VI. Some aspects of sustainable development

There is a growing concern that long-run sustainable development may be compromised unless measures are taken to achieve balance between economic, environmental and social outcomes both domestically and on a global basis. This section looks at three specific issues of sustainable development that are of particular importance for the United Kingdom: climate change, improving living standards in developing countries and sustainable retirement income. In each case, indicators are presented to measure progress and the evolution of potential problems, and an assessment is made of government policies in that area. The section also considers whether institutional arrangements are in place to integrate policy-making across the different elements of sustainable development (Box 6.1).

Climate change

Main issues

Concerns about climate change have prompted the United Kingdom to introduce measures to contain emissions of greenhouse gases (GHGs). While the United Kingdom has already put in place measures that should ensure that meeting the European Union (EU) Burden Sharing target of reducing GHG emissions by 12.5 per cent between 1990 and the period 2008-12 does not present real difficulties, the government has also set a demanding national target of moving towards a 20 per cent reduction in carbon dioxide emissions by 2010. Furthermore, on the basis of a recommendation from the Royal Commission the government is aiming to put the United Kingdom on a path to reducing GHG emissions by 60 per cent by mid century. As future abatement is likely to be much more costly than in the past, though technological advancement may reduce future costs, the main issue is to use instruments that impose the least burden on the economic and social pillars of sustainable development.

Performance

GHG emissions have fallen significantly since 1990, both in absolute terms and relative to GDP (Table 6.1, Figure 6.1). This is largely due to falling

Box 6.1. The integration of policies across sustainable development areas*

Policy integration in the United Kingdom is achieved through a mix of target setting and interdepartmental co-ordination. A national sustainable development strategy has been developed and includes a number of indicators to show progress in meeting the targets. The Sustainable Development Unit in the Department for the Environment, Food and Rural Affairs is the main body responsible for integrating policy. When interdepartmental differences arise, the Cabinet Office can play a role by bringing together various departments to ensure co-ordination. An additional means of co-ordination is through Public Service Agreements, which departments agree with the Treasury as part of the budgetary process. When a central governmental commitment is in danger of being missed, the Treasury can require different departments to assist in meeting the goal.

Cost-benefit analysis as part of regulatory impact assessments (RIA) is systematically applied to policies and projects. The RIAs consider the impact of policies on the different pillars of sustainable development. Separate environmental impact assessments are required for all large projects. Guidelines recommend the use of cost-benefit analysis early in the policymaking process, though on occasion this may offer insufficient time for the quantification of all the costs and benefits. In recommending a policy or project, ministers are required to affirm that the benefits warrant the costs, though not necessarily exceed or equal the costs. During mid-term evaluation of major policy initiatives, the costs and benefits are reviewed in the framework of an *ex post* RIA (OECD, 2002).

* The sections in this report dealing with climate change, improving living standards in developing countries, and sustainable retirement income are inputs into the Organisation's follow up on Sustainable Development as mandated by the Ministerial Council decision in May 2001.

emission intensities in the electricity sector, with power generators taking advantage of deregulation by shifting away from carbon-rich coal to natural gas. The reduction in the demand for coal also led to a sharp contraction of domestic mining and associated methane emissions. Outside the electricity generating sector, the decoupling of emissions from output trends was also stronger than for the OECD area on average. By 2000, overall emissions were close to the international target set for 2008-12. Although rebounding somewhat more recently, official projections suggest that current policies will hold emissions below this target.

Policies

The UK climate change strategy, adopted in 2000 (DEFRA, 2000), consists of a wide range of measures including a tax on energy use, an emissions trading

Table 6.1. **Main indicators: climate change**

Indicators of greenhouse gas (GHG) emission intensity, grams of CO_2 equivalent per USD[1] of GDP, in 1995 prices

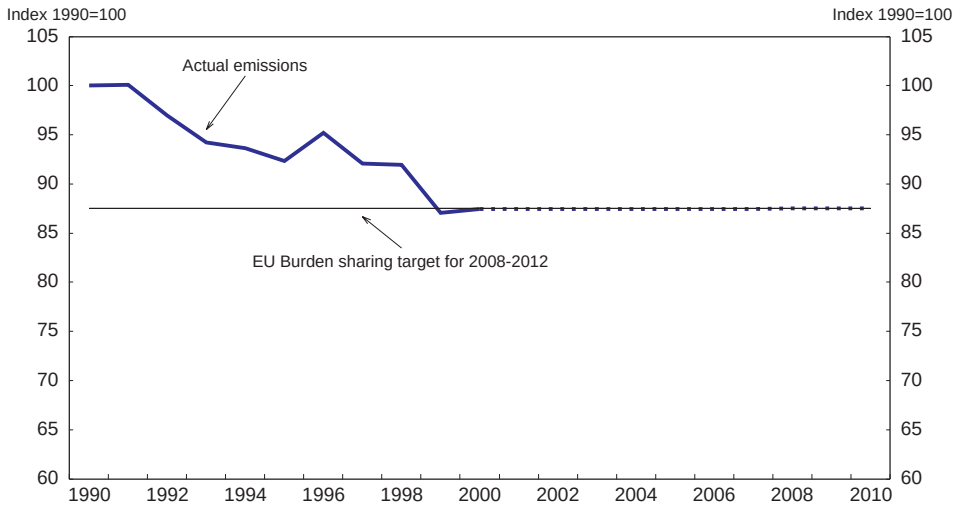
	Level of emissions, 1999				Average annual percentage change 1990-99			
	Total	CO_2 from electricity	CO_2 from transport	Other	Total	CO_2 from electricity	CO_2 from transport	Other
Australia	1 053	370	155	528	–2.07	–0.21	–1.93	–3.24
Austria	419	72	91	256	–1.87	–2.75	–0.52	–2.06
Belgium	617	97	101	419	–1.36	–2.12	0.16	–1.52
Canada	893	151	193	549	–0.98	–0.12	–0.36	–1.41
Czech Republic	1 058	457	88	513	–3.05	2.55	5.53	–6.93
Denmark	549	194	94	261	–1.64	–1.43	–1.49	–1.85
Finland	652	181	105	366	–1.88	–0.02	–1.29	–2.83
France	416	32	103	280	–1.69	–2.04	0.16	–2.26
Germany	536	169	96	271	–4.00	–3.86	–0.57	–5.05
Greece	813	275	130	408	–0.24	0.07	0.74	–0.73
Hungary	786	250	84	453	–2.33	1.44	0.38	–3.74
Iceland	395	4	88	303	–1.28	0.00	–2.31	0.81
Ireland	694	165	103	426	–4.27	–2.41	0.79	–5.75
Italy	439	105	92	242	–1.05	–0.82	0.37	–1.64
Japan	432	130	82	221	–0.30	–0.03	1.24	–0.99
Luxembourg	344	6	242	97	–11.46	–30.20	–0.45	–18.81
Netherlands	573	138	82	352	–2.38	–1.03	–0.94	–3.15
New Zealand	1 096	92	175	828	–2.28	4.58	0.65	–3.32
Norway	487	4	113	369	–2.54	1.31	–1.53	–2.87
Poland	1 195	481	90	624	–4.96	–6.63	0.50	–4.12
Portugal	540	149	106	285	0.41	2.58	3.37	–1.39
Slovakia	957	200	76	680	–4.47	–1.21	3.13	–5.78
Spain	537	127	130	280	0.41	1.12	1.28	–0.26
Sweden	358	41	112	204	–1.55	0.07	–0.65	–2.30
Switzerland	276	3	79	195	–0.62	–1.96	–0.28	–0.73
United Kingdom	**526**	**132**	**108**	**287**	**–3.66**	**–5.30**	**–1.38**	**–3.61**
United States	792	278	196	318	–1.89	–0.60	–1.18	–3.28
OECD total	649	196	140	312	–1.80	–0.98	–0.38	–2.83
EU	506	120	103	283	–2.36	–2.60	–0.16	–2.95

