal) projections are consistent with a prudent interpretation of the Stability and Growth Pact.

2. IMPLEMENTATION OF THE PREVIOUS UPDATE

Economic growth is expected to be lower, at 1½% in 2002, than the 2 to 2½% forecast in the 2001 update. Inflation, in 2002, is slightly higher than expected in the last programme. Sterling has remained relatively stable, throughout 2002, though it has fallen relative to the euro and risen relative to the US dollar. Long term interest rates are close to those in the euro area.

The general government deficit for 2001-02 was as projected in the last programme, at 0.2% of GDP, but the expectation for 2002-03 is now for a higher deficit of 1.8% of

GDP compared to a projected 1.1% in the last programme. It is higher than the outturn for calendar 2002 of 1.4%. Much of the shortfall may be attributed to lower than expected tax revenues associated with the global slowdown, especially those associated with profits of financial companies. Much of this is regarded as temporary and the projected cyclically adjusted deficit in 2002-03 of 1.1% of GDP is little different from the 1% projected in the last programme. The fall in the gross debt-to-GDP ratio to end 2002-03 is a little less than was foreseen in the 2001 update but debt is nevertheless very low and one of the lowest in the EU. A comparison with the previous update is shown below

Table 2.1. Comparison with previous update

% of GDP	2001	2002	2003	2004	2005
GDP growth					
previous update	2¼	2 to 2½	2¾ to 3¼	2¼ to 2¾	
latest update	2	1½	2½ to 3	3 to 3½	2¾ to 3¼
Actual budget balance					
previous update	-0.2	-1.1	-1.3	-1.1	-1.0
latest update	-0.2	-1.8	-2.2	-1.7	-1.6
Gross debt levels					
previous update	38.1	37.2	37.0	36.8	36.6
latest update	38.2	37.9	38.8	38.9	38.9

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3. MACROECONOMIC ASSESSMENT

3.1. External economic assumptions

These assumptions are not specified in detail in the programme. However, the Pre-Budget Report (PBR), from where the forecasts are taken, does not suggest a greatly different external macro-economic scenario from that assumed in the Commission Autumn forecasts. The programme projects UK export market growth in 2003 at 5% compared to the Commission services 5.8% but in 2004 has a more optimistic 8% compared to 6.6% of the Commission services.

3.2 Macroeconomic developments

3.2.1 Macroeconomic scenarios compared

The programme projects slower growth in 2002 than in 2001 as a result of the downturn in the global economy but, at 1½%, GDP growth will still be moderate. Growth in 2002 has been characterised by the dichotomy of strong household consumption but weak fixed investment and exports. Growth, centred on 2¾%, is expected in 2003. This is a little more optimistic than the Commission services Autumn forecast and indeed other forecasters. As in the Commission services forecasts, growth is sustained by continuing household expenditure growth, albeit slower than in 2002, and strong government expenditure growth together with a revival of investment expenditure. The latter is, however, much stronger in the programme's projections than in the Commission services forecasts. In 2004, GDP accelerates to above trend, centred on 3¼% compared to a 2.7% in the Commission services forecasts. The difference is largely explained by stronger household consumption growth and a stronger revival in UK markets in the update. Above trend

GDP growth is expected to persist, at a centred 3%, in 2005 in the update. The output gap in the programme is a negative 1¼% in 2002 that reduces to zero by mid-2005; it is based on 2¾% trend growth.

The inflation outlook for 2003 and 2004 is for the inflation target[1] of 2½% to continue to be met and the Commission services forecast, albeit on the HICP measure, is consistent with this.

Table 3.1 – Forecasts compared

Economic Forecasts 2002-2004 (% change on previous year)							
	2001	**2002**		**2003**		**2004**	
	Outturn	**CP 2002**	**COM autumn forecast**	**CP 2002**	**COM autumn forecast**	**CP 2002**	**COM autumn forecast**
GDP	2	1½	1.6	2½-3	2.5	3-3½	2.7
Household consumption	4	3½	3.5	2¼-2½	2.3	2¾-3¼	2.2
Fixed investment	¼	-4¼	-4	6½-7	2.7	4-4½	3.5
General gov. consumption	3	4½	3.7	3¾	3.0	3	3.0
Exports of goods and services	1¼	-1¾	0.0	3¾-4¼	5.1	7¾-8¼	5.9
Imports of goods and services	2¾	¼	1.4	4¾-5	4.9	7-7½	5.3
CPI	2[1]	2½[1]	1.2[2]	2¼[1]	1.5[2]	2½[1]	1.8[2]
Budget surplus (% of GDP)	0.7	-1.8[3]	-1.1[4]	-2.2[3]	-1.3[4]	-1.7[3]	-1.4
Debt (% GDP)	39.1	37.9[3]	38.5	38.8[3]	38.1	38.9[3]	37.6

[1] RPIX Q4
[2] HICP
[3] Financial years 2002-03, 2003-04, 2004-05 respectively
[4] The Commission services forecasts were finalised before the Pre-Budget report, on which the update is based, was released.

