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Trade and Industry Committee

Europe moves East: The impact of the new EU Member States on UK business

Eleventh Report of Session 2006–07

Report, together with formal minutes, oral and written evidence

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Footnotes

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Summary

This Report examines the impact on UK business of the accession of the 'A8' countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia) and A2 countries (Bulgaria and Romania) to the European Union in 2004 and 2007 respectively. It is, in part, a follow-up to two inquiries held by our predecessor Committee in the 1997-2001 Parliament. We conclude that the accession of these countries has been beneficial to UK business, but that these benefits could be greater if businesses were better informed about the resulting opportunities.

Our inquiry found that the A8 countries—and to a lesser extent the A2—should not be seen as primarily low-cost, low-value economies. They have shown consistently strong economic growth since the Russian crisis of the late 1990s. Their strong skills base, especially in technical skills, was repeatedly cited as a major reason for investing in the region. During our visits we were impressed with the sophistication both of the facilities being established in these countries and the understanding amongst governments and business alike that, to be successful, they cannot compete on labour costs alone and need to attract more high-tech and innovative investment. Although there remain some significant obstacles—in particular a growing labour shortage in the major centres of investment—the prospects for at least some of these countries to move rapidly up the value-chain look good.

Although UK trade and investment with and in the A8/A2 has increased substantially since the lead up to accession, the benefits to the UK economy could have been much greater if more companies had been aware of the opportunities emerging in the region during the 1990s. We do not, however, believe that the UK 'missed the boat'; there remain significant opportunities, not least those resulting from the 2007-2013 European Union funding round and the efforts of the most forward-looking A8/A2 countries to establish high-tech and innovative industries. We therefore recommend that government and business leaders work together to overcome the 'iron curtain in the mind' and encourage companies to look more seriously at the A8/A2 countries as potential partners and also, increasingly, as potential competitors.

The A8/A2 countries should also be taken more seriously as export markets for UK businesses. Despite the apparent reluctance of UK businesses to become involved in the region, Poland alone buys £2.8 billion of UK exports a year, around the same as China. We therefore believe that there is a good case for UK Trade and Investment to give greater attention to and more actively promote these countries.

The most visible and significant impact of the A8/A2 accession has been migration into the UK from the new member states—chiefly Poland, but also Lithuania and Slovakia. It is clear from the evidence we received that this has benefited UK business by easing skills and labour shortages and providing employers with a source of well-motivated employees, often skilled in areas where the UK workforce is traditionally weaker. In the longer term, the evidence suggests that migration from the A8/A2 to the UK is likely to slow: Central and Eastern European labour cannot, therefore, be a long-term solution to the UK's skills problems. Nonetheless, the cultural, social and economic links between the UK and A8/A2 generated by migrants returning to their home countries could result in significant

opportunities for UK businesses looking to move into those markets and we urge both government and the private sector to ensure that the UK derives the greatest possible benefit from these links.

During this inquiry, as with our inquiries into trade with Mercosur, India and China, we were told that British trade overseas is hindered by a relative lack of high-level trade missions compared to our major competitors. We believe that British ministers—especially those in trade promotion roles—should follow the example of our competitors and travel abroad more frequently to promote the UK interest; we welcome the new Minister for Trade Promotion and Investment’s intentions in this regard as a positive first step.

1 Introduction

1. On 1st May 2004 the fifth enlargement of the European Union saw the accession of eight Central and Eastern European states: the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia (the A8). Cyprus and Malta joined at the same time.[1] The fifth enlargement was the largest in the EU's history, adding ten member states and 75 million people. On 1st January 2007 the accession of Bulgaria and Romania (the A2) added a further 30 million people.

2. In the 1997-2001 Parliament our predecessors conducted a major inquiry into trade and investment relations with the Czech Republic, Hungary and Poland and a subsequent inquiry into trade and investment relations with the Baltic States.[2] This Report is intended partly to act as a follow-up to those Reports.

3. The previous Committee's Report into *Industrial and Trade Relations with Central Europe* identified a number of sectors—including retail banking, insurance and automotive—where British business had been reluctant to take up investment opportunities. It also identified sectors, such as energy, where British companies had been more enthusiastic. The Report expressed the view that privatisation programmes still offered good opportunities at the time of writing but that it was "getting rather late in the day" for British companies to take full advantage.[3] The Committee noted that there was "little doubt" that membership of the European Union would bring the three countries benefits, but "The balance of costs and benefits for existing member states, including the UK, is less obvious."[4] Overall the Committee expressed disappointment that "the level of UK investment in central Europe should be so relatively low."[5]

4. The Committee's report into *Industrial and Trade Relations with the Baltic States* came to largely similar conclusions. The Committee expressed disappointment at "the relatively low proportion of UK companies investing in the Baltic States" and in particular drew attention to the absence of UK banks and financial services companies in the region.[6] The report identified a strong desire among the Baltic States to invest in e-commerce and information and communications technology (ICT) more generally.[7] Opportunities arising from the restructuring of energy markets and development of tourism infrastructure were particularly stressed.[8]

1 Although Cyprus and Malta are not covered by this inquiry, where data refers to the ten countries which joined in 2004 they are referred to as the EU10. Likewise, EU15 refers to the fifteen countries which were member states prior to 2004.

2 Trade and Industry Committee, Twelfth Report of Session 1997-1998, *Industrial and Trade Relations with Central Europe*, HC893; Twelfth Report of Session 1999–2000, *Industrial and Trade Relations with the Baltic States*, HC835

3 *Industrial and Trade Relations with Central Europe*, para. 37

4 *Industrial and Trade Relations with Central Europe*, para. 17

5 *Industrial and Trade Relations with Central Europe,* para. 33

6 *Industrial and Trade Relations with the Baltic States,* para. 76

7 *Industrial and Trade Relations with the Baltic States,* para. 74

8 *Industrial and Trade Relations with the Baltic States,* paras. 52 and 75

5. This Report examines the impact resulting from the accession of the A8/A2 countries on UK business and the potential of those countries as business partners, export markets and possible competitors. It considers the extent to which UK business has taken advantage of the opportunities made available by the opening up of Central and Eastern Europe following the collapse of the Soviet Union, the implications for UK business of migration from the A8/A2 and the effects of relocation of business functions from Western to Eastern Europe.

6. This inquiry is focused on the effect of the accession of the A8 and A2 countries on UK business and the economy. It does not, therefore, address the impact on the A8/A2 countries themselves except insofar as this affects UK companies seeking to do business with those countries. Nevertheless, the relative size of the A8/A2 means that in all aspects of the relationship between the 'old' and 'new' EU the impacts on the 'new' EU are considerably greater than the effects on the 'old'—including the UK. For example, official statistics suggest that migrants from all A8 countries account for 1.24% of the UK workforce, whereas we were told in Lithuania that up to 15% of the country's entire pre-accession population is currently living in the UK and Republic of Ireland.

7. During this inquiry we took oral evidence from EEF, the Manufacturers' Organisation; Intellect, the trade association for the software and IT industries; Department of Trade and Industry, Department for Work and Pensions and UK Trade and Investment officials; British Chambers of Commerce; and Katinka Barysch, Chief Economist of the Centre for European Reform. We also undertook visits to Lithuania, Hungary and the Slovak Republic, in the course of which we met a wide range of UK and local business people, government officials, ministers and embassy staff. We also held informal meetings with the staff of these countries' embassies. We received 21 written memoranda and supplementary memoranda from government departments, individuals, businesses, employers' representatives and trade organisations. We express our gratitude to all those who helped arrange our visits, who gave their time to meet us or who submitted evidence to us.

2 Migration

8. Coverage in the British media of the impact of European enlargement on the UK has focused overwhelmingly on A8/A2 nationals coming to the UK to live and work. A study published in January 2007 into media coverage of the A2 accession found that the issues of immigration and labour featured in 45% and 44% respectively of related newspaper articles.[9] This reflects the importance given to the issue by, in particular, the British Chambers of Commerce and also by the Government in evidence to us.[10]

9. Nationals of A8 countries wishing to take up employment in the UK for more than a month are generally required to register on the Workers' Registration Scheme (WRS). Between May 2004 and March 2007 630,255 A8 nationals had registered on the scheme. The WRS figure is a gross measure of the number of first applications made; individuals are not required to de-register if they leave the country and the figures exclude the self-employed, students and the economically inactive, none of whom is required to register under the scheme.[11] It is also limited by those who choose not to register; a survey of 505 Polish nationals conducted by the University of Surrey for the BBC's 'Newsnight' programme found that only 64% of those interviewed had registered on the scheme.[12] **Worker Registration Scheme data are not a net measure of A8 migration nor are they a measure of the number of A8 nationals currently living in the UK. It is therefore a matter of serious concern to us that the Department of Work and Pensions has no better statistical source from which to gauge the impact of A8 migration to the UK.**[13]

10. Labour Force Survey figures give the total number of economically active A8/A2 nationals resident in the UK during the period January-March 2007 as 372,000. This would mean that A8 nationals accounted for 1.2% of the UK workforce during this period and 17.5% of all economically active foreign nationals.[14] Concerns have been raised that these figures significantly underestimate the numbers of migrants in work.[15] The Department for Work and Pensions accepted in their oral evidence to us that the Labour Force Survey figures were "not perfect"; weaknesses with the data are discussed in the Department for Work and Pensions report on Eastern European migration but are not the subject of the present Report.[16]

9 Cision (2007) *A Candid Assessment of the British Media's View of EU Expansion*, p. 3

10 Q50 (British Chambers of Commerce) Ev56 DTI; Ev73 (Department of Trade and Industry)

11 Border and Immigration Authority, Department for Work and Pensions, HM Revenue & Customs and Communities and Local Government (May 2007) *Accession Monitoring Report: A8 Countries May 2004 – March 2007* p. 2, Table 5; (hereafter 'UK Government' *Accession Monitoring Reports,* Applicants are required to re-register when they begin a new job, however the figures cited in the Accession Monitoring Report refer only to first applications.

12 Centre for Research on Nationalism, Ethnicity and Multiculturalism, University of Surrey, (2007) *Polish Migrants Survey Results* http://www.surrey.ac.uk/Arts/CRONEM/CRONEM_BBC_Polish_survey%20_results.pdf

13 WRS data provides the basis for the Home Office's Accession Monitoring Reports, supported by Labour Force Survey data it also underpins the Department for Work and Pensions documents cited elsewhere in this Report; Qq104-105 (Department for Work and Pensions)

14 Office of National Statistics (2007) *Labour Force Survey*, January to March 2007

15 *The Observer,* 29 April 2007, '"Immigration figures are 'false'": Councils say government statistics seriously underestimate the number of new arrivals and they need more money to cope'

16 Q104 (DWP); Department for Work and Pensions, (2005), *The Impact of Free Movement of Workers from Central and Eastern Europe on the UK Labour Market: Early Evidence*, section 4.1.1 (hereafter 'DWP, The Impact of Free Movement')

11. Migration from the A8 countries is overwhelmingly from Poland; in the first quarter of 2007 71% of WRS first registrations were made by Poles. Slovakia (9%) and Lithuania (7%) were the second and third largest contributors.[17] The Department of Trade and Industry cited David Coleman, Professor of Demography at Oxford University, as saying that the influx of Polish workers is the largest single migration into the UK since the arrival of the French Huguenots in the late seventeenth century.[18]

12. Although A8 nationals who come to work in the UK have to register with the Worker Registration Scheme they are not subject to any restriction on where or for how long they can work. This is in contrast to their position in the majority of EU15 states, which imposed restrictions under the 'transitional arrangements' provisions of the 2003 Accession Treaty; only Sweden and Ireland—in addition to the UK—applied no transitional arrangements.[19] Whilst in Lithuania and Slovakia, we heard that the UK had gained goodwill in these countries by not restricting access to its labour market.

13. Romanian and Bulgarian nationals have been subject to tighter controls on the right to work in the UK. On 24 October 2006 the then Home Secretary announced that A2 nationals would require a work authorisation document to gain employment in the UK. In the first instance workers from these countries were restricted to applying for quotas in the agriculture and food sectors or the highly-skilled migrant programme.[20] In December 2006 the Minister of State for Nationality, Citizenship and Immigration told a joint meeting of the European Scrutiny Committee and Home Affairs Committee that it was proposed that there be 16,250 places for seasonal agricultural workers and 3,500 places for workers in the food processing industry. Students and the self-employed are exempt and A2 nationals can still apply for existing programmes such as the highly-skilled migrant programme or work permits. The Government has committed itself to a review of these arrangements after a year.[21] In spring 2007 the Labour Force Survey estimated that 24,000 economically active Romanians and Bulgarians were living in the UK.[22]

14. **The lack of accurate or adequate information on the number of A8/A2 nationals working in the UK or from which countries they come is a matter of concern because of the consequences for wide areas of public policy. The available evidence suggests that Poles are the largest population, followed by Lithuanians and Slovaks. We recommend that, at the very least, the next census contain specific questions to ensure that more accurate data are available to enable the Government and the new Statistics Board fully to gauge the penetration of A8/A2 nationals in the labour market. We also recommend that the Government give urgent consideration to how it can improve the information it collects on A8/A2 immigration before the next census.**

17 UK Government *Accession Monitoring Report*, table 3

18 Ev64 (DTI)

19 European Commission (2006) *Enlargement, Two Years After: An Economic Evaluation*, p. 80; the majority of such restrictions have since been removed or relaxed.

20 *Official Report*, 24 October 2006, Column 82WS

21 Oral evidence received by a joint meeting of the European Scrutiny Committee and Home Affairs Committee, 7 December 2006, HC143-I, Qq 17 and 60

22 *Labour Force Survey*, January-March 2007

Impacts of Immigration

Skills

15. Our witnesses identified the filling of skills gaps as a major benefit of A8/A2 migration. The British Chambers of Commerce submitted the results of a survey of small and medium sized businesses which found that 25.6% of those surveyed employed migrant labour primarily because of a short supply of candidates with the required skills and 19.6% because of a shortage of candidates with the required experience.[23] The EEF told us that it was clear that A8/A2 migration had helped meet skills gaps in manufacturing.[24] The Greater Manchester Chamber of Commerce told us “there is a lack of specialised skilled workers available to many businesses in the UK” whilst migrant workers from the A8/A2 “are likely to be some of the best workers from these areas, as it is those with higher skill levels and stronger work ethics that stand a better chance of securing employment overseas”.[25] The Society of Motor Manufacturers and Traders told us that their members were recruiting in part directly from Central and Eastern Europe in order to find appropriately skilled staff.[26]

16. According to the British Chambers of Commerce survey, 23.3% of employers use migrant labour chiefly because they believe that immigrants have a better work ethic than native employees, whilst 17.4% cited greater productivity as their major reason for employing migrant labour.[27] Similar sentiments were expressed by representatives of Intellect, by individual chambers of commerce and privately to us during our visits overseas.[28] The Chief Economist of the Centre for European Reform told us that this was in part a product of the lack of equally attractive employment at home and the risk factor involved in moving overseas.[29]

17. The evidence we received suggests that those A8/A2 nationals who come to work in the UK are largely from the intermediate and higher end of the labour market.[30] The European Commission report on the impact of enlargement noted that a disproportionately high number of EU10 nationals who live in the EU15 (up to 60%) have intermediate skill levels.[31] Moreover, the education systems of A8/A2 countries, in general, specialise in skills relating to manufacturing, engineering and electronics, a legacy of the focus on heavy industry in many of these countries’ economies during the Communist period.[32] The UK’s weaknesses in intermediate level technical and practical skills, as identified by the Leitch

23 British Chamber of Commerce (2007) *Migration: Plugging the Gap*, p. 7 (hereafter ‘BCC, Migration: Plugging the gap’)

24 Q6 (EEF, The Manufacturers’ Organisation)

25 Ev106 (Greater Manchester Chamber of Commerce)

26 Ev129 (Society of Motor Manufacturers and Traders)

27 *Migration: Plugging the Gap*, p. 7

28 Q134 (Intellect) Ev86 (Confederation of West Midlands Chambers of Commerce)

29 Q277 (Katinka Barysch)

30 Q274 (Katinka Barysch); Ev65 (DTI)

31 European Commission (2006) *Enlargement, Two Years After: An Economic Evaluation*, p. 84

32 Q271 (Katinka Barysch)

Review and our own Report into manufacturing skills, mean that skill sets of migrants from the A8/A2 are well suited to plug these gaps in the UK's own skills base.[33]

18. **Our witnesses told us that the A8/A2 nationals who come to the UK to work tend to be the 'best and the brightest' and that their skills and work ethic are the major reasons why employers find them attractive employees. It is clear from the evidence we received that A8/A2 migration has helped plug skills gaps as well as alleviating labour shortages in certain sectors of the economy.**[34]

Wages

19. Despite being 'the best and the brightest', we were told that the majority of A8/A2 nationals initially work in relatively low-paid, low-skilled jobs in the UK.[35] The majority of registered workers (77%) earn between £4.50 and £5.99 an hour.[36] 5.9% of companies surveyed in the British Chambers of Commerce survey cited lower wage costs as their main reason for employing migrant labour.[37] According to the WRS figures the predominant occupations for Eastern European migrants are as process operatives, warehouse operatives, agricultural and hospitality workers. Whilst the overwhelming majority—97%—are registered as in full-time employment, 50% are registered as in temporary employment.[38] It is noticeable that there has been a significant fall in the number of migrants earning between £4.50 and £5.99 an hour, from 85% in the first year of the scheme (with a further 2%-3% reported as earning less than £4.50 an hour) to 77% in spring 2007.[39] This supports anecdotal evidence that migrants who remain in the UK are moving into higher-waged, higher-skilled occupations which make more use of their talents.[40] The Chief Economist for the Centre for European Reform told us that transitional arrangements in countries like Germany had limited this phenomenon—and therefore the potential benefits to the economy of migration—by not allowing migrants to move between occupations to those where they could add the most value.[41]

20. We received evidence that this movement of labour into higher-earning occupations combined with economic growth in the A8 is making it harder for employers in agriculture, who had previously relied on A8 nationals for their labour, to recruit staff. The National Farmers' Union told us that current estimates predict a shortfall of 5,130 workers (17% of seasonal labour demand) in 2008. We also heard that this situation will be

33 HM Treasury (2006) *Prosperity for All in the Global Economy—World Class Skills*, p. 2, para 2.9; Trade and Industry Committee, Fifth Report of Session 2006-2007, *Better Skills for Manufacturing,* HC 493-I, paras 28 and 50

34 Q274 (Katinka Barysch); Ev65 (DTI)

35 Q274 (Katinka Barysch)

36 *UK Government Accession Monitoring Report*, p. 17

37 BCC *Migration, Plugging the Gap*, p. 7

38 UK Government *Accession Monitoring Report*, table 7, para 8; Ev91 (DTI)

39 DWP *The Impact of Free Movement*, Figure 4.8; UK Government *Accession Monitoring Report*, p. 17

40 Ev66 (DTI)

41 Q274 (Katinka Barysch)

exacerbated by the Government's restriction of the Seasonal Agricultural Workers Scheme to Bulgarian and Romanian nationals.[42]

21. **We note that A8/A2 migrants tend to find work in the UK for which they are overqualified. This could be said to have a negative impact on the economic efficiency of Europe as a whole—their home countries are losing skills and the UK is not maximising its advantage from them. Nonetheless there is some evidence that A8/A2 nationals who remain in the UK are starting to move into the higher-paid, more-skilled jobs for which they are better suited. Whilst we welcome this, it has caused labour shortages in agricultural industries that had previously relied on Central and Eastern European workers entering the UK through the Seasonal Agricultural Workers Scheme (SAWS). We find it remarkable in these circumstances that the Government is proposing to allow only Bulgarian and Romanian nationals to apply through SAWS.**

22. It has been argued that A8/A2 migrants have reduced wage inflation in the economy. The EEF told us that migrations from the A8/A2 countries had allowed the economy to grow faster without creating wage inflation or forcing higher interest rates.[43] A report written by Professor David Blanchflower—a member of the Bank of England's Monetary Policy Committee—and two colleagues concluded that, by increasing the supply for labour by a greater amount than the demand for labour, Eastern European migration had reduced inflationary pressures on wages in the short run.[44] Similarly, the SMMT told us that recruitment from the accession states had "eased some pressures from wage costs".[45]

23. A report commissioned by the Low Pay Commission into the impact of all immigration into the UK on wage levels found a very small (0.7 pence per hour) negative impact on wage growth over a year at the lowest end of the spectrum and a modest increase (25 pence per hour) in average wage growth.[46] A second report, into the North Staffordshire Labour Market, found that the majority of migrant workers worked around or on the minimum wage level. Leaving aside exploited or illegal labour—which is discussed elsewhere in this Report—it found that lower levels of sickness absence and a stronger work ethic meant that employers could achieve savings on labour rates by employing migrants without cutting wage rates and that migrants were generally paid the same as their UK equivalents.[47] These findings tend to support the evidence of Katinka Barysch, who told us that the existence of a UK minimum wage had significantly reduced the undercutting of wages experienced to some extent in Germany.[48]

24. The Department for Work and Pensions told us that they did not have any evidence to suggest that there was a connection between wage inflation and migration. They told us

42 Ev132 (NFU); BBC News Online, 4 July, 'Labour shortage hitting UK fruit' http://news.bbc.co.uk/1/hi/business/6270642.stm; *The Guardian*, 28 May 2007 "Shortage of pickers may hit strawberry crop".

43 Q6 (EEF)

44 David G. Blanchflower, Jumana Saleheen, Chris Shadforth (2007) *The Impact of the Recent Migration from Eastern Europe on the UK Economy*, p. 32

45 Ev127 (SMMT)

46 Low Pay Commission (2006) *A Study of Migrant Workers and the National Minimum Wage and Enforcement Issues that Arise*, pp. 59-60

47 Low Pay Commission (2006) *The Impact of New Arrivals Upon the South Staffordshire Labour Market*, para. 3

48 Q282 (Katinka Barysch)

that there had been no noticeable slowing of wage growth in sectors and localities where A8/A2 migrants tended to work. They concluded by saying they had not been able to find data to support the notion that such migration had dampened wages.[49]

25. The British Chambers of Commerce told us that "it was a bit of a myth" that A8/A2 migrants were receiving lower pay than their UK equivalents. Their survey found that only 5.9% of businesses gave lower wage costs as the main reason for employing migrant labour. They accepted that by increasing the labour supply and reducing competition for staff between employers, migration may have reduced wage growth. A suggestion was also made that A8/A2 nationals may be less inclined to demand extra money for overtime work.[50]

26. **The evidence on whether A8/A2 migration has slowed wage growth in the UK economy is mixed. The Government suggests that it has had no discernable impact. Other studies suggest there may have been a slowing of wage inflation through an overall increase in the labour supply. The Low Pay Commission's report into migration in general concluded that a small decrease in wage growth at the lowest levels was more than compensated for by modest increases at higher levels of pay. What the studies that have found an impact agree on is that such impacts are small in the context of the whole economy. We do not rule out more significant impacts in relation to specific sectors and we will be returning to this issue during our forthcoming inquiry into the construction industry.**

Employment

27. The Department for Work and Pensions has conducted the only major study to date on the impact on the UK labour market of A8 migration this concluded. "Despite anecdotal evidence, there is no discernible statistical evidence which supports the view that the inflow of A8 migrants is contributing to a rise in claimant unemployment in the UK."[51] Officials from the Department reiterated this view in oral evidence to us.[52] This conclusion was supported by the European Commission's report on the impacts of enlargement on the EU15, which noted that those countries which had adopted the most open attitude towards A8 workers (the UK, Ireland and Sweden) were those with the best employment performance over the post-accession period.[53] The Trades Union Congress report on the impact of migration in general on the labour market similarly cited several reports which found no evidence to suggest that unemployment overall had been increased by migration and some evidence to suggest that migration may increase overall employment.[54]

28. Nonetheless, there have been suggestions that recruitment of A8 nationals by employers in low-skilled areas of work may have had some impact on employment rates. The TUC report noted that employers were more likely to have recruitment strategies

49 Q103 (DTI)

50 Qq 225 and 235 (British Chambers of Commerce); BCC *Migration: Plugging the Gap*

51 *The Impact of Free Movement*, p. 49; Trades Union Congress (2007) *The Economics of Migration*, p. 12

52 Q65('DWP)

53 European Commission Communication (2006) *Enlargement, Two Years After—An Economic Success*, para. 19

54 *The Economics of Migration*, section 7

targeting migrant workers than the core unemployed and referred to anecdotal evidence suggesting that in specific sectors—in particular, construction—this may be disadvantaging the long-term jobless.[55] A small regional study by the Low Pay Commission in South Staffordshire cited 'limited' evidence that employers who had previously relied on a variety of sources of migrant labour were now relying increasingly on A8 labour—in effect displacing non-EU workers.[56]

29. **Concerns have been raised that employers may be less inclined to pursue recruitment strategies aimed at the long-term unemployed due to the presence of skilled Central and Eastern European alternatives. Nonetheless, we have seen no evidence to suggest that immigration from the A8/A2 countries since their accession has increased claimant unemployment in the UK.**

Overall Impact

30. Our witnesses agreed that migration from the A8/A2 countries has been positive for the economy and UK business. The British Chambers of Commerce told us: "The view from the chambers of commerce is that it [A8/A2 migration] has significantly enhanced wealth in this country and wealth creation."[57] The EEF told us that "on balance, it has had a beneficial impact because access to more workers, and often very skilled workers, has allowed the economy to grow at a faster rate without problems of wage inflation taking off and interest rates needing to rise."[58] Intellect welcomed the opening of labour markets in that it had allowed greater freedom for companies to move staff between different parts of an international operation; however they expressed concern that as a result "there is a growing risk of EU discrimination against staff whose 'home country' is outside the EU."[59] The Government's position is that "the UK economy has benefited quite significantly from the influx of typically medium skilled workers who are prepared to work flexibly to fill gaps in the UK labour market."[60]

31. **Migration from the A8 since 2004 has benefited UK business, chiefly by filling gaps in the labour market. The Government's decision to open the UK labour market to A8 nationals has been beneficial from a labour market perspective because it has allowed workers to move flexibly between sectors following employer demand. Nonetheless, the Government should be aware that this has created shortages of seasonal labour in agriculture, which had previously relied on labour from restricted migration schemes.**

32. **We believe it is too soon to make a judgement on the decision to introduce restrictions on Bulgarian and Romanian nationals—but we note that countries in the A8 experiencing labour shortages are using labour from the A2 to plug those gaps.**

55 *The Economics of Migration*, para. 3.11

56 *The Impact of New Arrivals*, p. 65

57 Q227 (British Chambers of Commerce)

58 Q6 (EEF)

59 Ev113 (Intellect)

60 Q50 (DWP)

Exploitative Employment

33. A recent BBC news investigation raised the prospect that some A8/A2 nationals are being encouraged to come to the UK on the back of misleading or false promises of employment and then subject to exploitative working conditions once they arrive. The investigation focused on the role of middlemen and gangmasters in this process.[61] The Home Office report into the employment of migrant workers found that there were examples of exploitation both in terms of underpayment and denial of employment rights. Some respondents to the survey underpinning the report claimed that exploited labour was being used to undermine wages and conditions in low-skill, high-turnover sectors including hospitality and catering, construction and agriculture.[62]

34. The Department for Work and Pensions told us that there had been examples of abuses—in particular relating to the deduction of money from wages for accommodation—but that it was not sufficiently widespread to affect the labour market as a whole.[63] The Department of Trade and Industry told us that the influx of legal migrants from the A8 countries post-accession may have had a positive role in displacing illegal or exploitative labour by providing a legitimate source of low-cost employees.[64]

35. The accession of the A8 to the European Union was closely followed by a substantial increase in the employment rate among nationals of those countries living in the UK. In summer 2003 the figure was 57.3%—below the average for both migrants in general (65.3%) and non-migrants (75.8%). By summer 2005 this picture had reversed: the A8 figure was now 80.6% compared to 66.4% and 76.1% respectively. A major part of this increase has been associated with workers moving from illegal and unreported employment into the open economy.[65]

36. **Migrants from the A8/A2 countries should be clear that, as European Union citizens, they are entitled to the same protection in terms of the minimum wage, employment conditions, union membership and health and safety as a UK citizen. We encourage the Government to work closely with the A8/A2 nations to ensure that new and potential arrivals are made aware of their rights at the earliest possible opportunity.**

37. **We note that, whilst the Gangmaster Licensing Authority has helped address the problem of exploitative employment by intermediaries in the agricultural sector, there are no similar arrangements in other sectors where intermediaries play a large part in recruitment. We recommend that the Government give urgent consideration to extending the Gangmaster Licensing Authority's remit.**

61 BBC News Online, 25 April 2007, 'A New Form of Bonded Labour', http://news.bbc.co.uk/1/hi/uk/6593827.stm

62 Home Office (2006) *Employers' Use of Migrant Labour*, p. 63 It should be stressed that these were the subjective views of individual respondents to the survey.

63 Qq118 and 122 (DWP)

64 Q119 (DTI)

65 DWP *The Impact of Free Movement*, para 4.2.2

Long-Term Impacts

38. A8/A2 migrants have benefited British businesses in the period since 2004, chiefly through the plugging of gaps in the labour market. The longer-term impact of such westwards migration is less certain. The key variable here is the future intentions of A8/A2 nationals. The current trend is for A8 applications for the WRS to increase year-on-year, from 204,965 in 2005 to 227,710 in 2006.[66] Whether this trend continues in the years to come depends on future developments in the UK and A8/A2 economies. If, as widely expected, wages continue to increase in the A8/A2 countries, growth remains high, unemployment falls and other European countries continue to relax their restrictions on migrants then it would be reasonable to expect migration from the A8/A2 into the UK to slow. Indeed, the latest figures show 46,820 WRS first-time applicants in the first quarter of 2007—an increase of only 85 on the previous year—and 49,500 in the second quarter—a fall of 6,980 on the previous year.[67] These figures suggest that the numbers of A8/A2 nationals arriving in the UK may already be slowing. However, the problems already outlined with such data and the number of variables involved in predicting migration flows mean that it is difficult to establish how far this reflects the situation on the ground, or whether this slowdown will continue.

39. The other key aspect in determining long-term impact is the number of A8/A2 migrants who choose to remain in the country. Most people we spoke to in Lithuania and Slovakia said they envisaged the majority of migrants returning from the UK in the medium to long term. When registering on the WRS applicants are asked how long they intend to remain. In the period April 2006–March 2007 the majority (55%) said three months or less, 26% did not know and 9% said for more than two years.[68] There is no measure of the numbers of A8/A2 nationals actually leaving the UK.

40. Other surveys have been undertaken into the future intentions of A8/A2 migrants. Surrey University's study found that of the 505 Poles surveyed, 18.6% intended to stay less than six months, 12.7% intended to stay between six months and two years and a similar number aimed to stay between two and five years. Longer term, 11.1% aimed to stay more than five years and 15.4% had decided to stay permanently. The largest single group (29.75%) were those who had no set plan for how long they would stay.[69] A survey by the Polish Marketing company ARC Market and Opinion found that 45% of the 1,389 Poles surveyed planned to stay at least five years in the UK, 45% planned to go home within four years and 10% planned to stay permanently.[70]

41. Some of our witnesses raised concerns that a high number of returnees could cause problems for UK businesses. The British Chambers of Commerce told us: "Business has become increasingly reliant on migrant labour. We do not know whether these people will stay or go or what will happen and obviously there is a disappointment that businesses

66 UK Government *Accession Monitoring Report*, table 3

67 UK Government *Accession Monitoring Report*, *May 2004–June 2007,* table 1

68 UK Government *Accession Monitoring Report*, table 8

69 *Polish Migrants Survey*

70 *Daily Mail*, 5 July 2007, 'We're never going home'

cannot access locally that level of skill and work aptitude that they seek."[71] The EEF stressed that they did not see migrant labour as a long-term solution to skills shortages and gaps in the manufacturing workforce.[72] The Chief Economist of the Centre for European Reform told us: "There will be a big loss for the UK economy if a large number of the Central and East Europeans go home."[73]

42. **There is not enough data to make an accurate prediction of the numbers of A8/A2 nationals who will be living in the UK in the medium to long term; UK business cannot take this supply of skilled, willing labour for granted. Although A8/A2 labour has eased labour shortages in a number of sectors, it is not a long-term solution to those problems. We recommend that the Office for National Statistics and its successor body investigate the returnee rate among A8/A2 nationals and that Government and business work together to ensure that a skills and labour vacuum is not left behind when, and if, the flow of A8/A2 nationals to the UK slows or reverses.**

43. Whilst in Lithuania we saw examples of Lithuanians who had returned to their home country after a period in the UK and used the skills, contacts and expertise gained during that period to set up successful business ventures linking the two countries. **The presence of large numbers of A8 nationals in the UK and the goodwill generated in those countries by the opening of the UK labour market offer excellent opportunities for better business links between these countries and the UK, especially when, and if, those migrants begin to return home. Government and business need to develop strategies to maximise the UK competitive advantage gained from these returnees by, for example, ensuring effective British chambers of commerce are supported in these countries, developing cultural links and targeting UKTI resources. This is a significant and potentially highly beneficial long-term consequence of migration to which insufficient public policy attention has been given; greater attention should be paid to it if the advantages to the UK are to be maximised.**

71 Q234 (British Chambers of Commerce)

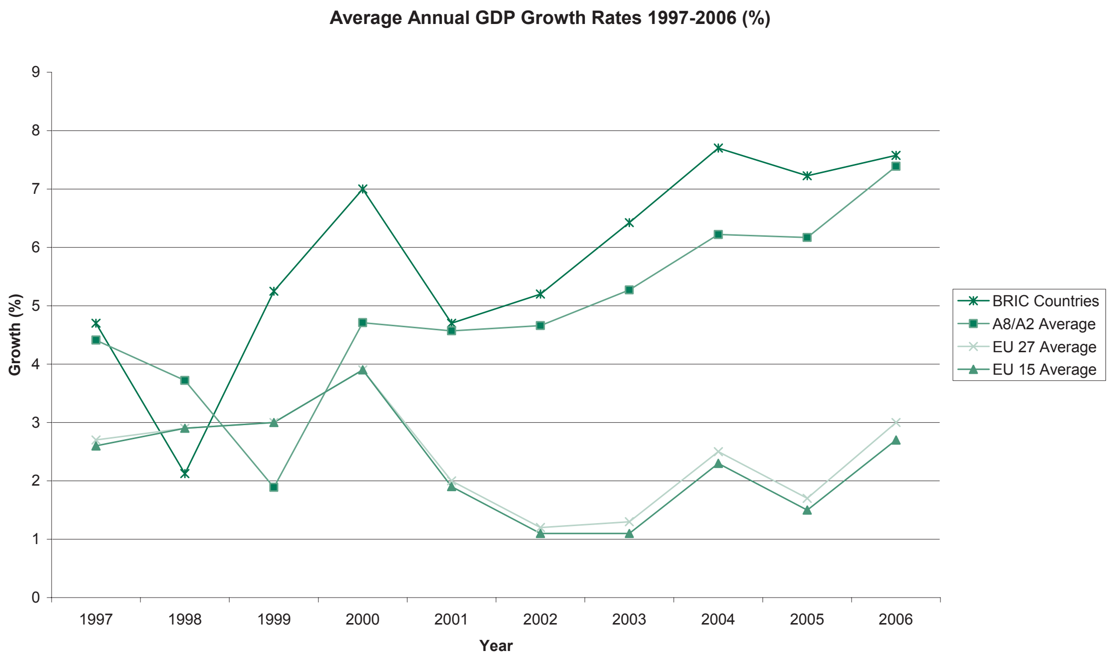
72 Q6 (EEF')

73 Q275 (Katinka Barysch)

3 The Business Environment in the A8/A2 Countries

GDP Growth

44. The A8/A2 countries have shown consistently strong economic growth since the Russian financial crisis of the late 1990s. Although growth varies significantly between individual countries, their combined average GDP growth rate has consistently been more than double that of the EU15 since 2001. Indeed, their average growth rates have been comparable with those of the so-called BRIC countries (Brazil, Russia, India and China) for much of the same period.



Source: Ev57 'DTI'; International Monetary Fund, World Economic Outlook Database, April 2007

45. Growth varies significantly between the individual A8/A2 member states. The strongest performers are Estonia (11.4% growth in 2006), Latvia (11.9%) and Slovakia—whose growth rate of 8.3% in 2006 significantly exceeded the expectations outlined in the DTI's evidence to us. The majority of countries had growth rates of between six and eight percent, led by Lithuania (7.6%) and Romania (7.7%). Slovenia (5.8%) and Poland (5.2%) both fell short of the six percent mark, but only Hungary (3.9%) had a growth rate comparable with the EU15 average of 2.7%.[74]

46. A key question for investors is whether this growth can be maintained. The pattern of growth outlined above suggests that the A8/A2 countries are becoming increasingly resilient to global downturns. The Russian crisis of 1999 affected these countries to a much greater extent than more established market economies or the more distant BRIC

74 Ev57 (DTI); World Bank, http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf

countries. An encouraging sign is that the A8/A2 as a whole seemed relatively unaffected by the post-2001 economic downturn compared to the EU15—indeed, average GDP growth marginally increased during the period 2001-2002.

EU Funding

47. The A8/A2 countries are set to benefit considerably from the 2007-2013 round of European Union spending on cohesion policy. In total around €176 billion will be spent on the A8/A2 countries over the five year period, with the A8/A2 countries receiving net transfers of, on average, around 3% of their GDP over the next funding period.[75] We heard that much of this money will be designated for infrastructure projects—such as investment in the ten transport ‘corridors’ intended to link Western, Central and Eastern Europe agreed at the 1997 Helsinki Pan-European Transport Conference—and some A8/A2 governments have expressed interest in public/private partnerships, which the UK is well placed to support.[76] **The significant influx of EU money into the A8/A2 during the 2007-2013 funding period will provide excellent opportunities for UK companies—particularly in the fields of construction and financing. The ministers and officials we met during our visits indicated that they were determined to achieve the best value possible and would welcome British involvement in the resulting investment. We hope that the British government and business look seriously at the new opportunities that will arise from these developments.**

Labour Market

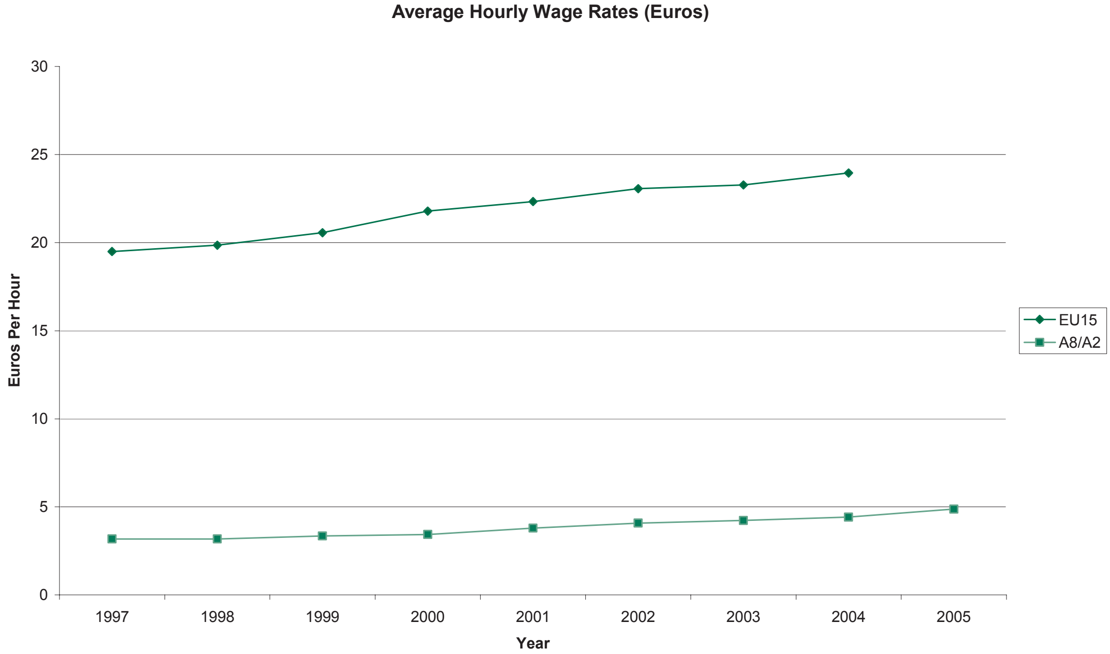
48. Wage rates in the A8/A2 countries remain around a fifth of those in the rest of the European Union. The average hourly wage for the A8/A2 as a whole in 2005 was €4.88 compared to €24.41 in the Eurozone and €24.47 in the UK.[77] Average wage growth across the A8/A2 between 2004 and 2005 was 9.5%. As the diagram below shows, although wage growth in the A8/A2 outstrips the EU15 in percentage terms, average wages will still remain significantly lower than the EU15 for the foreseeable future if current trends are maintained.[78]

75 European Commission *Enlargement Two Years After*, p. 34; Eurostat, http://ec.europa.eu/regional_policy/policy/fonds/pdf/annexe-recto.pdf - these figures are indicative.

76 Ev88-94 (Corporation of London)

77 Eurostat, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1073,46870091&_dad=portal&_schema=PORTAL&p_product_code=DBB10000

78 Ev58 (DTI)



Source: Ev58 'DTI'

49. Our witnesses told us that the major attraction of the A8 countries was not that they had the lowest wages. EEF told us that labour costs in China are "a mere fraction" of those in the A8/A2 and the Chief Economist of the Centre for European Reform observed that genuinely low-cost production was already being moved further east into the A2 and outside the EU.[79] Instead they stressed the combination of low labour costs relative to Western Europe with a high level of skills and competency. For example, Intellect told us that working with technology—for example in electronics or software—has a much more positive image in the A8/A2 countries than in the UK, leading higher quality people to take up a career in those sectors. Moreover, those graduates who do pursue such a career tend to be "highly competent" and often possess 'legacy' skills, which are no longer taught in UK educational institutions that consider the relevant technology obsolete.[80]

50. EEF told us that the relatively high skill levels of employees in the A8/A2 countries were a key factor in ensuring higher productivity than in lower-cost locations.[81] We were told by manufacturing companies in Lithuania, Hungary and especially Slovakia that the Soviet focus on heavy industry has left many A8/A2 countries with education systems and skills profiles especially suited to manufacturing and engineering work. For example, Slovakia was a major manufacturer of armoured vehicles during the Cold War and the skills legacy from this era is seen as a major reason behind Slovakia's success as a location for car manufacturers.

51. Although the wages: productivity: education ratio is very favourable to business in the A8/A2 we also heard that there are limitations. The education systems left over from the

79 Q28 'EEF'; Q257 (Katinka Barysch)

80 Ev113 (Intellect); Q144 (Intellect)

81 Ev101 (EEF)

Soviet era are rigid systems which are often narrowly focused on specific disciplines. We were told this has advantages in terms of producing a disciplined workforce with a strong focus on manufacturing and technology; indeed the results of these systems on paper are more impressive than in many Western European countries. On the other hand, we heard that the skills given by the existing system were limited in scope—problem solving, managerial and creative skills in particular were identified both by witnesses and by people in the three countries we visited as considerably weaker than Western Europe.[82] A good example comes from a DTI report on the computer games industry in the Czech Republic; whilst noting that Czech technical graduates have programming and development skills comparable with, if not better than, those in the UK, it notes problems recruiting people skilled in the arts side of the industry—animators, artists and so forth.[83]

52. We also heard widespread concerns about a growing shortage of skilled labour and resulting upward pressures on wages. In Slovakia and Lithuania we were told repeatedly that widespread migration westwards was beginning to cause a labour shortage in and around large urban centres such as Vilnius and Bratislava. Evidence from the British Romanian Chamber of Commerce and in Hungary also suggested a labour shortage despite lower migration rates.[84] The DTI told us that inward migration from outside the European Union—for example Moldova and Ukraine—was beginning to occur to fill these gaps. This was supported by evidence received during our visits.[85]

53. The concept of a labour shortage in countries with unemployment rates running as high as 13.8% (Poland), 13.4% (Slovakia) and 7.5% (Hungary) seems paradoxical.[86] We were told that this reflects the geographical concentration of investment, with labour in short supply around the major cities but high levels of unemployment—as high as 15% or more in parts of southern and eastern Hungary and Slovakia—in more disadvantaged areas.

54. Such geographical factors should also be considered when discussing average wage rates. We were told that wages in the highly developed areas around major cities were rising much faster than the statistics for the entire country would suggest. Some businessmen and officials we spoke to told us that the wages for the top employees and executives were comparable with those in Western Europe, and we heard that wages for construction workers in Vilnius were—in some cases—approaching those being paid in London. In Hungary we were told that wage growth was about 10% a year and that Bulgaria and Romania were both much more competitive in terms of labour costs—despite the very low labour mobility of the Hungarian workforce.

55. **Our witnesses cited the labour market as one of the major attractions of the A8 as investment locations due to the strong work ethic and technical skills of the workforce combined with relatively low labour costs. The evidence we received suggest that it is no**

82 Q256 (Katinka Barysch)

83 DTI (2006) *The Games Industry in Eastern Europe*, p. 15

84 Ev83 (British Romanian Chamber of Commerce)

85 Q54 (DTI)

86 Eurostat Data, http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=STRIND_EMPLOI&root=STRIND_EMPLOI/emploi/em071

longer accurate to describe the A8 as 'low-cost economies'. Although average labour costs remain just over a quarter of those in the EU15, genuinely low-cost, low-skill production is already heading further east, to the A2, Ukraine and China where wage rates are much lower. Employers in the A8/A2 countries repeatedly stressed to us that skills, not wages, were the major reason for their presence in the A8/A2 countries. This was further reinforced by government officials and ministers from the countries we visited, who accepted that their countries could not compete on cost with China, India or other emerging economies.

56. **One of the major economic challenges facing the A8/A2 at present is a growing labour shortage in the areas most attractive to overseas investment. Foreign investment is often concentrated around the major cities, increasing demand for labour on areas with relatively small populations. Rather than move to the cities to meet this demand many A8/A2 nationals—and especially the most skilled—are choosing to move to Western Europe, in effect putting employers based in Bratislava, Vilnius or Warsaw in direct competition for labour with employers in London or Dublin as well as local rivals. In some areas and sectors—for example the Lithuanian construction industry or the highest levels of company management—we were told that this is pushing wage costs up towards Western European levels. The people we spoke to during our visits emphasised that these shortages were a real problem for new companies seeking to move into well established sectors.**

Transparency and Corruption

57. According to Transparency International, corruption is still perceived to be more of a problem in the A8/A2 than Western Europe. According to their rankings, Estonia is the best performing of the A8/A2, with a global ranking of 24th. The majority of the A8/A2 are ranked between 61st (Poland) and joint 46th (Czech Republic and Lithuania), with Romania the worst performer at 84th.[87] These rankings do not entirely tally with our experiences of the three countries we visited. In Lithuania (ranked 46th) the overwhelming majority of people we spoke to told us that corruption was not a problem, whilst in Hungary (ranked 41st) we were given a wide range of examples, including the erratic application of regulations by local officials and unofficial payments to health professionals in return for appointments; similar concerns were also raised in Slovakia (ranked 49th). In all three countries it was agreed that the situation had improved significantly over the past ten years. **We commend the work being done by UK embassies in A8/A2 countries, for example in Hungary, to combat corruption. We recommend that the UK continues to be active through its embassies to assist national governments in building upon the improvements of the last ten years and further reducing corruption.**

Ease of Doing Business

58. The A8/A2 countries range widely on the World Bank's *Doing Business 2006* rankings. The Baltic States rank highly, with Lithuania in 16th place, Estonia in 17th and Latvia in 24th. The poorest performer of the A8/A2 on these rankings is Poland (75th) with Hungary (66th) and Slovenia (61st) also fairing poorly. The remaining countries fall between Slovakia (34th)

87 Ev70 (DTI)

and Bulgaria (54th). Nonetheless, even Poland fares considerably better than China—the best of the four BRIC emerging economies—at 93rd.[88]

59. As members of the European Union, the A8/A2 have committed to the *acquis*—the body of European law. In principle this provides a degree of commonality in terms of market regulation between these countries and the UK market which is lacking in non-European Union markets. We were told on several occasions that whilst European law is often associated with increasing regulation in the UK, in Central and Eastern Europe (with the exception of the Baltic States) it has actually served to reduce regulation.[89] The A8/A2 have rapidly adopted the *acquis* into their national law, with transposition rates (the percentage of European Internal Market law which has made it into national law) among the best in the European Union. The new member states also have some of the lowest rates of infringement of internal market legislation in the European Union.[90] We were given a number of explanations for this by our witnesses, including a greater respect for the Commission than among longer-standing members, a desire to impress in the lead-up to and immediate aftermath of accession, the relatively small size of these countries and the lack of time since accession in which infringement action could be brought against them.[91]

60. In terms of barriers to entry into these markets, the evidence we received was mixed. Complex, unfamiliar and slow administrative and legal procedures were a complaint which we heard in the three countries we visited—in particular relating to local administration in Hungary where there appeared to be a fine line between erratic application of regulations and corruption.[92] The Hungarian legal system also came in for criticism from some companies which had suffered from malicious or unfounded cases being brought against them, resulting in lengthy and time-consuming legal action. This ties in with a perception that although the legal, political and economic systems have changed since Soviet times, it will take longer to change many people's mentalities—particularly in some government ministries. This was particularly noticeable in relation to public procurement in Slovakia. The other major barriers to entry we heard about were the pressure on the labour market referred to earlier and the highly competitive nature of many of these markets.

61. Despite these concerns there are many areas in which the barriers to entry and risk in the A8/A2 are significantly less than in many other fast-growing overseas markets. A few examples we heard about were the lack of a major time difference between the UK and Central and Eastern Europe, a good level of English spoken in the business communities of many (though not all) A8/A2 countries, relatively minor cultural differences compared with Asia or the Middle East, a welcoming attitude towards UK investors (particularly in the Baltic States) and access to the Internal Market.[93]

62. **As with any overseas market, the A8/A2 countries present a range of challenges to UK investors and exporters. Our witnesses raised concerns about complex, unfamiliar**

88 World Bank, *Doing Business 2006* (via doingbusiness.org, accessed 27 June 2007)

89 Q81 (DTI)

90 Ev69 (DTI); *Enlargement Two Years after*, pp. 27-28

91 Ev69 (DTI) ; Qq 81-82, 85-86 'DTI';Q286 'Katinka Barysch'

92 Q74 (DTI)

93 Q134 (Intellect); Q28(EEF)

and slow administrative and legal procedures in many of the A8/A2 countries—although we note that similar concerns are also raised about some well-established EU15 countries. Nonetheless, we believe that in terms of high-growth economies worldwide the A8/A2 countries present relatively few barriers to entry and relatively few risks. Their comparative nearness to the UK, membership of the European Union and open economies are key competitive advantages for the A8/A2 countries in dealing with UK business.

Taxation

63. The introduction of 'flat' rates of taxation in many of the A8/A2 countries, initially by Estonia in 1994 and subsequently by other countries in the region ranging from Slovakia to Russia, has been cited as a key competitive advantage held by those countries. Some companies suggested to us that the relative simplicity of these tax regimes is an attraction to investors and therefore a competitive advantage. It was not regarded as a decisive advantage; and the majority opinion among the people we met in these countries was that issues such as skills base, labour costs, the granting of 'tax holidays' and economic growth were more weighty considerations in the minds of potential investors. The point was also made to us that a low, flat rate of tax does not always mean lower tax in practice when compared to the more complex systems used in Western Europe. For example, Estonia has a headline tax of 0% on reinvested profits, but collects a higher percentage of its GDP through corporation taxes than Germany where the headline rate is 38%.[94]

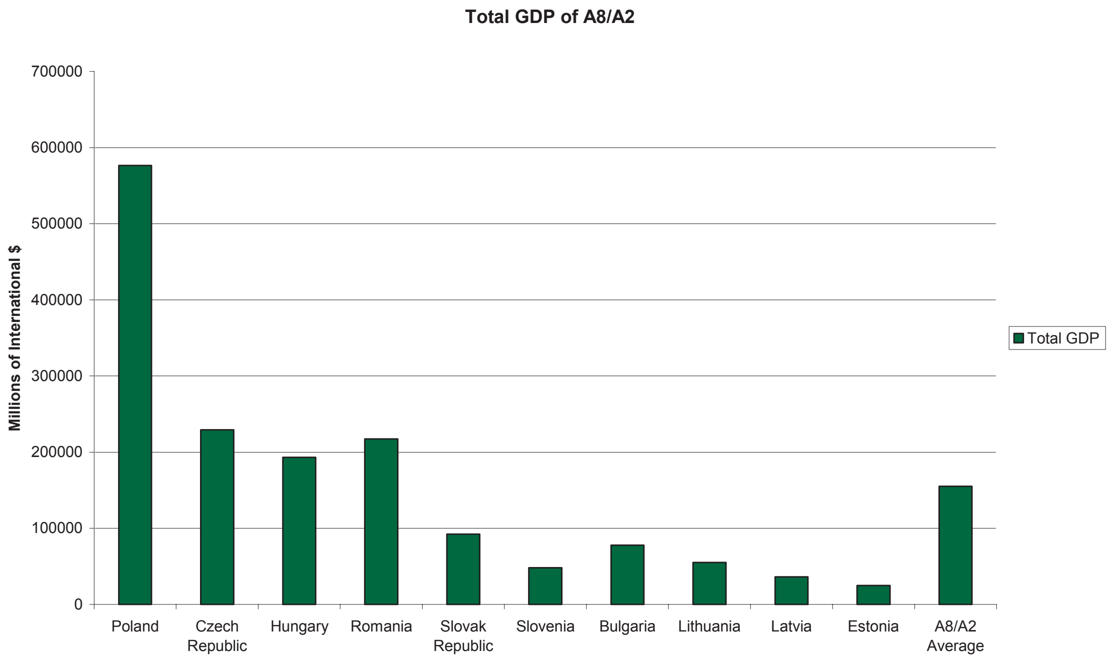
Size of Market

64. The majority of the A8/A2 countries are relatively small markets. As the figure below shows, in 2006 Poland was by far the largest economy in the region—the 21st largest in the world—with Romania the next largest and the 42nd largest worldwide.[95] In total, the A8/A2 countries have a combined GDP about a third that of the UK.[96] We were told on our visits that the relatively small size of many of the A8/A2 economies was a significant disincentive towards investment or exports by British firms. We heard that the A8/A2 countries do not comprise a homogenous market and that this is particularly true of service and communications sectors where different regulatory regimes and competitive environments ensure that each country has to be examined on its own merits. In such circumstances larger companies often do not feel that the market of, say, Lithuania, is large enough to warrant investment. This is less true of sectors like manufacturing, where we saw plants based in—for example—Slovakia or Hungary acting as a regional presence for a company within the EU and also exporting further east into Belarus or Ukraine.

94 Q260 (Katinka Barysch)

95 World Bank, http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf

96 Ev59 (DTI)



Source: World Bank Data http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf

65. **Although the A8/A2 countries are relatively small when compared to the major emerging economies—both in terms of population and GDP—we were reminded that when these countries joined the European Union their combined economy was the size of the Netherlands; now Poland alone has a larger economy than that of the Netherlands and it buys £2.8 billion a year worth of UK exports—around the same as China.**[97] Moreover, the World Bank places the A8 as 'upper middle income' countries (with the exception of Slovenia which is classified as 'high income'), making them more prosperous markets than countries like India or China.[98] Businesses we spoke to in Lithuania and Slovakia also told us that the small size of the country bought advantages in terms of access to senior people and also in terms of the availability of market niches where smaller companies could find opportunities. We were also told that while, for example, the large City of London law firms had decided not to invest in Lithuania, regional players (in particular from Scotland and the North of England) have an effective presence.

The Future

66. A key question for investors is the potential for the A8/A2 economies in the future. It has been suggested that the A8/A2 economies are reaching the peak of their economic performance, that a combination of pressures on the labour market, an increasing reluctance to pay the political price for economic reform now EU membership has been obtained, ever-increasing competition from Asia and the end of privatisation programmes will slow both economic growth and foreign direct investment flows into these countries.[99]

97 Q12 (EEF); Q88 (UKTI)

98 World Bank 'Doing Business', http://www.doingbusiness.org/ExploreEconomies/EconomyCharacteristics.aspx

99 *The Economist*, 25 July 2007, 'Over the hill?'

67. The opinion of our witnesses was that, in the short to medium-term, such views are excessively pessimistic. There is a great deal of confidence in the countries we visited that labour shortages can be met by a combination of returnees—attracted back by rising wages and standards of living—and migration from further east. It was pointed out that overall employment levels in the larger A8/A2 countries remain much lower than in Western Europe, partly due to geography and infrastructure, partly due to skills mismatches and partly due to longstanding social problems—for example among the Roma community in Slovakia. Significant investment of European Union funds in these poorer regions could create newly attractive regions for investment and British companies should be aware of this possibility.[100]

68. In the longer term we were told that future growth depends on these countries being able to move their economies up the value chain, to attract more innovative and creative industries and to increase the size and sophistication of their service sectors. The challenge in this area should not be underestimated. We were told that the A8/A2 perform poorly on international comparisons of R&D intensity and other indicators. Although the workforces of these countries were praised for their discipline, production and engineering skills we also heard that the education systems which produced them were in need of reform—especially in higher education.[101] Nonetheless, we were left with the impression during our visits that government and business were both very aware of this challenge and of their inability to compete with Asia on price alone. The ambition to attract high-value-added investments has been supported by government incentives—such as tax holidays and exemptions to labour laws—and we saw evidence that a number of companies were willing to make high-tech or innovative investments in the A8/A2 on that basis.[102] To judge from the sophistication of some of the facilities we visited, the A8/A2 countries can already compete with the UK in terms of cutting-edge technology.

69. **British government and business should be aware that the more forward-thinking A8/A2 countries are actively targeting high-value-added sectors such as biotechnology, ICT and pharmaceuticals and are seeking to attract research and development and other innovative investments—for example Samsung's and Kia's investments in Slovakia or GlaxoSmithKlein's vaccine research facilities in Hungary. This is both a significant opportunity for partnership—making use of the skills bases, newly built facilities and dynamism of these countries and the new opportunities that come with a developing market—and a potential competitive challenge for UK business in the longer term. UK policy makers need to recognise that in attempting to build an innovation-driven economy, our potential partners and competitors are not limited to the USA, France and Germany; the A8/A2 countries are increasingly becoming home to facilities of a very high level of sophistication and technical knowhow.**

100 Q265 (Katinka Barysch)

101 Q17 (EEF)

102 Q267 (Katinka Barysch)

4 UK Trade and Investment with the A8/A2 Countries

70. UK exports to the A8/A2 have roughly doubled in value from around €5,500 million in 1997 to around €11,000 million in 2005. This figure represents about 2.25% of the UK's total export revenues.[103] UK exports to the A8/A2 have been increasing faster than UK exports to the EU as a whole, but growth in UK exports to the 'big three' of the Czech Republic, Poland and Hungary has been slower than the equivalent growth in German, French, Italian, Spanish or American exports to these countries.[104] Indeed, UK exports to the A8/A2 grew at less than half the rate of French and German exports to the same region in the period 1997-2005.[105]

71. UK stocks of foreign direct investment (FDI) in the A8 stood at £5,550 million in 2005, the vast majority in Poland and the Czech Republic. The A8 therefore accounted for just over 1.5% of UK FDI in the EU (a substantial increase on 1.09% the previous year) and 0.8% of UK FDI worldwide. Noticeably the UK was not one of the top three investors in any A8 country in 2004—despite being the largest single investor in the EU15—and its share of FDI in the A8 was the lowest of any EU15 member state.[106] A8 stocks of FDI in the UK totalled just £36 million in 2005, with investments from countries other than the Czech Republic, Hungary and Poland too small to be recorded in the ONS figures. To put this in context, Portugal alone invested £128 million in the UK in the same year.[107] Think London, the body responsible for attracting FDI into London, observed that it did not do enough business with the A8 to justify a response to our inquiry.

72. The British Chamber of Commerce in Hungary told us that the British presence was 'hardly noticeable' in terms of FDI flows into the country.[108] In part this is because UK investors had missed out on many of the large-scale privatisations of the 1990s—a message echoed in Lithuania and Slovakia. The Hungarian Investment and Trade Development Agency described UK investment in the Central and Eastern Europe region as 'moderate', accounting for just 1% of FDI stock in Hungary from EU countries in the period 2000-2005, despite the purchase of Budapest Airport in 2005.[109]

Missed Opportunities?

73. The extent to which UK business has missed out in Central and Eastern Europe varies from sector to sector. EEF told us that UK manufacturers had been slower than many of their major European competitors to move into Eastern Europe—not just countries like Germany with long established geographic, economic and cultural ties to the region but

103 Ev60 (DTI)

104 Ev99 (EEF)

105 Ev62 (DTI)

106 *Enlargement Two Years after*, p. 71; Ev 60 (DTI)

107 Office for National Statistics, *Foreign Direct Investment 2005*, http://www.statistics.gov.uk/pdfdir/fd1206.pdf

108 Ev74

109 Ev77 'Hungarian Investment and Trade Development Agency'

also countries like France, Italy and Spain. Nonetheless, they told us that interest in the region was increasing and that, whilst China still tops the list of locations where manufacturers want to invest, Central and Eastern Europe is now second.[110]

74. We were told repeatedly in all three countries that we visited that there were no major UK retail banks trading in the A8/A2—although there are some strategic partnerships between UK banks and banks in these countries. Several reasons were given for this, including the size of the market and fierce competition from other foreign owned banks. Businesses and officials we spoke to told us that a UK banking presence would assist UK companies—especially smaller companies—to enter these markets.

