

Country Profile Series

# United Kingdom

In-depth PESTLE insights

REFERENCE CODE: ML00002-031

PUBLICATION DATE: July 2014

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## OVERVIEW

### Catalyst

This profile analyzes the political, economic, social, technological, legal and environmental (PESTLE) structure in the UK. Each of the PESTLE factors is explored on four parameters: current strengths, current challenges, future prospects, and future risks.

### Summary

#### Key findings

##### ***The UK has a strong democratic system, but differences on policy matters may force it to exit EU***

The UK adheres to a democratic, parliamentary system of governance known as the Westminster system. This system ensures adequate distribution of power between the executive branch led by the prime minister, the bicameral legislature and the judiciary.

The incumbent Eurosceptic Conservative British Prime Minister opposed Jean-Claude Juncker's nomination as a president of the European Commission, as the latter is a strong federalist. The British prime minister's main concern is that Jean-Claude Juncker as the president would seriously undermine Britain's chances of renegotiating its current membership terms with the EU, resulting in a referendum in 2017 to exit the EU. Britain fears that Jean-Claude Juncker—being a strong proponent of federalism (closer European Union)—could block several reforms that the UK wants (more decentralization of policies) to initiate to continue its membership in the EU, which includes reforms on access to benefits and competitiveness issues.

##### ***The UK economy is developed, but overheated property market remains a concern***

The UK is one of the largest economies in the EU and is one of the strongest in terms of social welfare, and standard of living. Among the EU nations, the UK has one of the highest levels of GDP per capita in terms of purchasing power parity. According to the World Bank's Doing Business indicators for 2014, the UK is the 10th best country in the world in terms of doing business. Further, the country ranks first in "Getting credit"—this indicates that any company wishing to enter the UK faces fewer hurdles in terms of meeting working capital and long-term capital requirements.

Housing market activity in the UK remains frothy as house prices continue to rise. As of 2014Q1, house prices have risen 9% year-on-year. House prices across the United Kingdom have been experiencing inflation, with property prices in London rising significantly above average. The surge is driven by easy credit (low interest rate) conditions and increased demand as economic uncertainty eases on the back of strong recovery.

##### ***The country has a strong education and health sector, but income inequality is still apparent***

The UK has high-quality educational infrastructure and has historically attracted students from all parts of the globe. The nation's tradition of education dates back hundreds of years and is constantly evolving. Qualifications obtained from UK institutions are recognized and respected worldwide. The UK has around 170 universities and higher education institutes, including three universities in the world's top 10, according to The Times Higher Education World University Rankings 2013-14. The ranking was based on teaching, research, knowledge transfer and international outlook.

The UK's healthcare system is one of the most successful social ventures in the world. This is due to the presence of advanced healthcare infrastructure and private sector involvement. The UK's public expenditure on health has

traditionally been very high, and has helped to maintain quality and efficiency. All residents of the UK, the European Economic Area, and countries that have bilateral healthcare agreements with the UK are eligible for NHS care. The system is one of the best in the world.

However, rising inequality is a concern. According to the OECD, as of 2010, UK gini coefficient (a measure of inequality in income) was 0.341 compared to the OECD-34 average of 0.313. The Gini coefficient score of zero corresponds to complete equality while a score of one corresponds to complete inequality. While in the OECD countries, the richest 10% of the country earn an average income that is around 9.4 times than that of the poorest 10%; in the UK, the average income of the richest 10% is 10 times that of the poorest 10%. The UK ranks among the top countries in terms of rising inequality. Further, inequality in market incomes (gross wages, income from self-employment, capital income, and returns from savings taken together) and household disposable income increased during 2007-11.

***The UK boasts of strong intellectual property laws, but fall in R&D expenditure remains a concern***

As the UK is at the forefront of innovation and R&D globally, it has concurrently developed its legislation concerning the protection of intellectual property rights (IPR). The UK Intellectual Property Office (UK-IPO) is responsible for granting IPR. Although the UK does not have a general statutory register of copyright, the UK-IPO is responsible for maintaining registers of trademarks, designs and patents. IPR protection legislation is frequently enacted and amended in line with industry developments.

However, according to the ONS (Office for National Statistics), gross expenditure on R&D decreased by 2% to GBP27.0 billion (\$46.26 billion) in 2012, compared with 2011. Moreover, when adjusted for inflation, in constant prices, the fall in expenditure was much steeper by 3%. Further, BERD (Business expenditure in R&D), which accounted for 63% of UK R&D expenditure in 2012, also witnessed a decline by 2%, in current prices, to GBP17.1 billion (\$29.30 billion) in 2012, compared with 2011. Total R&D expenditure decreased to 1.72% of GDP in 2012 from 1.77% of GDP in 2011.

***Business legislation encourages commercial activity; however, traditional liberties are coming under threat***

The legislation in the UK prioritizes the interests of investors. This is evident from the fact that domestic and foreign players have shown a continuous commitment to investing in the country. The majority of non-European multinational corporations seeking a presence in Europe tend to establish their Europe operations in the UK.

The government faces the challenge of maintaining a traditionally liberal society while taking steps to combat terrorism. For instance, a 2006 law bans the "glorification" of terrorism and gives law enforcement agencies special powers to act against websites deemed inflammatory. While the House of Commons approved the law by a comfortable margin, members of the House of Lords criticized it as restricting freedom of speech. In much the same way, legislation such as the Terrorism Act 2006 and the Prevention of Terrorism Act 2005 were controversial. The new immigration act of 2014, which has the given power to the authorities to strip suspected terrorists of citizenship, has also attracted controversy in the UK.

***The UK has a strong global influence in environmental issues, but high air pollution is a cause for concern***

With its position as an industrialized global power and a member of the G8, the UK has a leadership role to play in the global effort towards sustainable development and the protection of the environment. The UK, with its close ties to a number of countries and its influence in the Commonwealth, has the ability to obtain commitments from a number of developing countries that are unwilling to sacrifice economic growth for environmental gain.

The level of air pollution in London is among the highest in the UK, and the country as a whole is among the most

polluted. Regions such as Manchester, Glasgow and Birmingham also have dangerous levels of NO<sub>2</sub>. Exhaust fumes and emissions from factories and power stations around London are the main causes of pollution, and the UK faces a fine of around GBP300m (\$514.04m) from the European Commission as it has failed to contain these.

## **PESTLE highlights**

### ***Political landscape***

- The UK is one of the most prosperous and influential nations in the world and has a large role to play on the international stage. It is one of the five permanent members of the UN Security Council, one of the founding members of the North Atlantic Treaty Organization, and a member of the G8. Though a member of the EU, it has a conservative approach to the issue of European integration.
- The Scottish National Party (SNP) won a majority in the Scottish parliamentary elections held in May 2011, and is planning a referendum on independence in September 2014. However, independence is unlikely and there are high possibilities of an increased devolution of powers.

### ***Economic landscape***

- In June 2014, the S&P upgraded its outlook on Britain's AAA credit rating from negative to stable, citing the government's prudent fiscal measures to bolster its public finance.
- The UK has maintained persistent current account deficits since the 1990s. According to IMF, the current account deficit as of 2013 stood at 3.33% of GDP.

### ***Social landscape***

- The government faces a number of challenges when it comes to maintaining the level of public services on offer. Given the fact that the budget deficit is a clear point of concern for the authorities, maintaining expenditure levels on social welfare projects will prove a challenge.
- The UK's healthcare expenditure was \$234.45 billion or 9.45% of GDP in 2012, according to MarketLine, reflecting the dependence of the population on public healthcare services. Physicians per 1000 population (head count) was 2.8 in 2013, which was lesser than the OECD average of 3.2.

### ***Technological landscape***

- According to MarketLine, mobile penetration stood at 131.30 per 100 people in 2013 with total subscribers at 84.14 million. Mobile subscribers grew by an average of 9.97% during 2000-13. Internet users as of 2012 stood at 56.54 million, with a penetration rate of 88.76% in the same year. Internet subscribers grew at an average rate of 13.49% during 2000-12.
- Despite the quality of educational and research institutions within the UK, there is a shortage of work force in the R&D sector. The reason for this trend could be the attractive opportunities available outside of research within the UK. Moreover, technicians in R&D (per million people) were 970.9 in 2011, while Germany (1,363.7), France (1,855.9) and Spain (1,314.3) did far better in this parameter according to the World Bank.

### ***Legal landscape***

- According to Paying Taxes 2014, the UK's total tax rate (aggregate of profit taxes, labor taxes and other taxes) has been 34%, which was lower than the EU&EFTA average of 41.1%. Further, time to comply with taxes is 110 hours, far lower than the EU&EFTA average of 179 hours.

- British territories of Anguilla, Bermuda, Montserrat, the Turks and Caicos Islands, and the British Virgin Islands have signed treaties with the UK and other G5 nations to share tax information. The government has hailed this as a significant step to curb tax evasion.

#### **Environmental landscape**

- According to MarketLine, the UK renewable energy market had total revenues of \$10.2 billion in 2012, representing a compound annual growth rate (CAGR) of 22.1% during 2008-12. In comparison, the French and German markets grew with CAGRs of 10.2% and 11.9% respectively, over the same period, to reach respective values of \$10.9 billion and \$30.8 billion in 2012.
- According to MarketLine, CO2 emissions in the UK came down from 572.58 million metric tonnes in 2003 to around 496.80 million metric tonnes in 2011.

#### **Key fundamentals**

<b>Table 1: The UK - key fundamentals</b>							
	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014f</b>	<b>2015f</b>	<b>2016f</b>	<b>2017f</b>
GDP, constant 2005 prices (\$ trillion)	2.39	2.40	2.44	2.50	2.57	2.63	2.70
GDP growth rate (%)	1.12	0.28	1.66	2.84	2.48	2.49	2.47
GDP, constant 2005 prices, per capita (\$)	37742.58	37610.02	38011.56	38857.83	39595.81	40352.86	41136.31
Inflation (%)	4.50	2.80	2.63	2.00	2.05	2.27	2.21
Exports, total as a percentage of GDP	32.15	30.41	29.97	29.07	28.24	27.34	26.47
Imports, total as a percentage of GDP	34.42	34.81	35.08	34.64	34.22	33.66	33.06
Mid-year population (millions)	63.31	63.71	64.08	64.46	64.83	65.20	65.53
Unemployment rate (%)	8.06	7.92	7.62	7.23	6.88	6.68	6.46
Mobile penetration per 100 people	130.53	130.53	131.30	131.95	132.49	132.94	133.31

**Source: Country Statistics, MarketLine** **MARKETLINE**

## TABLE OF CONTENTS

<b>Overview</b>	<b>2</b>
<i>Catalyst</i>	2
<i>Summary</i>	2
<b>Key Facts and Geographic Location</b>	<b>13</b>
<i>Key facts</i>	13
<i>Geographical location</i>	14
<b>PESTLE Analysis</b>	<b>15</b>
<i>Summary</i>	15
<i>Political analysis</i>	16
<i>Economic analysis</i>	19
<i>Social analysis</i>	46
<i>Technology analysis</i>	51
<i>Legal analysis</i>	54
<i>Environmental analysis</i>	58
<b>Political Landscape</b>	<b>60</b>
<i>Summary</i>	60
<i>Evolution</i>	60
<i>Structure and policies</i>	63
<i>Performance</i>	66
<i>Outlook</i>	67
<b>Economic Landscape</b>	<b>68</b>
<i>Summary</i>	68
<i>Evolution</i>	68
<i>Structure and policies</i>	69
<i>Performance</i>	71

<i>Outlook</i>	78
<b>Social Landscape</b>	<b>79</b>
<i>Summary</i>	79
<i>Evolution</i>	79
<i>Structure and policies</i>	79
<i>Performance</i>	82
<i>Outlook</i>	84
<b>Technological Landscape</b>	<b>85</b>
<i>Summary</i>	85
<i>Evolution</i>	85
<i>Structure and policies</i>	85
<i>Performance</i>	86
<i>Outlook</i>	87
<b>Legal Landscape</b>	<b>88</b>
<i>Summary</i>	88
<i>Evolution</i>	88
<i>Structure and policies</i>	88
<i>Performance</i>	89
<i>Outlook</i>	89
<b>Environmental Landscape</b>	<b>90</b>
<i>Summary</i>	90
<i>Evolution</i>	90
<i>Structure and policies</i>	90
<i>Performance</i>	90
<i>Outlook</i>	91
<b>Appendix</b>	<b>93</b>

*Ask the analyst*

93

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93

## TABLE OF FIGURES

<i>Figure 1: Map of the UK</i>	14
<i>Figure 2: Multi-factor productivity growth</i>	21
<i>Figure 3: Labor productivity growth</i>	21
<i>Figure 4: Relative levels of GDP per hour</i>	22
<i>Figure 5: Productivity growth in the services sectors</i>	22
<i>Figure 6: Productivity growth in finance, insurance and business services, 1998-2007</i>	23
<i>Figure 7: Export market share across all countries</i>	24
<i>Figure 8: Real effective exchange rate (2005-13)</i>	25
<i>Figure 9: Nominal Unit Labor Cost (2007-14Q1)</i>	25
<i>Figure 10: European stress index</i>	27
<i>Figure 11: Historical 10-year government bond yields in major OECD economies</i>	28
<i>Figure 12: Historical 1-year yields on government bills in major OECD economies</i>	29
<i>Figure 13: Ten-year benchmark bond yields (peripheral countries)</i>	29
<i>Figure 14: Option implied volatility on interest rates</i>	30
<i>Figure 15: Compressed risk premium on different asset classes</i>	30
<i>Figure 16: Narrowing global corporate debt spreads</i>	31
<i>Figure 17: Market-implied default probabilities over the next five years for selected corporate debt</i>	31
<i>Figure 18: Liquidity risk premia of select corporate debt</i>	32
<i>Figure 19: UK banks Tier 1 capital ratio</i>	33
<i>Figure 20: UK banking leverage ratio and non-core asset reductions</i>	34
<i>Figure 21: Additional Tier 1 capital (AT1) public issuance by EEA and Swiss banks</i>	34
<i>Figure 22: UK banking risk weights and loan loss provision</i>	35
<i>Figure 23: Major UK banks' pre-tax return on assets</i>	35
<i>Figure 24: Perceived risks of UK's financial system (Short term)</i>	36
<i>Figure 25: Perceived risks of UK's financial system (Medium term)</i>	36
<i>Figure 26: The risk premium on the interbank market in the UK</i>	37
<i>Figure 27: General government deficit</i>	38
<i>Figure 28: House price index</i>	39
<i>Figure 29: House price inflation has risen in the United Kingdom</i>	39
<i>Figure 30: House price inflation across United Kingdom</i>	40
<i>Figure 31: Average UK mortgage rates on new lending</i>	40

<i>Figure 32: House price valuation in OECD countries</i>	41
<i>Figure 33: Credit to GDP</i>	41
<i>Figure 34: UK household balance sheet, 2012</i>	42
<i>Figure 35: Mortgage debt to income ratio</i>	42
<i>Figure 36: Borrowers with high mortgage debt to income ratios account for a large share of mortgage debt</i>	43
<i>Figure 37: New mortgages advanced for house purchase by LTI (Loan to Income)</i>	43
<i>Figure 38: New mortgages advanced for house purchase by LTV (Loan to Value)</i>	44
<i>Figure 39: Percentage of mortgagors that would need to take action if interest rates rose, by mortgage debt to income group</i>	44
<i>Figure 40: UK banks' lending and deposit composition, 2012</i>	45
<i>Figure 41: UK's external debt, 1988-2013</i>	45
<i>Figure 42: Old age dependency ratio</i>	48
<i>Figure 43: Gross public spending by benefit of in-kind for the total population, 2009</i>	48
<i>Figure 44: Gini coefficient of household disposable income, 2010 and S90/S10 ratio</i>	49
<i>Figure 45: Percentage point changes in the Gini coefficient of household market and disposable incomes between 2007 and 2011</i>	50
<i>Figure 46: Government funding of business R&amp;D, 2011</i>	52
<i>Figure 47: Product market regulations, 2013</i>	56
<i>Figure 48: FDI restrictiveness Index 2013</i>	57
<i>Figure 49: The UK - political events timeline</i>	62
<i>Figure 50: Key political figures</i>	63
<i>Figure 51: Composition of legislature</i>	65
<i>Figure 52: Historical GDP growth, 2003-2013</i>	69
<i>Figure 53: GDP and GDP growth rate, 2007-17</i>	71
<i>Figure 54: Sector-specific contribution to GDP, 2013</i>	72
<i>Figure 55: Agricultural output, 2008-13</i>	73
<i>Figure 56: Industrial output, 2008-13</i>	74
<i>Figure 57: Services sector output, 2008-13</i>	75
<i>Figure 58: The UK's external trade position, 2009-13</i>	76
<i>Figure 59: Consumer price index and consumer price index-based inflation, 2007-17</i>	77
<i>Figure 60: Unemployment in the UK, 2007-17</i>	78
<i>Figure 61: Major religions in the UK, 2011</i>	81

<i>Figure 62: Healthcare expenditure, 2006-12</i>	83
<i>Figure 63: Education expenditure, 2006-12</i>	84
<i>Figure 64: Internet users, 2008-12</i>	86
<i>Figure 65: Carbon dioxide emissions (million metric tons) and growth (%), 2004-11</i>	91

## TABLE OF TABLES

<i>Table 1: The UK - key fundamentals</i>	5
<i>Table 2: The UK - key facts</i>	13
<i>Table 3: Analysis of the UK's political landscape</i>	16
<i>Table 4: Analysis of the UK's economy</i>	19
<i>Table 5: Analysis of the UK's social system</i>	46
<i>Table 6: Analysis of the UK's technology landscape</i>	51
<i>Table 7: Analysis of the UK's legal landscape</i>	54
<i>Table 8: Analysis of the UK's environmental landscape</i>	58
<i>Table 9: Mid-year population by age (as % of Population), 2014</i>	80
<i>Table 10: Comparative performance on receipt of patents, 2011-13</i>	85

## KEY FACTS AND GEOGRAPHIC LOCATION

### Key facts

Table 2: The UK - key facts	
<b>Country and capital</b>	
<i>Full name</i>	The United Kingdom of Great Britain and Northern Ireland
<i>Capital city</i>	London
<b>Government</b>	
<i>Government type</i>	Constitutional monarchy and Commonwealth realm
<i>Head of state</i>	Queen Elizabeth II
<i>Head of government</i>	Prime Minister David Cameron
<b>Population (2014 est.)</b>	64.46 million
<b>Currency</b>	British pound (GBP)
<b>GDP per capita, constant 2005 prices (2014 est.)</b>	\$38,857.83
<b>Internet domain</b>	.uk
<b>Demographic details</b>	
<i>Life expectancy (2014 est.)</i>	Total population: 80.40 years Men: 78.30 years Women: 82.70 years
<i>Ethnic composition (2011 est.)</i>	White (87.2%), black/African/Caribbean/black British (3%), Asian/Asian British: Indian (2.3%), Asian/Asian British: Pakistani (1.9%), mixed (2%), other (3.7%)
<i>Major religions (2011 est.)</i>	Christian (59.5%), Muslim (4.4%), Hindu (1.3%), other (2%), none (25.7%), unspecified (7.2%)
<b>Country area</b>	243,610 sq. km
<b>Language</b>	English
<b>Exports</b>	Manufactured goods, fuels, chemicals; food, beverages, tobacco
<b>Imports</b>	Manufactured goods, machinery, fuels; foodstuffs
<b>Source: CIA - The World Factbook and Country Statistics, MarketLine</b>	
<b>MARKETLINE</b>	

Key Facts and Geographic Location

**Geographical location**

The country is located in Western Europe, between the North Atlantic Ocean and the North Sea, northwest of France.

**Figure 1: Map of the UK**



Source: CIA - The World Factbook

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## PESTLE ANALYSIS

### *Summary*

The UK, being an influential member of the European Union (EU) and one of the largest economies in the world, remains a significant economic and political force. Its membership of the United Nations Security Council, the EU, the North Atlantic Treaty Organization (NATO), and the G8, along with strong links with its former colonies through the Commonwealth and robust cultural and security ties with the US, place it in a unique position within the global community.

The UK's effort to maintain a foothold in both the European and American camps has become difficult in the aftermath of the Iraq war, putting an unprecedented strain on the Euro-American alliance. Economic conditions improved in the country in 2013 after nearly stagnating in 2012.

The educational infrastructure in the UK is of a very high standard and is attractive to foreign students. The UK's healthcare system is one of the most successful social ventures in the world, predominantly due to the presence of advanced healthcare infrastructure and the participation of the private sector. Public expenditure on health has traditionally been very high, helping to preserve the quality of services.

Despite the quality of educational and research institutions in the UK, there is a shortage of R&D personnel. The legal system in the UK is transparent and efficient and is conducive to business. In terms of environmental impact, the UK still needs to improve its air quality by curbing pollution.

## PESTLE Analysis

### **Political analysis**

#### **Overview**

The UK's political landscape is deeply entrenched in the ethos of democracy. The country's stable governance system ensures that there is remarkable consistency in its policies. Following the world wars, the UK emerged as a major global force, largely on the back of its rapid economic development. However, it continues to face terror threats from groups such as Al-Qaeda. With the Scottish National Party's (SNP's) landslide victory in elections in Scotland, there is a high possibility of increased devolution of powers.

<b>Table 3: Analysis of the UK's political landscape</b>	
<b>Current strengths</b>	<b>Current challenges</b>
<ul style="list-style-type: none"> <li>▪ Strong democratic setup and effective governance</li> <li>▪ Strong position in global politics</li> </ul>	<ul style="list-style-type: none"> <li>▪ Tensions in the ruling coalition and falling popularity of the government</li> </ul>
<b>Future prospects</b>	<b>Future risks</b>
<ul style="list-style-type: none"> <li>▪ Stronger ties with China</li> </ul>	<ul style="list-style-type: none"> <li>▪ Terrorism</li> <li>▪ The SNP's push for independence</li> <li>▪ Referendum on exiting the EU</li> </ul>
<b>Source: MarketLine</b>	
<b>MARKETLINE</b>	

#### **Current strengths**

##### ***Strong democratic setup and effective governance***

The UK adheres to a democratic, parliamentary form of governance known as the Westminster system that calls for distribution of power between the executive branch led by the prime minister, the bicameral legislature and the judiciary, with a system of checks and balances. As the World Bank's governance indicators illustrate, the UK is one of the most successful nations in terms of the application of the rule of law, control of corruption, government effectiveness, and regulatory quality. Furthermore, according to the governance indicators for 2012, the country had a high percentile rank of 92.42 in government effectiveness.

##### ***Strong position in global politics***

After the two world wars, the UK rebuilt itself into a prosperous and modern nation. It is a major power in global politics by virtue of its permanent membership of the UN Security Council, its membership in G8 and NATO, and the legacy of the British Empire. The UK also has considerable influence in multinational organizations such as the International Monetary Fund (IMF) and the World Bank. Successive decades of solid economic growth, initially built on the industrial sector and now largely driven by the services industry, have ensured its firm establishment as a global business hub and economic power.

## PESTLE Analysis

### **Current challenges**

#### ***Tensions in the ruling coalition and falling popularity of the government***

Growing differences between the Conservatives and the Liberal Democrats is making the ruling coalition vulnerable. Tensions between pro-Europe Liberal Democrats and Eurosceptic Conservatives on the extent of integration with EU might continue to plague British politics. Conflict of opinion between the two parties on issues such as welfare reform, immigration and the economy continue to strain relations; with the parliamentary election drawing near, the coalition may get weaker. Nevertheless, the rising antipathy of Britons towards more integration with Europe has lowered the ratings of Liberal Democrats, who support the UK's membership in the EU, thus making it difficult for them to withdraw from the coalition. The Liberal Democrats lost all but one seat in the European elections in May 2014.

On the popularity front, the ruling Conservative party is behind Labour Party in the opinion polls. As of June 2014, according to Opinium/Observer poll, around 35% would vote for the Labour Party compared to 31% for the Conservative Party. Further, the popularity rating of the new populist, anti-immigrant, Eurosceptic UK Independence Party (UKIP) has seen a sharp rise, which has helped it to increase its seats count in the European parliamentary elections. Taking into account all these factors, the ruling Conservative Party is likely to face considerable headwinds in the run-up to the parliamentary elections in 2015.

### **Future prospects**

#### ***Stronger ties with China***

The visit by Chinese Premier Li Keqiang to the UK in June 2014 is expected to usher in a period of better Sino-UK ties. The visit by the Chinese premier on the heels of a similar visit by the British Prime Minister Mr. David Cameron to China in December 2013 is suggestive of the ties getting stronger. The emergence of new, low cost centers of production and the rapid economic growth of certain developing countries (especially China) has made it important for the UK to cooperate with them for mutual benefit or risk heavy economic losses.

Relations between the two nations had cooled since Mr. Cameron visited the Dalai Lama in 2012, irking the Chinese government. This resulted in reduction of Chinese investments in the UK over the past two years. Nevertheless, relations have now improved considerably and the Chinese Premier's visit to the UK resulted in investment deals worth GBP14 billion (\$23.99 billion) in the fields of infrastructure, financial services and clean energy. The warming of ties is a big boost to the economic environment of the UK, as with the improved ties, the UK could experience an increase in capital inflows.

### **Future risks**

#### ***Terrorism***

The involvement of the UK in the war on terror in Afghanistan and Iraq seems to have had some negative consequences with the threat of terrorism now facing the country. The July 7, 2005 bombings in London brought the capital to a standstill, and the public threats issued by extremist groups such as Al-Qaeda are a clear indication of the constant dangers that they pose. Foiled terrorist attacks have also put the government and the public on edge.

In March 2010, the UK's intelligence and security service said that terror threats linked to Pakistan remained the primary area of concern. Additionally, according to a security committee, about 15% of the security services' work is now focused on East Africa and Somalia in particular, as there are an increasing number of extremists visiting the area for terrorist training. The committee said the UK faced a range of covert threats to its security, and identified Al-Qaeda as presenting the most significant risk. In a report titled "CONTEST The United Kingdom's Strategy for Countering Terrorism" published

## PESTLE Analysis

by the Secretary of State for the Home Department in April 2014, the government highlighted threats to the UK's interests from areas in Pakistan and the tribal areas along the Afghan border, Al-Qaeda in the Arabian Peninsula (AQAP), Northern Africa, Somalia and Syria.

### ***The SNP's push for independence***

The SNP won a majority in the Scottish parliament in elections held in May 2011, and has planned a referendum on independence in September 2014. There are major impediments to Scotland breaking away from the UK, including the division of debt and oil reserves. The SNP has already been pushing for greater financial independence, but its push for full independence from the UK is likely to be opposed by all other political parties including Labor, the Liberal Democrats and the Conservatives.

### ***Referendum on exiting the EU***

The incumbent Eurosceptic Conservative British Prime Minister opposed Jean-Claude Juncker's nomination as a president of the European Commission, as the latter is a strong federalist. The British prime minister's main concern is that Jean-Claude Juncker as the president would seriously undermine Britain's chances of renegotiating its current membership terms with the EU, resulting in a referendum in 2017 to exit the EU. Britain fears that Jean-Claude Juncker—being a strong proponent of federalism (closer European Union)—could block several reforms that the UK wants (more decentralization of policies) to initiate to continue its membership in the EU, which includes reforms on access to benefits and competitiveness issues.

The Conservatives and many British voters have become skeptical about the EU since the crisis and many are unhappy about the regulations related to competition, internal market and trade, which they want to reform. Mr. Cameron has promised that failure to negotiate with the EU will result in an in/out referendum for exiting the EU in 2017, if he is re-elected again in the 2015 parliamentary elections. Moreover, tensions have exacerbated with the EU after Mr. Cameron proposed a referendum to exit the EU, which can become a major impediment in re-negotiation with the EU. Even, the US supports the view that the UK should remain part of the EU. Apart from political ramifications, exiting the EU will have serious repercussions on the UK business and financial services, causing London to lose its importance as a major financial center.

## PESTLE Analysis

### ***Economic analysis***

#### **Overview**

The country boasts of high per capita GDP and a favorable investment climate, but the government is challenged by lower productivity and fall in export market share. However, the fiscal deficit is narrowing, which is positive news for the economy. In the short term, the overheated property market and high indebtedness are the risks facing the economy.

<b>Table 4: Analysis of the UK's economy</b>	
<b>Current strengths</b>	<b>Current challenges</b>
<ul style="list-style-type: none"> <li>▪ Highly developed economy and favorable investment climate</li> <li>▪ Excellent environment for doing business</li> </ul>	<ul style="list-style-type: none"> <li>▪ Low productivity</li> <li>▪ External imbalances and fall in export market share</li> </ul>
<b>Future prospects</b>	<b>Future risks</b>
<ul style="list-style-type: none"> <li>▪ Improving global financial environment</li> <li>▪ Macro-prudential measures to strengthen the financial system</li> <li>▪ Narrowing fiscal deficit</li> </ul>	<ul style="list-style-type: none"> <li>▪ Overheated property market</li> <li>▪ High indebtedness</li> </ul>
<b>Source: MarketLine</b>	
<b>MARKETLINE</b>	

#### **Current strengths**

##### ***Highly developed economy and favorable investment climate***

The UK is one of the largest economies in the EU and is one of the strongest in terms of social welfare, and standard of living. Among the EU nations, the UK has one of the highest levels of GDP per capita in terms of purchasing power parity. According to the World Bank's Doing Business indicators for 2014, the UK is the 10th best country in the world to do business. Further, the country ranks first in "Getting credit"—this indicates that any company wishing to enter the UK faces fewer hurdles in terms of meeting working capital and long-term capital requirements.

##### ***Excellent environment for doing business***

The UK is an open and competitive economy, and international businesses view the political and economic institutions favorably. The country has a robust science base and boasts of strong high tech manufacturing capabilities in aerospace, defense and automobiles. The UK's strength lies in knowledge economy sectors such as banking, software and pharmaceuticals. According to the World Economic Forum's Global Competitiveness Report 2013-14, the country ranks 10th among 148 countries. The UK, considered the doorway to the rest of the EU, has a favorable business environment in terms of the availability of skilled professionals, a central time zone perfectly positioned between the east and the west, a flexible regulatory environment to start a business, and a leading global financial center in London.

#### **Current challenges**

##### ***Low productivity***

Productivity growth in the United Kingdom has remained in the negative territory since the middle of the last decade. Both labor and multi-factor productivity (MFP) have witnessed a decline. In fact, it remains comparatively lower than the

## PESTLE Analysis

best performing OECD countries. Some part of the decline in productivity has been cyclical while the rest are longer term and structural problems.

Since the financial crisis, weak productivity growth has become common across Europe and this is not unique to the UK. The sharp decline in the level of UK productivity since 2007 cannot be attributed to any single factor. Cumulative factors (cyclical factors) such as hoarding skilled labor, structural shifts in production, negative spill-over effects from the global financial crisis and an impaired financial system that hampered the reallocation of resources across sectors have contributed to the decline.

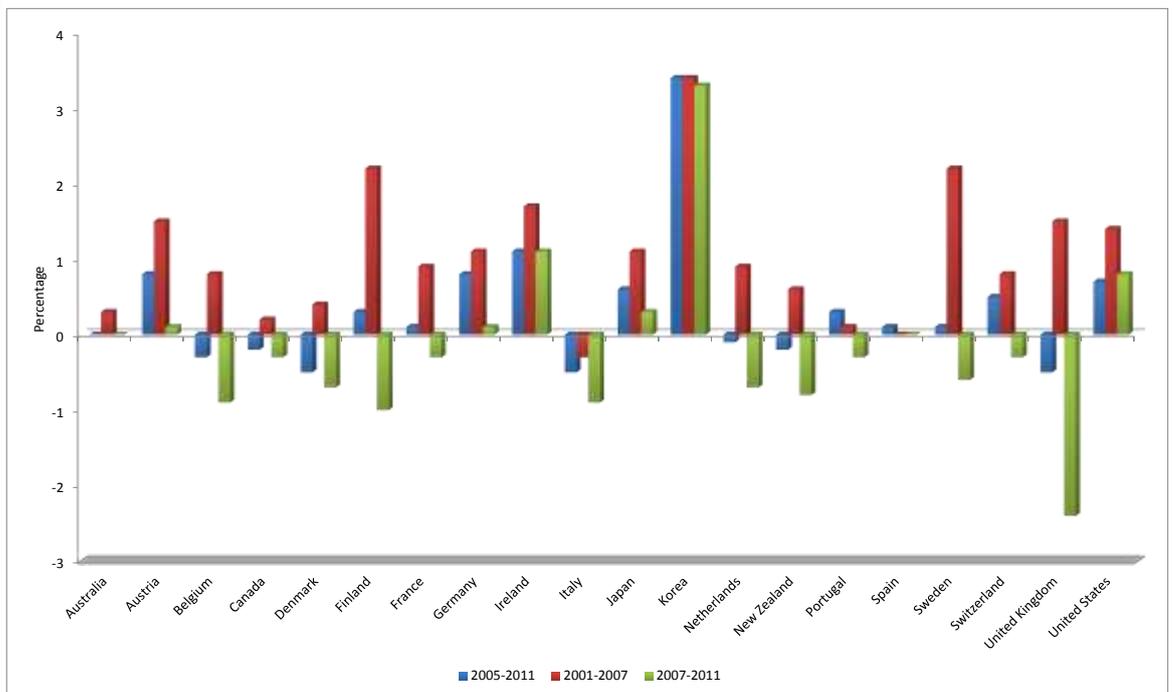
The pre-crisis growth in productivity was fueled by product innovation, especially in bio-technology, information and communication technology (ICT) and finance. The UK was clearly one of the productivity leaders among the OECD countries during 1998-2007 in finance, insurance and business services. Flexible labor market, rise in ICT capital and close interlinkages between business and university level research and innovation had resulted in strong services productivity in the pre-crisis period. However, to some extent, the rise in services sector productivity was cyclical and overvalued; as some of the innovations in the financial sector might have transferred rents instead of raising output. The financial crisis corrected this overvaluation, which could explain in part for the downward shift in productivity growth.

Despite the significant increase in productivity growth in the run-up to the financial crisis, overall level of productivity in the UK remains low, especially compared to the US, France and Germany. This can be attributed to structural factors such as skill gap and management quality in the UK. Skill gap between university educated and the school leavers, apart from poor management practices arising from the prevalence of family-owned business has kept overall productivity lower than the best performing OECD countries. Other long-term structural factors contributed to the decline include insufficient infrastructure, the skill level of the workforce and management practices, weak export performance, public sector inefficiencies, end of a product innovation cycle and waning effect of earlier structural policy reforms has also been responsible for the dip in productivity.