In the near term, the programme's forecasts for GDP growth are more optimistic than those of the Commission services in 2003 and 2004. Consequently there is a more rapid closing of the negative output gap in the programme. The programme's forecasts are also more optimistic than the average of independent forecasts for 2003. In particular, the forecasts of the IMF and OECD are for lower GDP growth of 2.4% and 2.2% respectively. They were made, respectively, in October and December of last year. The programme itself is aware of risks both upside and downside; the former include the (positive) effect of accommodating fiscal and monetary policy on the global recovery and a possible recovery in world stock markets. The latter include the negative effects of continued investor uncertainty delaying investment recovery and the impact of further equity falls on household wealth affecting household consumption. To the latter could be added the effects of a possible fall in house prices on household wealth and consequently consumption and the possible negative effects on consumption of the recent accumulation of gross debt to finance house purchase. All in all the short term forecasts of the programme appear on the optimistic side.

3.2.2 Potential growth and the output gap

[1] Based on RPIX (Retail Prices index excluding mortgage interest payments)

The programme's estimate of trend growth is 2¾% a year. This results from a consideration of developments in labour productivity, hours worked, the employment rate and the population of working age. They are based on recent patterns and demographic projections. They seem plausible. The estimate is consistent with the results derived from the Commission services Autumn forecast and is also consistent with the production function methodology applied to the economic assumptions underlying the programme as is reported below.

However, for the public finance projections, described later, the programme uses a more cautious estimate of trend growth of 2½% to 2006-07 (revised up from the 2¼% of the last update) and 2¼% in 2007-08. Together with the growth assumptions, this gives, in the programme, an output gap that is a negative 1.3% in 2002-03 and closes to zero by 2005-06 (Table 4 in Annex 1). The programme estimate of trend growth is not based on the Commission services production function methodology. However, as a check on the results the Commission services used, to the extent possible, the information in the programme's economic forecast to derive potential output growth rates and output gaps based on the production function approach. The information of the programme, allows this to be done until calendar year 2005. These are tabulated below:

Table 3.2 – Potential growth and output gaps

	2002 updated convergence programme			Commission's autumn 2002 forecast		
	GDP growth	PF Potential growth[1]	Output gap[1]	GDP growth	PF Potential growth	Output gap
2000	3.1	2.8	0.9	3.1	2.8	0.9
2001	2.0	2.8	0.0	2.0	2.8	0.0
2002	1½	2.5	-0.9	1.6	2.5	-0.9
2003	2½	2.6	-1.1	2.5	2.6	-0.9
2004	3	2.7	-0.8	2.7	2.6	-0.8
2005	2¾	2.8	-0.8		2.7	
2006					2.7	
2007					2.6	

[1] Commission services calculations. They are based on programme assumptions and the lower end of the GDP growth ranges
Comments:
GDP and potential growth as percentage change. The HP trend growth rate is 2.5% from financial year 2001-02 to 2004-05.

The calculations reveal that the programme projections are indeed consistent with a potential growth rate of 2¾%, in line with the neutral assumption of the programme. This also suggests that the 2½% trend growth underlying the public finance projections is on the cautious side, especially in the outer years of the programme. As a result, on the basis of the Commission calculations, a negative output gap persists at a little under 1% to 2005-06 in contrast to the closing of the gap in the programme's projections [Table 4 in Annex]. The analysis of the underlying budgetary position is made in section 5 below.

4. MEDIUM TERM MONETARY POLICY OBJECTIVES AND THEIR RELATIONSHIP TO PRICE AND EXCHANGE RATE STABILITY

4.1 Inflation developments

In recent months, RPIX inflation has ranged from 1.5% in June to 2.8% in November. The rate of inflation was very subdued during the first three quarters of 2002, and the rate of earnings growth has been relatively slow, despite low unemployment. The RPIX then picked up during Q4 as the effects of the fall in petrol prices in October 2001 dropped out of the annual comparison and the continuing rapid pace of house price inflation affected the RPIX index through the contribution of housing costs.

The updated Convergence Programme notes the widening gap between goods and services price inflation during 2002. Services price inflation picked up, while weak but highly competitive global markets ensured that downward pricing pressures on the tradable goods sector continued.

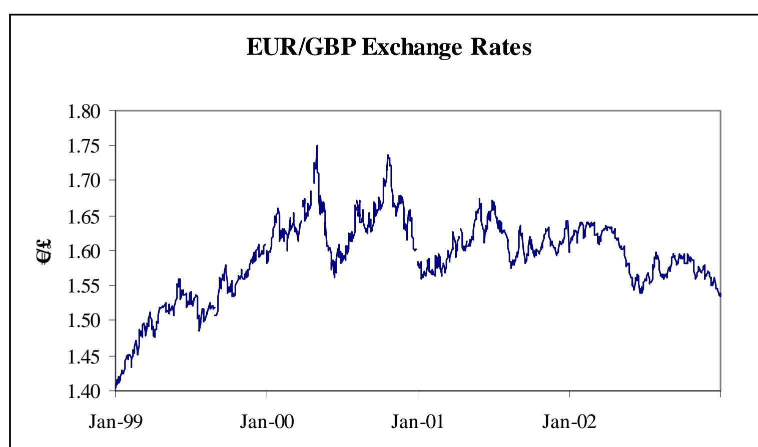
The UK authorities expect RPIX inflation to fall back again to marginally below target during 2003, as a result of slack in the economy. Thereafter, it is expected to rise to target during 2004 as output moves back towards potential and import prices pick up.