1. National currencies converted to USD using purchasing power parities.

Source: Greenhouse gas emissions: national submissions to the United Nations Framework Convention on Climate Change (UNFCCC) and national publications; carbon dioxide emissions for electricity and transport from the International Energy Agency (IEA, 2001) and GDP from OECD, National Accounts database.

scheme, and promotion of renewable sources of energy. The strategy should ensure that international commitments are comfortably met, but may fall short of the separate more ambitious national target (ECCM, 2003). A major reduction in GHG emissions in the longer term will be particularly challenging, given that the majority of GHG emission-free nuclear power plants[1] will be decommissioned as early as 2035.

Figure 6.1. **Greenhouse gas emissions**



Source: UNFCCC (2003).

A central instrument of climate change policy is the Climate Change Levy (CCL), which is a tax on downstream non-household energy supply. In terms of costs per tonne of carbon the CCL varies from £5 to £10, depending on the energy source. In part, the authorities avoided taxing household energy supply directly to prevent aggravating so-called "fuel poverty," which is estimated to affect around 10 to 20 per cent of households (BRE, 2003).[2] While this is a compromise between the social and environmental pillars of sustainable development, it is inefficient. To improve the trade-offs between the two dimensions, a Royal Commission (2002) recommended compensating the "fuel poor" for increased energy prices through social transfers. Furthermore, as the CCL is confined to final energy use it fails to provide direct incentives to reduce GHG emissions in the most emission-intensive sector, namely electricity generation.[3]

The application of the CCL may be relaxed for larger energy intensive companies. Such firms can enter into Climate Change Agreements (CCAs) that set abatement targets, which are generally specified relative to business-as-usual projections and applied to either GHG emissions or energy use. In return, firms meeting the targets pay only 20 per cent of the CCL. Abatement in the first year up to April 2003 of the CCA was triple the aggregate agreed targets, reaching almost 4 million tonnes of carbon. This outcome was mainly due to the downsizing of the steel industry, though most companies met their targets (Future Energy Solutions,

2003). Officially-commissioned research estimates that the overall impact of the agreements will attain 90 per cent of the abatement that would have occurred with the full imposition of the CCL by 2010 (ETSU, 2001), though other estimates show much smaller abatement (ACE, 2001).

An innovation complementing the CCAs was the establishment of the first tradable permit market for emissions of all types of GHGs. This voluntary market is open to the 11 000 facilities with CCAs. During the first year of operation a number of trades occurred with the price settling at around £10 per tonne of carbon. In order to ensure "liquidity", the government initially held an auction where companies could offer absolute emission reductions over five years in exchange for financial support worth £215 million in total. The cost to the government of the contracted abatement (for the 34 companies that made successful bids) was around £60 per tonne of carbon. Such a cost per tonne of carbon is higher than the likely price of an international emission permit, but lower than many programmes in other EU member states. The companies that contracted to make absolute emission reductions can only trade with the companies with CCAs through a "gateway" to prevent abatement relative to business-as-usual being used to satisfy their absolute targets.[4] The "gateway" opens if the marginal abatement cost for enterprises with absolute abatement targets is lower than for enterprises with relative targets. In this case, trading is likely to lead to an increase in emissions relative to the outcome in the absence of trade, though with the advantage of unifying marginal abatement costs (Fischer, 2003). In this light and as the Kyoto Protocol target is set in absolute terms, the government intends to phase out the trading of relative abatement from 2008.

While the emissions trading scheme offers companies valuable experience and complements other elements of climate change policy, its viability is threatened by its incompatibility with the proposed EU emission trading scheme (Sorrell, 2003). Unlike the UK scheme, the proposed EU scheme would be mandatory for a smaller set of companies, only trade permits based on absolute emission reductions, and at least initially be limited to just carbon dioxide abatement. Although limiting the set of companies and gases involved is a potential weakness of the EU scheme relative to the UK system, the inclusion of electricity generators will have the advantage of introducing better abatement incentives for this sector.