Noteworthy improvements were done in the deregulation of various sectors to infuse competition over the decade prior to the global financial crisis which raised productivity growth. For example, the shakeup of the gas industry in 1995 and the Competition Act of 2000 have added to the increased productivity over the next few years, however, their impacts are now waning and more structural reforms are needed to ramp up productivity. Lower productivity in the services sectors, including the public sector and the steady deterioration in traditional fields of high-tech manufacturing over the last ten years also contributed to the productivity drop. The government has taken a number of steps to boost productivity and competitiveness of UK business though much depends on effective implementation.

PESTLE Analysis

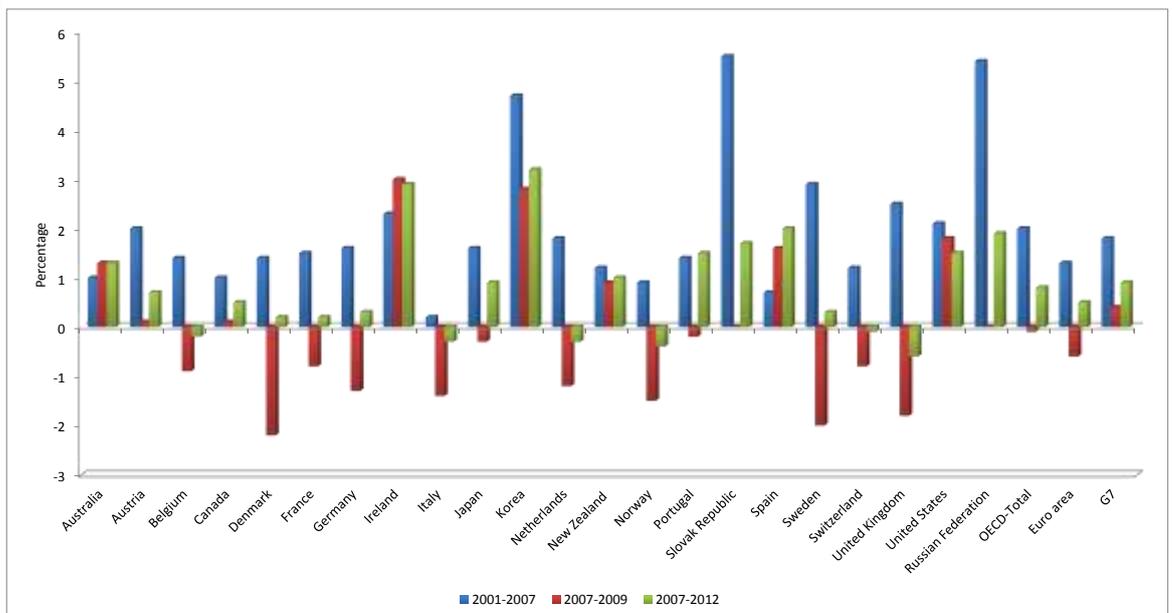
Figure 2: Multi-factor productivity growth



Source: OECD

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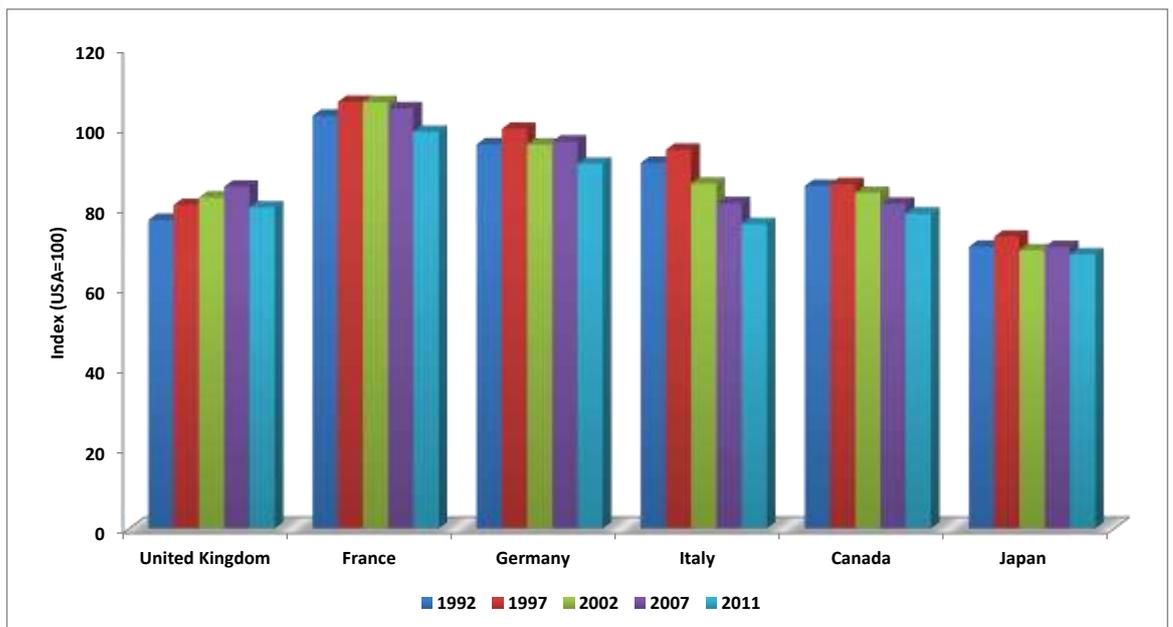
Figure 3: Labor productivity growth



Source: OECD

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**Figure 4: Relative levels of GDP per hour**

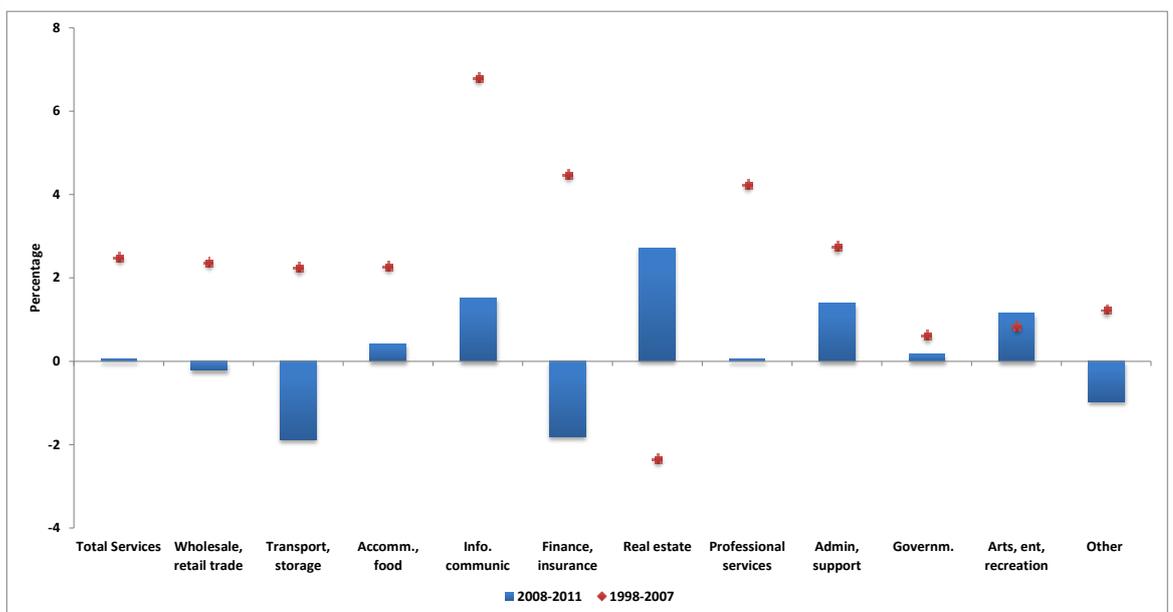


**Note:** Refers to the ratio of GDP at 2005 PPP in USD to total hours worked, whole economy

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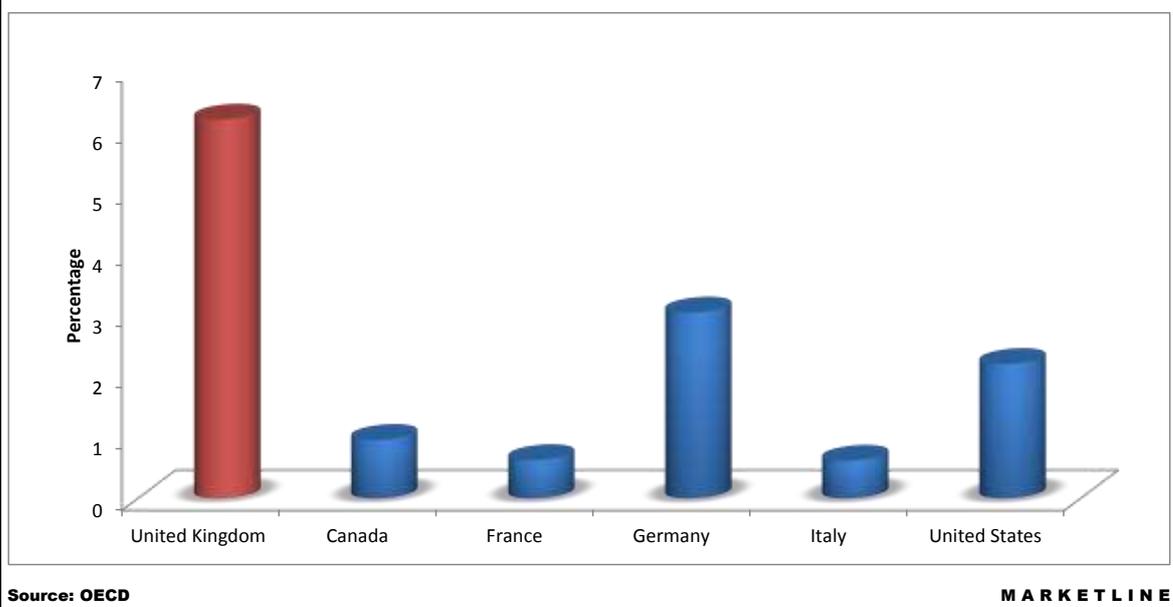
**Source: OECD**

**Figure 5: Productivity growth in the services sectors**



**Source: OECD**

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**Figure 6: Productivity growth in finance, insurance and business services, 1998-2007**

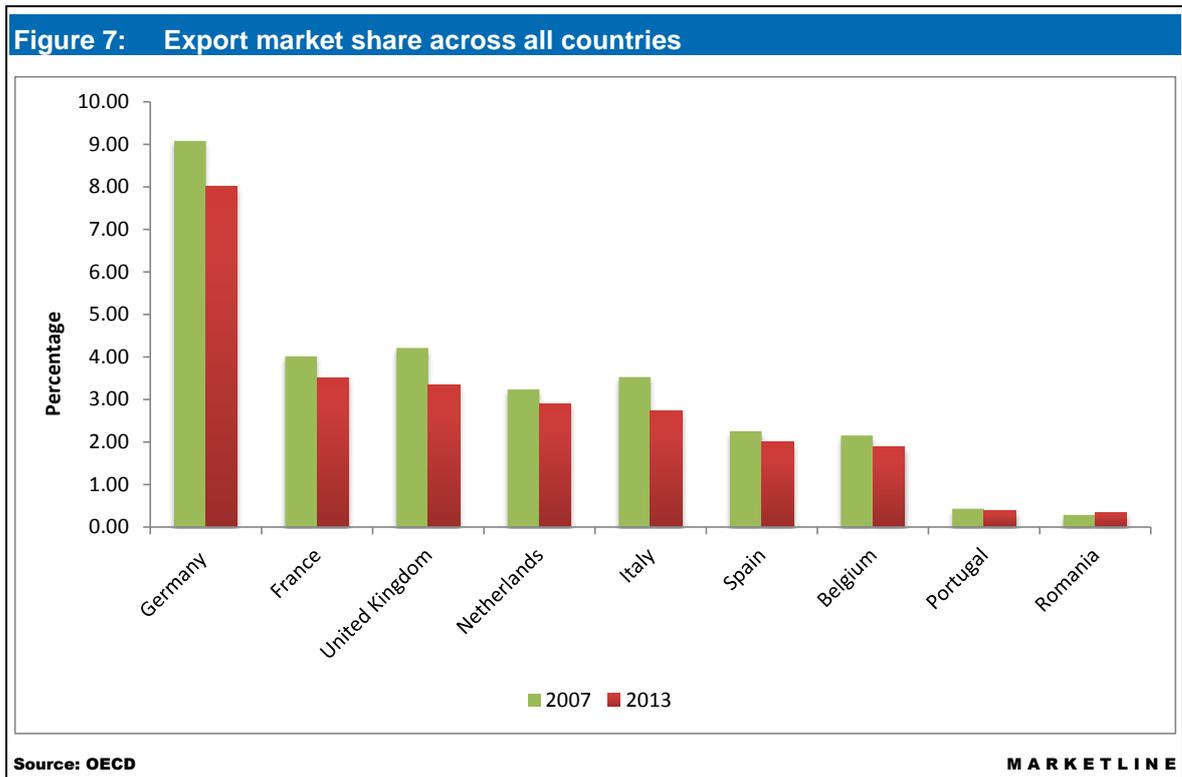
#### ***External imbalances and fall in export market share***

The UK has maintained persistent current account deficits since the 1990s. According to IMF, the current account deficit as of 2013 stood at 3.33% of GDP. Over the past 15 years, the current account balance showed a consistent deficit in goods and a positive in terms of services exports, however, the trade deficit has been wider than the services surplus. In the aftermath of the global economic crisis, income balance has been the major contributor to the current account deficit. Historical data shows that the income balance has been in surplus, but it has slipped into the negative territory; this can be attributed to the difference in returns between inward and outward investment of the UK. The UK's GDP growth has been faster than that of the European Union, which is a major export partner and investment destination accounting for around half of UK's exports and the UK contributes roughly 40% of its inward investment. Consequently, the UK's income from the investments in the EU would have been lower than its EU counterparts' investments in the UK, which resulted in the imbalances. If the projections for the EU economy to do better in 2014 prove accurate, it could result in an increase in the UK's net investment income, which will in turn reduce its deficit.

Further, in the aftermath of the global financial crisis, domestic demand was sustained by the fall in gross national savings rate. Consequently, the gross national savings witnessed a steeper fall than the investment rate. Hence, the movements in gross savings and investment may also have contributed to the deficit to some extent.

The economic recovery of the UK (mainly driven by domestic demand rather than net exports) from the financial crisis has been much faster than its EU partners. Therefore, import growth was higher than the export growth that did not help in narrowing the deficit. Since domestic demand is expected to pick up in the near term, import growth may further outstrip export, thus exacerbating the imbalance. The current trend in growth recovery (domestic demand led) hence is not balanced and this imbalance can only be countered through growth in net exports and increase in savings rate.

Another major challenge facing the UK is the loss of export market shares. During 2007-13, the UK has lost around 20% market share, although of late the pace of decline has slackened. It lost export market share even in the services sector where it is a relatively strong player.

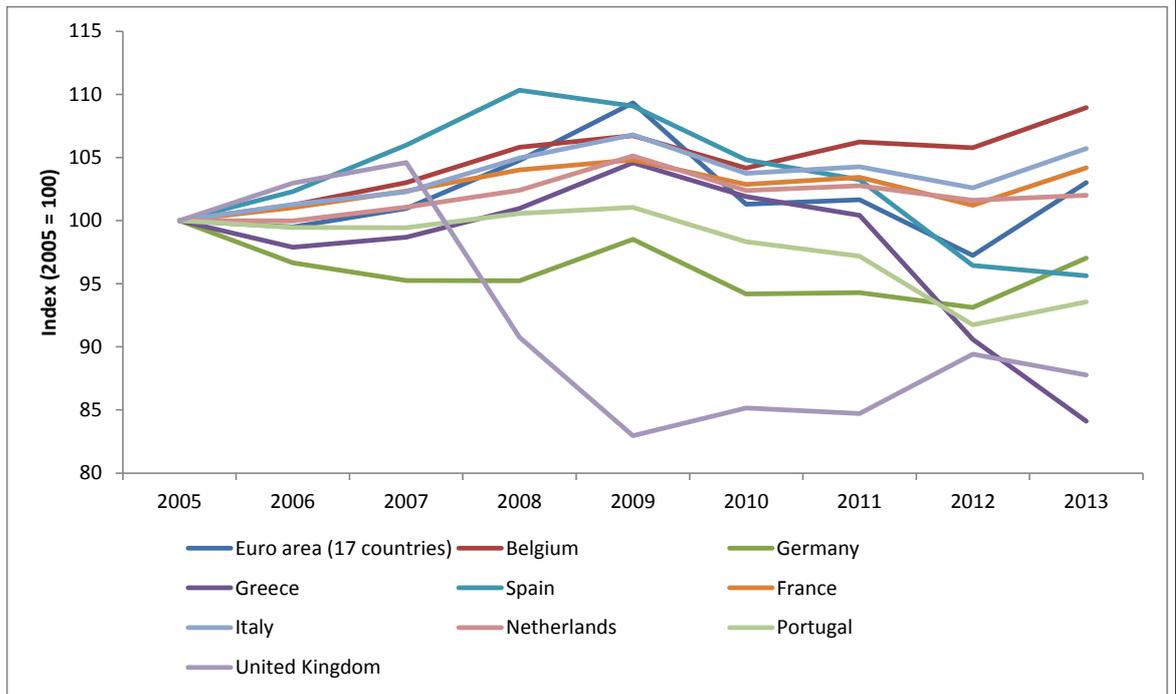


The loss in the export market share in goods can be explained by competition from emerging markets and intense competition in export destinations. The breakdown of UK's nominal growth in exports by geographical and product specialization reveals that during 2006-08, the loss of market share was driven by intense completion in similar product categories, rather than 'dynamism' (A destination country is 'dynamic' if its total imports grow faster than world total imports) of such markets, according to the European Commission. During 2000-12, the UK gained some export share in some markets (US, Germany, Netherlands, Belgium, Spain, Italy and Ireland). However, these markets are losing dynamism (with the exception of China and Switzerland), which does not bode well for the UK in the longer term as the probability of an increase in imports by developed economies in the future is low. The loss in export market share has been due to a host of factors such as the weakness in exports of financial services, diminished access to finance for exporters, and structural problems such as the quality and quantity of infrastructure and skills.

The massive depreciation of the pound sterling in the aftermath of the crisis led to a sharp fall in real effective exchange rate (REER), which is a standard measure of competitiveness. Lower REER generally implies higher competitiveness and vice-versa. However, that did not translate to a sharp rise in exports growth in spite of the exports becoming more competitive and cheaper for foreign purchasers, because the exporters responded by increasing prices to boost their bottom-line instead of increasing output.

To make matters worse, productivity has not seen a rise, while nominal labor costs have continued to rise since 2008. During 2009-13, goods exports increased by 21% (lower than EU15 average of 24%) while services exports increased by just 7% compared to EU15 average of 14%. To negate the imbalance, policymakers need to take steps to encourage net exports and savings. The government has announced measures in the 2014 budget, which encourage saving and provides impetus to UK's businesses.

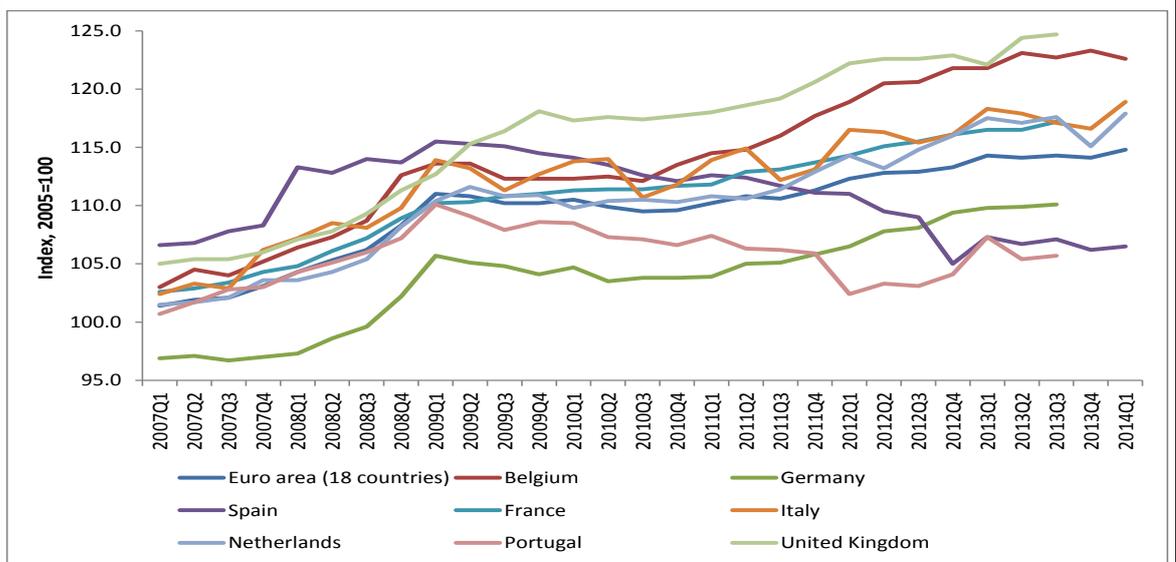
**Figure 8: Real effective exchange rate (2005-13)**



Source: OECD

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**Figure 9: Nominal Unit Labor Cost (2007-14Q1)**



Source: OECD

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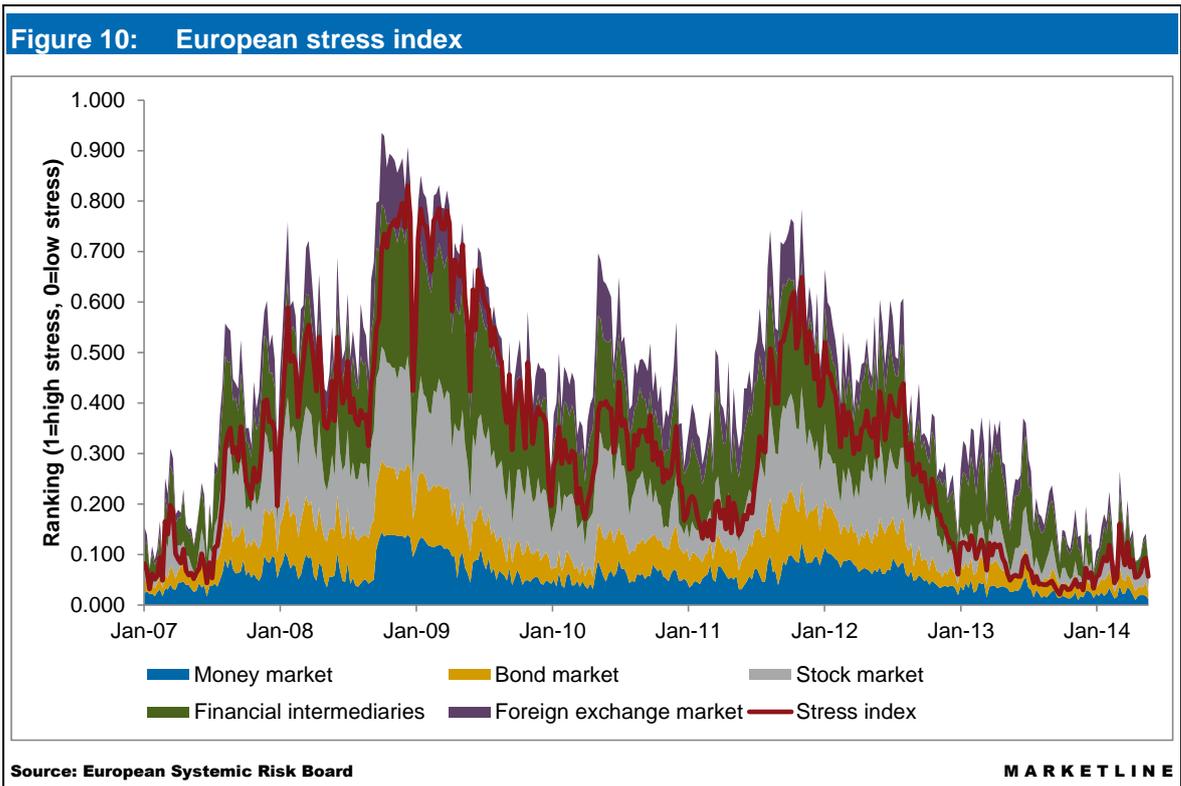
## PESTLE Analysis

### Future prospects

#### *Improving global financial environment*

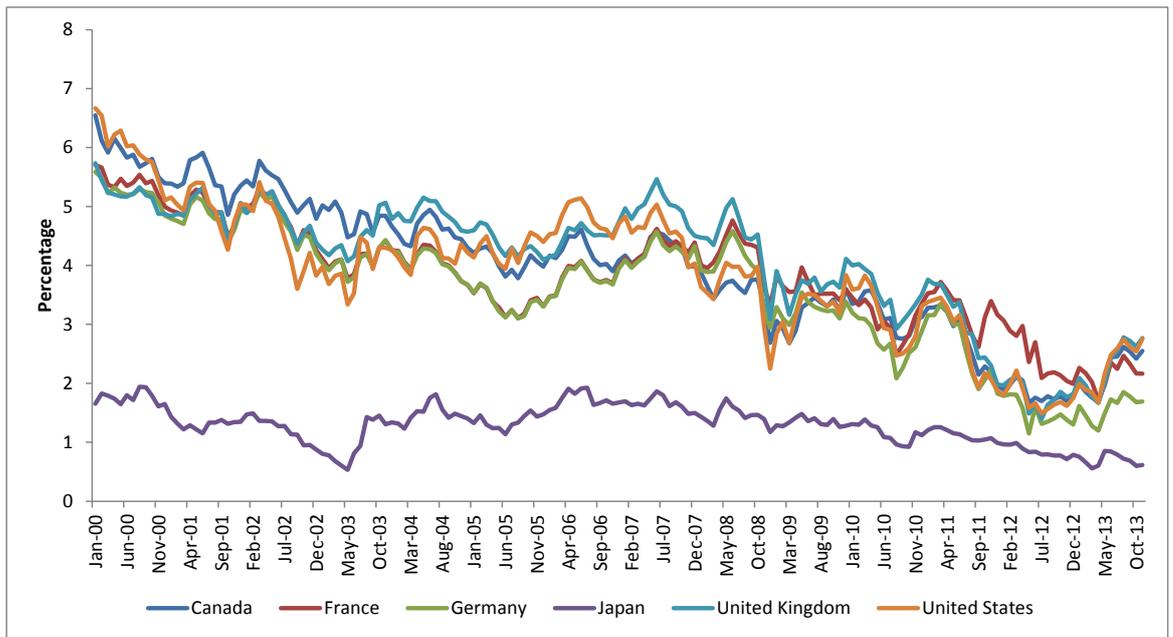
The world economy is on the recovery path and the UK has played a strong part in the overall recovery. In 2013, the economy had grown by 1.66%, which is among the fastest in the EU. This has boosted financial markets over the past year since large economies such as the US and the UK are on the path of expansion. Moreover, the large scale of monetary easing (low interest rate and purchase of financial asset) has also helped in reducing volatility in the financial markets and eased credit conditions. Consequently, lower volatility on the stock markets and low interest rates in the sovereign bond markets have driven investors towards higher risk assets, such as corporate bonds, to attain a higher return. This has helped significantly in compressing spreads for corporate bonds, thus easing conditions for them to raise capital. In addition, gradual recovery of the euro-area has been an added advantage for the UK economy since the euro area has been one of the important trade and investment partners of the country.

The CISS index (Composite Indicator of Systemic Stress) prepared by the European Systemic Risk Board (ESRB) based on aggregation of five market-specific sub-indices—the financial intermediaries sector, money markets, equity markets, bond markets and foreign exchange markets—showed the immense stress that the market experienced due to concerns over the debt serviceability of major European economies such as Spain, Italy, Greece and Portugal during 2012. However, since, the ECB has declared that it will do anything to defend the euro, yields on the peripheral countries' bonds have reduced dramatically, which is reflected in the stress index. Subsequently, the premiums for swapping euros for US dollars funding continued to come down in the cross-currency swap markets and as of April 2014 it virtually disappeared, which is suggestive of diminished risk perception from the investors' side of the viability of the euro currency.



The recovery also has diminished the perceived tail risks (rare and high impact event) in the UK among the investors, since UK banks are closely entwined with the EU financial system, according to the Bank of England. Option-implied probability (a measurement of market-based perception of tail risks) indicating a sharp decline in stock prices is close to pre-crisis levels. In addition, implied volatility has been at historical low rates across asset classes over the short term, while risk premium (both credit and liquidity) has also compressed drastically. Market-implied default probability over the next five years for select corporate debt has also depressed significantly, which indicates investors' perceptions of low default probabilities in the US and Europe. The easing of global credit conditions has helped Cyprus, Greece and Portugal to resume bond issuance in the market. According to the IMF, for the first time since 2010, developed nations will contribute around 30% to global growth rate in 2014. All this indicates that the UK is expected to continue to register strong growth in the medium term.

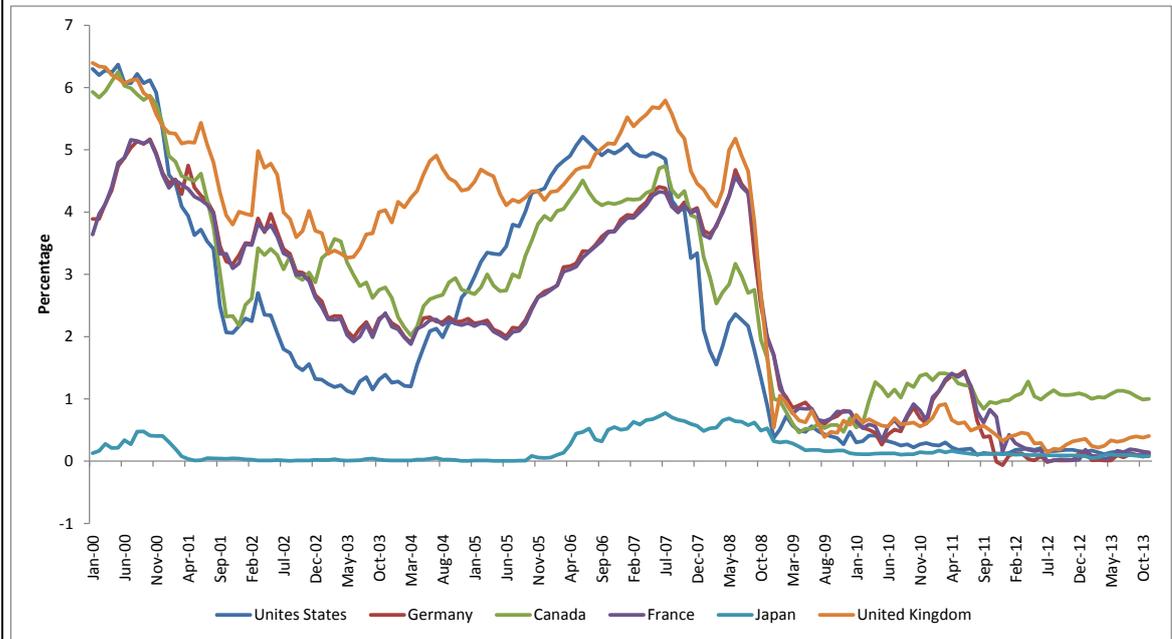
**Figure 11: Historical 10-year government bond yields in major OECD economies**



Source: OECD

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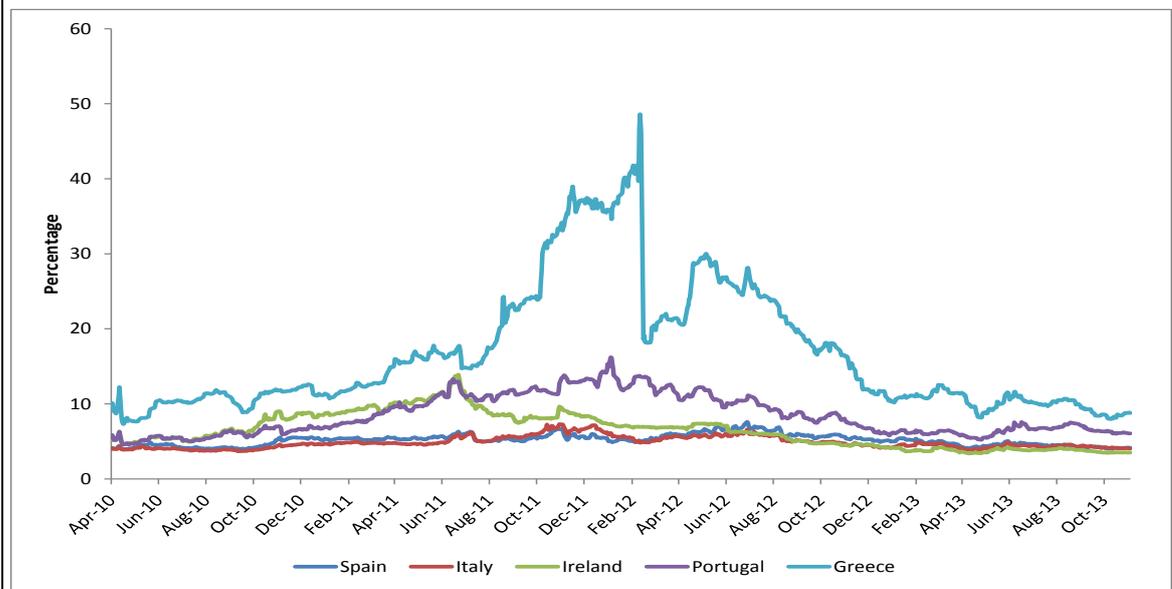
**Figure 12: Historical 1-year yields on government bills in major OECD economies**