This projection looks plausible, though there are short-term risks on both the downside and the upside. The former would include downward pressure on margins resulting from the expected slow-down in growth of household consumption. On the upside, there is a chance of higher-than expected oil prices, and the continued rapid rises in UK house prices may continue to boost the housing component of RPIX. A fall in the exchange rate, addressed below, remains an upside risk.

On an HICP basis, UK inflation was 1.7% in December. It continues to be among the lowest in the EU and would allow the UK to comfortably meet the convergence criterion on inflation.

4.2 Exchange rate developments

In 2002, the UK's nominal effective exchange rate index moved only within a narrow range and at the beginning of 2003, it was practically unchanged from a year earlier. In bilateral terms, sterling's value against the euro has stayed within a range of 1.52 to 1.64 euros per £ for most of the period since January 2001. Over the same period, sterling's value against the dollar has risen by around 9%.



The programme contains no explicit assumptions on GBP exchange rates and the implication is that the macroeconomic scenario assumes a broadly unchanged nominal effective exchange rate. This assumption may be appropriate on technical grounds. However, it is worthwhile recalling previous concerns about the uncertainty surrounding the evolution of the GBP over the medium term. In particular, some PPP measures and equilibrium exchange-rate estimates suggest that the GBP is significantly "overvalued" against the euro. There is also an argument that the current GBP/EUR exchange rate is justified by improvements in the fundamentals behind UK's recent economic performance relative to the euro area. These considerations suggest that the outlook for the GBP exchange rate against the euro – and, hence, in nominal effective terms – is a source of uncertainty in assessing the macroeconomic scenario underlying the programme. While there may be problems in the internationally tradable goods sector, the UK economy seems to be living with an exchange rate that is higher than that seen in the mid 1990s. However, ERM2 membership, once a judgement has been made, could add another pillar of stability to the sound and effective fiscal and monetary framework in place.

4.3 Interest rate developments

The fall in UK interest rates in recent years can be seen as a reflection of both lower inflation and reduced inflationary expectations. Inflation remained a little below target for much of 2002, and base rates stood at 4 per cent throughout 2002 (their lowest level since 1964) following the 2 percentage-point cumulative easing during 2001.

At the short end of the yield curve, three-month rates have moved in line with policy rates. The interest rate differential between the UK three-month interest rate and that of the euro area is currently at around 115 basis points.

Although long-term interest rates rose to around 5.2% in mid-2002, they have since fallen, to reach 4.5% at the beginning of January 2003. The yield differential with respect to the euro area is only 20 basis points currently. The UK would therefore easily fulfil the Treaty criterion with respect to the long-term interest rate.

5. BUDGETARY TARGETS AND MEDIUM-TERM PATH OF PUBLIC FINANCES

5.1. Programme overview

The thrust of the programme is the achievement of sustainable public finances as a pre-requisite to achieving long-term economic growth. According to the update, this is secured, over the programme period, by the government meeting its fiscal rules of a current budget surplus over the cycle and a low sustainable net debt level. The long-term shape of the public finances is demonstrated by details of public expenditure projections to 2051-52. The public finances are projected on the basis of existing policies and on audited assumptions, including the 'cautious' trend GDP growth assumption, for public finances, of 2½% to 2006-07. Other audited assumptions that can be called cautious include rising unemployment, a fall in VAT receipts relative to consumers' expenditure and a stock market that does not recover relative to nominal GDP.

After a period of consolidation, the public finances moved from a surplus of 1.7% of GDP in financial year 2000-01 to a deficit of 0.2% in 2001-02. The deficit is expected to rise substantially to 1.8% of GDP in 2002-03 as GDP growth slows, revenues are adversely affected and expenditure rises, as planned, as a share of GDP. This rise is in line with the outturn of a deficit of around 1.4% of GDP in calendar year 2002. This is higher than the Commission services' Autumn forecast of a deficit of 1.1% of GDP. The latter proved to be an under-estimate because it did not take full account of the effect of lower financial company profits and recent stock market falls, on revenues. These are estimated, in the programme, to increase the deficit in 2002-03 by around ½% of GDP since budget time.

The deficit is projected to rise to 2.2% of GDP in 2003-04 as investment expenditure is planned to rise further and the effect of the weakness in financial company profits persists. Thereafter, the projected deficit falls to 1.7% in 2005-06 and 1.6% subsequently as the adverse effects on revenue, associated with the slowdown in growth, fade. These projections show somewhat greater deficits than those of the last programme update when the deficit was around 1% of GDP by the end of he programme period in 2006-07 as shown in Table 2.1. This rise in deficit at the end of the programme period, compared to previous projections, results from a further rise in investment expenditure compared to previous plans. Gross debt relative to GDP rises a little from its 38.2% at the end of 2001-02 but stabilises around 39% from 2003-04 to the end of the programme in 2007-08.