The government has set separate and ambitious targets for renewable energy (10 per cent of electricity supply in 2010) and combined heat and power (CHP) (more than doubling capacity between 2000 and 2010). To attain the target for renewables, the authorities have obliged electricity companies to increase gradually the share of renewables in total electricity generation. Suppliers can trade their Renewables Obligations, giving companies where the cost of using renewables is comparatively high an opportunity to transfer their requirement to another company. Moreover, suppliers can "buy out" the obligation at £0.03 per

kilowatt hour to cap the costs of meeting the obligation, which could see the average cost per tonne of carbon abated rise to £312 (DTI, 2001). Such a level of support is significantly above a central estimate of benefits per tonne of carbon abated of around £70 (Clarkson and Deyes, 2002), which is likely to overestimate the external costs of current carbon emissions by a factor of ten (Mendelsohn, 2003). Furthermore, the government offers investment subsidies to renewable energy to help make it competitive with conventional sources of electricity. To promote CHP, the government offers a wide variety of measures of support, ranging from exemptions from the CCL and local business rates to subsidies (DEFRA, 2002a). While the level of support between £80 and £120 is considerably less than for renewables, it is nonetheless very high in relation to likely external costs.

Conclusions

The United Kingdom has in place a wide-ranging set of measures that should keep emissions below its EU Burden Sharing target. While the emission trading scheme should help in achieving abatement efficiently, abatement costs across the different policy instruments diverge significantly, suggesting that abatement could be achieved more cost efficiently. In particular, abatement costs are high where the authorities have set specific quantitative targets. Aligning the domestic emission trading scheme more closely with the proposed EU emission trading scheme, while pushing to expand the coverage of enterprises and gases in the EU scheme, could help introduce better abatement incentives in the power generation sector. Energy use included in the EU emission trading scheme should be exempt from the CCL, which in turn should be converted to an explicit carbon emission tax at the expected level of the international permit price for carbon. The levels of support offered to renewables and CHP should also be aligned against this benchmark, though this may jeopardise the United Kingdom's own target for reducing carbon dioxide emissions.

Improving living standards in developing countries

Main issues

A reduction in poverty in the non-OECD area will contribute to the achievement of globally sustainable development. Although developing countries themselves have the major responsibility to improve their living standards, trade and aid policies of OECD countries can help to reduce extreme poverty in the least developed and other low income countries. The United Kingdom can contribute to poverty alleviation in the non-OECD area by importing goods and services from these countries. Bilateral development co-operation is another area where the United Kingdom can enhance the opportunities for developing countries to overcome obstacles to development and improve living standards.

Performance

Imports from developing countries, notably of manufactures, have grown quite strongly since the beginning of the 1990s, outpacing overall import growth. Import growth of agricultural products from developing countries was somewhat weaker than overall import growth, leaving the share of developing countries in total UK agricultural imports in line with the EU average (19 per cent). Net official development assistance (ODA) is comparatively low by EU standards. It fell as a share of gross national income (GNI) to just 0.24 per cent in 1999, but since then the government has increased ODA – it reached 0.3 per cent of GNI in 2002 (Table 6.2 and Table 6.3). Country allocation shows a strong concentration, with the top 20 recipients accounting for almost two-thirds of bilateral ODA that is allocated on a country basis. Allocation also favours poorer countries, with almost 80 per cent of bilateral country programme assistance allocated to low income countries and 48 per cent to the least developed countries. During the 1990s, the estimated effectiveness, measured by how well ODA is targeted to where it will have the greatest effect, quadrupled, with an additional USD 1 million of ODA estimated to raise 400 individuals out of poverty by the end of the decade (DFID, 2003a).

Policies

Trade policy in the United Kingdom is set in the context of policy instruments that are uniform across the European Union. In 1999, average trade weighted bound tariffs for industrial goods were slightly higher in the EU than in the United States and Japan (OECD, 2003), irrespective of whether or not preferential trading arrangements are taken into account. The situation for the least-developed countries was more favourable and is becoming somewhat more advantageous with new initiatives. Under the EU Generalised System of Preferences programme and the Cotonou agreement with African, Caribbean and Pacific countries, developing countries are granted tariff concessions on manufactured goods. Indeed, only 3 per cent of the least-developed countries' exports face tariffs of above 5 per cent, while another 2 per cent of exports face a tariff of between zero and 5 per cent. Moreover, these tariffs are gradually being eliminated under the EU "Everything-But-Arms" initiative, though for the most sensitive products liberalisation is being delayed until 2009.[5] However, products from other developing countries still face tariffs and a number of textiles and clothing products are subject to import quotas at the EU level. In accordance with the Agreement on Textiles and Clothing, these quantitative restrictions will cease at the end of 2004, after which textiles and clothing will be subject to tariffs of 9 and 7 per cent, respectively. The Union, though, has been pursuing negotiations to completely eliminate tariffs on these products on a bilateral basis, if partner countries also lower their own tariffs.

Table 6.2. **Main indicators: trade**

	LDCs countries			Other low-income countries		
	Share in total imports	Composition of imports: manufactures in non-energy products	Annual growth rate	Share in total imports	Composition of imports: manufactures in non-energy products	Annual growth rate
	2001[1]	2001[1]	1990-2001[1]	2001[1]	2001[1]	1990-2001[1]
Australia	0.2	70.6	7.9	12.6	88.7	15.1
Austria	0.3	89.5	13.1	2.7	92.0	9.1
Belgium	1.6	87.1	5.7	4.5	90.6	9.9
Canada	0.1	79.7	5.1	4.8	93.1	17.0
Czech Republic	0.1	29.3	10.7	3.3	83.3	39.3
Denmark	0.3	73.3	0.3	4.4	92.6	10.9
Finland	0.5	33.5	16.6	4.5	88.4	13.7
France	0.6	59.3	1.0	5.4	87.1	11.2
Germany	0.4	72.3	4.4	5.3	88.7	10.0
Greece	0.7	67.9	7.0	5.1	88.3	13.4
Iceland	0.1	86.2	20.0	4.2	98.7	21.7
Ireland	0.3	34.4	5.6	2.9	88.8	17.9
Italy	0.4	59.2	–1.1	4.9	84.1	9.8
Japan	0.2	37.3	–4.7	24.6	81.4	14.0
Korea	0.1	45.4	–2.6	14.3	79.3	12.1
Luxembourg	0.1	88.7		0.7	57.3	
Mexico	0.0	72.0	–2.8	0.4	91.2	12.0
Netherlands	0.4	62.0	5.9	7.7	82.0	12.3
New Zealand	0.1	48.2	0.9	9.2	93.8	19.9
Norway	0.4	86.1	–17.5	4.3	93.9	14.4
Poland	0.4	70.9	12.4	4.9	81.3	22.7
Spain	0.5	34.3	3.2	5.5	79.5	13.9
Sweden	0.2	82.5	7.3	2.7	90.9	6.8
Switzerland	0.1	63.1	–1.2	2.5	89.5	10.2
Turkey	0.2	52.7	0.6	5.2	83.6	14.5
United Kingdom	**0.4**	**78.5**	**6.8**	**4.7**	**87.9**	**9.6**
United States	0.5	87.3	9.1	12.6	94.3	16.8

1. 2000 for the Czech Republic, Denmark, Germany, Mexico, New Zealand and Turkey.
Source: OECD.