Source: OECD

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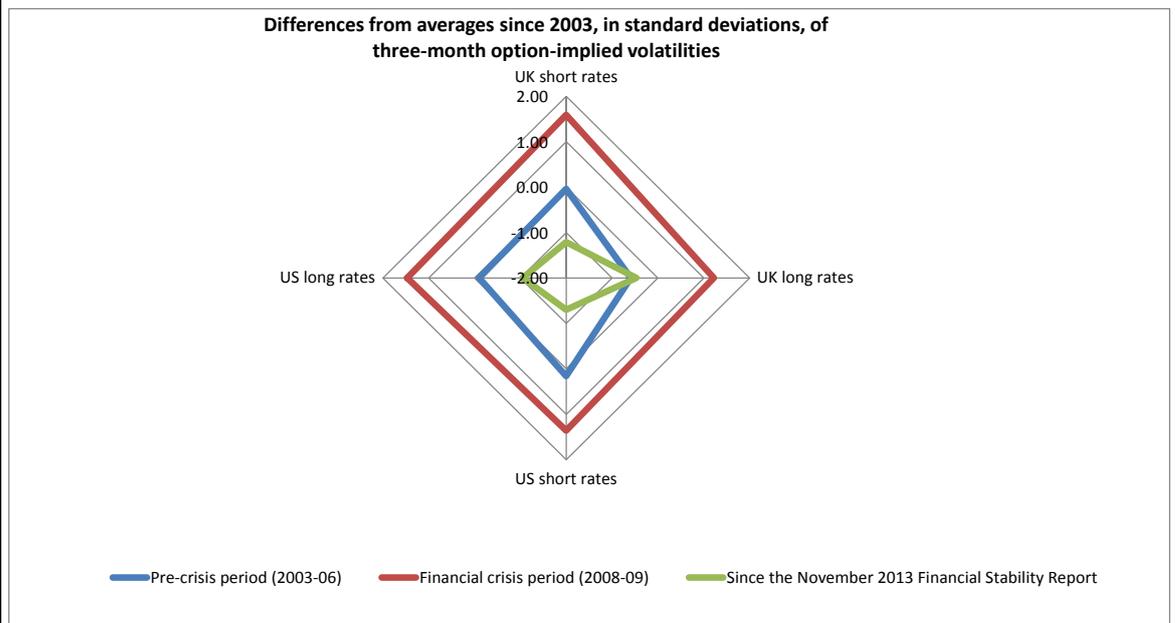
**Figure 13: Ten-year benchmark bond yields (peripheral countries)**



Source: OECD

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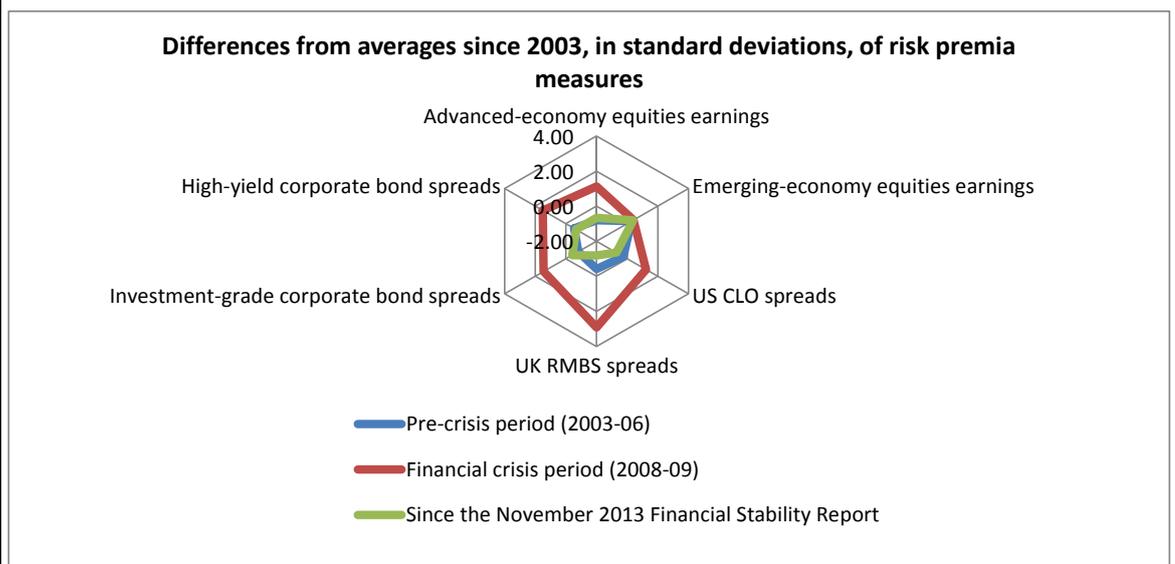
**Figure 14: Option implied volatility on interest rates**



Source: Bank of England

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**Figure 15: Compressed risk premium on different asset classes**



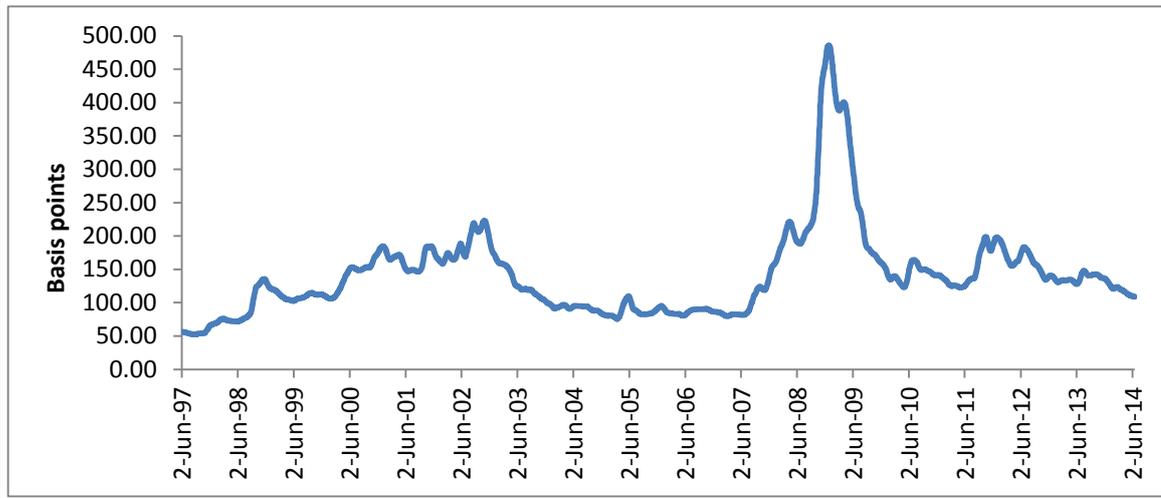
Note: 1) UK RMBS( Residential Mortgage-Backed Security (RMBS)

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2) US CLO (Collateralized loan obligation)

Source: Bank of England

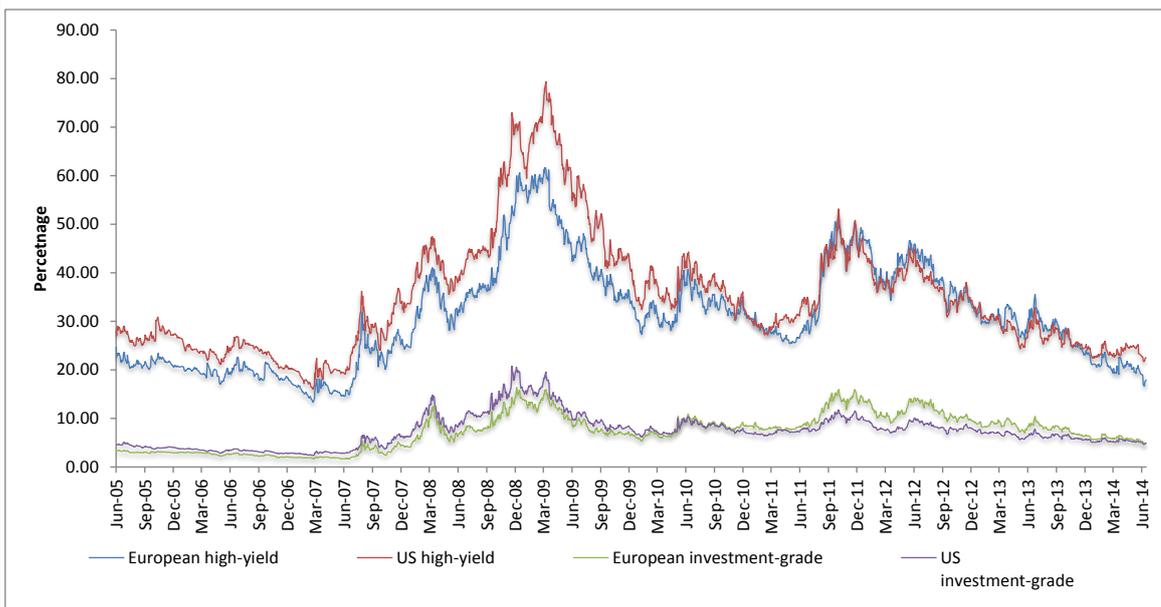
**Figure 16: Narrowing global corporate debt spreads**



Source: Bank of England

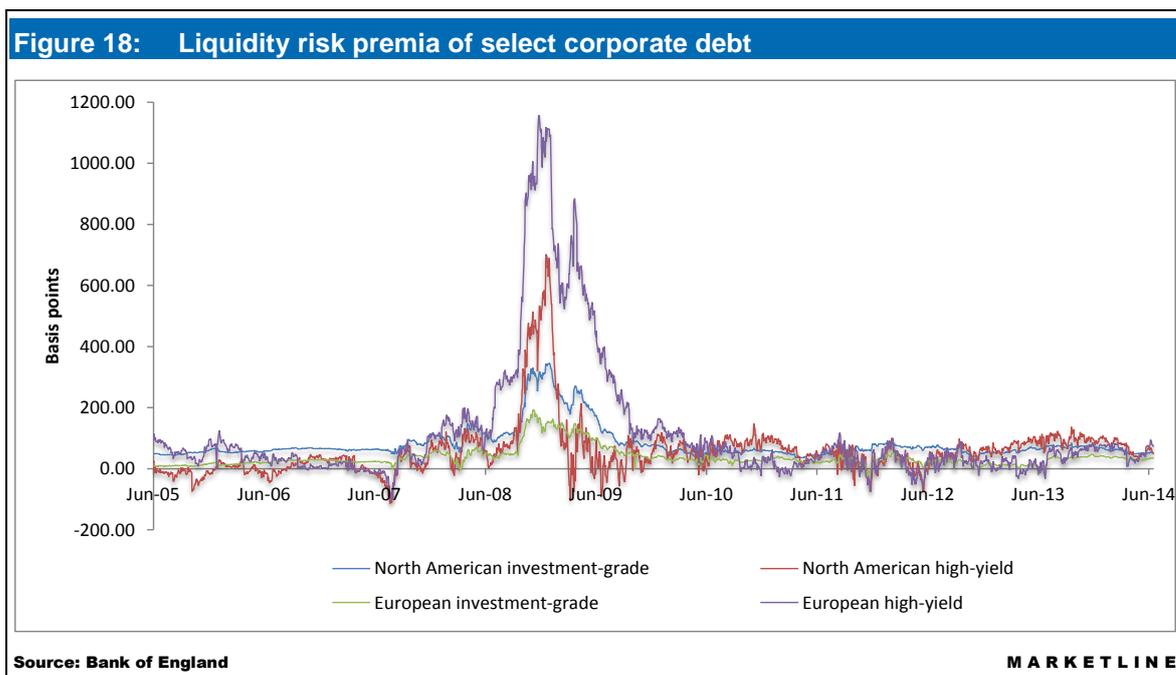
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**Figure 17: Market-implied default probabilities over the next five years for selected corporate debt**



Source: Bank of England

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**Macro-prudential measures to strengthen the financial system**

In the wake of the financial crisis and several cases of fraud, the government has taken steps to strengthen the financial system. A new financial regulation and supervision framework gives the Bank of England authority to monitor the day-to-day supervision of financial services firms (through the Prudential Regulation Authority). Subsequently, it also gets the responsibility for macro-prudential supervision of the financial system (through the Financial Policy Committee). The Financial Policy Committee (FPC) is in charge of identifying, monitoring and implementing measures to remove or reduce systemic risks from the financial system.

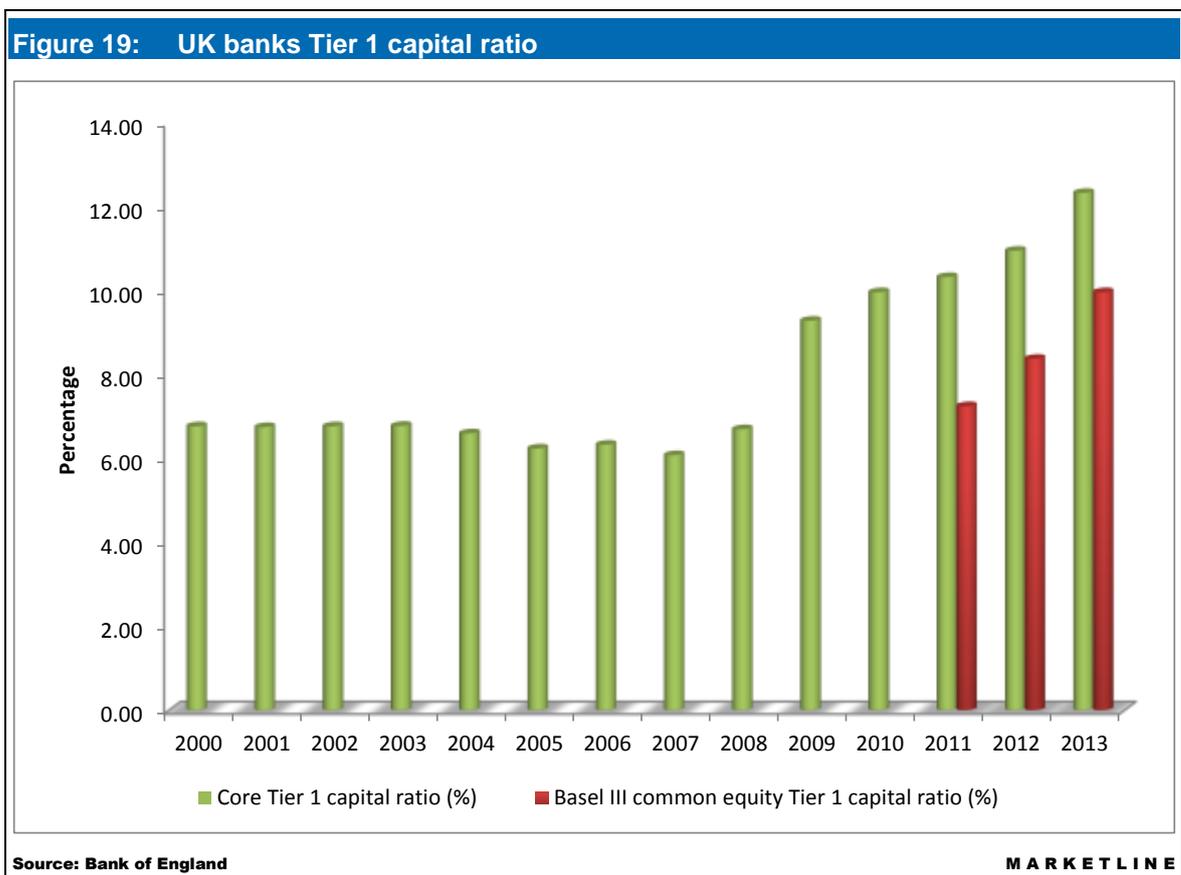
As of June 2014, many recommendations made by the FPC over the last two years were implemented. These include the following: contingency planning in a survival threat situation, managing and mitigating balance sheet risks from euro-area stress, ensuring capital resources of at least 7% of risk-weighted assets, increasing capital in a way that does not impact lending, ensuring credible plans to move to higher future capital requirements, assessing susceptibility to sharp rise in long-term interest rates, assessing the feasibility of calculating capital ratios by means of Basel III standardized approach and requiring mortgage lenders to consider any future FPC recommendation on interest rate stress tests. The implementation of other recommendations such as developing proposals for regular stress testing of the UK banking system and improving resiliency to cyber-attacks is underway. These macro-prudential measures undertaken by the authorities are improving the resiliency of the UK's financial system.

The core tier 1 capital has improved. Rising tier 1 capital will increase the banking system's ability to take a hit on their balance sheets if more assets go bad; therefore, probability of bankruptcy decreases for the respective banks. The leverage ratio (calculated by dividing Tier 1 capital by total exposure, expressed as a percentage) has also witnessed a rise during 2010-13. Hence, a gradual rise in leverage ratio indicates lower risks as more capital is available to cover losses if assets go bad. The banks have been able to increase their capital and leverage ratio by issuing new capital and shedding non-core assets. Risk weighted assets have continued to fall since 2010. In addition, the banks have also

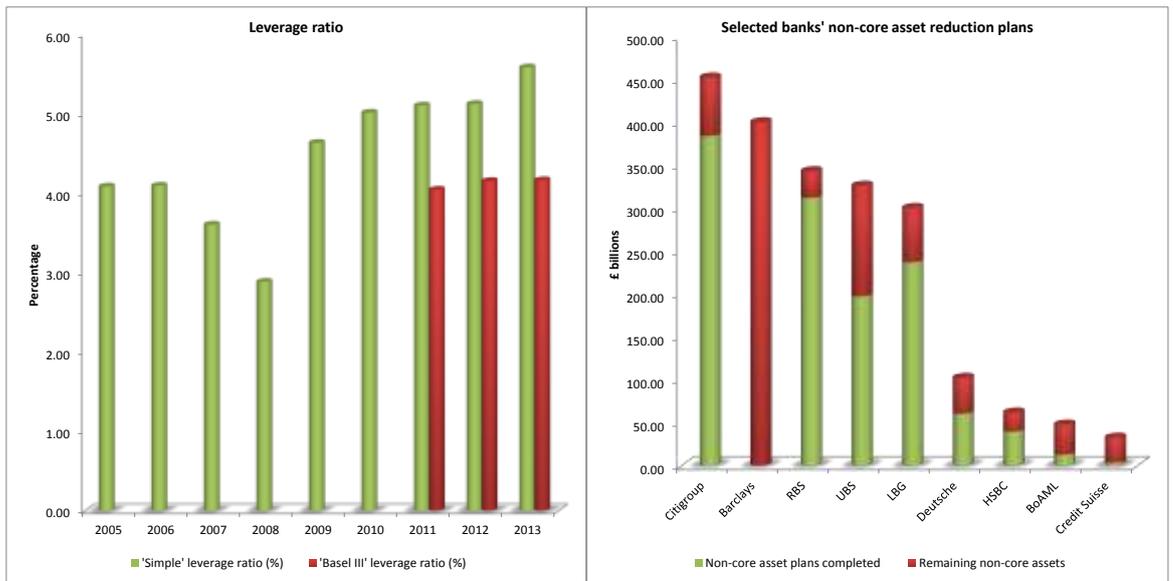
## PESTLE Analysis

increased their loan loss provision to cover losses from more bad debts. On the funding side, UK banks have significantly cut down on short term wholesale funding. Funding risks have reduced as a gradual shift towards core funding sources—customer deposits, longer-term wholesale borrowing, and bank capital—is being observed. This means the maturity period of the funds is increasing, thus reducing risks from short-term fluctuations in the financial markets. In 2013, the pre-tax return on assets has improved over 2012, which is a positive sign for the banking system; although it remains lower than the long-term average.

Nevertheless, the implementation of these measures has significantly brought down the perceived risks of the UK financial system. Another barometer that shows increased financial stability in the UK's financial system is the risk premium on the interbank market, which has compressed substantially since the global financial crisis as the western central banks since then flooded the banks with liquidity with their unconventional monetary policies. This has helped substantially in improving the liquidity in the financial system and reducing the funding problems for the banking sector. Cumulatively these factors point toward a more resilient financial system in the UK.



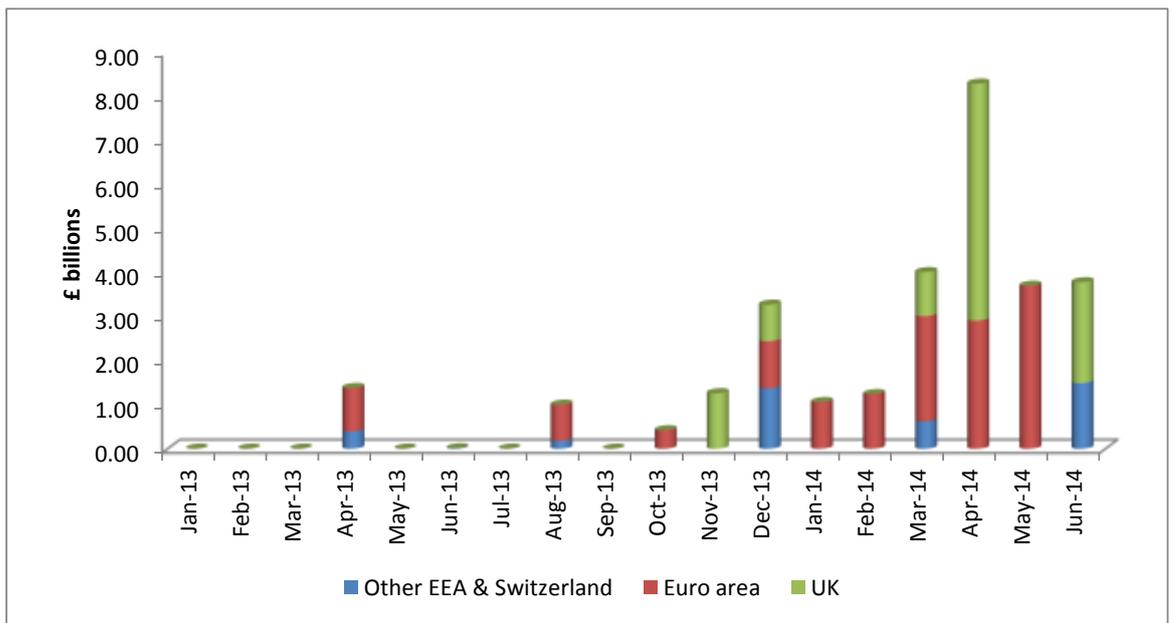
**Figure 20: UK banking leverage ratio and non-core asset reductions**



Source: Bank of England

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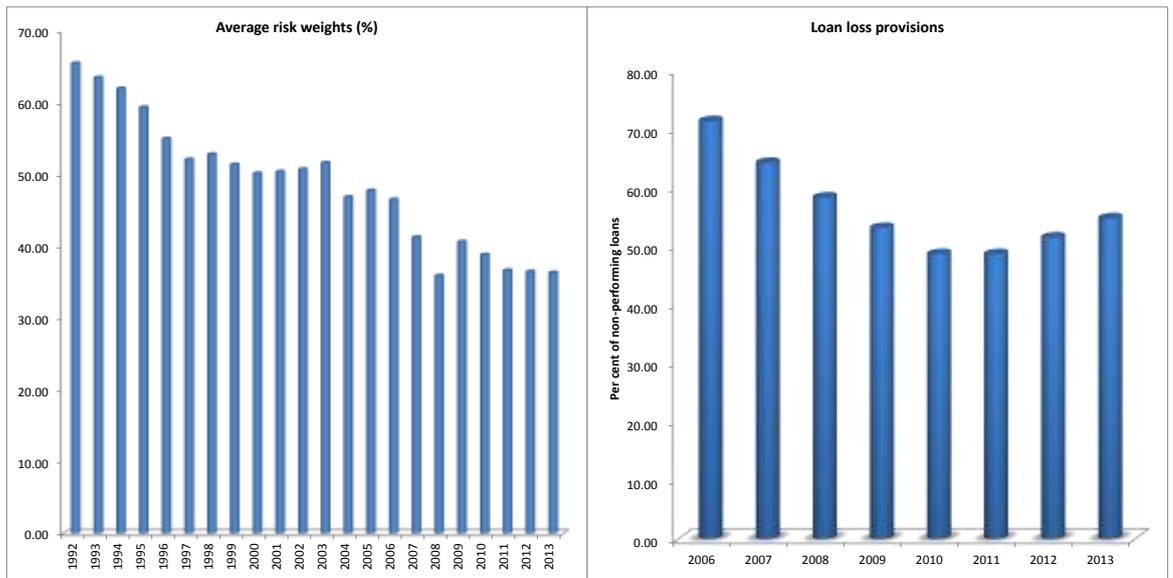
**Figure 21: Additional Tier 1 capital (AT1) public issuance by EEA and Swiss banks**



Source: Bank of England

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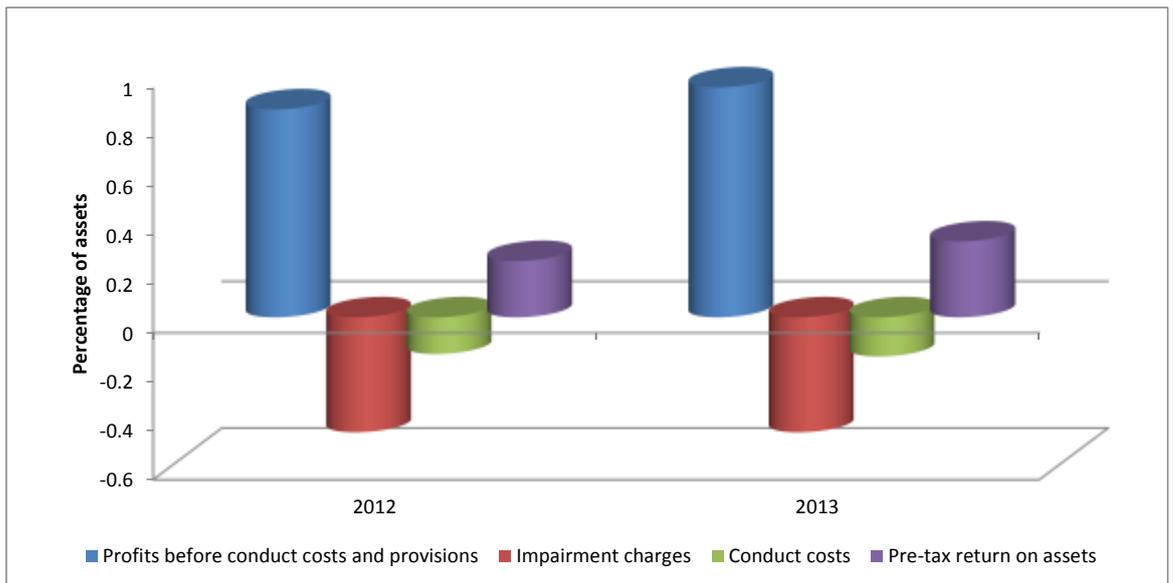
**Figure 22: UK banking risk weights and loan loss provision**



Source: Bank of England

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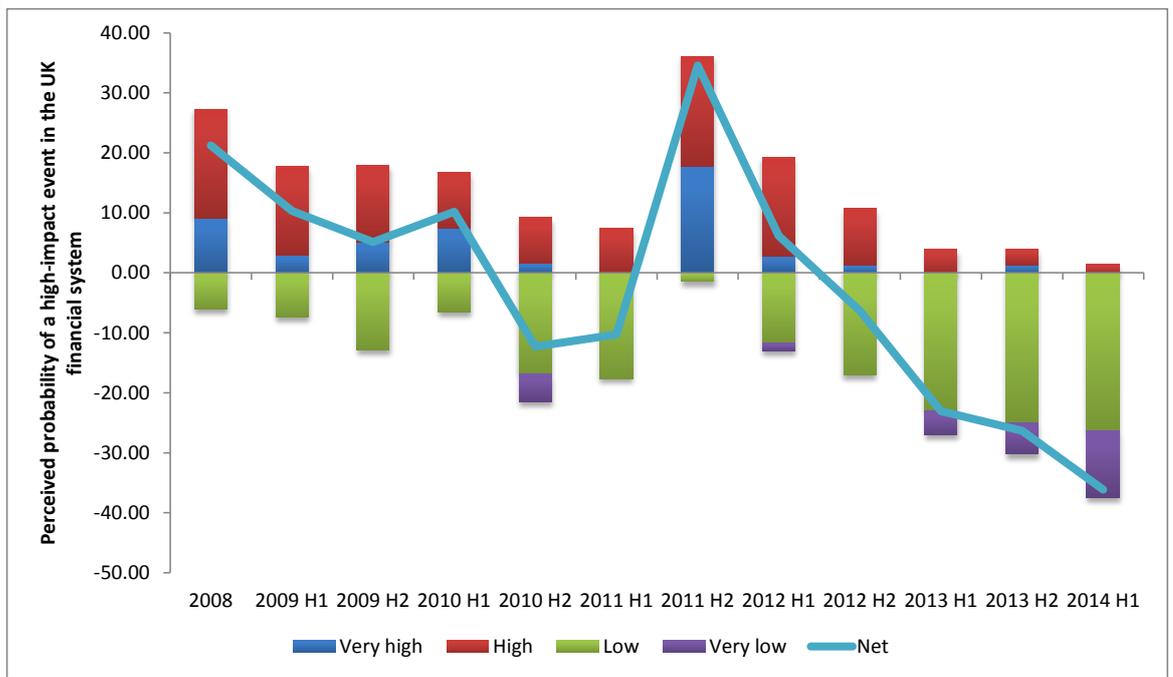
**Figure 23: Major UK banks' pre-tax return on assets**



Source: Bank of England

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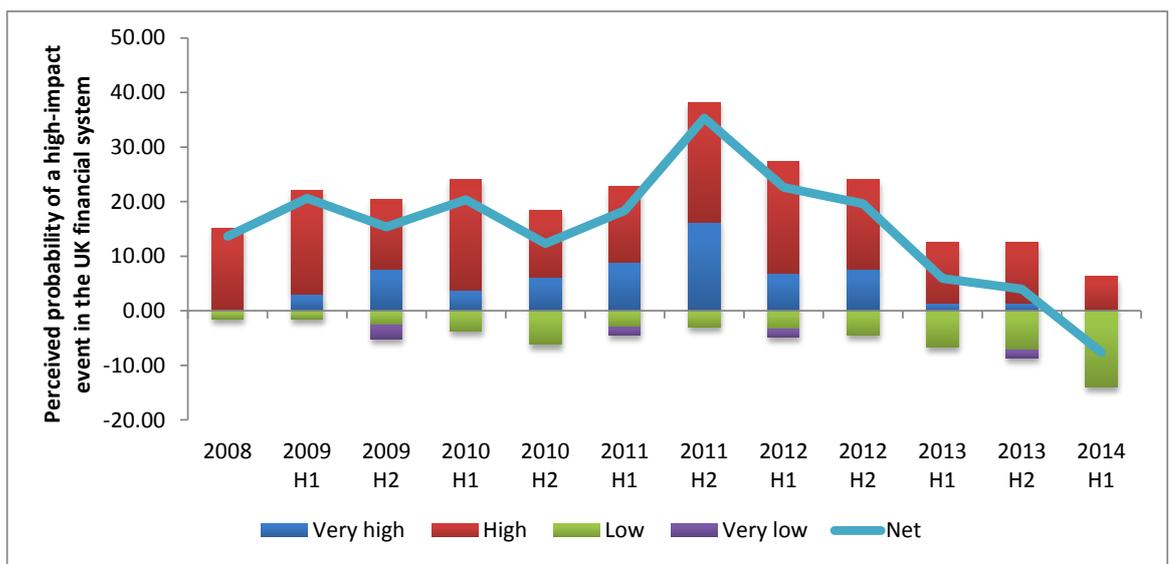
**Figure 24: Perceived risks of UK's financial system (Short term)**



Source: Bank of England

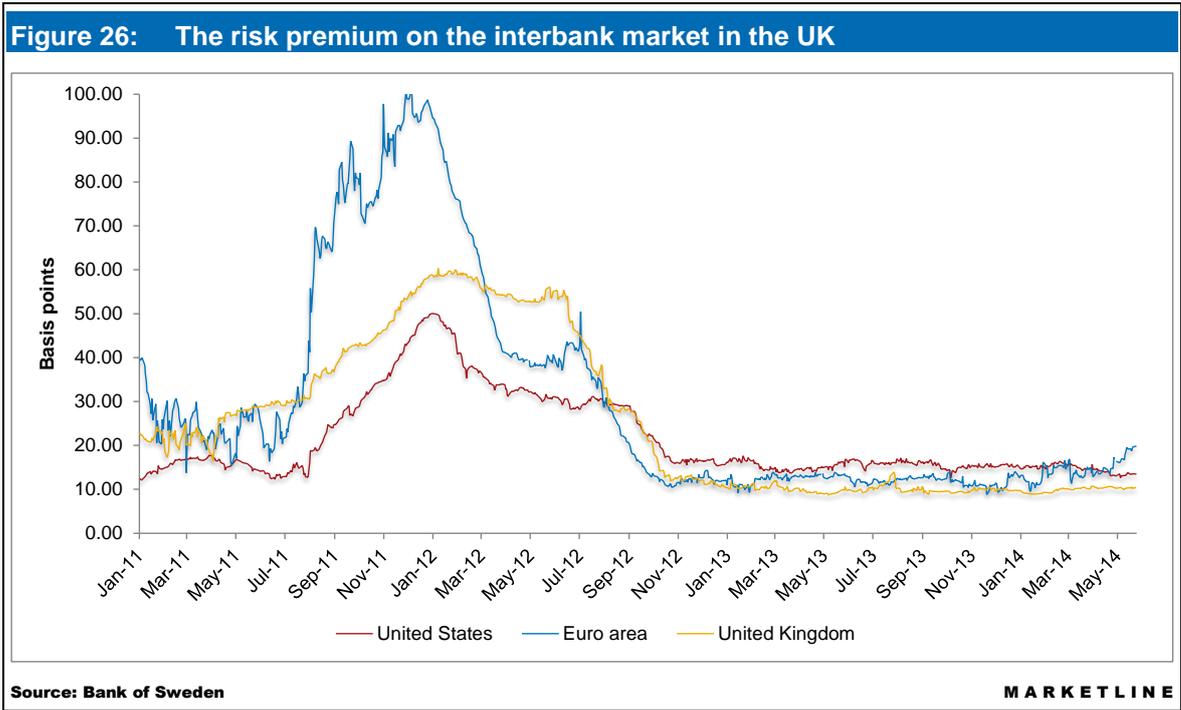
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**Figure 25: Perceived risks of UK's financial system (Medium term)**



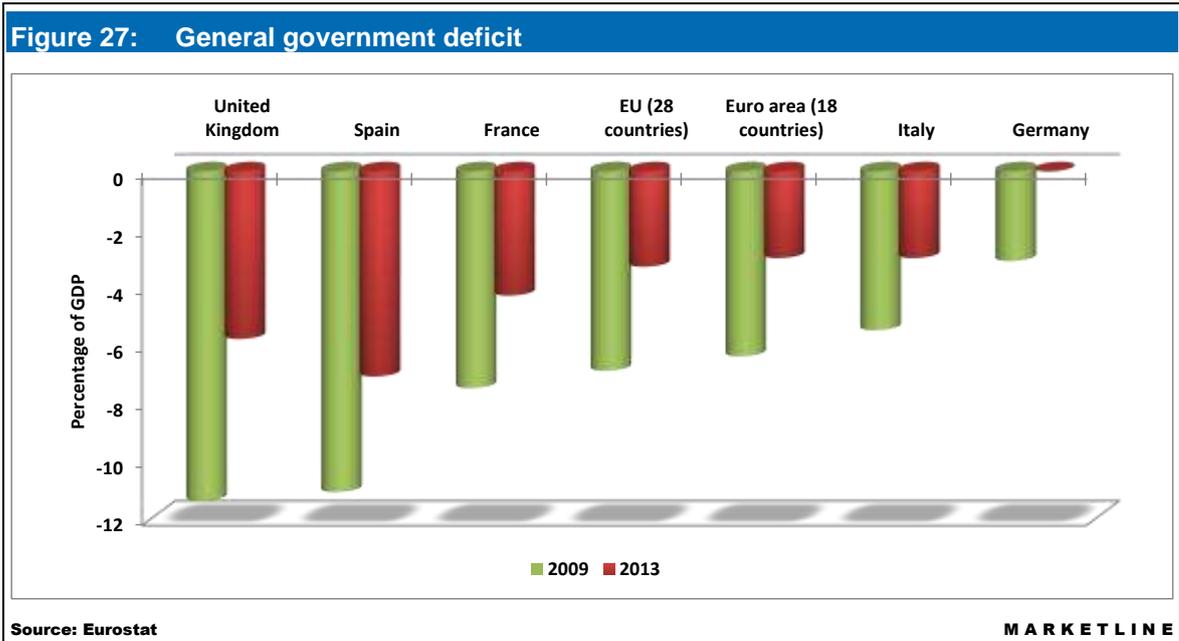
Source: Bank of England

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***Narrowing fiscal deficit***

The government has embarked on fiscal consolidation over the past few years to bring down the deficit. As of 2013, it stood at 5.8%, down from 11.4% of GDP in 2009, when it widened due to government-funded bailouts during the financial crisis. The quick recovery of the UK economy has helped the country in raising tax receipts. Income tax and VAT receipts both witnessed a jump in 2013. Moreover, a strengthening housing market has boosted income from stamp duties. In the 2014 budget, the government has proposed to cap the welfare budget to restrain spending to ensure that companies are the paying the full costs of public service pension schemes and restrict public sector pay hikes to narrow down the deficit.