75. The evidence we received from various chambers of commerce suggested that there is a lack of knowledge about the A8/A2 countries among the UK business community. Greater Manchester Chamber of Commerce told us that UK business had been largely oblivious to opportunities in these countries until recently; meanwhile competitors such as Italy, Germany and France were actively involved in the A8/A2 countries long before they joined the EU, putting them several steps ahead of their UK competitors. Despite this, the Chamber identified an increasing interest in Central and Eastern Europe, citing for example a large scale investment by Vodafone in Romania in 2005.[111]

76. The Confederation of West Midlands Chambers of Commerce conducted a survey of their members which showed that 54% of those interviewed thought that the UK was not exploiting the opportunities offered by the accession of the A8/A2; we would be interested to know how many of these companies are involved in the A8/A2 themselves. They cited insufficient resources, time and knowledge as key reasons for this and perceived countries like Germany as having a more aggressive, government-supported trade strategy in the new EU member states.[112]

77. The British Chambers of Commerce accepted that “the UK and UK plc have been a little bit slow and little bit late in recognising the opportunities for exporting as well as other initiatives in Central and Eastern Europe. There is a certain amount of catch-up that has to take place to realise the massive potential which is growing [in these countries]”. They cited a focus among UK business on doing business with existing partners and neighbours, a lack of government support for opening new markets compared to countries like Germany and geographical factors as key reasons behind this slow start. They also referred to a lack of confidence among UK businesses leading to a “fear factor” which deters business from investing overseas in new markets.[113] Intellect told us that companies needed access to better information about business conditions in the A8/A2.[114]

78. The importance of being involved in emerging markets early was emphasised by those UK companies which had invested early—that is, during the 1990s—in the Central and Eastern European economies. For example, Tesco—one of the most successful British

110 Ev100-1(EEF); Q14 (EEF)

111 Ev105 (Greater Manchester Chamber of Commerce)

112 Ev85(‘Confederation of West Midlands Chambers of Commerce)

113 Qq184, 191 and 201; Ev72-73

114 Q154 (Intellect)

investors in the region—stressed the importance of the knowledge gained during thirteen years of operations in the A8/A2 countries.[115] We heard that in Lithuania the financial services market is dominated by Scandinavian institutions that entered the market in the period 1995-2000, heavily supported by their respective governments, making it difficult for new entrants to the market. Nonetheless, none of the people we spoke to believed that all the opportunities in these countries had been missed; rather that companies looking to invest or export would have to work harder to find new markets than they would in the 1990s.[116]

79. **There is a widespread belief among our witnesses both in the UK and overseas that UK businesses were slow to take advantage of the opportunities opened up by the ending of Soviet control of Central and Eastern Europe and the A8/A2's subsequent accession to the European Union. Whilst interest in some sectors—such as manufacturing—is growing and beginning to make an impact, it is clear that investing early in newly opened markets brings significant competitive advantages. This echoes the findings of our predecessor Committee in the 1997-1998 and 1999-2000 sessions. We were therefore particularly disappointed to find that many of the concerns raised in those Reports about UK reluctance to invest in or trade with the Baltic and Central European states were repeated almost word for word by our witnesses in this inquiry. In particular it is regrettable that the UK retail banking sector has failed to establish a presence in these markets.**

80. **In view of the evidence we received in this inquiry stressing the importance of being well informed and investing early in rapidly developing economies, we propose to conduct an inquiry into the future of trade and investment relations with Turkey.**

81. **During our inquiry we came to the conclusion that a major reason for the relative lack of UK investment and trade with the A8/A2 was an 'iron curtain in the mind' of UK businesses. We were particularly concerned to hear from the British Chambers of Commerce that many UK businesses lack the confidence to invest in emerging markets. Awareness of developments in Central and Eastern Europe appears to be lagging behind reality. This raises the question as to whether an organisation such as UKTI should entirely follow the priorities of business, or whether it should be more active in promoting areas where UK business may be missing out and educating them about the vibrancy, high skills and ambitions of many of these economies.**

82. **As with our previous inquiries into trade and investment opportunities in Mercosur, China and India we heard that other countries make more frequent use of Ministerial visits for trade promotion purposes. We believe that British ministers—especially those in trade promotion roles—should follow the example of our competitors and travel abroad more frequently to promote the UK interest. To assist in this, firm agreements should be established between government and opposition to ensure that ministers on trade missions should not have to return to the House to vote, other than in the most exceptional circumstances. In this context we welcome the current Minister for Trade Promotion and Investment's announced intention to spend**

115 Ev130 ('Tesco)

116 Q11 (EEF)

more time undertaking such overseas visits as a step in the right direction. We note, however, that many of our competitors more regularly use much more senior ministers, including prime ministers and presidents to lead trade missions and assist in the negotiation of major deals than is the tradition for British ministers.

Trade Promotion

83. We heard several times during our inquiry that UKTI resources were being diverted away from the A8/A2 as a result of them not being designated as ‘emerging economies’. **We are concerned that UKTI has adopted a ‘one size fits all’ approach to European Union member states—cutting back on resources in the A8/A2 at a similar rate to the resources in the EU15. The A8/2 are in many ways more accessible markets, especially for SMEs, than other rapidly growing economies. Nonetheless the lack of awareness of opportunities in these countries suggests there is still a significant need for advice and assistance over and above that which is required in more established markets. Although ‘emerging markets’ may not be the most appropriate term for these economies, we think there is a good case for some, or all, of the A8/A2 to receive priority attention from UKTI.**

Relocation

84. Since the opening of the Central and Eastern European economies, and particularly since their accession to the European Union, there have been a series of high-profile relocations of production facilities from the UK to the A8/A2 countries. This is particularly true in the manufacturing and automotive sectors. EEF evidence to us shows that 17% of surveyed UK manufacturing companies in 2004 who had located any production overseas had chosen new EU member states in Eastern or Central Europe.[117] The SMMT noted that passenger car production in Central and Eastern Europe had doubled over the period 1997-2005 and expressed the view that production would continue to relocate from the UK eastwards.[118] Our Report into the future of the UK automotive industry agreed with this assessment, concluding “we believe that the closure of car plants in Western Europe and the opening of up-to-date facilities in Eastern Europe, using cheaper labour, will continue.”[119] Media reports have claimed a significant negative impact on employment in certain areas of the UK caused by off-shoring production to Central and Eastern Europe. For example, earlier this year BBC Wales ran a documentary ‘Going East’ which claimed that 4,500 jobs had been lost in Wales due to relocation to Eastern Europe—a claim picked up in the local press.[120]

85. The European Commission report on the impacts of enlargement cites several studies that show a small negative impact (around 1% of all employment) in countries which have closer economic ties with the A8/A2, such as Germany and the Netherlands—an impact

117 Ev98 (EEF)

118 Ev128 (SMMT)

119 Trade and Industry Committee, Fourth Report of Session 2006-2007, *Success and Failure in the UK Car Manufacturing Industry*, HC399, para. 12

120 *South Wales Echo*, 22 May 2007,‘Jobs go east’

concentrated on lower-skilled, manual workers.[121] Studies also suggest that these countries have experienced a counteracting positive impact on employment as a result of increased competitiveness resulting from offshoring. For example, a survey conducted in Germany found that 20% of companies surveyed said they had shifted jobs eastwards as a result of enlargement but 60% of these companies said such investments had preserved jobs in their German operations by making them more competitive.[122]

86. Similarly, a research paper by two economists from the OECD concluded that the productivity gains and resulting job creation generated by offshoring were sufficient to offset the jobs originally lost in the 'home' country and, in some cases, result in a net increase in 'home' employment. This does not imply that the process is without cost to the domestic labour force; the authors concede that the additional jobs generated are likely to have higher skill requirements than those lost—increasing the value of the business and therefore the economy, but potentially excluding those who were affected by the original relocation.[123]

87. Intellect told us that, in their sectors, offshoring business functions to the A8/A2 countries is driven by the need to remain competitive by accessing a wider talent pool and reducing costs.[124] A report by the consultancy Ovum into the impact of offshoring in the software and IT industries found that onshore labour costs were increasing faster than market growth—a situation that they concluded was unsustainable. Ovum estimated that to remain competitive, the percentage of the workforce employed by UK-owned software and IT companies based overseas had to increase from 13% in 2005 to 26% in 2008—a total reduction in UK headcount of 21,000. Increased competitiveness would result in employment gains in the UK, but importantly—and contrary to the findings of the Hijzen and Swaim paper cited above—only 5,500 jobs would be created in this way, leading to a net loss of 15,500 jobs over the three year period.[125]

88. It was stressed in evidence to us that the accession of the A8/A2 into the European Union occurred over a similar timescale to the integration of China, India and other emerging economies into the world market.[126] The European Commission in its report on enlargement noted that the impacts of A8/A2 accession "mirror closely" those of globalisation more generally.[127] The House of Lords European Union Committee in its report on the possible further enlargement of the EU noted that the sectors which had come under most pressure from the addition of the A8/A2 were those which had also come under most pressure from global competition, including automotive, pharmaceuticals and ICT. They argued that "for the investing companies, the choice was not between producing in their home companies or in a cheaper location. The choice was between cutting costs or

121 *Enlargement Two Years after*, p. 74

122 Katinka Barysch (2006) *Enlargement Two Years On*, p. 14; Q 259 'Katinka Barysch'

123 Alexander Hijzen and Paul Swaim (2007) *Does Offshoring Reduce Industry Employment?*, pp. 19-20

124 Ev113 (Intellect); Q148 (Intellect)

125 Ovum (2006) *The Impact of Global Sourcing on the UK Software and IT Sector*, pp. 11-14 Note this does not take into account estimates of potential employment losses due to falling competitiveness.

126 Q259 (Katinka Barysch)

127 European Commission *European Enlargement Two Years On*, p. 57

losing market shares—and thus reducing employment at home anyway."[128] The British Chambers of Commerce agreed with this assessment; they told us that the key to ensuring that the UK did not begin to lose economically through offshoring was to maintain a competitive environment in the UK for the high-value-added aspects of production, design, research and development.[129]

89. **The accession of the A8/A2 has led some companies to move production and other business activities from the UK to these countries. This has led to concern that UK jobs are being 'exported' overseas. The evidence we received suggests that a degree of relocation has been necessary to maintain UK companies' competitiveness in the face of global competition and can be compensated for to some extent by resulting gains in employment in higher value-added areas of the same industry. Nonetheless, it is clear that some sectors—such as IT and automotive—are experiencing net reductions in their UK based workforce. We would welcome a comprehensive study into the net effects on UK business and employment of relocation overseas to inform public policy responses more accurately.**

90. **Although the A8/A2 have proved attractive locations for UK companies looking to offshore some of their business activities, the evidence we received suggests that the phenomenon itself was not a direct consequence of these countries' accession to the European Union. Rather, relocation overseas has been driven by global competition from a variety of locations—including the A8/A2 but also Asia and more widely.**

128 European Union Committee of the House of Lords, 53rd Report of Session 2005-2006, *The Further Enlargement of the European Union: Threat or Opportunity?*, HL 273, para. 81

129 Q187 (British Chambers of Commerce)

5 Conclusions

91. **We believe that the accession of the A8/A2 to the European Union has been beneficial to the UK economy and business, chiefly through the plugging of gaps in the UK labour market, but also through increased opportunities for exports and investment. Longer-term opportunities from migrants returning to their home countries after a period in the UK need to be thought through and explored more systematically.**

92. **We are concerned that many of the messages we have heard from other rapidly growing economies—such as Brazil or India—about UK business being slow to take full advantage of opportunities in rapidly growing markets apply equally to Central and Eastern Europe. Although we realise that not every company should invest in every country we believe that the Government should look seriously at what it can do to reduce the 'fear factor' of investing outside UK businesses' comfort zones. This is particularly true in the new member states, which are relatively accessible to small and medium-sized companies and could provide a way for such companies to 'cut their teeth' abroad. The opportunities in and challenges from these often highly skilled and ambitious economies need to be better understood.**

93. **This inquiry has reiterated the importance of improving the skills of the UK workforce if UK business wishes to remain globally competitive. The accession of the A8/A2 has eased the pressures generated by a shortage of skilled staff for many companies, but this should not distract either government or business from the longer-term task of improving the skills profile of the domestic workforce.**

Conclusions and recommendations

Migration

1. Worker Registration Scheme data are not a net measure of A8 migration nor are they a measure of the number of A8 nationals currently living in the UK. It is therefore a matter of serious concern to us that the Department of Work and Pensions has no better statistical source from which to gauge the impact of A8 migration to the UK. (Paragraph 9)

2. The lack of accurate or adequate information on the number of A8/A2 nationals working in the UK or from which countries they come is a matter of concern because of the consequences for wide areas of public policy. The available evidence suggests that Poles are the largest population, followed by Lithuanians and Slovaks. We recommend that, at the very least, the next census contain specific questions to ensure that more accurate data are available to enable the Government and the new Statistics Board fully to gauge the penetration of A8/A2 nationals in the labour market. We also recommend that the Government give urgent consideration to how it can improve the information it collects on A8/A2 immigration before the next census. (Paragraph 14)

Impacts of immigration

3. Our witnesses told us that the A8/A2 nationals who come to the UK to work tend to be the 'best and the brightest' and that their skills and work ethic are the major reasons why employers find them attractive employees. It is clear from the evidence we received that A8/A2 migration has helped plug skills gaps as well as alleviating labour shortages in certain sectors of the economy. (Paragraph 18)

4. A8/A2 migrants tend to find work in the UK for which they are overqualified. This could be said to have a negative impact on the economic efficiency of Europe as a whole—their home countries are losing skills and the UK is not maximising its advantage from them. Nonetheless there is some evidence that A8/A2 nationals who remain in the UK are starting to move into the higher-paid, more skilled jobs for which they are better suited. Whilst we welcome this, it has caused labour shortages in agricultural industries that had previously relied on Eastern European workers entering the UK through the Seasonal Agricultural Workers Scheme (SAWS). We find it remarkable in these circumstances that the Government is proposing to allow only Bulgarian and Romanian nationals to apply through SAWS. (Paragraph 21)

5. The evidence on whether A8/A2 migration has slowed wage growth in the UK economy is mixed. The Government suggests that it has had no discernable impact. Other studies suggest there may have been a slowing of wage inflation through an overall increase in the labour supply. The Low Pay Commission's report into migration in general concluded that a small decrease in wage growth at the lowest levels was more than compensated for by modest increases at higher levels of pay. What the studies that have found an impact agree on is that such impacts are small in the context of the whole economy. We do not rule out more significant impacts in

the context of specific sectors and we will be returning to this issue during our forthcoming inquiry into the construction industry. (Paragraph 26)

6. Concerns have been raised that employers may be less inclined to pursue recruitment strategies aimed at the long-term unemployed due to the presence of skilled Central and Eastern European alternatives. Nonetheless, we have seen no evidence to suggest that immigration from the A8/A2 countries since their accession has increased claimant unemployment in the UK. (Paragraph 29)

Overall impact

7. Migration from the A8 since 2004 has benefited the UK economy and UK business, chiefly by filling gaps in the labour market. The Government's decision to open the UK labour market to A8 nationals has been beneficial from a labour market perspective because it has allowed workers to move flexibly between sectors following employer demand. Nonetheless, the Government should be aware that this has created shortages of seasonal labour in agriculture, which had previously relied on labour from restricted migration schemes. (Paragraph 31)

8. We believe it is too soon to make a judgement on the decision to introduce restrictions on Bulgarian and Romanian nationals—but we note that countries in the A8 experiencing labour shortages are using labour from the A2 to plug those gaps. (Paragraph 32)

Exploitative Employment

9. Migrants from the A8/A2 countries should be clear that, as European Union citizens, they are entitled to the same protection in terms of the minimum wage, employment conditions, union membership and health and safety as a UK citizen. We encourage the Government to work closely with the A8/A2 nations to ensure that new and potential arrivals are made aware of their rights at the earliest possible opportunity. (Paragraph 36)

10. We note that whilst the Gangmaster Licensing Authority has helped address the problem of exploitative employment by intermediaries in the agricultural sector there are no similar arrangements in other sectors where intermediaries play a large part in recruitment. We recommend that the Government give urgent consideration to extending the Gangmaster Licensing Authority's remit. (Paragraph 37)

Long-Term Impacts

11. There is not enough data to make an accurate prediction of the numbers of A8/A2 nationals who will be living in the UK in the medium to long term; UK business cannot take this supply of skilled, willing labour for granted. Although A8/A2 labour has eased labour shortages in a number of sectors it is not a long-term solution to those problems. We recommend that the Office for National Statistics and its successor body investigate the returnee rate among A8/A2 nationals and that Government and business work together to ensure that a skills and labour vacuum is

not left behind when, and if, the flow of A8/A2 nationals to the UK slows or reverses. (Paragraph 42)

12. The presence of large numbers of A8 nationals in the UK and the goodwill generated in those countries by the opening of the UK labour market offer excellent opportunities for better business links between these countries and the UK, especially when, and if, those migrants begin to return home. Government and business need to develop strategies to maximise the UK competitive advantage gained from these returnees by, for example, ensuring effective British chambers of commerce are supported in these countries, developing cultural links and targeting UKTI resources. This is a significant and potentially highly beneficial long-term consequence of migration to which insufficient public policy attention has been given; greater attention should be paid to it if the advantages to the UK are to be maximised. (Paragraph 43)

EU Funding

13. The significant influx of EU money into the A8/A2 during the 2007-2013 funding period will provide excellent opportunities for UK companies—particularly in the fields of construction and financing. The ministers and officials we met during our visits indicated that they were determined to achieve the best value possible and would welcome British involvement in the resulting investment. We hope that the British government and business look seriously at the new opportunities that will arise from these developments. (Paragraph 47)

Labour Market

14. Our witnesses cited the labour market as one of the major attractions of the A8 as investment locations due to the strong work ethic and technical skills of the workforce combined with relatively low labour costs. The evidence we received suggest that it is no longer accurate to describe the A8 as 'low-cost economies'. Although average labour costs remain just over a quarter of those in the EU15, genuinely low-cost, low-skill production is already heading further east, to the A2, Ukraine and China where wage rates are much lower. Employers in the A8/A2 countries repeatedly stressed to us that skills, not wages, were the major reason for their presence in the A8/A2 countries. This was further reinforced by government officials and ministers from the countries we visited, who accepted that their countries could not compete on cost with China, India or other emerging economies. (Paragraph 55)

15. One of the major economic challenges facing the A8/A2 at present is a growing labour shortage in the areas most attractive to overseas investment. Foreign investment is often concentrated around the major cities, increasing demand for labour in areas with relatively small populations. Rather than move to the cities to meet this demand many A8/A2 nationals—and especially the most skilled—are choosing to move to Western Europe, in effect putting employers based in Bratislava, Vilnius or Warsaw in direct competition for labour with employers in London or Dublin as well as local rivals. In some areas and sectors—for example the Lithuanian construction industry or the highest levels of company management—we were told that this is pushing wage costs up towards Western European levels. The people we spoke to during our visits emphasised that these shortages were a real problem for new companies seeking to move into well established sectors. (Paragraph 56)

Transparency and Corruption

16. We commend the work being done by UK embassies in A8/A2 countries, for example in Hungary, to combat corruption. We recommend that the UK continues to be active through its embassies to assist national governments in building upon the improvements of the last ten years and further reducing corruption. (Paragraph 57)

Ease of Doing Business

17. As with any overseas market, the A8/A2 countries present a range of challenges to UK investors and exporters. Our witnesses raised concerns about complex, unfamiliar and slow administrative and legal procedures in many of the A8/A2 countries—although we note that similar concerns are also raised about some well-established EU15 countries. Nonetheless, we believe that in terms of high-growth economies worldwide the A8/A2 countries present relatively few barriers to entry and relatively few risks. Their relative nearness to the UK, membership of the European Union and open economies are key competitive advantages for the A8/A2 countries in dealing with UK business. (Paragraph 62)

Size of Market

18. Although the A8/A2 countries are relatively small when compared to the major emerging economies—both in terms of population and GDP—we were reminded that when these countries joined the European Union their combined economy was the size of the Netherlands; now Poland alone has a larger economy than that of the Netherlands and it buys £2.8 billion a year worth of UK exports—around the same as China. (Paragraph 65)

The Future

19. British government and business should be aware that the more forward-thinking A8/A2 countries are actively targeting high-value-added sectors such as biotechnology, ICT and pharmaceuticals and are seeking to attract research and development and other innovative investments—for example Samsung's and Kia's investments in Slovakia or GlaxoSmithKlein's vaccine research facilities in Hungary. This is both a significant opportunity for partnership—making use of the skills bases, newly built facilities and dynamism of these countries and the new opportunities that come with a developing market—and a potential competitive challenge for UK business in the longer term. UK policy makers need to recognise that in attempting to build an innovation-driven economy, our potential partners and competitors are not limited to the USA, France and Germany; the A8/A2 countries are increasingly becoming home to facilities of a very high level of sophistication and technical knowhow. (Paragraph 69)

UK Trade and Investment with the A8/A2 Countries

20. There is a widespread belief among our witnesses both in the UK and overseas that UK businesses were slow to take advantage of the opportunities opened up by the ending of Soviet control of Central and Eastern Europe and the A8/A2's subsequent accession to the European Union. Whilst interest in some sectors—such as manufacturing—is growing and beginning to make an impact, it is clear that investing early in newly opened markets brings significant competitive advantages. This echoes the findings of our predecessor Committees in the 1997-1998 and 1999-2000 sessions. We were therefore particularly disappointed to find that many of the concerns raised in those Reports about UK reluctance to invest in or trade with the Baltic and Central European states were repeated almost word for word by our witnesses in this inquiry. In particular it is regrettable that the UK retail banking sector has failed to establish a presence in these markets. (Paragraph 79)

21. In view of the evidence we received in this inquiry stressing the importance of being well informed and investing early in rapidly developing economies, we propose to conduct an inquiry into the future of trade and investment relations with Turkey. (Paragraph 80)

22. During our inquiry we came to the conclusion that a major reason for the relative lack of UK investment and trade with the A8/A2 was an 'iron curtain in the mind' of UK businesses. We were particularly concerned to hear from the British Chambers of Commerce that many UK businesses lack the confidence to invest in emerging markets. Awareness of developments in Central and Eastern Europe appears to be lagging behind reality. This raises the question as to whether an organisation such as UKTI should entirely follow the priorities of business, or whether it should be more active in promoting areas where UK business may be missing out and educating them about the vibrancy, high skills and ambitions of many of these economies. (Paragraph 81)

23. As with our previous inquiries into trade and investment opportunities in Mercosur, China and India we heard that other countries make more frequent use of Ministerial visits for trade promotion purposes. We believe that British ministers—especially those in trade promotion roles—should follow the example of our competitors and travel abroad more frequently to promote the UK interest. To assist in this, firm agreements should be established between government and opposition to ensure that ministers on trade missions should not have to return to the House to vote, other than in the most exceptional circumstances. In this context we welcome the current Minister for Trade Promotion and Investment's announced intention to spend more time undertaking such overseas visits as a step in the right direction. We note, however, that many of our competitors more regularly use much more senior ministers, including prime ministers and presidents to lead trade missions and assist in the negotiation of major deals than is the tradition for British ministers. (Paragraph 82)

Trade Promotion

24. We are concerned that UKTI has adopted a 'one size fits all' approach to European Union member states—cutting back on resources in the A8/A2 at a similar rate to the resources in the EU15. The A8/2 are in many ways more accessible markets, especially for SMEs, than other rapidly growing economies. Nonetheless the lack of awareness of opportunities in these countries suggests there is still a significant need for advice and assistance over and above that which is required in more established markets. Although 'emerging markets' may not be the most appropriate term for these economies, we think there is a good case for some, or all, of the A8/A2 to receive priority attention from UKTI. (Paragraph 83)

Relocation

25. The accession of the A8/A2 has led some companies to move production and other business activities from the UK to these countries. This has led to concern that UK jobs are being 'exported' overseas. The evidence we received suggests that a degree of relocation has been necessary to maintain UK companies' competitiveness in the face of global competition and can be compensated for to some extent by resulting gains in employment in higher value-added areas of the same industry. Nonetheless, it is clear that some sectors—such as IT and automotive—are experiencing net reductions in their UK based workforce. We would welcome a comprehensive study into the net effects on UK business and employment of relocation overseas to inform public policy responses more accurately. (Paragraph 89)

26. Although the A8/A2 have proved attractive locations for UK companies looking to offshore some of their business activities, the evidence we received suggests that the phenomenon itself was not a direct consequence of these countries' accession to the European Union. Rather, relocation overseas has been driven by global competition from a variety of locations—including the A8/A2 but also Asia and more widely. (Paragraph 90)

Conclusions

27. We believe that the accession of the A8/A2 to the European Union has been beneficial to the UK economy and business, chiefly through the plugging of gaps in the UK labour market, but also through increased opportunities for exports and investment. Longer-term opportunities from migrants returning to their home countries after a period in the UK need to be thought through and explored more systematically. (Paragraph 91)

28. We are concerned that many of the messages we have heard from other rapidly growing economies—such as Brazil or India—about UK business being slow to take full advantage of opportunities in rapidly growing markets apply equally to Central and Eastern Europe. Although we realise that not every company should invest in every country we believe that the Government should look seriously at what it can do to reduce the 'fear factor' of investing outside UK businesses' comfort zones. This is particularly true in the new member states, which are relatively accessible to small and medium sized companies and could provide a way for such companies to 'cut their teeth' abroad. The opportunities in and challenges from these often highly skilled and ambitious economies need to be better understood. (Paragraph 92)

29. This inquiry has reiterated the importance of improving the skills of the UK workforce if UK business wishes to remain globally competitive. The accession of the A8/A2 has eased the pressures generated by a shortage of skilled staff for many companies, but this should not distract either government or business from the longer-term task of improving the skills profile of the domestic workforce. (Paragraph 93)

Formal minutes

Tuesday 9 October 2007

Members present:

Mr Peter Luff, in the Chair

Roger Berry
Mr Brian Binley
Mr Peter Bone
Mr Mark Hunter
Miss Julie Kirkbride

Draft Report (Europe Moves East: The Impact of the 'New' Member States on UK Business), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 93 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Eleventh Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Thursday 18 October at 9.15am]

Witnesses

List of written evidence

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2006–07

First Report	Local energy—turning consumers into producers	HC 257 (HC 494)
Second Report	Work of the Committee in 2005-06	HC 332
Third Report	Stamp of Approval? Restructuring the Post Office Network	HC 276 (HC 593)
Fourth Report	Success and failure in the UK car manufacturing industry	HC 399
Fifth Report	Better Skills for Manufacturing	HC 493-I
Sixth Report	Marketing UK plc—UKTI's five-year strategy	HC 557
Seventh Report	Trade with Brazil and Mercosur	HC 208-I
Eighth Report	Restructuring the Post Office Network	HC 593
Ninth Report	Recent developments with Airbus	HC 427
Tenth Report	Strategic Export Controls: 2007 Review	HC 117

Oral evidence

Taken before the Trade and Industry Committee

on Tuesday 5 June 2007

Members present

Peter Luff, in the Chair

Roger Berry	Mr Lindsay Hoyle
Mr Brian Binley	Mark Hunter
Mr Peter Bone	Judy Mallaber
Mr Michael Clapham	Mr Mike Weir

Witnesses: **Mr Stephen Radley,** Chief Economist, and **Ms Lee Hopley,** Senior Economist, EEF, the Manufacturers' Organisation, gave evidence.

Q1 Chairman: Thank you very much indeed for being our first witnesses in a formal evidence session on this Committee's inquiry into Europe moves East. We have already made one visit, as part of our inquiry, to Lithuania, and we have taken some formal evidence from others as well, but this is the first formal session. Thank you for your characteristically cogent and well-argued evidence, which we are used to, and we are very grateful for it once again. Can I begin by asking you to introduce yourselves?
Mr Radley: I am Stephen Radley; I am Chief Economist to the EEF.
Ms Hopley: Lee Hopley, Senior Economist at EEF.

Q2 Chairman: Thank you very much for coming here. Can I ask you a very general question, really, but it is, in a sense, the key question: your evidence is spent discussing the threats and opportunities from the new entrant countries. What do you believe are the most important threats and opportunities for the people you represent in our relationship with those countries?
Ms Hopley: If we look back to just before the accession countries formally became Members of the European Union, there was quite a lot of talk about the threats and opportunities for the UK manufacturing sector in terms of competition for foreign direct investment, competition for export orders and concerns about a mass exodus of manufacturing to these lower-cost economies. Broadly speaking, none of that has really materialised. The opportunities came from access to faster growing markets for manufacturers, certainly faster growing than the traditional Western European markets, and that is providing an opportunity that has been realised; exports to the new EU countries have grown quite a bit faster to the more traditional Western European markets. There have also been opportunities in terms of off-shoring, both locating manufacturing or just from a sourcing point of view, and opportunities for cost-cutting or relocating, perhaps, the non-core functions within a business. It is difficult to look at manufacturing as a whole, in answer to that question. Certainly, some sectors have been affected by EU expansion more than others—motor vehicles is probably quite a good example. Central and Eastern Europe has become something of a hub for automotive production and many of the international major car producers are located there, and that has had implications for suppliers based in the UK. I think there are still opportunities there for the taking, both in terms of off-shoring and exporting.
Chairman: That is very helpful. We will flesh that out, obviously, in more detail during our further questions.

Q3 Roger Berry: So some of the threats that people suggested did not materialise but there have been significant opportunities. Does that mean that, overall, you think the recent accessions have been a benefit to British manufacturing?
Ms Hopley: I think, on balance, the opportunities from trade have been important. Increasingly, manufacturers are dependent on export orders, and the rapidly-growing world economy in recent years has been a benefit, and I think the new EU Members, operating within a similar regulatory framework has offered opportunities—again, for some sectors more than others.

Q4 Roger Berry: You have mentioned the demand side. Clearly, greater access to a market where demand is growing more rapidly than in the UK is a benefit. You did not mention the supply side very explicitly, in the sense that it is also the case that where you have access to a wider market you increase the competition, increase the supply. Has that, for manufacturing as a whole, not caused significant difficulties? Competition with manufacturing produced by low-cost labour, and so on and so forth?
Mr Radley: It is very difficult to take these things in isolation. If you look at the last few years, certainly from the start of the decade manufacturing has been under a lot of pressure and has been changing a great deal over that period. Probably just as significant has been the rise of other low-cost countries, such as India and China. Manufacturing has had to address the issue of being stronger against other currencies—

to start with the euro and, more recently, the dollar—and also it had to cope, in the early years of the decade, with a downturn in world markets. So there has been a lot of forces which have been changing the pressures that manufacturing is under, and has forced manufacturing to change. You cannot really look at what is happening in Eastern Europe in isolation. What we have found is that in response to a range of these pressures, including increasing competition from Eastern Europe, manufacturing has reoriented its activities. It has looked at different ways to reduce its costs (part of that has come through investing abroad); it has embraced more fully modern manufacturing techniques, such as lean manufacturing, but, also, more fundamental changes—a lot more focus on innovation and getting into niche markets as well, where there is perhaps less intense competition on price, and a range of other factors as well.

Q5 Roger Berry: Do you see this general picture changing over the next five, ten, or 15 years? You have given reasons why the impact thus far may well have been quite positive. Do you see things changing in the future?
Ms Hopley: Certainly the larger Eastern European economies are trying to move more towards an innovation-led manufacturing strategy. The question there is the timescales over which it will succeed. At the moment, R&D intensity is low compared with Western Europe and the UK, and also they do not compare that favourably on other innovation indicators, such as proportion of those in the workforce with a higher education, for example. So they are moving in that direction and certainly policy is trying to encourage foreign direct investment not just in the production side of things but, also, in the innovation side. It is a question of over what timescale those policies will be successful.

Q6 Mr Weir: One of the things that has always concerned people, perhaps, is migration from the accession countries to the UK. Manufacturing has been the second-largest employer of workers entering from the new Member States. Can you tell us what impact this migration has had on the UK labour market in manufacturing?
Mr Radley: I think the starting point is, probably, just to look very quickly at the impact it has had on the UK economy. We would say that, on balance, it has had a beneficial impact because access to more workers, and often very skilled workers, has allowed the economy to grow at a faster rate without problems of wage inflation taking off and interest rates needing to rise. That helps manufacturers because it has meant that they have been selling into a stronger growing domestic economy. That has been one positive point. I think, in general, you obviously have to look at the number of workers that have come from the accession countries into manufacturing, and we are looking at round about—certainly on the official figures for registered workers—an extra 25,000 people a year between 2004 and 2006, which is not tiny but is still fairly small in relation to the overall size of the manufacturing workforce. So you have to bear that in mind. Certainly, if you look at the figures, and we have had a lot of conversations with members on that, they have actually said this has given them access to some very skilled workers with very good working habits, and also, probably, in parts of the country—particularly the South East where the problems are just as much labour shortages because the labour markets are so tight—as skills gaps. It has often helped to plug a gap there as well. I think what is clear is that, although it has actually helped to fill some skills gaps in manufacturing and helped manufacturers expand when they might otherwise have been somewhat constrained by skills or labour shortages, it is not a long-term solution to the problems and we still need to put more emphasis on getting more skilled people coming out of schools in science and technology subjects and actually helping manufacturers to develop more effective training, but it has certainly made the situation better than it would otherwise have been in the short term.

Q7 Mr Weir: Would it put off the evil day when manufacturers have to invest in more training?
Mr Radley: Well, our evidence is that manufacturers invest significantly in training. I think the problem is that often the investment is not as effective as it could be and we need to take steps to address that.

Q8 Mr Weir: When we were in Lithuania, we were told that some 15% of the population was now working overseas since accession and it is causing problems in Lithuania with skills shortages in reverse, if you like, and a rise in wages. You say it has helped the UK economy, but is there a danger of people being sucked back to Lithuania with the changing economic situation there and in other accession countries?
Ms Hopley: I have to say, I do not know.

Q9 Mr Weir: Finally, obviously in the last enlargement the UK put quotas on the number of people who could come to work from Romania and Bulgaria. Do you think in these circumstances they were right to do so?
Mr Radley: I think that what is sensible is to have some sort of priority system where you actually give greater priority to those workers that have skills that are in greatest demand, and I think that makes absolute sense for economic reasons. Beyond that, I think you are really looking at reasons of social policy, which we may all have a view on in terms of social cohesion and things like that, but probably that is not particularly the subject of our evidence.
Chairman: Of course that is to put limits on a free labour market, which the European Union is supposed to be.

Q10 Mr Clapham: Obviously your focus has been on engineering, but have you looked at any of the studies which have been done on other sectors? There is, for example, in construction a fear that what is happening is a casualisation in that industry.

Is that something that you have looked at and is there any indication that that type of casualisation is also sort of affecting manufacturing generally?
Ms Hopley: I do not think that is something we have picked up.
Mr Radley: I think we would find it surprising if that was happening because everything that we are actually picking up from the survey evidence we have done and from detailed discussions with members is that manufacturers are shifting upmarket and they are looking at producing high-value-added goods and that means that they need more skilled workers and that tends to require long-term investment in a long-term relationship with those workers rather than actually a more casualised approach where you take people on as and when you need them and then let them go again. Certainly we have picked up nothing which suggests we are going in that sort of direction in manufacturing.

Q11 Mark Hunter: I would like to ask you about comparisons with other Western European countries because the evidence that you have submitted to us implies that businesses from other Western European countries are better established in these Central and Eastern European Member States than the UK is. If this is the case, of course then we have the prospect of UK entrants, as it were, having to overcome well-established competitors in order to enter these markets. Could you tell us a little bit more about your view in this area and whether you think that the UK has missed the boat when it comes to exports and investment in the A8 and A2 countries particularly?
Mr Radley: I think it would be true to say that we have been slow off the mark, but I think it is a bit alarmist to say that we have missed the boat. Certainly if you look at the share of our exports going to the new members of the EU and also the Eastern European countries that are outside the EU at the moment, we are behind many of our European competitors, and that is concerning. I think if you just made a simple comparison with Germany, you would regard that as something of an unfair comparison because clearly Germany borders some of these countries and has got strong historical links with them. I think it is worrying that we are behind some of the other countries, such as France, Italy and even Spain, and that is clearly something we need to address. I think what is encouraging though is the most recent survey evidence that we have got has shown that there has been a big increase in interest amongst manufacturers in exporting to Eastern European markets, both within the EU and also outside the EU, so we may have come rather slow to the party, but it looks as though manufacturers are getting involved now. What our evidence also does suggest is that companies have low levels of experience in these markets, so that actually does put a premium on good-quality information provided by organisations like UK Trade and Investment.

Q12 Mark Hunter: So slow off the mark then rather than having missed the boat completely. You also raised concerns in your evidence submission that trade promotion strategies prior to the 2004 accession did not do enough, I think the words were, to ensure that the UK made the most of its opportunities in the region. Do you have any specific observations you would like to make about policy at that time and, perhaps more importantly, what implications are those lessons for today's trade policy?
Ms Hopley: This was also something that was picked up by this Committee in the late 1990s when there was a feeling that the Trade Promotion Board at the time might have been a bit slow in promoting the potential opportunities because the restructuring of these economies occurred long before they actually joined the EU. I think there might potentially have been more of a focus on promoting opportunities further afield in Asia and the Far East at that time, and there might have been reasons for that. If you look at the size of the A8 when they joined, their economy was only about the same size as the Netherlands', so that might have been one of the factors behind that. I think there probably are lessons for the future, depending on Turkey, which is potentially going to be joining at some point in the future, and how the opportunities and threats are promoted in advance of its membership. There are not any other sort of large economies that are probably going to join in the next five to ten years other than Turkey.

Q13 Mark Hunter: I do not want to over-labour this point, but could you just say a little bit more for me specifically about what you think the lessons are for today's trade policy, bearing in mind the mistakes of the past.
Mr Radley: I think one point we would want to make is that overall we have actually found that the new strategy which was developed by UKTI last year is a very sensible one and I think it has put more emphasis on the companies that are really going to be able to sell innovative products in world markets and really make a difference to our trade performance, and it has put more emphasis on emerging economies. I think what we are concerned about is that, although it is right to pay a lot more attention to China, India and possibly other major economies, such as Brazil, it still seems as though Eastern Europe is not getting the attention it deserves, so I think what is absolutely vital is that we address that immediately.

Q14 Chairman: There are wry smiles around the committee table. We have a report coming out tomorrow on the UKTI strategy and one next week on Mercosur Brazil, and some of these issues will be addressed, so I hope you are saying it is consistent with what we say in those reports. Before we move on, there is a very interesting table in your evidence, figure 6, from a survey in 2003 about UK companies viewing different parts of the world as better investment opportunities, and it shows that Britain has a particular interest in China and significantly

less interest in Central and Eastern Europe. It is dated 2003 and quite a lot has happened in our discussion of these issues in the last three years, so have you got more up-to-date information or is there more in the pipeline that is coming because not everywhere can be a priority for the British Government or for British business? The world is bursting with opportunities and everybody wants us to be there, it is very flattering, but we have to make these choices, so this is a very useful piece of information for the Committee.
Ms Hopley: We used this table to highlight the difference between UK companies' views of Central and Eastern Europe relative to French and German companies' and a sort of higher degree of interest in China. Since then, we have definitely seen a shift in interest. We have got a survey coming out probably in the next month or so which looks at investment intentions abroad. China is still at the top, but Eastern Europe is now second.

Q15 Chairman: So it will be out within the month, do you think?
Mr Radley: Roughly. What it in particular shows is that it looks at a range of activities that manufacturers are conducting and the area which is, not surprisingly, most likely to see some investment abroad is production and assembly and, if there is going to be any movement out of the UK as a primary location, it is more likely to move to Asia, but there is more of a focus on Eastern Europe than there was before.
Chairman: We look forward to seeing the details of that survey when it is published.

Q16 Mr Hoyle: Historically, government initiatives have been better placed towards Asia and the attraction has been pushed that way, and that has been the problem. Unfortunately, Eastern Europe has had better relationships, for whatever reason, with Germany—geographical or the language barriers have not been as bad. I just wonder what your views are, that the Government's emphasis has always been "Look at Asia, much bigger." Jetco agreements have been with India and China and, really, we have not pushed the boat out in the former Eastern Bloc. Would that be fair to say?
Mr Radley: I think that is right. However, even if you look in detail at Asia, we have done well in some markets, such as India and Hong Kong, compared with our competitors, where we have historical ties, and less well in China. Even in Asia, it is not a simple picture. The thing is we probably do need to pay more attention to Eastern Europe but what we always have to bear in mind is that companies invest abroad for a range of different reasons; they can be reducing costs, they can be market entry, it can be getting more flexibility, it can be access to specialist skills and facilities. What you need to do is provide information and promote a range of different markets and locations rather than loading all your eggs into just one or two baskets—and maybe we have been rather guilty of that in the past.

Q17 Judy Mallaber: A couple of times you have referred to the fact that some of the A8 states are looking to move more into the innovation area in their own economies, to the higher value end of the market, R&D, and so on. However, you have been studiously neutral in terms of whether you think they will succeed in making it. Can you come off the fence and say what your estimate is of how likely it is that those countries will be competing, either medium or long-term, with the UK at that high value end?
Ms Hopley: I think they will be successful eventually, but perhaps the prospects for the Czech Republic, or the Slovak Republic, will be faster than Bulgaria or Romania. If you look back at previous enlargements, such as Spain and Portugal, which were relatively low-cost compared with existing Members at the time, they still have not achieved the sort of innovation-led growth that France and Germany have, and they have been members of the EU since the late-80s, early-90s. So I think success will come but it is a question of timescales, and it will be different for each of the A8. There are issues, particularly for some of the smaller economies, in just having the critical mass of talent to engage in basic scientific research.

Q18 Judy Mallaber: How much information do you have from your surveys and data of where different countries are at in terms of making those developments? Do you feed that back to your own members?
Ms Hopley: Yes, our study was actually carried out by the World Economic Forum looking at innovation in the EU25. On every case, all the accession countries came lower than the EU average and Western European economies. That is something that we highlight to members, with a footnote that this is going to change because they are putting efforts into attracting international R&D investments, and they are putting money into their science base and their infrastructure.

Q19 Judy Mallaber: Which particular sectors are we looking at? Do some stand out more than others?
Ms Hopley: Different countries are focusing on different sectors. I would have to get back to you, but Hungary have outlined which particular sectors they are interested in in attracting R&D. I think biosciences is one of them and electronics maybe as well, but I would need to double-check that.
Chairman: That would be helpful because we are going to Hungary in a couple of weeks' time, so it would be nice to have information before we go, so we can talk about it with more knowledge. I think I have committed the unforgivable sin of rather anticipating my colleagues' questions, but Brian Binley is next.

Q20 Mr Binley: I have just returned from three days in Romania—22.3 million people, a growth rate of 8% and a traditional trading partner with Britain before the War, actually—and they say they are crying out for Britain to be involved. My question, really, is about how you see that sort of involvement,

because we have heard some stuff from you but why are we not there in greater force? Why were we not there in greater force ten years ago?
Ms Hopley: In Romania?

Q21 Mr Binley: Yes. The same could be said for a number of other Eastern European countries. The question is just the same: why were we not there?
Mr Radley: I think quite a lot of the answer relates back to what we have been saying already, that much of the support of information and advice from UKTI or (its previous name) British Trade International under-emphasised the opportunities that there were in many parts of Eastern Europe. There may also have been an issue, certainly in the early part of this decade, that because of the many pressures that manufacturers were under, in terms of recessions in the markets that we are selling into, and also cost pressures caused by currency, for many companies it was a fight for survival in the early years of this decade, and that may mean that they were not able to pay sufficient attention to investing in some of these new opportunities.

Q22 Mr Binley: If I gave you the name of the economic adviser to the Prime Minister, who said: "Please pass this message on to people in England", would you take it up?
Mr Radley: As part of what we do, we are just publishing a report for companies about both the trade pressures and, also, the investment opportunities around the world presented by these emerging economies, and we are actually running a number of seminars and events for them as well. So it is something we could look at.

Q23 Mr Binley: I am going to send you his name and see what happens. We will have a look at what happens in three months' time. Let me come on to what people say. The London Chamber of Commerce suggested, in relation to not exploiting our opportunities: "The UK needs more missions to these markets, especially for potential new exporters, but they are also needed for manufacturing too." The Edinburgh Chamber of Commerce said: "The correct type of market information is what we are often told is missing and maybe we should be structuring our market information in a format that meets the needs of specific economic ambitions rather than a holistic presentation". That leads me on to the question of whether UKTI should be prioritising these in a much more robust way and whether the information that you are getting as a feedback from that whole process is simply good enough.
Mr Radley: I think we have already said that, perhaps, we have in this country neglected some of these market opportunities in the past, but I think it is not that healthy to keep dwelling on the failings of the past, and we should look at what we need to do in the future. Certainly what we find from our own research and talking to companies is that the things that are really valued include the specialist knowledge that the consulates and embassies have on the ground and that they are able to provide to companies. We really need to ensure that we continue to invest in them. What is very helpful from what UKTI are seeking to do now is actually put more resources on the ground rather than having people located in the UK shifting the balance. What else companies say is an absolute priority is good quality information and research. Companies are willing to pay for this if it is provided and it is of good quality. Again, it is sensible that UKTI are moving to a strategy of actually charging for some of this information. That will be helpful, it will enable them to invest in and expand the quality of what they do. Looking into the medium term, you have to look at whether the private sector should be playing a greater role in providing some of this information and advice, and I think we need to look at ways to do that.

Q24 Mr Binley: I am glad you have turned to that, because it seems to me that British industry has lost all the entrepreneurial flair that it used to have when it went out and conquered the world. I think we got boring, I think we got complacent, and I feel that in the papers I have received here there is a moaning about everybody else but no responsibility placed on the manufacturers and the commercial enterprises themselves. Is that fair?
Mr Radley: I think some of those criticisms may have had some degree of truth in the past, but what you have seen in the last four or five years is that manufacturing has changed significantly. Those companies that went through the horrendous experience of the early decade and have come out of it the other end have realised they have needed to change, and they are doing a range of different things now, putting more emphasis on innovation, developing niche products, earning more revenue from services, but also they are being forced to look at developing a greater range of markets abroad. Our most recent evidence suggests that for 37% of companies in our membership exports are more than half of their markets. Clearly, if you are going to be that dependent on exporting you cannot just rely on the mature markets of the United States and Western Europe; you have to look all around the world to develop all the different market opportunities that are there, if you are going to see growth in your companies. That is what we are finding the majority of our members are doing now.

Q25 Chairman: What you have actually said, I think, in part, in answer to Mr Binley's challenging questions is that actually British business does, to a significant degree, take its lead from UK Government advice as to what markets it should exploit. I find that genuinely fascinating and, actually, rather surprising. It proves you need UKTI but it rather suggests that Mr Binley is right, that perhaps we are not being quite entrepreneurial enough in our relationship with the world.
Mr Radley: What you probably need to look at is how this differs by size and type of company. The issue is that for the smaller companies—and there are a lot of them now—it can be difficult for them. They can get some information but it can actually be

difficult for them to get the specialist information that Governments are offering in a privileged position.

Q26 Chairman: So small businesses trust government—shock, horror.
Mr Radley: On this issue they do.
Chairman: I will not pursue it. It is very interesting. Thank you.

Q27 Mr Bone: What I do not understand is why we are investing and training heavily with China, which is a long way away and has a Communist regime, so who knows what is going to happen, yet we have these countries in Central and Eastern Europe who are right on our doorsteps, which are democracies and where economically there are no trade barriers. I cannot understand why we are not doing better, relative. Is it the fact that there still is the concern of the Russian Bear or the fact that their energy supplies can be switched off? Logically, we should be much, relatively, stronger in Europe than we are investing all that many thousands of miles away in China.
Ms Hopley: Exports to China account for 1.5% of total UK exports. I do not think that should be overstated, but I think companies are taking out—

Q28 Mr Bone: I am sorry, I meant it the other way round. We are investing in China, for instance, and importing back to us. More logically, we should be investing in Central Europe, part of the EU. There does not seem a logic why it is the other way round.
Ms Hopley: I guess that very much depends on the product. In some cases it is just as cheap to source from Central and Eastern Europe once you have factored in things like lead times, transport costs and logistics, and in other cases it is not. Labour costs in China are a mere fraction of even what they are in Eastern Europe. So I guess it depends on the product strategy. In some cases it may make sense to go to somewhere like China, India or Vietnam, and in others, where there is, perhaps, a higher specification, or where you have concerns over intellectual property protection, Central and Eastern Europe does make more sense.

Q29 Mr Bone: With the single market and the fact that all the economic advantages are there, we are not using the EU to our greatest benefit whereas some of our continental cousins are much better at it.
Mr Radley: If you look at the statistics, combining the accession Members of the EU and, also, other parts of Eastern Europe that are outside the EU, our exports to those markets are over two times our exports to China and India combined, so it is not as though we are neglecting those markets. Also, when you talk about investing abroad, as I said earlier, it is not just about sourcing low-cost products, it is also about investing in these markets to be well-placed as they show strong growth. I think for many companies China is going to be one of the most exciting markets. It is a huge population with very rapid economic growth, so for many of them it would be an absolute mistake not to be in China.
Chairman: Was I not concentrating properly? Did we ask about energy security?
Mr Binley: Well, I dropped it in and it was rather rolled over. I suggested was it the fear of Russia, the fact that they can turn the energy supplies off, and it was sort of brushed past really.

Q30 Chairman: Exactly.
Mr Radley: I think for some manufacturers the fear of energy security in the UK has actually been affecting their investment decisions in the last few years, but hopefully that has been addressed now. We have not asked any specific questions in any of our surveys about whether energy security has affected companies' attitudes towards investing in Eastern Europe, but I think a parallel question which was actually asked about export opportunities to Eastern Europe has actually shown growing interest in selling to Eastern Europe over the past few years at a time when clearly worries about energy security have grown, so it does not seem as though our member companies are viewing concerns over energy security as something that is actually going to undermine the dynamism of economies in Eastern Europe.

Q31 Mr Binley: Or the influence of Russia?
Mr Radley: No.

Q32 Mr Clapham: Could I just refer to your submission because there is a very interesting point and I want to develop it. In paragraph 7, you say, "Nevertheless, our survey earlier this year showed that more companies see the potential for growth further east. Almost 40% of respondents cited the non-EU countries of Eastern Europe (including Turkey, Russia and other EU applicants)", and that compared with 30% of companies seeing future growth in the new EU members. Then at paragraph 10, you say, "Interestingly, these smaller companies expressed more interest in the growth potential of Eastern European economies outside the EU", so your submission tends to suggest that the smaller companies are looking for growth outside the new EU entrants. There is there an indication of entrepreneurship and they are looking at Russia and at Turkey. Why is it that it is the smaller companies that are looking at that kind of expansion?
Mr Radley: If you look at the responses to the survey, the high level of interest in Eastern European countries outside the EU is across the board of all firm sizes. All firm sizes see more opportunities outside the EU than within the EU. I think there is probably an issue for smaller companies in that they are seeing that perhaps some of their larger, more established competitors have got into the new EU countries already, so they are looking a bit further, saying, "Well, where are the big opportunities for us to get into which have not been covered adequately by other companies already?", and they are looking a bit further afield at Eastern European countries that are outside the EU.

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Q33 Mr Clapham: Is there any indication that UKTI, for example, is assisting those companies that want to explore the market, shall we say, outside the EU?
Mr Radley: Yes, there is. Are you talking about small companies here?

Q34 Mr Clapham: Well, the smaller companies.
Mr Radley: UKTI provides a lot of help within the UK in terms of helping these companies become export-ready and it provides sort of fairly general information, but then there is specialist information—

Q35 Mr Clapham: But are they giving direction to Eastern Europe outside the EU?
Mr Radley: No, I do not think there is any specific assistance, saying, "Don't think of the EU, think outside the EU". I do not think there is any specific direction that has been given.

Q36 Mr Clapham: So what we are saying is that there is the potential for growth there and companies see that, and UKTI is encouraging, but yet there is more needed to give those companies a push to get into those new markets?
Mr Radley: I think the thing is that a significant minority of companies are doing this for themselves and they are being forced to look at a range of different growth markets around the world because the opportunities to sell to major customers in the UK are less than they were before, so the process is already happening. I think probably what can happen is that UKTI, by providing good-quality, specialist information, helping companies developing contacts, can give this a further push and add a little bit more momentum to it.

Q37 Mr Hoyle: My good friend next to me, Mr Clapham, did mention countries like Turkey which are probably into the next EU enlargement, and there are a lot of aspirant countries out there who still wish to join. Can UK business and the Government learn anything from the 2004/07 enlargement when we are looking forward for business? What lessons can we learn from the failings we have previously had?
Mr Radley: Can you be a bit more specific? Are you thinking in terms of advice?

Q38 Mr Hoyle: Advice and how we can make benefits. What we have said is that we have already been through the issues and previously we missed out, did we not, and we did not invest when we should have done, did not take up the opportunities that were there, so what can we do next time round when we have an EU enlargement? Is there anything that we can learn from our previous mistakes, just generally?
Mr Radley: I think one thing to learn would be to act absolutely now because a lot of the restructuring and privatisation and all the opportunities that will be created are happening now and they happen well in advance of any countries joining the EU, so I think that would be the key point we would want to make.

Q39 Mr Hoyle: So get in now?
Mr Radley: Yes.

Q40 Mr Hoyle: Is that fair to say?
Mr Radley: Yes.

Q41 Mr Hoyle: Is that the same for Turkey?
Ms Hopley: I think there is already quite a lot of UK firm activity in Turkey at the moment. There are still many opportunities to highlight and in many industries they are going through the privatisation process at the moment, so that is an area that UKTI should be aware of and making firms aware of.

Q42 Mr Hoyle: So you accept that Turkey will actually get into the EU?
Ms Hopley: Well, I think whether it does or does not, it is the fastest-growing OECD country at the moment. It is in a good location, bridging Europe and Asia, and there are opportunities there. It has a large, fast-growing, young and low-cost labour force, so whether it becomes an EU member over the next couple of years or further out, it is still a location that our firms should be aware of.

Q43 Mr Hoyle: With or without joining the EU?
Ms Hopley: I think it is potentially an important market, yes.
Mr Hoyle: I agree with you.

Chairman: I am surprised Mr Bone is not challenging you on how British businesses are much more into the non-EU members than the EU members!
Mr Bone: It is obvious!

Q44 Chairman: You put at the end of your submission to us a very helpful chart about corporate tax rates, but you do not say a great deal about it in your written submission. In the political debates within the UK, a lot of attention is often paid to Britain's competitiveness in terms of corporate tax rates. We heard when we were in Lithuania that they are modelling themselves on Ireland's policy of low corporate tax rates. This inquiry is about the impact on the UK of the new Member States, the eight or the two, the recent ones. How concerned should we be about the fact that, according to that schedule, the UK is unique in not having reduced its corporate tax rates or is it not a matter of concern?
Mr Radley: Clearly more recently it has. I think what we would want to stress is that it is not just the corporation tax rates that we need to look at, but it is the overall tax burden on business and certainly for manufacturers a big issue in recent years has been the rise in taxation that adds to their costs before making profits, so those would cover national insurance, business rates and environmental taxation, so we want to address taxation in the round rather than just looking at corporation tax. I think on corporate rates in particular, there is clearly evidence that it does affect international decisions and it certainly would be a significant concern if our corporation tax rates were to get out of line with

many of our competitors'. I think in terms of offering any more definite conclusions than that, I would draw your attention to the fact that we are actually doing a piece of work at the moment that we will be publishing ahead of the pre-Budget, and I would like to slightly hold our fire on that one.

Q45 Chairman: Finally, I have heard some British businesses in the Midlands, manufacturers, who have said that they would actually rather we deregulated than cut tax rates to make us competitive with these new economies. For them, regulation is more important. Within the European Union, is there scope for significant deregulation or should we actually look to be racking up the regulatory burden on these Member States to counterbalance competitive issues that way?
Mr Radley: I think the ultimate issue is not either/or, but we have to pay attention to producing regulation and producing better-quality regulation just as much as paying attention to the competitiveness of our tax system. I think also what we are finding from our research on tax is that it is not just the issue about the level of taxation, but it is the level of regulatory burden that is associated with taxation.

Q46 Chairman: The complexity of the tax system?
Mr Radley: Yes.

Q47 Chairman: Well, we could explore this at great length, but my colleagues on the Labour side of the House are flying away to a hustings meetings for the deputy leadership of their Party, so we must draw matters to a conclusion here, but we really are extremely grateful to you for your very clear evidence and some very helpful insights during this oral session. If there are things that you would like to tell us on reflection, please get in touch with us, and we are waiting for the new survey which comes out in about a month or so's time. That would be very helpful.
Mr Radley: We will give you that.
Chairman: Thank you very much indeed.

Tuesday 12 June 2007

Members present

Peter Luff, in the Chair

Roger Berry	Miss Julie Kirkbride
Mr Peter Bone	Judy Mallaber
Mr Michael Clapham	Rob Marris
Mr Lindsay Hoyle	Mr Mike Weir
Mark Hunter	Mr Anthony Wright

Witnesses: **Mr Peter Dodd**, Director, International Economics, Department of Trade and Industry, **Mr Jonathan Portes**, Chief Economist, Work, Department of Work and Pensions, and **Mr Ken Timmins**, Director, Developed Market, UK Trade and Investment, gave evidence.

Q48 Chairman: Gentlemen, welcome to the second evidence session of this Committee's inquiry into the consequences of the eastern enlargement of the European Union. I understand you are a triumvirate and there is no *primus inter pares* among you, so I have already emphasised that it does not need everybody to answer each question. Can I, as I always do, begin by asking you to introduce yourselves, perhaps in alphabetical order?
Mr Dodd: My name is Peter Dodd. I am the Director of International Economics in the European World Trade Team at the Department of Trade and Industry.
Mr Portes: I am Jonathan Portes. I am the Chief Economist for Work at the Department for Work and Pensions.
Mr Timmins: I am Ken Timmins. I am Director, Developed Markets in UK Trade and Investment.

Q49 Chairman: Mr Timmins, we have seen you before us in the past but the two gentlemen you are with, welcome to you for the first time. Can I say that I appreciate the fact that the two departments were prepared to come together. It is certainly very helpful because the issues for this Committee do touch very much on the issues of Work and Pensions and the memorandum from the Department of Trade and Industry was very helpful so we are grateful for that. Was there any input from DWP into that memorandum?
Mr Portes: Yes.

Q50 Chairman: It was interestingly written. I was particularly struck by paragraph 32, "The large influx of Polish workers represents the greatest wave of arrivals from a single country since the flight of the Huguenots who came to Britain from France in the 17th century". That is the kind of context I certainly appreciate as the Chairman, so thank you very much. Can I begin with a very broad brush question and then we will delve down into the details when my colleagues ask their questions later on, and I appreciate that with some of those questions more than one of you may want to join in. It is quite clear that you believe very significant benefits have flowed from the enlargement of the European Union to both the A8 and the A2 accession states. Just to give colour to this discussion and get a sense of your priorities can I invite you to say what in your judgment are the most important benefits to flow both to the UK and to those accession states, not theses on the subject, just the headline answers?
Mr Dodd: In terms of the benefits to the accession countries, access to the European market and integration into the western European economy has been a huge prize for the accession countries through a very long and difficult process of transition. I think it is well worth emphasising just how far these economies have changed in what is a relatively short period of time and without full access to the European market and the wider benefits of membership of the European Union that would have been a much slower and more difficult process. The way in which that shows itself is in a dramatic increase in economic activity, re-orientation towards new markets, away from those which broke down in the east to new ones in the west, a great deal of inward investment and effectively building not quite economies from scratch but in many cases very dramatically different from those of only 30 years ago.
Mr Portes: On the labour market side, clearly, as laid out in the memorandum, the UK economy has benefited quite significantly from the influx of typically medium skilled workers who are prepared to work flexibly to fill gaps in the UK labour market. They have contributed to increased output. That has obviously benefited not only the individuals who have come from the accession countries but also their countries in terms of the remittances, the money they send back, which has gone into developing their own countries, but also over the longer term because many of those workers have already returned to their own countries with improved skills and improved earnings potential, and more of them will return in the future and that two-way migration I think is beneficial both for the UK labour market but also ultimately for the labour markets in the countries concerned.

Q51 Chairman: Mr Timmins, is there anything in particular you want to add?
Mr Timmins: I think Peter has covered it from the UK TI point of view. I would only add that there are clearly increased opportunities for UK companies

through these markets which are growing and these are opportunities in terms of both direct trade and investment.

Q52 Chairman: Can I ask Mr Portes a question which intrigues me? We were in Lithuania recently. We heard that at least 10% of the population, possibly a good deal higher, even as high as 20%, are now living in the British Isles, and typically these are people who are quite highly skilled doing low skilled jobs because the wage rates are higher in the UK than they are in Lithuania. In terms of economic efficiency that is not very clever, is it, for the whole European economy?
Mr Portes: Not as a long term state of affairs, no, but I think it is highly improbable that it will be a long term state of affairs. The relatively highly skilled people who have come here in my view over time are not going to continue to work in seasonal agriculture or bar work, just as the Australians, Canadians and New Zealanders who come here and work in similar jobs do not spend their lives doing that. Typically, migrants of that sort will either return to their home countries with improved skills, better English and all the rest of it, to contribute to the development of their country or a proportion of them will stay in this country, not working in those same jobs but progressing up the occupational ladder in this country. I do not think that is likely to be a long term issue for efficiency purposes either for the UK or for Lithuania. I think Lithuania will in time benefit quite significantly from the return of many of those people.

Q53 Chairman: Are there any significant economic downsides to the expansion we have seen in the European Union as far as you are concerned?
Mr Portes: I do not think there are any significant economic downsides on the labour market side for the UK. Obviously, there are some people who come here and find that they do not fit into the UK labour market for one reason or another and end up either not working or working in jobs that they are really not suited for so they have a bad time and maybe their employers have a bad time, but obviously when you have a large number of people that is inevitable. Overall I do not see any significant labour market downside for the UK. For the accession countries the concern that you raise in the case of Lithuania and which has been raised with me by some of my Polish economist colleagues is that it is clearly a real issue. It would be unfortunate for those countries if they continued a permanent outward migration of skilled workers with no return migration and a corresponding deskilling in their own economies. My judgment is that that has not occurred yet and, as I said in my previous answer, is not likely to occur over the medium and long term. It is clearly something they should be worried about. The answer is that they should ensure over time that their labour markets are sufficiently flexible and their industries sufficiently dynamic to absorb skilled workers locally, and I think over time, for the reasons that Peter outlined about the immense strides that they have already made, that is likely to happen.

Q54 Chairman: Gentlemen, are there any downsides you would like to highlight?
Mr Dodd: Something which is certainly a challenge for some of the more eastern economies' flow of labour, and particularly eastern Poland is one area that has commented on this, is having quite a problem in retaining skilled workers. However, there has been a quite a large degree of inward migration from countries further east and some countries such as Moldova and Ukraine have found some difficulties themselves in some of their workers moving to central Europe to take on higher paid jobs, leaving particular difficulties at home. I think Moldova is probably one country which has felt this particular hardship.

Q55 Chairman: The issue which is often discussed in the UK is the consequence on UK employment of bringing in cheap labour to this market and also the loss of jobs particularly to manufacture elsewhere. Slovakia I see from evidence is now the world's largest producer of cars *per capita*, which is quite a statistic as well. What would you say to that concern we often hear expressed about the impact on the UK?
Mr Dodd: Starting with cars, it is quite striking that the changes which have happened in the UK manufacturing sector over a rather longer period than that in which these countries have been part of the EU is fundamentally much more to do with globalisation and changes in the way that production is put together rather than necessarily lifting jobs out of the UK and dropping them into central Europe. In many cases the kinds of supply chains which are involved in producing products like cars involve different elements from many different countries being put together all over the world. Slovakia has been quite specialist in car manufacture and it is quite striking to see that western European car manufacturers have chosen to use it as a base within the EU. There are still some EU restrictions on car imports, which perhaps explains why quite a large number of cars are still made in the EU rather than there being greater imports from outside the Union. In terms of the evidence of the impact on the UK economy, I think the striking thing is that it has not been a zero sum game at all. It is certainly not a matter that the UK economy has shrunk and countries of central and eastern Europe have grown at our expense. It is absolutely the opposite of that. The growth which has happened over this time, particularly the employment growth in central and eastern Europe, is in areas where the UK is not particularly specialist any more. They are doing things which primarily we do not do.

Q56 Mr Hoyle: I think the Chairman is absolutely right to touch on the question of cars, but just to stretch a little bit more on that, would it not be fair to say that we are now seeing the sun setting on UK manufacturing as people have moved? You say we are no longer a specialist. The reason we are no longer specialist is that it has already moved to the former Eastern Bloc and new countries are taking up jobs and Hungary is a good example, whereas if you use Malta on the other hand what we have seen is adverts in Malta, "Come to the UK. Come and work in care homes". At the same time we are seeing our traditional manufacturing moving east. Do you not think that it is now happening that the sun is setting, or not?

Mr Dodd: I certainly do not think the sun is setting on manufacturing as a whole. I think the kind of manufacturing activities which UK firms are highly successful in are not necessarily identical to those which employed the majority of people in manufacturing 20 years ago. For example, in some sectors we are doing particularly well in design of product development in specific reaches of production, which sounds like a bad thing but in an increasingly globalised world where you have disaggregation of production to all kinds of different places it is very rare for any country to make all of anything any more and for the greatest prosperity of the UK I think it is only right that we are focusing on those areas which add value, require high skills and as a result are able to generate good wages. We are certainly never going to be the cheapest, and if we try to be the cheapest, particularly in relatively low-skilled jobs, that simply is not sustainable at the levels of income which we would want UK citizens to have.

Mr Hoyle: I totally agree we should not do it on cheapness. If we look at the strongest currencies and some of the highest wages, which are in Japan and Germany which have continued with a very strong manufacturing base, the problem we have is that ours is disappearing as we get wealthier and stronger.

Rob Marris: Is it not true that manufacturing output is in fact up over the last ten years?

Q57 Chairman: I think it is important to put on the record that one of reports highlighted that manufacturing growth has been an average of 1.2% in real terms and in Europe we have only had that for the last 20 years. It is very important that we put that fact on the record.