The update includes projections on the cyclically adjusted general government balance based on the cautious 2½% trend growth assumption and these are shown in the Annex in Table 4. Table 5.1 reports the cyclically adjusted balance calculated by the Commission services, using potential output growth based on the production function approach using the economic assumptions and the unadjusted fiscal projections of the programme. The potential growth rates underlying these calculations are reported in Table 3.2 on the left hand side and have been adapted for the financial year basis of the programme projections of the public finances. The cyclically adjusted budget deficits calculated by the Commission on the basis of the programmes' assumptions decline from 2003-04 and in 2005-06 become lower than those reported in the programme. This is because the Commission, on the basis of these calculations, arrives at a higher trend growth rate than the 2½% behind the cyclically adjusted public finance projections[4]. Consequently, the programme's projections of the cyclically adjusted deficits, towards the later years, may be termed 'on the cautious side'. However, the programme's trend growth assumption is in line with calculations derived from the HP filter. The basis of the programme's cyclically adjusted projections may be considered cautious, but not unduly so.

[4] The cyclically adjusted deficits in the very short term, in 2002-03 and 2004-05, on the left hand side, are higher than those in the programme, reported in Table 4 in Annex 1. This is, in very large part, because the actual deficit in these years is inflated by the big revenue shortfall associated with depressed financial company profits – equivalent to around ½% of GDP. This shortfall is expected to be transitory in the programme and fades away. However, this transitory nature is not allowed for in the Commission services calculation. These may consequently exaggerate the size of the cyclically adjusted deficit in 2002-03 to 2004-05 .

Table 5.1 – Public finances (% of GDP)

	2002 updated convergence programme[2]			Commission's autumn 2002 forecast	
	Budget balance	CAB (Programme)	CAB[1]	Budget balance	CAB
2000	1.7			4.0	1.2
2001	-0.2	-0.2	-0.1	0.7	0.7
2002	-1.8	-1.1	-1.4	-1.1	-0.6
2003	-2.2	-1.4	-1.8	-1.3	-0.9
2004	-1.7	-1.3	-1.4	-1.4	-1.0
2005	-1.6	-1.5	-1.2	-	-
2006	-1.6	-1.6			
2007	-1.6	-1.6			

[1]Commission services calculations
[2] Programme years are financial – 2000-01 to 2007-08

5.2. Public finances in 2003-04

5.2.1 The Budget for 2003-04

The budget for 2003-04 will be announced, soon, in the Spring and further measures may be expected then with associated budgetary impact in 2003-04 and subsequent years. While some measures were announced in the Pre-Budget Report their budgetary impact is small.

Expenditure

Expenditure plans for 2003-04 were laid down in July's Comprehensive Spending Review. (This Review also covers spending to 2005-06).

Table 5.2 General government expenditure (% of GDP)

	2001-02	2002-03	2003-04	2004-05	2005-06
Current expenditure on goods and services	19.8	20.3	20.8	20.8	21.3
Net social benefits	12.5	12.5	12.5	12.3	12.2
Net current grants	1.8	2.1	2.3	2.5	2.5
Interest and dividends paid	2.3	2.0	2.0	2.1	2.0
Subsidies	0.6	0.6	0.6	0.6	0.6
Margin	0.0	0.0	0.1	0.0	0.0
Total current expenditure	**37.0**	**37.5**	**38.3**	**38.3**	**38.6**
Net investment	1.1	1.5	1.9	2.1	2.2
Total expenditure	**38.1**	**38.9**	**40.3**	**40.4**	**40.8**

Expenditure is planned to rise substantially as a share of GDP, in 2003-04 - by 1.4 percentage points (of which 0.5 of a percentage point is accounted for by current expenditure and 0.4 percentage points is accounted for by net investment). However, there has been some slippage of investment expenditure in recent years. In the last programme update, on a slightly different coverage from the general government sector reported above, public sector net investment was projected to be 1.3% of GDP in 2001-02 yet the outturn reported in the latest update was 0.9%. The rise in current expenditure is partly offset by revenue increases announced in the 2002-03 budget.

Given that discretionary expenditure is set by strict limits over the next three financial years in the Comprehensive Spending Review, the expenditure projections, on the basis of announced policy, look plausible.

Receipts

Table 5.3 General government receipts
(% of GDP)

	2001-02	2002-03	2003-04	2004-05	2005-06
Taxes on income and wealth	14.5	13.8	14.0	14.7	15.1
Taxes on production and imports	13.7	13.8	13.7	13.7	13.7
Other current taxes	1.8	1.9	1.9	1.9	2.0
Taxes on capital	0.2	0.2	0.2	0.3	0.3
Social contributions	6.4	6.2	7.0	7.0	7.0
Interest income	1.1	1.0	1.0	1.0	1.0
Other	1.0	1.0	1.0	1.0	0.9
Total current receipts	**38.8**	**38.0**	**38.9**	**39.6**	**40.0**

Receipts are expected to rise in 2003-04, relative to GDP, as the rise in social contribution rates and other tax changes, announced in the 2002 budget, takes effect and economic growth recovers to raise taxes on income and wealth. Receipts are based on a 2¾% growth in GDP in 2003-04 which appears optimistic. However, despite the rise in social contributions, receipts only remain around those in 2001-02, relative to GDP. This results from the restraining effect of cyclical factors; particularly those associated with weakness in financial company profits.

5.2.2 General government finances in 2003-04

A deficit of 2.2% of GDP is projected in the programme in 2003-04 – a rise from 1.8% in 2002-03 - as expenditure is planned to increase more than the rise in revenue. It is much higher than the 1.3% of GDP deficit implied by the Commission services for 2003 but the latter is rather optimistic, as, again, it does not take full account of the weakness in revenue resulting from depressed financial company profits. It is recognised that the public finances are projected on audited assumptions that may be on the cautious side. Nevertheless the GDP growth projection, underlying the public finances, in 2003-04 is 2¾% which cannot be deemed cautious. It is higher than the Commission Services forecast and higher than those implied by the average of other forecasters. Lower growth than expected, could result in a higher deficit than the 2.2% of GDP projected in 2003-04.