### Future risks

#### Overheated property market

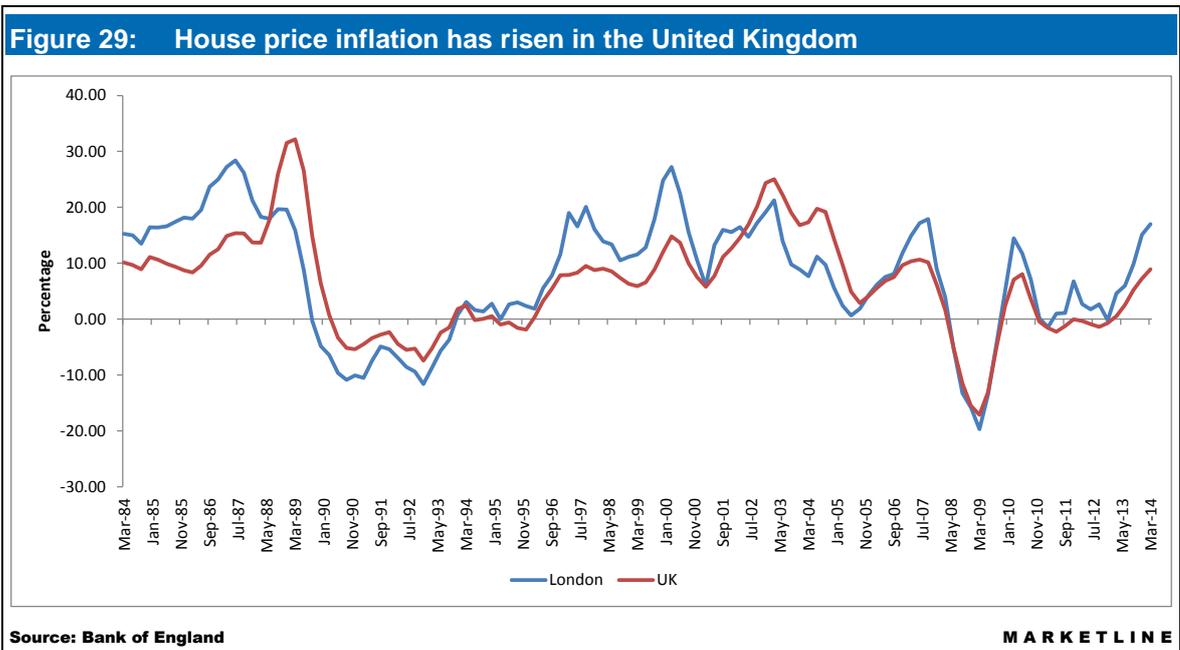
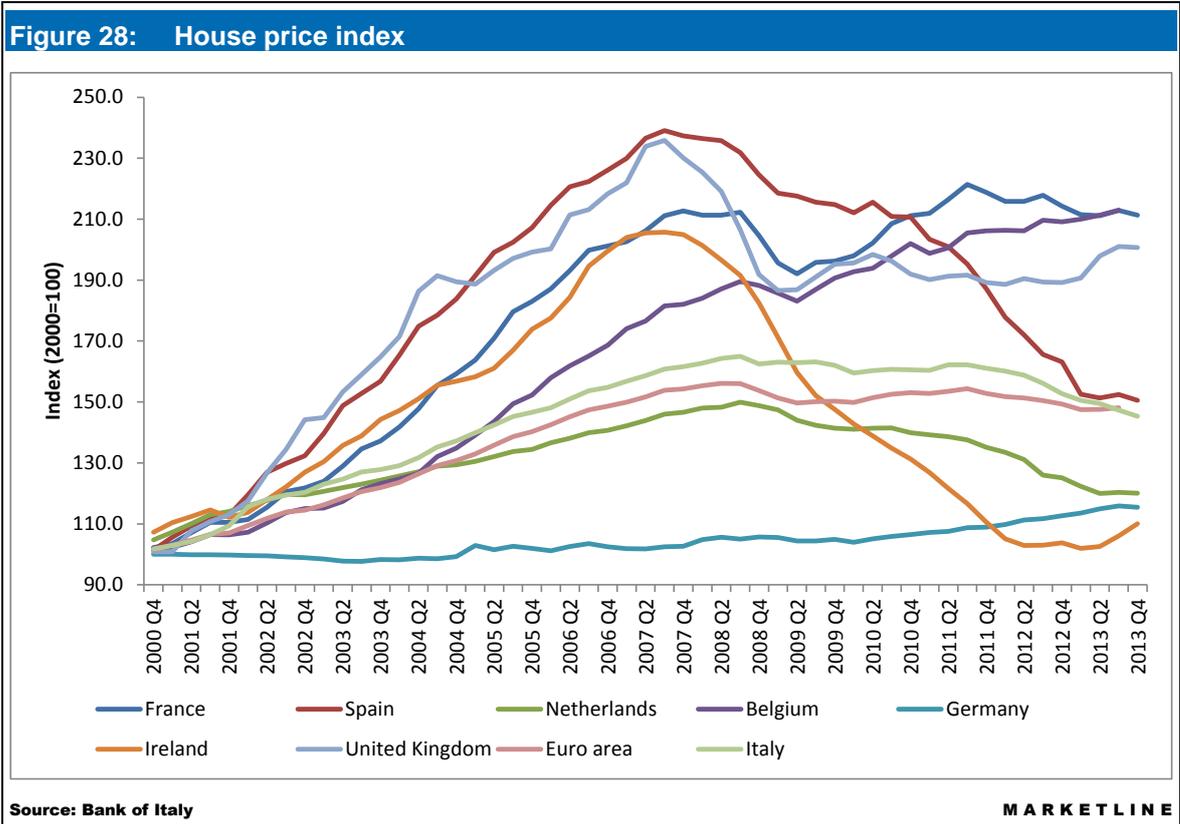
Housing market activity in the UK remains frothy as house prices continue to rise. As of 2014Q1, house prices have risen 9% year-on-year. Inflation in house prices has been seen across the UK, with properties in London experiencing significantly above average price rise. The surge in house prices is due to increased demand as economic uncertainty on the back of strong recovery reduces and easy credit (low interest rate) conditions. Moreover, a wide gap between demand and supply has exacerbated the inflationary scenario. As a result, over the past year, house prices have climbed more rapidly than average earnings. The market is significantly overvalued, as judged from a significant rise in price-to-average earnings ratio (a measure of affordability). Consequently, affordability has come down.

The persistent rise in house prices of late has raised expectations among the households of a continuous rise in the future, which is a cause for concern. This is because it induces households to take on more debt (household debt to income ratio is already elevated) to invest more in a second or third home, as payoff is not a problem in bullish real estate market. This further increases demand for houses, which are in short supply. The increased demand leads to expectations of further appreciation of house prices and starts a self-reinforcing demand cycle, causing prices to skyrocket. Elevated debt burden would not be financially distressful for UK households as long as interest rate remains low (of late BOE has been hinting a rise in interest rate) and house prices continue to soar. However, since a significant chunk of the household assets comprises real estate, any disruptive correction in the real estate market or rise in interest rate will bring substantial financial distress for them by wiping out a large chunk of household wealth.

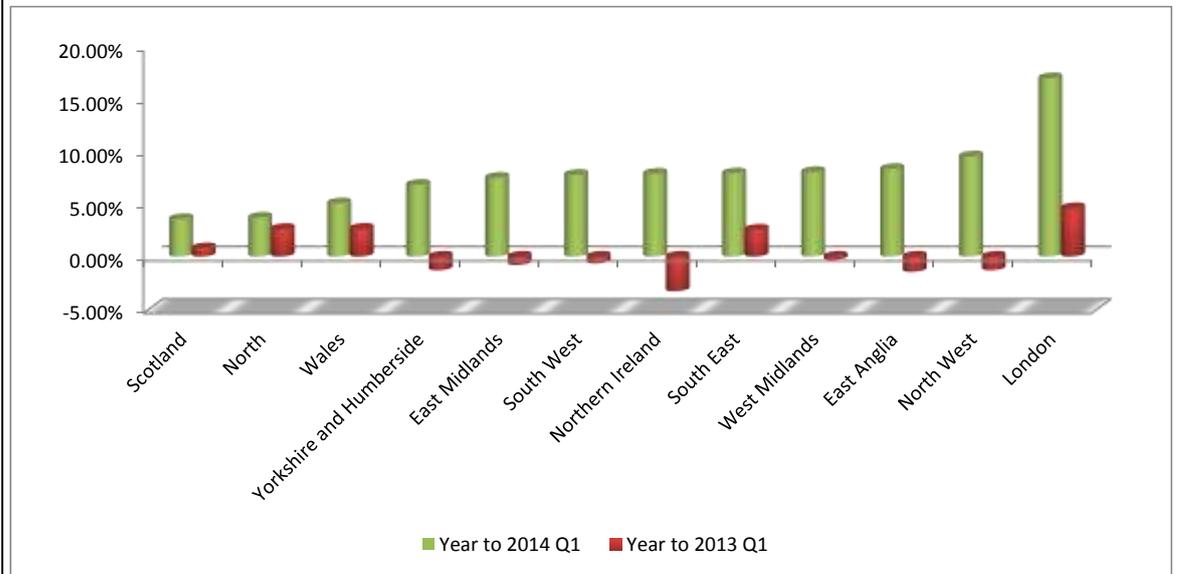
Further, rising net worth of households due to rising house prices could lead households towards debt-financed consumption and could affect their consumption pattern as net worth reduces, if prices fall. Another vulnerable point is the share of mortgages with high loan-to-income multiples and high loan-to-value ratio has risen lately, which may aggravate payment difficulties in an adverse scenario of falling house prices. Such a scenario could hit banks' balance sheet badly as more loans could go bad, denting the resiliency of the UK banking system and threatening economic

PESTLE Analysis

stability.



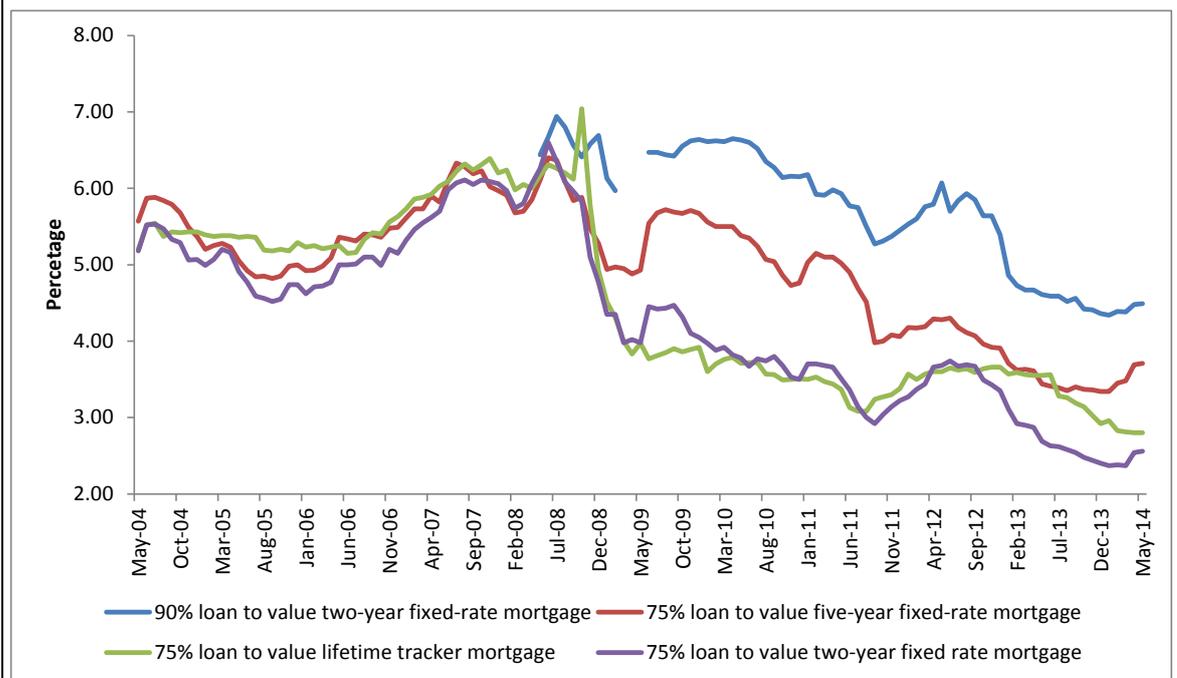
**Figure 30: House price inflation across United Kingdom**



Source: Bank of England

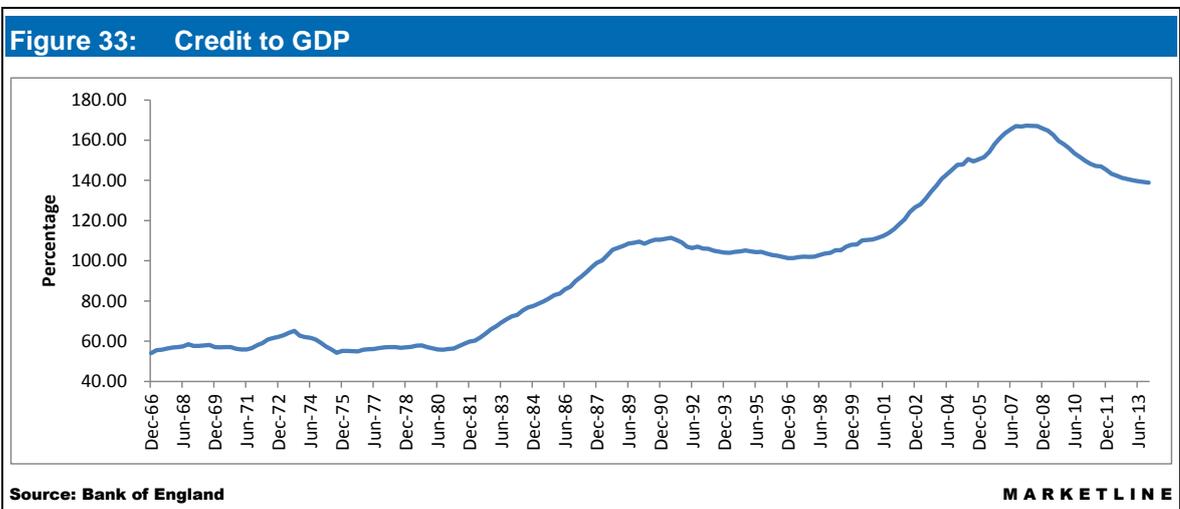
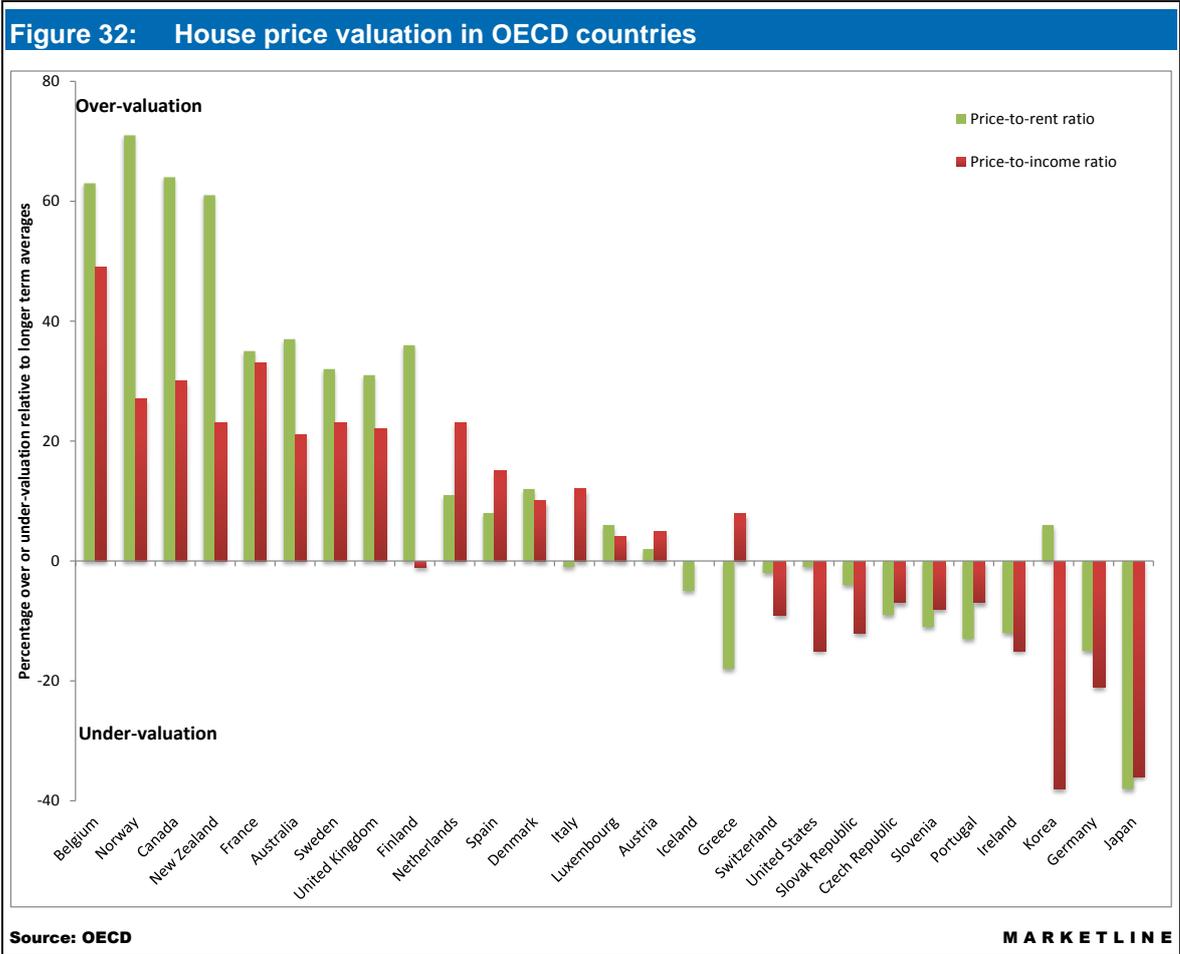
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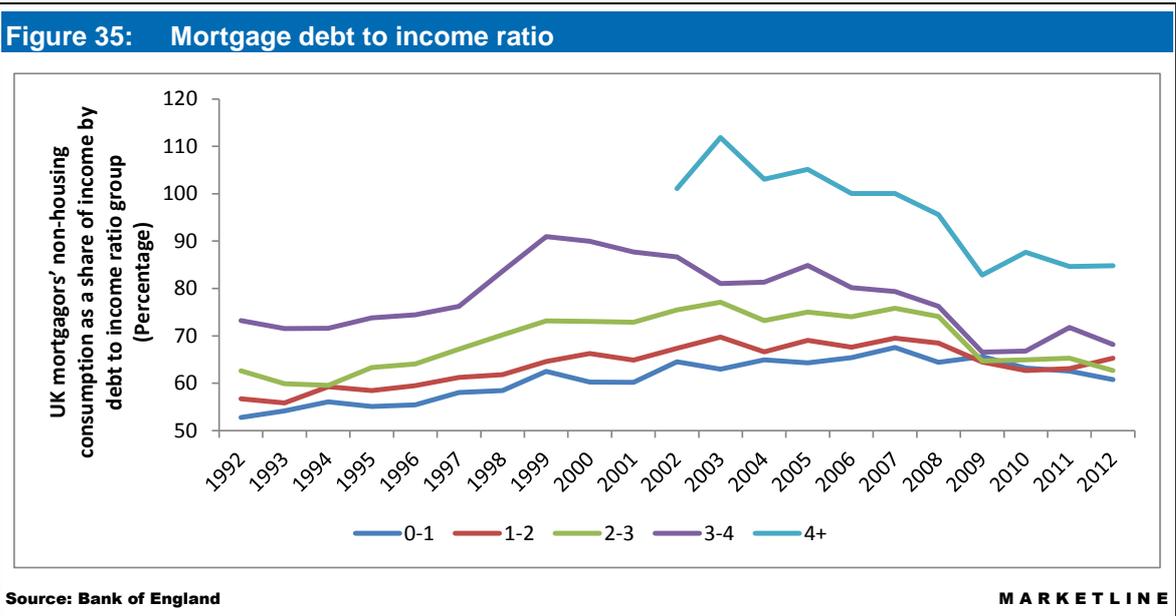
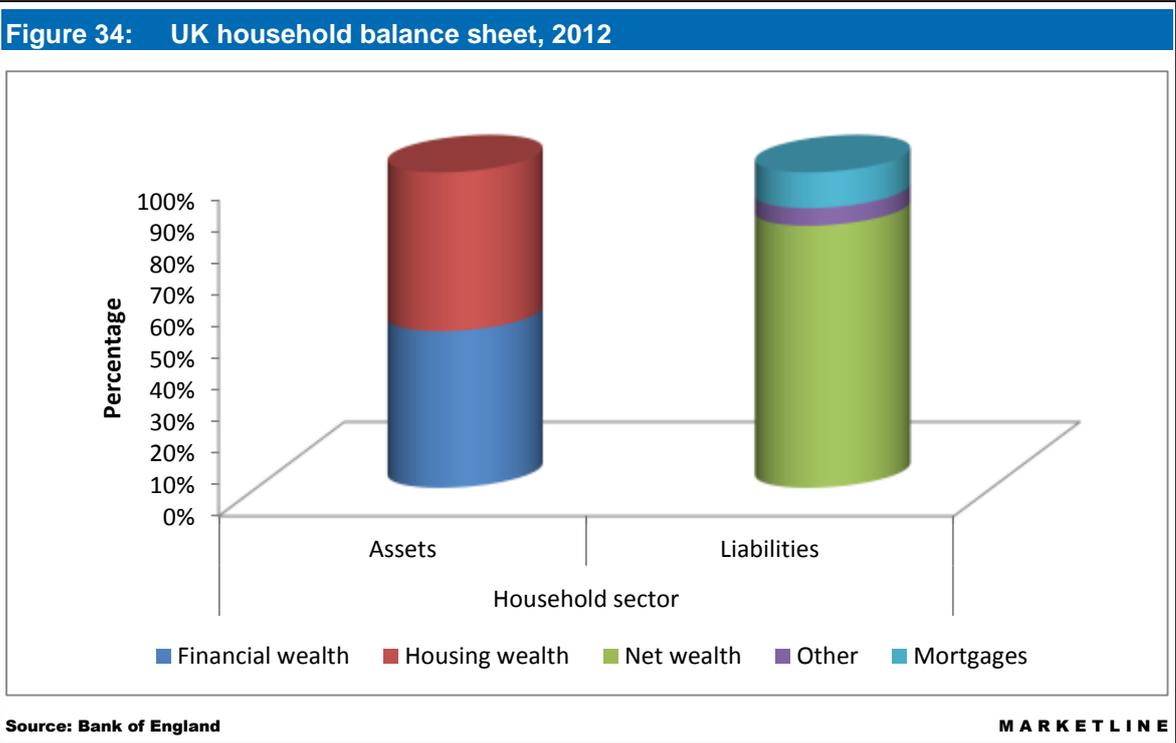
**Figure 31: Average UK mortgage rates on new lending**



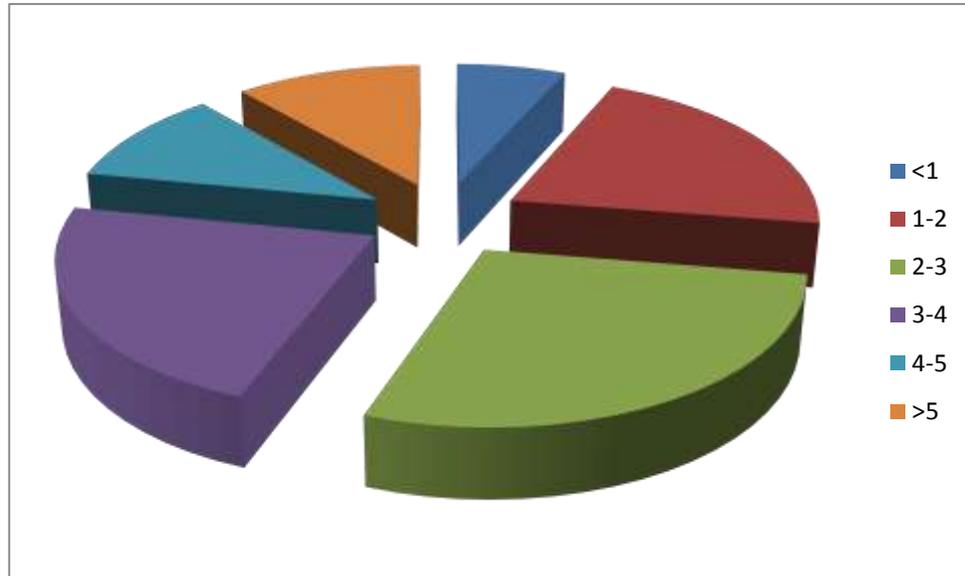
Source: Bank of England

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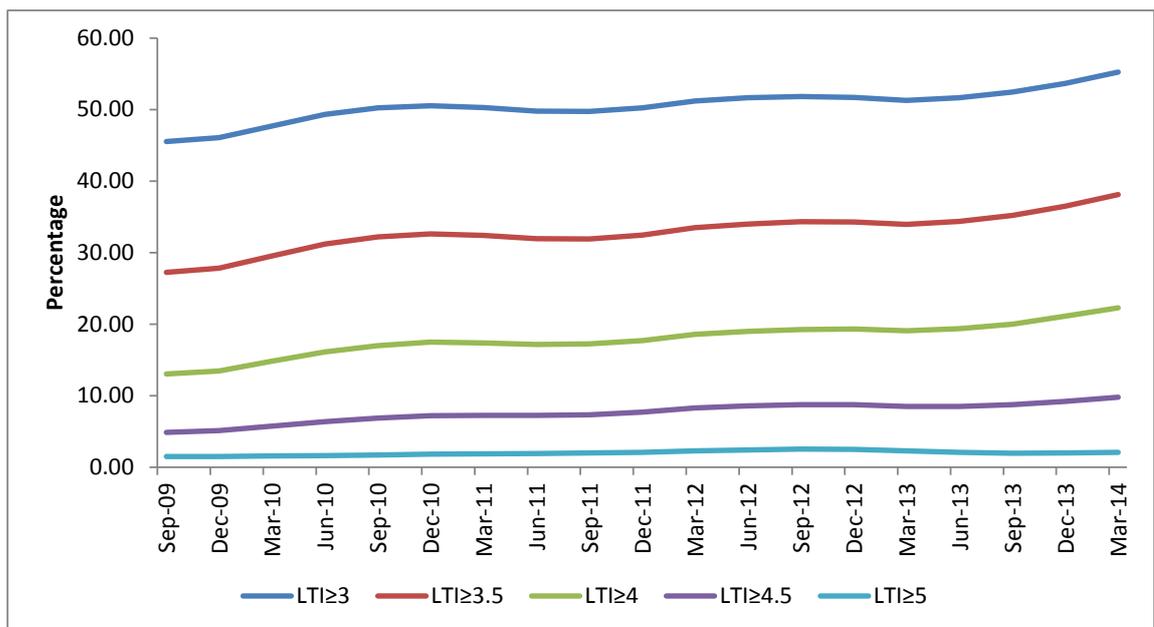
**Figure 36: Borrowers with high mortgage debt to income ratios account for a large share of mortgage debt**



Source: Bank of England

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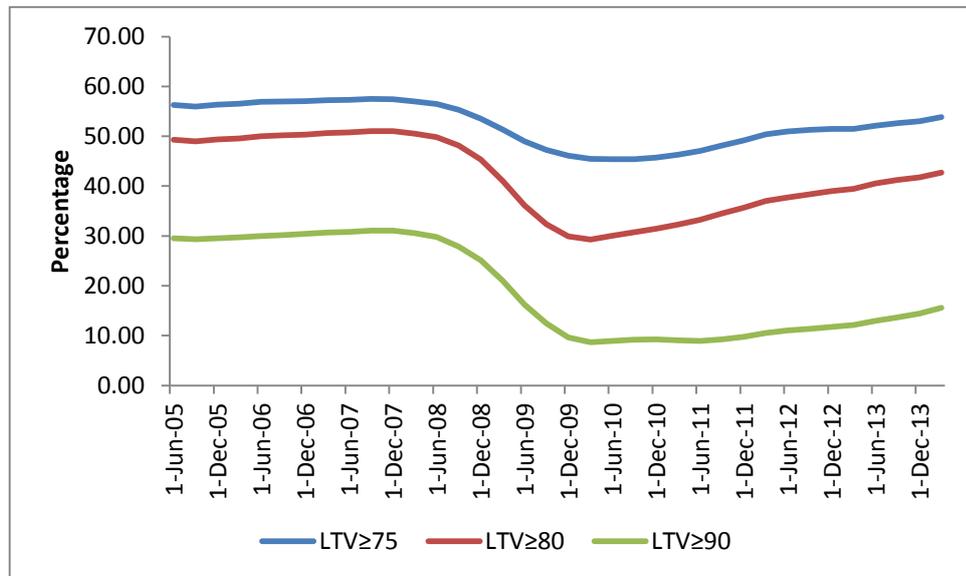
**Figure 37: New mortgages advanced for house purchase by LTI (Loan to Income)**



Source: Bank of England

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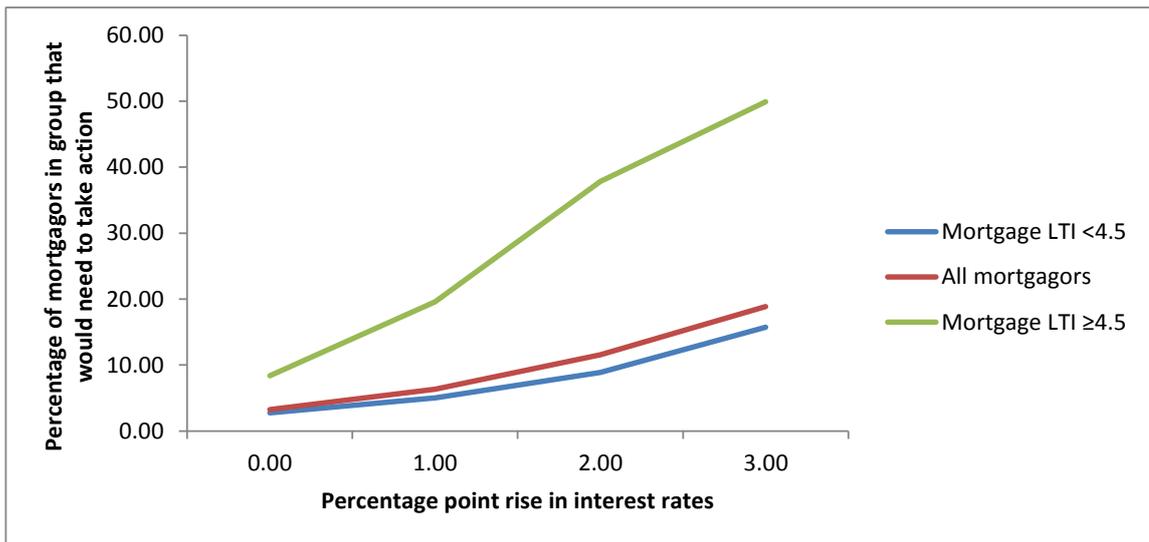
**Figure 38: New mortgages advanced for house purchase by LTV (Loan to Value)**



Source: Bank of England

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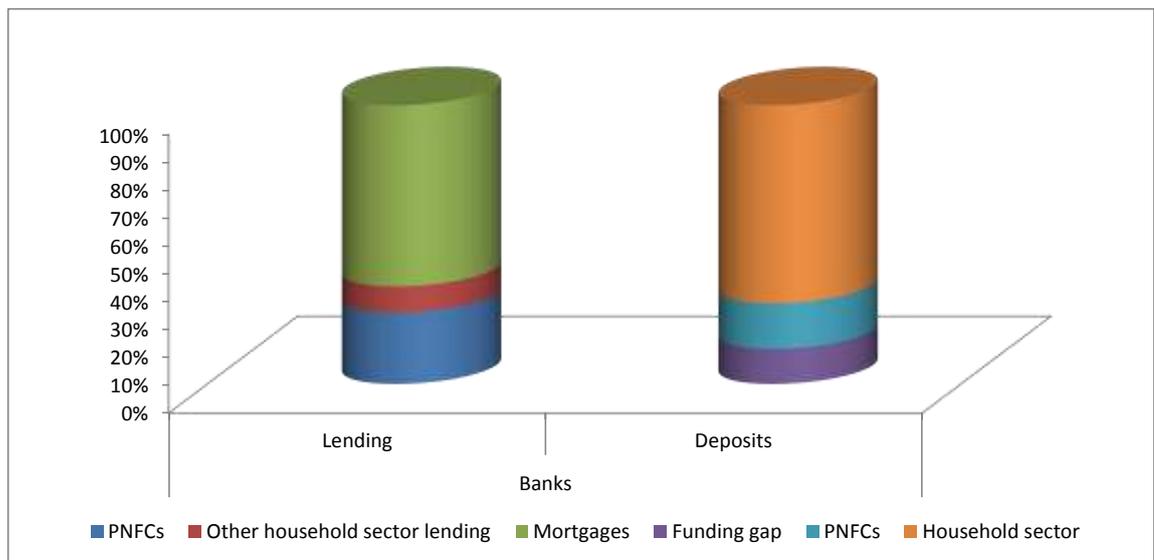
**Figure 39: Percentage of mortgagors that would need to take action if interest rates rose, by mortgage debt to income group**



Source: Bank of England

MARKETLINE

**Figure 40: UK banks' lending and deposit composition, 2012**



Note: PNFCs (Private non-financial corporations)

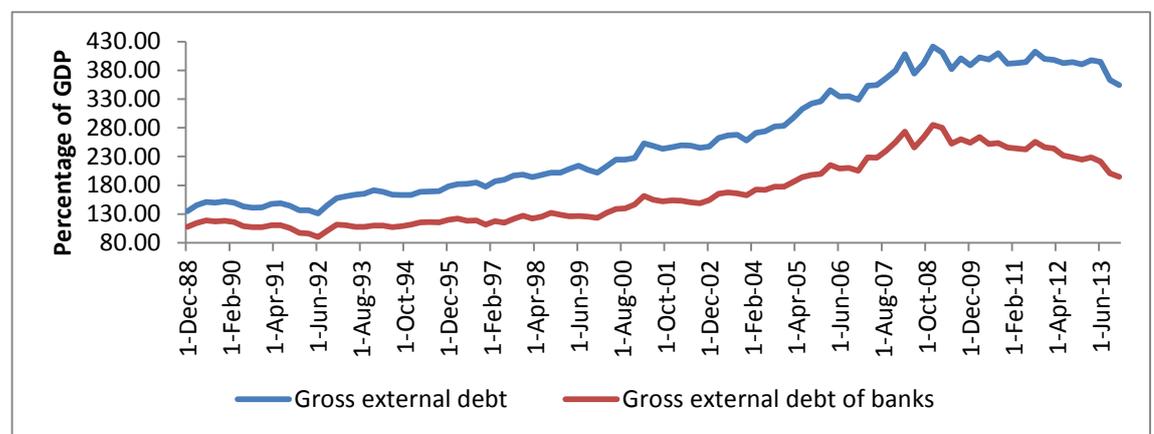
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Source: Bank of England

**High indebtedness**

The high indebtedness of households, private non-financial corporations and government is a cause for concern. The total debt in these three sectors was around 270% of GDP as of 2013, according to Bank of England. As of 2013Q4, PNFCs' debt to profit ratio stood at 384.6%. Such high debt can hurt private investment. Further, gross external debt also remains elevated, although it has declined slightly. Such high external debt can cause refinancing problems in times of financial difficulties as witnessed during the 2007-09 crisis, and exacerbate the magnitude of the crisis for the economy.