Mr Dodd: There has been a very dramatic process of change and with that change we tend only to see the downside in terms of where something is no longer done in the UK, but there has been an enormous growth in new jobs, the kinds of jobs which did not necessarily exist or jobs which have been installed into a much wider range of markets than was ever possible. Talking about Japan and Germany, for example, whilst they are both very large manufacturing powers, their major companies are active in globalisation in the same way that companies from anywhere else in the world are.

Q58 Mr Clapham: My question is to Mr Timmins. Last week we took evidence from the Engineering Employers' Federation and one of the things they noted was that some of the smaller companies are going even further east. Two countries that they referred to were Russia and Turkey and I just wonder if UK TI are doing anything to assist those companies that are looking to locate further eastwards.

Mr Timmins: Are you talking about companies investing in those markets as opposed to trading directly or both?

Q59 Mr Clapham: It would be investing and relocating.

Mr Timmins: Both those countries, Russia and Turkey, fall within our group of emerging markets within UK TI, where there is quite a lot of attention being paid to support for British companies, whether as investors or exporters, and quite a lot of the issues in those small companies revolve around market access and particular barriers to them, and therefore quite a lot of the focus of our UK TI activity in relation to those emerging markets is identifying those barriers and working to remove them. That is specific to those emerging markets but, of course, the whole panoply of UK TI services and support for British companies, whether it is providing tailored reports on the individual markets, that is, tailored to the company's needs and products, or whether it is providing support for the companies to visit the markets, is available for those markets as for others.

Q60 Roger Berry: It is notoriously difficult to predict the impact of enlargement on an organisation like the EU which, of course, has not prevented lots of us trying to do it, including, of course, DTI in its 2004 report. Where did you get it wrong in your predictions and why?

Mr Dodd: I think the expectation of growth in central and eastern Europe was probably rather lower in our study than has been the case in the last few years. I think there are quite a lot of issues around the sustainability of that growth in certain markets in the same way as the achievement of EU accession in some countries has enabled the taking off of the tight discipline that was needed in some economies to achieve that, with, however, the benefit of much faster domestic growth, growth in consumption, making it a happier place to live if you are a citizen of that country enjoying the extra consumption, so we probably underestimated that. The work within the DTI did not specifically focus on the impact of western European labour markets. That is obviously something the DWP were leading on.

Q61 Roger Berry: Just remind me, DWP, how good were your predictions about migration flows?

Mr Portes: We did not make any formal predictions because we commissioned an external report which did a review of the evidence using the methodology that had previously been used, which came up with the numbers which at the time many people thought were rather low and certainly turned out to be extremely low, so we did not make a formal prediction but I am certainly prepared to say that if you had forced me to pin down the number beforehand it would have been significantly lower than the number we have seen in terms of migrants from the east. Why did we get it wrong? The answer is that I know of no serious econometric models which predict migration flows very well. It is just a very difficult thing to model economically because it depends on people's individual decisions which it is very difficult to predict in this context. That is one reason we got it wrong. What things did we not take sufficient account of? Possibly the historical links, particularly with Poland, the generally good relationship between the UK and Poland—we probably should have taken a little bit more account of the fact that that would make Poles think that the UK was a nice place to come. We knew that the consequences of other countries, particularly Germany, closing their labour markets, at least in legal terms, to eastern Europeans, would mean there would be some diversion to us but we did not know how big it was and it turned out to be quite significant. Finally, on the good side, as it were, we did not know just how attractive the flexibility of the British labour market would be to the eastern Europeans and how well our labour market would respond to them and how well they would respond to our labour market, and it turned out to be a match well made, but we did not know that in advance and I do not think we could have predicted that it would have worked as well as it has in terms of employers being keen to offer jobs to migrants and them being keen to take them up. That in turn feeds on itself to some extent because there is word of mouth. People who come here say the UK is a good place to come. There are jobs, most employers treat you reasonably well and the pay is okay, or at least from the point of view of these workers it is attractive, so all that fed on itself to some extent and we certainly did not anticipate all of that, and frankly I think it would have been difficult to do so.

Q62 Mr Bone: Are you seriously telling us that the Government did not estimate what the migration figure would be, and if you had done that estimate all the experts would have been wrong? What is the point of having a department that is supposed to make trade when it has not even investigated it? Are you really saying that?
Mr Portes: It has never been and is certainly not the responsibility of the DTI to forecast on migration, nor indeed of the DWP. The research I referred to was commissioned by the Home Office with some input from us but it has never been the case that the Government, any government that I am aware of, has made forecasts of overall migration flows, either in total or from a particular country, for the reasons that I set out.

Q63 Chairman: But surely the regional spatial strategy has used flows of inward migration for their authority?
Mr Portes: That is true. The Government Actuary's Department makes quasi-independent estimates of overall nett migration (not gross migration) but it does not say, "There are going to be 20,000 people from Poland coming this year". It will say, "For the purposes of making the planning assumptions we are saying these are the stylised assumptions you should make", and those have been made by GAD and used by ONS for some considerable time, but the Government does not make formal forecasts of, say, the impact of migration flows such as was the case when we opened our labour market to the accession countries.
Miss Kirkbride: The migration from the former Eastern Bloc has been huge and it has been largely at the lower end of the labour market because of easy access, because of the flexibility and all those things, even though some of the migrants coming here are much more skilled. What evidence does your department have to suggest, whether or not this is the case, that that inflow of migration from the eastern European Bloc has displaced the lower end of the labour market in the UK and what is happening to those young people who might otherwise have done the jobs that these migrants are now doing?

Q64 Chairman: Can I just tease out one point from your evidence? In the evidence we got from the department it alternates between "no evidence" of such an effect and "little evidence" of such an effect. Both claims are made, so there must be some evidence that it has been happening.
Mr Portes: You will have to point me to where it says "little evidence". Our position is set out in paragraph 42, "There is no discernible statistical evidence that A8 migrants have contributed . . . ".

Q65 Chairman: It is in the summary box on page 4, above paragraph 20, "There is little discernible evidence of adverse effects on claimant unemployment".
Mr Portes: That should be "no", I think, or at least "no statistical evidence". Let me explain. The position is that we have done quite a lot of statistical analysis, including the department's published working paper on the impact of eastern European accession on the UK labour market, so we looked at whether there was any correlation between the geographical areas where A8 migrants had settled before according to working groups and the changes in claimant unemployment in those areas, which is the standard statistical method used in the analysis of immigration to see whether it has any impact on the labour market, and we found no statistical evidence of any relationship, and other people have looked at the set using the same type of methodologies and found approximately the same thing. We can see no evidence that there has been any displacement of British workers by the influx of workers from the eastern European countries.

Q66 Judy Mallaber: Can I turn to Mr Dodd's last answer, talking about growth rates? As has been said, the growth rates in the A8/A2 countries have been impressive, although in your evidence you point out that that followed a period of some contraction in many of those countries, but you did say that there were question marks over its sustainability. Can you expand on that? Is that growth sustainable and what are the question marks?

Mr Dodd: I think the situation varies very substantially between countries, primarily, the basis being what kinds of policies over a whole range of things—government spending, taxation, interest rate policy, a whole range of factors, and the degree to which maybe short-term political interests outweigh long term economic management. It is quite striking that organisations which watch this quite carefully, like the World Bank and the OECD, look at similar countries in rather more fragile economic positions than others. As a group I think it is well worth emphasising that they are not in a very bad state at all. This is about degrees of variation around what is achievable in the long term. If you, as it were, take out a great deal of consumption from the economy in the short-term you are going to have to pay it back at some stage. The economy is capable of growing at maybe 4% or 5% but appears to be growing at 7% or 8%. It is simply not feasible for that to continue and there has to be some process of adjustment to get back to a sustainable position.

Q67 Judy Mallaber: Can you make any assessment between which countries you feel are most likely to sustain their growth rates and which are not?

Mr Dodd: It is probably worthwhile referring to the organisations that do the deepest research, people like the World Bank, in that the DTI does not comment on the economic performance of individual countries. The World Bank is putting forward Latvia, Estonia and Bulgaria as countries where their current account deficit is so large as to be something which needs to be addressed in the fairly near future to avoid them having a painful process of stabilisation at some stage.

Q68 Judy Mallaber: How far do you think the sustainability of their growth rates depends on other issues like energy security, what Russia does and so on?

Mr Dodd: The underlying sustainable long term rate of growth that they can achieve is driven by a whole range of factors. Clearly, access to reliable energy supplies is one very important element of that. Their relations with near neighbours is a very significant factor. If you have a large neighbour next door that is trying very hard to prevent you from enjoying your success and if you still trade quite heavily with them it is bound to have an impact upon them. In terms of the overall range of economic variables which determine their growth rate it does vary quite a lot from country to country but fundamentally all the countries in Europe need to have the same things, which are a highly skilled labour force, high degrees of innovation, good capital markets which enable people to have access to macro-economic stability so that if people invest they do not perceive the risks of investment to be too great to do so. The recipe for success I think is pretty much identical wherever you happen to be in the world and some of the particular risk factors for central and eastern Europe are common but they also have some which are specific to each individual country.

Q69 Judy Mallaber: Can you identify if there are countries which have particularly good prospects in terms of future growth that might be the ones that in terms of our trade and investment we should be particularly focusing on?

Mr Dodd: I think it is worth emphasising that on a global scale they are all quite small markets. Poland is obviously a much larger economy than the others but each of these countries is relatively small and as a result I do not see that they are going to be very major markets for the UK. They will be useful markets but it is well worth putting them in pecking order and as places where a company might want to go and invest they may not necessarily be at the top of that list. Their very long term growth prospects are quite good and not necessarily the highest in the world.

Q70 Mr Wright: Just continuing on those lines of the growth and opportunities there, in the evidence it suggests that growth in French and German export markets to central and eastern Europe has been more than double that of UK exports whilst the proportion of UK foreign direct investment going into A8 and A2 is the smallest of any EU15 country. Has the UK missed out in central and eastern Europe relative to its competitors, do you think?

Mr Dodd: When looking back at the evidence before coming to see you today what we did was look at the kind of things which the countries of central and eastern Europe buy from us and are buying from the Germans, the French and the Italians. There is certainly a higher proportion of the goods which those countries are buying which Germany and France tend to have more of a specialisation in than we do. The UK currently tends to have a greater advantage in selling services which are successful in some markets but not necessarily huge in all markets all the time, so, looking at the kinds of things that the Czech Republic, Hungary and Poland are buying in the largest quantities, they tend to be transport related goods from Germany in particular.

Q71 Mr Wright: Do you not see that there is a missed opportunity there and that there are views held within industry itself that there appears to be a reluctance by some manufacturers to take that risk? One of the comments from the Black Country Chairman of Commerce was, "UK businesses tend to be more reactive than proactive in foreign markets. We are one step behind our competitors in the new EU markets and this misbalance must be addressed".

Mr Dodd: I think when firms are making investment decisions there is quite a complicated mixture of assessments of risks and rewards going on where things like market size and ease of doing business are key factors. Many UK firms, I suspect, look at many of the economies of central and eastern Europe and feel that the combination of small markets is not necessarily the easiest place to do business through a combination of language issues and administrative barriers which may lead them to feel that it is not their top priority. If you look at the UK patterns of trade compared to some other countries it is quite striking that our trade with the English-speaking world tends to be rather larger than that of the other EU Member States so many UK firms might find it easier to do business with people who are further away geographically and in terms of deciding where their natural expansion is I do not think they are necessarily going for geographical proximity when choosing.

Q72 Mr Wright: We have found evidence from other parts of the world, India and South America, for instance, that there tends to be this reluctance and that we are always one or two steps behind other areas when there is significant investment, whether it is in India or whether it is in South America, and obviously within Europe itself, which is the evidence session we have got today. It seems that wherever we go we always appear to be in manufacturing terms in exports that one step behind. Is it UK TI, is it the Department of Trade and Industry? What is the basic manufacturing sector? Is it the fact that we do not appear to want to take an element of risk or have we had our fingers burned in the past? What are the obstacles?

Mr Dodd: Many UK firms are highly successful in operating in many markets and, for example, in countries like India, and you mentioned Latin America as well, our energy sector companies are highly active, and with service sector firms, banking and so on, there is an awful lot of presence in many of these markets and the UK is the world's second largest outward investor. It is certainly not that the UK is not taking any advantage of international markets. Where we are doing it I think there is a sectoral concentration. For example, those firms from the UK who are the most successful in central and eastern Europe may not necessarily be in the manufacturing sector; they may be doing other things. In services and on the retail side UK firms are now quite active. It may be more of a reflection of the slightly different composition of the UK economy than that UK firms are any less good at operating in international markets.

Mr Timmins: I agree with all of that. Relative to our performance in these markets, British companies are doing rather well in these countries in terms of their export performance at the moment, and it is growing and I think that is something that is very commendable. If you look at a market like Poland, which is the largest market amongst the group for British companies, Poland's economy is half the size of Russia's and yet our exports to Poland are double those to Russia. The Polish economy is a fraction of the size of China's, yet our exports to Poland are on a par with those to China. These are quite interesting statistics about the performance of British companies and if you look at the investment area across these markets I think we are in third place in Poland, fifth place somewhere else. That is the order of our performance in these markets. The other point is that if there is a perception of lack of performance it is not always because there is lack of awareness. We all need to remember, and to some degree we keep frequently in our minds in UK TI, that companies do make conscious judgments based on knowledge that we and others provide about opportunities and markets worldwide, and, of course, companies in terms of their capabilities, in terms of their capacity, are not always able to realise opportunities in every market around the world, so there is an element of judgment in all of this.

Q73 Chairman: We were told that in Lithuania that UK TI was having quite a lot of success in matching up smaller UK service companies with Lithuanian partners, often working through their RDAs. Are you aware of that as a frequent activity in UK TI and new Member States?

Mr Timmins: I am not aware of that but I would not necessarily be aware of it, frankly, because those are the sorts of activities that our commercial teams engage in much more directly with business than we do in headquarters. It is not something that is particularly prominent across all these markets. That may be something which is particular to Lithuania.

Chairman: Especially as we also saw Marks and Spencer going home to Lithuania at last. Mr Marks was Lithuanian and so has come home.

Q74 Mark Hunter: I want to move us into the area of bureaucracy, the red tape, which, of course, we often hear from the business community is a major impediment. This question is directly largely at Peter and I suppose Ken could come in as well on it, but in your evidence to the Committee the DTI specifically refer to "cumbersome bureaucracy, inefficient and opaque judicial processes". Just how far do you think this is a problem for business in the UK, dealing with the new Member States, and does it vary much from country to country? If the answer to the last part of the question is yes, who are the good guys and who are the bad guys, so to speak?

Mr Dodd: I am sure they are all good guys. There is a huge amount of variation, not just from country to country but also in how different kinds of firms are treated. If you are a huge multinational making a multi-million dollar investment you are likely, I suspect, to be treated quite well, whereas if you are a small firm butting up against the local town council or something you will have not necessarily had the same degree of emphasis or attention on the need to generate an attractive environment for international business. Things can be quite difficult in some countries. The thing which business is most concerned about is uncertainty. Many firms are incredibly good at operating in quite difficult environments so long as they are clear what the rules of the game are and they can factor that into their costs. There are many countries where the legal situation on paper now looks fantastic; it looks as good as anywhere else in the world, but on the ground I suspect there are still cases in several countries where on a day-to-day basis getting issues resolve either with local bureaucracy or through the courts is much slower than we would like. As to which countries are doing least well in this, I suspect that it is those which are least far along the process of transition, so it is those who have been doing it for the shortest time, so I suspect those to the south and east are probably the ones where the difficulties are greatest.

Q75 Mark Hunter: Do you think even with those countries there is discernible progress being made yet or is it too early to say?
Mr Dodd: I think there has been a great deal of progress from where they were five to ten years ago. However, there are still people with difficulties in some markets and in some niches of some markets it is much tougher than in others.

Q76 Mark Hunter: Do you give advice directly to companies, and I am thinking particularly of small and medium sized businesses perhaps who are looking for investment opportunities in some of the countries that we are not naming specifically? Would your organisation be able to say to them, "You need to be aware of X, Y and Z"?
Mr Dodd: That is where UK TI comes in.
Mr Timmins: Yes, very directly, and it is more than that. It is more than giving advice. It is giving practical help to those companies. I was looking at the statistics and I found that over the past year our posts have actually helped around 200 companies which were having local difficulties or difficulties with a whole range of matters in the market.

Q77 Mark Hunter: Are they solely in the SME sector?
Mr Timmins: It can be a mix of companies—SMEs, mid-sized companies and, of course, even the larger companies that are investors in these countries.

Q78 Mark Hunter: Your colleague was saying the larger ones do not usually need the help because obviously they are a more attractive proposition.
Mr Timmins: I think you will find that the larger ones in some respects in some markets do need help. We have a very large retail company which is well established in several of these markets and there have been occasions when they have needed support from our commercial team. Quite often at that level or at the level at which the entry needs to be made into the authorities it is given by the ambassador, so there is quite a lot of that work going on, and, of course, for every issue that arises and every engagement with a government or a local government about a barrier or an obstacle clearly lessons are learned and we would expect it would then be easier for the next company that comes along and wishes to do similar things.

Q79 Mark Hunter: Do you think the whole issue about the bureaucracy though is overstated? Is it used more as an excuse, shall we say, rather than a proper reason in your opinion?
Mr Timmins: I do not think it is. Our experience is that there is considerable awareness of the opportunities in these markets and that is reflected in our growing exports and growing interest in these markets as investors, so companies are, I would say, fairly open-minded about these markets. The difficulties arise for them when they begin to engage in a serious way and that is when they need our support, but I do not think they necessarily as a general rule start off thinking, "These are difficult places and I do not wish to go there".

Q80 Chairman: I just want to question you on the legal system if I may. I have a constituency company which had an extremely bad experience in Hungary, not within the official legal system but effectively with a bogus case which was being progressed, and it had a lot of help from our post and the department, and they were very grateful for the help. It was not just that it was inefficient; it seemed that it was weighted very much against the foreigner. Is that a problem you have seen elsewhere in the new states, or is this experience an unfortunate one-off in Hungary?
Mr Timmins: I am personally not aware of it as a general problem.
Mr Dodd: One observation is that perhaps some of the countries of central Europe are not necessarily as outward-looking and as globalised as much of western Europe is.
Mr Timmins: I would say that we can have that sort of problem amongst the EU 15.

Q81 Miss Kirkbride: The report has identified "frictional" issues between the new states and the implementation of the single market. Can you set out what are the best examples of those frictional issues and how big a problem it has been?
Mr Dodd: It is worth emphasising just what a massive change in governmental and legal systems and ways of operating an economy, ways of operating bits of government has been involved in joining the EU. The *acquis* is a massive undertaking and for even the wealthiest and most sophisticated economy to take it on board would be a huge undertaking. It is inevitable that there have been some cases where the ways in which things have been done before and the ways that the EU wants them done are very different. In most cases some of those might seem quite strange to a UK audience. It is about liberalisation to join the EU, so about having rather less in the way of regulation and taking out unnecessary regulation in many cases. The experience again differs enormously depending what governments were like prior to getting into the accession process. Some of the Baltic economies complained vigorously about having to take on huge amounts of unnecessary bureaucracy that was spoiling their free markets. Other countries complained that this removed huge amounts of legitimate state power to decide how things should be done, so the experience is I think very different, but there is a common theme that this is simply a massive change in the way that things are done and as a result it is inevitable that there are pains along the way. Also, there is an issue that you can implement rules quite easily in terms of statute but

in terms of changing mentalities and the ways that people react and use those rules can be slow and therefore the process may not be wholly successful.

Q82 Miss Kirkbride: Have those new accession countries succeeded in doing the bureaucratic element? How far have they still got to go before they get to the rest of us?
Mr Dodd: I think the headline will be completely successful. The process of embedding the detail and, more fundamentally, the hearts and minds process in some cases has quite a long way to go. I think for some countries membership of the EU was the objective rather than taking on board a different way of doing things and I think that is a much slower process.

Q83 Miss Kirkbride: What about the Services Directive, which is particularly important to the UK economy? How far have they successfully implemented that?
Mr Dodd: It is a good question how far has anybody successfully implemented the Services Directive. It is very early days. The Services Directive is nothing like as dramatic a piece of legislation as we hoped it was going to be, so even full implementation of the directive is a fairly modest affair, unfortunately. There is an awful lot more liberalisation in the service sector that we should be trying to achieve across the whole European market.

Q84 Miss Kirkbride: And will we find allies in our new European countries?
Mr Dodd: Some allies in several countries which do not understand at all the mindset behind it. There is great diversity of opinion on it.

Q85 Chairman: Just out of interest, and I am surprise Mr Bone did not spot this, I notice figure 17 shows the saints and sinners of infringement cases in the European Union. Italy is the leading sinner, well ahead of the field, Spain then, France, Greece, and Germany are number five, interestingly, and I am surprised at that, but the saints are Estonia, Slovenia, Lithuania, Latvia. In your evidence you say this may be because we have not had enough time to bring up infringement cases yet, or are they genuinely following the rules better than the older EU 15?
Mr Dodd: They are also very small countries.

Q86 Chairman: Fewer opportunities to be a sinner?
Mr Dodd: Yes, but, to be fair, there are some countries towards the right hand edge of that diagram which very much believe heart and soul in the full market.

Q87 Chairman: We should have an adjusted one by population or economy size, which would be more accurate.
Mr Dodd: We can give you that if you like.
Chairman: Italy still would not do very even then, would it? No, I thought not.

Q88 Mr Bone: Can I just get it right that the central and eastern European states have had a high and sustained growth rate and we probably export more to them than we do to India and China?
Mr Timmins: I am not looking at these collectively. We export about £7.5 billion worth of goods and services to the 8 plus 2. If I just use the example I used previously of Poland, our exports to Poland are about £2.8 billion, which is around the same as we export to China.

Q89 Mr Bone: I think the answer there was yes, we do export more to the A8/A2 than we do to India and China. One of the great successes of the European Union has been to bring in the former Communist countries to an economic free trade area and to encourage democracy, so why is your department concentrating on the sexy things like India and China and not concentrating on these markets which we should be encouraging? They should be listed as emerging markets. Have you not got it completely wrong?
Mr Timmins: I think that is probably one for me in UK TI. There are a number of issues here. First of all, I need to say that we do a great deal and expend a considerable amount of resource in supporting our companies in these markets. I counted up the number of people we have in our commercial teams in these posts and the number came to 104. That is 104 people across these markets, including ambassadors, who are working to support British business, and, just by way of comparison, if I look at the numbers of people we have in the US, we have about 113 people in the US where our exports are £30 billion a year, so in terms of how we deploy resource I think we are taking account of demand and interest in these markets. That is the first point. The second point is that each of these markets in terms of the prospects for British business, in terms of their growth, in terms of the size of their economies, is different and each has to be looked at individually. There is quite a significant difference between these markets and the emerging markets that we have determined in UK TI and the one significant difference is that in the emerging markets a lot of what we need to do is really around market access and regulation and breaking down barriers. That is a major component of why we designated these markets as emerging because that is a major area of work. There are clearly issues in the 8 plus 2 which are similar but on a much smaller scale and, of course, one would expect that the EU regulatory framework would over time ensure that these barriers no longer existed, so this is not exactly apples and apples. There is an apples and pears connotation here. The last point I would make on that question is that there is an issue here of resources as well. For UK TI this is not a zero sum game. What that means is that if we designate markets as emerging we need to make sure that the resources we put in are commensurate with what we seek to achieve in those markets, and that means we have to take resources from elsewhere, so we have rob Peter to pay Paul, if you like. There is an issue therefore in that we have to be careful in terms of

looking at the opportunity, looking at the potential and making sure our resources are equal to the task, and I think for the present and looking ahead we have got our deployment of resources right for those markets.

Q90 Mr Bone: Are you saying then that it is almost because they are part of the EU and because you think that is going to work that you are not putting resources in there?
Mr Timmins: No.

Q91 Mr Bone: That seemed to be part of your answer.
Mr Timmins: I think I am saying that, having assessed demand for our services in these markets and having understood the potential of these markets, we are confident that the level of resources that I indicated is quite satisfactory in order to be able to deal with British businesses' aspirations towards those markets.
Mr Bone: You see these then as individual countries, not as a group of ten extra countries which have a huge market? The final point that I do not think you addressed was that it is very glamorous to go to China and India to develop trade. It is not quite the same thing to go to Lithuania to do it. Is there anything in that?
Mark Hunter: Oh, I do not know about that.

Q92 Mr Bone: Sorry, as the department might see it. Is there nothing in that? China is the big thing. Everybody is talking about China. Nobody is really talking about eastern Europe.
Mr Timmins: There may be something in that. We do, of course, provide support to companies that wish to visit Lithuania, as they may wish to visit China, and we do a great deal to create awareness of what the opportunities are in these markets through our website, through our support for companies visiting the markets and by a whole range of other means. It is quite interesting that in the last 12 or 15 months we have produced 55 sector reports for the 8 plus 2 which have been available to British business. That is opportunities across a whole clutch of sectors in those markets. I think that is quite a good story.

Q93 Roger Berry: Mr Timmins, you talked about robbing Peter to pay Paul. Are the new Member States Peter or Paul?
Mr Timmins: The new Member States would be Paul.

Q94 Roger Berry: Really?
Mr Timmins: If we were taking money. If we were taking resources from elsewhere in the network in order to support them we would be robbing Peter. We would be robbing other markets to pay them.

Q95 Roger Berry: If that were the case that would be true. My question is, what is true? We have heard that UK representation, for example, UK TI but I might also add the British Council, in the new Member States is being reduced. Have we been misinformed?
Mr Timmins: I am aware that the British Council have been looking at restructuring across these states and I do not know what the outcome of that is.

Q96 Roger Berry: What about UK TI?
Mr Timmins: In terms of UK TI, if we go back to the spending review 2004, in the intervening period we have removed six posts from our commercial teams across those markets but, as I say, we have 104 people still engaged in supporting British business in those markets, which is quite a significant resource.

Q97 Roger Berry: I accept the absolute number argument as one argument, but clearly you have confirmed that we are talking about Peter here and not Paul. I just wondered what the rationale for that was. Is there evidence that if you take one post away from the new Member States and allocate it to a India or China that is better for British business?
Mr Timmins: I think it is horses for courses, frankly. In the Chinas and the Indias of this world the task in some respects is different from the task in the 8 plus 2. What I mean by that is that the task in the 8 plus 2 has quite a lot of what I would call day-to-day support for companies. It is about market knowledge advice, how to do business, how to go about things. It is the sort of support and advice that can very readily be given by our local staff in these places, and very professionally too, I might say, in those markets. We have some of the best local staff in the overseas network in the 8 plus 2 and that is reflected in their performance in support of British business. In the Chinas and Indias, because there is work to be done on what I would call political lobbying for commercial purposes, that is, gaining entry into the ministries and tackling some of the major access issues, there is a sense in which that is best done by our UK-based staff.

Q98 Roger Berry: UK-based staff?
Mr Timmins: When I say "UK-based" I mean our diplomats. We call them UK-based as opposed to locally engaged. They are not based in the UK.

Q99 Chairman: They are UK staff employed overseas.
Mr Timmins: Indeed, so there is a difference in the way that we use and deploy staff in different types of market.

Q100 Roger Berry: I appreciate that. What I am trying to get my head round is that at the margin, okay, you either allocate resources at the margin to new Member States of the European Union or you allocate them to India or to China or Brazil or whatever. Given that you have admitted that we are reducing posts in relation to new Member States—and I have no idea whether this is good for British business or not, whether it is a better allocation of resources to shift those posts somewhere else—my question is, what evidence does UK TI have that this shift is good for British business?
Mr Timmins: We have a whole set of performance indicators for each of our posts in terms of the contribution they make to delivering our high level

objectives. These are indicators that are set and monitored and evaluated and we take into account demand from business in those markets, so we have a growing suite of what I will call performance management information which allows us to make those sorts of judgments. I will just make one other point here about resources in the emerging markets. It is not always a question of the numbers of people that you have in a particular place in terms of how that benefits British business. It can very often, of course, be about their professionalism and their knowledge but it can also be about how they work in support of British business. What I mean by that is that we are looking at different ways of working within parts of the overseas network. For example, in the Baltic States we have recently appointed a manager for the Baltic States based in Tallinn who will take an overview of the three countries on behalf of British business so that there is, let us say, a presentation to British business of the opportunities covering the three states which would be, we think, more attractive to them than the individual posts presenting opportunities in their own markets, and that is creating awareness for British companies of opportunities on a larger scale. Our expectation is that that will be more attractive to companies and will draw them into looking rather more carefully at some of these very small markets than they have done up until now.

Q101 Roger Berry: Just out of interest, why Tallinn and not Vilnius?
Mr Timmins: There are always issues around these sorts of things about communications, about transport links, about costs, and the decision we took in this particular case was that our regional manager would be best placed in Tallinn.

Q102 Roger Berry: Was that because there happened to be money available in Tallinn that was not available elsewhere?
Mr Timmins: No. It was a conscious decision taking into account a range of factors, such as those I have mentioned, that we should have someone in Tallinn, and indeed he has just taken up post and I think is going to be a very credible addition to our resources there.
Chairman: We will move on to a different area of questioning, one we have already touched on before. Mr Clapham?

Q103 Mr Clapham: Given some of the evidence that is both in the DTI brief as well as evidence that has been collected over the period since the accession of the first A8, the evidence does appear to be a little mixed because, on the one hand, some suggest that there has been a restriction perhaps on inflation but, on the other hand, the view is that there has been no statistical impact. I do note, Mr Portes, you are drawing our attention to paragraph 42. What assessment has the British Government made of the impact on the labour market?
Mr Portes: The main assessment is contained in the DWP working paper that I referred to earlier written by myself with an outside academic, an econometrician specialist, which concluded that there was no statistical evidence to there being any impact at all on claimant unemployment. We did that at the time because there was a particular concern. At that point claimant unemployment was rising and there were some anecdotal assertions being made to A8 accession. Based on our overall analysis of the labour market, our view was that claimant unemployment was rising at that point for other reasons and it would, in due course, reverse itself. It had little or nothing to do with the influx from the accession countries, but we wanted to subject that to proper rigorous analysis. We did so and we did, indeed, find no statistical evidence that there was any association whatsoever between the then rising claimant unemployment and the inflow of migrants from eastern European countries. Indeed, subsequently, as you know, claimant unemployment has turned around and is currently falling quite steadily, despite the fact that the migrants are still coming in at roughly the same rate, so we regard that as subsequent supporting evidence to suggest there really is not much of a connection. That is our assessment in terms of the impact on claimant unemployment, so we do not see any evidence that migrant workers are displacing British workers from jobs. In terms of wage growth, I would say the evidence is less conclusive. We do not have any evidence that there has been any particular impact on wage growth. Wage growth has been quite steady and stable overall for the last few years and there is no observable pattern. If you look at the sectors where migrants from the new countries have gone, wage growth has not been particularly slow in those sectors. If you look at the local authorities where migrants have registered to work, again wage growth has not been particularly slow in those local authorities and, so far, we do not have any reason to believe that it has had any significant impact on wage inflation. There is a general perception and some people, including the Bank of England, have said that their perception is that it has, overall, had some dampening effect but we have not been able to find that in the data and the analysis we have done.

Q104 Mr Clapham: The numbers that have come are quite significant. The worker registration register shows, for example, 600,000 and in terms of sectors the majority is going into the agricultural sector, whereas it is 27% into manufacturing. In terms of the direction that people coming into the country have indicated, is there any way in which we are able to track them? For example, people who come to agriculture, are we sure that they remain in agriculture or is there any evidence that they leave agriculture to fill gaps, for example, in construction?
Mr Portes: The answer to the first question is no, that is the worker registration scheme typically asks them to say where they are going to be working when they start and they are not required legally to re-register or to tell us if they subsequently move to another sector. Is there any anecdotal evidence that they have moved? The answer is I am not aware of any consistent patterns. I am sure that quite a lot of them do move from sector to sector, it would be very

surprising if they did not. A lot of the jobs that they are taking are likely to be temporary, so it would be surprising if there was not some movement. Our data is not sufficiently fine-grained to answer that question, though, in any statistical sense. You may well know it, but I do emphasise, whenever we talk about the 600,000-odd figure, it is very important to note that those are gross figures, they do not represent the number of A8 nationals who are living here at any one time because a considerable number have gone back. A lot of them say that they will go back and if we look at the Labour Force Survey data, which is not perfect but is a much better source for looking at the number at any one time, it suggests that the number currently resident is very much less than 600,000.

Q105 Mr Clapham: I take that on board. Could we say what the average stay is? Are there statistics that would say what average time a worker from eastern Europe would stay?

Mr Portes: We know that 55% roughly, about 50%, say when they come in—we ask them, although this has no legal force, it is just asking them what they say—that they are here only for a few months, that is what they say, so we know that. We also know that if you look at the Labour Force Survey data it says that there are about 330,000 people from the A8 countries currently resident, which would suggest that maybe half of those who come are still here and half have gone back, but the Labour Force Survey is only a survey and it probably undercounts to some extent because it does not pick up communal establishments fully. That is probably an underestimate. I do not think that it is wildly out of line to suggest that about half of those who come are still here and half have gone back, but I would not want to be any more precise than that given the data sources we have available.

Q106 Mr Clapham: Last week when we had the Engineering Employers Federation, what they said was there was not any evidence, for example, that the influx of labour was causing casualisation of labour in manufacturing, but we get a different story coming from the unions in construction. The unions in construction argue that there has been casualisation and many of the people, for example—this is their argument—that come in to work in agriculture find their way into construction and it is impacting negatively on wages in construction. Is there any evidence, again that you have looked at, with regards to construction which would suggest that is correct or that, indeed, it is different?

Mr Portes: The overall statistical evidence does not particularly support that so. For example, if you look at the Annual Survey of Hours and Earnings, which is DTI's very thorough main survey on how long people work and their earnings, in 2004–05 wage growth in construction was 3%, slightly above the overall average of 2%. If you look at 2005–06 wage growth in construction was 4.3%, which is as close as needs be to the national average of 4.1% in ASHE. The survey is not perfect, we are never going to pick up everything, there might be some localised impact but if there was a really big impact, a really big effect, it would be very surprising not to see it in the major national survey of hours and earnings which we have that looks at these things which is ASHE. As I say, I would not want to argue with people, like the trade unions who have a much better knowledge of what is happening on the ground, that there are localised, local level or site level effects, that is quite possible but, overall, there is no real evidence in the data that is happening.

Q107 Mr Clapham: Could I ask, people are coming over and we know where they are going to work from the worker registration. In those areas where most people are working, do we ensure that, for example, information is available in their own language? Particularly, I am thinking in terms of health and safety because in construction, again, we know that there was quite an increase in the number of fatalities last year, including five migrant labourers.

Mr Portes: I think that this is quite a significant issue which the Health and Safety Executive are well aware of and have been doing quite a lot of work on and, to some extent, in partnership with the unions, and it is something to be taken seriously. I am not personally familiar with what exactly the requirements are on the extent to which you need to post health and safety notices in different languages, for example, but certainly workers in these industries are subject to exactly the same health and safety requirements as UK workers and they need to be aware of the rules, the regulations and what they can and cannot do. If that means they need to understand them in their own language, then that should be happening, and I know that the HSE is well aware of the issues there.

Q108 Chairman: Could I pursue a couple of points flowing from that. First of all, I was interested in your written evidence to us. You highlighted construction as one sector where wage deflation might be a factor. You say that the CITE Construction Skills Draft Annual Report says that: "Overall wage increase in the industry might be kept within reasonable limits by immigration", that is paragraph 41 in your evidence. Your oral evidence seems to have slightly contradicted your written evidence. I can accept you are putting forward anecdotes in your written evidence. Paragraph 41 of your written evidence to us.

Mr Portes: I think that is what the construction industry trades board has said, it is not something that has come out of our own analysis and data.

Q109 Chairman: Your statistics are quite impressive but there are quite high levels of demand in the construction business in the UK, it is maybe keeping things down rather than rising faster.

Mr Portes: That is precisely the point I was going to make. If what we are seeing in the data is that in the construction industry wage growth is similar to that of the economy as a whole but demand is very high, because there are lots of big projects around, maybe the influx of labour is helping fill gaps without allowing inflation to pick up. That is certainly a possibility, I cannot show that is the case but that is certainly not—

Q110 Chairman: A parallel inquiry this Committee is doing at present is into construction, so we made a site visit to a London hospital where we were told that roughly half the people working on the site are eastern European, which suggests there is a strong impact on the market, or at least their removal might have a very strong impact.

Mr Portes: It certainly suggests that their removal would have a strong impact on the market, but that is true of migration, I think, generally. Clearly, if you were to go into any London hospital and ask the hospital administrator, "What would happen if you took out all the nursing staff of South Asian or Filipino origin?" You would, again, see there would be a very considerable impact.

Chairman: My colleagues want to come in with supplementaries, I know, so let me do that and I will come back to my questions just to see if they want to ask the same things.

Q111 Miss Kirkbride: Just going back to claimant count, I have slightly lost track of how it all works because I know the system has changed so much, but what about the NEETs? Are they different from Jobseeker's and, in which case, what does the evidence show about NEETs?

Mr Portes: The NEETs are typically not claiming Jobseeker's Allowance, they are not on the claimant count, so the evidence I referred to before does not relate directly to them. However, we have not done as thorough a statistical investigation for the NEETs because the geographical level data is good because they are not on the claimant count, we have different data measures, but we have looked again at the geographical pattern of NEETs compared with the geographical pattern of where migrants work. Once again, there is no discernible correlation, it does not seem to be that there are more NEETs or the number of NEETs is increasing in the areas where migrant workers are coming. Indeed, just by looking at London, for example, you see quite a strong variation between adjacent London boroughs in the number of NEETs which, I think, suggests to us that what is going on with the NEETs—and, as you know, we recognise there is a very significant issue there with the Department of Education and we are working on it quite carefully—is not primarily a question of lack of labour market opportunities for NEETs. It is a question of the NEETs engagement with the education, skills and skill system that enables them to progress into the labour market in the first place.

Q112 Miss Kirkbride: When my constituents say, "They're taking our jobs", et cetera, economically can you then explain why we have had a very significant influx of immigration into the UK, modest but not incredible growth, and this has not impacted the domestic population's job opportunities?

Mr Portes: Yes, this is very much the classic lump of labour fallacy, there are not a limited number of jobs to go around. The number of jobs in the economy is primarily determined by—and certainly the number of jobs for natives—natives' willingness to work, their motivation to work, the skills and capabilities they have to work and the barriers that they may face in terms of their knowledge, skills or other barriers, such as childcare or caring responsibilities. Of course, the bread and butter business of my department is to help people, British residents, be successful in the labour market by improving their motivation, enabling them to overcome their barriers and working in partnership with other government departments, like DfES, to ensure that they acquire the skills they need to succeed in the labour market. If we can do all of that successfully and that is, of course, a very big "if", because they are all very demanding tasks, then our British natives and residents will be successful in the labour market despite the fact that there are immigrants here, and the number of jobs will go up. If we fail on those important tasks, then keeping immigrants out will not help us. It is exactly the same as would a 35-hour week or compulsory retirement at 50 do anything for our people who are currently out of the labour market? The answer is no, it would not, it might even make matters worse.

Q113 Mr Weir: I was interested in the point that Mr Portes made earlier about the figure he quoted or the gross figures of people coming into the country. I represent an area where there is a lot of agriculture and a lot of semi-skilled workers. What I find is, though there are some immigrants who are now settling in the area—there is a long history of ties with Poland for example—very many of the people who come to work in my area are, in fact, students who come for a relatively small time to earn money and go back to their own countries to help them pay for their education. Do you keep figures as to how many people coming in are, in fact, in this category and not really immigrants as such but temporary workers?

Mr Portes: The answer is, as I said before, we do not have reliable figures. We ask people how long they are planning to stay and they tell us if they want to, but we do not hold them to that. There is no legal requirement on them to answer it truthfully and there is certainly no requirement on them, if they say they want to stay for three months, they are perfectly legally entitled to stay for longer if they so wish. We have what is effectively survey evidence which, as I said, suggests that about half of them say they are likely to go back quite soon and by comparing the different data sources, the workers' registration scheme and the Labour Force Survey, we can guess that perhaps half have gone back but, as I said before, I would not want to pin myself or the Department down to a much more precise estimate than that. We will not know for a while I think and a lot of people do not know when they come whether they are going to stay. Some of them may know that they are going to stay for three months, but some of them may think three months, maybe six months, maybe longer, and they will take those decisions as they come to it.

Q114 Mr Weir: Is it not an important statistic when talking about immigration into this country because the headline figures give perhaps a very much different and, if you like, scarier story than, in fact, is the truth?
Mr Portes: I agree and, although, as I said before, I do make the point every time I discuss the figures that they are gross not nett and the nett figures—

Q115 Mr Weir: That does not necessarily get across in sections of the media.
Mr Portes: It does not necessarily get in sections of the media and I think that, perhaps, looking back, we did not realise that is how it would have been presented and that, I think, is unfortunate.

Q116 Chairman: Will the census provide an opportunity to provide some more up-to-date information?
Mr Portes: Absolutely, yes. The census will provide a much more accurate and in-depth look at this. Of course, it will still only be a snapshot and five years later we will all be again in the same position talking about some other change in the population but the census will provide—

Q117 Chairman: As long as it is better conducted than the last census was. Could I ask one question about paragraph 39 of your written evidence to us. "There is some evidence that labour movement from the A8 has been associated with an arrest in the decline of business sectors in the UK", and you cite farm products. I want to ask specifically about farm products which are of interest to me and my constituency. Are there any other business sectors which have had their decline arrested by EU immigrant labour? It is an interesting point, that is why I was fascinated by it.
Mr Portes: It is an interesting point and I am not sure of the source of this. I do not know whether Peter does.
Mr Dodd: The evidence on this is largely anecdotal. Certainly, agriculture seems to be the most striking with both labour coming in for harvesting but also into food processing as well. There is a certain amount of evidence that crops which previously were not economic to plant in the kind of quantities which are now being planted, like strawberries for example, are booming as a result of the availability of large numbers of people prepared to undertake the very tough work required to harvest.
Chairman: I think it is best not to engage in a long discussion with you because the rest of my Committee will lose its patience, but in my constituency we are seeing quite the opposite. We are seeing the eastern European enlargement has had a devastating effect on horticulture, because the old SAWS scheme—the Seasonal Agricultural Workers Scheme—is no longer available. People from eastern Europe come in, spend a week or two, get the National Insurance numbers, and then move on out of farming. The ones who come in are not agricultural students, they are less talented people, and actually we have found that, ironically, in Worcestershire the enlargement of the eastern European Union has a very bad impact on horticulture. I might send you a copy of the letter I sent to the Secretary of State for Environment, Food and Rural Affairs on this subject. It has been very useful, but actually now the system has changed and we find the wrong kind of people are using it as an entry into other careers. I must not labour that point; I think the Committee might have its patience tried. I do not want to have a long discussion about that. Mr Marris.
Rob Marris: What I was going to ask I think has been covered in terms of exploitation.
Chairman: Yes, I think we ought, perhaps specifically, to ask it for the record if you do not mind.
Rob Marris: It is what we have been talking about in terms of the effect of wage rates and health and safety which Mr Portes was talking about and so on, as to what steps are being taken and what progress is being made to ensure there is not what one might call, perhaps somewhat emotively, "super-exploitation" of migrant workers in the UK who come from the A8 countries.

Q118 Chairman: There is a Gangmasters Licensing Authority dealing with farming, but there is some concern about the hospitality sector and the construction sector.
Mr Portes: Yes, this is a DTI point, of course, because the DTI is responsible for enforcement of the minimum wage legislation. A lot of this relates to abuses and there was a BBC investigation into this a few weeks ago which found some cases of fairly clear abuses of the provisions around the minimum wage, particularly relating to deductions for rent and so on, and clearly there is some of that. I think our perception is that overall it is not big enough to impact the labour market as a whole, but that does not mean it is not wholly deplorable and illegal where it happens.

Q119 Rob Marris: Your sense is that it covers a fairly small proportion of the migrant labour market?
Mr Portes: Yes, that is right, and that is what our data and some independent research show but do you want to say anything?
Mr Dodd: I think certainly one point worth making is that, as migrant labour coming in from the accession countries is legal and part of the system, they are much less likely to be abused in that way than illegal labour who would have no recourse whatsoever to the authorities and actually would be hiding from the authorities. Having a large influx of, as it were, legal labour is probably having quite a positive impact in terms of displacing illegal labour.

Q120 Rob Marris: Which takes us back to the point made earlier about translating stuff into Polish, Lithuanian or whatever. That is continuing, is it, so that those legal migrant labourers are aware of their rights?

Mr Dodd: I would have to refer that to the HSE.
Chairman: Could you? It is quite an important subject, we would appreciate a little more.
Mr Weir: Many of the local authorities are running projects.

Q121 Chairman: I think what Mr Weir just said is quite important, a lot of local authorities, particularly I know in my area, are seeking to draw workers' attention to the rights they enjoy under British legislation, under European legislation.
Mr Portes: It is not just health and safety, it is in particular the minimum wage and I think where there have been some clear abuses around deductions for the provision of accommodation.
Rob Marris: I think it is helpful having both of you here because it comes between the two departments: health and safety is DWP and the minimum wage is DTI.
Chairman: That is the first thing we have asked you for additionally so far. I would attach some importance to that.

Q122 Mr Wright: On that particular point, although it is on the low side in terms of numbers that may well be affected by unscrupulous employers, some of them from eastern Europe themselves, who are employing their fellow countrymen to come and work over here, they exploit them by deducting this money. Is the danger not that it then becomes a profitable business but more so if we turn a blind eye, we do not put effort into trying to tweak these people and it can actually grow? Also I came across just last year a situation where they were bringing over people from eastern Europe to work on an as-and-when contract and they were just providing two days' work for one week and a day the next week. Of course, these people were left high and dry with no funds, no ability to get any benefits whatsoever and they had to rely on friends to bail them out of the situation. That to me seems to be a very serious impact we might find in future.
Mr Portes: Yes. Certainly, when I said I did not think it was widespread or affecting a majority of workers, that does not mean we do not take it seriously and, as you say, we would not want to see it happen and certainly we would not want to see it grow. I think there is quite a bit of fairly rigorous enforcement action which people particularly on the minimum wage side would want to take in this area.

Q123 Mr Weir: I bring back the question of returnees which we discussed earlier to some degree. When we were in Lithuania we were told of several instances of people returning from the UK and spawning successful business links between the two countries. In Scotland we are very interested in having links with newly independent north European states, but could you tell us what efforts are being made to take advantage of the culture and economic links resulting from migration to the UK? He is looking at you, Mr Timmins!
Mr Timmins: I am not aware that in UK TI we have specifically addressed that point. I might plead that it is early days, but we certainly have not, as far as I am aware, looked at that.

Q124 Mr Weir: Given the level of immigration of people coming to work here, they are returning and the fact that we are all one market, is it not something that should perhaps be pursued more? Business investment is a two-way street after all.
Mr Timmins: It is indeed. It may be something that we ought to look at.

Q125 Mr Weir: We also got some evidence that there is a perception at least that some of the immigrant workers, both here and, indeed, in their home countries, are more skilled and have a better work ethic than UK nationals. Has the Government made any review of how widespread this assessment is?
Mr Portes: I do not think we would have made any review in those terms. As I said before, I think what we and the Department for Education and Skills regard as being our main business is to ensure that the British resident workforce has the skills, aptitudes and abilities to get jobs. There are some very big policy issues and questions around that and, in particular, the challenges that were identified by the Leach Report on the skills of the British workforce and what we need to do to make Britain a world leader in skills in ten or 20 years. There are some very demanding challenges and we are going to do our best to step up to them. I do not personally think that comparing our skills with those of immigrant workers is particularly enlightening. We need to do what we need to do, regardless of whether migrants come or do not come. If British workers do not have the skills they need to get jobs and compete in a global economy, then it will be very bad for the country. Correspondingly, if we can provide them with the skills and aptitudes they need, then we will do very well and that is the case regardless of the level of immigration.

Q126 Chairman: I would love to pursue that at a much greater length. It is a fascinating question but we got in difficulty once before with the questioning process, and I am very sensitive. We had a lot of evidence from the business sectors supporting those kinds of claims, particularly the British Chamber of Commerce, that young graduates from accession countries have greater practical experience than those coming from UK universities and, therefore, are more employable as far as they are concerned, so I think there is a lot to be learned from that. Three quick last questions from me, speculative questions on the future. First of all, we have heard that some low-cost producers who were originally out-sourced to Eastern Europe are looking further beyond all that is in Europe. How much have you seen of that happening and how successful do you believe these attempts will be to move to the non-EU countries in the east?
Mr Dodd: I think global sourcing decisions may involve in some cases moving to lower wage economies in Eastern Europe.

Q127 Chairman: Ukraine, Kazakhstan?
Mr Dodd: Possibly. However, in terms of the attractiveness of those countries relative to competitors much further away from the EU, I think there is a series of calculations that firms would take into account, of which distance is one element but it is not necessarily the defining factor. Whilst there is a huge potential pool of labour in countries like the Ukraine, Russia and Turkey, it is not automatic if they are priced out of central Europe that jobs will go there, they may go much further afield.

Q128 Chairman: How serious is the challenge from those countries beyond the EU borders to the east?
Mr Dodd: In terms of that overall assessment that the firm makes when arriving at a competitiveness decision, I think there are several factors which they would like to see improving in those countries before they become attractive places to invest in substantial amounts.

Q129 Chairman: I think I know what your answer to this question is but I ought to ask it, it is an important one. There will be, probably, further enlargements of Europe at some stage in the future, what lessons have we learnt from these enlargements that should apply to those enlargements?
Mr Dodd: Separating out the impact on the countries themselves from the impact on the UK labour market, which I will ask Jonathan to address in a moment, I think perhaps those countries which have found the accession process most difficult are those which have undertaken it quite quickly and who started along the road towards accession later and maybe had less time to absorb some of the elements of the *acquis.* It is a very difficult thing to do to change how things are done within the economy to that degree, and we can under-estimate it because politically it is incredibly attractive to get countries in quickly; economically it is a difficult and painful process for them to become, as it were, similar, homogeneous with countries in western Europe.
Mr Portes: On the labour market, I think we have probably learnt, as I said before, that it goes two directions. Making predictions of the likely influx of migrants is even more difficult than we thought at the time on the one hand but, on the other hand, counter-balancing that, the flexibility of the UK labour market is such that it can respond to quite significant influxes quite well and without any significant negative impacts that we can see, so that should give us confidence in future expansions.

Q130 Chairman: Just two final quite short answers to two short questions. English language, quite an important factor in making people come here to support the labour market rather than other Member States? Yes?
Mr Portes: Yes.

Q131 Chairman: Finally, are we seeing the development in the European Union of a labour market that is as flexible as the United States of America originally enjoyed and has played quite a big part in controlling inflation and boosting employment and growth in that country? It is not a political United States I am talking about, that would be very dangerous, are we seeing an economic United States of Europe?
Mr Portes: No is the short answer. There is huge variation in the functioning, flexibility and level of regulation in labour markets across Europe on a number of dimensions. I think our labour market is, for example, more flexible than the French labour market in general but whether you say that our labour market is more flexible or less than the Danish depends on how you look at it. There are various dimensions in which we differ. While there is quite a significant degree of labour mobility around Europe, as this latest experience has shown, I do not think it would be sensible to describe it as a single labour market in the same way as the US is with comparable levels of regulation. There is too much heterogeneity at the moment and I do not see, for both legal and cultural reasons, that will change in the short term.
Chairman: Gentlemen, that has been a very interesting session. I am very grateful to you for your thoughtful answers to our questions. I think you promised one additional piece of information but if anything else does come to mind we will get more of your excellent evidence. Thank you very much indeed.

Tuesday 19 June 2007

Members present

Peter Luff, in the Chair

Mrs Claire Curtis-Thomas
Miss Julie Kirkbride
Judy Mallaber
Mr Mike Weir
Mr Anthony Wright

Witnesses: **Mr Nick Kalisperas**, Director, Intellect and **Mr Nigel Hartnell**, Executive Director, Ffastfill PLC, gave evidence.

Q132 Chairman: Gentlemen, thank you very much indeed for coming into this evidence session and we are taking the advantage of your presence here to tack on a few questions relating to another inquiry that the Committee is pursuing as well, on public procurement; so we are doubly grateful to you. As always, we are grateful for your very helpful written brief, which sets out the importance of your sector for the UK economy and your highly representative nature of that sector. Can I begin, as I always do, by asking you to introduce yourselves for the record?
Mr Kalisperas: Good morning. My name is Nick Kalisperas; I am Director for Delivery at Intellect with responsibility for transformational government, transformational business, defence and security, ID and information management.
Mr Hartnell: I am Nigel Hartnell; I am a Director of an application services company called Ffastfill PLC, providing services to the derivatives capital markets in London and Chicago. I am Chair of the of the Intellect software group and recently appointed to the Intellect Board.

Q133 Chairman: But you are here representing Intellect rather than your company today?
Mr Hartnell: I will obviously use my own experience.

Q134 Chairman: Excellent, that is really helpful. Can I ask you first of all actually how important are the new accession countries to the European Union to your sector and how do they compare with other major markets to the UK, like India and China?
Mr Hartnell: Let me start with that. There are two aspects. The first one is as an expert market and clearly as a potential expert market they are just that—they are a potential market. None of them in the A8/A2 are particularly large at the moment, so from that point of view I think it is more to do with potential and future opportunity. Certainly the scale of those markets will never rival the scale either of the Indian market today or even the Chinese market today, let alone the potential of those two markets. From a sourcing point of view, what we tend to refer to as off-shoring, they are potentially very important. They have good skills; they are significantly lower cost than Western European equivalent skills; they have a very good work ethic from my experience, and I suppose some of the big advantages compared with, say, India and China, as off-shoring locations are that they are in the European time zone and so from a management point of view you can visit, review, discuss in a day as opposed to three or four days, and from a cultural point of view clearly their legal systems, taxation systems and those sorts of things progressively align themselves with the rest of the European Union, which clearly does not apply to India or China.
Chairman: That is a very useful introduction; thank you very much, Mr Hartnell. Julie Kirkbride.

Q135 Miss Kirkbride: I want to ask you how you think it differs from country to country in the accession countries? How would you describe your experience of them? If you could take us through the differences.
Mr Hartnell: I could not take you through all of them, to be quite honest. I could give you both experience and perceived information on a number. I think the first thing to remember is that all of these countries have had relations with countries in Western Europe for many years. So if we start, for example, with the Baltic States—Lithuania, Latvia and Estonia—they have had cultural, economic and in some cases political ties with the Nordic countries for a very, very long time—not surprisingly. In fact certainly three of the Nordic countries have fathered, parented each of these into both the European Union and in terms of economic growth. I cannot remember which one Finland has spent a lot of time with, or Sweden or Norway, but essentially each one has a sphere of influence, and so you tend to find that the companies from those countries are more represented in each of them than any other country from the European Union. The same thing I think applies in other States. Clearly the Romanian links with France and French culture clearly has a part to play, although my only experience—I do not know of any other experience—of Romania was 12 years ago and it was really just starting to emerge from behind the Iron Curtain. If you look at the Czech Republic and Slovakia, clearly closer ties with Germany, and if you look at Poland I would suggest much closer ties with the UK. So I think the first thing is that you therefore get different national players and countries having influence in the accession States. I think then there is a different approach which different types of companies take, so if you consider the three main economies, which I would regard as Poland, the Czech Republic and Hungary, then you will see that the multinationals, both the American nationals and also Asian multinationals and European multinationals have sought to establish a basis of

operation in those three States as being potentially important to them in the longer term, and having larger and deeper pools of skills. So there are clearly differences. But if you take the Czech Republic, which is one of which I have particular knowledge because we have a captive off-shore software department team in Prague, Prague acts almost as a magnet for talent in Eastern and Central Europe, so whilst there are a lot of Czech nationals there are also a large number of Russians, Ukrainians and other very technically skilled people, so you get different types of pools of labour. Whereas if you look in Poland at the moment there is a shortage of labour in our sector because in fact many, many Poles have a propensity to travel and clearly a lot are travelling into the UK. So that is not an off-shore opportunity, it is actually a UK skills opportunity. I hope that gives you some sense of some of the differences.

Q136 Miss Kirkbride: It is interesting how you say history explains quite a lot of what is happening. What about the comparison between those who have been quite advanced and who have really gone for this, like Estonia, who have invested heavily in high-tech industries versus—and you mentioned Romania—those that certainly relatively speaking has been quite backward in its economic development. How does your industry look at that? Do they want to get into the hiring market or do they see now more growth in the ones that have been slow to get on with it?
Mr Hartnell: I think it is very specific to what your business objectives are, so if you are looking maybe for a potentially large, medium, long-term market then you might decide that Romania was an opportunity for you. For example, if you were operating in the capital markets, where we operate, you might look and say that the Romanians are only one of three countries in Europe that have legislated for the new Financial Industries Directive, which is going to be pretty crucial to the development of capital markets. So, if we were thinking maybe to move into a country like that then from an export point of view that might be an interesting one to look at, whereas if you were looking for people who were particularly skilled maybe in advanced IT you might say—I do not know Estonia, I have to say—if that is where a lot of skills are because of the investment that the government has made, probably it reflects either Sweden or Finland's influence, to be quite honest, because they have always been very, very much at the front end of the technology revolution.

Q137 Miss Kirkbride: How has the Act of Accession changed the way that you are doing business in these markets?
Mr Hartnell: Separating out the Act of Accession as opposed to the breakdown of the Soviet Union, I find it quite difficult.

Q138 Miss Kirkbride: You do not find that easy.
Mr Hartnell: Pre-1990, if you wanted to trade—and I will take Poland as an example that again I have direct experience of—then you had to set up special mechanisms in order that you could effectively return hard currency to the UK. So there were all sorts of mechanisms which were set up, which would end up having electronic goods and software going into Poland and maybe furniture coming out and hard currency being generated in the middle. Clearly the breakdown of the Soviet Union and the progressive de-optimisation and introduction of capitalism into those countries had an effect so that in the 1990s you could trade in a different way, so you did not have to do that any longer—you could trade. Then you get an impact of the fact that the countries are preparing to accede, so everybody knows that they are preparing to accede and everyone knows they want to and they know that the Union wants them to. So it is an attitude thing, I think; so people then are more interested in investing. If you take the issue of travel visas, you did not need a visa to travel from Poland or the Czech Republic—and I cannot remember exactly when it was, some time in the mid-90s, maybe late 1990s—you did not need a travel visa to come to the UK, but clearly you still needed a work permit. Now, of course, as soon as the accession comes in you do not need a work permit and I think probably that is the only difference that actually happened on accession, but a lot of things have been changing pre-accession and continue to change post-accession in terms of legislation, frameworks for taxation and so on and so forth.

Q139 Miss Kirkbride: Given that progress that has been made what remains as to what it is that it is difficult to do business with in these countries? What are the problems and obstacles?
Mr Hartnell: I think there is nothing specific which is more difficult to do business in, say, Poland or the Czech Republic than there is maybe in Germany, France or Spain, or the UK if of course you were not a UK company. Every country has its customs and customer practice and every country still has its tax regime. I can take a specific example here: certainly in the Czech Republic, as the example that I am facing today, they do not use general accounting principles as we would use them, so they do not use UK GAAP and they do not use US GAAP, and they are unclear when they are going to move into International GAAP. So that is a specific. But they have local regulations with regard to intellectual property, which actually are more like German regulations than they are like British regulations. They still have food stamps; they have much higher national insurance at 35%. So you think you are paying X amount for a member of staff and actually it is 35% more, which is quite a significant uplift, as you will appreciate. So there is customer practice, local laws and local regulations and those really are the things. They are different for every country, but of course they are still different for every country within the older Union, but they are less different probably from the older Union as harmonisation has progressively been brought into effect.

Q140 Miss Kirkbride: So there is nothing to which you would draw our attention to on the legal processes of bureaucratic processes, bearing in mind that they came out of the Soviet style system? The new countries are the same as the older countries, but is every one different?
Mr Hartnell: Yes, they are not the same but every one is different. So there are an awful lot of bureaucratic issues if you want to establish operations, shall we say, in France, and larger ones if you want to dis-establish an operation in France. The same is true in the accession States and I am sure the same is true if you are a French company—you would feel that there were some regulations that you were not used to, and clearly we pride ourselves on the fact that our regulations are lighter touch and clearly in some instances they definitely differ.
Chairman: Before we move on, Claire Curtis-Thomas wants to ask a supplementary.
Mrs Curtis-Thomas: Forgive me for asking this, but you said right at the beginning about the importance of off-shoring for these developing countries. This Select Committee has done an inquiry in India—
Chairman: I am going to ask Tony Wright to ask his question and then I might bring you in.
Mr Wright: If you carry on and I will come in.

Q141 Mrs Curtis-Thomas: I am conscious of the fact that my colleague is about to ask you a question in relation to this but I would like you to add into the response the duration of time you think that Europe offers us in terms of an advantage for off-shoring and how that compares and contrasts with India?
Mr Hartnell: An advantage for off-shoring?
Mrs Curtis-Thomas: No, let me be quite specific. How long do we have in terms of time for off-shoring in Europe in comparison to the amount of time available to us for off-shoring in India?
Chairman: The cost advantages.

Q142 Mrs Curtis-Thomas: Yes.
Mr Hartnell: The question, I think, comes down to one of how quickly will Eastern European wage rates, as you might say, catch up with Western European wage rates? That is, I think, the essence of it. Wage inflation—and again it is different across all the countries—seems to be fairly stable, around 5% or 6% in most of the countries that I can see of the acceding States. So given that the relative costs are probably 25% of the UK costs at the moment—maybe 30%—and UK wage inflation is running at whatever the latest figure is, say 3% or 4%, you can see that it takes quite a long time. I am not an economic forecaster; I cannot say when that will change. I do know that in India the highly skilled people with lots of experience are now starting to command already western-style salaries.
Mrs Curtis-Thomas: That is all I wanted, thank you.
Chairman: Tony Wright.

Q143 Mr Wright: On the same lines in terms of the off-shoring and near-shoring, as we would term it, you put your evidence forward as very strongly supporting the concept of off-shoring and near-shoring. Can you outline what are the advantages and, of course, the disadvantages, specifically in this particular area for the A8/A2 countries?
Mr Hartnell: The advantages as against India, do you mean, or China, or generally of doing off-shoring?

Q144 Mr Wright: Generally, yes.
Mr Hartnell: There is the obvious one of cost, which I suppose is the first one that people address and in one sense this is a very significant opportunity for small companies, high growth companies, even start-up companies in order to compete with the large multinationals, who are absolutely exploiting global sourcing in order to bring their own costs and, as a result, prices down in the global market. The IT industry is a global industry and we have to compete with everybody and anybody—no markets are closed. So cost is a very important part of it. The second part is the availability of skills. In the UK we have a substantial shortfall of skills in the IT sector and by IT skills I mean real computing skills, I do not mean that I know which key to press in order to get *Word* to do whatever it happens to be. So I mean genuine computing, mathematical computational skills. We have less people going through those particular courses at university, we are producing less graduates and as a result the industry is experiencing a shortfall in this area. So as a pool of skills Eastern Europe is very attractive. People often say that they feel—or certainly they did feel—that Eastern Europe had rather backward skills in this area, but actually if you think of both the mathematical skills and the science programmes, and also the things that the Soviet Bloc was able to do with very, very poor electronic technology, you can see that an awful lot of that came out of the software skills that were being put to use in those programmes. So skills, cost and there is a very positive image for technology and in particular information technology and computing, so people want to be in this industry in the accession States; they see it as a way to earn a good wage, a way to participate in a global industry. They have, as they see it, grown up in a hidden economy and they now want to participate in the global economy and they find it attractive. That contrasts quite substantially with the UK where the image of IT, I would say, has progressively declined as an attractive career option over the past ten or 15 years substantially—so much so that you find very few parents would encourage their children necessarily to go into the IT industry.

