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Marco Buti
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14 October 2015

Dear Mr. Buti, Dear Marco,

REPORT ON UK ACTION BASED ON THE COUNCIL EXCESSIVE DEFICIT PROCEDURE RECOMMENDATION

1. I am writing to update you on the UK Government's most recent fiscal plans in the context of the Council Recommendation of 19 June 2015 that the UK achieve a headline budget deficit (treaty deficit) lower than 3 per cent of GDP by 2016-17. The Council Recommendation established a deadline of 15 October 2015 for the UK to implement appropriate measures, if required, and, in accordance with Article 3(4a) of Council Regulation (EC) No. 1467/97, to report in detail to both the Council and the Commission on the fiscal strategy required in order to achieve the targets.

2. The requirements set out in the Corrective Arm of the Stability and Growth Pact (Article 3.4a of Regulation 1467/97 as amended) state that, following a new recommendation, Member States need to provide information on:
   a. Targets for government expenditure and revenue and for discretionary measures, on both the expenditure and revenue side consistent with the Council's recommendation.
   b. Information on the measures taken and the nature of those envisaged to achieve the targets.

3. The new Government set out its fiscal plans in the Summer Budget on 8 July 2015. This letter, which I am jointly sending to Mr Carsten Pillath (DG, General Secretariat of the Council), accompanies a copy of the 2015 Summer Budget and the independent Office for Budget Responsibility's (OBR) Economic and Fiscal Outlook, and highlights the information in the Budget that is pertinent for the targets in the recommendation. I address each element of the EDP recommendation in turn:

End the present excessive deficit situation by 2016-2017.

4. The recommendation makes clear that to reach the targets set, "the UK needs to fully implement, in a timely manner, the measures announced up to and including the 2015 budget (March), with any modifications in relation to the current plans being fiscally neutral; in that case, <u>no further measures on top of those already announced will be needed</u>."

5. Following the Summer Budget, the UK remains on course to meet the Recommendation set by the Council in June to put an end to the present excessive deficit situation by 2016-2017. The OBR forecasts a UK treaty deficit of 2.3% GDP in 2016-17.

   This is underpinned by the UK's commitment, set out by the Chancellor in his Summer Budget, to eliminate the deficit. The Government will introduce new fiscal rules to: achieve an overall surplus in 2019-20; for the debt to GDP ratio to be falling in every year to 2019-20; and, embed the requirement for governments to run surpluses in normal times. Running a surplus is the most reliable way to reduce the debt-to-GDP ratio in the long term.

6. The attached Summer Budget provides an overview of consolidation plans over this Parliament to reach a surplus in 2019-20 (Table 1.5 on page 20). In addition to significant in-year savings announced in June, about half of the measures required to eliminate the deficit are detailed in the Summer Budget. This comprises £12 billion savings from welfare reform and £5 billion savings generated by reforms to the tax system which are intended to tackle tax avoidance and tax planning, evasion and non-compliance, and imbalances in the tax system. The remaining measures will be identified after rigorous examination in the Spending Review/Autumn Statement process, which the Chancellor will present to Parliament on 25 November 2015. We will confirm our commitment to increase spending on the NHS and ensuring that 2 per cent of GDP is allocated to defence spending.

7. These consolidation measures will be made smoothly over the current parliament, with £6 billion of consolidation by 2016-17 already detailed in the Summer Budget. This comprises approximately £5 billion of savings through welfare reform as well as over £1 billion of measures addressing avoidance and tax planning, evasion and compliance, and imbalances in the tax system. These measures are explained in detail in Section 2 of the attached Summer Budget (pages 71 – 98), as are the numerical impacts each measure is forecast to have on consolidation (Table 2.1 on pages 72 – 74).

8. The welfare reform measures that are forecast to have the greatest impact on reducing the 2016-17 deficit are reforms to tax credits and Universal Credit. We expect that increasing the tax credits taper rate to 48 per cent will reduce spending by £1.5 billion, while reducing income thresholds in tax credits and work allowances in Universal Credit will save a further £2.9 billion. Further announced changes to welfare reform include: changes to the welfare cap; further changes to tax credits and Universal Credit (including reducing the income rise disregard in tax credits); and changes to housing benefits (such as a reduction of social sector rents by 1 per cent each year from 2016-17 onwards). The net sum of these changes is an improvement of £5.0 billion in the government's preferred measure of the 2016-17 budget deficit, Public Sector Net Borrowing (Table 2.1 on page 74).

9. Increasing the Insurance Premium Tax from 6 per cent to 9.5 per cent is expected to increase receipts by a further £1.5 billion. Further announced measures include: addressing imbalances in the tax system (including equal treatment for generators under the Climate Change Levy); addressing avoidance and tax planning (such as tackling avoidance by hedge funds and private equity firms); preventing evasion (for example, increased compliance from large businesses); and promoting compliance (tackling illicit alchohol and tobacco). The net sum of all these changes is an improvement of £1.3 billion in 2016-17 Public Sector Net Borrowing (Table 2.1 on page 74).

Reach a headline deficit (treaty deficit) of 4.1 per cent of GDP in 2015-2016 and 2.7 per cent GDP in 2016-2017.