**Figure 41: UK's external debt, 1988-2013**



Source: Bank of England

MARKETLINE

## Social analysis

### Overview

Residents of the UK enjoy a standard of living comparable with those in other developed countries. Decades of solid economic growth have helped in the development of robust social infrastructure. The UK's education and healthcare delivery systems rank among the best in the world. The government is focused on alleviating income inequality and plans to eradicate child poverty by 2020.

<b>Table 5: Analysis of the UK's social system</b>	
<b>Current strengths</b>	<b>Current challenges</b>
<ul style="list-style-type: none"> <li>▪ Strong education system</li> <li>▪ Healthcare services</li> </ul>	<ul style="list-style-type: none"> <li>▪ Child poverty</li> <li>▪ Controversial immigration act</li> </ul>
<b>Future prospects</b>	<b>Future risks</b>
<ul style="list-style-type: none"> <li>▪ Policies to support pensioners and encourage savings</li> </ul>	<ul style="list-style-type: none"> <li>▪ Challenges of an aging population</li> <li>▪ Rising inequality</li> </ul>
<b>Source: MarketLine</b>	
<b>MARKETLINE</b>	

### Current strengths

#### *Strong education system*

The UK has high-quality educational infrastructure and has historically attracted students from all parts of the globe. The nation's tradition of education dates back hundreds of years and is constantly evolving. Qualifications obtained from UK institutions are recognized and respected worldwide. The UK has around 170 universities and higher education institutes, including three universities in the world's top 10, according to The Times Higher Education World University Rankings 2013-14. The ranking was based on teaching, research, knowledge transfer and international outlook.

#### *Healthcare services*

The UK's healthcare system is one of the most successful social ventures in the world. This is due to the presence of advanced healthcare infrastructure and private sector involvement. The UK's public expenditure on health has traditionally been very high, which has helped the country to maintain quality and efficiency. All residents of the UK, the European Economic Area, and countries that have bilateral healthcare agreements with the UK are eligible for NHS care. The system has established itself as one of the best in the world.

### Current challenges

#### *Child poverty*

The government has set a target of eliminating child poverty by 2020. As per the government definition, "Children are said to be living in relative income poverty if their household's income is less than 60% of the median national income". According to The Institute for Fiscal Studies (IFS) forecasts, child poverty will increase to 3.4 million by 2020 from 2.4 million in the past decade. This is in contrast to the improvement seen in reducing child poverty in the previous decade.

## PESTLE Analysis

According to a UNICEF report titled "Child Well-being in Rich Countries: A comparative overview", the UK was ranked 16th among the OECD countries and was clubbed in the group that includes Hungary and Portugal. The government has to do a lot more to tackle poverty, especially poverty among children, to achieve its goal by 2020.

### ***Controversial immigration act***

Immigration has always been a contentious issue in the UK. Since coming to power in 2010, the Cameron government has proposed reforms to immigration regulations to reduce overall immigration flows to the country. In May 2014, the bill turned into a law after getting Royal Assent. However, the negative impact of the controversial reforms, especially with regard to international students coming to pursue higher education in the UK, is intensely debated. The proposals include removal of free national health insurance (NHS) for international students, requirement for banks to verify the immigration status of new clients and changes that make it easier for the Home Office to remove people from the UK. The law also includes a provision to strip terrorism suspects of their citizenship, elimination of the right of appeal for extension applications made in the UK and the indefinite retention of biometric data.

The new law has faced criticism from student groups, universities and policymakers alike. The UK's highly reputed education sector fears that the new immigration laws will further reduce international student enrolment in UK universities, when they are already experiencing the lowest enrolment seen in the last 30 years. Critics believe this will lead to students moving to other countries for higher education where regulatory rules are more lenient. In addition, international students considerably add to the UK's research base, especially in science, technology, engineering and mathematics (STEM). According to the UK Council for International Student Affairs (UKCISA), international students account for 50% of those pursuing full-time research degrees and over 40% of UK postgraduate students. Additional declines in enrolment due to the new regulations may affect the competitiveness of UK's universities over the longer term.

### **Future prospects**

#### ***Policies to support pensioners and encourage savings***

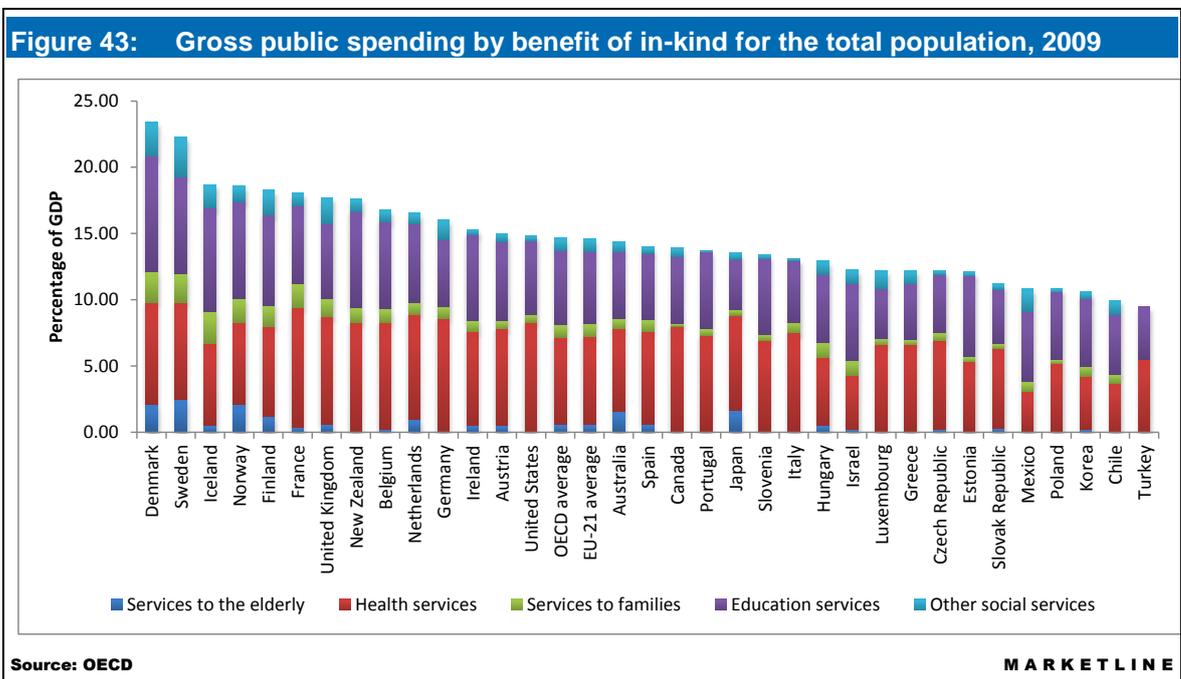
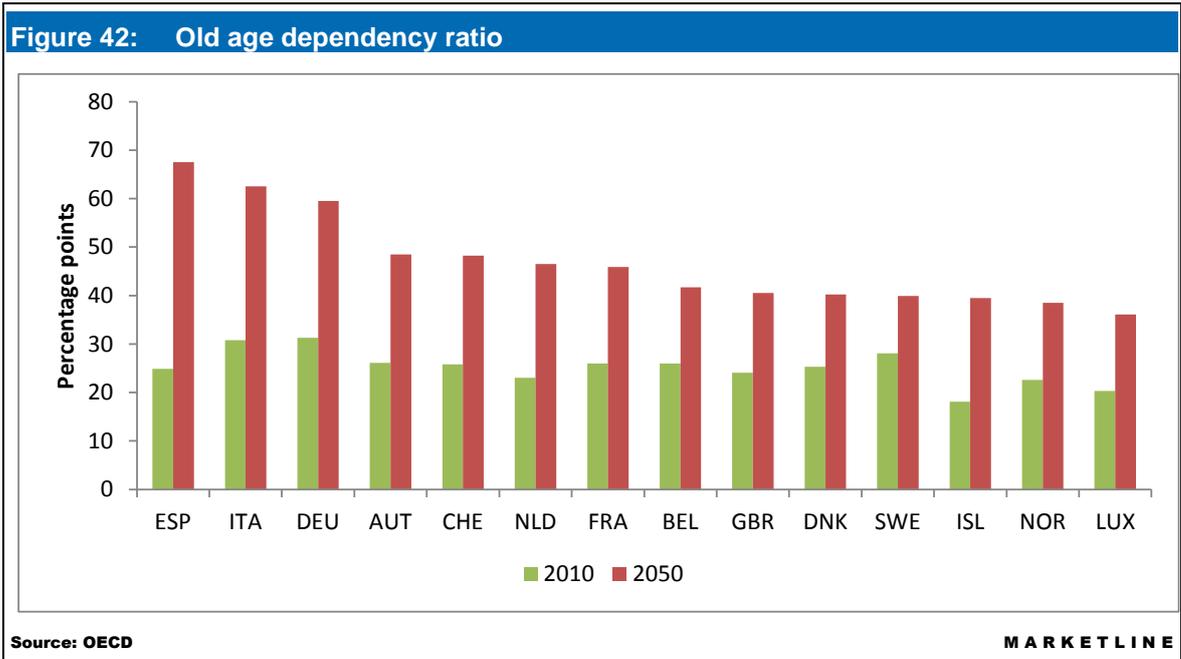
The 2014 budget has eased regulations, which makes it easier for individuals to access their pension savings. The budget will lower taxes by raising the level of the tax-free personal allowance further, from GBP10,000 (\$17,134.7) to GBP10,500 (\$17,991.4) in April 2015—to reward working people and increased the maximum Tax-Free Childcare support available to GBP2,000 (3,426.94) per year for each child.

### **Future risks**

#### ***Relatively high dependency ratio***

According to the OECD, the dependency ratio (over-65 population as a share of the working-age [15 to 64] population) will rise sharply from 24.1% in 2010 to 40.5% by 2050, a rise of 16.4 percentage points. The economic support ratio fell after the global financial crisis, as more people were unemployed; this resulted in lesser revenue from worker taxes.

The problem of aging population will plague the UK in the coming years, as people continue to retire in increasing numbers. With the country's older population increasing every year, the cost of social welfare will only rise; this could have serious implications for the country's finances as well as its economic activity. With the government on a deficit reduction path, welfare costs need to be controlled. The government's finances are under severe pressure to meet the needs of its aging population.

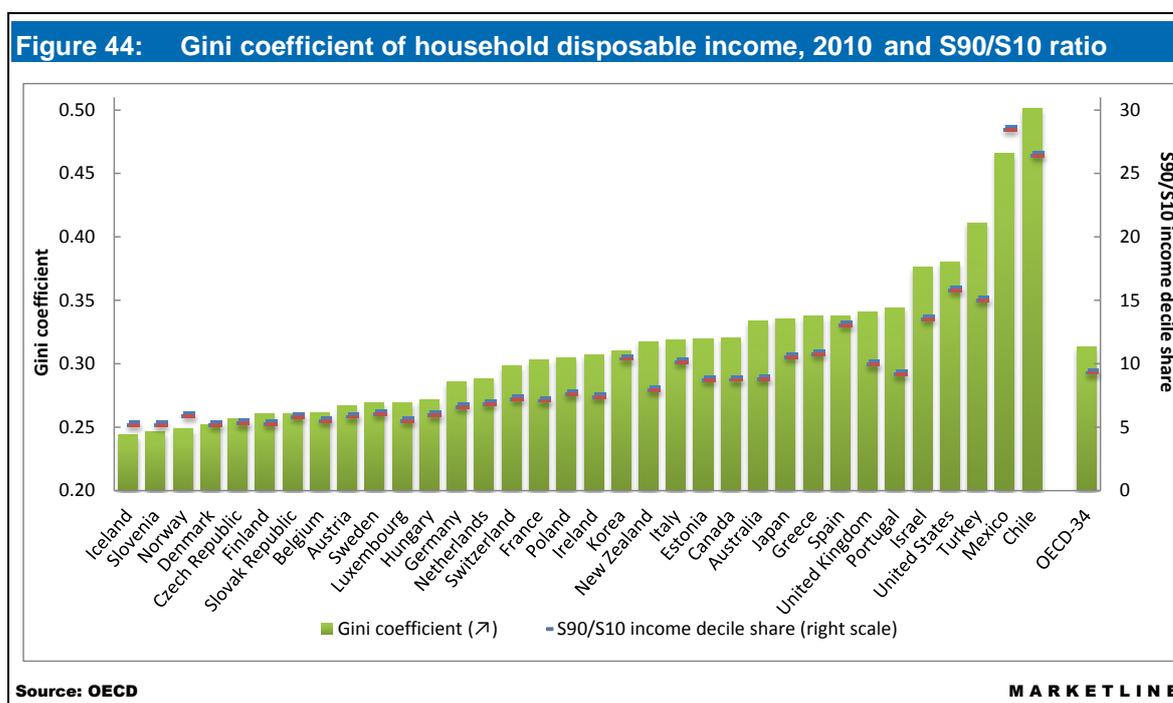


## PESTLE Analysis

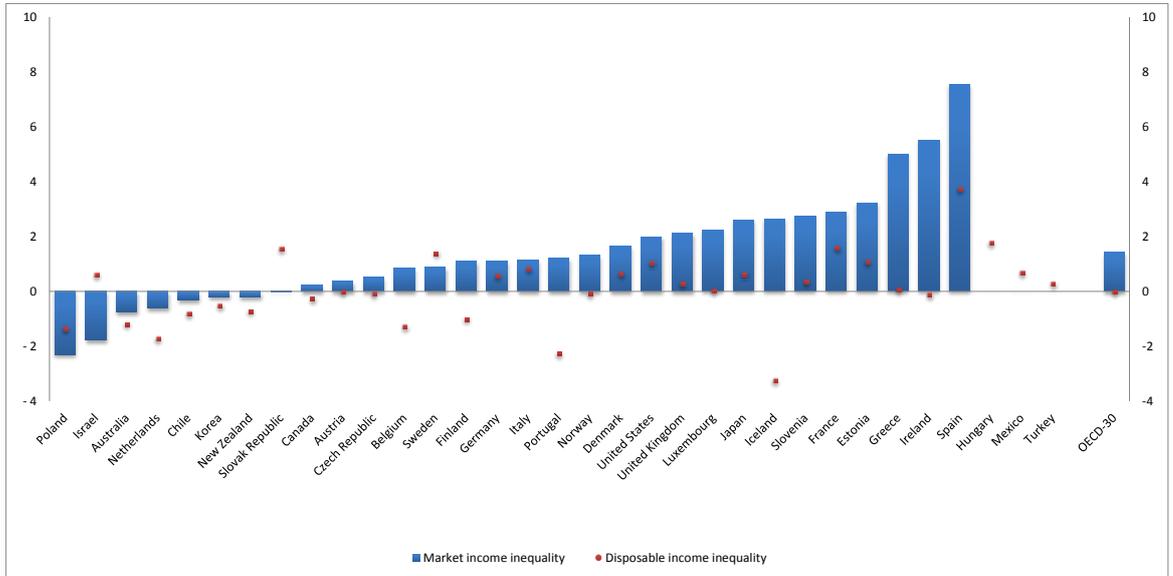
### *Rising inequality*

Rising inequality is a concern. According to the OECD, as of 2010, UK's gini coefficient (a measure of inequality in income) was 0.341 compared to the OECD-34 average of 0.313. The Gini coefficient score of zero corresponds to complete equality while a score of one corresponds to complete inequality. While in the OECD countries, the richest 10% of the country earn an average income that is around 9.4 times than that of the poorest 10%; in the UK, the average income of the richest 10% is 10 times that of the poorest 10%. The UK ranks among the top countries in terms of rising inequality. Further, inequality in market incomes (gross wages, income from self-employment, capital income, and returns from savings taken together) and household disposable income increased during 2007-11.

The government has been forced to undertake prudent fiscal measures to strengthen public finances, which is expected to increase the disparity in income in future. Inequality creates political, social and economic challenges and stifles upward social mobility. Taxes and benefits need to be reformed and redistributive policies need to be framed to challenge increasing inequality



**Figure 45: Percentage point changes in the Gini coefficient of household market and disposable incomes between 2007 and 2011**



Source: OECD

MARKETLINE

## Technology analysis

### Overview

The government has been successful in steering the R&D in the right direction, and is taking steps to boost competitiveness. R&D and IT are vital to a growing economy, and the dearth of skilled personnel could pose a serious challenge to the country's attempts to maintain its competitiveness.

<b>Table 6: Analysis of the UK's technology landscape</b>	
<b>Current strengths</b>	<b>Current challenges</b>
<ul style="list-style-type: none"> <li>Effective intellectual property rights</li> </ul>	<ul style="list-style-type: none"> <li>Lack of skilled personnel</li> <li>Regulatory control over indigenous innovations</li> </ul>
<b>Future prospects</b>	<b>Future risks</b>
<ul style="list-style-type: none"> <li>Scope for new industries</li> <li>Government policies towards encouraging R&amp;D</li> </ul>	<ul style="list-style-type: none"> <li>Fall in R&amp;D expenditure</li> </ul>
<b>Source: MarketLine</b>	
<b>MARKETLINE</b>	

### Current strengths

#### *Effective intellectual property rights*

As the UK is at the forefront of innovation and R&D globally, it has concurrently developed its legislation concerning the protection of intellectual property rights (IPR). The UK Intellectual Property Office (UK-IPO) is responsible for granting IPR. Although the UK does not have a general statutory register of copyright, the UK-IPO is responsible for maintaining registers of trademarks, designs and patents. IPR protection legislation is frequently enacted and amended in line with industry developments.

### Current challenges

#### *Lack of skilled personnel*

Despite the quality of educational and research institutions within the UK, there is a shortage of work force in the R&D sector. One of the reasons for this could be the attractive opportunities available outside of research within the UK. Moreover, technicians in R&D (per million people) were 970.9 in 2011, while Germany (1,363.7), France (1,855.9) and Spain (1,314.3) fared better than the UK on this parameter, according to the World Bank. Technicians in R&D are people whose main tasks require technical knowledge and experience in engineering, physical and life sciences (technicians), or social sciences and humanities (equivalent staff). They participate in R&D by performing scientific and technical tasks involving the application of concepts and operational methods, normally under the supervision of researchers. The decline in the working age population has had an impact on the progress of R&D within the country.

The UK has also witnessed a serious shortfall in IT and telecom talent, as the number of graduates with IT-related degrees has declined substantially in recent years. Both R&D and IT are vital to a growing economy, and the dearth of personnel could pose a serious challenge to the country's attempts to maintain its competitiveness in these areas.

## PESTLE Analysis

### *Regulatory control over indigenous innovations*

The authorities face the unenviable challenge of striking a balance between keeping the distribution of indigenous technology profitable and maintaining a competitive advantage. For instance, the UK is a key player in the defense industry. However, even if companies within this field are able to produce innovative products, they might not be able to profit as much as they could out of doing so, as the dispersion of this technology is sensitive. The government must therefore closely monitor developments in such industries and decide on a relevant export policy.

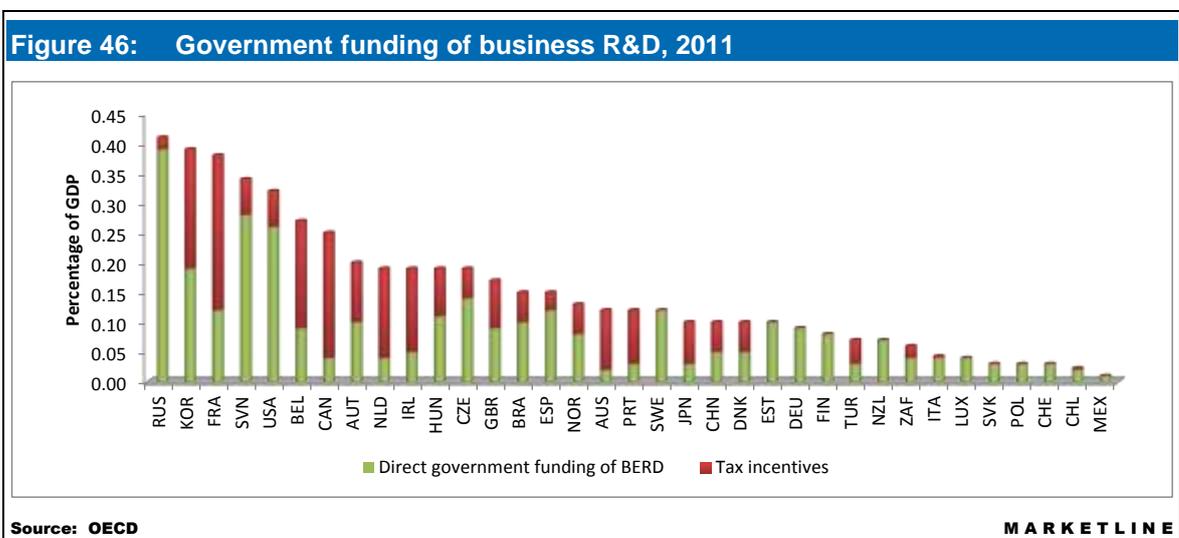
### **Future prospects**

#### *Scope for new industries*

As the UK is at the forefront of new technology, there are good opportunities for the development of relatively nascent fields such as nanotechnology, space exploration and tourism, and alternative energy. The government has implemented incentives such as tax concessions to make investment in such industries an attractive proposition. While such ventures are generally capital-intensive and returns are uncertain, prospects are extremely bright for companies that do manage to make a breakthrough, as is the case with other traditional technology-intensive industries such as pharmaceuticals and telecommunications.

#### *Government policies towards encouraging R&D*

The country needs to innovate in export-oriented sectors given the UK's competitiveness in high technology exports. Providing impetus to R&D is the key for UK to raise its productivity and living standards. Hence, the government's incentives to foster R&D are comparatively better than its European peers such as Germany, Spain and Italy. The government has created "Catapult centers" - technology and innovation clusters for scientists, engineers and businesses to work together to turn R&D into new products and services. The government has identified the following seven "Catapult centers": high-value manufacturing, offshore renewable energy, cell therapy, digital economy, future cities satellite applications and transport systems. This could be beneficial in the long run as companies will find it more attractive to invest in R&D.



**Future risks*****Fall in R&D expenditure***

The UK is renowned for the quality of its R&D and its strengths in science and innovation. The country has also traditionally been keen to encourage R&D in both the public and private sectors. However, according to the ONS (Office of National Statistics), gross expenditure on R&D decreased by 2% to GBP27.0 billion (\$46.26 billion) in 2012, compared with 2011. Moreover, when adjusted for inflation, in constant prices, the fall in expenditure was much steeper by 3%. Further, BERD (Business expenditure in R&D), which accounted for 63% of UK R&D expenditure in 2012, also witnessed a decline by 2%, in current prices, to GBP17.1 billion (\$29.30 billion) in 2012, compared with 2011. Total R&D expenditure decreased to 1.72% of GDP in 2012 from 1.77% of GDP in 2011. In addition, when compared to internationally, UK's gross R&D expenditure (1.72% of GDP) remains below the EU28 average of 2.08%. The fall in R&D expenditure does not bode well, especially when competitiveness has gone down and the UK needs to create high-skilled jobs to compete internationally.

## PESTLE Analysis

### Legal analysis

#### Overview

The legal system in the UK is organized, transparent, and efficient. This makes for an environment that is conducive to business, as legislation is passed in a practical manner, keeping all stakeholders in mind. At the same time, this legislation is enforced in a fair manner by a number of agencies set up for monitoring specific areas. The government has brought in general tax-avoidance rules to make evasion more difficult in the country. The British overseas territories have signed a treaty to improve tax transparency, which is likely to improve tax compliance. The UK government will have to bring about changes in its policies to attract FDI and to compete with BRIC and other advanced economies.

<b>Table 7: Analysis of the UK's legal landscape</b>	
<b>Current strengths</b>	<b>Current challenges</b>
<ul style="list-style-type: none"> <li>▪ High in business Freedom</li> <li>▪ Effective enforcement of legislation</li> <li>▪ Low total tax rate and tax compliance cost</li> </ul>	<ul style="list-style-type: none"> <li>▪ Tax evasion</li> <li>▪ Finding balance between traditional liberties and increased terror threat</li> </ul>
<b>Future prospects</b>	<b>Future risks</b>
<ul style="list-style-type: none"> <li>▪ Measures to cut down tax evasion</li> <li>▪ Improving product market regulations</li> <li>▪ Corporate tax reduction</li> </ul>	<ul style="list-style-type: none"> <li>▪ Lack of incentives to attract FDI</li> </ul>
<b>Source: MarketLine</b>	
<b>MARKETLINE</b>	

#### Current strengths

##### *High in economic freedom*

Laws that affect the UK's business environment have been created and amended with the interests of investors in mind. This is evident from the fact that domestic and foreign players have shown a continuous commitment to investing in the country. The majority of multinational corporations based outside Europe prefer to control their European operations from the UK. According to the 2014 Index of Economic Freedom, the UK ranked 14th in the world and fifth in Europe. The country scores high in business freedom, labor freedom, trade freedom, investment freedom and financial freedom. The government has made continuous efforts to ensure that the overall environment is conducive to business.

##### *Efficient regulatory environment for doing business*

An effective regulatory environment in which companies can conduct their business without too many regulatory hassles is important for a country's growth. According to the World Bank's Doing Business indicators for 2014, the UK ranked 10th out of 187 countries in overall ranking. In 2013, it made starting a business easier by providing model articles that can be used in preparing memorandums and articles of association. It takes 21.5 days to start a business in the UK, compared to the Organisation of Economic Co-operation and Development (OECD) average of 24.1 days. Moreover, the number of days taken in enforcing a contract is 437 days, which is lower than the OECD average of 529 days.

## PESTLE Analysis

### ***Low total tax rate and tax compliance cost***

According to Paying Taxes 2014, the UK's total tax rate (aggregate of profit taxes, labor taxes and other taxes) has been 34%, which was lower than the EU&EFTA average of 41.1%. Further, time to comply with taxes is 110 hours, far lower than the EU&EFTA average of 179 hours. A low tax burden and compliance costs make a country more investment friendly for businesses and startups as it reduces the cost of operating a business.

### **Current challenges**

#### ***Tax evasion***

The UK economy lost tax amounting to around \$110 billion due to the presence of a large shadow economy, according to the Tax Justice Network published in November 2011. According to the same source, the total size of the UK's shadow economy is estimated a whopping \$281 billion. According to HMRC (HM Revenue and Customs), the tax gap (difference between tax due as per UK law and tax collected) was GBP35 billion (\$59.97 billion) in 2012-13. Others estimate the number to be substantially higher. The collection of this revenue would reduce the demand to slash social and welfare expenditure, which hurts the poorest. Treasury data shows that those avoiding taxes are primarily wealthy individuals and corporations, so recouping this money would not harm the vulnerable. The government has brought in general anti-avoidance rules to make tax evasion more difficult.

#### ***Finding a balance between traditional liberties and tackling the increased threat of terrorism***

The government faces the challenge of maintaining a traditionally liberal society while taking steps to combat terrorism. For instance, a 2006 law bans the "glorification" of terrorism and gives law enforcement agencies special powers to act against websites deemed inflammatory. While the House of Commons approved the law by a comfortable margin, members of the House of Lords criticized it as restricting freedom of speech. In much the same way, legislation such as the Terrorism Act 2006 and the Prevention of Terrorism Act 2005 were controversial. The new immigration act of 2014, which has empowered authorities to strip suspected terrorists of citizenship, has also attracted controversy in the UK.

### **Future prospects**

#### ***Measures to cut down tax evasion***

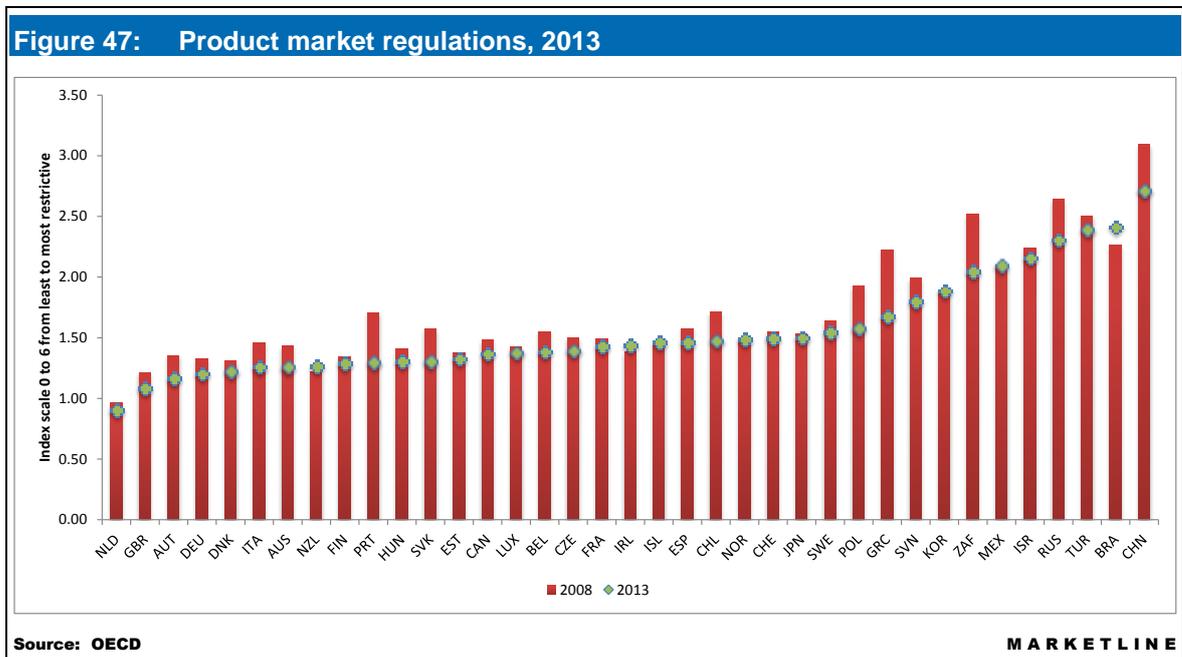
The British overseas territories have signed a treaty to improve tax transparency. British territories of Anguilla, Bermuda, Montserrat, the Turks and Caicos Islands and the British Virgin Islands have signed a treaty with the UK and other G5 nations to share tax information. The government has hailed this as a significant step to check tax evasion. Further, The Swiss/UK Tax Cooperation Agreement, which came into force from January 2013, is expected to improve information exchange and disclosures related to British assets in Swiss banks. Moreover, in June 2013, the G8 countries agreed to take steps to target tax evasion and avoidance. The government has recruited additional criminal investigators to prosecute those who evade tax because of which the number of people prosecuted for tax evasion went up from 420 in 2010-11 to 915 in 2013-14. Moreover, over the past few years the government has also taken various regulatory measures to crack down on evasions.

#### ***Improving product market regulations***

The UK has not done well in product market regulation. Product market indicators are a set of metrics that measure the extent to which policies framed by the government promote or inhibit competition in areas where competition is possible. Many of the sectors in the UK are not as tightly regulated as they are in its OECD counterparts. This is indicative of a more competition-friendly market and lesser monopolies in various sectors. Moreover, during 2008-13, it fell further, which suggests of more deregulation in the product and services market. Lower regulation increases the purchasing

## PESTLE Analysis

power of households and reduces expenses for businesses through lower costs of production. Moreover, the easing of regulations will attract investment in various sectors, which will open up new avenues of employment.