Q145 Chairman: That is a fascinating observation—if I could just stop you in mid flow there. You say that very few British parents would encourage their children to go into the UK IT industry.
Mr Hartnell: That is exactly what we are finding, yes.

Q146 Chairman: I am bewildered, amazed.
Mr Hartnell: So are we. Obviously that is particularly true, dangerously true of girls, but it is also significantly true of boys now.

Chairman: You learn something every day. I am going to take the liberty of cutting off there and asking Tony to move on in his questions as well because we are slightly up against time on the questions on procurement.

Q147 Mr Wright: Continuing along those lines, you have put the disadvantages, but you certainly seem to be very assertive in your view that the government should be doing more to promote more off-shoring from the companies. Really it goes against what my principle would be. I have a number of electronic companies in my constituency, who may well be members of your organisation, and I would certainly be averse to telling them to off-shore their work to another country because it would mean a loss of jobs in my constituency. So what you are saying is that because of these problems the government should be promoting more off-shoring and near-shoring to obviously increase the business of the particular companies. But it could be to the detriment of the UK as far as the employment opportunities are concerned, and that in itself would be a double whammy because then there would be fewer opportunities for IT graduates so therefore the parents would then say there are fewer opportunities there. Surely the other way round should be for you to promote and to encourage those parents and indeed the education establishments to push more students through into IT and encourage them into the UK companies rather than trying to off-shore or near-shore the business that we can see. Surely it goes against whom we should be pushing?

Mr Hartnell: What I would say to that is that we neither promote near-shoring, off-shoring, nor promote the use of local skills. Clearly that is a choice for each individual firm to take. The thing that concerns us is that we have a shortage of skills; that is an absolute fact and all our members have continued to tell us that, that they cannot find the skills that they want and therefore they cannot grow the business, which is not good for the UK economy. We need to find other sources of skills, particularly in the short-term, and there are these other sources of skills. The thing that concerns us is that there is very poor information in this debate about whether off-shoring is a good thing, whether it is for the national economy or not, and the danger is that it tends to be portrayed as that if you off-shore you are doing damage to the UK economy, and that is not the truth as we see it. In the Paper we ask very much that there should be a detailed survey and study of off-shoring and its impact on the UK economy because this is not just going to impact on the IT industry—the whole of the southeast of England is a services economy. It is progressively being off-shored, yes, whether you like it, I like it or anybody else does, to places like India and to the Eastern European States. We should understand the impact of that and we will all benefit from it. The most important thing as far as we are concerned is that firms are educated of the opportunities that they could have to off-shore, the benefits that they would get, the disadvantages that it might hold, and we have started to do that with our small companies because we think it is important that they have the facts as we see them in front of them and they can make those choices.

Q148 Chairman: Your evidence is slightly contradictory if it is misread, I suspect. Earlier on in your evidence you asked government to do more to produce evidence, objective data on the effects of off-shoring and near-shoring, and in later evidence you asked the government to do more to promote the benefits. So the reason you want the work done on the evidence is that you believe it will show how beneficial it is and therefore how much more it should be promoted, is that right? Just reconcile the contradiction.

Mr Kalisperas: Fundamentally the debate around off-shoring, outsourcing, is a sub-set of the wider debate about effectively what sort of economy is it that the UK is becoming or needs to become in order to remain competitive. One of the points that we make in the Paper is that in order for SMEs, particularly, to make informed decisions about where their businesses should be located they need to have access to all the relevant information in order to either access new markets or to remain in the UK. In the short-term it is recognised, as Nigel has mentioned, that we have a problem with skills, so therefore companies need to understand either how they can get skills from abroad into their organisations or what their other options are, in other words off-shoring. What we are saying in the paper is that our members—and probably wider than our membership—need access to the right information in order to make the right decisions for their companies. As Nigel has mentioned, it is in our interests for the UK to have a flourishing economy, but we need to address both the short-term and structural problems and the longer-term issues, and we have seen—just building on the point that Nigel has made—around skilling we have done some work which we can make available to the Committee that the IT industry is not doing enough to retain and recruit women into the workforce, so after they leave to become mothers we are not doing enough to get them back and we are not doing enough in terms of retraining, and there need to be more incentives in that regard.

Chairman: We are going a bit wider now. I understand what you are saying and if I had time I would explore it in more detail, but we are going to move on to Mike Weir.

Q149 Mr Weir: Following on from this question of off-shoring and near-shoring, a recent report commissioned by the DTI found that IT companies were not making use of the knowledge in the accession countries gained through near-shoring to develop export markets in these countries. Do you agree with that assessment and, if so, what do you think should be done about it?

Mr Hartnell: I can only give my own personal view on this. As I think I said in my opening remarks, in the main the accession countries are small economies; they are, in some cases, growing fast but they are small economies and therefore in terms of the attraction to companies who wish to develop export markets they have great difficulty in competing as an attractive opportunity with the Asian economies in particular, because we are all talking about India, China, South America and so forth. That does not mean to say that they are not attractive, but it does mean to say that they are not high on the list. In terms of using off-shoring as a way into an export market, quite clearly it is theoretically a way into an export market, but I do not think you would off-shore in order to enter that market—that would not necessarily be the right approach to this.

Q150 Mr Weir: From what you were saying earlier, presumably there is a large amount of off-shoring going on for the skills that you mentioned. These people are presumably developing their skills, developing products or whatever within these markets, so does it not make sense to then look at developing the export markets from that base? We talk about small markets but the whole of Eastern Europe presumably together must make a very substantial market?
Mr Hartnell: The whole of Eastern Europe together absolutely, but we have to remember that it is five, six, seven, eight, nine, ten countries—it is a lot of countries and they all have different characteristics. So this is not a homogeneous market in the same way that Western Europe is not a homogeneous market. My company has had an off-shoring operation in the Czech Republic since 2001 and was probably one of the first in there, and so we are well established and well known to the establishment and we know the market. The Czech capital markets set up a derivatives market, which is exactly the area in which we trade, so we went along to talk to them thinking that here is an opportunity for us, and the answer was, "You are probably five years too early for us, we are so under-developed at the moment, but anything you could provide us with would be completely inappropriate. Why do we not talk every year and see if there is anything you can do?" I give that as a single example but my point generally is the fact that these markets are not of themselves very large yet. They will become so—Poland clearly will become so and over a period of time it will recover from economic stagnation of 50 years or 70 years and will develop and it will be an attractive market. But as with all export markets timing is crucial—you go too early and it costs you a lot of money and you make no progress.

Q151 Mr Weir: We hear in some markets about leaping development stages, not going through what we went through. Is there not a market for doing that in IT, for example? The derivative market is an interesting one and I would have thought that it might look forward to get ahead of the game in that respect.
Mr Hartnell: They might aspire to but I think they are probably pragmatic. The danger with the classic rush of growth is that that is what happens in economies—they have a rush of growth and then they have a fall-off. Again, I am not an economist but it seems to me that in a number of the major accession States in Eastern Europe that that is what happened in the immediate years, in the 1990s, and we have a more stable growth which is probably a good thing.

Q152 Mr Weir: You have talked a lot about skills and acquiring new skills by near-shoring but much of the evidence we have received for this inquiry suggests that UK business was slow off the mark when realising opportunities in the new Member States. Do you think that is true of your sector?
Mr Hartnell: I would differentiate between the major multinational companies and the SMEs probably. I think the multinationals, no; they have not been particularly slow off the mark. All the ones that you would know about are located in some if not all of those countries and have been now for a number of years, and a number of major corporates have established part of their own IT departments. I think the smaller companies, from the Small Medium Enterprise Sector have been slow and are slow to take up off-shoring at all. It is nothing to do with the accession countries, the same is true in India, which of course is where the vast majority of global off-shoring is taking place anyway, as you know. I do not think in any sense that that is slower than any other country. The UK clearly is off-shoring a lot of its software development, particularly, things like that as aggressively as any other country is doing it, including America. So I do not think in any sense that the UK is behind, but I think that there is an important opportunity for the small and medium enterprises at least to understand the potential benefits of off-shoring into the Eastern European countries because there is a lot of fear, uncertainty and doubt, particularly when you say to a small company, "Why do you not off-shore?" because the first thing that comes into their mind is India—everybody talks about India, the government talks about India, unless they are talking about China—so a small company thinks, "India, that is a very, very long way away, it is a very different culture, how do I control it, how do I manage it?" So it then goes into a "much too hard" box and having put it in the much too hard box that means that after that the SME does not think about off-shoring, whereas if they thought about off-shoring in Central Europe that is much more attainable for them and they would gain many of the benefits—not all of the cost benefits but most of the cost benefits—and they would gain some additional ones, like ability to travel in and out because of the European time zone and like the progressive harmonisation of regulation and standards, like the European culture and so on. So I do think there is an opportunity, very definitely.

Q153 Judy Mallaber: In your evidence you state that in the longer term the A8/A2 could prove to be a potential competitive threat to the UK. How long do you think it is going to be before that competition emerges and where do you think the competition is primarily likely to come from?

Mr Hartnell: All one can do in these circumstances is to look at some other examples. India is quite clearly a competitive threat now to the whole of Western Europe IT sector and to the American IT sector—it is a global power. I would say that the Indian IT industry has been growing and supported for probably 20 years, from my experience of operating in India, and that was with an awful lot of Indian government support. I do not see the IT sector in any of these accession States getting the sort of centralised government support that the Indian industry has been receiving, so I suppose given that they had in some sense a start I would say probably five to ten years. Let us say ten years.

Q154 Judy Mallaber: Keeping on my question of support, you do talk about requiring government support. What kind of support would that be to enable the sector to compete with those countries and for you yourselves to play the role that you suggest in your evidence, and is it realistic to think that the government might give direct support?
Mr Hartnell: We are not looking for support in probably the traditional way of asking for support—the support we think is required is first of all information and education support. The thing we ask for is a proper review of the benefits and issues, advantages and disadvantages of off-shoring, so that then sensible, rational, supported arguments can be placed in front of particularly the SME sector. The second thing that I think is important is that industry—in our case the IT industry—receives better information on the accession States. A lot of this is fear, uncertainty and doubt—people do not know what the impact of the taxation legislation in Poland will be on them establishing something in Poland. So the question is: does every small company have to go and find that out for itself or is there actually something that government information could provide?

Q155 Judy Mallaber: To clarify this again, when you were talking about competition you were talking about that we might lose out on the opportunities to off-shore and government should help do a review to enable British companies to offshore into A8/A2 countries?
Mr Hartnell: To enable British companies to have the information in order to make the choice. This is about trying to give the Smaller Medium Enterprise Sector information so that they can make an informed choice about whether they should off-shore or continue to on-shore or a piece of both, given that there are skill shortages in the sector in the UK at the moment and that there are very large competitive threats in terms of pricing pressures from companies that operate from low cost economies.

Q156 Chairman: Can I test this a bit more? There is one report that the DTI has produced by a consultancy, Ovum, last year, The Impact of Global Sourcing on the UK Software and IT Services Sector, but how good is that report? Do you want more of that kind of thing? What exactly is it that needs to be done? I am not quite sure what you are asking for?
Mr Kalisperas: I think what we are asking for is not just the overall market, the top line financial stuff, but it is also if you are an SME one of the things that you need to do in the UK is to understand the tax laws here or regulatory laws were changed, employment law, et cetera, et cetera, et cetera, so that you need to get an accountant in or a lawyer in, et cetera. There is not a pithy amount of information readily accessible for an SME in this country, just to understand what is going on within the UK to keep up to date, whereas the larger multinationals have in-house resources which enable them, if they want to site an office in Poland or want to access European markets they would have done their research. For the SMEs, if an SME wants to say, "I want to do some work" or "I want to understand the market in Estonia," is the information there readily available from UKTI or DTI in an easily understood form? Also, if it is there in an easily understood form do they then have the opportunities to understand that market in terms of ongoing support, advice and guidance? In our view at the moment that information is missing, and for an SME, as Nigel has mentioned, if they want to make that decision they do not have the necessary information to make it.

Q157 Chairman: UKTI is not doing its job well enough in these Central European markets, because that is one of its core functions, to help people understand the way you do business in that market?
Mr Kalisperas: Yes, we think that more needs to be done and I think more needs to be done by better understanding the needs of that particular community. Fundamentally, yes, any community is very diverse; it has different needs and different drivers.

Q158 Chairman: You are asking for that and you are asking for the government to do more research on the overall benefits of off-shoring and near-shoring to the UK economy—more work done on that as well?
Mr Kalisperas: Benefits, disadvantages, there needs to be a review of how off-shoring in particular has affected the UK economy, what the benefits are and what the opportunities are.

Q159 Chairman: Last year's report is not good enough? It does not go far enough, it is not detailed enough?
Mr Hartnell: I have not read it myself.
Mr Kalisperas: It is a step in the right direction but it is not enough solely to publish a report—there needs to be an ongoing action plan in order to assist businesses.
Chairman: I am sorry to have interrupted; that is very helpful.

Q160 Judy Mallaber: I was moving on anyway. Looking forward to any potential future EU enlargement, do you believe that there are lessons that can be learnt by the IT and related sectors from the experience of the enlargement so far?
Mr Kalisperas: I think that where there are enlargements in the future—and it maybe further east, Turkey or the Ukraine, maybe possibly further east than that—there needs to be an earlier dissemination of the potential benefits of doing business with those countries, an earlier dissemination using the trades associations because they are entities that can facilitate a one to many engagement, in order to provide companies with the information they require and in order to make an informed decision as to whether countries such as Turkey or the Ukraine are the right sort of countries which they would like to locate offshore or would do business with as an export market.

Q161 Chairman: That draws the first and most substantial section of our evidence today, but my understanding of what I have heard from you is that Intellect sees the countries of Central and Eastern Europe more as an opportunity to enhance UK competitiveness by accessing their skills rather than as a market in their own right at this stage, at least in their development?
Mr Kalisperas: I think that would be a fair assessment, yes.

Q162 Chairman: Can we move to procurement, upon which you have kindly agreed to answer questions? A simple question first of all: government procurement is always about value for money, amongst other things, and it must be about delivering effective services, and it should also be about encouraging or assisting innovation, would you agree with that?
Mr Kalisperas: Theoretically, yes.

Q163 Chairman: So what is government doing wrong at present that is not encouraging enough innovation in your sector? How is it getting the procurement process wrong?
Mr Kalisperas: I think in the first instance you have to look at the public sector as the market place. It uses taxpayers' money, it is accountable to Parliament, it is governed by EU competition rules and it is very silo-orientated, so even within government departments there can be multiple silos and each government department, each agency, each unit within an agency tends to procure in a slightly different way. There is not a coordinated, joined-up approach on procurement across the public sector; there is not a coordinated strategy for the dissemination of best practice across the public sector; and there is not an overall attitude to encourage innovative solutions—procurements are based very much on the here and now more than looking five, ten years in advance to see (a) in the businesses of IT where the technology is going, and (b) to look at what are the solutions that could manifest themselves in terms of modernising services.

Q164 Chairman: I have heard it said by people in your industry—I do not know whether this is Intellect's view—that one of the problems is that government does not go out and say, "Hey, we have a problem, help us solve it," they go out and hire consultants to find the problem, to find the solution and then invite bids against a very tight specification, which means that your companies cannot offer the creative solutions that might be available to that particular problem. Is that fair?
Mr Kalisperas: That would be a fair assessment. The addition to that is that you then sometimes have Ministers standing up and saying, "We have announced this, we want it delivered by a certain date," and that automatically also curtails any sense of innovation because you are essentially delivering to a fixed timescale because that is the political dynamic currently existing at the moment. So, as I mentioned previously, you are very much procuring for the here and now without looking slightly further ahead, and also with the introduction of those deadlines you do not have adequate time to engage with the market to understand what solutions are out there, both from large multinationals and also from the smaller niche providers. That is the point at which innovation needs to come out. Once a tender is published it is too late—by and large the dye is cast. What needs to happen is a much better, a much earlier engagement between, obviously in our case, the technology industry and the procuring government department in order to understand not just the capability but also the capacity of the technology industry to deliver a solution.

Q165 Mr Wright: To continue along those lines, what we have to bear in mind of course is that the government, certainly in recent years, has procured an awful lot in terms of innovation, and of course we have always faced severe criticism from the general public. If we take just one example, the patients' electronic records in the NHS, and latterly when we talk about the ID cards. Anything that we do obviously creates a problem for us because the costing comes in and what we budget for increases and there are difficulties and problems, and so we get that criticism. So how do we overcome that argument where you have a government that wants to procure, they want to innovate, they want to invest in new technology, but we always get accused of wasting taxpayers' money and harming users of government outweigh any benefits from promoting innovation?
Mr Kalisperas: We have done a lot of work with the Identity and Passport Service on this sort of pre-procurement phase, that has been going on for four to five years now in terms of the National Identity Scheme, and there has been a very firm dialogue, I would say, a very honest dialogue between our members and the IPS about what sort of solution can be delivered and how should it be delivered.

Q166 Mr Wright: That is fine, but what I am saying is how do we go against our critics who say it is a waste of taxpayers' money?

Mr Kalisperas: I think it is very easy to criticise any IT project. If you take the National Identity Scheme, for example, much of the technology itself is already being used elsewhere and, to be honest, it has already been taken for granted by the general public particularly around the actual card itself in terms of chip and pin—we take that for granted when we use it in the financial services sector. The issue that we come up against is that we do not clearly communicate the benefits to the citizen in terms of any IT project. So financial services did a very good job in terms of introducing chip and pin; they said, basically, "If you use this technology it increases your security and it makes buying goods and services easier for you." Tesco, when they are using loyalty cards, in terms of the management of information they have communicated benefits clearly to the citizen. On the public sector IT projects by and large we have not done that, we have not articulated the benefits to the business community or to the citizen clearly enough, what it means for them—we talk about more general concepts around security, modernising public services, et cetera. Electronic patients' records by and large we take for granted now, that we can go into our local GP and he can look up our records—he no longer has that file of papers two or three inches thick because it is on a computer now. But we take it for granted and we do not articulate those benefits as effectively as we should.

Q167 Mr Wright: But the patient does not care whether the doctor has a pile of papers or has a computer screen, the patient is concerned about what the doctor tells that person about what is wrong with them, so how do we explain to that patient that it is going to cost billions of pounds for this technology?
Mr Kalisperas: Essentially if you take the National Programme the figure that is always quoted is the overall figure and when it breaks it down it is actually a smaller amount, but for the patient we have to say that, "Basically this is one step towards providing you with a better service, basically being able to provide you with an end to end service. If you go to see your GP you have to go into a hospital and then you have to have some after care after you leave hospital, with social services," and it should be the case that the technology should be there to enable better end to end tracking of the citizen, better benefits for them in terms of the care they will receive and how they are managed by healthcare professionals in the instance of electronic patient records because EPR should be just one component of a much wider solution, and that is where we are not at. As I said previously, we procure in silos so basically departments will look at what is important for them, and what we do not have is an implementation of the procurement strategy, which looks right across the board and says, "What are we trying to achieve through the procurement of these solutions? How can we best achieve that and how can we use organisations such as ourselves, the IT sector generally to deliver those solutions?" Fundamentally, the IT itself is just one component; there are significant cultural changes that need to take place within the public sector to use the technology, to realise that it is of benefit and it is not there to replace 80,000 civil servants, as we have been accused—it is very much about improving the service to the citizen, but we do not articulate it in those terms.

Q168 Chairman: Is there not always this tension in public procurement, about which you are expressing frustration, that playing safe is the easy option?
Mr Kalisperas: Yes.

Q169 Chairman: And that will always inhibit it because that way you are going to get less criticism in the media, less criticism in Parliament, but you will not get the innovation?
Mr Kalisperas: Yes, and there is always the fear that for a civil servant they will be up before the Public Accounts Committee or they will be up before any other Select Committee having to explain themselves, and fundamentally it is far easier to name the failed projects than the successful ones. The NAO, at the end of last year we contributed very fully with them, produced the report which listed 25 projects that they considered successful, projects that we have taken for granted, and the media coverage it received was minimal. It is not a surprise, but that is the environment.

Q170 Chairman: You sound like the Prime Minister last week—the "feral beasts" are at you, are they?
Mr Kalisperas: No, we accept that there will always be criticism and that is rightly so. If we are engaged with taxpayers' money, utilising taxpayers' money and we are not collectively between ourselves and the public sector delivering the solutions which are expected, then there should be a level of scrutiny, there should be a level of criticism, but that should not hinder the development of innovative solutions and it should not hinder the early debate between ourselves and government over not just procuring for here and now but what is the bigger picture and what role should technology play.

Q171 Chairman: But your experience of the Immigration and Passport Service is that you are getting that level of early discussion?
Mr Kalisperas: We run a served called Concept Viability, which provides for an early interaction between government departments and the IT industry.

Q172 Chairman: So there are examples of good practice in government which need to be more widely shared?
Mr Kalisperas: Yes.

Q173 Mr Weir: How well does the government use public procurement to promote energy efficiency and sustainability?
Mr Kalisperas: At the moment it is an emerging issue. I do not think the issue on energy and efficiency has been done as well as it could have been addressed. I think more needs to be done there.

Fundamental to that again is the dissemination of best practice and of coordinated approach. The issue on sustainability is essentially twofold, it is not just about ensuring solutions have a longer life span, it is also about making sure that solutions are effectively future proof, so you do have one eye on the future, and I think that is an area for further development from within the public sector.

Q174 Mrs Curtis-Thomas: On your website you comment about the best practice guidelines published by the OGC in 2004 and you said that they "do not accurately reflect the best interests of customers and ultimately those of the industry". Do you think that the OGC has done anything to address these deficits and, if not, what are the problems that remain?
Mr Kalisperas: I think the OGC has made significant strides in the right direction. Last year we published our best practice guidelines for contracting, which sought to highlight the industry perspectives on how to contract for successful outcomes. There is always going to be a tension. There is the contracting model which seeks to provide very stringent terms on the supplier and I think there is a general recognition that that is not the way to go; nor is it in the taxpayers' interests to develop contracting outcomes which overtly favour the supplier. I think we have to contract somewhere in the middle, where there is a balance between rewarding the supplier for the risks that they take and also recognising the responsibilities that the public sector has for utilising taxpayers' money. Ultimately there should be—and it is something that OGC have done—some standard Terms and Conditions which should act as a guide for specific government departments.

Q175 Mrs Curtis-Thomas: So would you say that the OGC is making progress in the light of your criticism or industry criticism and amending their practices iteratively to reflect the circumstances as they arise?
Mr Kalisperas: Yes, I would say that I have been in Intellect for seven years and in that time we have always had an open and very honest dialogue with OGC.

Q176 Mrs Curtis-Thomas: So they are moving forward then?
Mr Kalisperas: Yes, definitely.

Q177 Mrs Curtis-Thomas: In which case do you think you could change the comments on your website to reflect that?
Mr Kalisperas: Our website is currently being updated, so yes.

Q178 Chairman: Overall, public procurement by government, marks out of ten? I know it is a curate's egg, good and bad in parts, but an exam answer is good and bad in part—you always get a mark in the end. Overall, out of ten, how well does government do at procurement?
Mr Kalisperas: Six and a half with could do better.
Chairman: That is really helpful.
Mr Wright: That is not the answer the Chairman wanted, by the way!

Q179 Chairman: Given the political constraints and media constraints, what is the best score they could hope for—eight, nine?
Mr Kalisperas: I think it will be a path of steady improvement, but just probably as a closing comment one of the things I would say is that we generally take a far more cautious interpretation of the EU competition laws than a lot of our European counterparts and that has caused much creativity, so if there was a slightly more liberal interpretation of those rules—and I think a couple of years ago the Wood Review, from the Engineering Employers' Federation, to which we gave input, was very accurate, and it is a complaint we hear a lot from our members that other countries do much more in terms of assisting companies. If there were more liberal interpretation of the directives the mark would be higher.

Q180 Chairman: If you were able to give us any practical examples of how other countries are more flexible with the rules than we are we would certainly welcome that. There is always the constant cry from government, "Give us the evidence", as you know.
Mr Kalisperas: Yes.
Chairman: Thank you very much for giving us the evidence today, we are very grateful to you; you have informed our deliberations to you considerably and we express our gratitude to you, gentlemen.

Monday 2 July 2007

Members present

Peter Luff, in the Chair

Mr Brian Binley	Mark Hunter
Mr Peter Bone	Miss Julie Kirkbride
Mr Michael Clapham	Mr Mike Weir
Mr Lindsay Hoyle	

Witnesses: **Ms Sally Low**, Director of Policy and External Affairs, and **Mr Richard Lacy**, Chief Executive of Bedfordshire and Luton Chamber of Commerce, Business and Industry, British Chambers of Commerce, gave evidence.

Q181 Chairman: Thank you very much, Sally Low and Richard Lacy, for coming to us this afternoon. We are sorry to have kept you waiting, delaying the session. We thought in view of the very important statement on the floor of the House after the very important events of the weekend, it was right that we should not sit at the same time as that statement was happening, or at least was beginning, so thank you very much indeed. Also, thank you very much indeed to the British Chambers of Commerce as an organisation and to the individual chambers, I am glad to say, including my own, for the excellent written evidence we have had from a number of local chambers as well. We really do appreciate that written evidence and what is in it, and that will inform our questioning very much this afternoon. Thank you very much, we genuinely appreciate it. Can I begin by asking you, as I always do, to introduce yourselves.
Ms Low: Thank you, Chairman. Sally Low, Director of Policy and External Affairs for the British Chambers of Commerce.
Mr Lacy: Richard Lacy, Chief Executive of Bedfordshire and Luton Chamber of Commerce, Business and Industry.

Q182 Chairman: Thank you very much. Can I begin by asking you the kind of question that you could answer for the next hour, but try just to look at the headlines that would lie behind an answer to this question. What do you think the potential of the ten accession countries, the eight original ones and two newer ones, as business partners and markets really is for the UK, and what could we gain as a country if we fully engage with those markets in those countries?
Ms Low: Chairman, I think that the potential of those markets is enormous. I think Britain and UK business have already benefited hugely from access to skilled migrant labour from those countries. There has also been enormous value from the potential of opening up those markets and exploring business opportunities there, but I would say what is becoming evident from our businesses is a feeling that we have failed to fully exploit the opportunities that the accession countries could have provided for us. In a nutshell, we may well get into this in more detail as we go through, from our position there is definitely a feeling that we have not embraced the opportunities as fully as we might and as fully as other European Member States have done.
Chairman: That is a very helpful introductory comment and I think that does summarise the evidence we have had, not just from you but also from your individual chambers as well which have contributed evidence. Mark Hunter.

Q183 Mark Hunter: Thank you, Chairman, and thank you for giving me the chance to ask my question early, I am afraid I have to leave in a short while. I want to try and bring some clarity to something that we have had evidence on for this inquiry which came to our attention with regards to the A8 and A2 countries as investment and export destinations. On the one hand, we are told that the small size of the A8 and A2 economies relative to the rapidly growing, emerging economies has been stressed but, on the other hand, we have also been told that the evidence regarding UK exports to Poland, for example, are "on a par" with those to China. Could you help clarify this? How do you see the A8/A2 countries compared with other rapidly growing markets with regard to potential destinations for investment and exports?
Ms Low: I will defer to my colleague, Richard Lacy.
Mark Hunter: I think he is about to defer to you! As long as one of you has a stab at it.

Q184 Chairman: He gives the authoritative answer.
Mr Lacy: There has really been a great deal of excitement about some of the opportunities in the Far East and it is my belief, talking to many businesses, that the emphasis clearly in the mindset of businesses is to exploit what at the end of the day will be massively larger markets of not just China and India but some of the other emerging economies, Mexico, and I am not sure of the others that have been mentioned, but Brazil. I think that Eastern and Central European markets are seen very much as a poor relation and that is reflected, as Sally alluded to, by a lack of operation and activity to exploit those opportunities of Eastern and Central Europe. We may well get on to this, but to a large extent I believe that the UK and UK plc have been a little bit slow and a little bit late in recognising the opportunities for exporting as well as other initiatives in Eastern and Central Europe. There is a certain amount of catch-up that has to take place to

realise the massive potential which grows, in my opinion and of those businesses I speak to, and does still exist.

Q185 Mark Hunter: Do you have a view about what could best be done to help promote those opportunities?

Mr Lacy: I think that we are all aware, are we not, that there has not been very much of a concentration on the part of Government and government agencies, and certainly it is reflected in funding levels, to assist businesses directly to seek new opportunities as opposed to exporting, and I appreciate your question was specifically exporting-related. The emphasis of UKTI seems to be on attracting inward investors which, because of limitations of budget, would have meant clearly that funds have moved away from concentration on export initiatives. I think that at the very least to capitalise further on those markets, we need to shift that balance.

Q186 Mark Hunter: You seem to put the onus more on government agencies to be in the business of active promotion rather than accepting that perhaps it is the responsibility of some of our businesses themselves to proactively go out and seek these opportunities and find out for themselves. Where does the balance lie in your view?

Mr Lacy: I am not quite sure where the balance lies, but clearly both parties have a part to play. I think, frankly, without prevaricating too much, that it will be easier for businesses to capitalise on those opportunities which they recognise are their responsibility to pursue, but it would be easier if it was better facilitated by some of the agencies.

Q187 Mr Clapham: Could we just look at the effect of the relocation of British manufacturing in the A8/A2 countries. One of the things that is quite clear is that since the accession to the EU, there has been quite a considerable amount of relocating and there is some concern this has undermined the ability of the UK to maintain a competitive domestic manufacturing base. Have you done any research at all that may shine a light on this particular concern? Is it a correct concern or is it just a perceived concern?

Ms Low: I think what we have learned since EU enlargement is that there has been a shift, as we know very well, and manufacturing has been moved to other countries. The enthusiasm with which UK small and medium sized businesses have embraced migrant labour tells us an awful lot about the lack of access to skills and the ability of our business members—100,000 across the UK—to be able to source the people with the correct skills and the correct aptitude for work. The nett result of that has been an inherent disappointment on the part of businesses of not being able to access those skills locally. The message from that is that we must play to our strengths which lie in competing with regard to manufacturing by looking at other technologies, technology transfer, development, all the things that the UK plc has inherently as a strength and place those strengths. The very real danger that has come out of the evidence we have submitted to the Committee, and from our business membership, is that what has happened with the policies which Richard was talking about, the emphasis on inward investment rather than retaining the balance with export promotion, is that we have ended up with a situation where we are in grave danger of losing those skills. I refer, for example, to the pharmaceutical industry. Manufacturing went out of this country a while ago in pharmaceuticals; we lead the world in this sector and we lead the world in development, but there is a very real danger that there will be a shift in research and development of pharmaceuticals moving to follow manufacturing. That is coming out with regard to the creative industries. When you have got all the manufacturing resource based in the Far East, then it starts to make good sense, if you have got access to those skill levels, to relocate the development, research, innovation, technology transfer and all of those things to those locations as well, and that is a big problem. I know Richard has lots of examples in the banking sector as well. For example, in Poland we have one major bank and there are 82—

Mr Lacy: My figure is there are 86 different banks. I think all four of our major banks are there now, but four years ago my understanding was that there were not any. If I could add—and it is a separate point—to Sally's response to your question about relocating manufacturing. There is an argument that many businesses would make, and certainly they have made to me, that to ensure their own development, or even survival, they need to be forever competitive and the way in which they can improve their competitiveness is by seeking out those manufacturing resources and facilities elsewhere. That is what is keeping their other employees in the UK with a job, because they are becoming more competitive, and perhaps those who are not recognising opportunities of investments elsewhere, if I was an employee, I would perhaps be wondering about my future, dare I say it.

Q188 Mr Clapham: The indication then is that, although manufacturing has relocated and has taken some jobs, there are things like design, the smart side of manufacturing, which is retained in the UK?

Mr Lacy: That is very much the case and it is a very important point to make. The second largest employer in the private sector in Luton, for example, is a company that fairly recently announced it was outsourcing one of its manufacturing operations to Poland. Their argument was that would enable their other manufacturing plants in the country to remain open because, overall, they would be more competitive, but I think the point you are making is very valid. The creativity, design, research and development and let us call it "the technology and the professional nous" is what we are good at here, as we all know, all those innovative things and it is a matter of exploiting those to the full but perhaps outsourcing elsewhere might enable those businesses to flourish.

Q189 Mr Clapham: You would see the idea of relocating manufacturing as being part and parcel of that move towards nudging the economy to a higher value level?
Mr Lacy: One is in danger of generalising here, but I hear this from businesses a great deal, that they must consider the outsourcing, whether it is manufacturing or it is sourcing some of their basic materials elsewhere. It is not just less expensive, cheaper or other nice words you want to use, it is not just the financial element, it is very often the quality and the whole concept of working in partnership with others rather than, perhaps, doing everything themselves that also has some appeal to businesses. I think it is wrong to say that is the only route but at least if you do not check out those options, you are not as well informed as you might be to run your business.

Q190 Mr Clapham: It is not happening in the same way in the service industry, is that correct? You mentioned banking.
Mr Lacy: Probably not today, but it is developing and I see that, frankly, as the next big emerging market for UK businesses to pursue in Central and Eastern Europe and we have got a lot of catching up to do with the Germans and the French. If you take Poland, for example, I think it has eight other countries on its borders. Those countries have been trading with Poland, if we take that as an example, for centuries if not decades and we have got some catching up to do there.

Q191 Mr Clapham: On that question of the French and Germans, because it comes up time and time again that the French and the Germans are one step ahead, it is not just over recent inquiries which we have done, it is over the last decade we have heard this, are they so different? Are they using different techniques or is it merely that geographically they are positioned well to be able to exploit the current markets in the A8/A2?
Mr Lacy: I think Sally might want to come in on some of the government assistance and all sorts of initiatives that have been designed to help the Germans and the French and, for all I know, other business communities. My understanding is that there has been—it might not be so great today as it was ten years ago—throughout British industry, generally speaking again, massively generalising, some sort of aversion to necessarily embracing all the opportunities of doing things with other countries. We have tended perhaps to concentrate on doing trade down the road with our neighbour, and that is fantastic, but if there are other alternatives out there by looking elsewhere, I would say the French and Germans, in particular, have recognised that more than perhaps we have because of that thing called the English Channel getting in the way or whatever.
Ms Low: Italy, Germany and France gave a massive amount of assistance to the various accession countries prior to them joining the EU and that had a great effect on building relationships, so it meant from a UK business perspective we were very much on the back foot and not able to have all those relationships in place. Germany, in particular, has pursued a very aggressive policy towards that. Another perception we have gathered from our survey of our business members is the geographical advantage that Richard mentioned, but also firms are finding that European competitors tend to have an advantage in terms of their compatible systems and supply chains that are already in place, I suppose referring back again to the relationships that are already being built. That makes it difficult for UK firms competing on a sales level, for example. I have got a quote from a company, a member of the Birmingham Chamber of Commerce and it is a manufacturing company: "In our industry our other European competitors have more resources and are more proactive in the EU markets. There is also a notable presence of foreign government support for our European counterparts that is lacking in the UK". There is a fear factor as well, particularly for small businesses.
Chairman: We are going to come on to that in more detail later, so we will probably broaden that across the whole spectrum.

Q192 Mr Clapham: One final question, Chairman. Given that it does appear our competitors have been cultivating markets well before British industry became involved and relating that to some of the evidence that we have been given, that some British businesses are now going beyond the A8/A2, for example into Russia and Turkey, does it seem to suggest that we have learned a lesson and there is now, should we say, a feeling that we need to cultivate markets if we are going to see business in those markets grow? Is this what is happening, for example in relation to Russia and Turkey, or is there any indication that is happening?
Ms Low: I have to say that we have had no indication of the level of assistance and support businesses are getting from UK Trade & Investment in the DTI because of this emphasis on inward investment and not on trade promotion. We have seen no indication that policy is set to change and, until it does change, with budgets being cut for trade promotion, it makes it much harder for businesses to get out there into those markets beyond the EU markets and develop business further afield so, no, nothing that we have noticed and picked up.

Q193 Mr Weir: I was interested in what Mr Lacy was saying about the proposals or the opportunities for the banking sector. One of the things we have got in evidence in this inquiry, a recurring theme, is the lack of UK banking in Eastern Europe and the fact that UK banks have not moved into Eastern Europe at all. You are mentioning that the opportunity is there but, for example, in Hungary, we were told that all the banks, bar one, had been bought up by foreign competitors, the only one left is a former state bank which in itself is looking to expand east. I wonder is it a bit of wishful thinking on the banks' part that they have missed the boat in moving into these accession countries. I would be interested in your views on that.

Mr Lacy: I have to say I am not as up to speed with some of the detail, but I was talking to one of our major banks at length, frankly, one day last week specifically in relation to Poland and they clearly have very great ambitions to help British business overcome some of the hurdles that they believe businesses are facing, and are really facing. I was surprised to hear that bank had been established in Poland merely for the last four years. I frequently go over to Poland to help businesses develop relationships over there. I am absolutely amazed by the number of banks out there and I search and I search and I do not see very many names that I recognise, certainly not the British banks and the UK banks, neither do I, as it happens, see US banks. From my understanding, a lot of the banks seem to have local names; who they have been bought up by, I simply do not know. I suspect, but I really do not know, by inference a lot of them are partnerships between local, regional banks in Poland and other European banks, banking institutions, and I have assumed that they are from those countries that we know Poland, in particular, has been trading with, ie its neighbours.

Q194 Mr Weir: The example you quoted—and I am not asking what neighbour it was—is that bank buying up a local Polish bank or is it going in under its own name?
Mr Lacy: It is going in under its own name, that is its branding anyway.

Q195 Chairman: I think it is fair to say that we have heard consistently expressions of concern from the members of the governments we visited and British businesses about the lack of British retail banks throughout Eastern Europe and it is cited as a major obstacle, so I think we are being charitable. We will ask the British Bankers' Association for some assessment of their presence in these markets, it is an important point. Can I ask you about what these markets are. Are they markets in their own right, part of a larger region or a hub for a larger region? The reason I ask you this is your members' evidence does not contradict itself entirely, that would be uncharitable, but the London Chamber wrote: "However, one should never consider the bloc as a whole, as all the countries are in varying stages of development and, therefore, some are easier than others". The Manchester Chamber wrote that Slovakia has an excellent strategic position within Eastern Europe bordered by five countries, four of which are EU Member States, . . . which can be seen as a gateway to Eastern Europe and the Balkans. What are these markets? Are they gateway states or all individual, relatively small economies?
Mr Lacy: I am not sure I do have analysis. My knowledge is, in particular, a situation in Poland—

Q196 Chairman: Tell me about Poland. Is Poland a market in its own right or should it be regarded as a gateway to a wider number of economies?
Mr Lacy: Certainly the Chambers of Commerce are recognising that Poland is a gateway. Poland has obvious advantages and opportunities, and certainly the Chambers are seeing entering Poland as a gateway to then developing other markets but, of course, some of those other markets are comparatively tiny compared with Poland. Poland, Hungary and now Romania, as I understand it, are the three largest markets. Those who I have spoken to in business are treating those three as separate entities. My knowledge of the other States, I am afraid, I am very slim on.

Q197 Chairman: Sally, do you want to add anything to that gateway point or the gateway markets?
Ms Low: I must apologise, I am afraid I cannot really add anything more to that.
Chairman: No, that is fine. That is helpful, thank you.

Q198 Mr Binley: I am particularly interested in reading your evidence on barriers to investing in the A8/A2 markets and, indeed, it is noticeable that the World Bank ratings of ease of doing business, whilst it says that Lithuania is pretty good, the rest are pretty difficult, quite frankly: Hungary ranked 125th in the world, Poland 134th and Bulgaria is doing slightly better, 59th, so there are difficulties. You have talked in your evidence a little of both general difficulties and specific, but you have not really separated what those difficulties might be. Would you be kind and give me some idea what you consider the difficulties to investing might be?
Ms Low: What we have discovered from the submissions from the Chambers is that they include risk of not being paid, banking and financial procedures, bureaucracy generally, exchange rates, currency, product quality issues, fear of the unknown has come up as well, different tax and legal regimes adversely deflecting cash flow, posing particular challenges for the smaller end of the smaller businesses, and other issues highlighted by businesses, lack of restricted credit insurance and concerns around corruption being some of the things coming from the business side.

Q199 Mr Binley: You have come to the elephant in the room I think because you mentioned corruption and on our tours to Eastern Europe, without wishing to be overly specific, it came up very regularly only it was not called "corruption", it was called "pocket money", "regulation" or "licensing fees" or whatever. How seriously important did your members rate that, because we got from British organisations which had gone out that it is a sizable issue to come to terms with?
Mr Lacy: Can I say that I was chairing a conference, I think we had 77 businesses just across our region, East of England, at the launch of a specific initiative last week to help businesses pursue opportunities in Poland specifically, but as Poland is a gateway to other Eastern and Central European countries. Whilst there was a whole raft of difficulties that were discussed and, frankly, solutions as to how they could be overcome, not once in a whole day of conferences, questioning and break-out sessions did that dirty word come up. I have to say that for my half a dozen visits over to Poland specifically in the

last 18 months it has never reared its head at all to me. Maybe I am naïve and the rest of it, but it has not been an issue for me. I understand that some businesses might have quoted it; I can only speak from my experience on that one.

Q200 Mr Binley: Perhaps Poland is squeaky clean and the rest have some serious problems?
Mr Lacy: Who knows? I have not seen any evidence or heard any evidence about the situation in Poland.
Ms Low: I would be happy to go back to the chambers which have flagged this up as a concern and submit further detail to the Committee if you would like.
Mr Binley: I would like to have that back, thank you. That would be very helpful.
Mr Bone: We are saying that the French are doing particularly well. Is it perhaps they have slightly less standards of scruples about paying backhanders?

Q201 Chairman: You do not have to answer that question unless you want to. A Gallic shrug from Mr Lacy.
Mr Lacy: I would not know.

Q202 Mr Binley: I have got a supplementary I would like to ask. I want to know how you think they compare in terms of barriers for your members, what information, evidence, you have got as to how they compare with other developing markets in that respect, whether there are cultural differences—let us be absolutely kind and call it "cultural differences"—which make this part of the world in trading terms more difficult, perhaps, than some of the other emerging markets, or am I putting words into your mouth?
Mr Lacy: I have to say, if I respond somewhat bleakly to that, I spent four years living in the Middle East in banking and I would say that what you are describing as these cultural differences were more in evidence there than I have ever seen in Eastern Europe. I guess it depends who you are comparing with. There are cultural differences, and these are seen as obstacles by our members and they are the obstacles of language and understanding exactly what is meant both delivered orally and on paper. The advice that we and those others who we work with give to people looking to do business in Eastern and Central Europe is to make sure everything is in writing and very clear because by word of mouth there can be very different interpretations. That is what I would say about the cultural differences.
Ms Low: It underlines the point about smaller businesses having more support because there is an ignorance about the state of the economies of these countries, about cultural issues and demographics. That is putting people off and I have a number of examples of that which I can elaborate on.

Q203 Mr Hoyle: You mention in your evidence the fear factor and it is associated with investing overseas and it deters UK companies. Do you believe that the fear factor is more prevalent for UK companies than our competitors?
Ms Low: Yes, I think it is. It is a slightly unhappy situation where a great trading nation has to claim lack of confidence but there is a lack of business confidence and that has come back to us through survey evidence that we have gathered, for some of the reasons that I listed earlier: the risks around bureaucracy, complexity, claiming VAT back, political instability and all of these seem to be serving to erode confidence amongst small and medium sized businesses to get into these markets and practical support at that level could only be of benefit.

Q204 Mr Hoyle: We have had some evidence that A8 and A2 could be an attractive location for SMEs to cut their teeth in those markets. Do you believe that this could be a viable proposition and what do you feel the government can do to help in such matters?
Ms Low: I agree that that is a sensible proposition. Support for export promotion is absolutely vital, redressing the balance so that export promotion is back on the agenda and funding that properly. Also, looking at foreign direct investment in particular countries is another vital element of this and enhancing the UK's ability to exploit and maximise our obvious strengths, going back to the discussion we had about looking at the strengths in development, research and technology transfer and focusing on those things and then how to take those obvious strengths to these markets and joining that process up. That is a vital role that UK trade and investment could be fulfilling on behalf of our small and medium sized businesses. Chambers of commerce are very involved in doing this. At national level British Chambers of Commerce runs something called the Export Market Research Scheme which encourages UK businesses to conduct research before entering a new overseas market. There is also something called the Export Communications Review which aims to reduce the instances in which cultural and language barriers which come between UK businesses and success overseas. There are practical things that we are already doing. We also hold mandates from the DTI and Her Majesty's Revenue and Customs for the issue of all EU certificates of origin, EUR1 and ATR certificates. Once again, the network of chambers of commerce is facilitating that and Richard has excellent examples of what he is doing practically with regard to Poland and other markets.
Mr Lacy: Throughout eastern and central Europe, no less than any other country, there is a considerable network of Chambers of Commerce. Some Chambers have forged alliances with other Chambers and through those have introduced their respective members and businesses to all sorts of opportunities. My own Chamber of Commerce for example about six months ago opened up an office in Zamosk in the Lublin region of south east Poland and has facilitated a number of interactions and business opportunities that are being actively pursued. We must not, when we are looking at these opportunities, in any way forget the massive resource that is already in place in terms of the Chambers of Commerce. It would be great though

if there was some funding available to maximise the benefits of that for business. That is of course lacking.

Q205 Mr Hoyle: So that I get it right, we genuinely believe that R&D will remain in the UK. That is where our real strengths are but the true manufacturing will go overseas and what we ought to be doing is subsidising manufacturing to move abroad at the expense of British jobs. Is that what we are saying?
Mr Lacy: I am not saying that. I personally believe that, whilst we are talking a lot about exporting or manufacturing in some of these countries, the opportunities are in partnership frankly and organisations identifying how they can add value to each other in different parts of Europe for the benefit of those business people taking that initiative. I do not see it quite the way you suggest is the case.
Mr Hoyle: It is just that you said we ought to be subsidising to ensure—

Q206 Chairman: I heard it rather differently. You were calling for more support for export promotion and you were also saying you had a project to encourage your members to do the research before they went into those markets. What we heard last week in Hungary was criticism of British businesses that take the money to go to trade fairs, do not bother to do the research, sit on their backsides at the exhibition, do not follow any leads and go home having achieved absolutely nothing and waste a lot of taxpayers' money. That was contrasted with a minority of companies that do the research and do not necessarily sit on their backsides and go out to meet the possible partners while they are over there and use it well. The evidence was that the majority of British businesses do not use that support very effectively because they do not do their research. Is that a criticism that you recognise?
Ms Low: We provide a scheme which has 100% success approval ratings in terms of the quality of the research that is provided. That has been run since the late eighties and is a highly successful scheme. Our argument is absolutely that, for the growth and the benefit of the UK economy, we need to have strong, innovative—

Q207 Chairman: No. What I want to ask is do you think British businesses do their research in those markets when they go to them? Do they understand them?
Ms Low: I can only comment on the ones that benefit from the research that we provide via the schemes and from the trade missions that we run across the chamber network. The evidence is that that is highly effective. I cannot speak for all businesses.
Mr Lacy: If I may give an example, I have talked about a conference with 77 businesses in attendance last week. That was because we were promoting a new initiative. It is branded TradeArc Polska which is fairly self-explanatory. That is a not for profit organisation. It is an offshoot of my Chamber of Commerce and it was headlined by East of England Chambers of Commerce. Frankly, we could not have put on that conference, which was providing absolute practical help to businesses, if it was not for my chamber dipping into its reserves to fund that activity and getting sponsorship from an international bank and from the Regional Development Agency. It is great that you can get that sort of financial assistance but that was only the beginning, launching a service. We now have to hand hold businesses because if they do not do their research but they are interested in markets they need that help. Here I am talking about SMEs, not the big, multinational globals and frankly they have resources and they get on and do these things. It is the SMEs that need that help. There is evidence that they do not do their research, that they do not find out about this, that and the other and they do not know where to start so the Chambers of Commerce in this particular instance are helping them.

Q208 Chairman: I do not want to make a mountain out of this but you have just said that there is evidence that SMEs do not do their research when they approach these markets.
Mr Lacy: They need help.

Q209 Mr Binley: This is the essence of what we are trying to get at in some respects. The information we have is that of the 20 businesses which went to a trade exhibition in Hungary two left one person on the stand and went out visiting people and used the stand as a base. 18 simply sat there expecting people to come to them. That is what we mean by businesses—and I am a businessman—getting off their backsides, getting out, finding customers and talking to them. I want to know whether your people are doing that when they go out there on the back of taxpayers' money.
Mr Lacy: As a Chamber that is heavily involved in promoting trade and industry specifically with Poland, but not exclusively, it is precisely that advice that we are giving to our businesses: do not, for goodness' sake, do exactly what you describe. You need to understand the markets. You need to develop the right sort of contacts. You need to understand the culture, the language, the innuendos, the need to put things in writing, the differences between a letter of credit and an open account to do business. It is that practical stuff that businesses need assistance with perhaps because in the past—or from what you are suggesting even some currently—they are hanging around their stands. We have all seen that but that is what the chambers are specifically taking initiatives to sort out.

Q210 Mr Bone: If I am a medium sized company and I am making electromagnetic clocks, I have all the pressures of a medium sized business and I think it would be a good idea to go along to these new countries in the European Union, what help are you going to give me? What help does the government give me?
Ms Low: There are a number of different schemes and opportunities available which can be applied for in terms of support and advice in researching the

market of choice. The Export Communications Review assists on cultural and language barriers. There is language support and various other options for accessing support. There is also a whole raft of practical services that Chambers of Commerce provide.

Q211 Mr Bone: The answer is what I would expect you to say. If it was inward investment, if I was an American company making electromagnetic clocks and I was going to possibly move to this country, they would be falling over themselves with money and effort to do it. The difference between export promotion and inward investment promotion is enormous, is it not?
Ms Low: Yes.

Q212 Mr Hoyle: What support in which sectors would most assist companies looking to invest in A8 and A2 countries?
Mr Lacy: My understanding, not researching all the eastern European countries, is that construction comes high through production, bio anything this, that or the other, but anything to do with the natural resources of those countries, plastic moulding, plastic injection, timber specifically beyond construction and agriculture related. Those are the natural resources of some of these countries. Those are where I particularly see businesses saying they identify opportunities.

Q213 Mr Hoyle: We have been taking evidence as you would expect and it has been interesting that everybody says the same: that UK companies have been very slow off the mark. They have never been quick at coming forward, especially A8 and A2. We have been taking evidence particularly on India, China and Brazil. It has been the same story there. UK companies are just not up front. They are just not cutting it. We then went out and, when asked which sectors the UK was losing out to other countries, the British-Romanian Chambers of Commerce replied, "Regrettably, all of them." What do you think about that? Is it true that we are losing out in all sectors?
Mr Lacy: Are you referring to manufacturing or export opportunities?

Q214 Mr Hoyle: Everything.
Mr Lacy: I see massive opportunities where I visit—I repeat—specifically in Poland.

Q215 Mr Hoyle: You are absolutely right. You keep saying there are lots of opportunities. I agree with you. There are great opportunities but somehow we are not seizing the opportunities. If we look around France and Italy, they are always there. The Germans are so far in front of us. Why?
Mr Lacy: I am in danger of repeating myself. Our mindset is not European yet. Personally, I think there is a mystique surrounding will I get paid; will they understand me, to what extent do cultural differences exist. It is the fear factor, not getting stuck in there, looking at the nitty gritty.

Q216 Mr Hoyle: Do you think the currency has something to do with it?
Mr Lacy: Personally, no. I do not think our members have commented on that particularly other than natural exchange rate risks generally, but it is not seen as a big problem for businesses I speak to.

Q217 Mr Bone: We did inquiries on China, India and Brazil and we were told that businesses were slow to invest because of the fear factor, insufficient government support, language difficulties, lack of knowledge generally about the countries. We are the great trading country. We are built on trade and export. This group of countries we are talking about is in this wonderful EU which has the same level playing field. There are not going to be any regulations there because it is part of EU and as part of joining they have to sign up to all those things. Have businesses gone so far downhill that unless there is a government subsidy or a government holding their hands they are just not going to export? Is that the truth of the matter now?
Mr Lacy: It is even worse because it is merely two hours and £60 from London Luton Airport to Warsaw. It is so easy and yet so few businesses seem automatically to think about some of these markets. I have to admit that, whilst there are some businesses that are embracing the opportunities wildly, massively recruiting Polish workers and there is an empathy and greater understanding of what is happening in other countries, there seems generally to be a reluctance to stick their heads above the parapet. It is a different mindset from what we understand exists elsewhere. Perhaps it is because other countries are adjacent to or nearer to and perhaps there are other logistical advantages with motorways for all I know.

Q218 Mr Bone: You are agreeing with the idea that our companies are not keen to get stuck in there in this hugely expanding market, which is part of the EU. Do you think that is right?
Ms Low: No, I do not think that is fair. I have a vast number of examples of very good companies that are growing and exploiting markets overseas. Government policy has had an effect on confidence. A lot is talked about globalisation but there is a tendency to a feeling that you need to weather the storm and keep your head down because globalisation is coming and it is a bad thing, rather than go out and meet it head on and exploit markets abroad. Also, there are small and medium sized businesses that reach a point where they are large and confident enough to exploit markets overseas, to send sales teams to India and China. You need to be of a sufficient size to do that. When you are at a smaller level it is much harder because you do not have the resource and the personnel. That is where we have a gap and an opportunity to exploit at that level. I do not think that has been properly identified and addressed, frankly. That is an area which justifies government intervention in the market to enhance that.

Q219 Mr Bone: I am running a medium sized business. I have a product which I can sell in the UK. I could put distributors into Germany and France and do very nicely, thank you very much. I am not getting any help from the government to find distributors in, say, Poland and I do not have the time to do it. If I went to a government department and said, "How do I find the right distributor in Poland?" that would be really beneficial to British industry. The French perhaps do that sort of thing. I cannot understand why British business in terms of going out and getting business would be behind French business because I do not see that as natural, but I can see that perhaps the French Government is helping them more than we do.
Ms Low: The French Government does it through the Chambers of Commerce because the Chambers of Commerce is a publicly funded body in France. We run schemes as a private, independent organisation, as the Chambers of Commerce network. The history of chambers of commerce came from trade and out of a desire to encourage businesses to trade and assist them. More focused practical assistance at that younger level in a company's lifecycle is where we come in very often, but there is a limit in terms of the resources that we have to be able to do that as effectively as we might.

Q220 Mr Bone: The government does not see that as sexy, does it? It sees inward investment and companies coming in but it does not seem to want to get to the nitty gritty on exports, does it?
Ms Low: You are right. The emphasis has been on inward investment and that has been a great pity.

Q221 Mr Clapham: I wanted to pick up on this idea of business having to be a sufficient size in order to be able to exploit the markets or at least have the resource for investigating whether the market is worth exploiting. Are there any schemes that may operate where larger businesses are encouraged to take smaller businesses with them, almost piggy backing, if you like, into markets?
Ms Low: We have a number of workshops and mentoring type groups running across the chamber network.
Mr Lacy: It exists but it is limited. The larger ones are few and far between in comparison with the smaller ones. 96% are employing fewer than whatever it is. I have forgotten the figure. Those days are numbered because the largest companies are becoming medium sized as they are outsourcing so there would be limited opportunities for that. Personally, I have not heard in recent times whether piggy backing has taken place in terms of trade missions specifically. It is very often the case of the SMEs having to sort things out for themselves if they have any get up and go about them. Where do they go for advice? There are places if they are pointed in the right direction. The international chambers network can help but we do not make it easy for them because there is not the natural infrastructure to signpost people to the right sort of banking experts, the right legal advice, those providing the market intelligence, the connections and all of the other issues.

Q222 Mr Binley: There are 13,000 directly employed by Airbus in this country. They employ in their supply chain 135,000 people in many hundreds of companies. Is there anything the chambers could do creatively to use UK plc with that supply chain to increase British trade collectively?
Ms Low: Yes. We are a business network. We have access to 100,000 business members. We have online connections throughout the UK and via Eurochambre, our European counterparts, and across the bilateral chambers across the world. There is absolutely a possibility to be able to do that. We certainly do that UK-wide; we could do that Eurochambre-wide as well. Putting in place a mechanism for businesses to be able to access supply chains is absolutely vital.
Mr Binley: If there is anything in being I would be grateful and that could encourage us.

Q223 Mr Bone: Migration from eastern and central Europe into this country: there is certainly a perception that it has driven labour rates down and working conditions down. What is your view on that? Is that right or wrong?
Ms Low: I hope that Members of the Committee will remember receiving one of these.

Q224 Chairman: The next question is about it.
Ms Low: It is a survey on our members' views which we did in February this year. There is no doubt that 75% of the businesses polled think migration has been of great benefit to their businesses because of the fact that it has given them access to skilled labour, but as important, if not more important, is that they also report to us that migrant labour has a far better aptitude for work.
Mr Bone: You are not quite answering the question. It may well that businesses say it is great having all these people because it is driving labour rates and working conditions down.

Q225 Chairman: It is a question of wage rates and working conditions are the point.
Mr Lacy: It is a bit of a myth that those from central and eastern Europe are receiving lower levels of pay than their counterparts. We really need to blow that myth apart. If that statement has any sort of veracity, what is happening is that rather than pinching the most qualified people from each other and therefore bidding up the rates they are satisfying the demand by bringing in that sort of labour from elsewhere. In the experiences that our businesses are telling us about, they are definitely not coming in at lower rates. Some of the issues about migrant workers receiving substantially lower than market rates are not in the evidence that we are seeing in relation to the qualified, legitimate people coming in from central and eastern Europe.

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Q226 Mr Bone: In my constituency, Wellingborough in Northamptonshire, we were a manufacturing based area. We now have unemployment at higher levels than we had at the end of 1997. When I go and see a group of young people out of work, they say it is because Polish workers are coming in and undercutting the wage rates. They put the unemployment, the migration and the wage rates together and they have this rather nasty, antimigration feeling. It is a vacuum at the moment and if the BNP came in we would have a problem. You are saying it is more to do with the skills level?

Mr Lacy: I would say it is massively to do with the skills level. I believe there are other factors that lead to the comments of many of us here. I do not believe it can be justified in the vast majority of cases because I hear what businesses are telling me and I also know people from that part of Europe who are gainfully employed here. There are probably other issues that we can all get at which lead right to those comments.

Q227 Chairman: The official view of the Chambers of Commerce is that this significant influx of migrant labour into the United Kingdom, described by the DTI as the biggest influx since the Huguenots, has prevented a significant expansion of wages and wage inflation. It has not depressed wages?

Ms Low: The view from the Chambers of Commerce is that it has significantly enhanced wealth in this country and wealth creation. 45% of the businesses responding to the survey said the main reason that they employ migrant labour is due to local candidates lacking the relevant skills and expertise.

Q228 Mr Weir: I suppose it is the other side of the wage question because in the leaflet you have there is a quotation that says that in three years of employing from eastern Europe we have not had one negative experience. The only concern I have is that at some point they might want to go home. How serious is the danger of a labour vacuum if some of the immigrants from A8 and A2 return to their own countries with far fewer coming in the other direction? In which particular sectors is this a problem?

Ms Low: I cannot comment on particular sectors. There is a very real danger that the migrant labour that businesses have benefited from and relied upon could very easily go back in years to come. That could cause considerable problems.

Q229 Mr Weir: To what extent are we wrong in referring to migrant labour as immigrants? I represent a rural area and a lot of migrant workers come in to work in agriculture and fish processing. Many of them do not stay. They are relatively short term. They are students and young people working for a few months, to earn money to help their studies back home. When we took evidence from the DWP statisticians, there was a lot of confusion about how many people were immigrants and how many were temporary migrant workers.

Mr Lacy: Can I make a couple of fairly disjointed observations without responding to your specific question? I am a little bit confused about migrant, itinerant and the rest. There are clearly some sectors like catering that genuinely recognise that workers move on. The turnover is at astronomical proportions, something well in excess of 50%. I was hearing that a 35% turnover in the leisure industry was good.

Q230 Mr Weir: I understand that but the point is that if you go into a hotel you may be served by a Polish waitress or a Lithuanian barman. Five or ten years ago it might have been an Australian or a New Zealander. Is there much of a change in some of these sectors? There has always been a high proportion of fairly temporary migrant workers in some of these sectors.

Mr Lacy: My understanding is these people move on anyway. In Poland, the unemployment rate is something in excess of 13%. I understand that of course people can go back to Poland once they have made their money here, but I wonder what to, because if there is a 13% unemployment level I suspect their prospects are not that great. My overwhelming evidence based admittedly on a limited number of years—things might change in one year or five years' time—is that these people are becoming reasonably well integrated in what is going on, not least within those companies and they are progressing within those companies very often. They not only have the right sort of skills and knowledge of English but the right sort of attitude. They are achievers, generalising big time of course, but they are people who are progressing. I have not seen from those businesses that I talk to that there is any evidence yet that those people are moving back to their countries. After all, a lot of people from eastern and central Europe meanwhile have moved here. They are meeting people, getting married and settling here. There is quite a bit of evidence to suggest therefore that perhaps, like the Huguenots to whom the Chairman has referred, they may well stay here because the prospects of going back to whence they came are not that attractive. Perhaps the reasons why they came here in the first place still continue.

Q231 Mr Weir: We had evidence earlier from other witnesses that something like 10 or 15% of the population of Lithuania had left the country and was particularly in the UK and Ireland. There is also evidence that they were remitting money back to Lithuania. Many of them were finally returning to Lithuania and using the entrepreneurial skills that they had developed in the UK to set up business in Lithuania. I appreciate Poland is the area you know best. There is a long area between my area and Poland, going back many generations but is there evidence that this is a general trend and these people are coming here, remitting money back to Poland and perhaps ultimately helping the Polish economy to develop?

Mr Lacy: I do not see any evidence of that being more important than those that are staying here at this point in time.

Q232 Mr Weir: Is there a danger of a vacuum in industry? My experience is mostly in agriculture and fish processing, lower skilled industries. In some areas of agriculture there has been concern expressed that there are not enough people coming and there are limits put on those from the accession countries Romania and Bulgaria. Is that a problem your members have come across?
Mr Lacy: It is not a problem my members have cited at all. Reverting back to my experience when I have been to central and eastern Europe, what we are seeing now is a mass movement of Ukrainians into the eastern parts of eastern and central Europe to fill presumably some void that they see there, despite the comparatively high levels of unemployment.

Q233 Mr Weir: The evidence we had from Lithuania was exactly that because so many people had moved and there was a shortage in some areas of the Lithuanian economy because of people from Belarus, Ukraine and elsewhere. That seems to run contrary to your evidence of the situation in Poland. Is it different in Poland from other countries? Is there a particular reason for that?
Mr Lacy: I am afraid I cannot comment. It is not within my knowledge.

Q234 Mr Weir: Do you think the British government should be doing anything to mitigate the effects that there would be of people returning to eastern European countries?
Ms Low: On the skills side of things, yes. Business has become increasingly reliant on migrant labour. We do not know whether these people will remain for the long-term or what will happen and obviously there is a disappointment that businesses cannot access locally the correct levels of skills and work aptitude that they seek. The answer lies in us providing and skilling our young people and our workers to more effectively fill that gap.

Q235 Mr Hoyle: About 20 minutes ago, Mr Lacy, you spoke about salaries and you said that there was no evidence that people coming from the former Eastern Bloc were distorting wages. They were being paid the same salaries with the same conditions. You said it is a myth. I do not believe it is a myth. There is evidence within the construction industry that they have been driving wage rates down. Agency workers are being used without similar terms and conditions. Health and safety are being compromised and in other industries it has been the same as well. When it came to overtime payments, they were not being paid the equivalent so therefore the overtime was being given to people from Poland or wherever because they did not get time and a half, double time or time off in lieu. It has been distorting the labour market. It is causing a lot of unrest and if we are not careful we will see a backlash where the BNP and others will build on the back of what is happening because the terms and conditions are being eroded.
Mr Lacy: I think I can relate to the point about overtime and whatever. It is my understanding that the attitude to work and getting stuck in—generalising again—probably does mitigate against the desire for overtime. There is some evidence that overtime may not be seen as a natural part of the culture of some workers that come to this country, so I can see some correlation there.