10. The Summer Budget set out a strategy to smooth the path to the overall surplus in 2019-20, maintaining the same average pace of reduction in the headline measure of Public Sector Net Borrowing in this Parliament as in the last. Against EDP targets for the headline budget deficit (treaty deficit) of 4.1 per cent in 2015-16 and 2.7 per cent in 2016-17, the independent OBR forecast published alongside the Summer Budget projects the 2015-16 deficit at 4.0 per cent and the 2016-17 deficit at 2.3 per cent of GDP (see table 4.31 on page 156 of the OBR Economic and Fiscal Outlook). The UK's fiscal plans therefore remain consistent with the target in the recommendations to bring an end to the excessive deficit situation by 2016-17. The OBR will publish a new forecast alongside the Spending Review and Autumn statement next month.

Table 1- UK Performance against EDP headline deficit (treaty deficit) Recommendation Post Summer Budget

Measure		EDP target	EU Spring forecast	OBR July forecast
Headline Deficit	2015-16	4.1%	4.1%	4.0%
	2016-17	2.7%	2.7%	2.3%

Improvement in the structural balance of 0.5 per cent of GDP in 2015-2016 and 1.1 per cent of GDP in 2016-2017

11. Turning to the structural deficit, the Summer Budget forecast shows an improvement in the structural balance of 0.7 per cent in 2015-16 and a further improvement in the structural balance of 1.5 per cent in 2016-17 (see Table 2 below, or Table 1.6 on Page 23 of the attached Budget document).

Table 2: UK Performance against EDP structural adjustment Recommendation Post July

Measure		EDP Target	EU Spring forecast	OBR July forecast
Structural adjustment	2015-16	0.5%	0.5%	0.7%
	2016-17	1.1%	1.0%	1.5%

Implement all previously announced measures, with any modifications being fiscally-neutral in relation to the current plans

12. The Summer Budget sets out a smoother fiscal path, leading to a lower public sector net debt as a share of GDP and a higher surplus in 2019-20, relative to the March Budget. The recommendation also states that the UK should further detail planned expenditure cuts in the upcoming Spending Review. The current Spending Review is ongoing and the Government will publish the results on 25 November, alongside the Chancellor's Autumn Statement.

The UK should accelerate the reduction of the headline deficit in 2015-2016 and 2016-2017 if economic, financial or budgetary conditions turn out better than currently expected.

13. The UK Government plans to reduce the headline deficit (treaty deficit) over 2015-16 and 2016-17 at an appropriate rate, as set out in the targets above. The Government is continually monitoring developments in the global economy closely and their impact on the public finances. The recommendation also states that further cuts in capital expenditure should be avoided. The Government will set out its capital expenditure plans in the forthcoming Spending Review. This will enable us to achieve the Council's recommendation in a way that is consistent with the current government's targets of decreasing debt-to-GDP over each of the next five years and running a surplus in 2019-20.

14. The attached 2015 Summer Budget and the Office for Budget Responsibility's Economic and Fiscal Outlook provide further background on our fiscal measures over the medium term.

15. My team in the Permanent Representation, and colleagues at HM Treasury, stand ready to answer any questions you may have in relation to the UK's fisal policy.

Yours,
Ivan Rogers

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Annex 1: Council Recommendation (EU) 2015/1029 of 19 June 2015

(1) The United Kingdom should put an end to the present excessive deficit situation by 2016-2017 at the latest.

(2) The United Kingdom should reach a headline deficit of 4,1 % of GDP in 2015-2016 and 2,7 % of GDP in 2016-2017, which should be consistent with delivering an improvement in the structural balance of 0,5 % of GDP in 2015-2016 and 1,1 % of GDP in 2016-2017, based on the Commission's updated 2015 spring forecast.

(3) The United Kingdom should fully implement the consolidation measures incorporated into all budgets and autumn statements up to and including the 2015 budget to achieve the recommended structural effort, with any modifications being fiscally-neutral in relation to the current plans. The United Kingdom should further detail the expenditure cuts in the upcoming Spending Review. These are necessary to ensure the correction of the excessive deficit by 2016-2017.

(4) The United Kingdom should accelerate the reduction of the headline deficit in 2015-2016 and 2016-2017 if economic, financial or budgetary conditions turn out better than currently expected. Budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner. In particular, further cuts in capital expenditure should be avoided.

(5) The Council sets the deadline of 15 October 2015 for the United Kingdom to (i) take effective action; and (ii) in accordance with Article 3(4a) of Regulation (EC) No 1467/97 to report in detail the consolidation strategy that is envisaged to achieve the targets.

Furthermore, the UK authorities should (i) comply with the obligation to set out a medium-term budgetary objective as laid down in the Stability and Growth Pact; and (ii) implement the planned reforms of increasing the state pension age in order to contribute towards strengthening the long-term sustainability of the public finances.

Finally, to ensure the success of the fiscal consolidation strategy, it will also be important to back the fiscal consolidation by comprehensive structural reforms, in line with the Council Recommendations addressed to the United Kingdom in the context of the European Semester and in particular those related to the preventive arm of the Macroeconomic Imbalances Procedure.