### Corporate tax reduction

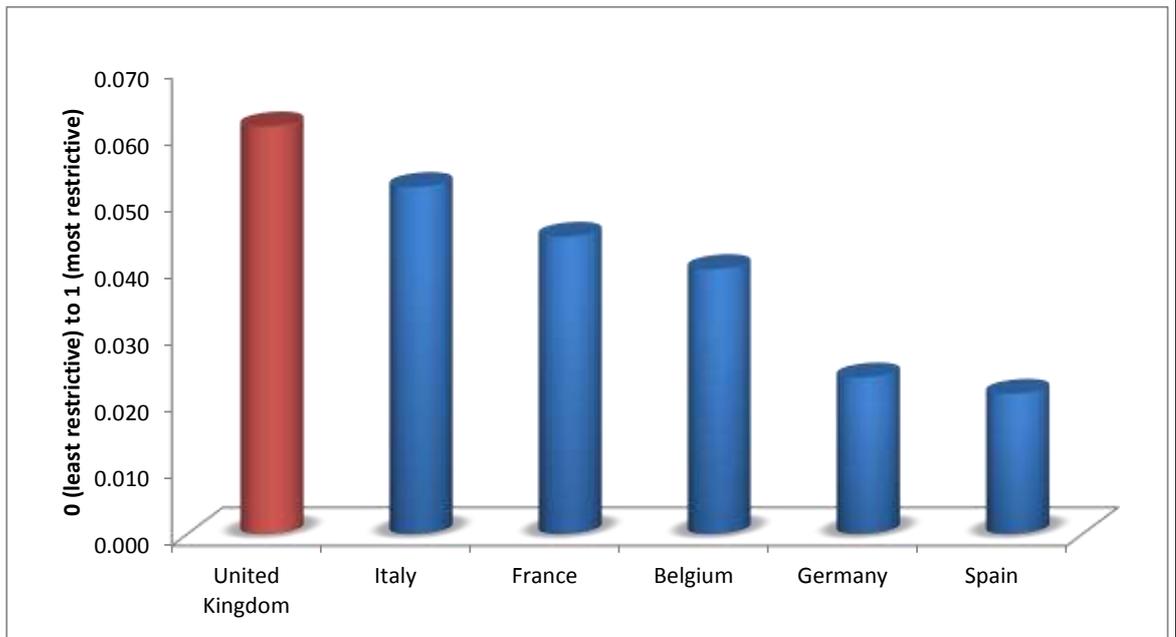
The government will cut the UK corporate tax rate to 20% by April 1, 2015—this will be among the lowest for G20 nations. This rate reduction is a welcome change for businesses, as they can spend a greater share of their profits on expansion. This policy will also make the UK a favorable investment destination for large businesses.

### Future risks

#### Lack of incentives to attract FDI

A number of emerging economies have introduced various pioneering schemes in an attempt to attract foreign investment. India, Russia, and China, for instance, have introduced various versions of special economic zones, which attract marquee global investors looking for tax exemptions or tax concessions. One trend that may define this decade is the increasing attractiveness of Germany to international investors. Germany's emergence from recession and its economic leadership in Europe is likely to field a challenge to the UK as a destination for foreign investment. The UK government will have to change policies to compete with other developed economies including the BRIC nations to attract FDI.

Figure 48: FDI restrictiveness Index 2013



Source: OECD

MARKETLINE

## PESTLE Analysis

### ***Environmental analysis***

#### **Overview**

The UK, considered one of the strongest players in global politics, has a large role to play in determining future global policies. Increasingly, world leaders are viewing climate change and sustainable development as global issues that require concerted global efforts and the UK has a major role to play in convincing other countries to commit to this cause. The government must also ensure that it meets its own commitments to send a positive signal to other countries.

The UK must achieve a greater reduction in the emission of pollutants if long-term environmental protection is its aim. Although targets have been set through a number of international and internal agreements, the process should be developed further. The great challenge lies in balancing economic development with progress in the environmental situation. This will be especially difficult in the face of increasing competition from emerging markets.

<b>Table 8: Analysis of the UK's environmental landscape</b>	
<b>Current strengths</b>	<b>Current challenges</b>
<ul style="list-style-type: none"> <li>▪ Strong global influence</li> <li>▪ Good track record in implementing policies</li> </ul>	<ul style="list-style-type: none"> <li>▪ High air pollution</li> </ul>
<b>Future prospects</b>	<b>Future risks</b>
<ul style="list-style-type: none"> <li>▪ Proactive policy toward Kyoto Protocol successor</li> <li>▪ Carbon budget</li> </ul>	<ul style="list-style-type: none"> <li>▪ Balancing environmental protection with economic development</li> </ul>
<b>Source: MarketLine</b>	
<b>MARKETLINE</b>	

#### **Current strengths**

##### ***Strong global influence***

With its position as an industrialized global power and as a member of the G8, the UK has a leadership role to play in the global effort towards sustainable development and environmental protection. The UK has with close ties with a number of countries and an influential position in the Commonwealth. Consequently, it has the ability to extract commitments from developing nations that are unwilling to sacrifice economic growth to protect the environment.

##### ***Good track record in implementing policies***

The UK has a good record of accomplishment in achieving a number of its environmental objectives and in expanding its environmental infrastructure. The country has broadened its environmental objectives because of various international commitments, and partly as a response to its goal of sustainable development. The step towards integrated pollution control is a major component of environmental management, although it is only half-complete and its scope is still limited to large sources of pollution.

The Energy Act 2011 brought about a significant change in the provision of energy efficiency measures for both homes and businesses. The act seeks to enable and secure low carbon energy supplies and ensure fair competition in energy markets. Seven environment-related directives have been combined into one piece of legislation to improve the framework of the act. The government has stated that it is committed to the use of market forces, although it is yet to

## PESTLE Analysis

make extensive use of economic instruments as part of its environmental policy.

### **Current challenges**

#### ***High air pollution***

In June 2010, the European Commission issued a second and final warning to the UK over air quality, and asked it to come up with a pragmatic solution to pollution. London suffers from high air pollution, while Manchester, Glasgow and Birmingham have dangerous levels of NO<sub>2</sub>. Exhaust fumes and emissions from factories and power stations around London are the main causes of pollution.

In May 2013, the Supreme Court ruled that the government had failed to bring down air pollution levels as per EU directives and the European commission can take legal action against the government for non-compliance. This exposes the government to a fine of around GBP300m (\$514.04m). In July 2014, the Department of Environment, Food and Rural Affairs has reported that London is projected to fail EU air quality limits until at least 2030, thus missing the deadline by two decades. This poses significant health hazard to its residents. Around 29,000 deaths in the UK every year are due to air pollution. The government has to take immediate and decisive steps to control air pollution in the country.

### **Future prospects**

#### ***Proactive policy toward Kyoto Protocol successor***

The UK played a central role in galvanizing support for extending the Kyoto Protocol beyond 2012. The UK supported ratification of the Kyoto Protocol's second commitment period, and worked to secure a mandate for a comprehensive legally binding instrument in protocol form by 2015. Indeed, by committing to a second commitment period, the UK through the EU has championed the next round of negotiations, helping to maintain essential elements that include its potential long-term viability as a framework. This is a significant step forward in curbing emissions to tackle global climate change.

### **Carbon budget**

Under the Climate Change Act, the UK government has to report annually to lawmakers on its progress in meeting its carbon budgets. The government has set an overall target of an 80% reduction in emissions from 1990 levels by 2050. The UK's reduction also compares well to cuts achieved in other countries. The government has targeted to limit emissions to 2,782 MtCO<sub>2e</sub> during 2013-17, 2,544 MtCO<sub>2e</sub> over 2018-22 and 1,950 MtCO<sub>2e</sub> over 2023-27. Furthermore, the government has started a new mandatory scheme for large public and private sector organizations to boost energy efficiency and reduce carbon emissions.

### **Future risks**

#### ***Balancing environmental protection with economic development***

The dilemma of striking a balance between economic development and protecting the environment is one that will remain an issue in the near future. In the UK, the relative decline of the industrial sector has meant that there is less pressure on the environment, although even the transition to a services-driven economy has not erased the harmful impact that overall economic development is having on the planet. The UK's economic growth would not be sustainable unless the government focuses on "green growth". Further, the continuing debate to choose between environmental protection and economic development is not mutually exclusive and the government has to take into account environmental issues in its growth strategies.

## POLITICAL LANDSCAPE

### *Summary*

The UK has strong democratic traditions. There is great respect for human rights and civil liberties, and the public sector is transparent and accountable. The system of governance in the UK has developed from a monarchy into a democratic parliamentary system of governance known as the Westminster system. The legislative, executive, and judicial functions are entrusted to separate bodies. Executive authority is vested in the cabinet, led by the prime minister, while legislative authority is vested in a bicameral parliament and judicial authority is vested in a system of courts. None of these institutions has absolute authority over the other, and there is an adequate system of checks and balances in place. The monarch, Queen Elizabeth II, is the head of state, but this position is largely ceremonial.

The UK emerged from the world wars as a dominant, industrialized nation, largely on the back of continuous economic development. As a result, the UK became a major force in global politics as a permanent member of the United Nations Security Council and the North Atlantic Treaty Organization (NATO), and an important member of the European Union (EU). The UK has distanced itself from complete European integration, but at the same time, the government has tried to keep itself involved in the EU's international commitments. The country was criticized for its support of the US-led war on terror in Afghanistan and Iraq.

In May 2010, elections to the House of Commons brought about a historic change in the political composition of the UK. The Conservative Party headed by David Cameron won the election with 36.1% of the vote, claiming 305 seats out of the 650 available, and went on to form the UK's first coalition government since World War II.

### *Evolution*

#### **Pre-1950s**

Early medieval Britain consisted of a number of small kingdoms, which had formed into the kingdoms of England and Scotland. The King of Scotland inherited the English throne in 1603 and acted as sole ruler over the two territories. These kingdoms were combined to form the Kingdom of Great Britain in 1707. In 1801, the Kingdom of Great Britain merged with the Kingdom of Ireland to form the United Kingdom of Great Britain and Ireland, which became a dominant power in the 19th century. The nation later became the United Kingdom of Great Britain and Northern Ireland after some parts of Ireland seceded in 1927.

At the height of its power, the "British Empire" covered around a quarter of the earth's surface. However, the nation suffered great losses during the two world wars in the first half of the 20th century. After World War II ended, the Labour Party came into power and established a welfare system. The UK became a permanent member of the UN Security Council and a founder member of NATO. The end of World War II also heralded the start of decolonization, whereby a number of the UK's colonies gained independence.

#### **1950-90**

In 1961, the UK's application to join the European Economic Community (EEC) was opposed by French president Charles de Gaulle, although the country eventually joined in 1973 despite widespread strikes. The late 1960s saw the start of intense violent conflict in Northern Ireland between elements of the unionist community and the nationalist community. Apart from the dispute between the two parties over the status of Northern Ireland within the UK, the minority nationalist community (primarily Roman Catholic) resented the treatment they received from the majority unionist community (primarily Protestant), while the unionists opposed the dominance of the nationalists.

## Political Landscape

The Conservative Party came to power in 1979, led by Prime Minister Margaret Thatcher. In 1982, the UK sent special forces teams to the Falkland Islands (an archipelago located off the coast of South America) after they were invaded by Argentina, and successfully regained control over the territory. Under Thatcher, economic reforms took place with the introduction of free market policies and the privatization of various state enterprises. Thatcher was re-elected twice, in 1983 and in 1987, but resigned in 1990 after facing a challenge for the leadership of the Conservative Party. John Major was then named prime minister.

### **1991-2013**

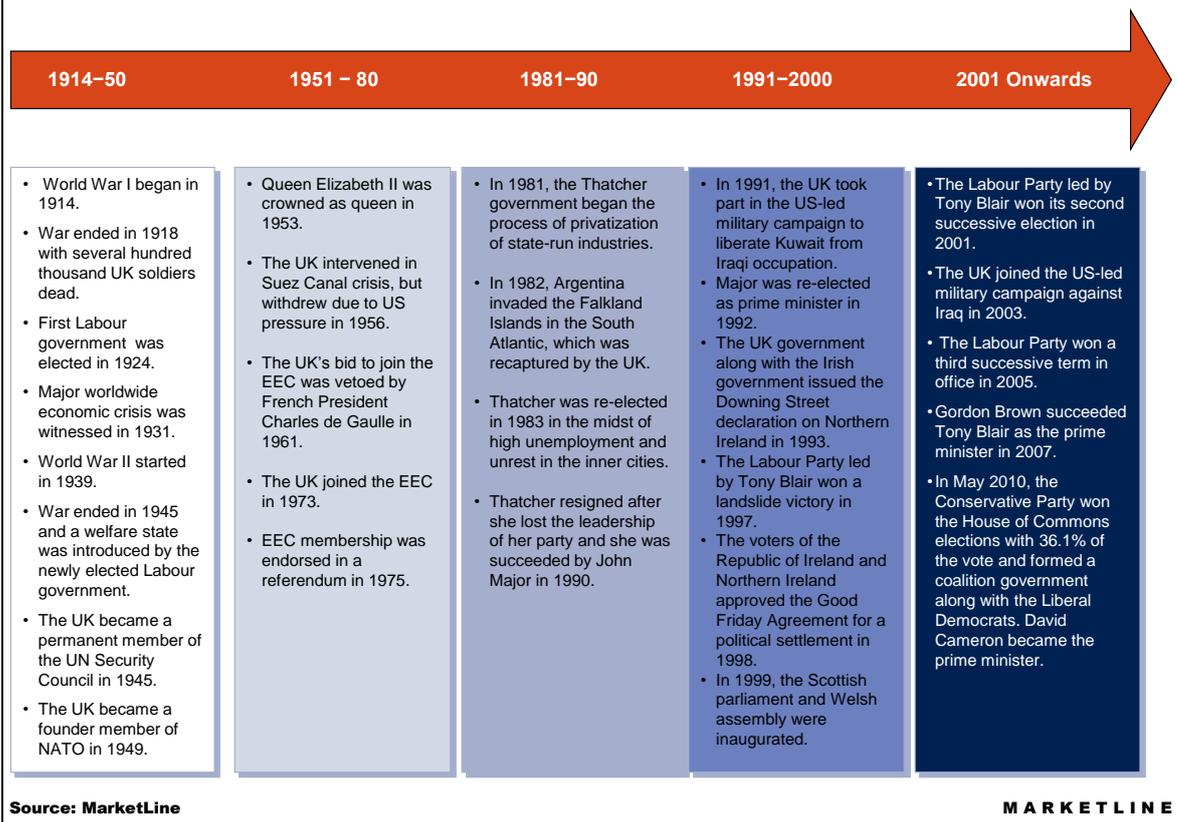
In 1991, the UK, as one of the US's allies, helped liberate Kuwait from Iraqi occupation. The Northern Ireland peace process received a boost in 1993 when the UK government issued a joint peace proposal with the Irish government. Eventually, the Belfast Agreement in 1998 ended the conflict in Northern Ireland. In recent times, there has been a significant devolution of powers from the central government to various sub-national entities. The devolved system of government is different from a federal system of government in that, under the doctrine of parliamentary sovereignty, devolution is in theory reversible and sub-national entities are subordinate to the UK parliament.

In 1997, the Labour Party, led by Tony Blair, emerged with a landslide victory over the Conservatives. Blair's party was subsequently re-elected twice, in 2001 and again in 2005, despite the party's policy of staunch support for the war on terror in Iraq and Afghanistan. In 2007, Gordon Brown succeeded Tony Blair as both the head of the Labour Party and the prime minister.

In June 2009, the governing Labour Party lost the European elections, ending in third position with only 15.7% of the vote, while the Conservative Party received 27.7%. In the May 2010 elections to the House of Commons, the Conservative Party won with a 36.1% share of the vote, winning 305 seats. The Conservative leader David Cameron subsequently went on to form a coalition government with the Liberal Democrats.

In December 2011, Prime Minister Cameron disagreed with proposals to make changes in the EU's Lisbon treaty stating that these proposals will jeopardize the status of London as a financial center. In December 2012, both the British and the Scottish government agreed on a referendum for Scottish Independence in September 2014. In January 2013, Prime Minister David Cameron proposed a referendum by 2017 on whether to leave the EU after the next parliamentary elections in 2015.

**Figure 49: The UK - political events timeline**



## Political Landscape

### Structure and policies

#### Key political figures

Key political figures in the UK are:

- Prime minister David Cameron
- Head of state Queen Elizabeth II

Figure 50: Key political figures	
	<p><b>Queen Elizabeth II</b> is the monarch of the UK and she is the only monarch of more than one state in the world. Queen Elizabeth II is a constitutional monarch of the country and she takes on certain representational duties, which are ceremonial in nature. The monarch of the UK has the right to dissolve the parliament and appoint a prime minister. Moreover, the monarch is the head of the commonwealth and so the official head of state for fifteen countries, which is largely a ceremonial position.</p>
	<p><b>David Cameron</b> became the prime minister and took office on May 14, 2010. He was elected as the leader of the Conservative Party in December 2005. Cameron believes that some of the issues that his party should focus on include promoting social justice and increasing the access to good schools, good healthcare and good housing. Cameron has been serving as the MP of Witney since 2001.</p>
<p>Source: MarketLine <span style="float: right;">MARKETLINE</span></p>	

#### Structure of government

The UK subscribes to a democratic, parliamentary system of governance known as the Westminster system. This system, developed over several centuries, is named after the location of the UK parliament. The Westminster system is characterized by the presence of a titular head of state, who in practice is more of a ceremonial figurehead, and a bicameral legislature in which at least one of the houses is elected. Other key features are a de facto executive branch led by the head of the executive—who is usually the head of the party with the largest representation in parliament, and a judicial branch that is independent of the legislature and the executive.

#### Center/federal

Legislative power is vested in both the government and the two chambers of parliament: the House of Commons and the House of Lords.

On a broad level, the duties of the houses are similar and involve monitoring the work of the government, passing legislation, and discussing issues of significance. There is a system of checks and balances, as the decisions made by one house usually have to be approved by the other.

#### State/provincial

In the late 1990s, a significant devolution of authority was carried out in the UK through the transfer of powers from the central government to various sub-national bodies. Despite the creation of a national parliament in Scotland and a national assembly in both Wales and Northern Ireland, the UK parliament had retained overall authority over these

## Political Landscape

devolved institutions. Referendums held in Scotland, Wales, and Northern Ireland in 1997 and 1998 confirmed that the public was in favor of devolution, and by 1999, the devolved powers were formally transferred.

Following the passage of the Scotland Act 1998, the Scottish parliament and executive formally came into existence; the parliament has the power to make laws, with certain areas being reserved for the parliament of the UK. All areas that are not reserved for the parliament of the UK come under the purview of the parliament of Scotland. The parliament and the executive have powers in specific areas such as economic development, education, health, law and home affairs, local government, transport, social services, housing, and the environment.

### **Key political parties**

#### ***Labour Party***

The Labour Party initially came into existence in 1900 as a political pressure group that was formed out of the trade union movement, and was influenced by the socialist political parties of the time. A leading left party in England, Scotland, and Wales since the 1920s, it has been a party of self-proclaimed democratic socialism. In recent times, the party has adopted a "third way" approach to policymaking, combining both socialism and laissez-faire principles.

Under the leadership of Tony Blair and Gordon Brown, it was at the helm of affairs in the UK from 1997 until 2010, although its majority in the House of Commons fell rapidly during this time. Brown took over from Blair as prime minister and head of the party in June 2007. However, in the May 2010 elections for the House of Commons, the party got 258 seats out of 650 and lost power. Ed Miliband is the present leader of the party.

#### ***Conservative Party***

The Conservative Party is arguably the oldest political party in the world, with roots in the Tory party of the 18th and 19th centuries. Indeed, even today, the Conservatives are often referred to as the Tories. The party is the largest in the UK in terms of public membership, and is the most successful party in the UK in terms of number of election victories.

The Conservative Party won the May 2010 House of Commons elections with 305 seats out of 650. The party, along with the Liberal Democrats, then formed a coalition government in the UK.

#### ***Liberal Democrats***

The Liberal Democrats trace their roots back to the formation of the Liberal Party in 1859. In terms of public membership, the Liberal Democrats are the UK's third largest party. In general, the party promotes social liberalism, which focuses on individual liberty, minimal state intervention in an individual's personal affairs, and the decentralization of power away from "unaccountable" public bodies. Nick Clegg was elected leader of the Liberal Democrats in December 2007 after the resignation of his predecessor, Sir Menzies Campbell.

The Liberal Democrats' policy initiatives are based on the objective of maintaining "a fair, free, and open society." For example, the party supports the decentralization of power away from national government and free education for all citizens including university students. The party opposes the anti-terror laws that were brought in by the previous Labour government.

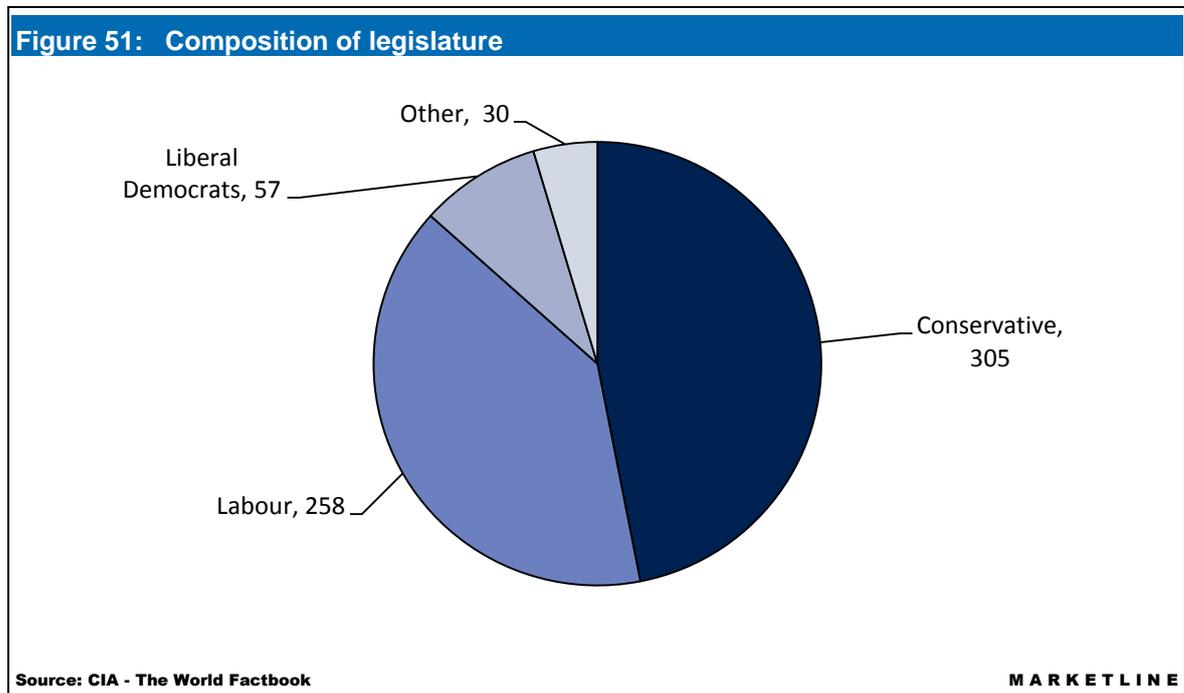
In the general elections of May 2010, the Liberal Democrats gained 57 seats in parliament. The party is part of the coalition government led by the Conservatives.

### **Composition of legislature**

In the last parliamentary elections held in May 2010, the Conservative Party won 305 seats in parliament. Apart from Prime Minister David Cameron, the party has other important members of the cabinet such as the ministers responsible

## Political Landscape

for finance, foreign affairs, home affairs, defense, health, justice, and the environment. While the Labour Party managed to secure 258 seats in parliament, the Liberal Democrats won 57 seats.



### Key policies

#### *Economic and social policies*

The economy has continued to be weak since the financial crisis of 2008. The government since then has been bolstering the economy with unprecedented financial support. The banking sector has not yet recovered from the crisis and concerns over bank balance sheets remain. In addition, elevated private sector and household debt continue to restrain investment and consumption. The housing market has been frothing in recent times; however, no significant measures have been taken to cool it, making it a potential point of vulnerability for the economy. On the external front, a lingering debt crisis in the Eurozone, a major market for British exports, has affected exports and manufacturing. The government's front loaded fiscal consolidation has narrowed the deficit figure, although it has remained elevated over the past few years.

Against this economic background, the 2014 budget, has proposed to cap the welfare budget to restrain spending, taking measures to ensure that companies are paying the full costs of public service pension schemes and restrict public sector pay hikes. The government proposed the lowering of corporate tax to 20% from April 2015, which will be among the lowest in the G20. To boost British businesses, the government doubled the annual investment allowance to GBP500,000 (\$856,735) until 2015 end. In addition, it also eased the regulations, which makes it easier for individuals to access pension savings. The budget will lower taxes by raising the level of the tax-free personal allowance from GBP10,000 (\$17,134.7) to GBP10,500 (\$17,991.4) in April 2015—to reward working people and increased the maximum Tax-Free Childcare support available to GBP2,000 (3,426.94) per year for each child. However, the government has not proposed any drastic measures to increase public capital spending and investment in infrastructure and skills.

## Political Landscape

### *Foreign*

The UK is one of the most prosperous and influential nations in the world and has a large role to play on the international stage. The country is one of the five permanent members of the UN Security Council, is one of the founding members of NATO, and a member of the G8. Though a member of the EU, it has followed a conservative approach to European integration. The UK-EU tensions could escalate in the near term as the government renegotiates the terms of membership with the latter. A modified relationship may lead to a diminishing role for the UK as far as future EU policy matters are concerned. The incumbent prime minister has also called for a referendum on exiting the EU by 2017 as the nation has become increasingly skeptical of its prospects. The issue of Scottish independence remains a serious risk, as there is a referendum in September 2014. With the Scottish National Party pressing for independence, the future of the union remains uncertain. Although full independence is unlikely, there may be more devolution. The UK will continue to remain a close ally of the US.

### *Defense*

As a permanent member of the UN Security Council, the UK has a responsibility towards global peacekeeping and crisis management efforts. The UK has committed troops to a number of peacekeeping missions in countries such as Sudan, Liberia, Sierra Leone, the Democratic Republic of Congo, Cyprus, Kosovo, Bosnia, Georgia, Iraq and Afghanistan. As one of its main defense policy objectives, the UK aims to combat terrorism and the proliferation of weapons of mass destruction. The UK has established a close relationship with the US, and has participated in the latter's war on terror in Iraq and Afghanistan. As part of its defense policy relating to the war on terror and tyranny, the UK has committed its forces against the Gaddafi regime in Libya and contributed to his overthrow. The current conflict in Syria and Iraq has not attracted an overt UK response.

## **Performance**

### **Governance indicators**

The World Bank report on governance uses voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption as indicators for 215 countries and territories over 1996-2012. Daniel Kaufmann of the Brookings Institution, Massimo Mastruzzi of the World Bank Institute and Aart Kraay of the World Bank Development Economics Research Group conducted the study. For any country, a percentile rank of zero corresponds to the lowest rank and 100 corresponds to the highest.

The UK ranked in the 92.42 percentile for voice and accountability in 2012. This parameter measures the extent to which a country's citizens are able to participate in selecting their government, along with freedom of expression, freedom of association, and the availability of free media. The UK ranks high due to its openness and liberal attitude toward the press. The UK is ahead of its neighbor France, which ranked in the 89.57 percentile.

The UK ranked in the 60.19 percentile for political stability and absence of violence in 2012. This parameter measures perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including domestic violence and terrorism. The UK was below its neighbor France, which ranked in the 63.51 percentile.

The UK ranked in the 91.87 percentile for government effectiveness in 2012. This parameter measures the quality of public services, the quality of civil services and the degree of their independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The UK's rank on this indicator has been impressive throughout recent times, as successive governments have broadly pursued similar economic policies, leading to stability in policy formulation and implementation. France was slightly behind the UK

## Political Landscape

with a percentile rank of 87.56.

The UK ranked in the 94.74 percentile for regulatory quality in 2012. This parameter measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. A high ranking indicates fair implementation of policies and regulations in the private sector. Under this category, France trailed the UK, ranking in the 83.25 percentile.

The UK ranked in the 92.89 percentile for rule of law in 2012. This parameter measures the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence. In this category, France placed lower than the UK, ranking in the 90.05 percentile.

The UK ranked in the 92.34 percentile for control of corruption in 2012. This parameter measures the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, and the appropriation of the state by elite and private interests. France was lower at 89.95.

### **Outlook**

Prime Minister David Cameron indicated that there would be a "seismic shift" in how the country was governed after unveiling a historic coalition with the Liberal Democrats in mid-May 2010. After taking office as Britain's first coalition government since World War II, the prime minister announced that the Conservative Party and its Liberal Democrat partner considered a record fiscal deficit to be the most important issue requiring immediate attention. The detailed joint policy program published by Cameron included a pledge not to join the euro. The government has a strong majority in parliament; however, the diverse opinions of the coalition partners have strained relations. In the short term, the main challenge in the political sphere will be the referendum on Scottish independence and EU-UK relationship. Although the ruling conservatives are highly skeptical of the EU, they will try to keep its membership in the EU but on re-negotiated terms.

## ECONOMIC LANDSCAPE

### *Summary*

The UK's economic development has historically been based on its strong industrial centers. However, in recent times the services sector has overshadowed the industrial sector to become the key driver of economic growth. This shift has led to unbalanced economic growth, as London and the South East have consistently grown, while the Northern cities such as Manchester, Liverpool, Newcastle, Sheffield, Leeds and Birmingham, which have traditionally been dependent on industrial activity, have not benefitted much.

The economy made a strong comeback in 2013 by registering a growth rate of 1.66% after growth nearly stagnated in 2012. Public debt remains elevated and thus remains a significant cause for concern. The government maintained that it would go ahead with fiscal consolidation measures to reduce the fiscal deficit. Strong fiscal consolidation is in progress, and remains vital to achieve a more sustainable budgetary position, that will reduce fiscal risk.

### *Evolution*

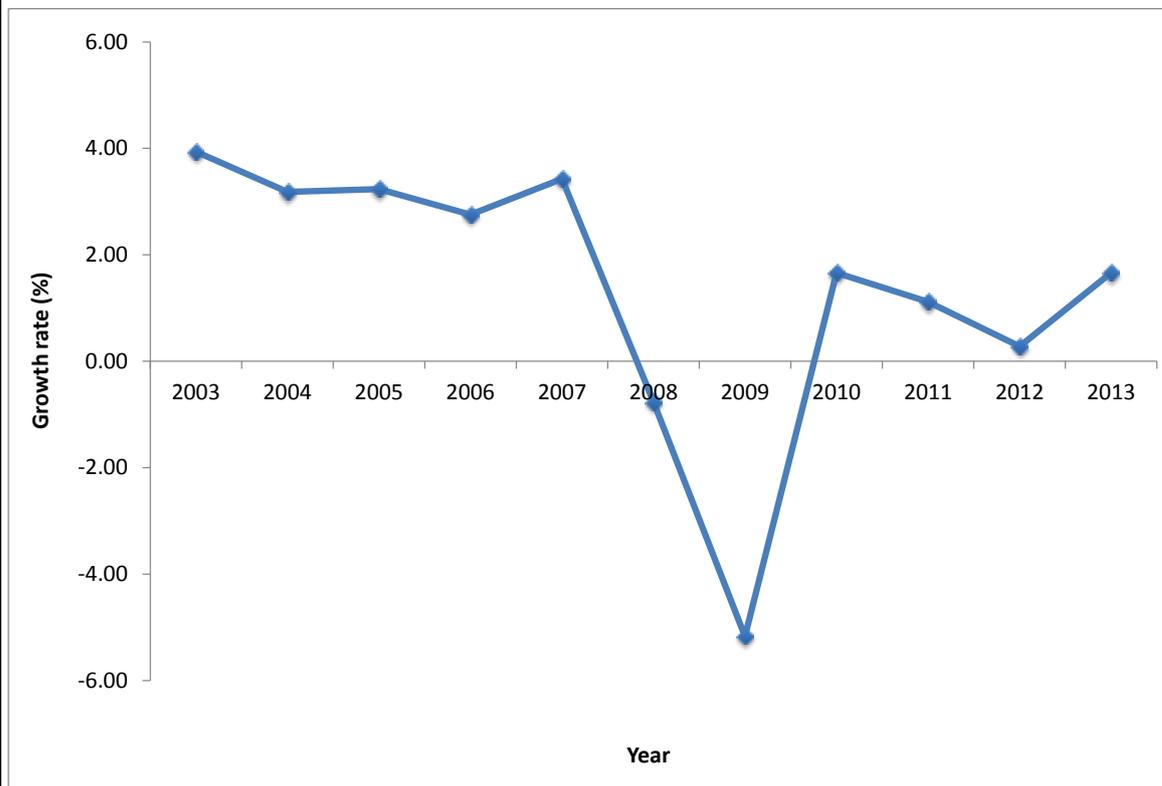
The UK has traditionally been at the forefront of economic progress. After the two world wars, a government led by Clement Attlee, the then leader of the Labour Party, was established. This government went about the nationalization of various industries and institutions such as the inland transport system, electricity, gas, telephones, coal mining, and even the Bank of England (BoE). The Labour Party still considers the establishment of the National Health Service in 1948 one of its most important achievements.

Led by Harold Wilson, the Labour government of the 1960s had a different focus than the government of the 1940s, choosing to concentrate on economic planning and the modernization of British industry. The government created large public sector companies that were technology-intensive, funded the creation of infrastructure to support industry, and encouraged innovation and the adoption of new technologies.

The victory of Margaret Thatcher and the Conservative Party in the 1979 elections brought about a change in direction for the UK economy. Under Thatcher, economic reforms took place with the introduction of free market policies and the privatization of various state enterprises, and the government sold a number of large public sector enterprises created by previous governments. Thatcher was re-elected twice, in 1983 and in 1987, but resigned in 1990 after her leadership of the party was challenged. John Major succeeded her as prime minister.