Q236 Chairman: You are saying typically the eastern European worker does not expect to be paid overtime rates?
Mr Lacy: I cannot comment on the specifics. The general work ethic of those people coming over to this country appears to be slightly different from that of our own breed. If someone goes to all the effort of coming over here, they want to make a success of it and I believe that their application to get on and do the job differs sometimes from that of others. That might impact on their expectation of payment for extra effort. I can see that but I have no evidence of it.

Q237 Mr Hoyle: There is a lot of evidence to say that they are being paid less.
Mr Lacy: I have no evidence.
Mr Hoyle: You have mentioned that terms and conditions have been agreed within a company, where overtime rates have been agreed, and obviously if workers then come in and do not get paid overtime benefits you see that as they are willing to work. The fact is it is eroding agreements and therefore it is having an effect on the workplace and it is benefiting the person from overseas. If you have been used to being on £1 an hour and you are on £10 an hour and there is no mention of overtime, you are much better off especially if your family is not here. You are sharing a house with six other people. You are sharing the cost and you are sending the money back to Poland. It does not matter. That is the problem and it really is beginning to cause unrest. I am sorry you do not have any evidence.
Chairman: Can I suggest that the problem may be that you are not talking about the same sectors? Is it true of the hospitality and the construction sector in particular?

Q238 Mr Binley: We had a case in Northampton. I live just above you. Tesco Warehousing got rid of 110 people and a number of them came to see me last September, replaced with Polish workers they got through their agency in Poland. It was clear to me that there was only one reason why they did that and it impacts upon what Mr Hoyle is saying. I have a bigger question about the real cost. I went to the Polish embassy the other week and I was told that very sizeable amounts of money are being sent back particularly to eastern Poland, which is a very poor area, and there were some billions a year going from this country. I am not sure that your rather limited view of the impact of working migration is really helpful in the long term, not least with regard to what we now call NEETs, not in education, employment or training, which is growing in a very disturbing way. I am a businessman. I understand

the attractions for business but it seems to me that there is a longer term view that we need to take into account that I do not see that you have taken into account. That is the impact upon Britain, the total cost of this, in relation to more than just good labour. I admit that much of it is good. I am not sure that you are taking into account the full impact on this country and I think you will argue yourselves into a difficult position if you are not careful. Can you respond to that?
Ms Low: Yes. On behalf of the British Chambers of Commerce, we undertook a survey of our members. 45% of respondents said the main reason they employ migrant labour is due to local candidates lacking the required skills or experience. As the British Chambers of Commerce, we are a British organisation. We represent our business members. That is what they are telling us. That is what we are telling government.

Q239 Chairman: Can I ask about this work ethic question? It is hinted at in all the evidence from all the chambers. They say that the people work harder. You said, Mr Lacy, that people make a lot of effort to come here. I remember Marcus Brigstock on *The Now Show* recently rampaging around, agreeing with the point you are making about his Polish carpenter.
Mr Lacy: Businesses are in business to make money. They tell us—everyone in this room knows this—that to make money you need the right sort of skilled people within your organisation, company or whatever it is. Businesses look for the most appropriate people to help them get there. They tell us time and again they are having difficulty recruiting people with the right sorts of skills, qualifications, experience and aptitude and attitude to work. Businesses are telling us, as a result of our surveys, they cannot get enough local people with what they are looking for to help them improve their businesses and make money. Therefore they welcome with open arms people from other countries.
Ms Low: In the survey which I know you have all seen migrants who have a skilled trade are a significant part of the migrant labour employed by UK business. They are the 19.2%, not elementary occupations or people with no skills. It is people who are skilled. They have had quality training in the countries that they are coming from and those are the ones that businesses are employing.

Q240 Mr Weir: How much of this is the short term? If you are a worker from eastern Europe who is used to having a very low standard of living and earning very low wages, you come to the UK. Suddenly you are being paid ten times what you were back home or more. You are going to work harder obviously. How long is that going to last until the standard of living rises in eastern Europe because of migration?
Mr Lacy: I cannot answer that. I do not know. It is looking into the future.
Ms Low: The Chambers of Commerce care very deeply about the impact this is having. I do not want the impression of the Committee to be that we are taking a short term view on it because we are not. Chambers of Commerce are heavily involved in training and skills programmes for workers in our local areas right across the country and we are seeing it at first hand but the basics have to be in place. There is a limit even to the reach and the abilities of the Chambers of Commerce in this country to be able to solve this problem on their own.

Q241 Chairman: What we heard in Lithuania, where they have lost at least 10, possibly 15 or even 20% of their population to the British Isles, where high skilled people are coming to do relatively low skilled jobs here in the UK in comparison, is that Lithuania has a problem with maintaining its skills base. In Hungary we heard that they import workers from neighbouring countries to keep their factories going. Have your members experienced problems of skills shortages in any of the Member States in which they have invested?
Ms Low: I cannot answer that.
Mr Lacy: I have not heard anything along those lines at all.

Q242 Chairman: The big question that underpins the discussion we have just been having is that China, India, Poland, Hungary, Lithuania all have the same ambition. They all want to go up the value chain. They want to be high skill, knowledge economies. They all want to do the things that we want to do. How long will it be before they catch up with us? Do the British people really understand the scale of the challenge we face?
Ms Low: In answer to the question how long, not very long at all and in many respects they have already caught up. In India, the skills levels and the highly technological nature of a lot of the businesses that have been set up in India rival us easily. We face a very serious challenge. The key to this from our perspective lies in maximising our strengths, exploiting what we do very well in this country which is around research and development, innovation, technology transfer and all of these things.
Mr Lacy: I totally agree.

Q243 Chairman: If this Committee were to look at the issue in more detail, would you welcome it?
Ms Low: We would.
Chairman: We have wandered rather widely round the issues this afternoon, for which I apologise, but you responded magnificently to the challenge and we are very grateful to you. Thank you very much.

Tuesday 3 July 2007

Members present

Peter Luff, in the Chair

Roger Berry	Miss Julie Kirkbride
Mr Brian Binley	Mr Mike Weir
Mr Michael Clapham	Mr Anthony Wright
Mr Lindsay Hoyle	

Witness: **Ms Katinka Barysch**, Chief Economist, Centre for European Reform, gave evidence.

Q244 Chairman: Welcome to what I think will prove to be the last evidence session of this Committee's inquiry into the consequences of Eastern European enlargement. We are very grateful to you for volunteering to come in and speak to us and tidy up some of the loose ends of our inquiry and give us the view of an economist. I wonder if I could just ask you to introduce yourself as I always do, and perhaps say a word about yourself and the organisation you come from because I do not think everyone is familiar with the Centre.
Ms Barysch: My name is Katinka Barysch. I am the Chief Economist at the Centre for European Reform and have been there for six years. The CER is an independent think tank which was set up ten years ago with two objectives: one was to improve the quality of the debate on Europe in the United Kingdom; and the other one was to be a very British pragmatic voice for policy improvements in Europe. Having failed miserably in the first objective it is now going to concentrate on the second! We have become an international organisation. We try to work cross-party as much as we can. Half of what we do, our events, our meetings, takes place outside the United Kingdom. We do not take any government funding; we survive on corporate donations. We describe ourselves as "pro European but not uncritical". In other words, in the context of the British debate we would be seen as pro-European; but if I go to Brussels or to Berlin they think I am a euro sceptic. We are not federalists. We do not advocate European integration for its own sake. Personally I have worked on eastward enlargement since 1997. I was in the European Commission when they first wrote the opinions on eastward enlargement. I then spent five years at *The Economist* and The Economist Intelligence Unit also mainly looking at Eastern Europe. For the last six years I have continued that focus to some extent at the CER.

Q245 Chairman: Your organisation would have a lot in common with a lobby group like Open Europe, for example?
Ms Barysch: No, we do not have an agenda as such. We certainly do not have an agenda that is targeted to the British debate. What we are doing is really trying to generate ideas for making Europe run better. We think that Europe does a lot of good things but often does them badly. We would look at different areas—be it energy policy, be it defence procurement, be it transatlantic relations or how to deal with China; but we certainly do not target our activities to a domestic policy debate.

Q246 Miss Kirkbride: The evidence would suggest, and it would be interesting to see whether you agree, that whilst the EU with the new countries has been economically very successful, that in terms of their own opinion polls that has paid a price in terms of the popularity of the EU in the new European accession states. Do you think that is true? In which case do you have any reasons why that might be?
Ms Barysch: Economically certainly eastward enlargement, to my mind, was a huge success because it left the EU economy overall better prepared for globalisation, which is something I would like to come back to later if I may. In political terms also I would say it is a huge success because I have watched over more than the last ten years how these countries have changed, and have changed for the better. How they have gone from post-Communist upheaval to functioning democracies and open capitalist societies. I do believe that the accession objective was instrumental in achieving that change. If you want to compare Hungary with Serbia, or Poland with the Ukraine you will see what a powerful anchor the EU accession objectives can be. If you define success in the European context only as steps in internal integration then maybe it is problematic because it has slowed down the integration process; but since I believe that our big challenges in the future will lie outside the EU's borders or in our neighbourhood you can just see how, on the one hand, we have not only created a stable neighbourhood by taking these countries inside the European Union, but we have also vastly increased what we call our "soft power". Just look at the line up of countries that want to join now after they have seen how much the EU admission has benefited those countries.

Q247 Miss Kirkbride: Why do you think it is then that in many of these new countries the EU is quite unpopular when it has had what would seem to be very obvious benefits?
Ms Barysch: In the new Member States?

Q248 Miss Kirkbride: Yes.
Ms Barysch: There is not actually any clear evidence that you have a huge increase in euro scepticism in these countries. I expected it to be much worse, because usually countries are the most enthusiastic about Europe the further they are away; whereas what you saw in the new Member States, those countries that have always been broadly pro-Europeans such as Hungary, they are still very enthusiastic; and those that have always been a bit more sceptical, like some of the Baltic countries, they

are still a little sceptical. I expected there to be a much bigger backlash against the European Union, because they have been told what to do for ten years and then they come inside and I expected them to get their own back—but they did not; they remain broadly supportive of the European Union. They are just finding their feet within the EU, so the backlash that I perceive is amongst the old Member States that have a certain nostalgia for the cosy club that the EU once was when it had six or 12 members; and they have not quite realised that this cosy club has gone anyway and that has very little to do with eastward enlargement. The fact is that the EU, even with 27 member countries, functions reasonably well. Policymaking has not ground to a halt. Obviously we now have the new amending treaty that should fix some of the institutional flaws, and hopefully make the institutions work even better with the larger number of Member States.

Q249 Chairman: Before I bring in Mike Weir, could I just ask you whether you think it is accession or the end of communism that was the determining event? In Hungary last week we were told very clearly that actually accession had been a relatively unimportant event from the point of view of the country; it was the end of communism that was the defining moment. They began a process of reform then which EU accession merely reinforced but did not actually contribute to that significantly.

Ms Barysch: Of course that was the really significant event—the fall of the Berlin Wall—because without that accession would not even have been conceivable. Once the Wall was gone, and once the Soviet domination was gone, this overwhelming sense of returning to Europe has provided a focus to the political system that, from anything I have ever seen in politics, was completely unprecedented. There was not a single mainstream party in any of the accession countries that even voiced any doubts about the fact that EU accession was the number one priority. For ten years there was the strongest conceivable cross-party consensus in these countries that that was the right thing to do; and whatever it took to get into the EU they were ready to do. I do believe that this kind of focus is really important in making the changes. The changes they had to make to get into the EU of course were good for the countries for their own sake—they might have done them without the EU objective—but the speed with which these were pushed through, and the fact that they were largely uncontroversial, I cannot imagine that would have happened in the absence of the EU accession anchor.

Q250 Mr Weir: Just following on from that, do you feel then that the main driving force for the EU membership is more political than economic—having come out of communism they wanted to anchor democracy by joining the EU—rather than the economic benefits of it?

Ms Barysch: I think it was certainly a mainly political objective to join the EU. The fact that the EU happens to be a rich nations' club and especially small open economies, like most of the Central and East European countries are, gain from the kind of trade integration and legal approximation that the EU single market is about, that obviously is an added benefit; but the initial drive to get into the EU was a security one. These countries thought at the time it would be ages, if ever, before they could join NATO, and there was a lingering fear that they might fall back under Soviet domination, or Russian domination. I think initially the drive to get into the EU was predominantly a security one; and then later on they realised there were all sorts of benefits, and one was obviously to have a seat at the table in Brussels where the policies are made that affect countries that are in the EU's neighbourhood.

Q251 Mr Weir: There has been in recent years a lot of political instability in some of these countries. How do you feel politics has changed since accession? For example, we were in Hungary and speaking to Hungarian politicians of allegedly Left and Right it seemed to be backwards/forwards almost, where the Conservatives were in favour of keeping things under State control and the Socialists wanted to privatise and we found that quite difficult to get our heads round in many ways?

Ms Barysch: The old Left/Right divisions never really applied in Central and Eastern Europe. It was the old guys, the Communists, which we would define as Left, but for them it is the Conservative force against the new guys, the Centre Right parties, which we would define as Conservatives. Yes, it is a bit muddled. You saw one really striking fact—in 2004, the year of accession, every single one of these Central East European accession countries, I think bar one, lost their government. You really saw quite a significant increase in political instability in these countries bang on the date of accession. Within one year all the governments tumbled—not in a big crisis, but prime ministers had to step down for all sorts of reasons. I put that down to the idea, as I already pointed out, that the EU accession objective acted like a kind of political glue that held the political spectrum together. Once you are inside the EU that glue dissolves. All of a sudden, after ten years of being told what to do and just keeping your eyes on the prize, you are allowed to have policy debates; and they enjoyed that. These are democracies, after all. You saw more antagonistic, more real policy debates. At the same time there was a certain amount of reform fatigue in the population. Populism gained a foothold in Central and Eastern Europe. Many of the things you need to do for the EU accession—such as liberalising your banking system—are relatively easy compared to what they have to do now—such as reforming their social security systems. You put all these factors together and you just see this increase in populism and political instability pretty much across all the countries. You have been to Hungary where there were riots last year; the Czech Republic was without a government for seven months last year; Slovakia and Poland elected populists; now Bulgaria and Rumania have joined and you saw, bang on the date of accession, in Romania a huge standoff between the government and president; coalition tensions in Bulgaria; so you see it across the region.

Q252 Mr Weir: Going to Hungary again, going through their austerity package in a moment, the reform of the health care system and social security, you mentioned the election of populism in Poland and some other areas—do you see that as leading to greater instability in the likes of Hungary? Do you think stability will reassert itself? How will that affect business decisions to invest in these countries if there is political instability?
Ms Barysch: It is almost impossible to foresee whether you will see even a greater drive towards populism. I observe two things: even in those countries that elected populist governments, such as Slovakia, the actions of those governments have been nowhere near as bad as their rhetoric. I also observe that in those countries where you had quite intense political instability, such as Poland and Romania, you still had a record year last year for foreign direct investment. We did see a slow-down in reform which, as I said, I put down to reform fatigue, and the fact that many of the tasks that now have to be done are more difficult than the ones in the past; but reforms do continue across the region. One thing that is striking is, despite the fact that Central and Eastern Europeans basically never elect incumbent governments, that is a very strong fact across the region, no matter which government you had in power, no matter which country basically continued the same broadly liberal reform agenda, there have been slight setbacks but no big policy reversals; and investors do not seem to be too concerned about the increase in political stability, because foreign direct investment is flowing in like never before and these countries are growing faster than ever before. So far we seem to see that there is a decoupling between the political side and the economic success story that Central and Eastern Europe is today.

Q253 Mr Weir: The reform of the health service is always a difficult issue in countries in Eastern Europe where traditionally there has been very strong health service. People losing a lot of these benefits, is that likely to lead to greater instability? It is one thing to reform economically, but when you start reforming social services that is opening a whole new different can of worms, if you like. Is that not likely to lead to instability?
Ms Barysch: If income growth continues at the same time and people do not feel that they are losing out from the economic transition altogether then I do not see why reforms should not be possible. In some of these countries, for example, pension reforms have been much more daring and drastic than anything we have seen in the old EU countries. It is possible to reform the social security system and it is also necessary because, contrary to what most people think in Western Europe, they actually have quite extensive social security systems in Central and Eastern Europe, but they are badly targeted so they are expensive. If these countries do want to join the euro one day and they need to reduce their budget deficits that is where the work needs to be done.

Q254 Mr Hoyle: Just taking a point the Chairman raised, he mentioned they did not gain that much more once they joined the EU; but is it not fair to say that a lot of the companies invested very early on because they knew they were going to join the EU and the investment took place much earlier than everywhere else; and that is why they did not see the benefits in the end but they had had them at the very beginning?
Ms Barysch: Absolutely. Accession is not an event, it is a process. Whenever economists model the impact of accession on economies in both East and West they usually define it as a ten or 15 years process of economic input.

Q255 Mr Hoyle: Of course people would say part of the main reason for investments in Central and Eastern Europe is actually low wages. Would you agree with that?
Ms Barysch: It is one factor. There are actually surveys out there that ask companies why they go and invest in one location rather than another and wages come quite far down the list. What investors are after is political stability, macroeconomic stability, infrastructure and a good legislative framework. The things people think are so important, such as wages and taxes, actually come quite far down the list. If it comes to Central and Eastern Europe obviously there is a big wage gap. I looked up the figures recently. In 2005, which is the last year for which we have comparable statistics from the European Commission, and you have an average wage level in the EU of about €20 per hour. In the Czech Republic, Hungary and Poland it is about €6 per hour; and in Bulgaria and Rumania it goes down to €1 to €2 per hour. The wage gap is big. You always have to bear in mind that, although wages there are lower, they are growing fast and these countries cannot and will not compete with wage levels in China. They need other advantages and these advantages are very clear. As I have said, the EU accession process is an anchor. As a foreign investor you are basically insured against policy reversals. You also see a business environment that, through the *Acquis Communautaire,* is very similar to what you are used to at home, because the laws are basically the same for product standards or competition policy across the European Union. You also know that if you invest in a country that will join the European Union you have completely free access to a consumer market of almost half a billion people. It is very important to have these added benefits. Wages are important but they certainly are not the main reason why companies would go to one country rather than another.

Q256 Mr Hoyle: Just looking at that, what is the most important competitive advantage in ranking? If it is not wages what would you say—education?

Ms Barysch: Certainly wages are only one part of the equation. It is the wage:productivity ratio that counts. The education levels in Central and Eastern Europe are very high. On some indicators these countries score better than the old Member States, for example secondary school enrolment and drop-out rates, which are more numeric indicators. When you go and test the actual skill levels, let us say, through the OECD PISA studies you find that all is not well in Central and Eastern Europe because their education systems still need a lot of reform; they tend to be quite rigid, very heavily focussed and they do not really give people the kind of generic skills of, let us say, management and problem-solving and foreign languages that people need in a market economy. Again, these things are improving but, for the time being, they have good technical skills which are still adequate for their current level of development, which is mainly in manufacturing; but if they want to move up the value chain they obviously need to fix their education systems.

Q257 Mr Hoyle: Looking at that, it would be fair to say to go up the value chain that low cost production is actually moving further east now?
Ms Barysch: It is, yes. For some sectors, when it comes to the mass manufacturing of electronic gadgets, these countries are already losing investments; but at the same time they are now attracting services, not only call centre outsourcing but all sorts of other things; they are moving up the value chain into higher value-added. Then you have the huge success story of the automotive sector. I understand there that other things rather than just wages levels are important, because wages actually only make up a very small proportion of the cost of producing a car.

Q258 Mr Hoyle: I visited the Ford plant in Czechoslovakia and they made a major investment and what they said was it is not just about low wages but about the higher education standards they can achieve. The qualification levels really mattered to them and that is why they made that investment and moved from the UK, so other companies must be copying that model?
Ms Barysch: Yes, but the wages in these export-oriented manufacturing sectors tend to be rather high. The productivity there is almost as high as you would find in Western Europe, which is understandable give that Volkswagen or Ford go in and put in a brand new car plant so obviously it is the latest machinery, so the productivity would be on an equal level, or even higher than what they have at home. Plus you take the people who are highly skilled but, because they have high productivity, they can pay them rather large wages. If you look at the average wage levels across the region that is misleading because some people make very good money; but then you go into Eastern Poland or Eastern Slovakia and the wages are just a fraction of what people could get in industrial centres or urban areas.

Q259 Mr Clapham: Picking up from what you said about wages, yesterday we had the British Chamber of Commerce, and one of the things they made quite plain is the relocation of manufacturing is driven by the incentive of profit. The two factors there would be low wages and higher productivity. My question relates to the fact that not only the UK but the other 15, particularly the Germans and the French, also see relocation of their manufacturing bases being important, the relocation into the A10. Firstly, do you feel that as manufacturing relocates from the 15 that it is undermining, if you like, the domestic manufacturing base of the 15? Secondly, would you subscribe to the view that as manufacturing moves into the A10 what is happening in the EU15 is that they are nudging their economies to a higher value level?
Ms Barysch: I think that is pretty much inevitable. The basis of our wealth is not the share of GDP that is produced in factories rather than offices; it is how much value each worker can add. If we insisted on keeping all our old industries we would still all be making T-shirts and cigarette lighters. I am glad we are not because that makes us a wealthier society. A lot of the manufacturing that has gone into Central and Eastern Europe in the early days was either labour-intensive, because of the lower wages, or was capital-intensive. You had heavy industry, steel, maybe chemicals and so on. It is only now that they are also moving up the value chain because actually Central and Eastern Europe is in a slightly uncomfortable spot between high-tech Western Europe and very low-cost Asia and further Eastern Europe. They need to move ever faster just to stand still. If you want to look at the impact of the shift of production processes into Central and Eastern Europe I would argue that it has been good for the EU economy as a whole; because what we have not seen, for example, is a massive increase in unemployment in Europe during the time when this shift of production processes happened. You have seen, of course, friction which you would expect in economies that are not fully flexible. We have not seen a huge set-back for any of the countries that start outsourcing to the region. The key thing for me to bear in mind is that eastward enlargement happened at the same time as China and India started integrating into the world economy. Eastward enlargement and globalisation happened at the same time. What that means is that the increase in global pressure on, let us say, automotives, on pharmaceuticals, on these globalised sectors has really increased quite fiercely. What do the companies do in response to that? They do not have a choice between producing at home and producing abroad. Nokia does not face that choice because it has a choice between either cutting costs or going out of business and laying-off everybody in Finland anyway. The choice is, how do we make our production more effective? Just heaven sent, all of a sudden you have several hundred million low-cost, high-skilled workers right at your doorstep with a brilliant business environment, and of course you start shifting some of the production processes eastward. That has actually helped these

companies—Volkswagen and so on—to stay competitive on a global scale. The alternative would not have been that all the production takes place in Germany; the alternative would have been that Volkswagen lay off workers anyway. I do see obviously production processes are moving but there are some very interesting surveys out there particularly with regard to Germany, because that has been the biggest foreign investment centre in East Europe. They asked these companies: "Have you shifted jobs abroad?" Quite a few said, "Yes, we have". The share of companies that said, "This relocation process has actually allowed me to create jobs at home, and create higher value- added jobs at home", is much, much larger.

Q260 Roger Berry: To what extent are the tax regimes in the new Member States more competitive than in "old Europe" as it were? Is it a significant factor in determining whether or not new Member States have a competitive advantage?
Ms Barysch: Again, taxes are not the main reason why a company goes to a country; but everything else being equal obviously they can make a difference. If you look at the overall tax intake in the Central and East European countries, it is a bit lower than in the EU15 but not very much. We are talking about the difference between, let us say, 35%-36% of GDP versus 40% of GDP as an EU15 average. The difference is not huge. A difference which is big is in headline corporation taxes. There obviously you have countries which go from 0% in Estonia to, let us say, 13% in Slovakia, up to over 30% in some of the other countries. If you compare that to what is happening in Germany, France and Italy, obviously the headline tax rates on corporate profits are much lower in Central and Eastern Europe. There is another difference because the tax base in these countries is much more coherent. Germany has a high headline tax rate, but it has so many exemptions and loopholes in its corporate tax system that most large German corporations do not pay corporate taxes. It is very difficult to calculate what the effective tax rate is. In Germany, for example, the effective rate could be only half the 38% headline rate, and the Commission and the OECD also publish figures where they look at the amount of money that governments collect in corporate taxes as a share of GDP. The last time I looked in Germany this was less than 1% of GDP. In Britain, mind you, it is more than 3% because you have a lower headline rate, but you have a move consistent tax base. In Estonia, which has a 0% tax rate on reinvested profits, Estonia collects more as a percentage of its GDP in corporate tax than Germany. The whole debate is seriously flawed when you then have politicians in Western Europe saying, "Oh, we shouldn't give these people structural fund money because they are competing unfairly"; then you have to ask yourself where these arguments come from. The other reason why Central and Eastern Europe is seen as a low tax paradise is obviously the flat taxes on income that some of these countries have adopted and for good reasons, because they are very ineffective tax systems, and tax evasion was so high that these taxes make sense in the context of transition economies. The main advantage that they have is not the level of the tax rates. As I said, payroll tax rates are very, very high; VAT can be high, so the overall tax take is not lower than, let us say, here but the big advantage is that many of these tax systems are quite simple. If you look at Slovakia, Slovakia has the most beautifully simple tax system in the world. It is a 13% tax rate on absolutely everything. 13% flat income tax rate, VAT, capital gains tax, no matter what. You can really do your entire tax declaration on the back of an envelope. Obviously the Germans look across the border and say, "Why can these guys do it and we can't?" I think that is the competitive advantage. Not so much the low tax rate, but they have really got it right in terms of the simplicity.

Q261 Roger Berry: What are the implications of that for the debate on tax harmonisation?
Ms Barysch: Certainly you cannot do that with the Central and East Europeans because they see very clearly the demands for tax harmonisation are basically a way of trying to force them to raise the headline rate. As I said, the European Commission called the bluff of the Germans and the French by saying, "Okay, if you want to go down the route of tax harmonisation it is good, but we have to start with the tax base". Companies are actually in favour of that, because the companies that operate across Europe would very much welcome more common rules for tax bases. Then what happens next? First, it becomes obvious that the whole debate is flawed; and, secondly, I think that the competition between tax rates would intensify; that is quite clear. The East Europeans certainly do not want any harmonisation in tax rates. They might or might not be willing to talk about the harmonisation of tax bases; but only if they can make quite sure that the outcome of this is not any large EU countries forcing them to raise their rates.

Q262 Chairman: The implication of harmonisation of tax bases would be a British Chancellor of the Exchequer would not be able to offer certain reliefs that he currently enjoys offering? The loss of the ability of the Chancellor of the Exchequer, or any Member State equivalent finance minister, to offer specific reliefs to companies would disappear?
Ms Barysch: You cannot do that anyway. Under EU law you are not allowed to. EU law is quite strict on how far you are allowed to give benefits to one company or another.

Q263 Chairman: I am not talking about a company, but am thinking of things like research and development tax credits, for example?
Ms Barysch: That would not necessarily be affected because we have common rules across the EU for that already.

Q264 Chairman: There is a debate in political parties in the UK about research and development tax credit. My Party says we should abolish it and simplify the tax system; the Labour Party says no, we

should keep it because it benefits R&D. A common tax base—that debate would disappear, would it not?
Ms Barysch: Not necessarily, no. It might affect it. The example you just gave shows how huge the challenge would be trying to harmonise such rules across 27 countries. I think what we are basically stuck with (and I think that is a good thing) is minimum rules that say, "You cannot subsidise your pet industries through whichever means". I do not foresee any big move towards a harmonised tax base. Companies would welcome more joined rules because it would make their lives easier.

Q265 Mr Wright: We are seeing for ourselves the huge growth rates currently being experienced by the A8/A2 countries. Do you believe it is sustainable? How do you see them developing over the next ten years?
Ms Barysch: In the short-term certainly the high growth rates do seem to be sustainable. A lot of that growth is from export-oriented sectors. These countries are small open economies so their growth rates to some extent depend on what happens in the euro zone, which is their major market. They have also managed to reorient some of their exports to fast growing Asia; but these are basically export-oriented economies. You see the large amounts of investment that are still going in these countries; new factories are being built because privatisation is basically over so the money that comes in now is really building new production facilities. From that perspective, over the short to medium term, it all looks good. Over the medium to long term, as I already pointed out, they need to move up the value chain. Their wage levels will rise. They cannot afford to compete or they will not be able to compete with China. They need to have high skill levels. That is a policy challenge that these countries are very well aware of. Then you have another issue in the medium to long term, which is demographics. In Central and Eastern Europe populations are aging even faster than some of the euro zone countries. In order to maintain output when your workforce is actually shrinking you desperately need higher productivity. They still have a lot of new resources to bring into the labour force. If you look at overall employment levels, the share of the workforce that is employed is actually much lower than in most of the West European countries. Some of these people are idle because they have the wrong skills; because they are in the wrong areas. That again is a big policy challenge, because it is not only about re-training, it is also about fixing the housing market; building new transport and housing infrastructure and so forth. There are big policy challenges over the medium to long-term if they want to sustain these very high growth rates they are seeing at the moment.
Mr Wright: We have recently visited Hungary and Lithuania, two completely different countries in terms of the difficulties and obviously some of the issues they face in the future. In Lithuania, for instance, large numbers of the population have migrated abroad, mainly to Ireland. In Hungary they have not got a stable workforce. In those two countries obviously it is going to create difficulties. Do you see their aspirations to become high value-added economies being achieved?

Q266 Chairman: I want to ask you in detail about migration impacts in a moment.
Ms Barysch: I am not too familiar with what Lithuania is doing at the moment; but in the case of Hungary certainly if you look at the share of the exports that are already accounted for by high-tech industries you see how quickly the country is changing. It seems to be taking advantage of the situation in Europe, yes.

Q267 Mr Wright: They see themselves as the hub really of Central Europe—do you accept that as a viewpoint? That is what their strength is for the future in terms of becoming a high value economy.
Ms Barysch: They have a very good international image, the Hungarians. They were early reformers. They have an image of stability. They have a highly qualified workforce. The good thing in Central and Eastern Europe is that these countries are all very aware of the fact that they are competing against each other. It keeps them on their toes. From what you have just told me about Hungary they seem to be taking advantage of that.

Q268 Chairman: Is that concept of hubs very useful in looking at the Central and Eastern European economies, or are they all individual markets, and can a British company say, "I can base myself in Slovakia, Hungary and use it as a hub"?
Ms Barysch: It probably depends on which sector you are in. For Hungary to claim it is the automotive hub of Europe would not be plausible.

Q269 Chairman: Slovakia could?
Ms Barysch: Slovakia is probably closer to that, but I think it all depends on which sector you said. The term "hub" I would associate with transport, which is certainly not a sector that Hungary sees its future in.

Q270 Mr Clapham: A little earlier you mentioned education in the A10 countries being a factor that does help in attracting relocation. Is it possible to say what the strengths and the weaknesses of the A10 education systems and workforce skills are compared, say, not just with the UK but with the other EU15?
Ms Barysch: As I said, on many educational indicators these countries are doing great—better than, say, the euro zone average. If you look at countries such as the Czech Republic and Poland and you find that over 90% of the population have completed secondary education, it is much higher than the EU average; but then these skill levels are adequate for their current specialisation in manufacturing and basic services; but if they really want to become knowledge economies, if they want to become high tech economies they need to make their secondary education more flexible and they also urgently need to reform their tertiary education. The enrolment rates in tertiary education,

universities, are still much lower than you would find in most West European countries. The curricula tend to be very rigid. There is a heavy specialisation early on, which is not very good because you need a flexible workforce. Money is only so much of a problem, but it would certainly help if the state budgets in these countries were not under so much strain at the moment. The countries are aware of the importance of educational reform for their future competitiveness.

Q271 Mr Clapham: On the rigidity of the curriculum, is that leftover from the Communist period? For example, is Hungary or Poland introducing a more flexible curriculum?
Ms Barysch: I think they are working on it. The curricula changed very slowly because they sort of evolve in line with what your country is good at. If you look at Germany, for example, the heavy focus on engineering skills was perfectly adequate for most of Germany's post-war period, but not they are becoming more service-oriented you see this huge super-tanker of an educational system being very slow to turn around. I suppose that is the same in Central and Eastern Europe where they were specialising in manufacturing and heavy industry during the Communist period, and it is very difficult to change the mindset of a whole education sector that was once very useful and is maybe now a little less useful. What we see very clearly across the region is that the private sector is stepping in where there are the most obvious failings. You have private business schools all across Central and Eastern Europe that are doing very good work. Skill shortages do exist in some sectors. If you ask companies they will always tell you they do not have IT skills and other technical skills, but that is not something that is specific to the Central East Europeans; you have that in most West European countries too.

Q272 Mr Clapham: Given also that education has a civilising influence, are we seeing for example different attitude towards gender mix in both education as well as in work? Is that beginning to happen in the A10?
Ms Barysch: They have traditionally been very egalitarian societies, simply because under Communism most women worked, and they still do. The participation of women in the labour force there is very high, although it has been declining a little bit because there was more choice; under Communism there was not choice. These are broadly egalitarian societies.

Q273 Mr Binley: Can I just ask a supplementary about education because we were told in Hungary by a very articulate, senior manager that one of the strengths was in fact related to some of the discipline and rigidity within the educational system. Whilst he recognised that were more creative in terms of educational approach, there needed to be a mix of the two. That is slightly different from what you are telling me. Is he right, or have I misunderstood what you have said?
Ms Barysch: I think the two statements might be compatible in the sense that I said for their current specialisation in manufacturing, engineering and electronics their education systems are adequate, because they do produce good engineers and technicians, and that is what these education systems seem to be good at. If they really want to go into creative industries and software engineering and so forth then maybe they need a bit more of that. I would not advocate that all the professional education they have at the moment becomes worthless; but you need a bit more of the more flexible kind as well, I guess.

Q274 Mr Binley: Thank you. Can I move on to migration of labour, because we always see the figures from national perspective, not from localised geographic perspective; and we always see the movement on national basis and not on segmented population basis; when in fact migration is very much about localisation, local areas and it differs massively within national boundaries. Secondly, it is very much about specific levels of the population—for instance, Lithuania. Not only are we seeing many people coming from Lithuania, but they are mostly young, they are skilled, they are very energetic. We are seeing them come to specific areas within the UK. In fact in those specific localised areas the figure is very much higher, and the drain from Eastern European countries is very much more relevant to given, important age groups, and our figures are misleading in that respect. I want to ask you where you see the long-term impact in terms of taking the very brightest and the most energetic and the most skilled from Eastern European countries; and whether you see that there will be a shift back as people say, leaving a real skills problem in the UK, for instance?
Ms Barysch: For the time being it is good for us, bad for them, I would say. You could also argue that since we are, as you rightly point out, getting the best and the brightest from Central and Eastern Europe—however initially they tend to work in rather low skilled jobs in our economies until they have gained a foothold—there is a net loss for the EU economy as a whole because we are under-using skills on quite a broad level; having said that I would not be unduly pessimistic. We do not have good numbers about these migration flows from Central and Eastern Europe, but there is anecdotal evidence that people come over here and quite a few of them are going back. In the meantime, they are making more money here than they could at home, otherwise they would not come, and they are sending that money home. They are spending some of it here but they are still sending some of it home. There are remittances that help some of these countries. They are obviously also picking up skills whilst travelling in terms of the jobs they do, but also language skills and the general way things are done around here. They might go back with new enthusiasm and new skills and set up their businesses. That would be the optimal scenario. The labour market opening I think is too recent to say whether that is the case or not. I think the UK has done a very good thing by opening

up its labour market. Here the people come in and you leave it to the market for them to find the best way to apply their skills. If you look at the big euro zone countries that decided to keep restrictions on labour movements, they did not keep these restrictions to keep the East Europeans out, they just kept them to keep control over who comes in and for how long. For example, there are still more Polish people going to Germany than there are Polish people coming to the UK. In Germany they get work permits for six to 12 months so that they can work in agriculture or the building trade. At the end of the day the German economy probably gets less out of its immigrants than the UK, which has the courage of leaving those people to sort out where they can add the most value and achieve the highest earnings.

Q275 Mr Binley: How in the long-run does this impact upon Britain a) when people go back; b) with the fact that they have got real skill shortages in the UK; and c) that we have got a growing number of young people not in education, employment or training? There seem to me to be some very dangerous factors coming together which could impact very detrimentally upon Britain in five or ten years' time. Is that a fear we ought to take seriously?
Ms Barysch: I do not think you can solve the problems of the British education system or skill shortages through immigration alone. I would not go down that route. What certainly has happened is through the rather sudden and sizeable influx of Central and East Europeans that has put pressure on other lower skilled professions in this country. You see a bit of wage pressure, and you have seen people who have not had quite high skill levels and motivation being pushed out by these young, energetic people who have come in. Personally I think competition is good but there might be additional demand for state intervention, helping these people to retrain and succeed in the labour market. There will be a big loss for the UK economy if a large number of the Central and East Europeans go back home. I do not know, whether they will, but even if they do, there is nothing we can do about it. The only thing we can do is make Britain open and attractive and keep the labour market flexible so that people feel at home and welcome here. Apart from that there is nothing we can do. What we should not do is actively recruit in areas that have shortages across the European Union; I am particularly talking about the medical professions here, because there are some countries, including those that have restrictions such as the Netherlands, that are actively going to Central and Eastern Europe and recruiting for doctors and nurses. Since there is already such a shortage in the Central and East Europe health care systems that is not something I would support.
Chairman: I thought Mr Binley was going to ask about the impact of migration on the accession states and Mr Weir was going to ask about the impact on the UK, but it seems to have gone the other way round!

Q276 Mr Weir: It was interesting what you were saying about the energetic young people coming from Eastern Europe. One of the things we have been told by someone is that the immigrants and migrant workers have a greater work ethic than many in the UK. Do you think that is true?
Ms Barysch: I honestly do not know.

Q277 Mr Weir: People coming from countries that have just come out of Communism, low wage economies, are they more likely to work harder than somewhere where they are being paid a lot more money. Is that the driving force behind them, do you think?
Ms Barysch: I guess it always depends on what your alternative is. If you grow up in Eastern Poland and your local job opportunities are very severely limited and you get this one crack at going abroad and making a living and setting up a career saving enough money so you can start something new you are probably quite motivated. We do not only see that with the Central and East Europeans; we clearly also see that, for example, with Asian immigrants that come into the United States that are said to be working much harder than the local population. Then again, why would Europeans work so much harder if they do not have to? This is a wealthy society and one of the great achievements of that society is that people do not have to work 16 hours a day any more. Since this is not necessary I do not see why people should.

Q278 Mr Weir: People who are coming to work in the UK, for example, remitting money back to Eastern Europe, is there evidence they are acquiring entrepreneurial skills in the UK and going back home to start businesses in Eastern Europe? Is it a benefit to Eastern Europe as well? We hear about losing the brightest to the UK, but is it a cross-fertilisation backwards, helping business in these countries?
Ms Barysch: I can only say that I hope that this is the case, but I have not seen any evidence because these migration flows are probably too recent and we do not seem to have the statistics—or at least I have not seen them—to say whether that is happening on a large scale.

Q279 Mr Weir: That is interesting because we had the statistician from the Department of Work and Pensions. One of the discussions we had was about the true number of immigrants and it seems nobody really knows how many immigrants there are from the accession states within the UK. My experience, representing an area with a lot of agriculture and food processing, is that we get a lot of temporary migrant workers; perhaps students who work for a while, earn money to help with their studies and return to their home countries. As far as you are aware there are no figures as to how many actually settle as opposed to those who are temporary workers?

Ms Barysch: I have not seen any figures. I know we count those who come in but not those who go back. I am not aware that the countries themselves produce such figures of how many come back, but it would certainly be an interesting area of study.

Q280 Mr Weir: Finally on the effect on Eastern European countries, one of the things we were told in Lithuania and Hungary (perhaps not so much in Hungary but certainly in Lithuania) because so many people had left Lithuania and come to the EU15 they were now sucking in people from further east, from Belarus and Kazakhstan, and places like that. Is that happening in a lot of other Eastern European countries as well, are you aware? What effect is that having on their economies?
Ms Barysch: I think it is happening to some. Again, I have only heard anecdotal stories of Ukrainians going to work in Poland, and Romanians going into Hungary as these countries' own populations move further west. Again, I do not see a big problem with that. People should be able to go there where they can add the most value. It is difficult for those countries from outside the European Union because we have a visa regime and the new Member States want to join the Schengen areas, so they need to enforce these visa regimes quite rigorously. It is not actually that easy for Ukrainians and people from Belarus and Kazakhstan to come and work in what are now EU countries because we have quite strict rules about that.

Q281 Mr Weir: Possibly quite a lot of legal work going on?
Ms Barysch: Yes, but by definition we do not have numbers on that.

Q282 Mr Clapham: A little earlier you mentioned the German system where there are work permits and people are restricted to certain sectors, in comparison to the UK where there is a free labour market. Given that there is this freedom in the UK, does it not result in people moving from certain sectors that they came to work in, for example in agriculture, to work in construction, and consequently you then get a depression of wages in the construction industry; whereas in Germany there is much more control and, therefore, you would not get the sector wage depression? Would that be a correct analysis between the two?
Ms Barysch: It is difficult to compare the two systems because, unlike Britain, Germany does not have a general minimum wage. What you saw in Germany is that all wages, and all agreements that affect wage levels, working hours and so on are negotiated between the employers' federations and the labour unions. Some sectors have a minimum level of wages and others do not. What you saw in Germany, and what caused a lot of the controversy, is that people came in and they worked in the building trade and in slaughterhouses for as little as €1 an hour. They actually found women working in call centres for €0.50 an hour, and that obviously caused a lot of upheaval in an economy that is used to being a high wage economy. That is why now in Germany you see a debate about introducing a general minimum wage. Here the situation is fundamentally different because the Government made the decision that there should be a general minimum wage which applies to all sectors. This is a political decision; this society decided we do not have to wage depression below that level because we do not think that is human and that is a political issue. Obviously that is the minimum floor, and you might argue that illegal immigrants might put pressure on that but I do not know if that is then a matter of enforcement but not a political decision. Yes, you probably will not see unskilled wages rise much higher than the minimum wage, but you do have that floor.

Q283 Mr Clapham: Really what we ought to be doing is to ensuring that as we get people coming in from the A10 countries we should be directing them through the trade union route?
Ms Barysch: I am not sure that is necessary. I understand the minimum wage is binding whether you are a member of the trade union or not.

Q284 Mr Clapham: The minimum wage is but of course the rate of pay in a particular sector is not. The rate of pay in a sector like construction may well be negotiated by the trade unions, and well above the minimum wage. Whereas when you get the movement of labour from, say, agriculture into construction they can be relocated by virtue of gangmasters who pay a very low rate. One of the things we are told by the construction unions is that is what is occurring.
Ms Barysch: It is true that this is an issue quite a few of the European countries face at the moment. I do not know if you have heard of the *Vaxholm* case in Sweden where there was a Latvian construction company that built a school and then the Swedish trade union said, "This is unfair because, unlike everybody else, they have not closed a bilateral deal between the trade unions and the employers about the wage level on that particular construction site". The Latvians argued that they did not need to do that because they operated under the rules of their home country, not the country they happened to be in. That went to court and the Latvians had to go home. It then went to the European Court of Justice, and the European Court of Justice recently expressed a certain amount of sympathy with the point of view of the Swedish trade unions. I am quite sure that the trade union leaders in this country will be following very closely what comes out of that debate, because that might ultimately allow trade unions here also to go to the European Court and enforce what they see as their rights. I think because the differences between the various EU countries in setting wages levels (be it at the company level, the industry level or where the governments are involved or not involved) are so vast, you probably will not see a European solution to that. Not being a trade union specialist I do not really know what the outcome in this country will be.

Q285 Chairman: Would labour shortages and, in particular, certain skills in some accession state economies now mean that the viability of British inward investment to those economies is limited?
Ms Barysch: Yes. You do see companies that are complaining about skill shortages in and around Prague and some urban areas, which is why they now want to go further east where land is cheaper and labour is still more available. For that, you obviously need infrastructure investments which are happening in some of these countries, so I would not say that the potential of these countries is exhausted. You also need to put things into perspective, these countries got about $40 billion worth of foreign direct investment last year, the Central and Eastern Europeans together, but if you take that amount, that is only about 7% of what the EU got as a whole in foreign direct investment. The fact is that most of the investment that goes out of the UK still goes to other European countries and the US. The Central and Eastern Europeans are really just a tiny share of where British companies put their money abroad.

Q286 Chairman: Just a few other concluding questions from me and if there is anything else you need to say at the end, by all means, please do. First of all, the acquis, which is all signed up to by the accession states, obviously on paper they have done very well. What do you think about enforcement on the ground of those new sets of rules?
Ms Barysch: I can only say what the official figures show, which is that they have fewer infringement cases and less of what they call the "transposition gap" which is the share of EU law that you should have adopted but have not than many of the old Member States, so on paper it looks as if the new Member States are quite diligent when it comes to implementing the acquis. This might have to do with the fact that they joined relatively recently and as long as you are outside, you fear the European Commission because it has some real power because it gives you a school report every year; once you are inside the European Union you feel much freer to ignore the European Commission. My friends in the Commission tell me that there is a kind of lingering respect for the Commission that you do not see in other countries, so when Brussels says, "Can you please implement that law?", they are still more likely to do it than, let us say, some other countries.

Q287 Chairman: They are also smaller so there would be fewer cases, you would expect. Italy tops the league table I think, whatever measure you use.
Ms Barysch: Yes, France is also not very good in these statistics.

Q288 Chairman: Structural and cohesion funds, we had some very interesting sessions in Hungary last week looking at the way the government is really being very diligent in the way they use those funds to make sure they bring maximum advantage to the Hungarian economy and that funds are appropriately used and not misappropriated, which is an issue in Hungary. How effective do you think the accession states are proving generally at using those funds?
Ms Barysch: I believe it is too early to tell because the rules, according to which these funds are spent, are very complex and complicated. You might criticise that, but that is just a flipside of the coin of the demands that we make on the European Union to spend the EU budget wisely and in a way that is transparent and safe. You cannot say, on the one hand, "We want maximum control and prevent wastage and corruption", and, on the other hand, say, "We want super-simple rules that allow for the fast spending of money", so these two things go together. Because these rules are complicated, it took the Central and Eastern Europeans a little while to identify projects that fit into that framework, to apply for the money and I understand that in many of the areas they are just now at the stage where the money starts flowing in. What has not happened is the scandals of money being stolen or wasted that we expected to come out of some of these countries, I have not seen any headlines claiming that this is the case. What is also interesting is it should get easier now because they are getting used to the bureaucratic process and also I think it was a British initiative, because it was under the British Presidency, under which the last budget was negotiated, they reduced the overall amount of the structural funds that will go to Central and Eastern Europeans, but in return offered an easier set of rules for these countries according to which they spent their money and they reduced the co-financing requirements in some areas. It should now get easier for these countries to spend the money and it is also encouraging that they are trying to learn from the old Member States what to do and what not to do. There was a lot of interest in how Ireland managed to spend EU money in a way that was so good for the country's long-term growth rate and also a lot of interest in the Greek case on how not to do it.

Q289 Chairman: The main purpose of this inquiry is to assess what the impact of these developments has been on the UK economy and we have not exploited our opportunity as we might. We have heard consistently quite a lot of criticism of the UK banking sector for not being sufficiently entrepreneurial in its approach to Central and Eastern European economies and the pretty well widespread absence of the major high street retail bank names from those economies. Do you think that is a matter of concern?
Ms Barysch: It is a very small market so—

Q290 Chairman: They are saying that the British companies do not want to go and invest because they have not got the bank names they are familiar with to do business in these countries.
Ms Barysch: I cannot imagine that British businesses say, "Well, I can only do business with Barclay's but not with Deutsche Bank", that would surprise me—maybe that is the case—but since predominantly these banking sectors are in the hands of West European banks, not necessarily British ones but

Germans, Italians, French, these are well-known names so you would not cite that as a major impediment for British businesses to go and do business there. As I said, these are small markets, so some of the most successful banking players in Central and Eastern European countries themselves come from small countries, such as Austria, because Austrian banks would not have the scale to roll out big foreign projects, let us say, in the German or British market, but they were quite successful niche players in Central and Eastern Europe and they still are.

Q291 Mr Binley: We got a different message from two of the accession countries I have been to and I think you got the same sort of message from Lithuania. What is missing is not the ability to cash cheques and shove credit cards into holes in the wall but real skill about public sector financing, big project financing, PPI-PPP stuff, the capital elements of investment that they really are crying out for that they reckon are skills best lodged in the City of London and they are saying, "Please come". That is the impression I got from the states we went to, so there is a slightly different story between the two of you there.
Ms Barysch: That is a very good point but, then again, if the demands are really there in Central and Eastern Europe, I would be highly surprised that the very crafty people we have in the City of London are not taking advantage of that. I believe if there is a real demand for the skills that are only available here, then I do believe that is—
Mr Binley: We were told that they were missing.

Q292 Chairman: We have had a fairly consistent complaint that the financial services sector has not been quite as entrepreneurial as it ought to be in these states.
Ms Barysch: That is a very good point.

Q293 Chairman: We seem to have got a pretty clear impression that Britain was behind the curve on taking advantage of opportunities in Central and Eastern Europe compared with other Member States, not just Germany but also countries like Spain, Italy and France. Do you think that general comment, that British business was a bit behind the mark, is fair?
Ms Barysch: It seems to be the case that other countries were quicker to invest in these markets and also put in larger amounts. I think partly that is just a case of geographical proximity, partly it is the case of necessity, because German businesses, for example, are under particular pressure due to re-unification and all sorts of other areas, and partly it is a question of the industrial structures. As I said, a lot of the foreign direct investment in the earlier years was in manufacturing. Since the continental European economies have more export-orientated manufacturing sectors than Britain, the opportunities just presented themselves in a different way, because half of the FDR in the 1990s was manufacturing orientated and half was just basically acquiring existing businesses and building up telecoms companies and supermarkets. Some British businesses, such as Tesco, were at the forefront of this and others might have been a little slower, but I am not entirely sure why that would be the case.

Q294 Mr Hoyle: We keep bouncing this around, but I think the truth of the matter is that when the wall came down and it was opened up, we were too busy looking to the Pacific Rim countries and the ASEAN countries that we thought the East was where we ought to be. Germany went straight in and bought out the banks and the supermarket chains, Tesco was a late player even then coming into the market, most of it had all been bought up by German companies. When we looked at banking, by the time we got around to even considering it, all the banks had been bought out and there was nothing really left for us to pick up and Tesco had to buy chains off the Germans in order to get a foothold. Is that fair?
Ms Barysch: That might well be the case, but then I do not see any huge damage that might have done to the UK economy as a whole.
Mr Hoyle: The Government was expecting business to look to the East—when I say the "Far East", not Eastern Europe—but Germany was well placed and it took advantage.

Q295 Chairman: We got a complaint last week that the British Government back in the 1980s was steering, exactly as Lindsay said, British businesses towards the Pacific Rim and was not focusing their attention on the opportunities in Central and Eastern Europe that emerged but you are saying that has not damaged the British economy overall?
Ms Barysch: I do not see any evidence of this because, as far as I can see, the British economy is doing fairly well. You have to bear in mind that these markets are small. If you put together all the accession countries, the outcome is an economy the size of The Netherlands, so it is not as if you are missing out on a huge market, these are fast-growing markets but they are still relatively limited in size.

Q296 Chairman: You certainly think the Turkish market is a hugely important market, judging by a recent paper, and that there is a need to make sure that the accession process continues on a smooth path for Turkey.
Ms Barysch: I just observed what the accession anchor did to Central and Eastern Europe and I want some of that magic to rub off on Turkey, a country which I think is hugely strategically important and is going the right way at the moment. I would very much wish whatever we can do to help that country continue its transition, we shall do, rather than having a debate about the borders of Europe, which would be ultimately futile. I do believe that there are big opportunities. The accession anchor, in the case of Turkey, will invariably be weaker for all sorts of reasons than it was in Central and Eastern Europe, but if we can help make Turkey more stable, open and prosperous, I think we should do that.

Q297 Chairman: Is there any other country outside the current European Union we could apply that logic to as well?
Ms Barysch: We cannot really. In the case of Turkey, the decision to allow Turkey to start negotiating was maybe not a well-thought out, strategic decision, maybe it just so happened but it is good that it happened. If we now said to, let us say, Ukraine, "We will give you what we call a membership perspective as well", it just would not be credible, so we cannot and for the time being I do not think we are in a position to make any more promises of future membership to anybody else other than the countries that are already lined up in the queue, which are the Western Balkans and Turkey.
Mr Hoyle: But Turkey cannot join. It cannot resolve its Cyprus issue, it has also got France opposed to it, it has got The Netherlands opposed to it. The problem we have got is we have real problems out there. Austria just will not bend at all, and it is how do we overcome those major issues politically that are driving against Turkey completely. Turkey has got itself into a situation where it has even closed its ports to Cypriot ships, so instead of getting better, it is actually getting worse at the moment.

Q298 Chairman: This is a subject to which the Committee may well return, it is not part of this inquiry. It is an in-house message. Is there anything else you would like to add that you have not had a chance to say in answer to the questions?
Ms Barysch: No, thank you.

Q299 Chairman: We are enormously grateful to you, you have been an extremely informative witness, and we are ending this particular inquiry on a very high note. Thank you very much indeed.
Ms Barysch: Thank you.

Written evidence

Memorandum submitted by the Department of Trade & Industry

EUROPE MOVES EAST: THE IMPACT OF THE "NEW" MEMBER STATES ON UK BUSINESS

Executive summary

1. The enlargement of the EU to include the countries of Central and Eastern Europe -Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Romania and Bulgaria (as well as Cyprus and Malta) has been a clear political success, and it has brought enormous economic benefits to the accession countries as demonstrated by their progress with economic transition to market economies and impressive growth rates over the last few years, representing the EU's ability to prosper in a globalising world.

2. The UK has traditionally competed in the world economy through high levels of trade and foreign investment (both inward and outward), and the economic impact of enlargement on the UK has been positive in this respect. Trade and investment flows between the UK and the A8/A2 have increased, although not as much as for some other member states, which can in large be explained by geography (countries close to each other tend to trade more). Given the UK's location it is understandable that accession has not had as large a trade impact as for Germany, Austria and Italy.

3. Relatively cumbersome bureaucracy, inefficient and opaque judicial processes and residual levels of corruption could be reasons to explain why UK business in general has not addressed these markets more aggressively and tenaciously. There is no evident discrimination against UK businesses or products in A8/A2 markets, but UK businesses have been less active in these markets than firms from some other member states.

4. The main economic impact of enlargement for the UK has been the flow of migrant labour from the A8, particularly Poland. This is the result of a the UK opening its labour market to workers from the A8 policy on intra-EU labour movements, which has plugged gaps in the domestic labour market in a number of low-skill occupations across the UK contributing to strong UK growth. A8 migrant labour has increased employment in the UK and appears to have benefited UK firms and contributed to economic growth without any evidence of a negative effect on aggregate unemployment or wage growth.

Introduction

5. The enlargement of the European Union in 2004 to include the eight countries of Central Europe, Cyprus and Malta was the biggest and the most ambitious expansion in its history, adding 75 million citizens to the Union. In 2007 a further expansion brought in Romania and Bulgaria and added another 30 million citizens.

6. This submission focuses on the economic impacts of enlargement, but it is important to place these in a wider political context. In this respect we note the Conclusions of the December 2006 European Council:

"Enlargement has been a success story for the European Union and Europe as a whole. It has helped to overcome the division of Europe and contributed to peace and stability throughout the continent. It has inspired reforms and has consolidated common principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law as well as the market economy. The wider internal market and economic co-operation have increased prosperity and competitiveness, enabling the enlarged Union to respond better to the challenges of globalisation."

7. From the UK point of view the enlargement of the EU has also helpfully changed the dynamic in the EU Council in relation to certain economic dossiers. For instance, the closest allies to the UK on the issue of Working Time have been the A8/A2 countries, and it is doubtful that the blocking minority against the proposed Working Time Directive could have been maintained without the support of these countries. Another example is the Services Directive where the constructive approach of these countries during the negotiations helped ensure that the final Directive was more liberal, and contained stronger enforcement provisions than would have otherwise been the case.

8. The impact of enlargement is also evident in a number of non-economic policy areas where increased co-operation has made for a far more effective response to cross-border problems such as international crime, trafficking in people and drugs and environmental protection. Although these issues fall outside the scope of this memorandum, it is nevertheless important to take them into consideration when assessing the impact of enlargement on the UK as a whole.

9. It is also important to recognise the economic benefits that enlargement has brought to UK consumers. And this impact is not only felt on the British high street. EU enlargement has also enabled British tourists to more easily visit these countries for holidays and to invest in property there.

Historical context

10. The accession of Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary and Slovenia (A8) in 2004 and Romania and Bulgaria (A2) in 2007 were historic events, but it in some respects accession to the EU represented the culmination of a long process of economic *rapprochement* between these countries and the existing EU15. This process can be traced back to the late 1980's when limited elements of a market economy began to appear, most notably in Hungary, and developed as reforms from centrally planned to market economies took root. These were prompted by the political changes of 1989 and the subsequent increasing integration with the economies of the existing EU member states first through Partnership and Co-operation Agreements and then through the process of EU accession, leading to the steady adoption of the EU's *acquis communautaire.*

11. The fact that there was a long process leading up to accession has two important consequences:

12. First, in assessing the impact of the enlargement of the EU to include A8/A2 it is relevant to consider trends and developments *prior* to accession as well as developments *after* accession. Hence much of the quantitative material in this memorandum will include data from periods prior to accession.

13. Secondly, the process of negotiating accession to the EU gave these countries a clear focus for their national political and economic reform programmes that enabled them to transform more quickly from centrally-controlled, closed economies, to open societies based on free-market principles.

UK enlargement policy

14. The UK has been an enthusiastic proponent of the enlargement of the EU to include the A8 and Bulgaria and Romania. At a political level, the goal of EU membership provided an important focal point for the economic and political reform processes in these countries. At the economic level, the enlargement of the EU has created a bigger internal market and higher levels of competition, which in turn has stimulated the competitiveness of the EU economy, making it more prosperous and better able to respond to the challenges of globalisation.

Overview of the A8/A2 economies

15. Economic growth in the A8/A2 has been strong in recent years. But it should be noted that this followed, in most A8/A2 countries, a period of economic contraction in the years immediately after the collapse of COMECON. This period of contraction coincided with radical restructuring programmes designed to shift these economies away from central control towards open and free markets. Though painful at the time, these economic reforms have resulted in much more dynamic economies, which over the last ten years have enjoyed growth rates well in excess of those of the EU15. The catch-up growth of less mature economies, with low levels of per capita GDP, can be expected to moderate in the long run as these countries reach income levels similar to the rest of Europe. Strong growth in the medium term will depend on the reform process in these countries staying on track (which is true for any economy) to ensure they remain attractive to investors. In this respect, EU membership can help because it establishes a framework for peer review amongst member states on micro-economic reform (Lisbon process) and also at the macro-economic level through the review of national Stability and Convergence programmes. Most commentators expect growth is expected regional growth to remain high, at or above 5%, in the medium run.

Figure 1: GDP growth rates (%)

Country	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006 (est)*	*Average (97-06)*
EU 15	2.6	2.9	3.0	3.9	1.9	1.1	1.1	2.3	1.5	2.7	2.3
Bulgaria	−5.4	3.9	2.3	5.4	4.1	4.9	4.5	5.6	5.5	6.0	3.7
Czech Rep	−0.7	−0.8	1.3	3.6	2.5	1.9	3.6	4.2	6.1	6.0	2.8
Estonia	11.1	4.4	0.3	10.8	7.7	8.0	7.1	8.1	10.5	10.9	7.9
Latvia	8.4	4.7	3.3	6.9	8.0	6.5	7.2	8.6	10.2	11.0	7.5
Lithuania	8.5	7.5	−1.5	4.1	6.6	6.9	10.3	7.3	7.6	7.5	6.5
Hungary	4.6	4.9	4.2	5.2	4.1	4.3	4.1	4.9	4.2	3.9	4.4
Poland	7.1	5.0	4.5	4.2	1.1	1.4	3.8	5.3	3.5	5.2	4.1
Romania	n/a	n/a	−1.2	2.1	5.7	5.1	5.2	8.4	4.1	7.8	4.6[1]
Slovenia	4.8	3.9	5.4	4.1	2.7	3.5	2.7	4.4	4.0	4.8	4.0
Slovakia	5.7	3.7	0.3	0.7	3.2	4.1	4.2	5.4	6.0	6.7	4.0

Source: Eurostat

[1] Average for Romania covers period 1999–2006

16. As a result of strong overall GDP growth, consumers in the A8/A2 are becoming wealthier and more able to afford the higher value-added goods and services that are produced in the UK and elsewhere in the EU15. Per capita GDP in most A8/A2 countries is still considerably lower than in the EU15, but the gap in purchasing power between the A8/A2 and the EU average is in all cases narrowing.

Figure 2: GDP per capita in Purchasing Power Standards (EU-25 = 100)

Country	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*
EU 15	110.2	110.1	109.9	109.6	109.5	109.2	108.9	108.6	108.2	108.0
Bulgaria	25.6	26.0	26.0	26.5	28.0	28.3	31.0	31.8	32.9	34.2
Czech Rep	69.2	66.8	65.9	64.7	65.8	67.7	70.7	72.1	73.7	76.1
Estonia	38.4	39.3	38.7	42.1	43.7	46.8	51.2	53.4	59.8	65.0
Latvia	33.0	33.9	34.0	35.3	37.1	38.7	41.2	43.6	48.0	52.3
Lithuania	37.2	38.8	37.4	37.9	40.1	41.9	47.1	49.0	52.1	54.9
Hungary	49.8	50.9	51.7	53.9	56.9	59.1	60.8	61.3	62.5	63.5
Poland	44.2	45.1	45.8	46.7	46.1	46.3	46.9	48.7	49.7	51.1
Romania	n/a	n/a	25.3	24.9	26.2	28.1	29.9	32.6	34.1	35.8
Slovenia	71.0	71.9	73.6	72.7	73.9	74.5	77.4	79.9	81.9	83.6
Slovakia	47.4	47.6	46.9	47.4	48.7	51.0	52.8	54.4	57.1	59.4

Source: Eurostat

17. Wage rates in many A8/A2 countries are still considerably lower than in many EU15 countries. These low rates make many A8/A2 countries attractive locations for investment, particularly in those instances where low wages are combined with relatively high skills levels. Wage inflation in the A8/A2 is higher than in the EU15, and so the labour cost advantage for the A8/A2 is slowly being eroded, but on current trends it will take many years for most of these countries to reach average EU wage rates.