In contrast to the industrial sector, many agricultural products faced tariffs of above 15 per cent in 1998. In this group, consisting mainly of meat, dairy products, cereals and sugar, the average most favoured nation tariff is above 40 per cent (Gallezot, 2002). The European Union has a number of agreements granting preferential access to developing and central and eastern European countries, lowering the actual tariff paid to 25 per cent. In the case of sugar, the special regime has allowed five countries to capture four-fifths of the value of the preferences,[6] while excluding low cost sugar producers from the European Union market.

Table 6.3. **Main indicators: development co-operation**

	Official development assistance		
	2001		1995-96 to 200-01 average annual percentage change in real terms
	USD million[1]	Per cent of GNI	
Australia	873	0.25	0.6
Austria	533	0.29	0.2
Belgium	867	0.37	3.5
Canada	1 533	0.22	–2.6
Denmark	1 634	1.03	4.4
Finland	389	0.32	5.0
France	4 198	0.32	–6.6
Germany	4 990	0.27	–1.2
Greece	202	0.17	8.2
Ireland	287	0.33	11.9
Italy	1 627	0.15	–2.3
Japan	9 847	0.23	3.0
Luxembourg	141	0.82	18.1
Netherlands	3 172	0.82	5.0
New Zealand	112	0.25	5.6
Norway	1 346	0.83	1.7
Portugal	268	0.25	6.7
Spain	1 737	0.30	7.3
Sweden	1 666	0.81	4.4
Switzerland	908	0.34	3.0
United Kingdom	**4 579**	**0.32**	**5.8**
United States	11 429	0.11	3.2
Total DAC	52 336	0.22	1.8
Memorandum item:			
Median		0.31	

1. EC aid was USD 5 961 million in 2001.
Source: OECD.

Intense lobbying, including within the United Kingdom, led to a slower transition for sugar being adopted in the EU's Everything-But-Arms initiative (IDC, 2003; OECD, 2001). For all agricultural products, preferential tariffs have the impact of lowering the actual tariff to 9.7 per cent, relative to an most-favoured nation tariff of 16.5 per cent, with 40 per cent of imports entering under preferential regimes. Most of the gain from preferential treatment, in terms of tariff revenue foregone, is concentrated on a few products – notably fresh and dried fruits that account for almost one-third of foregone revenue. Community-wide subsidies also protect the EU agricultural industry from imports and such support has declined only modestly since the mid-1980s (Table 6.4).

Table 6.4. **Producer support equivalents and their components**

	Total PSE[1]	Market price	Output	Input	Input constraint	Area numbers	Historical entitlements	Other forms of support
2000-02								
Australia	4.0	0.1	0.1	2.7	0.0	0.1	0.4	0.6
Canada	19.0	8.9	1.0	1.5	0.0	2.3	2.5	2.9
European Union	35.0	20.0	1.4	2.8	1.4	9.5	0.4	0.0
Japan	59.0	53.1	1.8	3.0	1.2	0.0	0.0	0.0
Korea	66.0	62.0	0.0	2.0	0.0	0.7	0.0	1.3
New Zealand	1.0	0.7	0.0	0.3	0.0	0.0	0.0	0.0
Switzerland	73.0	43.1	3.7	2.9	1.5	8.8	12.4	2.2
United States	21.0	7.4	3.4	3.8	3.2	1.1	0.2	1.9
OECD	31.0	19.5	1.9	2.8	0.9	4.0	1.6	0.6
1986-88								
Australia	9.0	4.2	0.0	2.9	0.0	0.0	0.0	1.9
Canada	34.0	16.7	5.8	5.4	0.0	5.8	0.0	0.7
European Union	40.0	34.4	2.0	2.0	0.4	1.2	0.0	0.0
Japan	61.0	54.9	1.8	2.4	1.8	0.0	0.0	0.0
Korea	70.0	69.3	0.0	0.7	0.0	0.0	0.0	0.0
New Zealand	11.0	2.1	0.0	4.3	0.0	0.0	4.1	0.6
Switzerland	76.0	62.3	0.8	6.1	0.0	4.6	0.0	2.3
United States	25.0	11.8	1.8	0.0	4.0	6.8	0.0	1.0
OECD	38.0	29.3	1.9	3.0	0.4	2.7	0.0	0.4

1. Producer support equivalent.
Source: OECD.

The abolition of all agricultural trade and subsidy barriers within OECD countries would raise total income of developing countries, but the extent of the gains would differ across country groups. Existing food exporters (notably in Latin America) would be the main beneficiaries of such reforms. By contrast, the majority of developing countries might face small losses as a result of increases in food prices, as might a number of countries that already have preferential trading agreements with developed countries. Indeed, the least-developed countries appear to gain little from across-the-board reduction in agricultural support in developed countries alone (Roberts *et al.*, 2002). However, changes in agricultural policies are likely to take place in the context of multilateral agreements covering services, manufactures and agricultural products and involving tariff concessions by developing countries themselves. In such a context, no region would experience any loss in welfare (Nagarajan, 1999).[7] In addition, a multilateral reform would be likely to result in dynamic changes to the pattern of production in developing countries, especially if development assistance helps to build the capacity to export. To this end, the United Kingdom has been an important provider of

trade-related technical assistance, especially in Africa, and has recently doubled its support to the Integrated Framework initiative,[8] which gives trade-related technical assistance to the least developed countries.

Within the European Union, further measures to base agricultural support on farmers' income rather than their production would be advantageous for the least developed countries. Such a restructuring of support is indeed envisaged in the EU Agenda 2000 programme. The United Kingdom has been the only country to take the opportunity to reduce direct payments to farmers and transfer money to rural development programmes. Moreover, the 2003 Common Agricultural Policy reform for sustainable agriculture partially ended supporting products in favour of supporting producers, with the introduction of a partially or fully decoupled system of payments per farm. The United Kingdom supports such efforts, setting the achievement of greater decoupling as a major objective in government policy (DEFRA, 2002b).