Since the 1990s, the UK economy has made a pronounced shift from its traditional dependence on its industrial sector. The services sphere has come to the forefront, and successive governments have promoted this trend. During 2000-07, economic growth averaged 3.17%. However, due to the global financial crisis, the country's GDP contracted by 0.77% and 5.17% in 2008 and 2009, respectively. The economy recovered in 2010 to register growth of 1.66%, but slowed again in 2011 to 1.12% as the European debt crisis lingered. Economic growth was nearly stagnant in 2012 as the economy grew by 0.28%. However, in 2013, the economy made a strong recovery led mainly by strong domestic demand.

Figure 52: Historical GDP growth, 2003-2013



Source: Country Statistics, MarketLine

MARKETLINE

## Structure and policies

### Financial authorities and regulators

From April 2013, the Financial Services Authority ceased to exist and became two separate regulatory authorities. The Financial Conduct Authority was established to supervise the financial services authority and the Prudential Regulation Authority was formed to supervise banks, building societies, credit unions, insurers and major investment firms

### Stock markets and derivatives

The London Stock Exchange (LSE) is responsible for providing a platform to trade in a wide array of securities, including domestic and international equities, covered warrants, exchange-traded funds, depository receipts, debts, and fixed interest products. The LSE allows companies of every size to raise capital through four primary markets. It comprises the following components:

- **The Main Market:** Arguably the most prestigious listing and trading environment in the world.
- **The Alternative Investment Market (AIM):** The equities market for smaller companies.
- **The Professional Securities Market:** For depository receipt securities and listed debt.
- **The Specialist Fund Market:** Dedicated to specialized investment entities.

### Insurance

According to MarketLine, the UK insurance market had total gross written premiums (GWPs) of \$311.3 billion in 2012, representing a compound annual rate of change (CARC) of -2.1% between 2008-12. In comparison, the French and German markets grew with compound annual growth rates (CAGRs) of 0.2% and 2.3% respectively, over the same period, to reach respective values of \$242.5 billion and \$232.0 billion in 2012. The life insurance segment was the most lucrative for the UK insurance market in 2012, with total GWPs of \$205.8 billion, equivalent to 66.1% of the market's overall value. In comparison, sales of non-life insurance generated GWPs of \$105.5 billion in 2012, equating to 33.9% of the market's aggregate revenues.

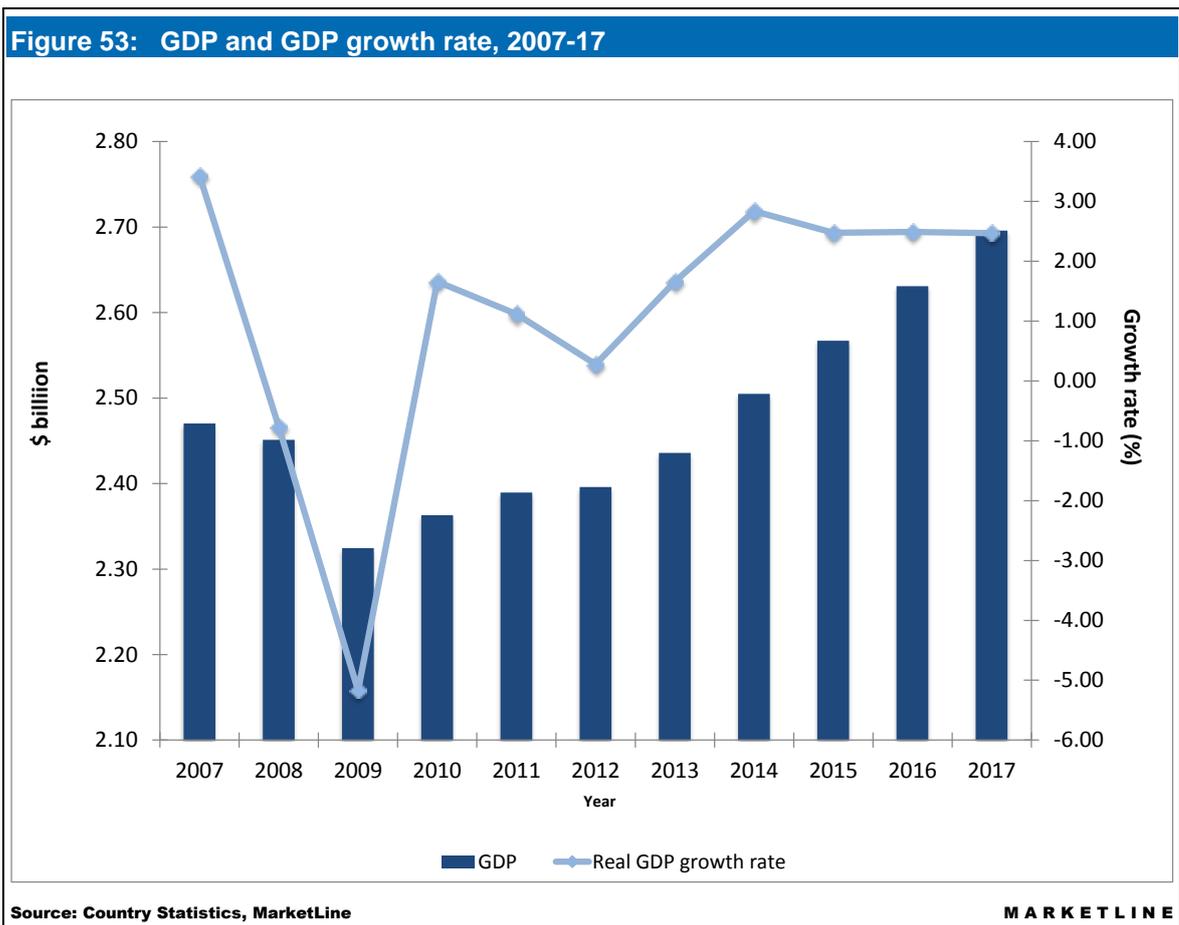
The performance of the market is forecast to follow a similar pattern with an anticipated CARC of -2.0% for the five-year period 2012-17, which is expected to drive the market to a value of \$282.0 billion by the end of 2017. Comparatively, the French and German markets will grow with CAGRs of 1.8% and 2.6% respectively, over the same period, to reach respective values of \$265.0 billion and \$263.4 billion in 2017.

### Performance

#### GDP and growth rate

##### Overview

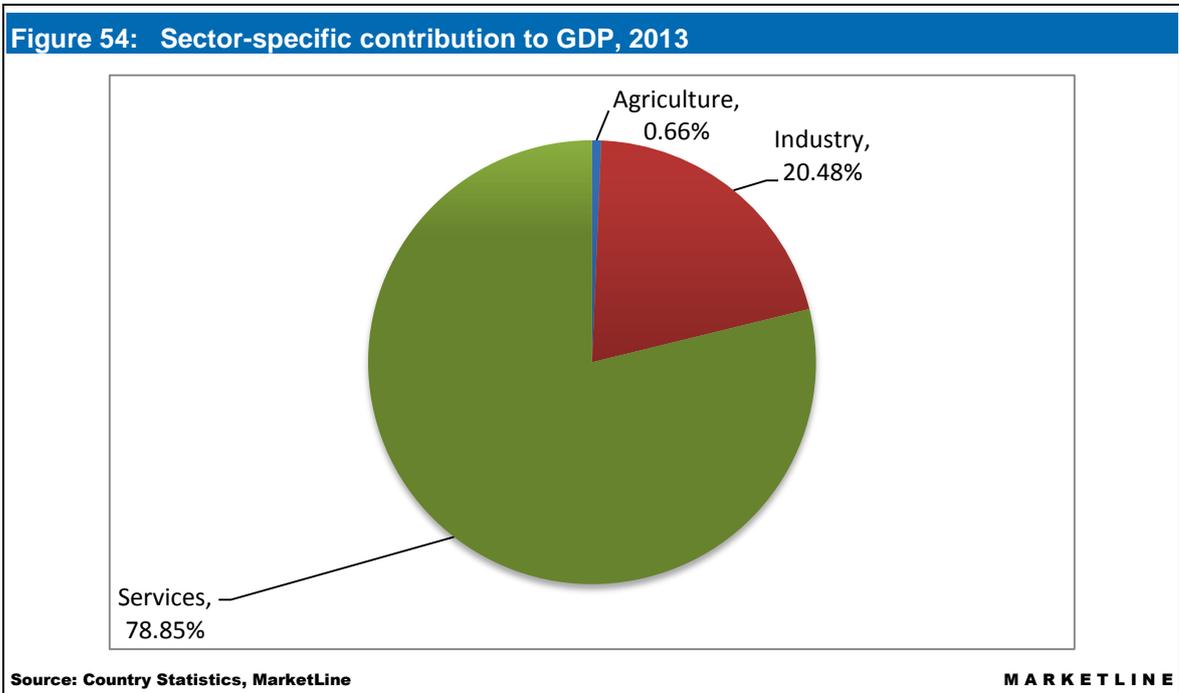
During 2000-07, economic growth averaged 3.17%. However, due to the financial crisis, the country's GDP contracted by 0.77% and 5.17% in 2008 and 2009, respectively. The economy rebounded in 2010 to register growth of 1.66%, but slowed again in 2011 to 1.12% as the European debt crisis lingered. Economic growth was nearly stagnant in 2012 as the economy grew by 0.28%. However, in 2013, the economy made a strong recovery led mainly by strong domestic demand.



Economic Landscape

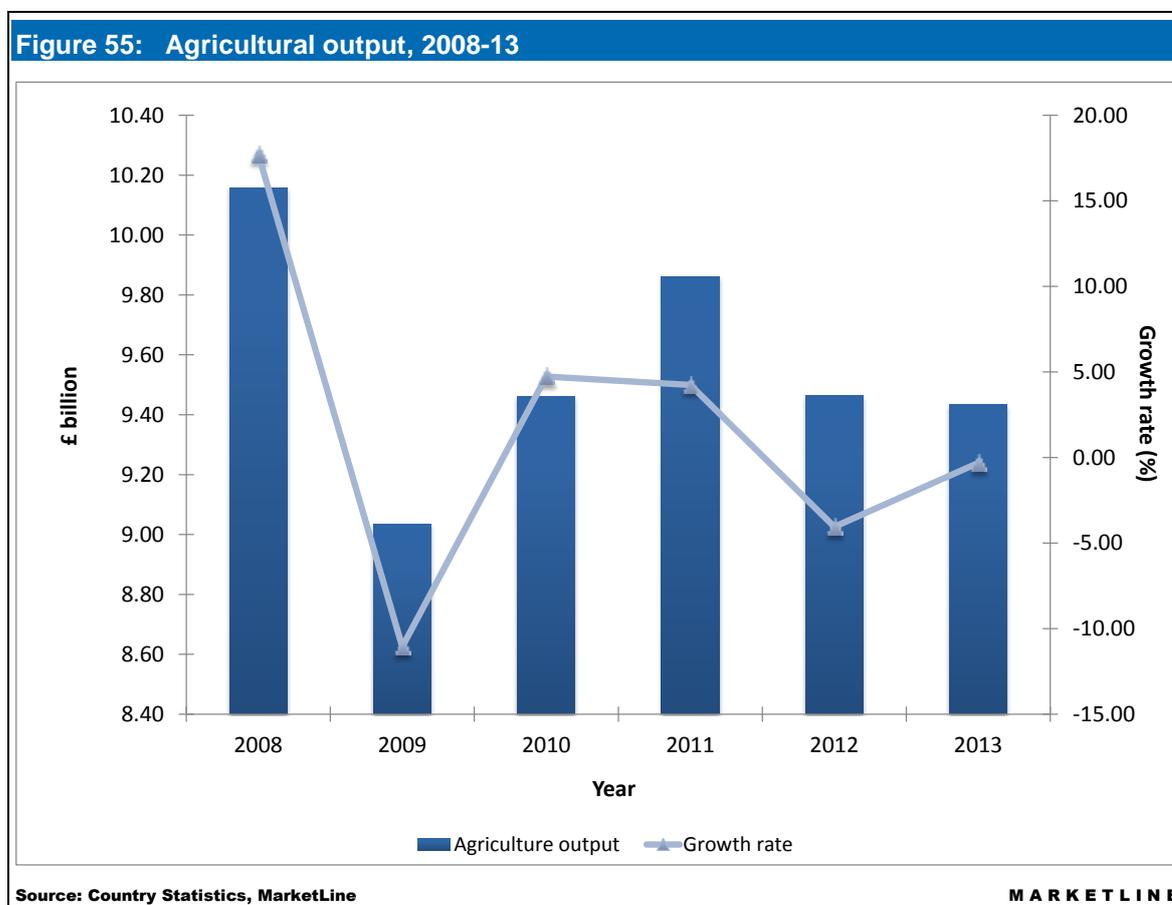
***GDP composition by sector***

Traditionally, industrial activity has been concentrated in the northern parts of the country, while the southern region has been driven by the services sector. Because of the relative decline in the importance of the industrial sector and surging activity in the services sector over the past few decades, the South has flourished while the North has developed at a much slower pace. The industrial sector accounted for close to 20.48% of GDP in 2012, while the services sector's contribution stood at 78.85% and agriculture made up for the remainder.



**Agriculture**

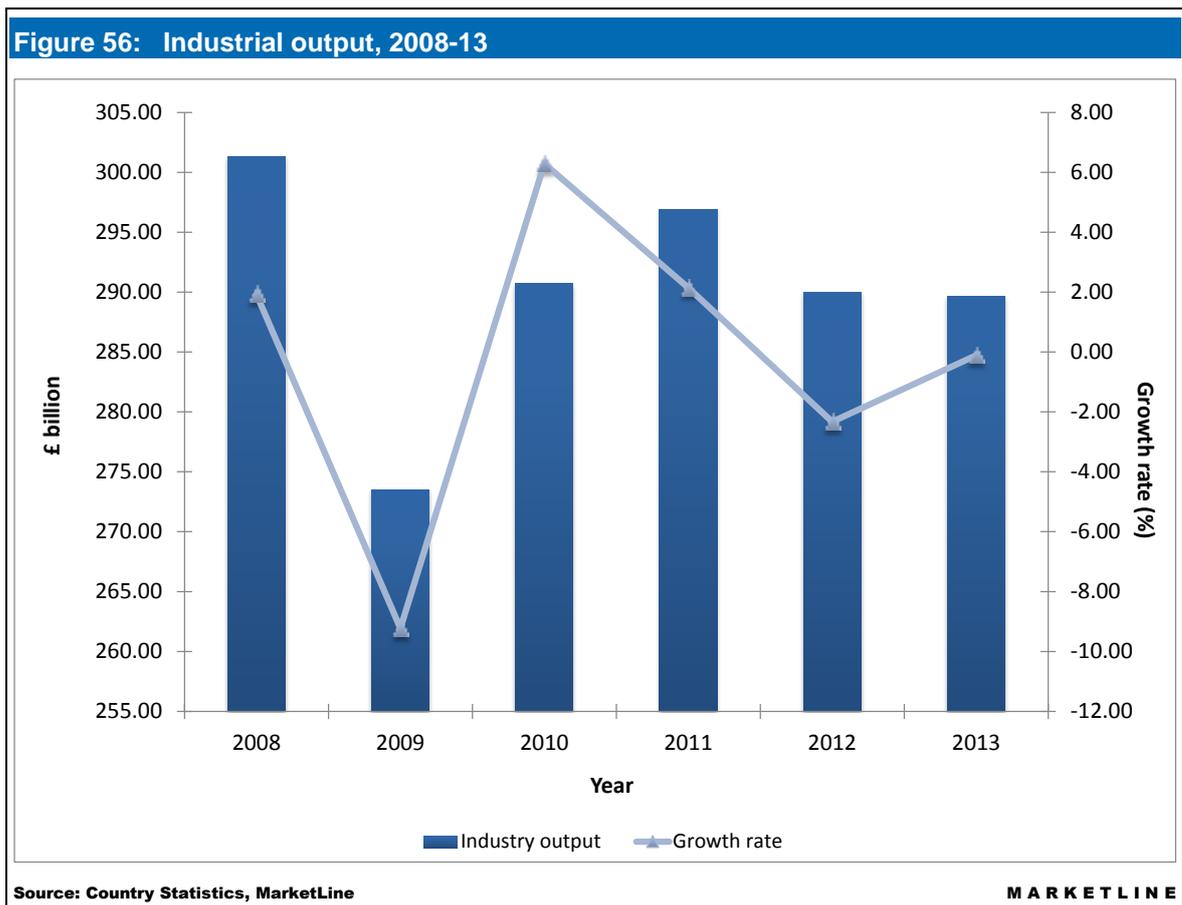
Because of the UK's high population density and relative scarcity of land, only around a third of total production is devoted to arable crops, while the rest is devoted to livestock. According to MarketLine, the sector grew by an average rate of 1% during 2002-13, with agricultural output reaching GBP9.43 billion (\$16.16 billion) in 2013.



## Economic Landscape

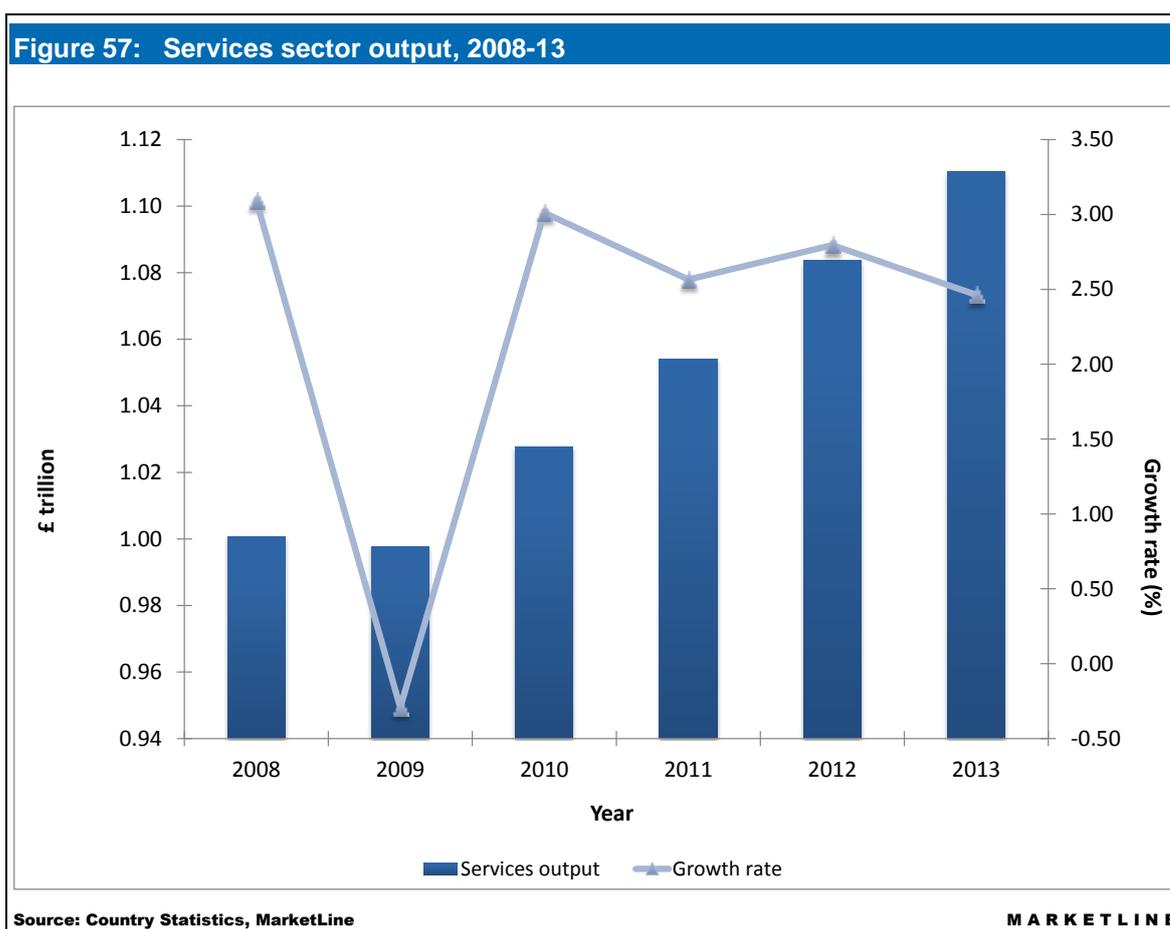
### Industry

Much has been made of the steady decline in the relative contribution of the industrial sector toward GDP over the past couple of decades. The main commodities produced by the industrial sector are machine tools, electric power equipment, automation equipment, railroad equipment, ships, aircraft, motor vehicles and parts, electronics and communications equipment, metals, chemicals, coal, petroleum, paper and paper products, textiles, and clothing. The UK has a large number of globally recognized industrial brands, and its main exports include manufactured goods, fuels, chemicals, food, and beverages. According to MarketLine, the sector grew by 1.84% during 2000-13, with industrial output reaching GBP289.68 billion (\$496.36 billion) in 2013.



**Services**

The UK's services sector has been consistently growing in importance over the past decade and, as is the case with most developed countries, it dominates in comparison to the other sectors. London is arguably the world's largest financial center, and thus the UK services sector is dominated by financial services—especially insurance and banking. In recent years, tourism and education have emerged as important contributors to the economy, with the UK growing in popularity among foreigners with disposable income and the student community in particular. Public services and defense have also contributed significantly to the sector's recent growth, as the global financial crisis hit financial services relatively hard. According to MarketLine, the sector grew by 4.57% during 2000-13, with services output reaching GBP1.11 trillion (\$1.90 trillion) in 2013.



## Economic Landscape

### Fiscal situation

The government has embarked on fiscal consolidation over the past few years to bring down the deficit. As of 2013, it stood at 5.8%, down from 11.4% of GDP in 2009, when it widened due to government-funded bailouts during the financial crisis. The quick recovery of the UK economy has helped in raising tax receipts. Income tax and VAT receipts both witnessed a jump in 2013.

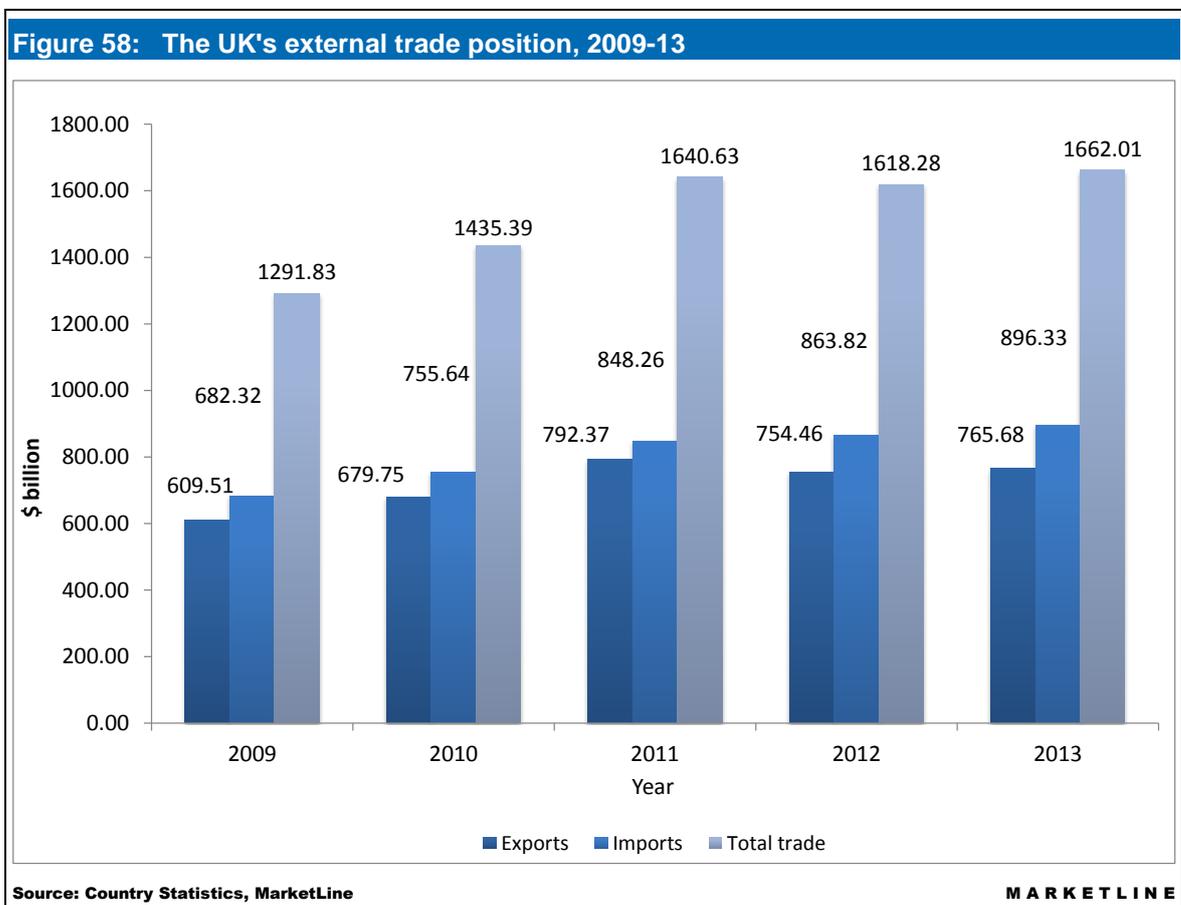
### Current account

The UK has maintained persistent current account deficits since the 1990s. According to IMF, the current account deficit as of 2013 stood at 3.33% of GDP.

### Exports and imports

UK's major trade partners are almost exclusively European Union (EU) member nations. According to CIA - The World Factbook, the main destinations for goods and services produced in the country in 2012 were Germany (11.3%), the US (10.5%), the Netherlands (8.8%), France (7.4%), Ireland (6.2%), and Belgium (5.1%).

In 2012, the UK sourced its imports from Germany (12.6%), China (8%), the Netherlands (7.5%), US (6.7%), France (5.4%), Belgium (4.4%) and Norway (4%). Exports rose from \$754.46 billion in 2012 to \$765.68 billion in 2013, while imports increased from \$863.82 billion to \$896.33 billion over the same period.



## Economic Landscape

### International investment position

According to the United Nations Conference on Trade and Development Investment Report 2014, foreign direct investment (FDI) inflow came down to \$37.10 billion in 2013 from \$45.80 billion in 2012.

### Credit rating

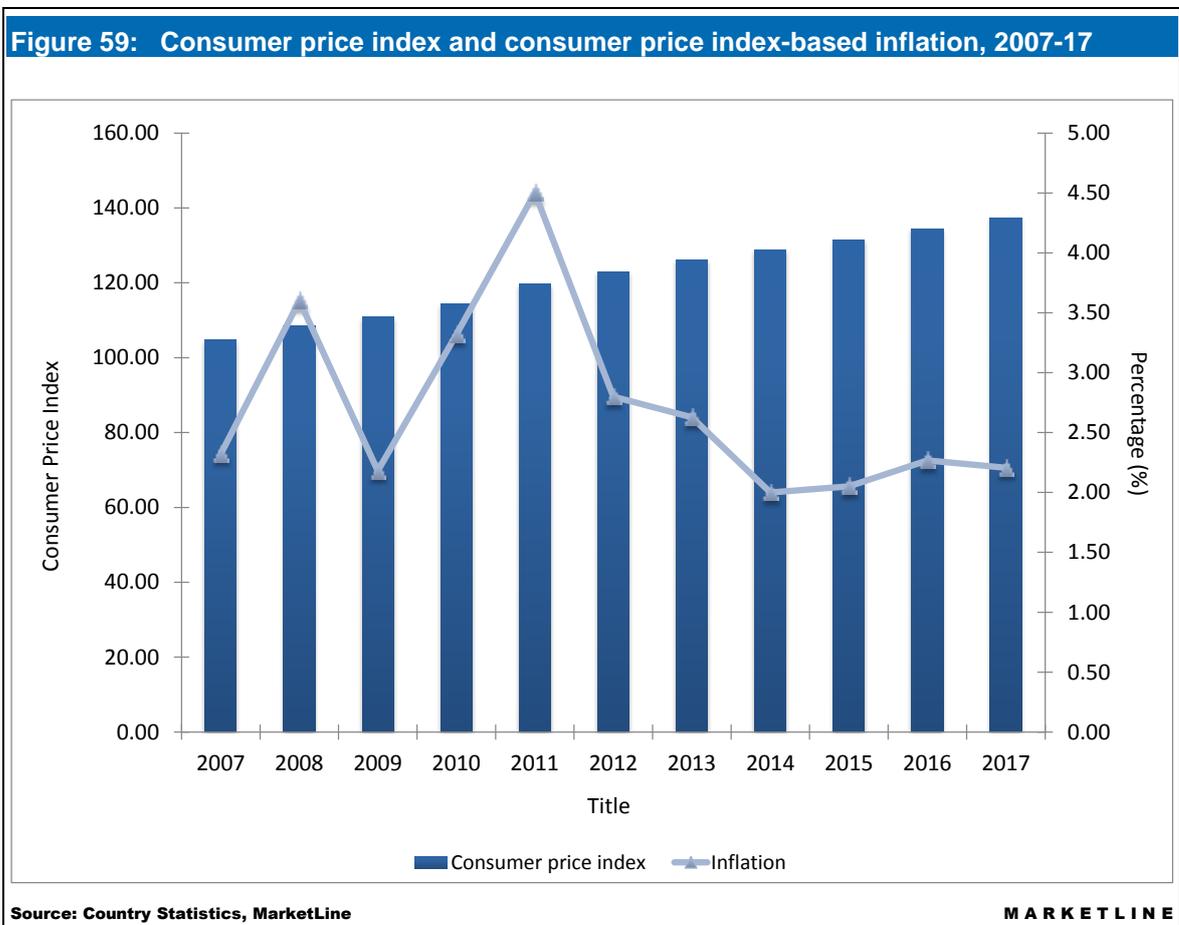
In June 2014, the S&P upgraded its outlook on Britain's AAA credit rating to stable from negative, citing the government's prudent fiscal measures to bolster its public finance.

### Monetary situation

#### Key monetary indicators

##### Inflation

Inflation eased to 2.63% in 2013 from 2.80% in 2012 on the back of lower commodity prices and an appreciated sterling.



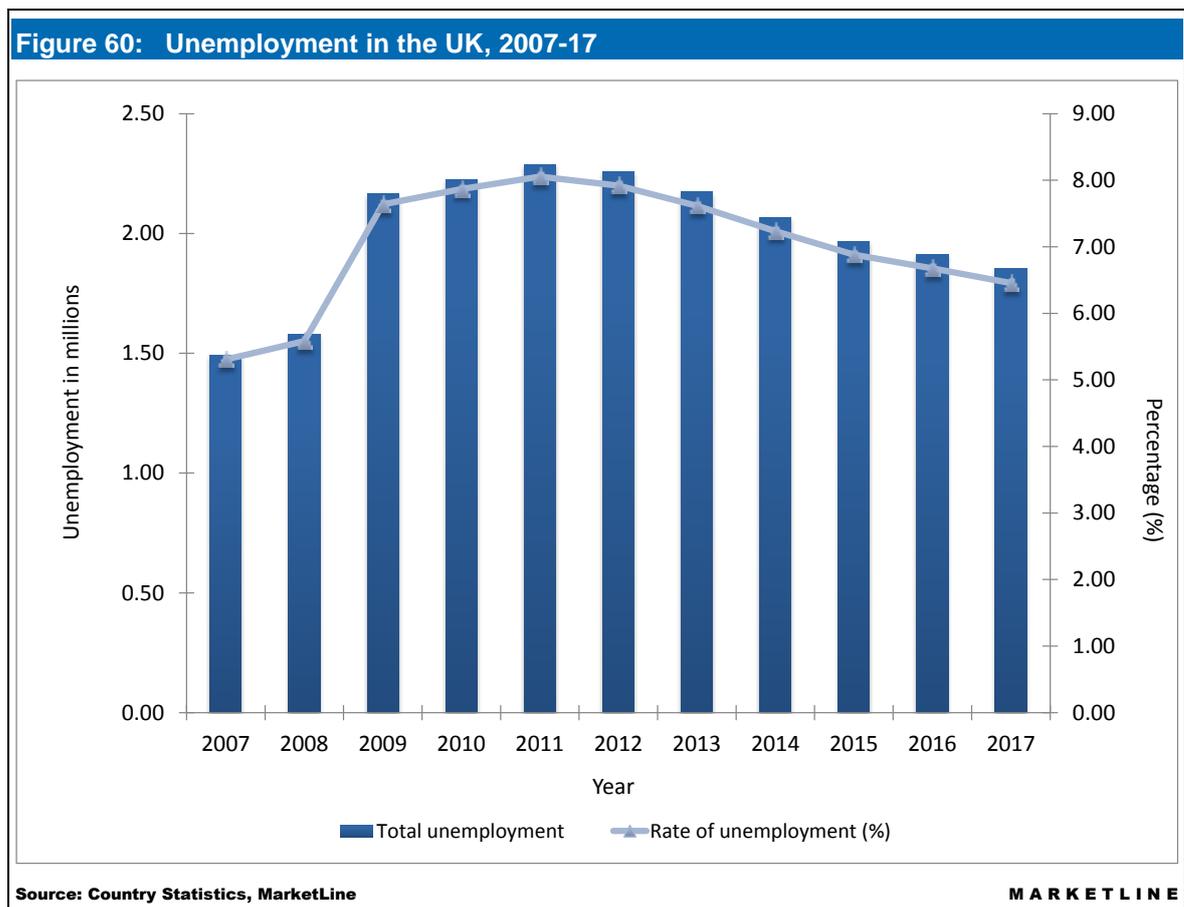
## Economic Landscape

### Interest rates

Since March 2009, the Bank of England (BoE) has kept its base interest rate at a historic low of 0.5%; however, it has hinted at a rise by the middle of next year.

### Employment

According to MarketLine, the unemployment rate was 7.62% in 2013, down from 7.92% in 2012, due to faster economic recovery in 2013.



## Outlook

Prime Minister David Cameron and Chancellor George Osborne have unveiled a host of measures to cut fiscal deficit. Financial strain on households due to gloomy prospects for earnings, combined with high household debt levels and an uncertain employment scenario mean that consumer spending will be constrained. Inflation is expected to come down, according to MarketLine estimates. Nevertheless, the outlook is expected to change for the better, as economic recovery is taking place in the European countries, which are the UK's main trading and investment partners.

## SOCIAL LANDSCAPE

### **Summary**

The UK is one of the most densely populated developed countries. The standard of living enjoyed by residents is among the best in the world. Apart from the civil liberties and rights afforded to individuals by the authorities and government, residents have access to one of the best social welfare systems in the world. The majority of the population relies on public healthcare services, and there are special projects to care for children, the unemployed, the disabled, and the aged. The education system is world-renowned and attracts a large number of international students. The UK is home to people from a number of countries. The demographic characteristic that is a cause for concern is a rapidly aging population, which poses a number of social, economic and political challenges.