Figure 3: Average hourly labour costs (euros)

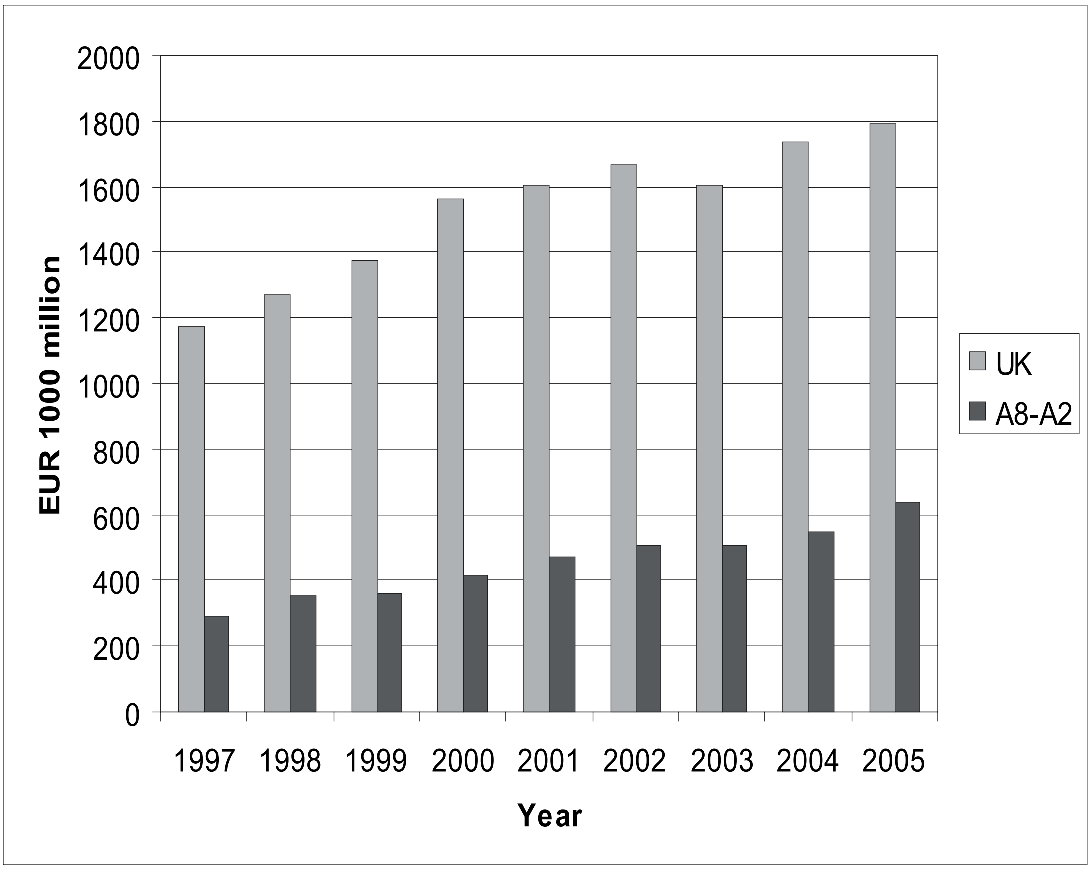
Country	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*
EU15	19.49	19.85	20.57	21.79	22.33	23.06	23.28	23.95	n/a
Bulgaria	n/a	1.11	1.22	1.23	1.29	1.32	1.39	1.45	1.55
Czech Rep	2.97	3.23	3.41	3.86	4.64	5.39	5.47	5.85	6.63
Estonia	2.13	2.42	2.60	2.85	3.22	3.67	4.01	4.24	4.67
Latvia	1.59	1.71	1.85	2.22	2.29	2.39	2.37	2.52	2.77
Lithuania	1.68	1.95	2.16	2.63	2.76	2.90	3.10	3.22	3.56
Hungary	3.15	3.02	3.14	3.63	4.04	4.91	5.10	5.54	6.14
Poland	3.38	3.73	4.05	4.48	5.30	5.27	4.70	4.74	5.55
Romania	n/a	n/a	n/a	1.41	1.55	1.67	1.60	1.76	2.33
Slovenia	7.90	8.51	8.94	8.98	9.58	9.70	10.54	10.41	10.76
Slovakia	2.61	2.91	2.76	3.07	3.26	3.59	4.02	4.41	4.80

Source: Eurostat

18. All the countries of the A8/A2 continue to overhaul the basic infrastructure of their economies. This process has involved the privatisation of large parts of the economy and a significant investment in upgrading facilities and equipment. This latter process is being supported by considerable amounts of EU money, largely through the Structural and Cohesion Funds.

19. While it is true that the economies of the A8/A2 have grown rapidly and continue to offer a range of opportunities to UK businesses, it is nevertheless important to put this growth into a wider perspective. In particular, collectively, the economies of the A8/A2, taken together are still small—something like a third of the size of the UK economy alone.

Figure 4: Gross Domestic Product: Comparison of UK and A8/A2



Source: Eurostat

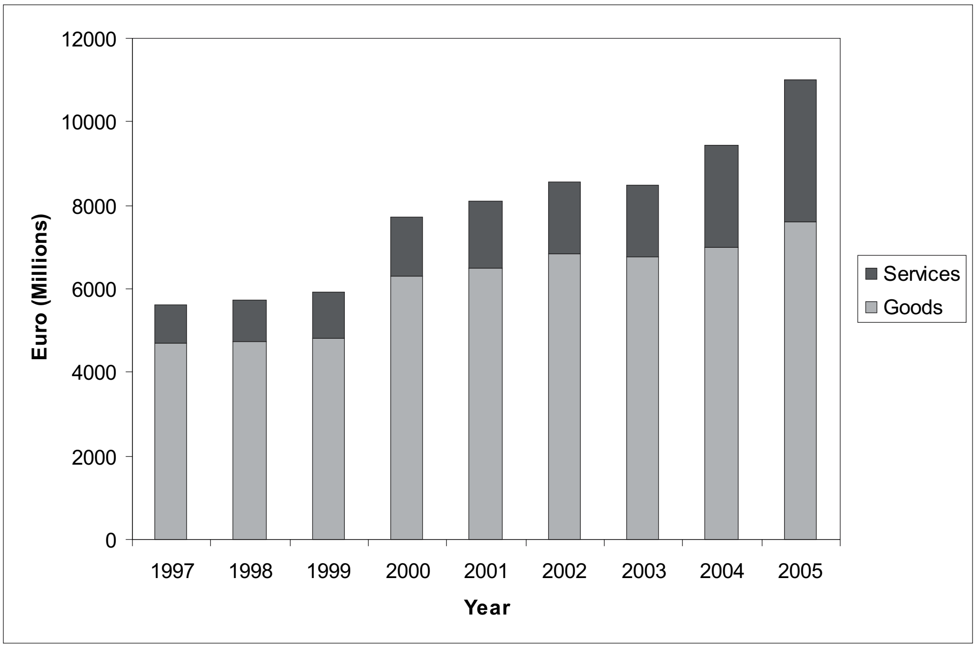
Question 1: Is the UK exploiting the opportunities offered by the accession of these countries to the EU?

Summary:
Yes, to an extent. UK exports to, and investment in, the A8/A2 countries has been steadily rising for the past decade with the share of exports to these countries increasing from less than 1% in 1992 to $2\frac{1}{4}$% in 2005. UK consumers are benefiting from an increase in imports of competitively priced goods from these countries, and workers from the A8 are filling gaps in the UK labour market and there is little discernable evidence of adverse effects on claimant unemployment.

20. There has been a clear increase in the value of British exports to the A8/A2 during the period running up to accession (when many of the tariff and non-tariff barriers to trade were progressively removed) and since. They are not the UK's most important export markets for a range of reasons including size, geography and economic history, but nevertheless, UK exports to the A8/A2 collectively outstrip UK exports to either India or China.

21. The most important UK export sector in terms of value was machinery and transport equipment. In 1997 this sector accounted for 42% of exports to the A8/A2. By 2005 that figure had risen to 46%.

Figure 5: UK exports to A8/A2



Source: Eurostat.

22. Imports into the UK from the A8/A2 have also been increasing, and at a faster rate than UK exports. The most notable sectoral development has been in the increase of imports of machinery and transport equipment, which in 1997 accounted for 29% of all UK imports from the A8/A2. By 2005 this figure had increased to 47%. This implies that British business is increasingly taking advantage of keenly priced supplies from the region.

23. Outward investment to the A8/A2 markets has also increased. But again, it is important not to overstate the importance of the relationship between the UK and the A8/A2 in this area. In 2004 the UK held more foreign direct investment stock elsewhere in the EU than any other member state (494 billion euros). Of that stock only around 1-2% was invested in the A8/A2. Of the 236 billion euros of invested stock held by other member states in the UK, only around 100 million euros was from A8/A2 sources.

Question 2. What are the most promising areas for developing business? Is there potential for exporting more goods and services to these countries?

Summary:
Business opportunities vary from market to market. However, most A8/A2 markets are experiencing rapid growth and there are particular opportunities associated with the development of the physical and technological infrastructure. As the consumers in these countries become more affluent there will also be more scope for exporting higher-value added goods and services.

If UK firms wish to exploit these opportunities they will need to invest time and energy establishing a profile in their markets of choice. This is especially true for services providers. To date, firms from some other member states have generally been more willing to do this than those from the UK.

24. The economies of the A8/A2 are not homogeneous, each offers different challenges and opportunities. However, a common theme for all these countries—and its true for markets outside the EU as well—is that success, whether it be in terms of inward investment or exporting opportunities, depends on maintaining visibility in the market either through regular visits or through establishing at least a small presence in the market itself. The following country-specific information has been provided by UKTI:

Bulgaria

There are increasing requirements in the construction and regeneration sectors, financial and legal expertise. Services relating to the environment, particularly water services and waste treatment will be opened for concessions and private management. The energy sector will need more investment in nuclear and renewable energy resources to meet increasing local and regional demand.

Czech Republic

UK Trade & Investment has identified several sectors—automotive, biotechnology, creative and media, engineering, financial services, healthcare and regeneration, food and drink, technical textilesı where there are good opportunities for UK firms. In some sectors (eg automotive, electronics, engineering), the trend is towards sourcing supply from, or investing into, the Czech Republic, rather than exporting from the UK.

Estonia

There are opportunities for UK suppliers in the areas of real estate management, construction, investment and consultancy services. However, the very low unemployment rates, together with the small labour force make it difficult for investors requiring a substantial workforce.

Hungary

Particular opportunities exist in the transport and environment infrastructure, combined heat and power generation and a range of services industries including consultancy and shared service centres.

Latvia

Wealthy Latvians outspend per capita even Muscovites on luxury goods. A number of UK luxury good suppliers have found that their per capita sales volumes outpace most if not all other European markets. There are also particular opportunities in the construction sector which has been enjoying per annum growth rates in excess of 12% for the last three years.

Lithuania

The markets with the greatest potential for UK exporters include ICT, chemicals, construction, education and training, environmental goods and services, leisure and tourism, financial and legal services and power. There are also outsourcing opportunities in the textiles and furniture sectors.

Poland [2]

The UK is the 8th largest exporter to Poland and the 5th largest investor, with accumulated investments of $4.34 billion since 1989. Particular opportunities in construction, engineering, water and waste water, railways, power, PPP agriculture and security.

Romania

Romania is a large country in rapid transition with sustained economic growth. Opportunities for UK firms exist in most sectors including water, environment, construction, oil and gas, legal and financial services, engineering, rail, power security, agriculture, retail, roads, airports, business services, ICT, property, healthcare, chemicals, education and training.

Slovakia

This year Slovakia will become the world's largest producer of cars per capita as a result of the presence of VW, PSA Peugeot and KIA. VW alone accounts for 20% of Slovakia's exports. This presents significant supply opportunities for second and third tier automotive suppliers. The requirement for suppliers to be close to their customers means that British firms wishing to exploit these opportunities would need to supply from Slovakia rather than export from the UK.

Slovenia

Opportunities for developing UK business include the construction and modernisation of infrastructure, the power sector, tourism and education and skills. Slovenia is also an excellent gateway to the Western Balkans, who are not only major trading partners, but also potential future EU member states; she is the only former Yugoslav republic to be in the EU and the only A8 country to have joined the Eurozone.

[2] UK Trade & Investment's Overseas Market Introduction Service (OMIS) is a serivce used by firms interested in developing their commercial relations (be it through exports, investments or partnerships) in other markets. For the first three quarters of 2006–07 Poland was the fourth popular market for OMIS enquiries, behind Russia, the United States and China.

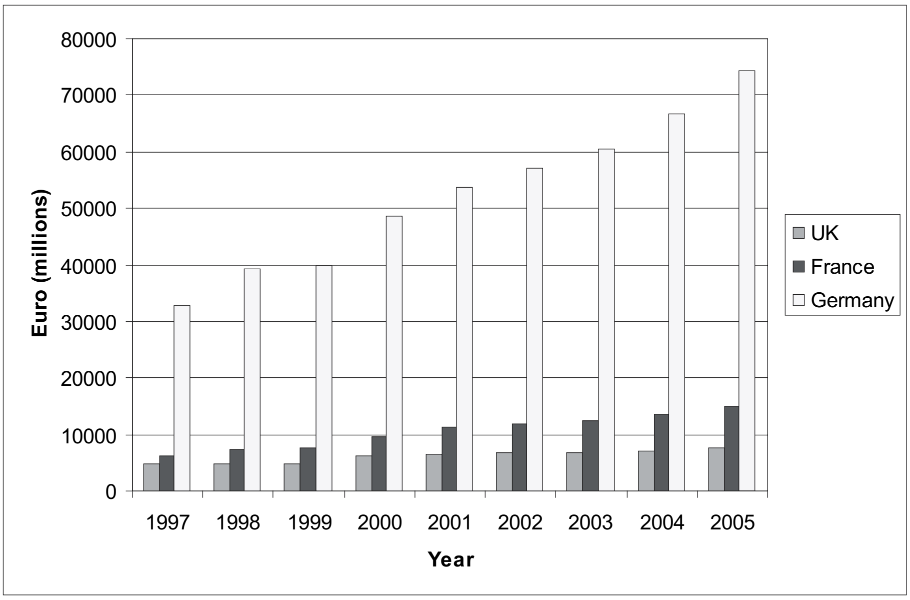
Question 3. Where may the UK be losing out to competitiors?

Summary:
Some other EU member states, in particular Germany, export more to, and invest more in the A8/A2 than the UK. The reason for the relatively low levels of UK trade and investment appears to be that, generally speaking, British firms are not attracted as much by these markets as firms in other EU member states. Geography may play a part. There is no evidence of any systematic discrimination against British firms in A8/A2 markets: indeed anecdotal evidence from UK posts in the A8/A2 suggests that British firms and products have a good reputation locally. However, posts in the A8/A2 report consistently that UK firms visit less frequently, are less persistent, and are less inclined to set up a local presence in the markets of the A8/A2 than firms from many other member states.

25. There are no obvious institutional or legal barriers to British firms investing in or exporting to the A8/A2. However, in almost all instances, the levels of UK bilateral trade and investment with these countries are lower than those of our leading competitors in the EU15. This in part reflects the geographical proximity of the A8/A2 to some other EU15 countries and longstanding cultural and business links. Gravity models demonstrate that geography really does have an impact on trade flows. But anecdotal evidence from UK posts in these countries also suggests that firms from other member states visit more often and maintain a higher profile in the local markets and are quicker at following up business leads generated.

26. It is clear that in respect of exports to the A8/A2, the UK is a long way behind some other EU member states, in particular, Germany. UK exports of goods to the A8/A2 started from a much lower base than exports from Germany in 1997, and by 2005 had fallen even further behind. Overall growth of UK goods exports over this period was 61% compared with overall growth of 126% for Germany. Exports from the UK and France were at a similar level in 1997 (4.7 billion euros and 6.1 billion euros respectively). However, French exports to the A8/A2 have accelerated at a much faster rate, registering overall growth of 143% over the period.

Figure 6: Exports of goods from the UK, France and Germany to A8/A2



Source: Eurostat.

27. The picture in relation to foreign direct investment is even more pronounced. In 2004, the UK invested more elsewhere in the EU than any other member state (494 billion euros). However, only 5.4 billion euros of this investment went to the A10[3], putting the UK behind Germany, France, the Netherlands and Austria in absolute value terms. Moreover, the UK's investment of 5.4 billion euros in the A10 represented 1.09% of its total FDI in the EU, by far the smallest proportion of any EU15 country.[4]

[3] Figures for foreign direct investment are available for the A10, ie. The A8 plus Cyprus and Malta.

[4] Figures for FDI have to be treated with a degree of caution because some investment is routed through other countries, usually for tax purposes. We are aware of some investments from UK firms being routed through the Netherlands. These investments are recorded as Dutch FDI.

Figure 7: Foreign Direct Investment

Country	*Total FDI in EU (billion euros)*	*Total FDI in A10 (billion euros)*	*FDI in A10 as percentage of total FDI in EU*
Austria	27.9	12.6	45.16
Belgium	n/a	n/a	n/a
Denmark	40.0	3.5	8.75
Finland	43.0	2.3	5.34
France	374.1	13.3	3.55
Germany	358.7	29.6	8.25
Greece	5.5	3.1	56.3[5]
Ireland	46.6	3.1	6.65
Italy	154.4	3.5	2.26
Luxembourg	n/a	n/a	n/a
Netherlands	241.7	12.2	5.04
Portugal	17.4	0.5	2.87
Spain	139.5	4.9	3.51
United Kingdom	494.0	5.4	1.09
Total	1,942.8	94	4.84

Source: Eurostat

Question 4: What advantage might the UK draw from the existence of the skilled workforce in these countries?

Summary:
The main benefit to the UK of the workforce of the A8 has been through migrant labour plugging gaps in the UK labour market in predominantly low-skilled jobs. Overall, the inflow of migrant workers has increased employment in the UK and helped the economy to grow. There is no evidence that migrant workers have displaced native workers, nor is there evidence that aggregate levels of wage growth have been affected by the influx of A8 migrant labour.

28. It is important to say at the outset that the following analysis is based on figures available for *employed* migrants. It is very difficult to give any assessment for self-employed migrants because there is no requirement for self-employed to register on the Worker Registration Scheme. Moreover, self-employed contractors agree terms with those engaging them, and in a bona fide arrangement the relationship is contractual, rather than an employment one. Payment is therefore not covered by National Minimum Wage legislation. It is also important to note that this section refers mainly to A8 migration. Since Romania and Bulgaria only acceded to the EU on 1 January 2007 it is to early to identify any trends in labour migration.

29. A European Commission report on the economic impact of enlargement highlighted that the three countries that opened their labour markets to the A8 countries at the time of accession (UK, Ireland and Sweden) were also among the top performers in employment rate growth amongst the EU15 in the two years following accession.[6] In its February 2006 Inflation Monitoring report, the Bank of England confirmed that overseas workers—including those from the A8—played a significant role in boosting the available pool of labour and helping ease shortages.

30. From 1 May 2004 people from the A8, Malta and Cyprus were granted free access to the UK labour market. Individuals from the A8 countries are required to register on the Home Office administered Worker Registration Scheme (WRS) if they are employed in the UK for a month or more. Between 1 May 2004 and December 2006 there were almost 580,000 applicants to the scheme and around 555,000 applicants were approved.

Figure 8: Applicants to the WRS, May 2004–December 2006

	Approved	*Refused*	*Exempt*	*Withdrawn*	*Outstanding*	*Total*
2004	125,880	1,250	640	6,780	–	134,550
2005	204,955	1,800	310	5,245	5	212,310
2006	224,195	1,130	195	4,930	1,600	232,050
Total	555,030	4,180	1,145	16,955	1,605	578,910

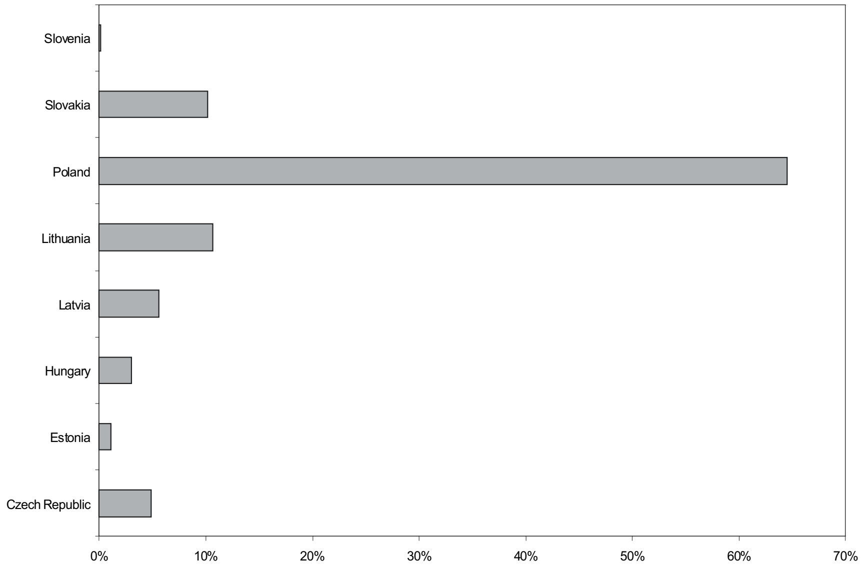
Source: Accession Monitoring report, February 2007

31. The majority of applicants to the WRS over the period May 2004—December 2006 were from Poland (65% of the total), followed by Lithuania (11%) and Slovakia (10%).

[5] It is likely that the high level of Greek FDI in A10 is accounted for by investments in Cyprus

[6] Four additional member states, Spain, Greece, Portugal and Finland have now also lifted restrictions on movement of workers from the A8, while France, Italy, Belgium, Denmark the Netherlands and Luxembourg have eased restrictions.

Figure 9: Proportion of total approved applicants by nationality

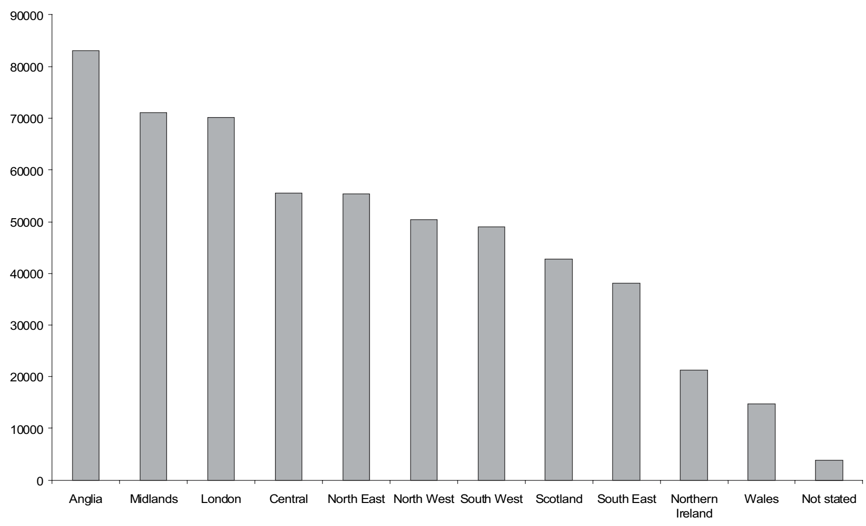


Source: Accession Monitoring Report, February 2007.

32. The large influx of Polish workers represents the greatest wave of arrivals from a single country since the flight of the Hugenots who came to Britain from France in the 17th century.[7]

33. Most A8 migrants (15%) between May 2004 and December 2006 registered with employers in the Anglia region, followed by the Midlands and London with around 13% of workers registered. Unlike previous cohorts of migrants who have tended disproportionately to settle in London, A8 migrants have registered to work right across the UK, flowing to parts of the UK not traditionally associated with migrants.

Figure 10: Geographical distribution of employers of registered workers



Source: Accession Monitoring Report, February 2007.

34. The WRS data record the total inflow of A8 migrants into the UK, there is no requirement to de-register, so the figures cannot provide an accurate estimate of the current population of A8 workers who remain in the UK. Evidence from the WRS suggests that most—around 60%—A8 workers who register on the scheme expect to stay in the UK for less than a year. This is supported by evidence from the Labour Force Survey which enables us to estimate the current population of A8 workers in the UK.

[7] David Coleman, Professor of Demography, University of Oxford, quoted in *The Scotsman,* 15 May 2006.

35. In spring 2004 there were around 130,000 A8 migrants living in the UK; by spring 2006 there were around 360,000, an increase of 230,000. Over roughly the same time period there were around 430,000 approved applicants on the WRS. This suggests that possibly up to half of A8 migration has been of a temporary nature.

Figure 11: Estimated population of A8 migrants in the UK

	2001	*2002*	*2003*	*2004*	*2005*	*2006*
Number of A8 migrants in the UK	110,000	100,000	130,000	130,000	225,000	360,000

Source: spring quarters of the Labour Force Survey

36. Accession country workers are working in relatively low skilled, often hard to fill jobs in the UK labour market and are helping to fill gaps in the labour market, though they are relatively well educated (higher education leaving age than the average domestic worker), so migrants staying in the UK could be expected to advance to higher skilled jobs Table 3 shows the top twenty occupations in which registered workers are employed. The most popular occupation is process operative, followed by warehouse operative. Most registered workers are working full-time (97%) and the majority—almost 80%- are earning between £4.50 and £5.99 per hour.

37. The WRS records the initial occupations in which registered workers are employed and so does not reflect job mobility following registration. From anecdotal accounts, it is believed that migrant workers from the A10 are often occupationally mobile, working in relatively low-skilled occupations (compared to their previous occupations in their country of origin) whilst developing language and other skills, before taking up more highly skilled occupations.

Figure 12: Top 20 occupations in which registered workers are employed, July 2004–December 2006

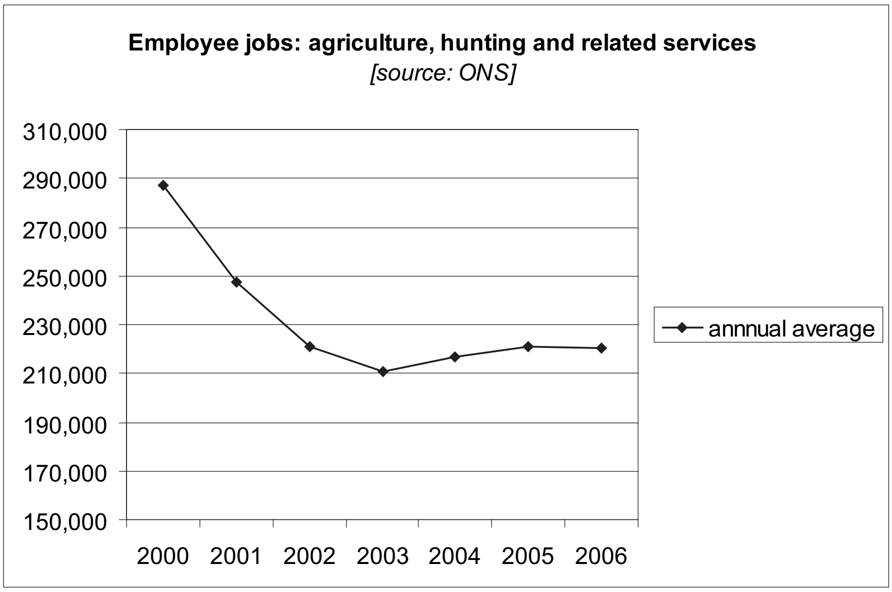
	Total registrations
Process operative (other factory worker)	133,845
Warehouse operative	39,155
Packer	31,955
Kitchen and catering assistants	31,165
Cleaner, domestic staff	27,430
Farm worker/farm hand	22,255
Waiter, waitress	19,960
Maid/Room attendant	18,015
Care assistants and home carers	15,665
Sales and retail assistants	14,185
Labourer, building	14,130
Crop harvester	9,640
Food processing operative (fruit/veg)	7,835
Bar staff	7,385
Food processing operative (meat)	6,600
Chef, other	6,100
Administrator, general	4,675
Driver, HGV (heavy goods vehicle)	4,520
Fruit picker (farming)	4,390
Carpenter/joiner	3,435
Total top 20	422,320

Source: Accession Monitoring Report, February 2007

38. Workers from the accession countries have contributed to employment and helped to make the economy grow. There is little discernible evidence to date to suggest that A8 workers have had a negative impact on the labour market outcomes of native workers. New workers on the whole would appear to have complementary skills to the native labour force. This is a view supported by the European Commission which concluded in its report on the "Functioning of transitional arrangements" that accession country workers are complementary to natives, they help alleviate labour shortages and contribute to long-term growth.

39. There is some evidence that labour movement from the A8 has been associated with arresting the decline of business sectors in the UK, for example farm products which depend on access to specific volumes of affordable labour at defined periods.

Figure 13: UK agricultural employment



Source: Office of National Statistics.

40. In January 2005 claimant unemployment began to rise in the UK and there was a widespread perception that A8 migration might explain at least part of this rise. The Department of Work and Pensions has published research in conjunction with an independent academic on the impact of A8 migration on claimant unemployment. This research found no discernible statistical evidence of a link between concentrations of A8 workers and rises in claimant unemployment at Local Authority District level. This is consistent with most of the international academic literature on the impact of migration which finds little discernible evidence of a large negative impact on native labour market outcomes.

41. The Bank of England has argued that the inflow of accession country workers may have helped to restrain upward pressure on labour costs, reducing inflationary pressures in the economy. However, at the aggregate level, there is very little evidence of reduced wage growth since accession. Average earnings including bonuses were up 4% in the three months to December 2006 compared with the same period a year earlier. In evidence to the Low Pay Commission (November 2006) ASHE data were used to examine whether there was a statistical relationship between growth in average earnings and WRS registrations. There was no evidence of a statistical relationship, suggesting that average earnings growth has not been affected by the inflow of A8 migrants. This is supported by surveys of employers (eg Chartered Institute of Personnel and Development) that have found that the relative cost of employing migrant workers is not a primary consideration for them compared to other factors such as job readiness, skills and work ethic. However, the impact of migrant labour on wage inflation may vary from sector to sector. For instance, in its draft annual report for 2006, CITB-ConstructionSkills says that the use of non-UK workers appears to have minimised labour inflation, keeping overall wage increases in the industry within reasonable limits.

42. Overall the impact of A8 migration on the labour market has been modest, but broadly positive. A8 workers have helped to increase employment and have helped the economy to grow. There is no discernible statistical evidence that A8 migrants have contributed to the rise in claimant unemployment or have led to reduced wage growth in the economy.

43. The UK's labour market is being opened gradually to citizens of Bulgaria and Romania following their accession to the European Union in January 2007. The temporary restrictions on workers from Bulgaria and Romania were put in place to allow time for the UK to make progress on immigration reforms and understand the transitional impacts from the last round of accession.[8]. In the UK low skilled workers from Romania and Bulgaria are restricted to existing quota schemes to fill vacancies in the agricultural and food processing sectors. There has been no net increase in these existing schemes and workers are required to have an authorisation document. Skilled workers will be able to work in the UK—as now—if they get a work permit or qualify under the Highly Skilled Migrants programme. These new arrangements will be reviewed at the end of this year, taking account of the needs of our labour market, the impact of the A10 accession and the positions adopted by other EU countries. In spring 2006 there were around 35,000 Romanian and Bulgarian migrants in the UK, based on the spring 2006 Labour Force Survey. Their employment rate is high—around 85%- above the native average of 75% and the average for all migrants of 67%.

[8] From that date, Romanians and Bulgarians have had the right to travel throughout the EU. The self-employed will continue to be able to work in the UK, but must be able to prove they are genuinely self employed.

Figure 14: Estimated population of Romanian and Bulgarian migrants in the UK

	2001	*2002*	*2003*	*2004*	*2005*	*2006*
Number of Romanian and Bulgarian migrants in the UK	10,000	15,000	20,000	15,000	35,000	35,000

Source: spring quarters of the Labour Force Survey

44. In addition to the benefits from A8/A2 migrant labour working in the UK, UK firms can benefit from the workforce of the A8/A2 through outsourcing of certain activities to these countries. For the UK, this has been most evident in the textile and clothing sector.

Question 5: Is there scope for the UK's educational establishments and businesses to build relationships with students and educational institutions in eastern Europe?

Summary:
There is considerable scope for UK educational establishments to deliver education services to students from A8/A2. UK educational establishments have good reputations and internationally recognised qualifications. Courses delivered in English are particularly attractive to many students. The main constraint on demand is cost.

45. The UK has long been an attractive location for students from other countries to undertake all or part of their higher eduction. Numbers of higher education students coming from the A8/A2 are still relatively modest, but have nevertheless been showing consistent growth. By 2005/6 students from A8/A2 accounted for 4.6% of the total number of overseas students studying in the UK. However, it should be recognised that students from the A8/A2 only pay UK fees, and therefore may not be as attractive to UK universities as students from outside the EU, who pay higher fees. On the other hand, UK universities are still keen to recruit EU undergraduates as a large proportion of them (around 35%) will stay on to do post-graduate study, when they will pay fees and contribute to the instituition's research base. Moreover, a majority of EU undergraduate students are accepted through the clearing process, and are filling spaces that might not otherwise be filled.

Figure 15: Incoming & visiting exchange students from A8/A2

Year	*Students from A8/A2*	*Total overseas students*	*A8/A2 as a percentage of total overseas students*
2000/1	740	27,935	2.6
2001/2	770	26,600	2.9
2002/3	885	26,945	3.3
2003/4	945	26,570	3.5
2004/5	1,085	27,280	3.9
2005/6	1,250	27,075	4.6

Source: HESA student records

46. Though there are some links with educational establishments in the A8/A2, generally speaking these establishments suffer from a lack of financing and in particular there is little money allocated to scientific research.

47. As part of their preparation for full membership of the EU, from 2000-2006, the countries of central and eastern Europe were able to participate in the SOCRATES (education) and LEONARDO da VINCI (vocational training) European action programmes. Both programmes aimed to use transnational cooperation to enhance quality, promote innovation and support the European dimension in education and vocational training systems and practices. The activities supported by these programmes included the participation of students, pupils and teaching staff in project activity which frequently involved spending some time in another country. Since 1 January 2007, the two programmes have been subsumed into the EU Lifelong Learning Programme.

Question 6: How could the UK and these countries pool their scientific and technical know-how to reap the maximum benefit for all concerned?

Summary:
The EU Framework Programme for Research and Technical Development will continue to be the main vehicle for delivering collaborative R&D in the EU. Under the 6th Framework Programme the UK was involved in more than 3,000 collaborative contracts, with a total of more than 2,500 partners from the A8/A2[9]

48. The Framework Programme for Research and Technological Development is the main EU-wide mechanism for supporting collaborative research and development within the EU. The 7th Framework programme runs from 2007 to 2013 and has a budget of 53 billion euros. The Framework Programme is open to applicants from all EU member states.

49. By mid-July 2006 a total of 6,662 contracts had been awarded in relation to the 6th Framework Programme. Of these UK organisations (usually academic institutions or businesses) are involved with 3,106 contracts. Individual contracts can involve a number of partners from different member states. Collaboration rates between UK participants and those from the A8/A2 are comparable to collaboration rates between participants from Germany and France participants (the other two of the top FP countries) and A8/A2 participants.

50. There is no specific UK strategy to increase the level of Framework Programme collaboration with the A8/A2. Organisations apply for Framework Programme funding at their own discretion and likewise they decide, depending on the nature of the project involved, which other parties they wish to bring on board.

Figure 16: Participation rates in EU Framework Programme 6 contracts

Country	*Collaborations with the UK*	*Collaborations with Germany*	*Collaborations with France*
Poland	640	740	579
Estonia	132	139	104
Latvia	81	93	72
Lithuania	121	133	96
Slovakia	162	188	155
Hungary	416	470	375
Czech Rep	422	474	370
Slovenia	226	273	204
Bulgaria	158	178	135
Romania	175	209	171
Total	2533	2897	2261
UK		1849	1565

Source: European Commission

51. In addition to the Framework Programme, the UK has a small bilateral programme of interaction agreed with Poland. The programme includes trips to the UK for selected Polish scientists, a technology transfer seminar, partnering events in life sciences and materials engineering and a clean technology seminar. The UK's Office of Science and Innovation is also at the early stages of planning a bilateral programme with the Czech Republic on climate change.

Question 7: What are the advantages and disadvantages of doing business there? Is it still easier to operate in western than in Eastern Europe; and if so, why? What barriers exist?

Summary:
The main advantages with doing business with the A8/A2 are that they are rapidly growing economies, with relatively highly skilled, but low cost pools of labour. English is widely spoken. On average, these countries have a better record of implementing single market legislation than the EU-15. In many instances business in these countries shares the same entrepreneurial ethos with business in the UK.

However, many of these countries still suffer from inefficient bureaucracies and judicial systems and a level of corrunption which makes doing business there less certain and more time consuming than it needs to be.

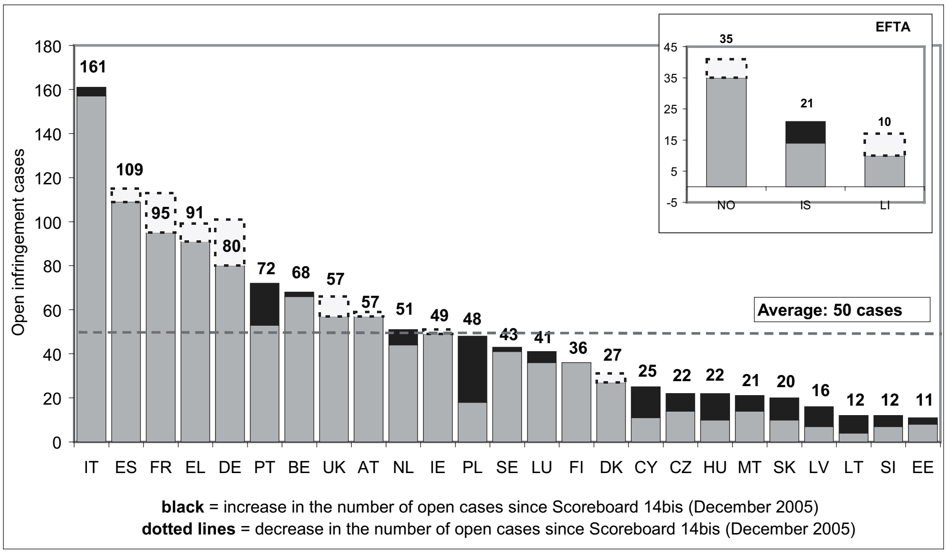
[9] Individual contracts can involve a range of partners, and any individual contract may involve collaboration with more than one partner from the A8/A2.

52. There is no strong evidence to indicate that it is more difficult to do business in the "new" member states than in the EU15. Indeed, many of the A8/A2 countries are attractive to investors because of their low rates of tax.

53. When considering openness to business, one relevant indicator is the degree to which member states have transposed EC internal market legislation into national law. The European Commission's recently published Internal Market Scoreboard shows that transposition rates amongst the A8 are amongst the best in the EU.

54. However, transposition rates only tell a part of the story because a correct transposition into national legislation does not necessarily mean that the law is correctly applied on the ground. When the Commission considers that Internal Market rules have not been properly applied it may take infringement action against the member state in question. Here, the A8 currently outperform almost all the "old" member states, although this may reflect the lack of time since accession for such action to be taken since the vast majority of the net increase in open cases from 2005 to 2006 came from the A8/A2.

Figure 17: Number of infringement cases



Source: European Commission Internal Market Scorecard No 15 bis.

55. The transition from centrally planned to more open, market-based economies can be demonstrated through the evolution of these countries' indices of economic freedom. These show that not only are the A8/A2 becoming more open at a faster rate than most of the EU15, but it also shows that in economic terms several of the A8 countries are now more open than many in the EU15.

Figure 18: Index of economic freedom

Country	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*
EU15	68.2	67.8	68.1	68.3	70.5	70.2	70.9	70.9	69.9	72.6
Bulgaria	47.2	47.2	45.0	50.4	52.7	55.9	55.6	57.1	59.9	64.3
Czech Rep	70.4	68.9	72.3	71.6	70.9	66.6	67.2	66.8	66.6	70.0
Estonia	71.2	72.6	75.8	74.2	79.0	79.5	79.4	79.0	76.6	75.9
Hungary	58.4	58.8	59.8	66.4	67.3	64.6	63.3	63.0	63.4	67.1
Latvia	61.9	62.4	63.3	63.0	64.9	64.3	65.0	66.2	63.0	69.2
Lithuania	56.3	60.9	62.8	63.3	65.7	67.2	68.2	70.9	69.5	73.0
Poland	57.5	61.3	62.2	63.0	62.6	64.8	61.5	58.7	59.0	61.6
Romania	52.1	55.7	53.1	55.3	48.3	46.0	47.7	48.4	50.8	58.9
Slovakia	53.5	53.5	51.6	52.7	60.1	59.6	59.2	64.2	64.7	69.2
Slovenia	53.5	58.6	59.2	56.2	59.2	56.2	58.6	62.2	60.9	63.5

Source: Heritage Foundation/Wall Street Journal

56. SOLVIT is an informal problem solving network with offices in each member state. The purpose of SOLVIT is to resolve problems with the application of Single Market rules on behalf of business and industry. The UK's SOLVIT service is operated out of the Department of Trade and Industry. To date only one complaint against an A8 country has been reported to SOLVIT by UK businesses.

57. Anecdotal evidence supports the view that there are no significant overt barriers to trade or investment with the A8/A2. However, many UK posts in these countries report difficulties with inconsistent application of regulations, a tendancy towards red tape and inefficient legal processes. According to transparency International, corruption remains a problem in some of the A8/A2 countries, but there are

signs of improvement. In its 2006 Corruption Perceptions Index, Transparency International identifies the Czech Republic, Latvia and Slovenia as countries that have all made significant improvements in perceived levels of corruption between 2005-2006. However, overall, there is still a perception that the A8/A2 are more corrupt environments in which to operate than most other EU member states.

Figure 18: Corruption Perceptions Index 2006

Country	*2006 CPI score*	*Global ranking*
Finland	9.6	1
Denmark	9.4	4
Sweden	9.5	6
Netherlands	8.7	9
Austria	8.6	11
Luxembourg	8.6	11
UK	8.6	11
Germany	8.0	16
France	7.4	18
Ireland	7.4	18
Belgium	7.3	20
Spain	6.8	23
Estonia	*6.7*	*24*
Portugal	6.6	26
Malta	6.4	28
Slovenia	*6.4*	*28*
Cyprus	5.6	37
Hungary	*5.2*	*41*
Italy	4.9	45
Czech Republic	*4.8*	*46*
Lithuania	*4.8*	*46*
Latvia	*4.7*	*49*
Slovakia	*4.7*	*49*
Greece	4.4	54
Bulgaria	*4.0*	*57*
Poland	*3.7*	*61*
Romania	*3.1*	*84*

Source: Transparency International

Question 8: How could the UK exploit any synergies with the economies of these countries?

58. In many ways, the answers to the previous questions, taken together, answer this question. However, there are three specific synergies that are worth reiterating here.

59. Overall, the accession of the A8/A2 has provided a significant economic stimulus to these countries, which has led to high rates of growth in recent years. On-going economic growth in these countries should continue to provide a range of opportunities for UK economic operators, be they investors, exporters or employers.

60. Migrant workers from the A8/A2 have displayed high degrees of flexibility; they go to where the work is and work when work is available. Flexible and mobile labour is a key component for the UK's on-going international competitiveness.

March 2007

Memorandum submitted by the Black Country Chamber of Commerce

Thank you for the opportunity to contribute to the inquiry. The timescales involved have precluded a comprehensive consultation process with Chamber members. However in discussions, a number of themes emerged quite quickly.

— Local companies are willing employers of workers from the accession States. The work ethic and level of education are the most notable characteristics of the "average" worker from the accession States who has made the journey to the United Kingdom. No conclusions can be drawn about the workforce as a whole in these countries vis-à-vis that in the UK. It is accepted that only individuals with a particular motivation will leave home to seek work in another country. However, those individuals who do come here are seen as being eminently employable.

- One significant attraction of the accession states is the low cost base. This has encouraged many companies to look at moving production, or other services, out of the UK. The geographical proximity, and favourable time zones, make such countries a worthwhile, and more manageable, alternative to India and China. There is little evidence that the legal process of accession has generated an increase in the number of such ventures.
- The UK is at a certain geographical disadvantage from other countries, such as Germany, in being further away. We cannot access these markets in a couple of hours by car.
- The English language, culture and history are advantages that need to be exploited more actively. Our geographical remoteness is an advantage in this respect in that we have not been linked with one side or the other in local conflicts. However our record in worldwide conflicts is still a matter for respect. Our language is seen as the most useful one for anyone wishing to maximise opportunities on a wider stage.
- The accession States were not seen as being difficult markets for exporters beforehand. The change of status has not made a major difference in their attractiveness to exporters.
- Whilst we talk of 2004 and 2007 as being the accession dates, all of the affected countries were preparing themselves well before these points. It might well be argued that the fall of the Berlin Wall was the significant event. Entrepreneurs started exploiting the opportunities in a big way once the Iron Curtain came down. If UK companies have fallen behind, then the analysis needs to go back 15 to 20 years.
- It is accepted that these countries will receive extra assistance from the European Union. However unless UK companies are particularly involved in improving the infrastructure (in the widest sense of the term), then the relatively small economies are only going to become significantly larger over a long time period, notwithstanding their rapid growth rates.
- If the UK is serious about wanting to win a greater market share in the accession States, then the focus of support to exporters requires attention. Recent changes in emphasis at UKTI have moved towards supporting larger companies and away from smaller ones. There will not be many medium sized companies that have not investigated the potential of Poland, the Czech Republic or Hungary. However smaller companies seeking new markets, or becoming first time exporters could well benefit from being encouraged to try these countries.
- The absolute size of the markets needs to be taken into consideration. Spain and Poland have very similar populations. However the economy of Poland is approximately half that of Spain. The West Midland has a population slightly larger, and a GDP slightly smaller, than that of Finland, the 18th largest economy in the EU. The Black Country, with a population slightly larger than Birmingham, has a GDP approximately 30% larger than Estonia. Armed with these numbers it is quite simple to see why local business leaders are not rushing to set up trade links in countries that have sizeable populations but relatively small economies.

14 May 2007

Memorandum submitted by the British Chamber of Commerce

Introduction

The British Chambers of Commerce (BCC) welcomes the opportunity to submit evidence to the Committee's inquiry into the impact of the "new" EU Member States on UK business.

The BCC is the national voice of local business; a national network of quality-accredited Chambers of Commerce, uniquely positioned at the heart of every business community in the UK. The BCC represents 100,000 businesses of all sizes across all sectors of the economy who together employ over 5 million people.

Opportunities for UK Business

There are significant opportunities available for UK businesses in the new EU Member States, however responses from Chamber business members suggest that these are not yet being fully utilised or exploited. A survey by Birmingham Chamber for instance found that 54% of their business members do not think the UK is exploiting opportunities afforded by the accession of the new EU countries. So, while some firms are taking advantage of the new opportunities that these countries can offer, the majority of UK firms do not seem aware of the potential of these markets.

The 10 newest EU member states are diverse and at differing stages of economic development themselves. As a result each requires a different approach from firms looking to develop trading links with them.

There are however significant prospects for UK companies in a range of sectors within the new accession countries—from the environmental sector to property development and regeneration, from the financial services sector to the tourism and leisure sectors. One area that could be more fully exploited by UK firms is technology transfer ie exporting UK expertise and knowledge to accession states and using their cheaper manufacturing capacity and reduced labour costs. Knowledge transfer, joint research and product development are areas that the UK has a very solid foundation in, but companies are not doing enough in this sphere to take such activities abroad to regions where they would be useful and successful. What is more as the accession countries develop and have surplus capital to spend and diversity, the opportunities to sell UK knowledge and technology is likely to increase.

EU funding can also offer incentives and opportunities for UK firms. The European Regional Development Fund (ERDF) is one such example. The new member states receive a significant amount from ERDF funds dedicated to machinery improvement and the upgrading of manufacturing plants and this offers scope for the UK manufacturing sector. However while EU funds are available, there is a distinct lack of understanding amongst firms about how to access them.

BCC believes that in order to fully exploit the exporting potential to the new accession countries the UK needs to encourage partnership working and share best practice to help businesses, particularly SMES identify and take advantage of the opportunities on offer. The 56 accredited Chambers that make up the Chamber network across the UK can play an important role in facilitating and fostering relations.

With their economies developing, many accession countries are also experiencing wide-ranging social change. In particular, some states have a rapidly developing middle class with increasing purchasing power, who will want to buy high value consumer goods (like Russia and China). UK products have a good reputation in Central and Eastern Europe and with the growing appetite for Western goods, UK firms are in a prime position to take advantage of these new markets and demands.

Despite these prospects however, there is a sense among many in the SME community that there are greater opportunities to be had in other (non-EU) countries and markets such as China, South Korea and South East Asia for UK businesses than in the new EU Member states. Despite the elongated supply chain for these markets, some are finding the experience of purchasing in the Far East much more competitive.

However while UK firms may not be making the most of the opportunities within the accession countries themselves, they have been taking advantage of the increased migrant labour that has been coming over to the Britain from these countries, particularly Poland.

How are the UK Faring Against their Competitors?

In comparison to some of our major European competitors, the UK has been slow to identify the importance of new EU markets and to getting its expertise to the market at the right time. Italy, Germany and France for instance assisted the various accession countries before they joined the EU meaning that when they became EU member states relationships had already been cemented which made it difficult for UK companies to develop new consortiums with local public and private organisations.

There is also a perception amongst some businesses that our continental competitors can often have a head start when it comes to developing and deepening trade and relations with the new accession states. There are a number of reasons for this. One is the geographical location of the UK which can make the logistics and transport of goods and raw materials to and from the EU more expensive. Firms also find that their European competitors tend to have an advantage in terms of compatible systems and existing supply chains that can make it difficult for UK forms to compete on a sales level. For small businesses in particular there can also be a fear factor associated with developing overseas—either looking to export for the first time or expanding their operations. BCC believes more work needs to be done within the DTI and UKTI to build business, particularly SME, confidence in the international trade arena. In addition, a number of Chambers expressed concern that compared to our key European competitors, not enough support is provided for businesses, particularly SMEs looking to access these markets.

The BCC and its Chamber network can play an important role in offering practical help to businesses who wish to identify overseas opportunities. One example of pro-active action can be seen in Luton and Bedfordshire where the local Chamber, Chamber Business has set up TradeArc Polska which helps businesses develop partnerships in Poland. TradeArc Polska offers businesses help, support and expertise from the UK and within accession states—it is about to host a conference on doing business in Poland for instance.

Barriers to Entry

The main barriers to entry for companies wishing to enter the markets of new accession countries are those that are most common to many developing countries. These include issues such as risk of not being paid, banking and financial procedures, exchange rates, currency and fear of the unknown. Different tax and legal regimes can adversely affect cash-flow which can pose particular challenges for SMEs. Other issues in some "new" EU member states highlighted by businesses include: a lack of restricted credit insurance and concerns around corruption.

One Chamber highlighted the problem that non-UK or EU passport holders can find it difficult to obtain an EU pass and so are not able to travel freely state to state. This problem has been cited by a number of their business members, who find their business partners unable to join their UK passport holding counterparts trying to generate business opportunities abroad. This can be particularly problematic as in these regions, in the service sector, particular importance is placed on meeting potential business partners in person.

For any business looking to export cultural differences need to be understood and recognised. What is more the political environment in some of the accession countries can be complex. Firms need to be aware of this and ensure they have done research before entering a new market. The BCC and individual Chambers can play an important role in this respect.

The BCC supports and advises businesses in all areas of international trade development and international exporting including managing and delivering two schemes on behalf of UK Trade & Investment:

— the Export Marketing Research Scheme which encourages UK businesses to conduct research before entering a new overseas market; and

— the Export Communications Review, which aims to reduce the instances in which cultural and language barriers come between UK businesses and success overseas.

BCC also holds mandates from the DTI and HM Revenue & Customs for the issue of all EU certificates of Origin as well as EURI and A.TR certificates.

The Accredited Chamber network also provides numerous international trade services to the SME community including:

— Training in all aspects of world trade.

— Export documentation services.

— Export Clubs and International Networking.

These can be invaluable resources for SMEs looking to enter new markets such as those of the accession countries. Initiatives by Chambers, specifically focusing on the new EU Member States like TradeArc Polska can support businesses and help them gain confidence to build up and develop their exporting.

The implementation of the Services Directive should make it easier for businesses wishing to access other member state markets. However, we would like to alert the committee to our early concerns about the progress of an exercise which is extremely important to the UK's sizeable service sector. At the moment the momentum behind transposition in member states is partial. There are early signs that the approach being taken to Points of Single Contact (PSC) differs between member states. For the directive to deliver an equitable exchange of services across EU borders it must be implemented to a similar timetable and the final PSC must deliver a similar customer experience irrespective of which member state market is being accessed. The way in which implementation is approached in different member states has the potential to negate the benefit of the original directive.

Skills and Education

One major development for UK businesses since the accession of the new EU Member States has been the increase in migrant labour coming from those countries. UK businesses are becoming increasingly reliant on skilled workers from these countries. Official figures show that 375,000 Polish workers alone have registered in the UK since the EU expanded in May 2004.

One of the biggest problems that UK businesses face is finding the skilled people they need to drive their businesses. A recent survey of BCC members, UK Skills: Making the Grade found that 55% of member firms stated they find it more difficult to recruit skilled staff today than they did 5 years ago.

In January 2007, the BCC published a pamphlet "Migration: Plugging the gap" which set out the results of a member survey. Over 36% of businesses who responded said they were employing workers from A2 accession countries, including Poland, Hungary and Slovakia. BCC data also suggests that migrant workers are filling a variety of different types of occupations.

Evidence from businesses suggests that they are finding that young graduates from a number of accession countries have greater practical experience than those coming from UK universities. This again is backed up by BCC survey data. Over 45% of respondents to the BCC migration survey said that the main reason they employ migrant labour is due to local candidates lacking the required skills or experience. Migrants are also believed to be more productive and to have a better work ethic than domestic workers. Over 40% said that they employed migrant workers for these reasons.

As a result, migrant workers from Poland to Slovenia have plugged skills gaps in a variety of industries, from agriculture and construction to hospitality and catering. Unlike previous occasions where migration has been confined to major urban centres, migration from the accession countries has benefited many regions of the UK from East Anglia to Edinburgh. Such is the reliance on migrant labour in some sectors of the UK economy (Leisure, tourism and construction) however that there are dangers of creating a vacuum when and if workers return to their own countries when those economies start to improve.

The fear amongst much of the UK's business community is that the influx of eastern european workers to the UK is masking serious skill deficits in the labour market. The Government must ensure that our educational institutions are producing school leavers and graduates that are well prepared for the world of work. If the UK is to compete globally then urgent action is required to educate and train the indigenous labour force to meet the skill needs of employers. .

In addition to the benefits of skilled workers coming to the UK, the accession of the new EU member states also offers significant opportunities for the UK's educational institutions to forge new links that can benefit all. These could include the twinning of universities, colleges and schools, and the development of training programmes and internships. The twinning process can also occur at local levels via Chambers of Commerce in the UK and established international Chambers.

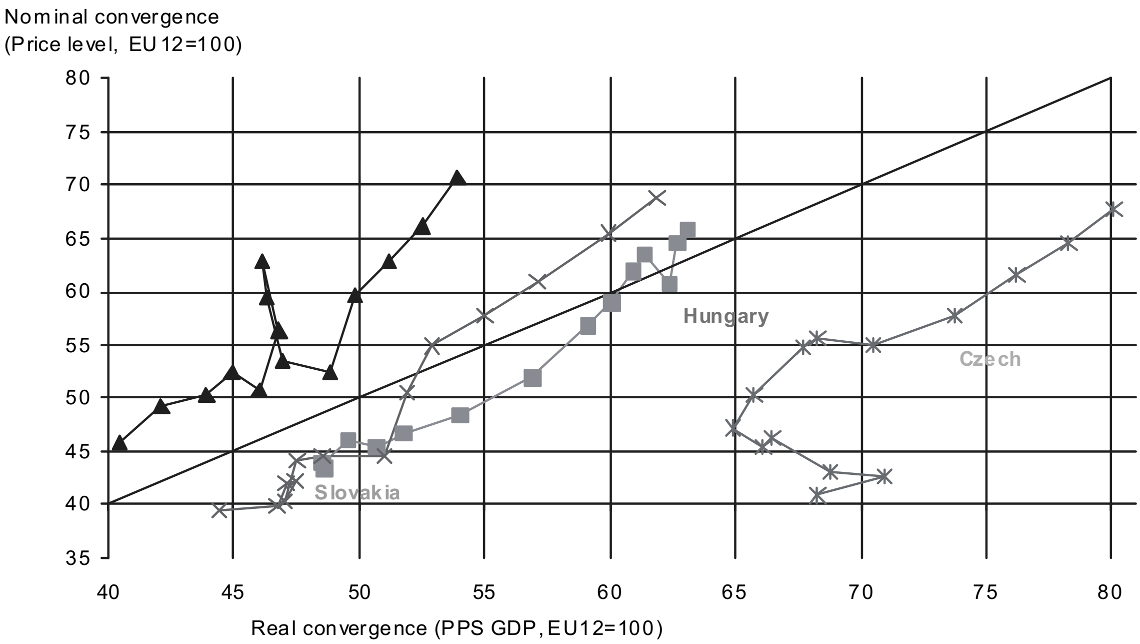
EU funds such as Da Vinci and Cornelius can also provide useful channels to help build partnerships with organisations within the UK and the accession countries. This type of funding has enabled one Chamber to develop projects to enable individuals from across the EU to compare qualifications in the construction sector and address language training issues for instance.

June 2007

Memorandum submitted by the British Chamber of Commerce in Hungary

Is the UK exploiting the opportunities afforded by the accession of these countries to the EU?

EU accession accelerated the legal and economic convergence of Hungary to the average of the former EU 12. The below chart shows the convergence level of Hungary and three other CEE countries in terms of price levels and GDP (historical, and forecast until 2009). Though the achieved level of legal convergence can be assessed high, there is still a considerable gap in price levels and GDP. This represents a yet not fully utilized opportunity for British investors both in terms of FDI potentially securing above average returns in the medium-term and also export potential. The following parts of this document will further analyze this opportunity.



Source: ING.

What are the most promising areas for developing business? Is there potential for exporting more goods and services to these countries?

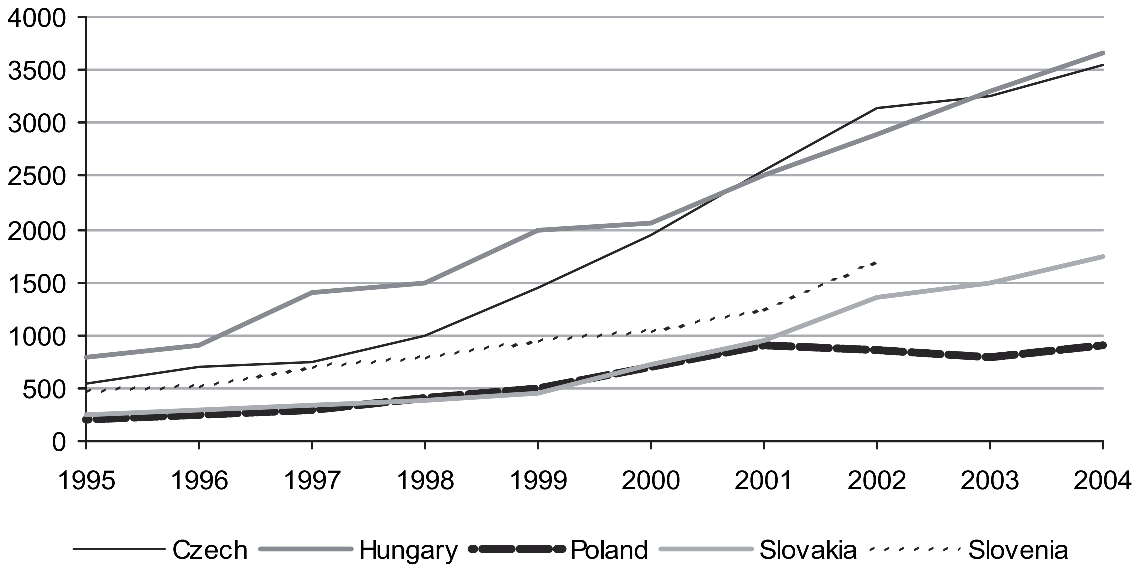
For Hungary one of the key areas in the medium to longer term development is the modernisation of the infrastructure. This can include not only the projects that are linked to the transport infrastructure like the railway developments or/and eventually the potential investments into river transport and port developments, but also projects that address intermodal logistic centres. More than a quarter of the total development funds made available in the Hungarian National Development Plan had been allocated to this area for the period of 2007–13.

The question of environment protection while introducing new or upgrading existing facilities and technologies enjoys equally critical and focussed area for improvement of the quality of life in Hungary in the medium term. The Hungarian National Development plan has envisaged providing financial support to such programs at the level of some 20% of the total budget and promotes the use of Hungary's agricultural and natural resources to enhance the use of alternate energy together with more renewables in the energy portfolio as well. In line with the initiative of the EU for energy saving, more and more projects will deal with energy efficiency and the speed of the implementation of projects supporting this will grow significantly in Hungary in the near future, too.

Concerning services the changes in the educational system and the planned reforms in the state administration including cost effectiveness of the institutions, higher organisational performance together with better people management in the administration are areas where the British experience and the learning of the reforms implemented in the UK could offer opportunity to establish links and enter into dealings.

Where may the UK be losing out to competitors?

Privatisation type investments into production areas have already taken place and except a few key sectors and activities being still in state hand (eg post, electricity wholesale, railways, health institutions) privatisation had already been completed. Hungary however remains a leader in the C&EE region in terms of FDI stock per capita.



Source: National Bank of Hungary (1995-2003), ING (2004)

Beyond the classic large scale privatizations (such as the purchase of Budapest Airport by BAA which has now been sold further to Hochtief) and growing private-to-private M&A market (such as the acquisition of Borsodchem by the private equity fund Permira), there is a consistent flow of capital into the Hungarian SME sector. This happens less by acquisition, rather greenfields are created, typically as suppliers to the regular customer base of the mother company utilizing the better cost base, incentives and good workforce experienced in Hungary. Often large investors to Hungary attract a satellite investor base relocating production to Hungary. A typical example is the automotive industry with a growing number of mostly German and Japanese suppliers.

British presence is hardly noticeable in this latter type of flows: Britain seems to lose out in FDI. There are only approximately 340 sizeable British investments with readily available data in Hungary.

Out of these, 55 have yearly net sales above GBP 5.5 mio, and 14 above 28 mio.

Industry	*Total*	*Above 5 mio*	*Above 30 mio*
Manufacturing	61	12	4
Wholesale	113	27	6
Retail	44	10	4
Services	120	15	3
Financial, Real Estate	45	3	0

(These figures are sourced from Dun & Bradstreet, and may be influenced by incomplete data submission by British investors and indirect ownership of investments into Hungary, such as through a Dutch tax driven investment vehicle).

Hungary is also considered to be a good location for Treasury and other International Service Centres. Recent examples in that respect have been Alcoa, Diageo, Morgan Stanley and Vodafone. Key drivers here are: quality and availability of workforce, acceptable rent, legal transparency, normative tax benefits and other investment incentives.

What advantage might the UK draw from the existence of the skilled workforce in these countries?

The skilled workforce in Hungary could provide opportunity to the extent that it shows a high degree of adaptation and willingness for learning. Although mobility of the Hungarian workforce is—even in-country—very low, the readiness and ability to learn is high and a key advantage compared to other nations in the same group. The traditional limitation in language skills seen with older generations is now rapidly diminishing among the young, skilled workforce.

Is there scope for the UK's educational establishments and businesses to build relationships with students and educational institutions in Eastern Europe? How could the UK and these countries pool their scientific and technical know-how to reap the maximum benefit for all concerned?

Setting up relationships between UK educational establishments and businesses with institutions in Hungary is most welcomed and particularly supported in the field of IT, biotechnology, medical and engineering cooperation with existing smaller scale research centres. Obviously the question of autonomy and providing direct incentives are linked issues that need careful approach and proper steering.

What are the advantages and disadvantages of doing business there? Is it still easier to operate in western than in Eastern Europe; and, if so, why? What barriers exist?

Of course, the answer is rather complex. The easiness of doing business in the newly joining countries is mainly linked to local knowledge and deep enough familiarisation of the investors with the local circumstances. Legal system is stable and transparent, although complex and sometimes difficult to follow. Fiscal changes however do take place with short term notice and with impact on cost structure, but corporate tax levels are overall advantageous—despite higher taxes and duties on human resource.

Positive elements of operating at this part of the world are the desire of perform, the willingness to learn and to deliver as well as the overall growth attitude of people who are skilled and capable of accommodating new processes and systems as well.

How could the UK exploit any synergies with the economies of these countries?

Considering the GDP gap, natural EU convergence and also structural development, a well timed and placed investment into most sectors can still provide an over average return for a British investor.