The UK's development co-operation programme sets poverty reduction as a central goal (DFID, 2003b).[9] The Department for International Development (DFID) furthermore bases its objectives on the internationally agreed UN Millennium Development Goals (MDGs). However, estimates of the financing necessary to meet the MDGs by 2015 suggest that annual development assistance from all donors would need to double from current levels to USD 100 billion. Given this shortfall, the United Kingdom has proposed creating an International Finance Facility, which through bond issues would allow donors to raise additional resources on the basis of longer term commitments (H.M. Treasury and DFID, 2003). The United Kingdom intends to increase ODA from 0.3 per cent of GNI in 2002 to 0.4 per cent in 2005. The government remains committed to the longer term United Nations 0.7 per cent ODA/GNI target.

Accompanying an increasing volume of resources, the government is working to increase further the effectiveness of its ODA. This includes better targeting of poor countries and raising the share of bilateral ODA going to low income countries to 90 per cent by 2006. DFID also intends to improve allocation by gradually reducing the number of projects and countries funded and, within the remaining countries, support poverty reduction strategies. In addition, co-ordination with other donors is increasing. Despite a wide variety of means used to monitor progress, there is recognition that performance assessment and evaluation could be improved and better linked to allocation decisions (DFID, 2002).[10] Assessing the impact of policies in relation to its public service agreement objectives is hindered by the international nature of the MDGs and the lack of robust data. The authorities are working on both these areas by elaborating how to assess policies and supporting the development of the statistical capabilities of developing countries.

Another evolving aspect of the United Kingdom's development co-operation is the increasing use of partnerships, and direct budget support. Partnership

agreements with developing countries are often centred on those countries' poverty reduction strategy papers. In suitable countries, development assistance is moving increasingly to direct budget support, which is expected, *inter alia*, to increase allocative efficiency, reduce transaction costs, increase the accountability of the recipient government, and support long-term poverty reduction strategies more effectively. The slightly longer-term nature of budget support (typically three years) could enhance the predictability of aid disbursements. But, uncertainty persists in the implementation of some of the partnership agreements, partly due to differences between the United Kingdom's and the developing countries' objectives (OPM and ODI, 2002). However, in the case of Tanzania, the United Kingdom together with other bilateral donors and the World Bank have agreed benchmark indicators with the national government, which has responsibility for monitoring implementation.

Conclusions

The United Kingdom has been a strong advocate of further liberalisation of the international trade regime, stressing the importance of reducing barriers to trade on a multilateral basis. At the same time, the authorities have recognised the importance of ensuring that developing countries can benefit from such liberalisation through assisting the development of their trade capacity. The government should continue promoting innovative measures to raise the amount of global financing. As the authorities recognise, continual attention should be paid to project evaluation and assessing the linkages between policies and outcomes to ensure increased effectiveness of ODA. Agreeing longer-term programmes centred on poverty reduction strategies offers potential gains in aid efficiency and effectiveness. Ensuring that the national government and all principal donors agree on a single set of benchmarks would be helpful through ensuring greater financing stability and donor co-ordination.

Sustainable retirement income

Main issues

In response to foreseeable pressure on the public pension system due to ageing, corrective actions were decided upon as early as the 1980s to arrest the tendency for public pension outlays to increase. The government provides a foundation for retirement income through the state pension system, which individuals can supplement with their own saving in order to determine their level of income on retirement and age at which they retire. In this context, the main issue for the authorities is to ensure that the retirement income system enables individuals to make adequate provision for their retirement.

Performance

Unlike most OECD countries, public pension spending is projected to remain broadly unchanged relative to GDP over the medium to long term. This is mainly due to more favourable expected demographic developments than in many OECD countries and increases in the (earning-related) State Second Pension for those that rely principally on the state system and income related benefits (rising in line with earnings) offsetting a decline in the basic state pension replacement rate. Indeed, by 2050 the basic state pension (indexed to prices) could be expected to fall from 17 per cent at present to just 7½ per cent of average earnings; however between 1997 and 2003 the basic state pension was increased by amounts closer to earnings than prices.[11] The impact on income adequacy in old age will be offset by an already well developed occupational and private pension system, which helps raise the average net replacement rate on retirement to 78 per cent. Recently, a combination of factors, including stockmarket falls and rising longevity has seen some employers close defined benefit systems to new members and move towards greater use of defined contribution private pensions.[12] The risk of relative poverty on retirement has been slightly higher in the United Kingdom than the average for EU countries (Table 6.5). However, the incidence of relative poverty of pensioners, according to some measures, has declined by one-fifth over the past five years, despite a rapid rise in overall median incomes (Goodman *et al.*, 2003).[13] While the average age of withdrawal from the labour market has declined over the past decades (as is the case in most OECD countries), at 62 years of age it is above the EU average of 60 years but below the average age of retirement in some OECD counties (Table 6.5).

Policies

The public pension system has been subject to a number of reforms and consultations, giving rise to both considerable uncertainty and an extremely complex retirement system (Faculty and Institute of Actuaries, 2002). The series of reforms introduced since 1999 has targeted reducing poverty on retirement as a major goal. For this purpose, a new income related Pension Credit will become an important source of retirement income. Around two-thirds of pensioner households could be eligible for such support by mid-century at a cost to the budget of up to 1½ per cent of GDP (DWP, 2002a). With these reforms in place, low-income earners stand to gain significant increases in their pensions, which rise the longer retirement is delayed (Figure 6.2). However, at present only 5½ per cent of the elderly remain in employment beyond the age of 65. Reducing the incidence of poverty on retirement will also depend on improving the take-up of income related benefits (Goodman *et al.*, 2003). This has been a problem in the past with almost one-third of the elderly eligible for different income related benefits not applying (Hancock *et al.*, 2003). In recognition of this problem, the system for