### **Evolution**

Since World War II, the UK has developed into a multicultural, multi-ethnic and secular country with a large white majority and minority communities from all over the world. The standard of living is among the highest globally and the system of social welfare is one of the best in the world.

In contrast with some European countries, immigration is contributing to a rising population, accounting for about half of the population increase between 1991 and 2001. The Labour Party came into power in the UK shortly after World War II and focused on an approach that leaned left, in line with public opinion at the time. The years between the world wars saw the Conservative Party associated with widespread poverty and mass unemployment, so the Labour government focused on industrial development and the creation of a solid social infrastructure. The concept of the welfare state was introduced and several industries were nationalized. The establishment of the National Health Service (NHS) in 1948 is one of the party's biggest achievements.

The victory of Margaret Thatcher and the Conservative Party in the 1979 elections brought about a change of direction in the UK economy. The Thatcher government was more focused on involving the private sector and developing the economy as a whole rather than on the creation of a welfare state. More recently, the Labour government of the late 1990s and 2000s adopted the "third way", a combination of the previous approaches to governance.

### **Structure and policies**

The 2014 budget has eased regulations, making it easier for individuals to access pension savings. The budget will lower taxes by raising the level of the tax-free personal allowance further, from GBP10,000 (\$17,134.7) to GBP10,500 (\$17,991.4) in April 2015—to reward working people and increased the maximum Tax-Free Childcare support available to GBP2,000 (3,426.94) per year for each child.

#### **Demographic composition**

##### ***Composition by age and gender***

Approximately 17.32% of UK's population is below 15 years of age and around 17.53% is above 65 years of age, according to MarketLine. The UK is a relatively old country, with a median age of 40.4 years in 2014, according to CIA - The World Factbook.

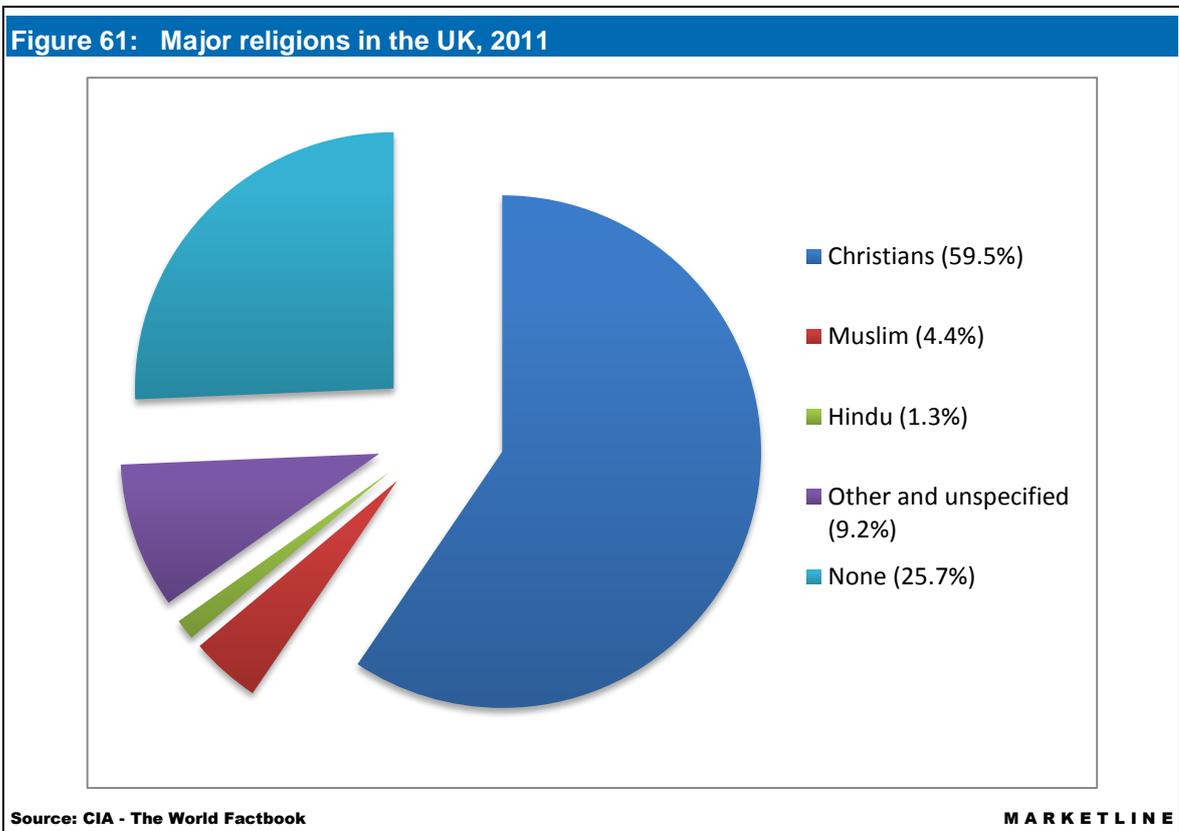
<b>Table 9: Mid-year population by age (as % of Population), 2014</b>		
Mid-year population by age	Female	Male
0-4	5.86	6.23
5-9	5.72	6.07
10-14	5.22	5.56
15-19	5.75	6.09
20-24	6.56	6.90
25-29	6.78	7.14
30-34	6.39	6.81
35-39	5.81	6.23
40-44	6.62	7.06
45-49	7.36	7.63
50-54	7.12	7.11
55-59	6.04	6.08
60-64	5.51	5.35
65-69	5.67	5.35
70-74	4.22	3.81
75-79	3.49	2.93
80+	5.88	3.66

**Source: Country Statistics, MarketLine** **MARKETLINE**

## Social Landscape

### *Religious composition*

The largest religion in the UK is Christianity, accounting for 59.5% of the total population in 2011. Historically, the Church of England and the Church of Scotland had significant roles to play in British society. The UK has evolved as a secular society that embraces people of various faiths. Due to the large number of residents with ethnic roots in the Indian sub-continent, in 2001, Muslims, Hindus, and followers of other religions accounted for a large section of the total population. Furthermore, 25.7% do not follow a religion.



## Education

### *System of education*

Schooling is compulsory for all children aged between five and 16, and most children attend government-funded schools. The UK is famous for its educational institutions, especially its higher education institutions, which attract students from all over the world.

While the systems in place in England, Wales, and Northern Ireland are broadly similar, Scotland has a different educational system. The Education Reform Act of 1988 introduced the National Curriculum for state primary and secondary schools in England, Wales, and Northern Ireland. Independent schools, which do not depend on the government for funding, can decide on their own curriculum.

In general, the National Curriculum attempts to focus on a greater depth of knowledge across a narrower range of disciplines, while the Scottish curriculum attempts to focus on a broader range of disciplines. The National Curriculum

## Social Landscape

covers core subjects, foundation subjects, and basic curriculum subjects. Core subjects include science, mathematics, and English; foundation subjects include history, geography, art and design, music, technology, ICT, and modern foreign languages; and the basic curriculum includes citizenship, religion, and physical education.

### ***Primary and secondary education***

Parents may choose to enroll their children in pre-school activities such as playgroups or nursery school before sending them to primary school. Children usually begin attending primary school between the ages of four and six. Parents can send their children to a local school, which must accommodate them without imposing any special conditions. The first year of secondary education usually starts between the ages of 11 and 13. Students who go on to pursue higher education are usually between the ages of 17 and 19.

### ***Tertiary education***

The majority of students who wish to pursue higher studies use the Universities and Colleges Admissions Service, although for certain courses different admission services may be required. While the UK's universities are not owned by the state, most are financed by the government.

### **Healthcare**

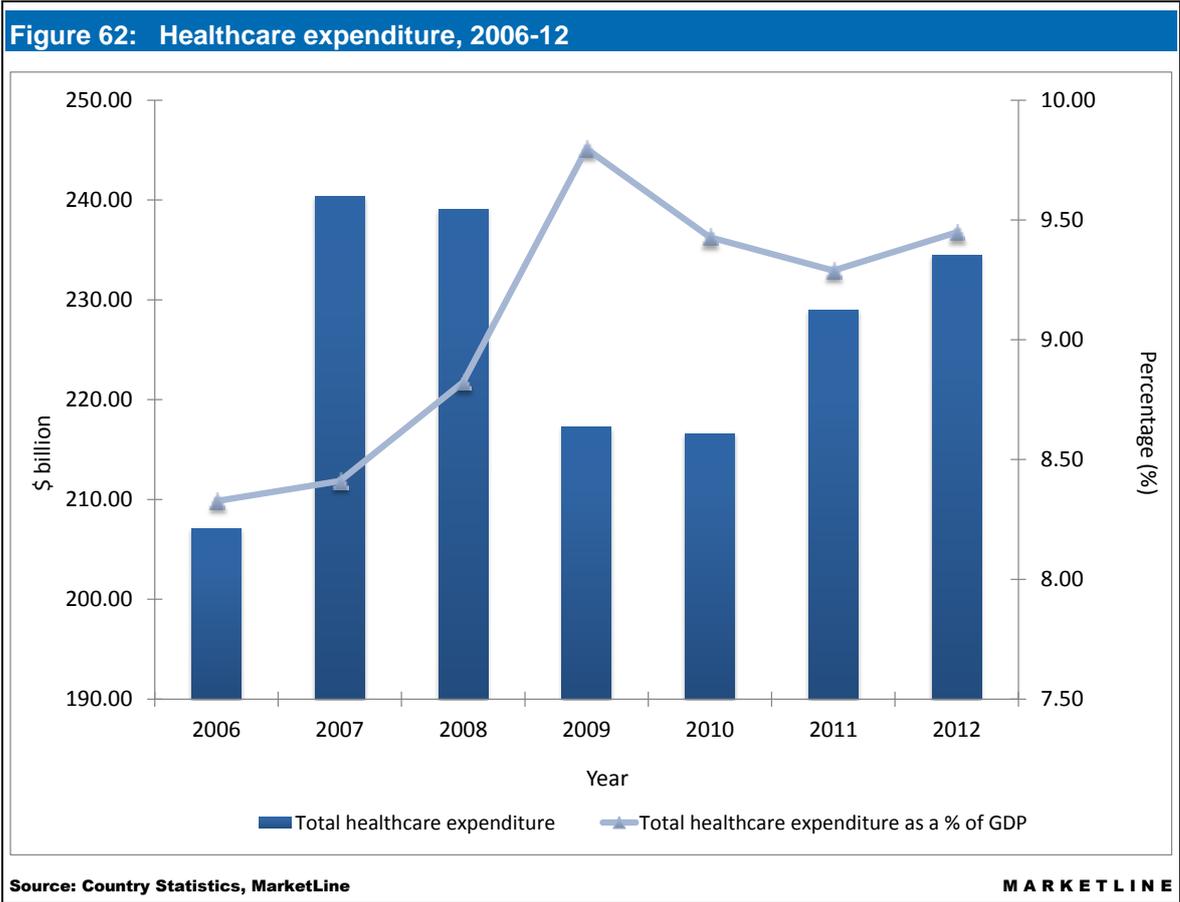
The NHS was established in 1948 as the single authority for public health in the UK. Since the devolution of power, the constituent countries of England, Scotland, Wales and Northern Ireland each have their own services that are mainly funded through public taxation. While independent healthcare organizations do exist, the health services of the constituent countries provide the majority of healthcare services.

The Health and Social Care Act of 2012 was passed to curtail burgeoning costs against the backdrop of the UK's aging population. While the government argues that the reforms will reduce costs by 45% while expanding treatment options, it remains to be seen if it can bring significant changes to the strained NHS.

## ***Performance***

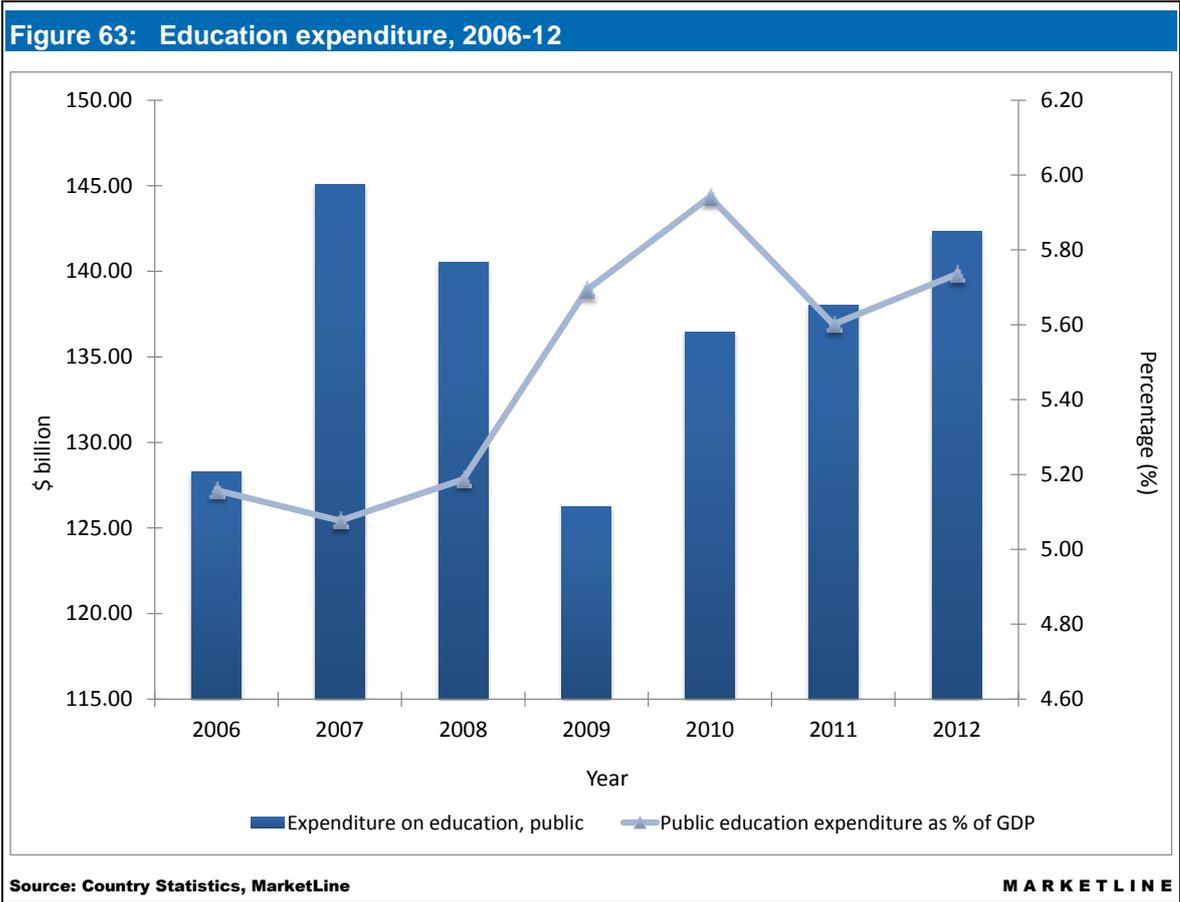
### **Healthcare**

The UK's healthcare expenditure was \$234.45 billion or 9.45% of GDP in 2012, according to MarketLine, reflecting the dependence of the population on public healthcare services. Physicians per 1000 population (head count) was 2.8 in 2013, which was lesser than the OECD average of 3.2. Nurses per 1000 population (head count) was 8.2 in 2013, which was also lower than the OECD average of 8.8.



### Education

The UK's literacy rate is 99%. In 2012, the state allocated 5.74% of GDP to education, and spent around \$142.30 billion. Compared to other OECD nations, the UK has a high number of people with a tertiary education as of 2011. In the age group between 25-34 year-olds, UK's percentage of tertiary education population was 46.91% compared to its peers France (43.01%) and Germany (27.67%).



### Outlook

The government faces a number of challenges when it comes to maintaining the level of public services on offer. Given the fact that the budget deficit is a clear point of concern for the authorities, they will face the challenge of maintaining current levels of expenditure on social welfare projects. In recent times, government expenditure and revenues have both increased dramatically, but expenditure has outpaced revenues to quite an extent. The government has publicly declared its goal of eliminating child poverty by 2020, and despite progress in the past, a recent forecast shows a likely increase in child poverty by the end of this decade. Another challenge facing the government is that of income inequality.

## TECHNOLOGICAL LANDSCAPE

### Summary

The UK is at the forefront of research and development (R&D) and innovation. The government has helped to establish an environment conducive to the development of new technology in all sectors of industry. Expenditure on R&D and other measures to encourage R&D within the private sector have borne fruit, and the UK has emerged as a key exporter of technology. The Department for Innovation, Universities and Skills (DIUS) is the government department that oversees the progress of the UK in this regard. The DIUS envisions its role as involving the creation and maintenance of a "world-class research base" and utilizing this research base to "support innovation across all sectors of the economy."

A few industries stand out in terms of innovation. Pharmaceutical, defense, e-commerce, and telecommunications firms are competitive with their counterparts across the globe. In the face of increasing global competition, innovation will help developed countries to compete with emerging economic powers.

### Evolution

The Royal Society, which is the national academy of science in the UK and the Commonwealth, is the most prestigious source of innovation in the UK. The Royal Society was set up in 1660, and since 1850, it has been the beneficiary of government support. In subsequent years, many research centers were established in various scientific streams. These include the Biotechnology and Biological Sciences Research Council, the Council for the Central Laboratory of the Research Councils, the Medical Research Council, the National Environmental Council, and the Particle Physics and Astronomy Research Council. There are also many private R&D centers in UK.

### Structure and policies

#### Intellectual property

The UK Intellectual Property Office (UK-IPO), an executive agency of the DIUS, is the official body responsible for granting intellectual property rights in the UK, including trademarks, designs, patents, and copyright. Direct administrative responsibility for the examination and issuing of patents lies with the UK-IPO.

Table 10: Comparative performance on receipt of patents, 2011-13				
Year	UK	France	Germany	Japan
2011	4292	4532	11919	46139
2012	5211	5386	13835	50677
2013	5806	6083	15498	51919

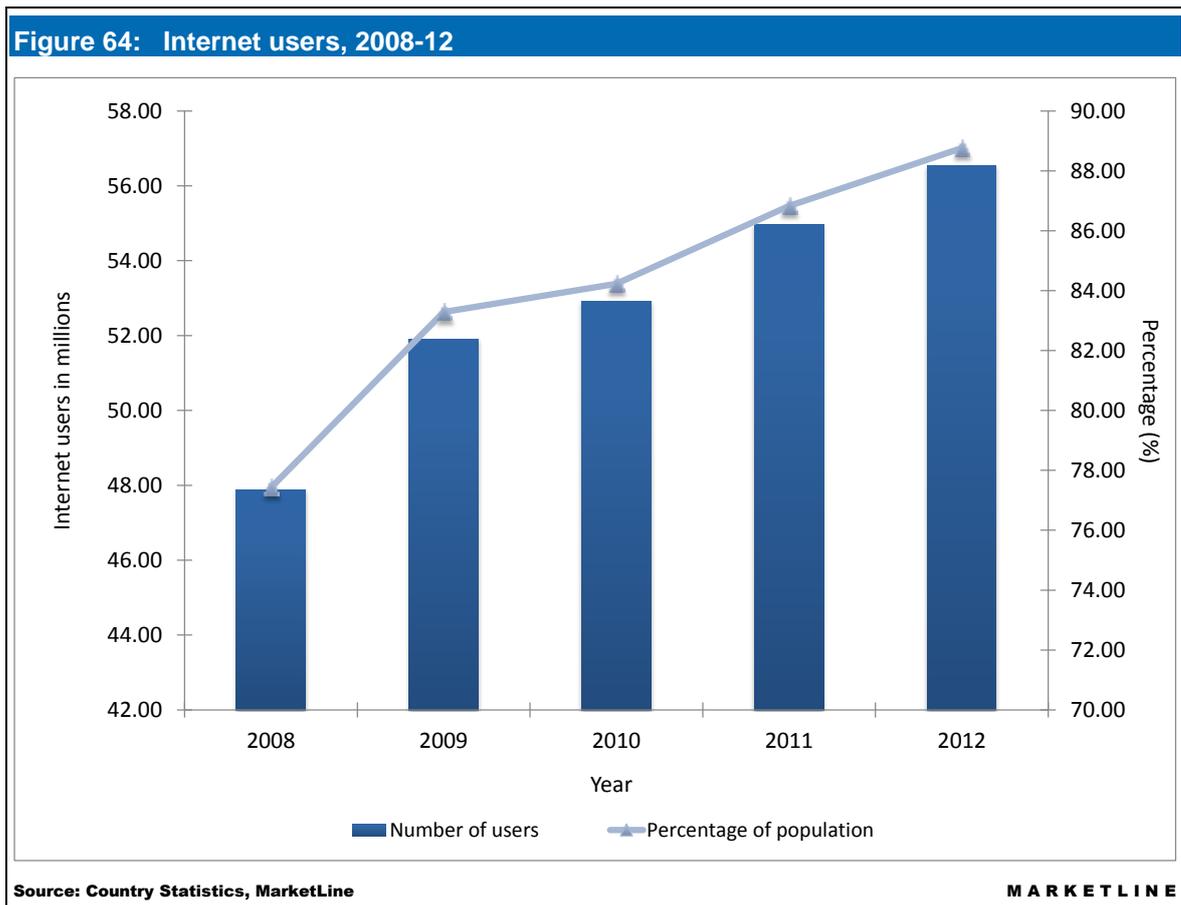
Source: US Patent and Trademark Office MARKETLINE

**Performance**

**Opportunity sectors**

**Telecommunication services**

According to MarketLine, mobile penetration stood at 131.30 per 100 people in 2013 with total subscribers at 84.14 million. Mobile subscribers grew by an average of 9.97% during 2000-13. Internet users as of 2012 stood at 56.54 million, with a penetration rate of 88.76% in the same year. Internet subscribers grew at an average rate of 13.49% during 2000-12.



**Aerospace and defense market in the UK**

According to MarketLine, the UK aerospace & defense market had total revenues of \$34.8 billion in 2013, representing a compound annual growth rate (CAGR) of 3.8% during 2009-13. In comparison, the French and German markets grew with CAGRs of 4.4% and 4.2% respectively, over the same period, to reach respective values of \$47.4 billion and \$39.1 billion in 2013. The defense segment was the market's most lucrative in 2013, with total revenues of \$19.3 billion, equivalent to 55.3% of the market's overall value. The civil aerospace segment contributed revenues of \$15.6 billion in 2013, equating to 44.7% of the market's aggregate value.

The performance of the market is forecast to accelerate, with an anticipated CAGR of 4.6% for the five-year period 2013-

## Technological Landscape

18, which is expected to drive the market to a value of \$43.5 billion by the end of 2018. Comparatively, the French and German markets will grow with CAGRs of 1.7% and 4.7% respectively, over the same period, to reach respective values of \$51.5 billion and \$49.3 billion in 2018.

### ***Outlook***

The UK has the world's largest aerospace industry outside of the US. Apart from being a key supplier of aerospace requirements, the country also excels in the fundamental areas of research. Furthermore, the country also develops advanced technology for nanomaterial and the usage of wave and tidal energy. As the UK is at the forefront of new technology, there is a good possibility of it developing relatively nascent fields such as nanotechnology, space research and tourism, and alternative energy. The UK has all the required makings to be at the frontier of innovation.

## LEGAL LANDSCAPE

### *Summary*

The judicial system in the UK is considered to be one of the fairest and transparent systems in the world. Scotland and Northern Ireland each use a different legal system compared to that employed in England and Wales, but both are based on the same fundamentals. There are a number of laws governing business in the UK. These laws are largely conducive to the business environment. The most important laws relate to the incorporation of business, taxation, monopolies, and restrictive trade practices, intellectual property rights (IPR), and labor laws.

### *Evolution*

There are three different legal jurisdictions in the UK, with each having its own legal system; these are based on English law, Northern Irish law, and Scots law. English law uses a common law system, while the law of Northern Ireland is based on the common law system and is partly influenced by English law. Scots law is influenced both by the ancient Roman law and by civil law, and as a result, it is called a mixed legal system. Laws pertaining to the commercial and business sector are common for the whole region. Although the labor law was formed in 1823, all laws were amended after the formation of the European Union (EU). Similarly, all laws relating to company law, commercial law, competition law, and IPR have been amended.

### *Structure and policies*

#### **Structure of the judicial system**

The UK does not have a single criminal or penal code, and there is an emphasis on the separation of the judiciary and the prosecuting authorities. England and Wales, Scotland, and Northern Ireland have separate legal systems. Common law principles apply for English and Northern Irish law, while civil law principles along with some elements of common law form the bedrock of Scots law. For England, Wales, civil cases in Scotland, and Northern Ireland, the Supreme Court is the highest court. Furthermore, for criminal cases in Scotland, the highest court is the High Court of Justiciary. In the past, the structure of the judicial system has been criticized for its lack of transparency and for being archaic. In response to this criticism, the Constitutional Reform Act 2005 was passed, laying the foundation for the establishment of the Supreme Court of the UK, which started functioning in 2009 and took over the House of Lords' jurisdiction as the highest court in the land. The Supreme Court hears all appeals from England, Northern Ireland, and Wales, and civil appeals from Scotland.

#### **Tax regulations**

##### ***Corporate income tax***

From April 2014, the corporate tax rate has been revised to 21%. The small profits tax rate is 20% for profit up to GBP300,000 (\$514,041). Profit between GBP300,000 (\$514,041) and GBP1.5m (\$2.57m) is taxed between the main corporate income tax rate and the small profits rate on a sliding scale basis.

##### ***Individual income tax***

Income tax rates are progressive, with a maximum of 45% beyond GBP150,000 (\$257,020) for the year 2014-15.

## Legal Landscape

### ***Value added tax***

The standard VAT rate is 20.0%. A reduced rate of 5% is applicable to certain items. Zero-rated exemptions are also applicable to some specific items.

## ***Performance***

### **Effectiveness of the legal system**

According to the 2014 Index of Economic Freedom, the UK ranked 14th in the world and fifth in Europe. The country scores high in business freedom, labor freedom, trade freedom, investment freedom and financial freedom. The government has made continuous efforts to ensure that the overall environment is conducive to business.

## ***Outlook***

The government is focused on creating the best business environment in the G20. Through reforms and deregulation, the UK government wants to encourage more investment in the country, and the latest incentive is a further cut in corporate tax, which will be reduced to 20% by 2015. The patent box regime, an incentive scheme that would encourage businesses to retain and commercialize existing patents and to develop patented products, has been effective from 2013. Moreover, the patent box would incentivize the creation of high value jobs and activity linked with the development, manufacture and exploitation of patents in the UK. However, the UK government needs to continue with deregulatory reforms in order to attract investment.

## ENVIRONMENTAL LANDSCAPE

### *Summary*

In the UK, the Department for Environment, Food and Rural Affairs (DEFRA) holds the responsibility for drafting and implementing environmental protection and sustainable development policies. DEFRA identifies its priority as "the need to tackle climate change internationally and through domestic action to reduce greenhouse gas emissions, and to secure a healthy, resilient, productive, and diverse natural environment." Environmental policy in the UK now aims to tackle air, water, noise, and land and soil pollution as separate problems.

### *Evolution*

The first initiative geared toward the environment in the UK was the establishment of the Control of Pollution Act 1974, followed by the Environmental Protection Act 1990 (EPA), the Water Resources Act 1991, and the Land Drainage Act 1991. Environmental conservation activities in the UK were increased with the establishment of the Environmental Act 1995. This act brought the following institutions under its control: the National Rivers Authorities, Her Majesty's Inspectorate of Pollution, the waste regulation authorities in England and Wales, and the London Waste Regulation Authority.

### *Structure and policies*

#### **Environmental regulations**

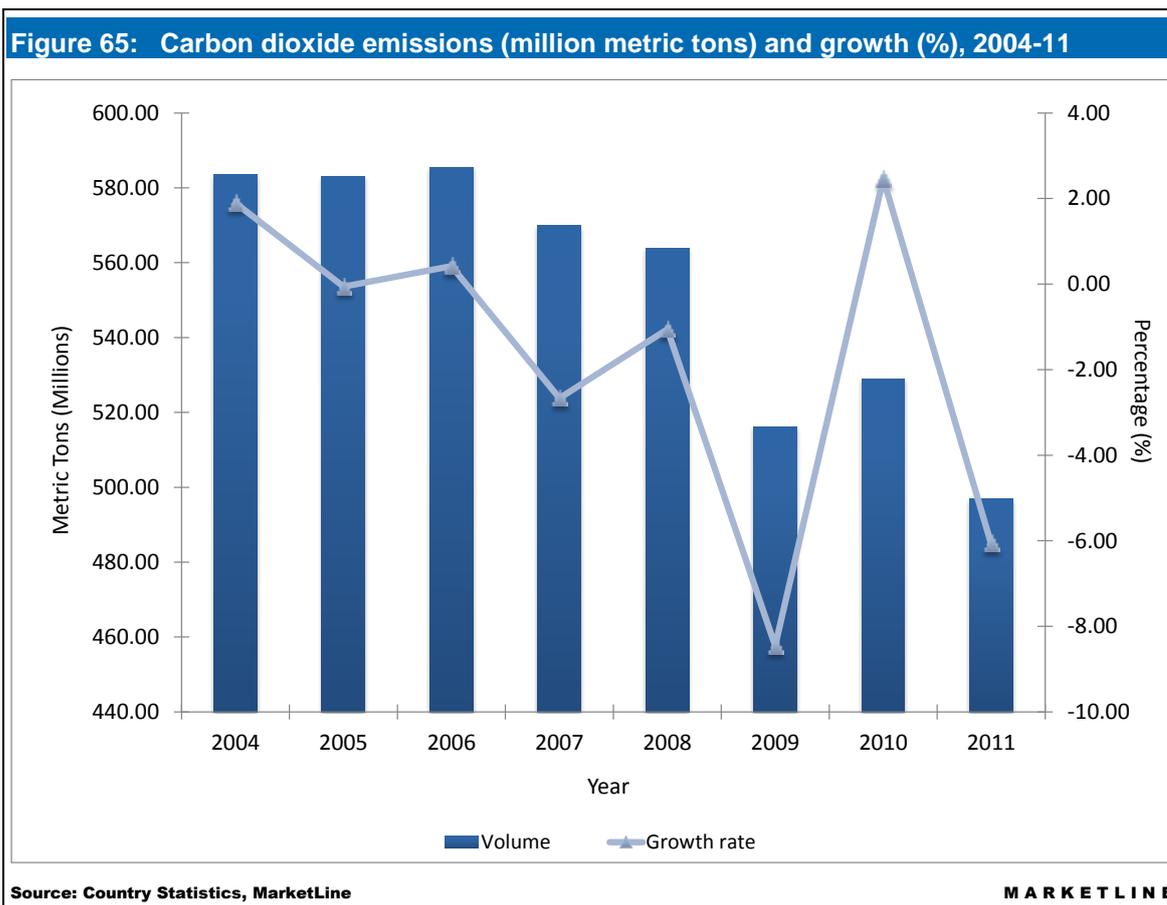
DEFRA is the government department responsible for environmental concerns in the UK. DEFRA's aim is to "enable everyone to live within our environmental means." Traditionally, environmental policy in the UK has been based on the "command and control" principle, whereby possible polluters are given certain quotas or standards and the authorities carefully monitor these and deal strictly with any infringements. The concept of integrated pollution control prescribed in the EPA looks at dealing with pollutants in such a way that their harmful effects on the environment as a whole are reduced.

### *Performance*

#### **Environmental impact**

The UK has made significant improvements in reducing the impact of economic growth on the environment. It has achieved strong progress in controlling major air pollutants and agrochemicals. This progress reflects both the reshaping of the economy and the strengthening of the UK's environmental policies in the EU context. The 2009 Renewable Energy Directive sets a target for the UK to achieve 15% of its energy consumption from renewable sources by 2020 compared to 3% in 2009.

As a result of the UK's attempts to meet its target, CO<sub>2</sub> emissions in the country came down from 572.58 million metric tonnes in 2003 to around 496.80 million metric tonnes in 2011.



### The renewable energy market in the UK

According to MarketLine, the UK renewable energy market had total revenues of \$10.2 billion in 2012, representing a compound annual growth rate (CAGR) of 22.1% during 2008-12. In comparison, the French and German markets grew with CAGRs of 10.2% and 11.9% respectively, over the same period, to reach respective values of \$10.9 billion and \$30.8 billion in 2012.

Market consumption volume increased with a CAGR of 17.7% between 2008-12, to reach a total of 55.1 TWh in 2012. The market's volume is expected to rise to 95.1 TWh by the end of 2017, representing a CAGR of 11.5% for the 2012-17 period. Geothermal, biomass and waste energy sales had the highest volume in the UK renewable energy market in 2012, with total sales of 28.5 TWh, equivalent to 51.7% of the market's overall volume. In comparison, sales of wind energy had a volume of 20.4 TWh in 2012, equating to 37.0% of the market total. The performance of the market is forecast to decelerate, with an anticipated CAGR of 13.0% for the five-year period 2012-17, which is expected to drive the market to a value of \$18.9 billion by the end of 2017. Comparatively, the French and German markets are expected to grow with CAGRs of 5.1% and 8.9% respectively, over the same period, to reach respective values of \$14.0 billion and \$47.2 billion in 2017.

### Outlook

The UK government started a green initiative of budgetary support to increase environmental awareness in the country in

## Environmental Landscape

2008. The government's main objectives were to equip the country for the challenges of the future, and confront climate change in the medium term. The UK adopted the Climate Change Act 2008, which made it the first country in the world to have a legally binding long-term framework to cut carbon emissions. Under the act, the UK government has to report annually to lawmakers on its progress in meeting its carbon targets.

The government has set an overall target of 80% reduction in emission of pollutants from 1990 levels by 2050. The future energy policies of the government will focus on both reducing energy bills and carbon emissions. The best way forward for the government to implement a greener and cheaper climate policy that would be able to help lower the cost of renewable energy by creating and supporting infrastructure for growth in that market.

## APPENDIX

### *Ask the analyst*

MarketLine's Country Analysis Practice consists of a team of economists, analysts, and researchers, all with expertise in their given fields. For any questions or comments about this report, you can contact the author directly at [reachus@marketline.com](mailto:reachus@marketline.com)

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MARKETLINE | 119 FARRINGDON ROAD | LONDON | UNITED KINGDOM |

EC1R 3DA

T: +44 20 7551 9565 | F: +44 20 7551 9343

E: REACHUS@MARKETLINE.COM

**MarketLine**