The fields of climate change and related R&D programs, joint technological developments related to enhanced security needs (both for IT and for individual security) as well as in the field of sharing best practices in professional and efficient government and business governance could be areas for the UK and its businesses to exploit existing and emerging opportunities.

Infrastructure, logistics, environment protection, education and the health sector remain areas of enhanced interest in Hungary.

30 May 2007

Annex

1. Foreign Direct Investments from the United Kingdom between 2000–06

The interest of British capital in Hungary and the whole CEE region has remained moderate since 1990. This is partly due to the fact that FDI from UK favours the English speaking countries and considers the region as a territory dominated by German capital. Investments from the UK are mostly realized through mergers and acquisitions and rarely through green-field investments; as privatization in most CEE countries has ended British firms rarely try to expand in the region.

Since 2000, the FDI inflow from the United Kingdom to Hungary has been fluctuating between €18 and €111 million that is about 3.4-9% of the total inflow from the EU25 countries (see Table 1.); this fluctuation can be attributed to the low number of FDI projects. The FDI stock invested by UK companies amounted to € 172.1 million in 2000, and reached € 322.8 million in 2004 (the data from 2005 is misleadingly high, due to the purchase of the Budapest Airport and FDI stock data from 2006 are not yet available). However, the share of UK investments in the FDI stock from EU countries remained at around 1% over the period 2000–05 (see Table 2.). The major target areas of the British investments included services, tourism and trade.

On the basis of the change in the number of FDI projects (see table 3), Germany seems to have benefited from the investment opportunities in Hungary more than the UK. The United Kingdom lost grounds between 2002 and 2006 in terms of its share in the total projects. The 10.4% share in 2002 decreased to 5.2% in 2006 (see table 4). Apparently, manufacturing projects could take more advantage of what Hungary has to offer. These projects accounted for only 21% of the total projects. Opportunities in biotechnology, ICT and in other higher value added sectors have also remained unused.

2. Hungary's Comparative Advantages in the Central and Eastern European Region

Macro economic trends in Hungary

In the last 15 years the Hungarian economy integrated successfully into the global economy: in 2005 the value of export amounted to 56% of GDP. Hungary demonstrated strong economic growth in the past decade and several economic sectors such as transportation equipment and vehicle manufacturing, electronics, IT, chemical production, and financial and business services performed outstandingly. Since 1996 the steady growth of the GDP with its 4.2% per annum rate has considerably exceeded that of the average of the EU 25 countries with more than 2 percentage points. Thanks to the strong economic growth, the GDP per capita has reached 15,600 Euros at purchasing power in 2006, which is twice as much as that in 1996 (7,919 €).

GDP growth in Hungary has been mainly driven by the expansion of export and investments. A large proportion of export and economic growth has been generated by multinational companies. The volume of foreign direct investment has been exceptionally high in Hungary, in per capita terms it has exceeded that of each country in the region.

At the end of 2006 FDI stock per capita in Hungary reached 6,162 Euros (forecast by National Bank of Hungary). The same figures in other CEE countries are: Czech Republic: 5,552 Euros, Slovakia: 2,970 Euros and Poland: 2,307 Euros.

Since the 1990's inflation rate has followed a declining trend, from the 10% range to 3.9% in 2006. During 2007 consumer prices are expected to grow by 5-6%.

Lowest labour costs for the highest productivity

Hungary's population is well educated and highly skilled. Some two-thirds of the workforce has completed secondary, technical or vocational education. Hungary boasts the highest productivity rate in the region, and it seems to keep it this way in the future. Last year productivity grew by 11.1%.

Hungarian "brain" is greatly appreciated worldwide. By means of reforms in education the Hungarian Government makes significant efforts to fine-adjust the education to the market's requirements. In recognition of the high standards of the Hungarian education, several major foreign corporations have established their research and development units in Hungary, as well as their production units to take advantage of the skilled, experienced workforce.

Wages in Hungary are significantly lower than those of Western Europe; additionally Hungary has the highest productivity in the Central and Eastern European region. Unit labour costs decreased by more than 10% in 2006.

Logistics features

Hungary's central role in transportation and logistics in the CEE-region is based on several advantageous features like the favourable geographical location of the country, the international transport corridors passing through Hungary, the EU membership, political and economic stability, the presence of multinational companies, the intensive foreign trade with EU-members and relation with states of the Far East. Concerning logistics costs Hungary reflects a very attractive picture in the Central and Eastern European region. Thanks to the above mentioned factors we can offer the lowest freight costs in the CEE region.

3. Priority Sectors

Electronics

In the 1990s Hungary emerged as a major global production location in the electronics industry. The inflow of capital boosted the sector to achieve record levels of growth, which is still about 10% every year.

Today, with its USD 10 billion electronics production output, Hungary represents 40% of the production of the Eastern European Region (including Russia and Ukraine as well).

Electronics is one of the leading-edge sectors of the country: 17% of the industrial employees work for electronics companies producing 25.5% of the industrial output and 42% of the total export.

In the past few years, foreign investors have shown a particularly keen interest in four areas: information technology, communications, consumer electronics and automotive electronics. Several of the major global original manufacturers are present in the country such as GE, Philips, Siemens, IBM, HP, Ericsson, Nokia, Sony, Samsung. However, Hungary has been a popular location for CEM companies as well, including global tier one suppliers such as Flextronics, Sanmina-SCI, Solectron, Jabil Circuit and Elcoteq.

Sector specific R&D centres in electronics provide basic research in telecommunication systems (Ericsson), lighting device development and X-ray technical devices (GE) and software and hardware development for telecommunication systems (Nokia).

In the past decade a close cooperation was established between universities and multinational companies particularly in telecommunications, electronics and medical research.

Automotive Industry

Automotive industry is one of the economic sectors that have benefited the most from the heavy foreign direct investment inflows after the change of the political regime in Hungary in 1989. One quarter of the total FDI in manufacturing industry was invested in the automotive sector. Like the whole manufacturing industry, automotive is FDI-driven and mainly characterised by the presence of foreign companies that have invested heavily in Hungary since the 1990's. In parallel, the small and medium-sized local automotive companies have become stable and strategic partners of local based and Western-European car manufacturers. Owing to the quick introduction of modern corporate management and quality assurance systems, productivity in the sector reaches the Western-European average. Automotive sector contributes to the total industrial output with EUR 10.6 billion which is 16% of the total amount. Since the motor companies—especially OEMs and TIER1s—manufacture mainly for export, the 630 automotive companies account for 25% of total exports.

The industry employs some 97,000 people. The world-class training and education of engineers in 5 major university towns make sure that this quality is maintained and even improved. Nearly 20% of the working engineers are engaged in product-improvement, while the others are active in technological development, production, quality assurance and sales. The wages are essentially lower than those in Western Europe and this comes together with the highest productivity rates in the region.

Original manufacturers, such as Suzuki and Audi are continuously expanding their capacities and their workforce to meet growing demand. 14 of the world's top 20 TIER-1s have already operations in Hungary in order to make the presence in Central and Eastern Europe, in a strategically significant automotive hub. Numerous multinationals have set up R&D centres in Hungary, examples include: Audi, Bosch, Knorr-Bremse, Magna-Steyr, ThyssenKrupp, Arvin Meritor, Denso, Continental, Visteon, WET, Draxlmaier, Edag and Temic Telefunken, DENSO, ZF etc.

The reliable, extensive supplier network of micro, small and medium sized local companies can provide a good soil for further automotive investments.

Information and Communications Technology

The Hungarian ICT market exhibited strong growth in the past couple of years. Between 2003 and 2006 the average annual growth rate was 10%, slightly exceeding that of Central Eastern Europe (9.6%) and well exceeding the rate of the European Union (2.75%). Today the Hungarian ICT market represents 18.7% of the Central Eastern European total. Hungary has been on top concerning the per capita ICT expenditure and the ICT expenditure as% of GDP in the region.

Hungary has become one of the major players in hardware production in the region. In computer assembly and communications equipment production the country is the leader in CEE. The largest producers in the ICT sector include IBM, Flextronics, Samsung, Albacomp, GE, Nokia, Siemens, Solectron, Sanmina, Elcoteq, Videoton, Orion, and Sanyo .

The software market is the fastest growing IT segment in Hungary, its weight grew considerably in the past couple of years. The country has strong positions in IT security, virus protection and character recognition software development as well as in bio-informatics. Last year the demand has been growing for security software, business intelligence and data management applications and ERP solutions for small and medium sized companies.

Today the banking and financing sector and the SMEs play a major driving role in the IT services market. IT services are expected to grow at about 8.6% in 2006-2007. A higher than average growth is expected in outsourcing and systems integration (IDC, 2006). The outsourcing market showed a robust growth last year, the rate reached 11%. The large outsourcing companies in Hungary have focused on the regional market and have offered more offshoring and nearshoring services. The demand in the Hungarian market concentrates on desktop and system hosting and operating services.

The major players in the ICT services market are: IBM, HP, Nokia, Ericsson, ORACLE, SAP, CISCO, Siemens, Satyam, TATA Consultancy, Synergon, T-Systems, EDS, FreeSoft, Getronics, Dataplex, BT, Sun Microsystems, Microsoft.

Many IT companies long-established in Hungary have begun relocating R&D activities here. This is what Nokia, Ericsson, Siemens, Avaya, Motorola, Philips, Oracle, SAP, TATA Consulting Services and HP-Compaq did, just to name a few.

Life Sciences, Biotechnology

Life sciences, which have a strong tradition in Hungary, achieved widespread recognition all over the world. Even a decade ago biotechnology as a business sector was virtually non-existent in Central and Eastern Europe. However, with the active support and commitment from the Hungarian Government, the biotechnology industry now shows dynamic expansion and development.

As a result of interventions and the fact that investors have started to realize the underlying potentials of the sector, in 2005 there were 50 core biotech companies registered with more than 800 employees. Without doubt, Hungary has the strongest biotech sector among the 10 new European Union member states. Nevertheless, the major goal is to be recognized as one of the top ten leading biotech countries in the EU.

During the past few years more emphasis has been laid on international relations, which boosted the export activity of the sector not only to maintain and improve the position of the industry, but also to attract investors. Hungary contributes to the biotech industry with vital know-how, with world-renowned academic excellence and a long tradition in R&D activities. By integrating the intellectual resources with research and development and with the possibilities the world-wide market offers, this area can be one of the most promising industrial segments of the Hungarian economy.

Biotechnology has been chosen by the Hungarian government as one of the top five priority sectors of the country's mid-term development plan. The strategy had been developed in 2005 and discussed with the relevant public bodies, the Ministry of Economy and Transport, the National Office for Research and Technology and with the Hungarian Investment and Trade Development Agency (ITDH). (PCA,2006)

Aims of the Strategy:

— Two to three big biotech investors (over 100 m EUR).

— Five to eight middle-size investment (over 10 m EUR).

— 15 to 20 small-size investment (1-10 m EUR).

— Two to five new R&D investment from the fields of biotechnology and Pharma industry.

— Several thousand high value jobs with highly skilled employees.

— Global recognition of Hungary as an "up and coming" biotech country.

Beside the Governments" biotechnology strategy, it is important to mention the fact that first among the Central-East European countries the Hungarian Biotechnology Association was founded in 2002, which now represents more than 70 companies.

Renewable energy

Hungary boasts large potentials in biofuels, biomass, biogas, geothermal, wind and solar energy. Even though the share of renewables in the energy matrix is relatively moderate at the moment, the government has made long term commitments to increase the share of alternative energy in the coming decades in line with the requirements of the European Union.

Biomass accounts for almost 90% of all renewable production with the over 10 large biomass plants in the country and a yearly 110 million tonnes of raw material production. Large potentials stem from the strong agricultural background and the favourable supply chain supported by well-developed transportation networks. Besides the numerous energy crops produced in Hungary, the energy grass of Szarvas provides excellent opportunities for heat production.

The role of biogas is expected to strengthen the most in the coming years. While in 2005 only 10% of potentials were used, large scale production of inputs such as liquid manure, sewage sludge and slaughterhouse waste provide excellent opportunities for further development.

Due to the relative thinness of the earth's crust, Hungary boasts favourable potentials in geothermal energy. Heat stemming from underground is twice as high as the continental average. There are over 3,000 thermal springs of different quality, over 200 of them are used by spas and baths.

Demand for solar thermal and photovoltaic energy is expected to grow in the coming years. Today, it is mostly hotels and spas that utilise the most of the solar radiation, however newly introduced subsidies are expected to encourage households to install solar equipment. Japanese SANYO has been producing PV panels in Dorog since 2004 and expects to double production until 2008.

The efficiency of wind energy production is supported by competitive feed-in tariffs (currently 23 HUF/kWh) and guaranteed quotas. Break-even time has shortened to 7 years, which provides producers stabile business opportunities in Hungary.

After developing a national biofuels strategy, harmonizing national laws with EU directives, and amending excise tax code, the stage is now set for biofuels to be produced and sold in Hungary. Sales of biofuels receive a tax benefit, what's more, to avoid a tax gap, sales of petroleum fuel that contain no biofuel will carry a tax penalty. These measures were taken to bring Hungary in line with EU directive that 0.4% of all vehicle fuel consumed in the country is of biological origin in 2006, increasing to 4% by 2010.

A market of biofuels is emerging in Hungary, as evidenced by recent investment moves but there are still huge potentials in biofuel production supported by agricultural products, integrators, well developed infrastructure, inland waterway ports, such as the Rhine-Main-Danube Canal.

From 2007, significant resources (200 million Euros) are earmarked for supporting the renewable energy sector in the new National Development Plan (2007-2013). The particular operative programs of the Development Plan are being worked out at the moment.

R&D

According to the survey of Ernst and Young (European Investment Monitor, 2006) Hungary is included in the top 10 European destination countries by attracting 3% of the R&D projects over the 2001–05 period. Within Central and Eastern Europe, Hungary was 2nd destination for R&D projects, receiving 17% of these projects during the same years. The three top sectors included software, automotive and pharmaceuticals, accounting for 68% of total R&D investments.

In 2005 Hungary spent about € 780 million on R&D, which represents a 14.4% increase compared to 2004. R&D is 50% state funded and 40% financed by corporations. The Hungarian R&D represents 23.000 FTE jobs, of which 70% are scientists and engineers. There are altogether 2500 R&D units in the country, of which 750 business units. Chemical engineering, mechanical engineering and informatics accounted for 40%, while clinical medicine, health sciences and pharmacology accounted for 6% of the total R&D expenditure in 2005.

Transnational corporations lead applied R&D activities in Hungary. In the prioirity sectors several companies conduct research and development, such as:

Automotive industry: Audi, Continental Teves, Denso, Draxlmaier, EDAG, General Motors, Knorr—Bremse, Magna Steyr, Michelin, Remy Automotive, Temic-Telefunken, ThyssenKrupp, Valeo Auto-Electric, Visteon, W.E.T., ArvinMeritor, ZF Hung¬ria

Electronics: Elcoteq, Electrolux, Flextronics, GE, Samsung

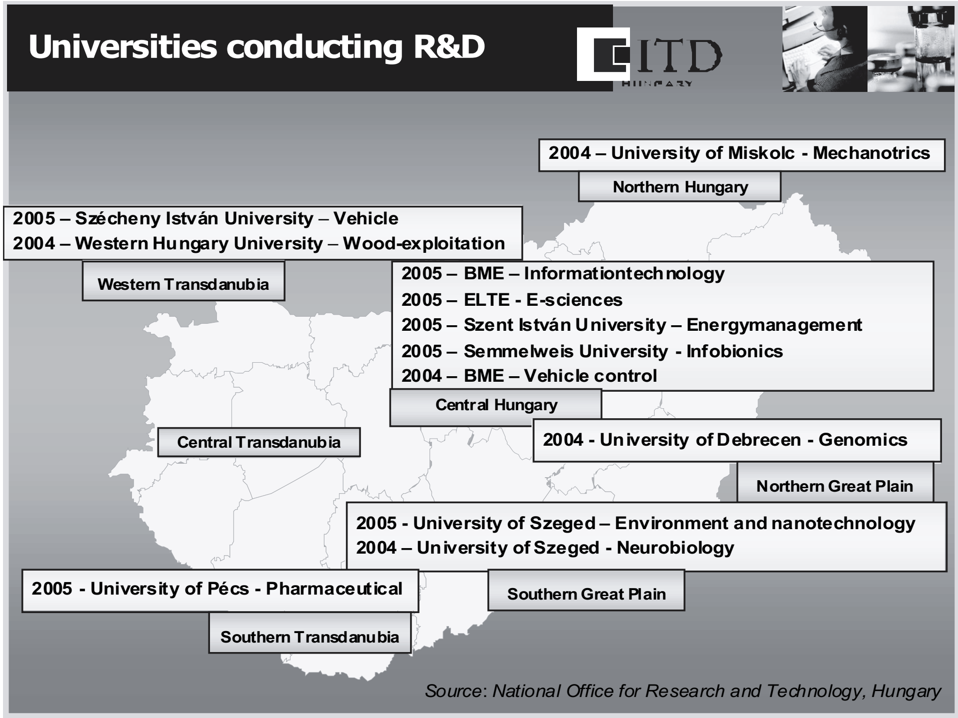
ICT: Nokia, Ericsson, Siemens, T-systems, Satyam, TATA, SAP, IBM

Biotechnology and lifesciences: Astra-Zeneca, GE Medicor, Novartis-Sandoz Sanofi-Aventis (Chinoin), Servier (Egis), Teva-Biogal.

In the National Development Plan €2 billion is earmarked for R&D activities.

To strengthen economic competitiveness through innovation, the National Plan defines seven regional R&D centres (Debrecen, Györ, Miskolc, Pécs, Szeged and the Székesfehérvár-Veszprém axis). The pole cities receive a grant of HUF 100 billion to promote innovative research and development in their region.

The Program defines the following priority areas:



Sources: OECD Statistics, Hungarian Central Statistical Office, Convergence Plan, Ministry of Finance, Ministry of Economy and Transport, Wiener Institut fr Internationale Wirtschaftsvergleiche, OCO Consulting:

Indicative FX rates in 2006:

1 USD = 210.51 HUF.

1 EUR = 264.27 HUF.

TABLES

Table 1

FDI STOCK IN HUNGARY

Place of origin	*UK*	*EU*	*Total*
2000	172.1	16 143 (1%)	21 048,00
2001	280.7	19 341 (1.5%)	25 543,00
2002	327.4	22 521 (1.4%)	29 757,00
2003	286.3	26 691 (1%)	33 238,00
2004	322.8	31 884 (1%)	40 425,00
2005	3181	36 846 (8%)	46 670,00
2006	not available		

Table 2

FDI INFLOW TO HUNGARY

Place of origin	*UK*	*EU*	*Total*
2000	111,1	1 187 (9.3%)	1 509
2001	18,2	453 (4%)	1 096
2002	33,2	980,2 (3.4%)	1 156,7
2003	27,2	–866	–664
2004	52,4	658.9 (8%)	1 081,6
2005	2458*	3 501	3 966
2006	–145,3*	1 180	1 394

* The inflow in 2005 was exceptionally high due to the purchase of the Budapest Airport by BA. In 2006 the Airport was sold by the British, that is why the inflow was negative in 2006.

Table 3

NUMBER OF FDI PROJECTS IN HUNGARY

Origin country (Parent)	*2002*	*%*	*2003*	*%*	*yoy*	*2004*	*%*	*yoy*	*2005*	*%*	*yoy*	*2006*	*%*	*yoy*
Germany	47	22,3%	52	24,2%	110,6%	36	17,0%	69,2%	30	17,1%	83,3%	58	25,0%	193,3%
Austria	19	9,0%	23	10,7%	121,1%	40	18,9%	173,9%	35	20,0%	87,5%	40	17,2%	114,3%
USA	26	12,3%	38	17,7%	146,2%	27	12,7%	71,1%	20	11,4%	74,1%	30	12,9%	150,0%
UK	22	10,4%	14	6,5%	63,6%	19	9,0%	135,7%	15	8,6%	78,9%	12	5,2%	80,0%
Belgium		1,4%	4	1,9%	133,3%	1	0,5%	25,0%	6	3,4%	600,0%	11	4,7%	183,3%
Japan	13	6,2%	8	3,7%	61,5%	13	6,1%	162,5%	6	3,4%	46,2%	8	3,4%	133,3%
Switzerland	5	2,4%	7	3,3%	140,0%	5	2,4%	71,4%	2	1,1%	40,0%	8	3,4%	400,0%
Netherlands	10	4,7%	4	1,9%	40,0%	6	2,8%	150,0%	5	2,9%	83,3%	7	3,0%	140,0%
Sweden	5	2,4%	3	1,4%	60,0%	8	3,8%	266,7%	2	1,1%	25,0%	6	2,6%	300,0%
France	13	6,2%	20	9,3%	153,8%	13	6,1%	65,0%	18	10,3%	138,5%	5	2,2%	27,8%
Italy	8	3,8%	7	3,3%	87,5%	9	4,2%	128,6%	2	1,1%	22,2%	5	2,2%	250,0%
Ireland	1	0,5%		0,0%	0,0%	2	0,9%	100,0%	1	0,6%	50,0%	4	1,7%	400,0%
Spain	4	1,9%	2	0,9%	50,0%	6	2,8%	300,0%	2	1,1%	33,3%	4	1,7%	200,0%
other countries	35	16,6%	33	15,3%	94,3%	27	12,7%	81,8%	31	17,7%	114,8%	34	14,7%	109,7%
Total	**211**	**100,0%**	**215**	**100,0%**	**101,9%**	**212**	**100,0%**	**98,6%**	**175**	**100,0%**	**82,5%**	**232**	**100,0%**	**132,6%**

Table 4

NUMBER OF UK FDI PROJECTS IN HUNGARY BY YEAR AND SECTOR

Key business function	*2002*	*2003*	*2004*	*2005*	*2006*	*Total*
Manufacturing	7	4	1	3	2	17
Business Services	1	1	2			
Construction	1	2	3	1		7
Customer Support Centre					1	1
HQ				1		1
Internet or ICT Infrastructure	1			1		2
Logistics and Distribution	1		1			2
Maintenance/Service		1				1
Research and Development	1				1	2
Retail	9	7	10	9	6	41
Sales, Marketing and Support	1				1	2
Shared Services Centre			2		1	3
Technical Support Centre			1			1
Total number of projects	**22**	**14**	**19**	**15**	**12**	**82**

Memorandum submitted by the British Romanian Chamber of Commerce

TRADE AND INDUSTRY COMMITTEE QUESTIONNAIRE

1. *Is the UK exploiting the opportunities afforded by the Accession of Romania to the EU?*

Clearly the UK is exploiting the opportunities afforded by the Accession of Romania to the EU, but also clearly it is not maximizing its opportunities. Whilst there are some significant UK companies in the Romanian market—for example GlaxoSmithKline, Vodafone, BAE Systems plc—other large UK companies are notable for their absence.

This in part is due to the decline of the manufacturing base in the UK, but this is not the entire explanation, because there are many large UK companies with overseas manufacturing operations who could look to Romania, but do not.

The UK has no presence yet in Romania in the banking sector (although it is making small inroads into the financial services sector), no significant presence in the retail sector and no significant presence in the manufacturing sector.

On the other hand the UK has made good progress in the SME service sector.

2. *What are the most promising areas for developing business? Is there potential for exporting more goods and services to Romania?*

The opportunities are there across all sectors, both for goods and services. However, these opportunities are at present being taken by other EU countries. Clearly there is a role for major infrastructure projects, services across all sectors, light manufacturing to support major manufacturing, construction projects, and property development.

3. *Where the UK might be losing out to competitors?*

Regrettably, in all sectors.

4. *What advantage might the UK draw from the existence of a skilled workforce in Romania?*

There is a skilled workforce in Romania but there is also a shortage of skilled labour. Whilst it is true to say that it is possible to hire people with appropriate skills, finding them is not so easy.

Paradoxically, the UK might benefit by hiring Romanian workers in the UK, as witnessed by the search for Romanian construction workers to work in the UK on the 2012 Olympics project.

5. Is there scope for the UK's educational establishments and businesses to build relationships with students and educational institutions in Romania? How could the UK and these countries pool their scientific and technical know-how to reap the maximum benefit for all concerned?

No comments to make

6. What are the advantages and disadvantages of doing business in Romania? Is it still easier to operate in Western Europe than in Romania; and, if so, why? What barriers exist?

The advantages of doing business in Romania are

(a) a growing economy (GDP growth 6% annually)

(b) large population (22 million) with growing middle class spending power

(c) inflation under control

(d) willingness to receive foreign investors

(e) desire to fully integrate into the EU

The disadvantages of doing business in Romania are

(a) lack of infrastructure (motorways, fast train services, internal flights)

(b) other countries are already well established in a number of sectors making it difficult to break in to

(c) Labour cost advantages are being eroded. In the case of textiles, Romania is proving to be uncompetitive because of lower costs in neighbouring countries like the Ukraine and Moldova, and of course there is the constant competitive threat of the Far East

7. *How could the UK exploit any synergies with the economies of these countries?*

It is very important to recognise the strong bonds between Romania and the UK, particularly because of the support of the UK for Romania's Accession to the EU. However, this goodwill is in danger of being eroded because of the position being taken by the UK in restricting the number of Romanians able to work in the UK. This issue needs to be addressed urgently. Using the natural goodwill in Romania for the UK could be a useful springboard for UK initiatives.

The UK Government could also take the lead by supporting and helping Romania access EU funds. These funds, to be used, will require viable projects, which could be carried out by UK businesses.

Memorandum submitted by the Confederation of West Midlands Chambers of Commerce and Industry

Introduction

The Confederation of West Midlands Chambers of Commerce (which will be referred to as "the Confederation" throughout the course of this document) is pleased to respond to the House of Commons, Trade and Industry Select Committee inquiry in to the impact of the new European Union (EU) member States on UK business. The Confederation consists of all of the Chambers of Commerce within the West Midlands Region, which include:

— Birmingham Chamber of Commerce and Industry (which incorporates Solihull Chamber of Commerce and Industry)

— Black Country Chamber of Commerce and Industry
— Coventry and Warwickshire Chamber of Commerce and Industry
— Herefordshire and Worcestershire Chamber of Commerce and Industry
— North Staffordshire Chamber of Commerce and Industry
— Shropshire Chamber of Commerce and Industry
— South Staffordshire Chamber of Commerce and Industry

The Chambers of Commerce that comprise the Confederation represent over 13,000 businesses in the region as a whole, offering extensive services to industry and commerce, promoting trade and advocating the interests of business locally, nationally and internationally.

The Confederation conducted a survey to elicit the views of its business members to gather views on the committee's inquiry. The results of the survey are detailed in this submission.

In consulting with our members there was a view that the UK has been slow to identify opportunities that the new EU accession countries have offered. Therefore, the Confederation welcomes the Government's current inquiry.

The Confederation recognise that UK business must do more to become innovative and diversify their business activities to compete on a Europe and international scale and that business must examine opportunities that the EU enlargement has offered. However, there are clear areas in which further Government assistance could ensure a larger number of UK businesses exploit the opportunities that the new EU countries offer.

The main themes/issues that were identified in consultation with our members are:

— Challenging perceptions of the EU
— Government assistance and support
— Utilising and developing skills

The Confederations Research

The business respondents to the Confederation's survey were predominantly working with the Czech Republic, Poland, Slovakia, Hungary, and Romania. Business respondents had limited business in Estonia, Cyprus, Latvia and Malta. The majority of UK business activity with these countries is in exporting goods and services. Recruiting staff is also a key activity.

UK Business interaction in the EU

54% of business respondents do not think the UK is exploiting opportunities afforded by the accession of the new EU countries. UK business has been slow to pick up on opportunities to trade with the new EU countries and to some extent this has meant less market share for the UK and greater competition from our EU counterparts such as France and Germany.

"UK businesses tend to be more reactive than proactive in foreign markets. We are one step behind our competitors in the new EU markets and this misbalance must be addressed." Peter M Mathews CMG, Managing Director of Black Country Metals Ltd & Chairman of Black Country Chamber of Commerce.

Insufficient resources, time and knowledge to access trade opportunities were the main reasons that respondents gave for why UK businesses, particularly Small to Medium sized Enterprises (SMEs), may not be looking to access new EU markets.

"It is still easier for us to operate in Western Europe largely because at present they have the money to buy products. Significant time and investment will be needed to establish trade with the developing markets." Adrian Allen, Managing Director, Anderen Ltd.

Business respondents perceived that countries such as Germany were more aggressive at pursuing and investing in the new EU markets. Business also alleged that countries such as Germany are receiving clear, strong Government support to pursue new EU trade links.

"In our industry, our other European competitors have more resources and are more proactive in the new EU markets. There is also a notable presence of foreign Government support for our European counterparts, that is lacking in the UK." Adrian Allen, Managing Director, Anderen Ltd.

UK Trade & Investment (UKTI) is the Government organisation that helps UK-based businesses to access EU and other international markets and offer a range of expert knowledge, advice and practical support on trading abroad. However, recent changes in emphasis at UKTI have moved towards supporting larger businesses and away from SMEs. SMEs that may or may not be seeking new markets could well benefit from receiving more Government support and encouragement. It is unclear what level of awareness there is within UK business of what the Government can currently offer and what opportunities exist for them to access the new EU markets.

However, businesses already trading in the new EU countries identified that there are unexplored markets that could be better exploited by UK businesses with the right products and services if they have a better understanding of what is required of them to form EU trading relations.

Business respondents also recognised that there is an opportunity to sell UK technology and knowledge to the new EU countries as they develop and have surplus capital to spend. For instance, the development of industries and factories in the new EU countries offer opportunities for UK businesses to sell them good quality products, services and expert knowledge.

There is a clear need to tackle some of the misconceptions of EU trading amongst UK business and better promote the opportunities and Government support that exists to assist UK business in trading with the new EU countries. The Government should also examine what extra support may be needed to support SMEs to trade with the new EU countries.

Business disadvantages to EU trading

54% of business respondents do not believe it is easier to operate in Eastern Europe than the UK and believe there are key barriers stopping UK businesses from exploiting opportunities in the new EU countries.

"There are numerous reasons why UK businesses are not exploiting the opportunities in the new EU countries at present. Some reasons are basic while others are more complex. A lack of time, resources and Government support are key barriers to UK businesses trading aboard. Many smaller companies are not willing to take high-level risks that can be involved with trading abroad and tend to concentrate on developing relations with trusted local trading partners. In addition, there are more complex issues over knowledge of the countries in terms of economies, demographics and cultures that may be putting some businesses off." Parveen Mehta, Operations Director, Minor Weir & Willis Ltd.

Key barriers to doing business in Eastern Europe identified by business respondents were:

— Cultural barriers.

46% of business respondents noted that perceptions of the new EU countries and their different business manners are a key deterrent for UK business. An "Us vs. Europe" mentality is a particularly predominant view of those businesses not currently looking to trade with the new EU countries.

— Language barriers

The majority of business respondents noted that not being able to communicate in the native language of the business they were trading with was a key barrier to trading abroad. Although English is one of the world's major commercial languages, speaking the native language of the company can be the key factor in securing a business deal.

"Language skills are of vital importance for UK businesses trading abroad. If there is a German business and a UK business competing to sell widgets to a Polish company based in Warsaw but the German company can speak Polish and the UK business cannot, the German company will undoubtedly win the contract. UK business could double their trading success abroad if we improve our language skills set." Peter M Mathews CMG, Managing Director of Black Country Metals Ltd & Chairman of Black Country Chamber of Commerce.

The Confederation believes more must be done to ensure the UK has the foreign language capabilities that are vital to international trading and UK business success abroad. In a recent Birmingham Chamber of Commerce survey 80% of business respondents noted language skills assisted their business in selling and buying abroad.[10] In addition, there is a potential to harness and utilise the language resources in existing UK migrant workers and minority ethnic groups to develop innovative business partnerships and lucrative EU business deals with the newest EU accession countries.

— Bureaucracy and business processes

The majority of respondents noted bureaucratic processes such as form filling and the related administration time and costs incurred as key barriers to trading in the EU. Businesses also indicated practical difficulties in business negotiations with EU countries, including trust and product quality issues, a lack of restricted credit insurance, poor records of payments, rules of law and corruption. These higher business risks and obscure business negotiations either real or perceived are preventing UK business from trading with the new EU countries.

— Geographical distance.

Businesses indicated that the UK's geographical distance from the rest of Europe was a key trading barrier. Poor logistics and infrastructure both in the UK and the EU was cited as a disadvantage to trading abroad. However, many businesses have taken the opportunity to move their production, or other services, to the new EU countries due to the geographical proximity to the new emerging markets.

[10] "Language Skills—A Business Perspective', Birmingham Chamber of Commerce and Industry Submission to the Lord Dearing Review in to Languages, January 2007, page 2.

Business advantages to EU trading

85% of business respondents think there is potential for more UK businesses to access EU trade opportunities. The main advantages identified were:

— The free movement of goods.

— Low costs in regards to labour, production and materials.

— Less regulation in EU countries compared to the cost and burdens of red tape facing business in the UK.

— A willing market as the new EU countries have a growing middle class with a disposable income to buy UK products and services.

Skills

Migrant workers are becoming a strong characteristic to the region's workforce. There were 11,550 national insurance registrations from overseas in Birmingham alone in 2005–06.[11]

"Employers in the region have been quick to diversify their workforce and address skills shortages by taking on skilled employees from outside the UK." Teresa Dolan, Partner, Hammonds.

The majority of business respondents noted the high level of practical/vocational skills and employability skills (attitude, willingness and work ethic) that migrant workers possess. Businesses highlighted that migrant workers from the new EU States were hard working and committed to getting jobs done to a high quality.

"EU graduates have greater practical experience than those coming from UK Universities. Eastern European students also demonstrate a high level of work ethic." Adrian Allen, Managing Director, Anderen Ltd.

It could be argued that individuals who migrate to work in the UK have particularly strong social and economic motivations and are more likely to possess the types of skills business are looking for. However, there is an opportunity to examine how differing EU education systems are producing, supposedly, highly skilled and more enthusiastic workers.

"We must do more to utilise the skills of those migrant workers with higher-level qualifications. We should be ensuring that these types of migrant workers stay in the UK for longer for the benefit of the country and the economy." Lorna Sheldon, Managing Director, The Complete Works Ltd.

Business respondents highlighted that UK business needs to utilise the higher-level skills of migrant workers more effectively. The Organisation for Economic Co-operation and Development (OECD) states that the UK ranks 13th out of 22 countries in the numbers leaving education with poor qualifications.[12] Utilising the higher skill levels of migrant workers can play a key role in solving the UK's skills deficit and support the further growth of the country's economy. The importance of migrant workers to the economy is noted in the Leitch Review published in October 2006,

"Migration generally has a positive effect, helping to mitigate skills shortages and fill jobs that cannot be filled domestically." Lord Leitch, The Leitch Review, 2006.[13]

Several businesses also indicated that a key advantage of the recent EU enlargement has been the availability of cheap labour. However, as migrant workers are legally entitled to the National Minimum Wage the Government must do more to ensure businesses are aware of the potential legal pitfalls. The Confederation supports the Department for Trade and Industry's current "Vulnerable Workers" Pilot in Birmingham, which is aiming to provide advice and support to some employers and vulnerable workers in the hospitality sector. Depending on the success of this pilot the Confederation would urge the Government to develop this type of employer support to all sectors of business.

Although the majority of UK businesses are benefiting from recruiting migrant workers from the new EU countries, parts of the region's farming industry are currently experiencing recruitment problems. Despite offering wages higher than the National Minimum Wage the sector is struggling to access sufficient workers and some farmers are leaving crops to rot because they cannot fill vacancies. This indicates that more must be done to promote working in the UK to migrant workers to fill vital skills gap and secure future economic development in the UK's agricultural sector.

[11] LSC Data: http://www.lsc.gov.uk/regions/WestMidlands/

[12] Education and Skills Statistics, OECD, www.oecd.org.

[13] "Prosperity for all in the global economy- world class skills" Lord Leitch, December 2006, page 7.

Opportunities to exploit synergies with the economies of EU countries

The main opportunity cited by business was the opportunity to develop joint technology innovation projects. Although there was some hesitation by respondents that EU countries would use it for their own gain and questioned whether inherent competition between countries would mean joint ventures were not achievable.

Joint business ventures and education institution partnerships were also mentioned. However, most businesses did not identify any new ways in which the UK could exploit the developing relations.

Conclusions and Recommendations

The Confederation's research indicates that the UK has been slow to recognise the opportunities presented by the recent EU enlargement. General misconceptions and low awareness levels of trading opportunities with the new EU countries is stunting the potential for further growth in both export and import markets. Key to improving all foreign market activity in the UK is the need for more SME tailored Government support. The development and better promotion of SME tailored Government support is vital to exploit opportunities in the future.

Business is generally positive that more can be done by UK business to exploit the opportunities the EU enlargement still offers and that there are potential opportunities to create joint business and education ventures. In addition, UK business believes the Government could do more to promote the UK to migrant workers and utilise the high level skills set offered by our existing migrant workforce.

Our main recommendations to Government are to:

— Tackle the misperceptions of UK businesses towards EU countries and low levels of awareness of the trading opportunities in the EU.

— Ensure assistance and support for UK business in Europe. The Government should offer more SME tailored support to assist them in accessing the new EU markets. The Government must also offer more legal support to UK businesses employing migrant workers and actively promote UK job opportunities to potential migrant workers.

— Improve the utilisation of migrant workers higher-level skills and language skills to benefit UK business and the economy. The Government must also assist in improving the UK's language skill levels to assist the UK's economic competitiveness in the future.

Memorandum submitted by the Corporation of London

Thank you for giving notice to the City of London Corporation of the Committee's inquiry into the impact of the new EU Member States on UK business. As you will appreciate, for the City of London the issue of enlargement is of considerable importance. EU-owned banks, insurers, asset managers and many other companies form a critically important element of London's capacity, accounting for major levels of employment and significant volumes of business. Meanwhile, financial services firms from outside the EU—from the United States, Japan, Canada, Australia, the Middle East and many other regions—use London as their main point of entrance to Europe's markets. I appreciate that the Committee's deadline for submissions has now passed, and I am sorry not to have sent these comments sooner, but I hope they may still be of some use to the Committee in its deliberations as background.

The fact that the newly enlarged European Union forms one of the largest single markets for trade and investment in the world gives rise to opportunities for British business to gain substantially from the enlargement and indeed over 15,000 British companies from all parts of the UK are now active in the new EU countries. Furthermore a significant proportion of these are small and medium-sized companies proving that new opportunities in the Union are not only for big firms.

Anecdotally at least it appears justified to contend that the business community has taken on board comments made by your predecessor Committee in 2000 which expressed disappointment at "the relatively low proportion of UK Companies investing in the Baltic States and in particular at the absence of banks and financial services companies whose presence in other markets does much to aid smaller investors and traders" (Industrial and Trade Relations with the Baltic States, Select Committee on Trade and Industry, Twelfth Report, Session 1999-2000, HC 835). Opportunities will continue to arise and so efforts to engage with new Member States must be maintained.

For its part, the City of London Corporation has already done much to engage with the new Member States. During 2003, when planning for the Overseas Visit Programme for Sir Robert Finch's Mayoralty in 2003–04, Accession states were included in both the inward and outward visits strategy. Between March and July 2004 visits were made to Poland, Latvia, Lithuania, Estonia, Hungary, Slovakia, the Czech Republic, Slovenia, Bulgaria and Malta. Alongside the visits, the City of London Corporation hosted a roundtable discussion during the State Visit of the President of Poland on the subject of trade and investment opportunities in Poland post accession and hosted a dinner for the Finance Ministers from the Accession States. Earlier this year, the Lord Mayor and City Corporation hosted an event at Mansion House to mark

Bulgaria and Romania's accession to the EU. The Lord Mayor continues to make regular visits to EU Member States, both "old" and "new", coupled with biannual visits ahead of a Member State assuming the EU Presidency.

A further illustration of the importance which the City attaches to an enlarged European Union is the briefing and placement programme for practitioners, government officials and regulators run by the City Corporation's Economic Development Office for the New Member States and Accession countries. First established in 2003, the programme has recently completed its fifth series of placements. The first Programme in 2003 was dedicated to practitioners, government officials and regulators from the Czech Republic, in 2004 the focus was Poland, in 2005 the selected countries were, Lithuania, Latvia and Estonia and in 2006 Hungary. The 2007 Programme focused on Slovenia and Slovakia.

The aim of the programme is to promote the UK financial services industry, share best practice in regulation and related matters and build personal and corporate links between the City and figures of influence in the new Member States and Accession Countries. The Programme centres around a 5-day tailor-made City course followed by a work placement in a firm or institution for 9 weeks. The placement offers an opportunity for the participants to gain insight into City practice while creating and maintaining helpful relationships with City institutions. A variety of international City firms in the financial and business related services sector as well as HM Treasury, the Financial Services Authority and HM Revenue and Customs, have participated in the programme. The increasing number of firms wanting to take part is testimony to its value and success.

In 2004, the programme was bolstered with an "aftercare" element providing the City Corporation with the opportunity to keep in touch with participants and to ensure that relationships with the host firms are maintained. The number of Alumni has now increased to 43 and many have gone on to secure senior posts. These include a former employee of the Polish Securities and Exchange Commission who is shortly due to take up a position at the European Commission (DG Internal Market) and a former employee of the Czech Securities Commission who is currently the adviser to the Czech Deputy Minister of Finance.

EXTRACT FROM THE REPORT ON THE VISIT OF THE LORD MAYOR ALDERMAN ROBERT FINCH TO THE BALTIC STATES JUNE 2004

The visit was one of a series which the Lord Mayor is making this year to key European capitals, including ten of the twelve new Member States of the European Union. The aim of the visit was to promote the City of London and, in particular, its financial and business services sectors, and to hold discussions in each country with business leaders and with Government ministers and officials at both city and national level. In each of the countries he visited, the Lord Mayor sought to emphasise the reasons behind London's success as an international financial centre and the role that London wished to play as the financial capital of Europe with its expertise in many key areas—in particular, shipping and Public Private Partnerships (PPP).

Lithuania

The Lord Mayor completed his Baltic tour with a visit to Vilnius, where he was hosted by the Ambassador, Mr. Colin Roberts. As with the other Baltic countries, the main objective of the visit was to support our efforts to promote the development of PPP in Lithuania.

He participated in a very successful seminar on PPP for senior representatives of government departments—including the Prime Minister's and President's Offices and the leading municipalities. The seminar succeeded in strengthening the base of understanding about PPP among key departments and municipalities and we have opened up opportunities in specific sectors—in particular in defence infrastructure, prisons and infrastructure projects at municipal level.

The Lord Mayor attended a lunch hosted by the British Chamber of Commerce, Lithuania and delivered a keynote speech. He held separate meetings with the Vice Minister of Finance and a Defence Minister, where PPP issues were again discussed. He also had an enjoyable meeting with the Mayor of Vilnius, Mr Artûras Zuokas and toured a number of municipal projects.

The Lord Mayor was received by the Acting President of Lithuania, Mr Artûras Paulauskas, where they held friendly discussions on investment policy and Anglo-Lithuanian relations. The Lord Mayor stressed to the Acting President as well as to other ministers, the need to find a political champion for the PPP process. Whilst the PPP delegation took the education process forward successfully there is clearly much more to do and a degree of scepticism remains at the higher levels of government. He was a guest also at a dinner hosted by the Ambassador where he had the opportunity to meet many senior members of the Lithuanian community.

The Lord Mayor was pleased to be able to present a Mansion House scholarship to Mr Zilvinas Martinaitas, who is to undertake a Masters Degree in Economic Policy for Developing Economies at Bradford University in October 2004. He highlighted the Corporation's City of London Training Scheme for new EU member states which he had announced in both Tallinn and Riga. He also floated the idea of establishing for Lithuania, an access to venture capital scheme on the lines of Seed Forum in Norway. The Embassy in Vilnius will take this issue forward with the Corporation, the Lithuanian government and the British Chamber of Commerce.

Comment

The visit to Vilnius completed a hectic twelve day trip which had taken in six cities. The Lord Mayor was glad to learn that the PPP process was enthusiastically received in certain quarters and that Lithuania looked naturally to London as a source of expertise. However, he was conscious that there is a natural reluctance at political level to admit that public services could not be provided by government, particularly in an election year and that there is much more education and persuasion to be done. Nonetheless, as with Estonia and Latvia, the country has advanced remarkably in a little over 10 years and is now embarking on an ever increasing process of reform to take its place in the EU.

EXTRACT FROM THE REPORT ON THE VISIT OF THE LORD MAYOR ALDERMAN ROBERT FINCH TO HUNGARY AND SLOVAKIA JULY 2004

Introduction

The visit to was the third in a series of four to the new Accession States in Central and Eastern Europe (CEE).

The particular aims of the visit were as follows:

(a) *Hungary*

— to keep up the momentum for progress in PPP;

— to follow up specific opportunities in the Healthcare Sector; and

— to support investment in the Water and Defence Sectors.

(b) *Slovakia*

— to promote the principles of PPP/PFI;

— to discuss pension reform; and

— to discuss Emission trading.

In all countries the reception was most welcoming and our hosts were grateful for the efforts the Corporation of London had made to mark their entrance into the European Union (EU) and the ongoing offers of help in understanding the way the City operates internationally within the Financial Services Sector.

A strong business party accompanied the Lord Mayor throughout. In particular Mr Stephen Harris of IFSL, a most experienced practitioner of PPP, was responsible, together with Posts, for running a number of very successful seminars and round table discussions on the value of public-private partnerships for major infrastructure projects.

Hungary

In advance of the visit, the Ambassador, HE Mr John Nichols (in Post for 10 months after a secondment with IFSL), provided a scene setter that concentrated on the EU issues facing the Government. Hungary had effectively managed the detailed preparations for membership and had been vocal on relatively few issues, although important exceptions were minority rights for ethnic Hungarians in the EU constitution, and equality in all areas between old and new Member States—a recurring theme throughout the visit. Having secured what it wanted in the IGC on minorities, Hungary was now in a position to be more helpful on UK "red lines'—such as tax. It would be less so on future financing, though there was some understanding of UK arguments in the Finance Ministry. Hungary had given strong support on the working time directive and remained helpful on Lisbon Agenda issues.

There had been a number of opportunities for Britain to help with the modernisation of Hungary and the Prime Minister and Finance Minister remained open to advice from the UK—notably on PPP. HMA was well briefed on their major foreign and security policy issues, and was aware, through Ministers, of Hungary's desire to develop her relationship with the UK as a counterbalance to traditional links with Germany. Future growth in the economy would come from SMEs that would need considerable help to compete in the Single Market. Budapest was increasingly viewed as a regional business hub.

Most of the privatisation in the banking sector took place in the mid-1990s, when the key banks had been bought by German, Austrian and French banks. The Hungarian sector was still "overbanked" and further consolidation in the sector had to be expected. British companies had some presence in the insurance and credit sectors. Aviva had purchased the life insurance arm of a Hungarian company and Provident Financial had moved into the market around the same time and now had over 100,000 customers and an impressive growth strategy throughout the CEE Region. HSBC had entered the market as the personal credit arm of Dixons, but had since expanded to offer loans more generally. Other large UK companies in Hungary included Glaxo, Tesco, BT, and Vodafone.

HMA explained that Hungary lay on two transit routes for organised crime: via the Balkans, and via the former Soviet Union. Hungarian desire to be full participants in the European institutions, including Schengen, had meant agreeing to the unpopular decision to isolate the minorities living over the borders, eg the unpopular imposition of visa regimes on Serbia and Ukraine, to comply with the acquis. The Hungarian border guard had been making reasonable progress towards Schengen membership. The police had been restructured with a greater emphasis on organised crime, but remained overly hierarchical. The Embassy continued to focus on improved law enforcement intelligence capabilities, closer co-operation with neighbours, assistance on tackling corruption and improved operational co-operation with the UK.

Ministry of Finance and the PPP Roundtable

In the absence of the Minister of Finance in Brussels, the Lord Mayor was received by Dr Elemér Terták, the Administrative State Secretary in advance of the PPP Seminar run by Stephen Harris. Although unaware of it at the time, discussions with Mr Tertak were to show the difference of approach between the Ministry and the National Bank in solving Hungary's economic problems. The Ministry thought the convergence plan realistic, but had initially doubted the need to cut bureaucracy and bring in far reaching public administration reform. Earlier attempts at PPP had failed, more often than not due to deviations from the sound advice proffered by disinterested third parties. Nevertheless current projects appeared to be going well and there was still an interest in seeking further advice and support from the UK in this field.

The Lord Mayor outlined a programme the Corporation was running for the new members of the EU that provided a series of briefings for middle management on the role of the City as Europe's pre-eminent Financial Services Centre. He also iterated what he had said at the Corporation Dinner in May with regard to the "City Fellowships" that would be run by the Corporation for senior officials and leaders in the private sector. Whilst in London they would be briefed at an appropriate level by leading academics and practitioners on the Business City and its interaction with European global trade and development. It is planned that they would then undertake a project that would contribute to the work of their parent organisation, with the aim of making a constructive contribution to the development of bilateral and multilateral relationships within the EU. The scheme would take some time to set up, and the first fellowships were unlikely to be offered before the second half of 2005. Meanwhile, he commended the training and professional development opportunities offered by institutions such as Cass Business School, the Securities Institute and other bodies. After further discussions the Lord Mayor offered to send him a copy of the City of London's position on key issues being considered by the EU at present.

The Lord Mayor and the State Secretary then delivered keynote speeches at the PPP Seminar. The event took forward the discussions on PPP that the Embassy had been holding with different Ministries over the last two years. The Ministry of Finance was still concerned about the effect of PPP on the national accounts, specifically the budget deficit, at a time when the Hungarians were trying to reduce the deficit to meet Maastricht criteria. Nevertheless, there seemed to be a dawning recognition that PPP could form part of the urgently needed public administration reforms.

Later Mr Tertak asked the Lord Mayor to write to him with his observations on what he had seen in Hungary, Hungarian competitiveness, his recommendations on PPP, and details of what the UK might have to offer. He also asked for views on the development of Budapest Airport.

The State Privatisation Agency

The Lord Mayor then called on Dr Tamás Mészáros, Chairman of the Hungarian Privatisation and State Holding Company who, together with the CEO Dr Miklos Kamaras, outlined progress on the privatisation of all state owned businesses. In 1990, 1,859 state-owned companies awaited privatisation. Currently there are 158, many of which are agricultural, industrial or transport companies; of these, 38 are likely to remain in long-term state ownership. Discussions focussed on the privatisation of Budapest's Ferihegy Airport and their Flag Carrier, MALEV, as well as the added advantages of exploiting the adjacent land. It was suggested that modernising the whole area with, say, the inclusion of clusters of business and retail enterprises would enhance the airport's reputation and provide the impetus for it to become a major transportation and communication hub within the Region. HMA and Stephen Harris volunteered their considerable experience and the Lord Mayor suggested that the Embassy contact Sir John

Egan, a recent Chief Executive of BAA, whose experience might be invaluable to the Agency.

National Bank of Hungary

The call on Mr Zsigmond Járai, the Governor of the National Bank of Hungary, elicited a different view on the economic way ahead for the country. He believed the convergence plan to be unrealistic without root and branch administration reform. Although optimistic in the long term, he identified the main short term problem as excessive social transfers, too high a proportion of GDP (9%) going on debt-servicing, and too high a proportion of GDP (50%) being redistributed by Government. In addition, he expressed scepticism about the use of PPP as a reform tool, insisting that there was still not enough transparency in the system. He did not believe that the Government had the political will to tackle reform issues, for without reform, Hungary would not be competitive, and the currency would be open to speculative attack. During discussions on the EU, the Lord Mayor emphasised that the City was committed to achieving a genuinely single market and that he and others were actively involved in trying to ensure that EU regulation is the best it can be and is properly regulated. Later the Governor accepted the offer of a copy of the "Position Paper" and noted the offer and value of the two Corporation courses.

British Chamber of Commerce in Hungary

The Lord Mayor was guest of honour at a lunch hosted by the BCCH, where he delivered a key note speech. Over lunch, he heard from a representative selection of leading businessmen about the need for reform and the difficulties of doing business in Hungary without a fully transparent and stable framework of legislation and procedures.

AIM Seminar

The Lord Mayor went on to open a seminar on behalf AIM Exchange and the BCCH organised by Mr Jonathan Wilde, a solicitor with the Ormos Law Office. The presentation focused on the laws and regulations relevant to AIM and the legal documentation required for an IPO.

Emissions Trading Seminar

On the final morning, Dr Jeff Chapman was the Moderator for a UKT&I and Corporation sponsored seminar on Emissions Trading. The Lord Mayor and Deputy State Secretary for the Ministry of Economic Affairs and Transport delivered the two Keynote Addresses. This was a new area for the Hungarians and was well attended. It has since generated considerable interest.

Budapest Stock Exchange

As guests of the newly appointed Chairman, Mr Attila Szalay-Berzeviczy, and his CEO, Mr Zsolt Horvath, the Lord Mayor was briefed on the state of the BSE. After opening the trading, he delivered a keynote address to members of the Stock Exchange emphasising London's role in the international market place compared with that of Frankfurt whose links with Budapest were still strong. He then conducted a lengthy media interview.

Hungary—Summary

This was a highly successful and timely visit and its objectives were achieved. The Lord Mayor engaged with numerous interlocutors and there was much common ground. He and the business parties were delighted with the level of access and were able to promote the City's on-going role in international finance.

In his report on the visit, HMA said the UK had a good profile in the retail and manufacturing sectors in Hungary: less so in the financial services sector, which was dominated by the Germans and Austrians. The Lord Mayor's visit had helped redress the balance and had raised awareness of London as the premier international financial services centre, and that the UK had a great deal of potentially helpful experience and expertise that we were ready and willing to share with our new partners in the EU. These were important messages which had enabled progress not only towards meeting our objectives in promoting the UK's Financial Services industry in general, but also our expertise in PPP and Privatisation in particular.

Slovakia

As far as EU issues were concerned the Slovaks' own IGC red lines (tax and social affairs) had coincided with ours and elsewhere they made pragmatic compromises to achieve a consensus. They supported our preferences over the Commission President and had been vocal in their appreciation of the help and co-operation extended to them at the European Council. They had been helpful on the Working Time Directive and appeared natural partners across all the competition and deregulation agendas. As for future financing, despite a clear preference for a larger budget, the arguments for a 1% ceiling were being studied pragmatically. A recent public verdict that the Constitution was a good victory for individual member states underlined the lack of any European federalist appetite within Slovakia.

The Government had continued to support UK/US policy in Iraq and Afghanistan and had undertaken, despite some domestic opposition, to deploy peacekeeping forces. Slovakia had also begun to support and develop relations in their immediate neighbourhood—the Ukraine, Serbia/Montenegro and Croatia. They also realised the need to control their borders more effectively should they wish to join Schengen by 2007.

Their desire for EU and NATO enlargement appeared genuine despite some reservations over Turkey.

Economically the omens were good. Current growth had risen to 4.4%; inflation had levelled at 8% and FDI was running at record levels. Slovakia was enjoying the kudos associated with its planned massive automobile expansion. Once operating this would make Slovakia the largest producer of cars per head in the world. Thanks to strong exports and the budgetary impact of the reforms, the budget deficit would level out at about 3.9% this year with a planned entry to the ERM by 2007. Eurozone entry would follow within two or three years.

Nevertheless there were concerns at the inequitable spread of FDI within Slovakia, overall high levels of unemployment—averaging 30% in East Slovakia—and concern at the possible lack of absorption of EU funds. They were pleased at the positive impact the flat tax rate appeared to be having on investment but concerned at the hostile reaction this had evoked, particularly with neighbouring states and with France and Germany. Domestically, there had been hostility to the VAT and other tax increases, allied to decreases on social services. Much of the major privatisation was now complete, but the energy sector, including nuclear and considerable infrastructure improvement in the public sector/service had yet to be tackled.

Slovakia's interest in PPP had been historically low—reflecting their late start in the reform stakes, lack of information and political will. But the Finance Minister had appointed his adviser, Martin Bruncko, as PPP co-ordinator not just for Slovakia but also for the A8 countries, plus Bulgaria and Romania. The Lord Mayor" programme would enable him to promote the concept at the highest political level, creating useful contacts and opportunities between practitioners. On a separate note, and in the face of some local difficulties, it would be useful to reinforce the message that full access to UK financial, legal and commercial services should be permitted within Slovakia.

The PPP Seminar

The PPP seminar was pivotal to the Lord Mayor's programme. Historically there had been little appetite in Slovakia for PPP projects but there was now an increasing interest in the concept and recognition that this could meet a real need, particularly in developing the public service infrastructure—transport, health, the environment and tourism. This was an opportunity to broadcast the message widely and encourage the Slovaks to develop a more joined up approach, particularly within the government and follow it up with calls on key Ministers. HMA who had been in Post for three weeks, introduced the event in a mixture of English and fluent Slovak, under the Chairmanship of John Barron KPMG (and Chairman of the BCC). The Lord Mayor gave the opening Keynote speech and was followed by a number of highly experienced practitioners who delivered a series of well structured and focussed presentations.

Attended by over 100 senior level delegates, it generated serious interest focussed and informed debate. Before the hall was cleared, one UK law firm secured its first PPP contract in Bratislava.

Call on the Mayor of Bratislava

A courtesy call on Mayor Durkovsky became a useful business meeting when PPP was discussed as a possible solution to Bratislava's wish for an integrated tram network linking parts of the old and new City together, with another that would link Vienna and Bratislava airports. A prompt meeting was therefore arranged between the Deputy Mayor and Stephen Harris to consider the UK experience, particularly in Manchester and London.

Call on the Prime Minister

Accompanied only by the Ambassador, the Lord Mayor called on the Prime Minister, Mr Dzurinda. He gave a qualified welcome to PPP and appreciated the offer of advice and support for the City. He was pleased with the amount of FDI coming into Slovakia, highlighting the recent Peugeot and Hyundai-Kia deals, but said there was scope for more. It was also a good time to invest in Slovakia as the majority of the necessary reforms in healthcare, pensions, social security, labour code, and fiscal reform, etc. had been achieved. Slovakia's simplified flat tax system would continue and at its current rate (19%). Whilst satisfied with UK investment (the fifth largest), he hoped that there would be more in future.

Call on the Justice Minister

As with all the ministerial meetings that day, discussions focused on PPP. Mr Lipsic, the Justice Minister saw no legal reason why such solutions should not proceed across all sectors. He concurred with the Lord Mayor about the importance of transparency and honesty in the financial regulatory framework. He outlined the progress in the fight against corruption and in reducing the power of organised crime—not least in public procurement. The problems that had occurred following the Slovak Bar Association's decision to introduce regulations preventing international law firms from using their recognised names in Slovakia were discussed, as was the delay in registering UK lawyers as Euro-advocates. The Lord Mayor forcefully underlined the importance of early action against such unlawful actions and the deleterious effect it would have on the wider financial community. The Minister promised personally to tackle the Slovak Bar

Association saying that he would not be backing any disciplinary proceedings against law firms who did not change their names. If his representations were unsuccessful and the Slovak Bar took such action, he would initiate new legislation. He subsequently confided in the Sheriff that his statements could be known publicly.

Call on the Finance Minister

Mr Miklos' priority was to reduce Slovakia's fiscal deficit (3.5% of GDP last year) with a target of less than 3% by 2006 and reaffirmed Slovakia's intention to enter the Eurozone by 2008, subject to negotiations with Brussels on related issues such as pensions. He spoke with authority and conviction on his reform package, rejecting criticisms of his tax initiatives and anticipated the flat tax rate would decrease to 15% in the next three to four years. Originally a detractor of PPP, he was now prepared to support specific projects. He did say, however, that someone (consumer or tax payer) would have to pay ultimately for the large infrastructure renewal projects for which PPP was being suggested. The Minister confirmed that his adviser, Mr Martin Bruncko, would co-ordinate PPP and welcomed the Lord Mayor's offer of a task force from IFSL to visit Slovakia to brief his adviser in his new role. He also welcomed the proposal to send an up and coming Finance Ministry official or banker to take up the offer of a "City Fellowship".

Call on the Economy Minister

It was clear from this call that Mr Rusko was pleased with the Hyundai deal, but acknowledged the need for FDI elsewhere in the country. He recognised the relevance of PPP, particularly in highway construction and indicated a tender for the east-west highway was now being prepared with the Transport Ministry. He questioned the value of PPP above other forms of private investment but was interested to discuss it further. He underlined the importance of getting beyond the theory and looking at specific projects. He accepted the Lord Mayor's arguments about the importance of political leadership and he indicated his Ministry would be interested to see an IFSL task force at an early stage.

Call on the Health Minister

In a frank overview of the health sector, Mr Zajac advocated the need to close down hospitals not build new ones. A number of health reform laws had still to be passed, including one to enable the entry of private capital into health care. Initially sceptical that the UK PPP experience could offer much to Slovakia, he was interested, in particular, in the Lord Mayor's description of the design and management of new public health service units and accepted an invitation from the Lord Mayor to send two to three Ministry officials to the UK to see some successful PPP health care projects in operation.

British Chamber of Commerce

The Lord Mayor was the principal guest at a working breakfast hosted by the BCC, where he delivered a keynote speech underlining, once again, the close links between international financial confidence in Slovakia and the provision of clear and fair procurement processes.

Slovakia—Summary

Described as a seminal visit by the Ambassador, the Lord Mayor achieved all his aims in Slovakia and set in motion a number of follow-up actions relating to PPP. The visit undoubtedly brought greater focus and understanding to PPP within the key ministries where the Lord Mayor's arguments carried weight and were listened to with care. Although more willing to embrace PPP, they remain wary of the downside for their FDI programme if they make unwise choices. An early and successful PPP project will be critical for the programme's future and proactive follow-up action by IFSL would be crucial. As was usual on such a visit, the Lord Mayor's presence opened a number of doors for the business Party.

March 2007

Memorandum submitted by the Edinburgh Chamber of Commerce

IMPACT OF THE "NEW" EU MEMBER STATES ON UK BUSINESS

Much has been written concerning EU enlargement and its potential impact on the economies of the EU15, some such documents presented a "doomsday" prediction of a "flood" of workers from Central and Eastern Europe. The impact of this predicted migration flow has in fact delivered a positive benefit to many small to medium size enterprises that were combating with a lack of economic labour and skills provision. Similarly the EU10 with their 76 million consumers have opened a huge market for the EU15 and this has been evidenced by the substantial increase in internal trade between the EU25 [now 27]

Less encouraging, however, is that reference to the "Pink Book" does show that the UK has not achieved its potential share of this large new market-place, with Germany in particular being the main beneficiary.

Our experience does show that one of the "inhibiting" factors, facing UK businesses, is the lack of economic "mobility" that our SMEs suffer from. We have not been wholly successful in creating the "Internationalisation" mind-set and therefore our SMEs are inclined to interface with their consumers from "distant" rather than "proximate" location.

It is necessary for us to bring UK Business to the heart of the internal domestic market of each of the accession States, so as to compete for all economic offerings originating in the market. For this we need to create as many UK Business locations as possible and here the mobility of the "Internationalisation" mind-set is essential.

Scottish companies have had reasonable successes in the enlarged EU but nowhere near the real potential on offer. In Scotland we have a fantastic financial services sector, a superbly developed bio-science sector, a globally recognised tele-communications sector and an education sector that needs no introduction. We also host a huge level of expertise in social and infrastructure development, a knowledge base that can compete favourably at any international level.

The correct type of market information is what we are often told is missing and maybe we should be structuring our market information in a format that meets the needs of specific economic ambitions rather than in a "holistic" presentation. The cost of market-research can be expensive, even with research programme support, and the quality of the initial information is paramount for a quality research remit. Too much information can be counter productive and we should be looking towards developing specific information packs for specific economic ambitions. It would be interesting to know the amount of time spent by International Trade Advisers, chasing for information, that no doubt is there, but extremely difficult to find.