Table 6.5. **Performance indicators: sustainable retirement income**

	Projected increases in old age pension spending	Low income rate of the elderly[1]	Relative disposable income of the elderly[1]	Private pension funds 1999	Age of withdrawal, 1994-99		Participation rate, 2001, per cent		
							Aged over 65	Aged 55-64	
	Change in per cent of GDP 2000-50	Per cent of the elderly with income less than 50 per cent of median disposable income	Per cent of the disposable income of all individuals	Per cent of GDP	Male	Female		Male	Female
Australia	1.6	16.1	67.6	63.8	59.7	61.3	6.0	60.0	36.9
Austria	2.2	14.9	86.6	3.6			2.8[1]	42.1[1]	17.5[1]
Belgium	3.3	13.8	77.9	6.1			1.3	36.6	15.7
Canada	5.8	2.5	97.4	45.7	62.6	61.1	6.0	61.3	41.7
Czech Republic	6.8			3.8			4.0	55.0	24.5
Denmark	2.7	9.2	73.0	24.4	62.4	61.5	4.6	65.5	51.8
Finland	4.8	7.5	79.0	10.7	59.8	60.0	3.7	51.2	49.5
France	3.9[2]	10.7	89.7	6.3	59.3	59.8	1.2	43.8	34.1
Germany	5.0	10.4	85.6	3.2	60.5	60.8	3.0	50.6	32.4
Greece		29.2	76.8	4.6	61.7	62.2	5.0	57.0	23.6
Hungary	1.2	6.0	85.2	2.2			3.1	36.3	15.4
Iceland				86.0			19.9	92.8	81.7
Ireland		16.7	74.6	57.8			7.9	66.1	29.5
Italy	–0.3	15.3	84.1	3.0	59.3	58.4	3.4	57.8	26.6
Japan	0.6			18.7	69.1	66.0	21.8	83.4	49.2
Korea	8.0			3.2	67.1	67.5	29.6	71.3	47.9
Luxembourg	2.0[3]	6.7[4]	98.0[3]	. .			0.0	38.1	14.3
Mexico		32.9	85.3	2.4			30.5	80.5	27.6
Netherlands	4.8	1.9	86.3	119.3	61.6	60.1	3.1	52.0	26.9
New Zealand	5.7			. .			8.6	74.6	51.7
Norway	8.0	19.1	74.1	7.4	64.2	64.7	13.2	73.6	63.2
Poland	–2.5	8.4[4]		. .			7.5	41.5	24.1
Portugal				11.4	65.3	66.5	19.0	63.7	41.9
Slovak Republic							1.1	43.0	11.2
Spain	8.0	11.3[4]		2.3	61.1	61.1	1.6	61.4	23.6

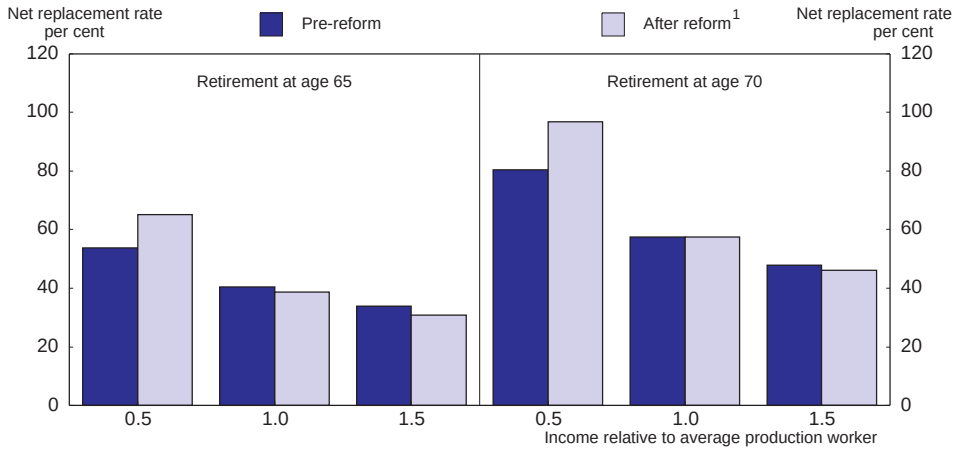
Table 6.5. **Performance indicators: sustainable retirement income** (*cont.*)

	Projected increases in old age pension spending	Low income rate of the elderly[1]	Relative disposable income of the elderly[1]	Private pension funds 1999	Age of withdrawal, 1994-99		Participation rate, 2001, per cent		
							Aged over 65	Aged 55-64	
	Change in per cent of GDP 2000-50	Per cent of the elderly with income less than 50 per cent of median disposable income	Per cent of the disposable income of all individuals	Per cent of GDP	Male	Female		Male	Female
Sweden	1.6	3.0	89.2	. .	63.3	61.8	9.4	73.5	67.4
Switzerland		8.4[4]		97.3[5]			11.4	82.4	56.1
Turkey		23.1	92.7	. .			18.1	50.8	18.4
United Kingdom	**–0.7**	**11.6**	**77.8**	**84.1**	**62.0**	**61.2**	**4.8**	**64.4**	**44.6**
United States	1.8	20.3	91.7	74.4	65.1	64.2	13.1	68.1	53.0

1. Förster and Pellizzari (2000).
2. Secretariat estimate in OECD (2001). Official reports suggest a 4.4 per cent increase on unchanged labour market policies for the period 2000-40.
3. IGSS (2002).
4. Smeeding (2002).
5. 1998.

Source: Förster and Pellizzari (2000); Jesuit and Smeeding (2002), Luxembourg Income Study; OECD Labour Force Statistics, Scherer (2001).

Figure 6.2. **Effect of reforms on public pensions**



1. These estimations are the effect of the introduction of the pension credit and state second pension on 2001 incomes. The additional impact of increasing the minimum income guarantee is not taken into account.

Source: OECD.

claiming the Pension Credit introduced is much less onerous. In particular, from age 65, unless their circumstances change, pensioners only need to undergo an assessment once every five years rather than weekly, which is the case at present.