5.3 2004-05 and beyond.

Announced plans suggest a rise in expenditure relative to GDP of 0.5 percentage points from 2003-04 to 2005-06 to 40.8%. The rise comes from planned rises to improve delivery of public services, including investment. A small fall in social benefits expenditure is projected as, among other factors, benefits are up-rated by inflation based on the Retail Prices Index (RPI) which is projected to be low.

Receipts are projected to recover further as the output gap is expected to return to zero by 2005-06 from a negative 1% in 2003-04. In particular, the adverse effects of low financial company profits fade away.

The consequence of the recovery in receipts is that the actual projected deficit falls from a peak of 2.2% in 2003-04 to 1.6% in 2005-06 and subsequently.

Given the existence of a negative output gap currently (of around 1%), that is expected to persist into 2003-04, it is reasonable to project the gap to close over the programme horizon. The actual deficit may therefore be expected to fall from 2003-04 as projected in the programme. There is of course a risk that the fall in the deficit may be more gradual than projected in the programme as downside risks to economic growth may persist in the short term. In particular, the 3% GDP growth assumption for 2004-05 may prove to be optimistic.

The programme provides calculations of the cyclically adjusted balance. These reveal a deficit of 1.1% in 2002-03 rising to 1.6% in 2006-07. The rise results from the planned rise in expenditure, (especially net investment which is projected to rise from 1.4% of GDP in 2002-03 to 2.1% in 2006-07). As discussed in Section 5.1 above, the programme's calculations are based on assumptions that appear to be cautious, but not unduly so.

5.4 Debt ratio

The general government gross debt ratio, at 38.2% of GDP in 2001-02, was well below the 60% reference level. In the 2001 update, a reduction in the debt ratio was foreseen to the end of the programme period. In the 2002 update a small rise, to 39.1% by 2006-07, is foreseen though most of this occurs between 2002-03 and 2003-04 and the ratio remains stable thereafter.
The difference in debt projections between updates results from the larger deficits foreseen in the latest update and, to a smaller extent, slower growth of nominal GDP. Gross debt nevertheless remains low relative to GDP and in net terms for the slightly wider public sector (that is, after accounting for short-term financial assets) is even lower at 33% - quoted in the update as being the lowest in the G7 and among the lowest in the EU. It is this definition that the government uses to gauge compliance with its 'sustainable investment' rule. Table 5.3 compares the gross debt developments according to the previous update, the current update and the Commission's scenario.

Table 5.4 – Debt developments compared

% of GDP	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Gross debt levels						
2001 update	38.1	37.2	37.0	36.8	36.6	36.3
2002 update	38.2	37.9	38.8	38.9	38.9	39.1
Commission scenario[1]	39.1	38.5	38.1	37.6		

[1] Calendar years 2001 to 2004

5.5 Sensitivity analysis

The programme reports that if GDP growth were one percentage point higher or lower than that assumed over the coming year, net borrowing might be lower or higher than 0.7 percent of GDP, after two years. Another reason for uncertainty, in the medium term, is where the economy is in relation to its sustainable path. An alternative projection is made in which the output gap is 1% higher than the central view. Such a gap lowers the structural surplus on current budget by around ¾% of GDP a year. The average cyclically adjusted public finance position, on current account, is forecast to be in surplus over the economic cycle and so the golden rule is still upheld. Nevertheless projections on this basis would take the public finances, in cyclically adjusted terms, further away from the 'close to balance or surplus" medium-term requirement of the Stability and Growth Pact. (by around ¾ percent of GDP a year)

6. THE SUSTAINABILITY OF PUBLIC FINANCES

The 2002 updated convergence programme contains a detailed section on the sustainability of public finances. It includes national projections for age-related public expenditures which show an overall increase in age-related spending of 4.6 % of GDP between 2001-02 and 2051-52. The convergence programme also contains a variety of indicators to assess the sustainability of public finances and intergenerational equity. This section draws on the analysis reported in Annex2.

It is first necessary to consider whether current budget polices can ensure that the SGP will be respected in the future in light of the budgetary implications of ageing populations. The Commission considers that on the basis of current policies, the UK is in a relatively good position to meet the budgetary costs associated with ageing populations, in part due to the relatively low level of implicit pension liabilities.

A second issue is whether the budgetary strategy outlined in the programme is compatible with improving the sustainability of public finances. The medium-term budget projection in the programme is for a deficit of around 1½% of GDP in 2005-06 to 2007-08. A more ambitious outcome, in the medium-term, of a small limited deficit, below that of the current programme projections, would help avoid any risk of emerging budget imbalances in the context of ageing populations and give greater assurance to the programme view that the public finances are sustainable on current policies in the long-term

Finally, it is necessary to consider the type and scale of the budgetary challenges that will emerge in coming years to ensure sustainable public finances. A conclusion that public finances are in a good position to meet budgetary costs of ageing populations is to a considerable extent based on the fact that the demographic changes underway, and in particular the large projected increase in the old-age dependency ratio, are projected to have little or no impact on public spending on pensions as a share of GDP. Such projections are in marked contrast with those of other Member States where significant increases in public spending are projected in coming decades: it largely arises because the pension projections of the UK (as required by the Ageing Working Group of the EPC) are based on a 'no policy change' assumption, which *inter alia* involves the strict indexation of pension entitlements to prices. Much of the financial sustainability of the pension system depends, to a larger extent than in other countries, on the performance of private pension providers. If private provision

produces significantly less than the anticipated coverage or level of pensions, future governments may face increased claims of means-tested benefits.

7. STRUCTURAL MEASURES AND OTHER REFORMS WITH LIKELY BUDGETARY IMPACT

The projections take account of the Government's latest spending plans that channel extra resources into public services. The long term goal is to deliver world-class public services through investment and reform while ensuring that taxpayers receive value for money. In particular, the plans are designed to fund long-term improvements in healthcare. Spending on the National Health Service is planned to rise by a real 7.4% a year to 2007-08. Budget 2002 raised national insurance contributions and froze income tax allowances to finance this. Further, a significant planned increase in capital investment would reverse a long-term decline as recommended in the 2002 BEPGs. It is noted that the cyclically adjusted balance declines by 2.8 percentage points of GDP between 2000-01 and 2007-08. Of this, 1.6 percentage points results from the planned rise in net investment. The planned rise in net investment is consistent with the targeting of the driver of productivity performance – encouraging investment to improve the stock of physical capital in all sectors and industries.

8. OVERALL ASSESSMENT OF COMPLIANCE WITH THE SGP

The public finances are projected to show a deficit, both nominal and cyclically adjusted, of around 1½% of GDP from 2004-05 to the end of the programme period.

Gross debt is low relative to GDP and is stable at around 39% from 2003-04 to the end of the programme period in 2007-08.

In its recent Communication on strengthening the co-ordination of budgetary policies, the Commission suggested that a small deviation from the 'close to balance or in surplus' requirement of a longer-term nature be envisaged for Member States where debt levels are well below the 60% of GDP reference value, and when public finances are on a sustainable footing. The projections in the UK convergence programme show a low and stable level (around 39%) of the general government gross debt-to-GDP ratio from 2003-04. It was also noted above that on the basis of current policies, ageing populations are projected to have a limited impact on public spending on pensions as a share of GDP. Given these considerations, the UK could envisage running a small deviation from the 'close to balance or in surplus' requirement without jeopardising the sustainability of the public finances in the longer term. However, the deficits projected in the programme of around 1½% of GDP, both actual and cyclically adjusted, would not constitute a 'small' deviation, and therefore would not be in line with the medium-term requirement of being close-to-balance or in surplus of the Stability and Growth Pact.

It is also noted that the relatively high projected deficit of 2.2% of GDP in 2003-04 is based on an optimistic 2¾% GDP growth assumption; thus the deficit could potentially approach the 3% Treaty threshold. Consequently, the UK authorities should aim for a 'medium-term' budgetary deficit that is small enough to ensure that the 3% deficit ceiling is not breached in any year.

As regards the implementation of the 2002 BEPGs, the update shows some progress with respect to the recommendation regarding increasing public investment but, as yet, there are no new measures to address the second recommendation that addresses the terms of the SGP though the budget for 2003 has yet to be announced.

ANNEX 1

Summary tables derived from the 2002 updated convergence programme

Table 1. Growth and associated factors

	2001	2002	2003	2004	2005
GDP *growth* at *constant* market prices (7+8+9)	2	1½	2½ to 3	3 to 3½	2¾ to 3¼
GDP *level* at *current* market prices	988	1033	1082 – 1087	1143 – 41163	1204 – 1220
GDP deflator	2	3	2	2½	2½
RPIX	2	2½	2¼	2½	2½
Employment growth					
Labour productivity growth					
Sources of growth: percentage changes at constant prices					
1. Private consumption expenditure	4	3½	2¼ to 2½	2¾ to 3¼	2¼ to 2¾
2. Government consumption expenditure	3	4½	3¾	3	3½
3. Gross fixed capital formation	¼	-4¼	6½ to 7	4 to 4½	4¼ to 4¾
4. Changes in inventories and net acquisition of valuables as a % of GDP	-¾	-¼	-¼ to 0	¼	0
5. Exports of goods and services	1¼	-1¾	3¾ to 4¼	7¾ to 8¼	6¾ to 7¼
6. Imports of goods and services	2¾	¼	4¾ to 5	7 to 7½	6¼ to 6¾
Contribution to GDP growth					
7. Final domestic demand (1+2+3)					
8. Change in inventories and net acquisition of valuables (=4)					
9. External balance of goods and services (5-6)					
Basic assumptions					
Short-term interest rate (annual average)					
Long-term interest rate (annual average)					
USD/€exchange rate (annual average)					
(for non-euro countries) exchange rate vis-à-vis the €(annual average)					
World excluding EU, GDP growth					
EU-15 GDP growth					
Growth of relevant foreign markets					
World import volumes, excluding EU					
Oil prices					