The pension reforms introduced since 1999 have targeted those most at risk of falling into poverty. The government is nevertheless concerned that everyone makes adequate provision for their retirement and is concerned to ensure that they are not undersaving. While calculating the number undersaving is difficult[14] the government estimates (on the basis of current retirement ages) that around 3 million individuals may be making insufficient saving to secure a gross replacement rate of 50 per cent, while an additional 5 to 10 million may be unable to attain a gross replacement rate of two-thirds (DWP, 2002b). The authorities introduced a Stakeholder Pension in 2001, specifically targeting the groups most at risk from under-saving.[15] More than 1½ million persons have subscribed to such pensions, and over £1.5 billion has been contributed to employee and self-employed stakeholder pension schemes in 2002-03 (ABI, 2002). Individuals can also contract out of the earnings-related state pension (State Second Pension) and join a company pension scheme or invest in individual pension vehicles as well as making additional voluntary pension savings. In order to reduce barriers to pension saving, new proposals in late 2002 include simplifying the pension system, and improving portability and vesting rights for employees (DWP, 2002b). The

Pension Credit rewards, within limits and from age 65, those with savings or income from employment and in this respect is an improvement on the Minimum Income Guarantee. Nevertheless, the operation of the system will introduce disincentives for some others to save and work at the margin. (Emmerson and Wakefield, 2003). The government strongly supports individuals making additional voluntary saving for retirement and it has established the Independent Pensions Commission to monitor and assess progress in this regard and to decide whether there is a case for further strengthening voluntary saving or mandating additional retirement saving.

In addition to increasing the attractiveness of pension saving, the authorities are acting to restore public confidence in occupational pensions in the wake of growing concern regarding the winding up of occupational defined benefit pension plans and unfunded liabilities of occupational defined benefit pension funds of up to £300 billion (29 per cent of GDP as measured on the FRS17 accounting standard) (Faculty and Institute of Actuaries, 2003).[16] For long term savings like pensions, the level of unfunded liabilities will overstate the problem and does not mean the funds are insolvent. However, the government is acting to ensure confidence in the system and issued proposals in June 2003 (DWP, 2003) that included better protection for employees in the case of wind-up, introducing a Pensions Protection Fund to safeguard (defined) benefits when the sponsoring employer becomes insolvent, and better regulation of the pension sector. In the case of wind-up of company pension schemes, the changes proposed would require sufficiently solvent companies to honour their liabilities in full and in other cases change the priority order of creditors to give protection to scheme members with longer contribution periods. The proposed Pensions Protection Fund will require all employers offering defined benefit schemes to pay a levy to the fund. To reduce the risk of moral hazard, part of the levy will be risk based – the level of which will be based on the extent the pension scheme is underfunded. While the actions to increase member protection involve a cost to pension providers, other measures in the recent proposals should provide cost savings. The existence of a compensation scheme could help to increase confidence in defined benefit pensions and lower costs for pension providers may slow the move to defined contribution schemes. In general, the move to defined contribution systems need not present a problem, provided contribution rates are maintained at the same level.

Finally, additional resources in old age can be obtained by reducing barriers to continued work at older ages. In this context, the standard age of retirement for women is being harmonised to that of men at 65 by 2020. Second, the age of eligibility for the Pension Credit will also be raised to 65 by 2020 (aligning women with men), which will also partly counter the adverse incentives it introduces for labour supply on those eligible. Third, the authorities make actuarial adjustments to the basic public pension by increasing the initial benefit level by 10.4 per cent

for each year retirement is delayed (Figure 6.2).[17] While the basic pension offers a relatively small replacement rate, it could at the margin lead to people remaining in the labour force longer, particularly if they have limited alternative sources of retirement income. Fourth, the voluntary "New Deal 50 Plus" scheme supports older individuals re-entering employment by making a supplementary payment for one year. Recent reforms have also attempted to close the use of incapacity benefit as a pathway to early retirement. In 2001, the authorities introduced means testing for incapacity benefit for the first time and are tightening access to limit its use as a pathway to early retirement, particularly in areas of the country where it represents a greater challenge. However, as earlier initiatives have only met with moderate success, reducing the use of this pathway to early retirement may prove to be difficult (Disney and Hawkes, 2003).

Conclusions

The public retirement-income system has been made financially sustainable by reducing the future generosity of public pensions. However, provided that take-up is high, the income related Pension Credit will guarantee basic income for older people. The disincentives to save in the income-related system will be countered by other measures aimed at encouraging voluntary retirement saving. The authorities should, as intended, examine carefully the impact of these measures before deciding whether encouraging further voluntary pension saving or mandating additional saving are warranted. With respect to work incentives, the use of income related benefits could depress labour supply after the age of 65. However, the more immediate challenge for the authorities is to help those who have needed the support of Incapacity Benefit to return to the workplace as soon as they are fit to do so and close the use of incapacity benefit as a route to early retirement. The authorities face some issues in ensuring confidence in the occupational pension system. Toughening the regulatory environment is a welcome initiative. However, the proposed Pensions Protection Fund needs to be carefully designed to prevent moral hazard and imposing unnecessary burdens on well run pension schemes. While further adjustments may be necessary, it is important to establish stability in pension system rules and allow time for individuals to digest the implications of the latest wave of reforms.

Notes

1. Nuclear power currently accounts for one-quarter of total electricity supply.
2. "Fuel poverty" occurs when the energy bill is greater than 10 per cent of household income. Households also pay reduced rate value-added tax on energy products.
3. Newbery (2001) argues that the CCL was also based on energy use rather than carbon to protect coal.
4. In addition, companies can sell surplus renewable energy certificates, but emission trading permits cannot be used to meet the Renewables Obligation.
5. Welfare gains flowing from the reduction in tariff barriers by the European Union as a whole are estimated to exceed 1 per cent of GDP in countries such as Malawi and Tanzania (UNCTAD and Commonwealth Secretariat, 2001).
6. These countries are Fiji, Guyana, Jamaica, Mauritius, and Swaziland.
7. This result is conditional on the particular assumptions used in the simulations, notably that there are imperfectly competitive sectors that exhibit increasing returns to scale.
8. This initiative has been sponsored by International Monetary Fund, International Trade Centre, United Nations Conference on Trade and Development, United Nations Development Programme (UNDP), World Bank, and World Trade Organization.
9. See OECD (2001) for the Development Assistance Committee's review of the United Kingdom.
10. For example, Output-to-Purpose reviews were not effective in disseminating lessons learnt. Project Completion Reports evaluated around three-quarter of projects a success. Subsequent, independent evaluation of a small subset of these projects ranked under one-third as successful (DFID, 2001).
11. Between April 1997 and April 2003 the basic state pension increased 24 per cent, which is closer to the increase in average earnings of 29 per cent than the increase in retail prices of 16 per cent.
12. The high share of defined benefit pensions in the United Kingdom is unusual in comparison with other OECD countries. In the United Kingdom, as well as some other countries, the relative importance of defined benefit pensions has been declining, shifting risk from the employer to the employee in some cases.
13. The proportion of pensioners with incomes below 60 per cent of the median income (after housing costs) was about 22 per cent in 2001-02, representing a fall of about one-fifth since 1996-07, although the reduction based on other definitions of the poverty line has been smaller (Goodman *et al.*, 2003).

14. For example, people's saving patterns change and adjust across their life-cycle and people may save in other forms, such as housing or a business.

15. The Stakeholder Pension offers low income individuals a simple pension product, which caps management fees at 1 per cent and with no penalties for breaks in contributions or for switching between pension plans.

16. The accounting standard FRS17 is a matter for the independent Accounting Standards Board to create greater transparency and sharper focus to the costs and risks of provision of defined benefit pensions. The government currently specifies a Minimum Funding Requirement. This is being replaced with scheme-specific funding requirements that will give schemes greater funding flexibility, whilst requiring employers, trustees and actuaries to work together to ensure security.

17. The government announced in October 2003 that individuals may be able to receive a lump sum of up to £30 000 if retirement is delayed five years beyond the "official" retirement age. The tax treatment and how these assets are accounted for in Pension Credit means testing will determine whether the lump sum offers a more attractive incentive to work beyond the "official" retirement age than the actuarial adjustment.

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Glossary of acronyms

BETTA	British Electricity Trading and Transmission Arrangements
BHPS	British Household Panel Survey
BSP	Basic State Pension
CAT	Competition Appeal Tribunal
CC	Competition Committee
CCAs	Climate Change Agreements
CCL	Climate Change Levy
CHP	Combined Heat and Power
CPI	Consumer price index
DFID	Department for International Development
DTI	Department of Trade and Industry
EC	European Commission
EMU	Economic and Monetary Union
EU	European Union
FDI	Foreign direct investment
FRS17	Financial Reporting Standard #17
FSA	Financial Services Authority
FTSE	Financial Times Stock Exchange Index
GAD	Government Actuary Department
GAP	Output gap
GDP	Gross domestic product
GHG	Greenhouse gases
GNI	Gross national income
G7	Group of seven countries (France, Germany, Italy, Japan, United Kingdom, United States, Canada)
HICP	Harmonised index of consumer prices
H.M. Treasury	Her Majesty's Treasury
ICT	Information and communication technology
LLU	Local loop unbundling
MDGs	Millennium development goals
MIG	Minimum income guarantee
MNOs	Mobile network operators
MPC	Monetary Policy Committee
NAO	National Audit Office
NDDP	New Deal for disabled people
NDLP	New Deal for lone parents
NDYP	New Deal for young people
NETA	New Electricity Trading Arrangements
NGC	National Grid Company

NHS	National Health Service
ODA	Official Development Assistance
Ofcom	Office of Communications
Oftel	Office of Telecommunications
OFT	Office of Fair Trading
OPRAF	Office of the Passenger Rail Franchising
ORR	Office of the Rail Regulator
PC	Pension credit
PISA	Programme for International Student Assessment
PPP	Purchasing power parity
QC	Queen's Council
R&D	Research and Development
RECs	Regional Electricity Company
RIA	Regulatory Impact Assessments
ROSOCs	Rolling stock companies
RPIX	Retail Price Index excluding mortgage interest payments
RUO	Reference unbundling offer
SBP	System buy price
SFO	Serious Fraud Office
SGP	Stability and Growth Pact
SRA	Strategic Rail Authority
SSP	System sell price
TOCs	Train Operating Companies
TR	Tax rate
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
UNFCCC	United Nations Framework Convention on Climate Control
US	United States
USD	United States dollar
WFTC	Working Families Tax Credit

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BASIC STATISTICS OF THE UNITED KINGDOM (2002)

THE LAND

Area (1 000 km^2):		Major cities (thousand inhabitants, 2001):	
Total	243	Greater London	7 188
Agricultural (2001)	186	Birmingham	976
		Leeds	716
		Glasgow (local government district)	579

THE PEOPLE

Population (thousands, mid-2002)	59 207	Total labour force (thousands, 2002)	29 934
Number of inhabitants per km^2	244	Civilian employment (% of total, 2002):	
Net increase in population, 1991-2001,		Agriculture, forestry and fishing	1.4
estimated annual average (thousands)	136	Industry and construction	24.1
		Services	74.5

PRODUCTION

Gross domestic product:		Gross fixed capital investment	
In £ billion	1 043.9	As a % of GDP	16.3
Per head (USD)	26 453	Per head (USD)	4 307

THE GOVERNMENT

Public consumption (% of GDP)	20.0	Composition of House of Commons	
General government (% of GDP)		(number of seats):	
Current and capital expenditure	40.5	Labour	408
Current revenue	39.0	Conservatives	163
Net debt	31.9	Liberal	54
		Other	34
Last general election: 7 June 2001		Total	659

FOREIGN TRADE

Export of goods and services (% of GDP)	26.1	Imports of goods and services (% of GDP)	29.1
Main commodity exports (% of total):		Main commodity imports (% of total):	
Chemicals	15.2	Manufactured goods and articles	28.2
Manufactured goods and articles	23.5	Electrical machinery	21.3
Electrical machinery	20.7	Road vehicles	12.2
Mechanical machinery	12.2	Mechanical machinery and other transport equipment	12.4

THE CURRENCY

Monetary unit: Pound sterling		December 2003, average of daily rates:	
		£ per USD	0.544
		£ per euro	0.669

This survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

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The economic situation and policies of the United Kingdom were reviewed by the Committee on 16 December 2003. The draft report was then revised in light of the discussions and given final approval as the agreed report of the whole Committee on 5 January 2004.

•

The Secretariat's draft report was prepared by David Turner, Jens Lundsgaard, Maria Maher, Douglas Sutherland, and Michael Wise under the supervision of Peter Hoeller.

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The previous Survey of the United Kingdom was issued in January 2002.