Table 2. General government budgetary developments

% of GDP	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Net lending by sub-sectors							
1. General government	-0.2	-1.8	-2.2	-1.7	-1.6		
2. Central government	-0.1	-1.6	-2.1	-1.5	-1.5		
3. State government							
4. Local government	-0.1	-0.2	-0.1	-0.1	-0.1		
5. Social security funds							
General government							
6. Total receipts	38.8	38.0	38.9	39.6	40.0		
7. Total expenditures	38.1	38.9	40.3	40.4	40.8		
8. Budget balance	-0.2	-1.8	-2.2	-1.7	-1.6		
9. Net interest payments	1.1	1.0	1.0	1.0	1.0		
10. Primary balance	1.0	-0.8	-1.2	-0.6	-0.6		
Components of revenues							
11. Taxes	30.2	29.7	29.8	30.6	31.1		
12. Social contributions	6.4	6.2	7.0	7.0	7.0		
13. Interest income	1.1	1.0	1.0	1.0	1.0		
14. Other	1.0	1.0	1.0	1.0	0.9		
15. Total receipts	38.8	38.0	38.9	39.6	40.0		
Components of expenditures							
16. Collective consumption (incl. social transf. in kind)	19.8	20.3	20.8	20.8	21.3		
17. Social transfers in kind							
18. Net current grants	14.3	14.6	14.8	14.8	14.7		
19. Interest payments	2.3	2.0	2.0	2.1	2.0		
20. Subsidies	0.6	0.6	0.6	0.6	0.6		
21. Gross fixed capital formation	1.2	1.5	1.9	2.0	2.1		
22. Other	0.0	-0.1	0.1	0.0	0.1		
23. Total expenditures	38.1	38.9	40.3	40.4	40.8		

Table 3. General government debt developments

% of GDP	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Gross debt level	38.2	37.9	38.8	38.9	38.9	39.1	39.2
Change in gross debt	-1.7	-0.3	0.9	0.1	0	0.2	0.1
Contributions to change in gross debt							
Primary balance	-1.0	0.8	1.2	0.6	0.6		
Interest payments	1.1	1.0	1.0	1.0	1.0		
Nominal GDP growth	-1.4	-1.7	-1.8	-2.1	-1.9		
Other factors influencing the debt ratio	-0.4	-0.4	0.5	0.5	0.4		
Of which: Privatisation receipts							
p.m. implicit interest rate on debt	6.0	5.4	5.2	5.4	5.1		

Table 4. Cyclical developments

% of GDP	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
1. GDP growth at constant prices	1½	2	2¾	3	2¾	2½	2¼
2. Actual balance	-0.2	-1.8	-2.2	-1.7	-1.6	-1.6	-1.6
3. Interest payments	1.1	1.0	1.0	1.0	1.0		
4. Potential GDP growth	2½	2½	2½	2½	2½	2½	2¼
5. Output gap	-0.3	-1.3	-1.0	-0.3	0.0	0.0	0.0
6. Cyclical budgetary component	0.0	-0.7	-0.8	-0.4	-0.1	0.0	0.0
7. Cyclically-adjusted balance (2-6)	-0.2	-1.1	-1.4	-1.3	-1.5	-1.6	-1.6
8. Cyclically-adjusted primary balance (7-3)							

Table 5. Divergence from previous update

% of GDP	2001	2002	2003	2004	2005
GDP growth					
previous update	2¼	2 to 2½	2¾ to 3¼	2¼ to 2¾	
latest update	2	1½	2½ to 3	3 to 3½	2¾ to 3¼
Difference	-¼	-¾	-¼	+¾	
Actual budget balance					
previous update	-0.2	-1.1	-1.3	-1.1	-1.0
latest update	-0.2	-1.8	-2.2	-1.7	-1.6
Difference	0.0	-0.7	-0.9	-0.6	-0.6
Gross debt levels					
previous update	38.1	37.2	37.0	36.8	36.6
latest update	38.2	37.9	38.8	38.9	38.9
Difference	0.1	0.7	1.8	2.1	2.3

Table 6. Long-term sustainability of public finances

% of GDP	**2001**	**2011**	**2021**	**2031**	**2041**	**2051**
Total expenditure	38.6	40.6	39.6	41.4	41.5	40.8
Old age pensions	5.0	5.0	4.8	5.2	5.0	4.8
Health care	6.3	8.2	8.5	9.3	9.7	9.8
Education	4.6	5.9	5.6	5.8	5.7	5.7
Long-term care	0.9	1.2	1.2	1.2	1.2	1.2
Interest payments						
Total revenues						
of which: from pensions contributions						
National pension fund assets (if any)						
Assumptions						
Labour productivity growth		2	2	2	2	2
Real GDP growth		2¼	1¾	2	2	1¾
Participation rate males (aged 20-64)						
Participation rates females (aged 20-64)						
Total participation rates (aged 20-64)						
Unemployment rate						

Table 7. Basic assumptions from the Commission's 2002 autumn forecast

	2001	2002	2003	2004
Basic assumptions				
Short-term interest rate (annual average)	5.0	4.0	3.7	4.0
Long-term interest rate (annual average)	4.9	4.8	4.4	4.8
USD/€exchange rate (annual average)	0.89	0.93	0.98	0.98
(for non-euro countries) exchange rate vis-à-vis the €(annual average)	0.62	0.63	0.63	0.64
World excluding euro area, GDP growth	2.3	2.9	3.8	4.2
EU-15 GDP growth	1.5	1.0	2.0	2.6
Growth of relevant foreign markets	0.1	1.6	5.8	6.6
World import volumes, excluding euro area	-1.4	3.0	6.5	7.1
Oil prices	25.0	25.5	24.1	22.5

ANNEX 2

The quantitative assessment of the sustainability of public finances

This is the second assessment of the sustainability of UK public finances as part of the Stability and Growth Pact. The quantitative indicators are similar to those used last year, but have been adjusted in line with the recommendations of the Ageing Working Group to the EPC.[5]

The UK convergence programme contains a detailed section assessing the sustainability of public finances and includes national budgetary projections for public expenditures and tax revenues. These projections are made on the basis of different demographic projections to those used by the EPC, and are also based on alternative assumption on labour market and macroeconomic developments. They project an increase in age-related expenditures of some 4.6% of GDP between 2001-02 and 2051-52. They are thus of a similar order of magnitude to the projections of the EPC. This is partly offset by a decline in other spending of 2.4% of GDP, reflecting the assumption that most non-pension social benefits will rise in line with prices after 2007-08, reducing their share of GDP.

In assessing the sustainability of public finances under the SGP, the Commission has to draw a balance between using national projections which may be more comprehensive and up to date, and the need to ensure comparability across countries. Given their comprehensive nature and the explanations provided in the convergence programme, the Commission used the detailed national projections in running the sustainability indicators.

The table below presents the debt and budget balance development according to two different scenarios, a "programme scenario" and a "2002 situation scenario". The "programme scenario" is calculated on the following basis:

- the projections for age-related expenditures and 'other' expenditures have been derived from table 4.8 in the convergence programme;

- government revenues are assumed to change up to 2008 in line with the figures reported in table 4.2 of the convergence programme: thereafter they are held constant as a share of GDP. It is however, recognised, as in the programme that it is difficult to pick up all the potential developments on the revenue side that can be expected.

- the starting point for gross debt and the primary surplus are the 2005 levels reported in the programme.

The "2002 situation scenario" is based on the budgetary data for 2002 in the programme. It is that no budgetary adjustment occurs during the time frame of the stability programme: in other words the primary balance remains unchanged at its

[5] 'How the sustainability of public finances was assessed using the 2001 updates of stability and convergence programmes: recommendations for improvements in future years', Note from the AWG to the EPC, EPC/ECFIN/396-02 of 23 July 2002.

2002 level until 2005. This allows one to gauge the impact on the sustainability of public finances of the proposed change in the underlying budget position during the programme, although the impact in the case of the UK is rather small.

These quantitative indicators give broadly similar results to the indicators presented in the convergence programme. Public finances appear to be in a good position to meet the budgetary costs of ageing populations. However, the projections point to debt levels approaching the 60% of GDP by the end of the projection. This result largely stems from the fact that the starting budget position at the end point of the programme (2005) is a deficit of some 1.6% of GDP: a modest improvement in the medium-term budget target would lead to debt levels at the end of the projection period being well below the 60% of GDP reference value.

Notwithstanding this broadly favourable conclusion, the UK faces challenges in ensuring the sustainability of public finances. In particular, the change in age-related expenditures could be higher than what is indicated in the programme. Much of the financial sustainability of the pension system depend, to a larger extent than in other countries, on the performance of private pension providers. If private provision produces significantly less than the anticipated coverage or level of pensions, future governments may face increased claims of means-tested benefits.

Quantitative indicators on the sustainability of public finances

Main assumptions - baseline scenario (as % GDP)	2005	2010	2020	2030	2040	2050	changes
Total age-related spending	18,1	20,3	20,1	21,5	21,6	21,5	3,4
Pensions	5,0	5,0	4,8	5,2	5,0	4,8	-0,2
Health care	7,0	8,2	8,5	9,3	9,7	9,8	2,8
Other age related expenditures	6,1	7,1	6,8	7,0	6,9	6,9	0,8
Total non age-related spending	21,4	20,3	19,6	20,0	20,0	20,0	-1,4
Total revenues	39,9	40,8	40,8	40,8	40,8	40,8	0,9

Results (as % GDP)	2005	2010	2020	2030	2040	2050	changes
Programme scenario							
Debt	38,9	38,4	38,3	43,5	59,2	77,8	38,9
Net borrowing	-1,6	-1,9	-1,0	-3,0	-4,0	-4,9	-3,3
2002 situation scenario							
Debt	37,4	38,9	41,1	48,9	67,6	89,9	52,5
Net borrowing	-1,7	-2,1	-1,3	-3,5	-4,6	-5,7	-4,1

Tax gaps	T1*	T2**	T3***
Programme scenario	1,9	1,4	2,8
2002 situation scenario	1,3	0,8	3,2

* it expresses the constant difference between projected revenues and the revenues required to reach in 2050 the same debt to GDP ratio as the close to balance position holds for the whole projection period. P.m. debt to GDP at the end of the period: 7.2%

** it expresses the constant difference between projected revenues and the revenues required to reach in 2050 a debt to GDP ratio equals to 40%.

*** It indicates the change in tax revenues as a share of GDP that guarantees the respect of the interteporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon.

Source: 2002 UK convergence programme. Commission calculations.