Student exchange programmes are another initiative that we would very much recommend and we do not engage currently to the required extent Businesses must be encouraged to participate and University/Colleges must be supported in developing exchange programmes that have a business sentiment. This fantastic mixing of young people between the UK and the EU10 would create a considerable support mechanism to our ambition of positioning UK Business at the heart of economic activities within the individual EU10 States.

We could continue at length on this EU enlargement subject but for the sake of brevity we would conclude :

1 . . . Yes we could do much better with EU10 trade

2 . . . Yes we have much to offer on a competitive basis

3 . . . There are no disadvantages other than that which we create ourselves

4 . . . We lose out partly because our companies are not properly prepared and partly because we have not yet grasped the real meaning of "Single Market".

5 . . . We need more familiarisation with those markets

6 . . . We need to encourage the involvement of students in our familiarisation approach

7 . . . Our International Trade Advisers that interface with our companies must be market orientated to a much higher degree. We created those Advisers, we encouraged companies to have confidence in them, so we should make sure they are properly equipped with the required knowledge.

May 2007

Memorandum submitted by EEF The Manufacturers' Organisation

About Us

1. EEF, the manufacturers' organisation, has a membership of 6,000 manufacturing, engineering and technology-based businesses and represents the interests of manufacturing at all levels of government. Comprising 11 regional associations, the Engineering Construction Industries Association (ECIA) and UK Steel, EEF is one of the UK's leading providers of business services in health, safety and environment, employment relations and employment law, manufacturing performance, education, training and skills.

Context

2. In terms of the number of new member states the enlargement of the European Union (EU) in May 2004 was the largest in its history, although not in terms of impact on the size of the EU economy. While the 2004 expansion of the EU was broadly welcomed, there were still concerns about how the admission of new members would impact on existing members. For example, it raised the possibility of increased

competition for investment and export orders and of a manufacturing exodus to Eastern Europe. Two and a half years after entry there are few signs of these prophecies becoming a reality. For example, the UK remains one of the largest recipients of foreign investment in Europe and a strong world economy has supported robust export growth from the UK and other Western European economies. In addition, while there has been some offshoring to Central and Eastern Europe, manufacturing continues to make a vital contribution to the UK economy.

3. The ten accession countries, primarily from Central and Eastern Europe were, in many ways, very different from existing members. In particular, average per capita incomes across the region were considerably lower than those of previous new entrants in previous enlargement phases. While the pace of transition varied (and continues to do so) across the new EU members, economic and institutional reform offered them the potential to grow more rapidly and therefore narrow the gap with existing member states.

4. The combination of fast growing economies and low labour costs provided both competitive challenges and opportunities for UK manufacturers. Almost three years after these Central and Eastern European countries gained entry to the EU, these challenges and opportunities remain. Furthermore, they extend to more recent EU members, future members and even beyond EU borders.

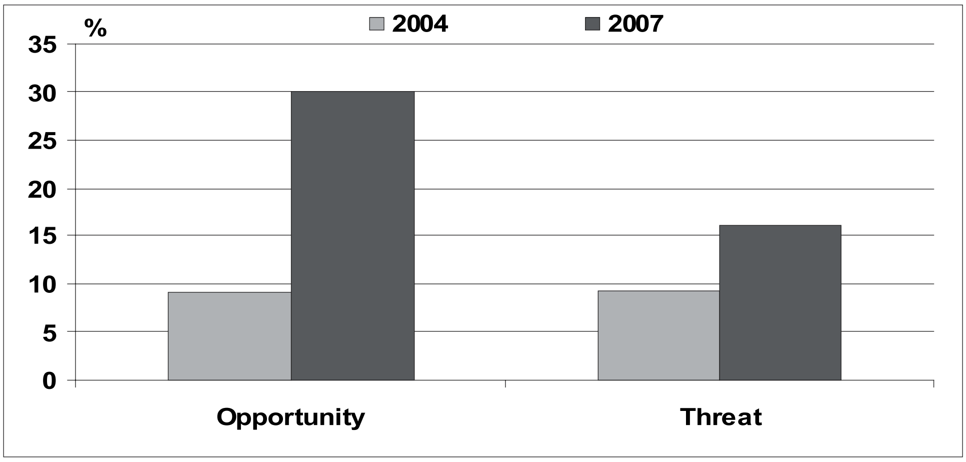
5. This submission will look at the actions of UK manufacturers in respect of the eight Central and Eastern European countries which joined the EU in 2004. In some instances, it will look at how UK companies have engaged with the new member states compared with other Western European economies. .

Is the UK exploiting the opportunities afforded by the accession of these countries to the EU?

6. UK manufacturers have become increasingly aware of the challenges posed and opportunities offered by the new EU members. In Figure 1, the findings of EEF surveys show that in 2004, the year of accession, a relatively small proportion of manufacturers regarded the new EU members as either a competitive threat or an opportunity. However, in the past three years, the picture has changed significantly with three in ten firms now seeing the potential for growth in these markets. There has also been an increase in awareness, albeit to a lesser extent, of the region as a lower cost competitor.

Figure 1

Perceptions of Competitive Challenges Posed by New EU Member Countries



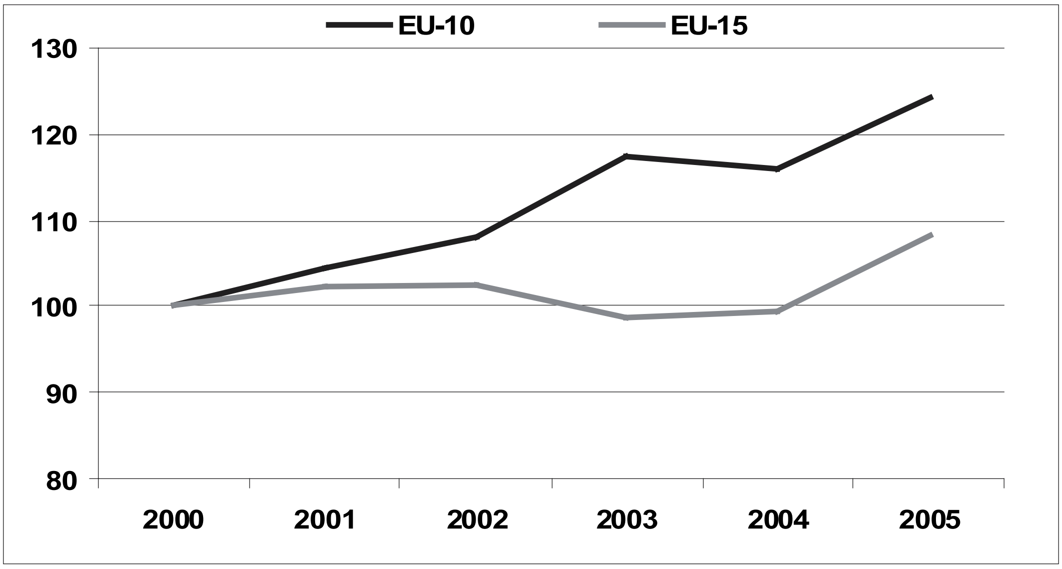
Source: EEF/NOP Competitive Challenges Survey 2004; EEF/Barclays Export Survey 2007.

7. Nevertheless, our survey earlier this year showed that more companies see the potential for growth further east. Almost 40% of respondents cited the non-EU countries of Eastern Europe (including Turkey, Russia and other EU applicants) as offering growth potential over the next five years. This compares with 30% of companies seeing future growth potential in the new EU members. The size of non-EU Eastern Europe, in terms of population and GDP, is likely to be a significant factor in this outlook.

8. One of the greatest opportunities that EU enlargement has created for UK firms is the potential to expand into new export markets or to build on existing experience of the region. The relative proximity of these lower cost markets, which now operate within a more consistent regulatory framework, will have increased the ease with which UK manufacturers can trade with the new EU members. Official trade data, as shown in Figure 2, confirms that UK goods exports to the new EU countries have been expanding more rapidly than that to our more traditional market (the EU-15).

Figure 2

UK exporters benefit from EU expansion
Goods exports (2000 = 100)[14]



Source: HM Revenue and Customs.

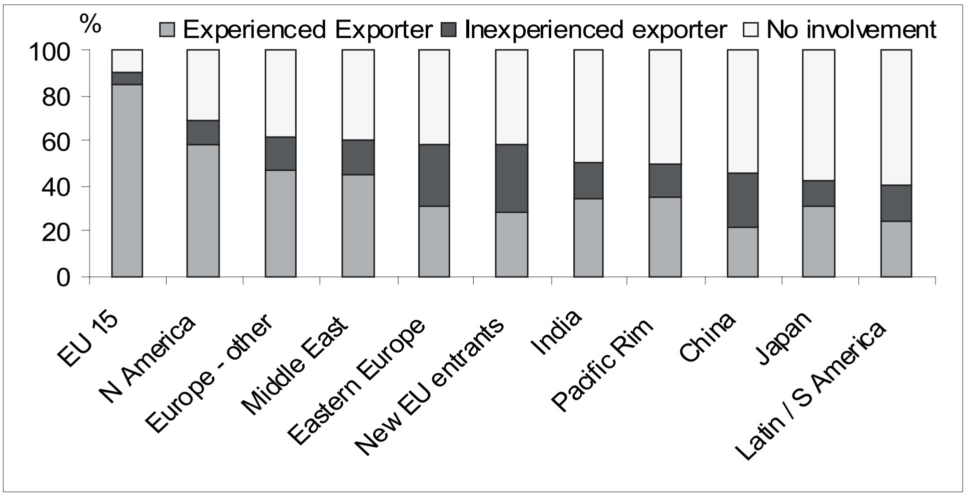
9. EEF's 2007 survey on exporting confirms that more companies have become engaged with exporting to the region over the past five years. EEF's survey asked firms about their export experiences across a range of markets—the results are outlined in Figure 3. Almost 29% of companies described themselves as experienced exporters to the new EU entrants (exporting to the region for more than five years) and this was just outweighed by the proportion saying they had come to the market more recently. While this is encouraging, it still leaves over two-fifths of firms with no experience of exporting to the new EU entrants. In addition, most of those which have no involvement in this market have at least some experience of exporting elsewhere, including other emerging markets

10. Our survey evidence would, therefore, suggest that while many companies are exploiting the trade potential of the new EU members, there remains scope to increase the involvement of UK manufacturing in these markets. There are, for example, some considerable differences by firm size and by sector. Smaller companies (with less than 100 employees) are more likely to have no involvement or be less experienced in the new EU markets. Furthermore, this group is also less likely to see potential for growth in the region. Interestingly, these smaller companies expressed more interest in the growth potential of Eastern European economies outside the EU. From a sector perspective, machinery and transport equipment manufacturers tend to be the most experienced exporters to the new EU members. This tallies with the official statistics, which show that around half of UK goods exports to the eight new EU members from Central and Eastern Europe are generated from these sectors.

[14] EU-15 = UK, Ireland, France, Spain, Portugal, Belgium, Luxembourg, Netherlands, Germany, Denmark, Italy, Austria, Finland, Sweden and Greece.
EU-10 = Poland, Czech Republic, Slovakia, Slovenia, Hungary, Malta, Cyprus, Estonia, Latvia and Lithuania.

Figure 3

More companies trading with new EU entrants
% respondents by experience in overseas markets



Source: EEF/Barclays Export Survey 2007.

11. The opportunities presented by the addition of these countries to the EU go beyond trade. They are also potential locations for outsourcing and investment. In 2004 EEF conducted a survey[15] on the competitive challenges facing manufacturing and what strategies firms were putting in place to respond. Our analysis showed that of the firms that had located some manufacturing outside of the UK, 17% had chosen the new EU entrants as a location for production. A more recent (and as yet unpublished) survey showed that the new EU members were the second most popular destination after China for firms planning investments overseas in future.

12. A competent workforce, favourable business environment and better transport infrastructure contribute to the region's continued attractiveness for offshoring. Other surveys on FDI attractiveness show that the new EU members remain a popular choice. AT Kearny's FDI confidence index[16] places Poland, Hungary and the Czech Republic in the top fifteen most attract FDI locations—above France, Japan and South Korea. Even for companies that are seeking significant cost reductions through offshoring the new EU member can still compete with China. Research from the Boston Consulting Group[17] points to the longer lead times and greater variability in delivery times from China, often due to severe port congestion. It also shows that Central and Eastern Europe's higher productivity than developing Asia more than compensates for its higher labour costs.

13. It is worth noting that as the economies of the new EU members evolve so will the challenges and opportunities they present. While this enquiry is focusing primarily on the opportunities, the region will continue to pose a competitive threat to some industries. Furthermore, the nature of the challenge is a dynamic one. In the past trade and investment in this region has been concentrated in manufacturing—much of which has been of a low cost nature. As the economies of this region mature further, they will be seeking to diversify their stock of inward investment and to focus on competing for more, higher value-added investment opportunities.

14. In addition, further eastward expansion of the EU to take in, potentially, Turkey should not be overlooked. We have already noted that more firms see the potential for growth in Eastern Europe outside of the EU. The next possible expansion (to take in Turkey, Croatia and FYR Macedonia) is likely to be more significant than the one that brought Bulgaria and Romania into the EU club earlier this year. Adding Turkey to the EU's membership alone would add some 74 million to the population but the three countries in total would increase EU GDP by only 3%.

15. In terms of the number of foreign investment projects, the UK is the second largest investor in Turkey after Germany. And in 2005 the UK exported over £2bn worth of goods to Turkey. While much of its production is dominated by lower value-added sectors, such as the manufacture of textiles, the automotive industry is a growth area. Manufacturers are attracted by a plentiful, low cost labour supply and productivity that is higher than in most other Eastern European countries. It also has an advantageous geographical position, straddling both Europe and Asia. It is less dependent on the EU for trade than other Central and Eastern European economies (although it accounts for around half of Turkish exports) and counts the Middle East, Russia and the US as important trading partners.

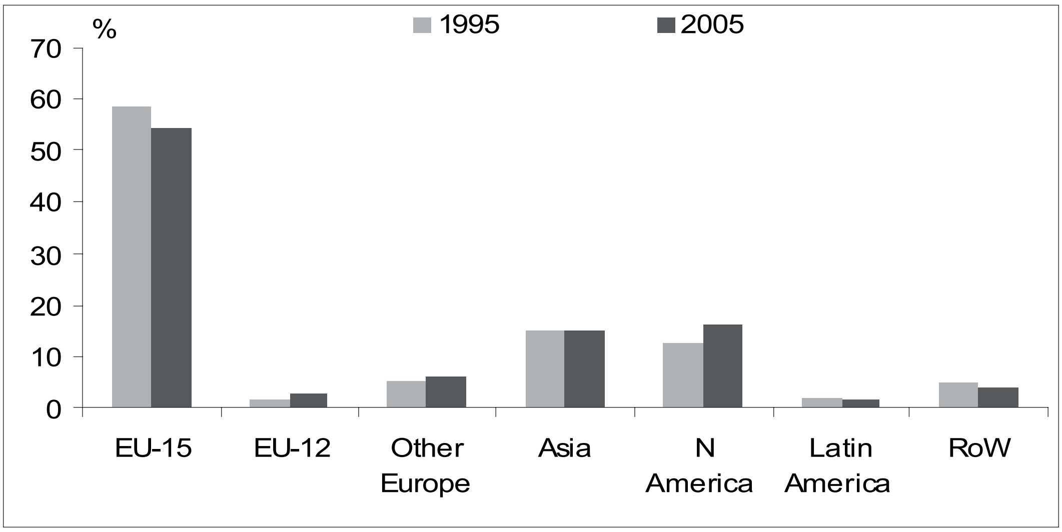
[15] EEF (2005) Where now for manufacturing?
[16] A T Kearney (2005) FDI Confidence Index.
[17] Boston Consulting Group (2006) Sourcing in Central and Eastern Europe: An Overlooked Opportunity.

What are the most promising areas for developing business? Is there potential for exporting more goods and services to these countries?

16. Our analysis shows that there is scope to increase the numbers of firms trading with the new EU members and the value of their exports. Despite the increase in awareness of these countries as potential markets and rise in numbers exporting to the region there has not been a significant reorientation in goods trade by destination, as illustrated in Figure 4.

Figure 4

Export-orientation little changed in past decade,
% of UK goods exports by market[18]

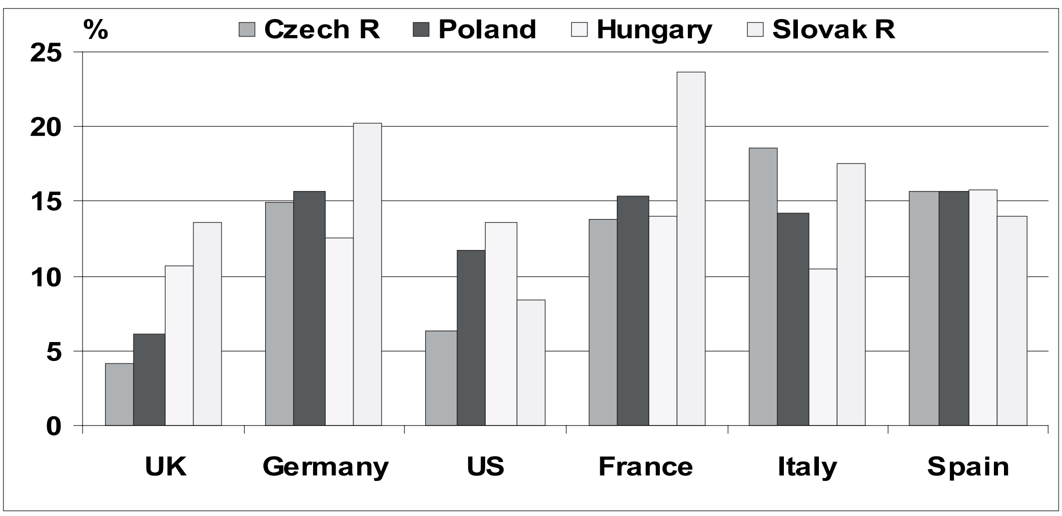


Source: National Statistics.

17. In addition, UK exports to Eastern Europe as a share of total exports are substantially less than that of countries such as Germany, Italy and even Spain. Around 15% of German export revenues and 14% of Italian export revenues are earned from Eastern Europe compared with about 5% for the UK. Germany's high share reflects its proximity and historical ties to some of the major countries in Eastern Europe but not all of the gap with other competitors can be explained by this. Exports from the UK to the region have also grown more slowly that those from other EU-15 nations (see Figure 5).

Figure 5

Slower growth in UK exports to new EU members,
Annual average% increase 2000–05



Source: IMF Direction of Trade Statistics.

[18] EU-15 = UK, Ireland, France, Spain, Portugal, Belgium, Luxembourg, Netherlands, Germany, Denmark, Italy, Austria, Finland, Sweden and Greece.
EU-12 = EU-10 plus Rumania and Bulgaria.

18. In terms of the most promising areas for further development, organisations such as UK Trade and Investment (UKTI) are better placed to identify specific areas of growth in export demand and how best UK companies can meet those demands. However, our survey from earlier this year suggest that all sectors across manufacturing see at least some future potential in the region going forward. This is likely to be not just merchandise exports, but also in engineering services. This is likely to include expertise in areas of environmental management and utilities as the new EU members and other emerging economies strive to comply with EU environmental and efficiency targets.

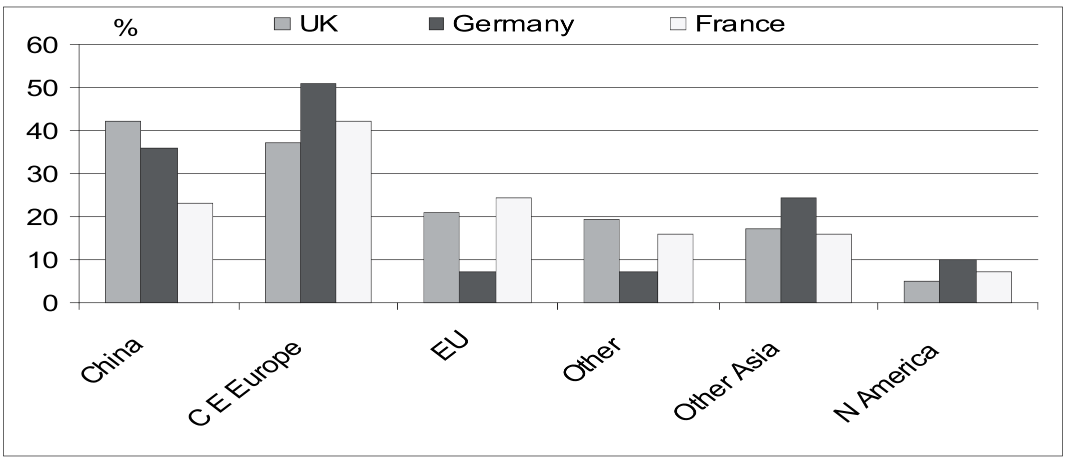
Where may the UK be losing out to competitors?

19. Other EU countries seem to have seized the trade opportunities presented by the new EU members to a greater extent than UK companies. While this is an important and fast growing region within the single market and relatively close to the UK, the new EU members represent only a very small share of the global market. On a purchasing power basis the new EU members account for only around 2% of the world's total output (a fraction more than South Korea).

20. It may also be the case that firms are overlooking the new EU members as a destination for offshoring production, preferring lower cost locations in the Far East. In fact, UK firms may have been somewhat slower to recognise the opportunities in Eastern Europe compared with some of their Western European counterparts. The potential opportunities in the new EU members were available to Western European firms some time before they acceded to the EU. Even in 2003, UK firms were less aware of the potential than French and German companies—as shown in Figure 6. This may explain why near neighbours—Germany, Austria and the Netherlands—have a larger investment presence and stronger trading links with the new EU members compared with UK companies.

Figure 6

UK companies view China as more significant investment opportunity,
% respondent citing regions as location for future investment



Source: EEF NOP Productivity Survey 2003

21. This raises questions about whether the trade promotion strategy at the time was sufficiently forward-looking. Economic restructuring, together with privatisation opportunities, were coming on stream many years before these countries formally became EU members. The fact that the UK may have lost some ground to other countries—in terms of both trade and investment—has implications for future trade promotion strategies. These relate to the opportunities and challenges presented by potential further EU enlargement and the type of goods and services that the previous batch of new entrants will be purchasing as their incomes rise.

What advantage might the UK draw from the existence of the skilled workforce in these countries?

22. The relatively high skill levels across the new EU members contribute to its higher levels of productivity relative to other lower cost locations. This could be an important factor for firms considering offshoring some manufacturing functions. The region could offer opportunities for co-location of research and development. R&D has become more international—previously R&D has been located in developed economies, but as companies have expanded around the globe to access new markets, R&D sites have been increasingly dispersed. Often this is to meet the requirements and tastes of local markets. In addition, the internationalisation of R&D has been driven by the emergence of countries with different or complementary skills and expertise.

23. The majority of UK firms carry out all their innovation activity at sites in the UK. Retaining control of the development of new technologies or the advancement of existing ones in the home country is vital to a successful economy and maintaining a vibrant manufacturing base. In some cases, companies will see the need to keep all or most of their R&D activity at home, particularly if they are concerned about protecting their intellectual property. Nevertheless, taking an international approach to research and development can allow companies potentially to increase the quantity and speed of innovation. Some international evidence suggests that firms are increasingly thinking about establishing some R&D capacity outside their home location. According to A T Kearney,[19] the Asia Pacific region is the most popular destination for firms planning to increase R&D investment abroad over the next three years, but is followed by Eastern Europe.

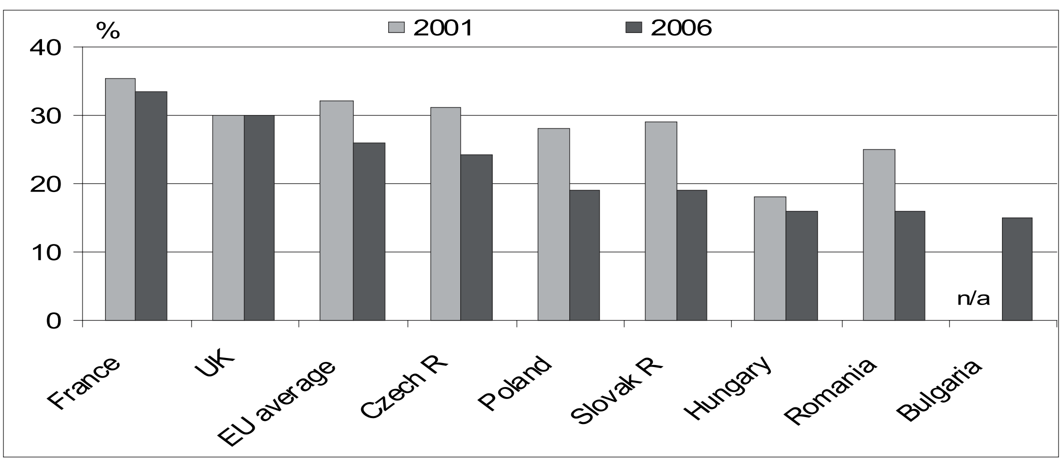
24. Nevertheless, the skilled workforce of the new member states is also likely to contribute to the changing nature of the competitive threat as these economies seek to move up the value chain. Many of the new members are making a start by promoting the opportunities for mobile R&D investments. In Hungary, for example, the government has identified R&D as a priority sector for foreign investment. Its investment promotion agency highlights the country's network of research institutions and existing foreign-funded R&D centres. It also offers generous incentives in the form of tax allowances and subsidies, for firms bringing not just production to Hungary, but also research activities. CzechInvest is similarly publicising the Czech government's commitment to providing an environment for R&D and innovation, access to technical universities and incentives for foreign investors. In future, these economies could increasingly be competing with the UK for these higher value-added investments. If the UK loses out to central and eastern Europe, there will be implications not just for new job creation, but also for the secondary benefits that investments like this can bring—such as spillovers from innovative foreign firms to the domestic sector.

What are the advantages and disadvantages of doing business there? Is it still easier to operate in western than in Eastern Europe; and, if so, why? What barriers exist?

25. Previous EEF research[20] showed that that skills, productivity and proximity to key suppliers were important for firms making the decision to offshore to the new EU entrants. In addition, some of the new members continue to offer incentives for some activities, which might add to its attractiveness as a location for investment. Some countries across the region have also reduced business taxes, which may provide a further draw for companies seeking to establish a presence there (see Figure 7). Proximity and the ability to operate within a similar regulatory framework will also have supported export activity. The new EU member states, therefore, have some advantages over Western Europe as business locations. However, at the moment they are perhaps competing to a greater extent with other lower cost locations for trade and investment. The new EU members are therefore likely to be similarly concerned about the competitiveness of their business environment relative to low cost countries outside Europe as their Western neighbours.

Figure 7

Lower tax rates in new members,
Corporate tax rates



Source: KPMG

[19] A T Kearney (2005) FDI Confidence Index.
[20] EEF (2005) Where now for manufacturing?

CONCLUSIONS

The new EU entrants have changed the economic landscape of Europe, with big implications for manufacturing. Both as markets for UK manufacturing, and as potential locations for activities, the impact of the accession of ten new member states between 2004 and 2007 is increasingly being felt. It is important that UK manufacturing is at the vanguard of these changes, and that we are in a position to make the most of the new opportunities and challenges.

16 March 2007

Memoranda submitted by Ernie Reading—Managing Director of SDG Group

1. Autoliv is the biggest seat belt/airbag producer in the world.

2. I am the MD of SDG group a subsidiary of Autoliv based in Milton Keynes but with satellite production units in Argentina, Estonia, Mexico, Poland, Thailand and Turkey.

3. Seven years ago we just based here in UK but recognised that we needed to change our strategy as the UK was from a high labour content work going to be in trouble. This was because we were neither high nor low labour cost country which is the worst of all positions as low would be competitive and high would generate investment to be cost effective but being in the middle meant we achieved none of these and would eventually be uncompetitive. The increasing cost of logistics was going to further add to our problems.

4. Our strategy was to move all high labour content and finishing operations to low labour cost countries to be near our eventual customers so hence our current position and next year we will open a unit in China.

5. Being in automotive is a cost down driver so we need to look at every saving possible, not just for the customer but to keep the competition from overtaking us. So our final strategy is to keep our Milton Keynes base as our centre of excellence and the high tech of our products with the satellites as high volume producers.

This should work but the flaws are the skill base here in UK as the quality of worker is far higher in Eastern Europe particularly in Hungary ,Poland and Romania. We have had to recruit in Poland for our technical operators here in UK as the quality just isn't there or available. Whoever decided to move what was around 7% of young people 15 years ago going to university to 43% today didn't do their homework. Who established that the market needs this output or even can differentiate between what is a good degree/ university and a poor one. We have taken the element that would have been apprentices /articled clerks/ trainees etc and put them into, in the main, poor quality universities raising their expectation with massive debt, vast dropout rates and the ones left in the 57% simply not up to meeting the needs of business. Who says when leaving university these graduates should not then be apprentices etc unfortunately they themselves will not accept this because government ministers have told them how much better off they will be now they can be the BOSS.

Now compare this to Wroclaw in Poland where we have our subsidiary. It is town of 638,000 inhabitants with 66% in working age of which 12% are unemployed. There are 22 universities with 130,000 students achieving an output of 22,000 MSc. graduates p.a.. On top of this they have a further 18,000 students in 49 high schools and 97.8% of all students speak English with 65.9% speaking German. All of whom are prepared to start at the bottom unlike the UK where they all want Gordon Brown's job. One of our trained engineers is now the plant manager in Autoliv's seat belt webbing plant in Romania who advises me that it is the same there with highly skilled workforce mainly graduates. On this basis we should be asking how long before we get overtaken.

There is little doubt in my mind Eastern Europe offers both a great potential market as well as a good source of highly educated and skilled labour force but the danger is that they will eventually together with Asia push the UK into a 3rd world position unless we radically and quickly rethink our education policy.

June 2007

Memorandum submitted by the Greater Manchester Chamber of Commerce

INTRODUCTION

Greater Manchester Chamber of Commerce (GMCC) welcomes the opportunity to share it's views with the Department of Trade & Industry's Select Committee on the impact of the "new" EU member states on UK business. As the largest Chamber of Commerce in the country, with over 5,000 members, we represent the biggest and best cross section of businesses in the Greater Manchester region.

New Opportunities for the UK

There are still very many opportunities that UK members can exploit in these countries. Opportunities in the 10 newest member states have not been fully utilised by the UK since their accession in 2004. There is potential for developing business further and increasing exports to these countries, especially due to the EU trading legislation. This allows a greater level of trade than free trade agreements negotiated with countries outside the EU. Furthermore, the two most recent countries that joined the EU in the 2007 stage of enlargement, Bulgaria and Romania, offer new opportunities for business expansion and increasing exports that might not have been previously considered due to lack of EU membership.

Promising Areas for Developing Business

There are many promising areas within the Central and Eastern European market, which have even been likened by a number of commentators to the Asian "Tiger" economies, in some cases. Each of the 10 newest EU member states are very different and of them the Czech Republic tends to be considered the most developed, with a highly educated workforce (99.9% literacy), yet low unemployment and wage levels. Companies who penetrated the market before 2004 have done very well. The main areas of success were engineering joint ventures or partnerships and consumer goods export. Slovakia is also very developed, but there is still capacity for development in manufacturing and exporting consumer goods from the UK.

There are a number of opportunities within the environmental sector, regeneration and development. One of the biggest issues in the majority of these countries is the environment, with land remediation (improving environment for redevelopment), recycling among projects of main concern. Brownfield regeneration is a priority for many local governments, so UK companies with environmental expertise have a great potential to establish partnerships and joint ventures, which are central to successful developments in these countries.

A big incentive is the ERDF funds in these regions, but most are administered via the public sector, so it is often vital for UK companies to have a local partner with a good level of knowledge and strong contacts. These regions receive a lot of ERDF funds dedicated to machinery improvement and upgrading of manufacturing plants, so there is scope for expansion in the manufacturing sector as well. One problem that stands out in eastern European markets is the lack of understanding on how to access EU funding. Various government organisations are struggling to understand the audit, monitoring and delivery side of EU funding. There is a vast amount of knowledge and experience within the UK with regards to securing EU funding and the development and management of EU funded projects and as such there are many opportunities within the EU for these types of organisations.

As these member states are diverse, each will require a different approach. However, one common trait among these countries is a similar business culture. Chamber members have cited the importance of meeting potential business partners in person. This applies mainly to the service exporting sector. Services such as finance, education and training have large potential once prospective local partners have been identified. Most of these countries have a lot of tourist resources which are not promoted enough so there is a lot of space for theme tourism, such as hiking tours, rock climbing, beauty treatment etc. Property development has been booming and there is space for developers with the expertise of environmentally friendly building.

Financial services offer large potential because there are still not enough mortgage systems to accommodate all consumer needs, and many Chamber members have expertise to exploit these opportunities. Imports from these countries into the UK are also very undeveloped. There is also a great potential for import from these regions in all sectors, for example, furniture from Lithuania, mineral water and beer from the Czech Republic, timber from Slovakia, etc.

UK Competitors

The enlargement of the EU in 2004 was regarded as quite contiguous. Adjacent countries to the new member states have received the greatest benefits, but the UK, on the other hand, has been slow to identify the importance of new EU markets. In the example of the Czech Republic, foreign direct investment into the country almost doubled in 2003, of which the UK was only a 4% partner at the time. Even so, this still totalled in excess of £1bn, which illustrates how wide the scope for business development is in this region.

UK member companies have shown to be somewhat short of knowledge on the countries or in some cases oblivious to the opportunities that are available in them. The UK are losing out in getting their expertise to the market at the right time. Italy, Germany and France assisted the various accession countries before they joined the EU. When the countries and markets were ready to join, relationships within the country had already been built, making it difficult for the UK to develop new consortiums with local public and private organisations.

In competition terms, one of the most significant problems for businesses is that the UK is not part of the Eurozone. This makes for a more difficult comparison for companies interested in foreign direct investment into Europe. The exchange rate also increases risk for UK based companies when compared to the large size of the Eurozone, and the strength of the pound can make it difficult for exporters to compete on a global scale.

The geographic location of the UK can have an impact on business. The island is separated from the rest of the EU by the English Channel, which makes the logistics and transport of goods or raw materials to and from the EU more expensive. Even so, the UK can still trade freely within the EU and the only member state with which it has not significantly increased its balance of trade has been Greece.

UK products have a very good reputation in Central and Eastern Europe. However, German business are very well established in most of these regions mainly due to the geographical proximity and knowledge of these markets. Knowledge transfer, joint research and product development are areas that the UK has a very solid foundation in, but companies are not doing enough in this sphere to take such activities abroad to these areas where they would be useful and successful.

More recently, UK businesses have become increasingly involved with countries as they prepared set to join the EU in 2007. The number of UK investors in Romania doubled in 2005, with a Vodafone deal in particular making the UK the number one investor in Romania in that year. Bulgaria is also an attractive area for investment due to its stable economic and political outlook, high level of education and low tax and labour costs.

Eastern Business Advantages

Eastern EU member states can be seen to contrast those in the west in a number of ways. These differences give some countries a competitive edge that attract inward investment and trade, while others can create hurdles that businesses must surmount.

In recent years, legislation has also been adjusted to align more closely with that in the west, such as improved legal frameworks, simplified licensing, permit and registration regimes, and the adoption of International Accounting Standards (IAS). These will make the transition into these countries easier for businesses. Often these advantages can be purposefully created by governments for the sole purpose of encouraging businesses to invest, so businesses should be wary of the longevity of these benefits.

Slovakia has an excellent strategic position within the eastern European Union. Bordered by five countries (four of which are EU member states,) Slovakia can be seen as a gateway to eastern Europe and the Balkans, especially with its impressive infrastructure featuring a dense road network, as well as rail system, water/ship ways and numerous airports.

One of the most significant cost benefits is the cheap land available in these areas, especially considering the short supply, and therefore expensive prices of, land in the west, particularly in the UK. These factors, coupled with low tax levels and other tax structure incentives, gives eastern EU member states a multitude of advantages for business investment over western member states.

These examples demonstrate the best aspects of eastern Europe, which are comparable to those in western European countries. It is worth noting that recent advancement in these areas, especially in economic terms, have often been at rapid rates. This illustrates one of the main differences from the west, and explains why there are so many more gaps in markets and spare capacity for growth, although there are risks, such as inflationary pressures in economically booming regions.

Eastern Europe vs Western Europe

Western workers tend to demand a higher wage than those in the east, but the job types are also frequently different, with more focus on the service sectors, such as finance, and other more highly skilled work. Trumeter, a Chamber member company, are a UK based manufacturer that moved most of its manufacturing facilities to Asia, and some other operations to Czech Republic, purely to reduce cost. They did, however, retain some manufacturing, but most importantly their research and development facilities, in the UK due to the more highly skilled workforce.

Particularly frequent complaints often relate to the time and money spent complying with laws, tax regimes, and legislation. It is worth noting that these regimes are not necessarily worse than those existing within the UK, they are simply different. Consequently any attempts to engage with these markets must be pre-empted by a detailed knowledge. Furthermore, the various rates of interest across the EU states adversely affect payback and business transactions in general.

One member company found that that they had been slandered by a business competitor. This type of problem is by no means unique to countries within the accession states, however in this instance the legal process was excruciatingly slow, causing them to lose business in the meantime. Obtaining an injunction against the competitor who had slandered them also took a particularly long time. Another business had trouble attempting to claim VAT back which they had paid out on legitimate business expenses, it was time-consuming and required a lot of form-filling. The different tax and legal regimes in the various member states can adversely affect the cash-flow of an SME.

A UK company was seeking to expand its activities into the accession states but first wanted clarity on the Commercial Agents Regulations in the new countries. As none of these countries had, at that time, adopted the Directive this meant the plans for expansion were halted, as the firm could not confidently appoint agents in the new countries.

Barriers to Entry

Cultural differences need to be recognised and understood, especially when conducting business with central and eastern EU members, in order to limit incompatibility. In addition, the political environment in some of these countries is very complex and differs greatly from country to country.

A Manchester based regeneration consultancy established very close links with Czech Invest and hosted a number of their delegations here as well as participated in a number of conferences in the Czech Republic. Czech Invest was very close to commissioning a high value regeneration consultancy project with this company, but the Prime minister replaced the Czech Invest Managing Director with a more politically stable candidate, causing the whole regeneration department to resign so the company lost their project. This is just one example of the political instability present in some of the regions.

Implications that can impede trading and business can include cultural differences and language barriers. Furthermore a non-UK or EU passport holder may find it difficult to obtain an EU pass and will not be able to travel freely state to state. This is a problem cited on numerous occasions by our members, with business partners unable to join their UK passport holding counterparts trying to generate business opportunities abroad.

Skilled Workforce

UK member businesses are becoming increasingly reliant on the import of skilled workers from new EU member states, ranging from local plumbers operating independently to welders and system engineers providing support for manufacturers. This trend is a direct consequence of two factors.

Firstly, there is a lack of specialised skilled workers available to many businesses in the UK—a skills gap that has been constricting labour market supply and pushing costs upwards for UK firms. Secondly, workers from the new states who have been keen to emigrate in search of work are likely to be some of the best workers from these areas, as it is those with higher skill levels and stronger work ethics that stand a better chance of securing employment overseas, especially in more developed economies.

Many of the new EU member states have a highly educated workforce. Bulgaria, one of the two countries approved for EU membership in January 2007, has outstanding human capital, as Bulgarians have been ranked second in international IQ tests by MENSA International and they also come second in the world in SAT scores. Despite this, hourly labour costs are the lowest of the ten newest EU member states, at the equivalent of €1.35 per hour.

The UK economy is operating at almost full employment levels. Whilst unemployment still exists, retraining those unemployed is increasingly difficult. Many remain affected by complex social and economic problems such as third generation worthlessness or a fundamental lack of training education or skills. Returning to work for them remains a real difficulty. In the economies of new EU states there is not as much demand as there are workers, so they move in order to find employment. This is also often rewarded with higher pay. UK businesses take advantage of the EU by recruiting workers who are often more highly skilled, and on occasion more cost effective to employ, than those from the UK labour force.

Educational Institutions

There is scope for the UK's educational establishments and business to build relationships with students and educational institutions in eastern Europe by creating links through partnership working, for example, with individual institutions. This may prove somewhat difficult given current trends among UK businesses to retain more innovative activities, such as research & development, in the domestic base of their home country. Trumeter have chosen this approach in relation to new product development, despite the shift of most of their activities overseas. Further links can be generated by exchanging information on the skills needs of each sector more explicitly, inviting firms to take advantage of these opportunities.

Exploiting Synergies with these Economies

UK has a lot to offer and so does the east. West has money, technology and the east has available land, cheap labour, and a need for investors in order to help them improve their living standards and economic prospects in the country as a whole.

Businesses in UK can invest in potential areas where it may be derelict and increase property value as they will be introducing more jobs and the need for other investors to see it as a good investment point. However it will take time but there is good potential as these regions are like a blank canvas, where land is available, and transport routes can be built to their own accord, also since businesses in Europe have no barriers on trade and relations, goods, technology, raw materials etc can all be imported and exported freely.

May 2007

Memorandum submitted by the Herefordshire and Worcestershire Chamber of Commerce

Introduction

The Chamber of Commerce Herefordshire and Worcestershire is very pleased to have the opportunity to contribute on behalf of its member businesses to the inquiry that is being carried out by the Select Committee. International business has been an area of activity for Chambers of Commerce from their very early days. Of all the business support organisations ours is the only truly international brand. Chambers of Commerce exist in every country in the world, although their form and effectiveness will vary considerably depending on local circumstances.

Herefordshire and Worcestershire Chamber has been active in the markets of Central and Eastern Europe for many years. Certainly before the countries concerned applied for membership of the European Union.

The Chamber has a strong international trade team. The Chamber delivers services on behalf of UK Trade and Investment (UKTI) as well as organising and delivering other events and services. It provides one to one advice and guidance to businesses of all sizes, organises and escorts trade missions and market visits, develops programmes for inward trade missions coming to the area, processes export documentation and organises seminars and training courses for new and existing exporters and importers. The Chamber has also been the UKTI regional lead for trade with Poland, Czech Republic, Hungary, Bulgaria and Romania.

In 1999 the Chamber signed a cooperation agreement with Békés County in Hungary. This led to the exchange of information between the two and visits by reciprocal delegations to promote two way trade and investment and also the exchange of knowledge and information.

Similarly the Chamber has been at the forefront of the process that led to the establishment in 2004 of a regional twinning link between the West Midlands and Lower Silesia in Poland to develop business and economic cooperation. In addition a letter of intent was signed between the West Midlands and Lodzkie Region in Poland in February 2000.

The Committee's Questions

The following responses to the Committee's questions are made on the basis of responses from members and also on the Chamber's experience of working with many local businesses.

Is the UK exploiting the opportunities afforded by the accession of these countries to the EU?

UK businesses are increasingly exploiting the opportunities in the markets. The Chamber has noted that there has been a marked increase in activity and interest by businesses of all types since the countries joined the EU in 2004. This is welcome, although there is a little frustration given that the Chamber has been trying to encourage greater interest in these markets for many years prior to their accession.

It is notable that the majority of the businesses, particularly in this area, that are putting effort into these markets since accession are SMEs, which is very encouraging. Many of the larger businesses had already explored the opportunities for them and invested in the accession countries.

There is no doubt that while all the new markets offer opportunities offer opportunities for UK business, some markets are stronger than others. Poland has certainly shown the most growth and has been very open to exploiting opportunities for two way trade, discussing investment and cooperation in a variety of fields.

In its forward plan UKTI has identified a number of high growth markets on which it intends to concentrate its efforts. These include Brazil, China, India and Russia. The Chamber believes that these markets are very important to the UK and agrees that support for UK business needs to be focussed on them. However, we are disappointed that none of the new accession states are identified for special support, not even Poland, which has demonstrated significant levels of growth.

Of the ten new EU members, only Poland and the Czech Republic feature among the top 30 UK export markets and import sources. However, both are showing some significant growth. The Czech Republic was not one of the top 30 export markets before 2006, but in that year it entered at number 30, while Poland moved from Position 26 to position 17, the highest percentage rise of any market.

As a source of products to import into the UK the Czech Republic moved from position 29 to 27 and Poland moved from 25 to 18. The following table shows the value of the trade with comparisons for China, India and Russia.

	UK EXPORTS				UK IMPORTS			
	2006		2005		2006		2005	
Country	*Ranking*	*Value*	*Ranking*	*Value*	*Ranking*	*Value*	*Ranking*	*Value*
Czech Rep	30	1.57	—	—	27	2.60	29	1.88
Poland	17	2.79	26	1.65	18	4.02	25	2.32
China	14	3.26	15	2.81	6	15.27	6	12.96
India	18	2.69	16	2.80	23	3.13	22	2.78
Russia	25	2.05	23	1.90	15	5.75	14	5.01

Source: UK Office of National Statistics. Export and import values in £ billions. Rankings show position of each market in UK top 30 markets for exports and imports.

Therefore between 2005 and 2006 UK exports to Poland increased year on year by £1.14 billion, our exports to China increased by £0.45 billion, to Russia by £0.15 billion and our exports to India saw a decline of £0.11 billion.

What are the most promising areas for developing business? Is there potential for exporting more goods and services to these countries? Where may the UK be losing out to the competition?

There are many opportunities in the new member states and our international trade team have helped a very diverse range of businesses to explore the markets. The British Embassies produce useful analyses to show sectors that have particular opportunities and while theses are drawn to the attention of businesses making enquiries it does not follow that a product or service that does not figure on them can not find a market with some determined effort.

Particular sectors that we would see have opportunities, with some variation between the states in question are, consumer goods, construction—equipment and services, professional services and the development of outsourcing, both within companies in the markets them selves and as outsourcing hubs for the wider sections of the EU market place.

One of the issues that UK companies need to consider is that it may take time to establish their name and brand in the market and that it can take time to change the attitudes of customers. This may be particularly the case when a product may seem to the consumer similar to products they are familiar with and the main difference may be in quality.

For example, there is a growing DIY market in many of the countries, notably Poland. Harris Brush, the well known UK manufacturer of quality paint brushes has found that private individuals are used to buying cheaper products which last for a shorter time, and it will take time to get the message across that paying more for their brushes can be an investment because they will help to give you a better finish and last longer. Equally, the professional decorators do not know the name "Harris" and so tend to stick with the brands they are used to. For Harris and for many other businesses there may need to be a long term campaign to educate and change attitudes before significant market share is obtained.

Many of the businesses in the new member states are making rapid developments. A Polish businessman said recently to a Chamber representative that "During the last five years, we have made advances that took you thirty years in the West and we must do the same in the next five years."

The speed of development is both a challenge and an opportunity. It is a challenge for the UK to ensure that we do not find we have been left behind and it is an opportunity because we can provide support and advice to businesses and organisations in the new markets that wish to develop. Many UK professional businesses and consultants have the chance to offer their services and expertise in these markets. Other firms in a variety of sectors may also be able to become involved to assist the development of businesses that seek to make up the time they feel they have lost and catch up with their western neighbours.

However, it is important for the development of this market in services, and for the wider issue of protecting the interests of UK business, that there is an even implementation of the EU Services Directive. The Directive has been supported by Chambers of Commerce because it will help to open up the market for services across the whole of the European Union. There is concern that the implementation of the Directive across the whole of the Union is not proceeding evenly.

The British Chambers of Commerce, speaking on behalf of the Chamber network, and several individual Chambers, including Herefordshire and Worcestershire, have made our concerns on this matter clear to the UK government. It is possible that the DTI is proceeding efficiently with the implementation of the Directive in the UK and that this is faster than the progress being made in other members states. The result would be that the UK market is open to competition, but the markets of other member states, and not just the ten new members, are not as open to UK business. That situation would be unacceptable.

What advantages might the UK draw from the existence of the skilled workforce in these countries?

British businesses that chose to establish themselves in these markets find the existence of an educated and enthusiastic workforce a significant advantage. They are able to take on a wide range of tasks and have proved adaptable and willing to accept training.

It has been observed that while a few years ago, a UK business establishing itself in one of these countries would almost always install UK management, it is increasingly the case that managerial positions are now filled by local people.

Is there scope for the UK's educational establishments and businesses to build relationships with students and educational institutions in Eastern Europe? How could the UK and these countries pool their scientific and technical know how to reap the maximum benefit for all concerned?

Higher education institutions in the West Midlands are already very active in developing links in the new member states. This is both to show what they have to offer to students that increasingly wish to study in the UK but also to develop collaborative projects in a variety of fields.

The Universities of Worcester, Birmingham, Coventry, Warwick and Central England have already got established and growing links in some of the new member states. Several projects are now being pursued that will help to develop new technologies. This Chamber of Commerce is collaborating with the University of Worcester on several projects, which may expand into European wide projects that will enable us to work with Chamber and University partners in several member states including within the new ten.

Herefordshire and Worcestershire Chamber has been working with the British Chambers of Commerce network on a proposal that would use the business outreach that is offered by the Chamber of Commerce network as a route to market for the research base in the UK in both the university, defence and other research institutions. At present discussions are taking place at UK level but there are undoubtedly opportunities for this model to work on a Europe wide basis.

What are the advantages and disadvantages of doing business there? Is it still easier to operate in Western than Eastern Europe; and, if so, why? What barriers exist? How could the UK exploit any synergies with the economies of these countries?

The number of barriers are decreasing and the positive attitude towards working with the UK and other established member states which exists in the countries concerned undoubtedly helps. Equally, the accession of the ten to the EU has, as was mentioned earlier, stimulated an upsurge in interest by UK businesses perceiving that they are now part of the home European market.

However, real barriers do still exist. The private sector in the accession ten is moving faster to modernise and embrace a European or world view than the public sectors. Governments within the accession ten are moving slower to change and the weight of bureaucracy, while easing at varying rates, still has elements of the state control that characterised their economies for so long.

Several of our member companies have complained about the slowness of the systems with which they have to work if they are involved with any aspect of the government systems. For example, a member business in financial services seeking to establish a base in Poland found the time and paper work involved in registering a company and then registering for VAT took many months.

However, several member states in western Europe have a more complex registration system than the UK, which does have a very straightforward system for establishing a new business. This point has been made in conversations by several business people from central and eastern Europe, commenting favourably on the clarity and ease of the UK system.

These issues emphasise the importance of the principles behind the Services Directive. All member states should be looking at the barriers that are preventing the establishment of cross border trade in services. We believe that changing the thinking that applies to the provision of services will help to identify barriers in general to the development of trade between member states.

Real advantages exist in doing business in the accession ten. There is a genuine enthusiasm among individuals and businesses to see their business and their markets develop and grow, the workforce is educated and hardworking, and we should not forget the fact that English is very widely spoken. In addition, there is admiration for the UK among many people and in some countries there is still a relationship existing from the second world war.

There are very positive personal links that exist between the UK and several of the new states, especially Poland, because of the numbers of families in the UK that have a Polish connection. The fall of communism and more recently the candidature, and then accession, of these states to the EU has reinvigorated many of these family ties. Low cost air fares and improved transport and communication links have meant that the exchange of both information and people between the UK, Poland and other states has grown hugely. These relationships provide a very positive atmosphere in which business can develop.

The flow of migrant labour into the UK has been valuable in helping to fill vacancies for both skilled and skilled posts that local firms were finding difficult. Without glossing over the concerns of many people arising from the scale of the migration, the impact economically has generally been very positive.

In the north of Worcestershire in particular around Kidderminster, there is a large Polish community, with its origins in the settlement of people in the area after the second world war.

Schools, including first and junior schools, have to take children that arrive with little or sometimes no English at all. The children generally learn quickly. It has been observed that other children will help them and the support of the local community has been excellent. The local education authority is also supportive but additional financial support for schools is not available until there are a certain number of children in the school for whom English is an additional language. Schools need assistance when the first child arrives.

Conclusion

It is the Chamber's view that the new member states provide excellent business opportunities for the UK and we are pleased that we have been able to help many businesses in Herefordshire and Worcestershire and indeed the wider region to develop their business there.

Opportunities exist because of the demand from consumers and also from the demands of business to develop and grow. The rate of growth and development of the liberated private sector in the accession ten is challenging and worthy and admirable.

These markets have the advantage of being able to learn from the mistakes of others. In many areas they can see what has worked or not worked in other markets and choose the best for them. It is this process of learning that has helped them to make achieve the astonishing rate of progress that they have. It is important that we encourage greater engagement by UK businesses with these markets so that we can build on the good relations that exist for our mutual economic benefit. It is also important that we do not become complacent about our own strength and position or we may find that we are being over taken.

In this respect, it is worth repeating a recent quote from Reinhardt Hild, Economist with Ifo Institute for Economic Research at the University of Munich. "The Polish economy may overtake the German one in 10 years with regard to labour efficiency. The task will be very difficult indeed, as it will require among others additional investments in education and vocational training, Poland will be substantially supported by the EU structural funds".

The challenges to the UK economy are clearly great but can be met if we are willing to commit ourselves to the task

May 2007

Memorandum submitted by the Hungarian Embassy in UK

We refer to your letter of 15 March, 2007 regarding the Trade & Industry Committee's inquiry into the impact of the "new" EU Member States on UK business.

As requested, we have drawn the inquiry to the attention of a few non-governmental organisations in Hungary including the British Chamber of Commerce in Hungary (BCCH), the Confederation of Hungarian Industries (MGyOSZ) and the Hungarian Chamber of Commerce (MKIK) which may have sent their views to the Committee in the meantime directly.

As for particular aspects of business relationships between the UK and Hungary / for example, areas in which our Government feels there could be substantial benefit from greater trade or closer business ties or co-operation in R&D—we have also consulted with various government agencies including ITDH, the Hungarian government's investment and trade development agency and NKTH, the agency responsible for research and technology.

We shall be pleased to discuss these views during the Committee hearing today but we have felt it useful to summarise the key points also in writing here, for ease of reference along the lines of your questions as listed in your letter.

Is the UK exploiting the opportunities offered by the accession of these countries to the EU?

— It was not the accession date in 2004 that brought a breakthrough in British-Hungarian trade relations. Trade turnover had significantly increased since the early nineties when a) administrative trade barriers were gradually abolished after Hungary had signed the Europe Agreement; b) several British companies set up companies in Hungary and started business activities.

Britain's trade with some Central European countries are shown in the following table.

	Poland		Czech Rep		Hungary	
	Export	*Import*	*Export*	*Import*	*Export*	*Import*
2002	1,318	1,265	1,031	1,250	750	846
2003	1,462	1,545	1,003	1,412	856	1,120
2004	1,413	1,834	975	1,291	933	1,579
2005	1,653	2,318	1,080	1,883	834	1,859
2006	2,806	4,093	1,581	2,575	858	2,102

As shown, whilst Britain's import from these countries grew considerably, its export growth lagged behind.

Britain's modest export performance may be the result of a combination of several factors including:

- Central Europe is still considered as a remote and "exotic" area for British business;
- the lack of a British retail bank in the region;
- the lack of "perseverance" of British SMEs: slow response from potential business partners (often caused by language difficulties) or if there are no immediate business results after initial contacts no further efforts are made; and
- it seems, UKTI's priority areas currently include other strategic regions and fewer trade promotional instruments are offered to British SMEs wishing to do business in the Central European region.

As far as British investments are concerned we have found that these represent about 6% of total Hungarian FDI stock. We believe that this share could be significantly increased if the benefits Hungary offers to foreign investors could be made widely known in the UK. We recognize the important role UKTI and other British institutions may play in this process.

What are the most promising areas for developing business? Is there potential for exporting more goods and services to these countries?

Considering the open nature of the Hungarian economy there is a permanent need for imports of a very wide range of products. British companies, products and services enjoy a generally favourable reputation.

British companies should look at Central Europe as a region and not as a bunch of small, ethnically divided states. With the accession of Romania and Bulgaria this is a market of about 100 million people with huge potentials particularly in the following areas:

- Selling and buying goods and services: biotech, ITC, automotive, electronics, quality merchandise;
- Subcontracting, outsourcing: engineering, contract research, prototypes, small series production, high value added products, software development;
- Logistics operations: distribution centres, warehousing, transport facilities;
- Shared services centres: regional corporate headquarters, call centres, back-office services;
- PPP/PFI initiatives: roads, water, sewage, waste management, urban and industrial regeneration, alternative energy utilisation; and
- Property development: housing, tourism facilities, airports, health & care facilities.

Where may the UK be losing out to competitors?

For a neutral observer it may seem that governments of some other EU15 countries provide a more effective and consistent assistance to their SMEs to perform at these very competitive markets, where prices often override other conditions.

British companies are quite ignorant of the enormous opportunities offered by public procurement tenders and, as pointed out earlier, need more perseverance in their marketing activities.

What advantage might the UK draw from the existence of the skilled workforce in these countries?

Production costs in the UK are increasing in spite of the influx of skilled labour from Poland and other Central European countries. By relocating certain high value-added activities such as contract research, prototype and tool making, small series production, etc. to Hungary, UK companies could maintain the high standards required while keeping production costs at a competitive level.

Is there scope for the UK's educational establishments and businesses to build relationships with students and educational institutions in Eastern Europe? How could the UK and these countries pool their scientific and technical know-how to reap the maximum benefit for all concerned?

British educational institutions have already established excellent partnership with their Hungarian counterparts in many areas.

As mentioned earlier, using Hungarian facilities and skilled workforce in joint research, development and innovation programmes eg in biotechnology, ICT and material sciences could reap high benefits for the UK. British companies should gain encouragement from good examples in life sciences including AstraZeneca conducting and coordinating all clinical trials in the Central-Eastern European region from Hungary, or GlaxoSmithKline investing in a large vaccine production plant and associated research and development.

What are the advantages and disadvantages of doing business there? Is it still easier to operate in western than in eastern Europe; and, if so, why? What barriers exist?

Hungary's main attractions for foreign business are her central geographical location and the advanced logistics infrastructure with EU-defined transport corridors which enable the country to serve as a trade post and logistical hub for the entire Central, Eastern and Southern European region. These characteristics coupled with high educational standards and competitive labour costs, and the traditional creativity and resourcefulness of Hungarians have made the country one of the favourite business locations in Europe.

The Hungarian legal framework provides a secure climate for business and guarantees the full repatriation of profits. Hungarian intellectual property laws are now harmonised with the EU and also apply product patent, Supplementary Protection Certificate (SPC) and Data Exclusivity (DE) which were long-standing issues especially in the pharmaceutical industry.

The Hungarian government is well aware of the difficulties foreign businesses may face when running a business in Hungary and intends to introduce a series of measures to simplify business procedures.

We trust these answers, together with our verbal contributions, plus the findings of the Committee's forthcoming visit to Hungary will provide a clear and comprehensive view on the prospects of British-Hungarian business relations for the inquiry.

19 June 2007

Memorandum submitted by Intellect

Background

Intellect is the UK trade association for the IT, telecoms and electronics industries. Its members account for over 80% of these markets and include blue-chip multinationals as well as early stage technology companies. These industries together generate around 10% of UK GDP and 15% of UK trade. Intellect is a vital source of knowledge and expertise on all aspects of the hi-tech industry.

The following paper provides the initial views of Intellect member companies on the impact of the new EU Member States on UK business.

Intellect welcomes the opportunity to provide input to the committee and looks forward to a programme of continual engagement with relevant government departments, agencies and other stakeholders on this and related issues.

Introduction

This paper gives Intellect's view of the impact of the new EU member states (the Accession 10 or A-10) on its membership. A significant number of Intellect's members are active in Eastern Europe, and this submission draws on their experiences. This submission addresses those issues raised by the Committee's call for evidence that are of relevance to Intellect's members, and also raises issues that Intellect believes it is important to address in this inquiry.

In this paper, the term offshoring refers to the practice of moving a business function from the country where a company operates to another country. The term outsourcing refers to the practice of acquiring a business function through an external provider, which is provided as a service. It is important that these two terms are understood as separate and distinct business practices: you can outsource without offshoring; and by the same token, you can offshore without outsourcing.

Intellect's Position

Intellect believes that the new member states in Eastern Europe, the A-10, provide an excellent opportunity in the short to medium term for Intellect members specifically, and the wider UK economy generally. There are a number of benefits to using these states as offshoring ("nearshoring") locations, for both majors as well as SMEs, and there is potential for UK business to export a number of services to these growing economies. The skills available in these states will also assist UK businesses in filling the skills gap created by the strong growth in the UK IT economy and a reducing number of IT graduates being produced in the UK.

There are a number of issues, however, that should be addressed in order for Intellect members and the wider UK economy to make the most of the opportunity. Most importantly, more work needs to be undertaken to better understand and communicate positively the real benefits of offshoring to the UK economy; Intellect is calling for a comprehensive review by the DTI/HMT to cover this issue. There also needs to be a programme of education and engagement to inform SMEs in the UK of the opportunities that exist in the new states, and also of the benefits of offshoring more generally.

1. *Benefits of Offshoring*

Intellect members know that outsourcing and offshoring are beneficial to individual companies and the economy as a whole. The majority of the global IT majors (most of whom, including those of Indian ownership, are members of Intellect) are developing global sourcing capabilities that include operations in the A-10 states. They are motivated by the need to access a wider talent pool, and the need to maintain a globally competitive cost base. The UK is a strong net exporter of IT technical services, of professional services such as architectural engineering services, and financial and insurance services, which are all rich in enabling IT. While the assumption is that outsourcing, offshoring and captive offshore operations must improve the competitiveness of the UK economy, there is little objective data on the issue. It is possible that this lack of information underpins a low key and defensive government and political attitude to offshoring. Given the contribution that these service sectors make to the UK economy, and their increasing importance in a globalising world, we believe it to be vital that further work is undertaken to understand the effects of outsourcing and offshoring on the UK economy.

Therefore, Intellect recommends a comprehensive review of offshoring by Government. This review would include the effects of not only offshoring to India, but also of nearshoring to Eastern Europe, to the A-10 states. For industry, the government and the public to understand the real effects of outsourcing and offshoring it is important that accurate, objective data is produced to identify these effects.

2. *The Skills Issue*

The UK currently has a skills gap created by a reducing number of IT graduates coming through the education system. The consequences of the skills gap are wider than the terms of this inquiry; however, the accession of the new Member States provides an opportunity to fill this gap in the short term*. Graduates in these countries are technically highly competent, and can provide a pool of skilled graduates that UK businesses need. Further, these skills are cost-competitive compared to equivalently skilled and experienced graduates in the UK.

A related skills issue is that Eastern Europe produces a number of graduates who are "old-skilled". These individuals have technical capabilities on old, legacy systems that are still used in many Eastern European operations. These skills are of value to organisations in the UK as many will deal with legacy systems; however, there is a shortage of these skills in the UK; further, these skills are no longer taught on IT courses.

The drive by large IT firms in the UK to build extended global sourcing capabilities in part to access a wide skills pool requires an open and constructive attitude on the part of Government to the Inter Company Transfer (ICT) of employees. ICT should be treated as a natural process of international staff mobility within corporate global sourcing structures, and enables outside of immigration or work permit regulations. While the accession to the EU of the A-10 means that such staff mobility can become a norm within the EU, there is a growing risk of EU discrimination against staff whose "home country" is outside the EU. In intellect's view, UK competitiveness will increasingly depend upon open and free ICT staff mobility on a global basis, regardless of country of origin.

3. *Export Opportunities*

In the short and medium term, there is a significant opportunity for UK businesses to export a range of corporate services to Eastern Europe. Growing and modernising corporations in the new Member States require legal, accounting, engineering, educational and other services, most of which are now rich in applied IT.

Further, as organisations in these countries grow and their economies undergo a period of modernisation, the UK will benefit from the partnerships and commercial alliances now made by UK businesses. Engagement with business in the economies of the new members states should be encouraged, as the UK will reap the benefits in the medium to long term. Organisations from other countries will be investing, and it will be important for the UK to have taken advantage of this opportunity relative to other states.

4. *Opportunities for SMEs*

There are major opportunities in Eastern Europe for UK SMEs. Large firms require wider and more varied skill-sets for offshore operations, the availability of which are limited in the accession states. In comparison, SME offshoring requires smaller skill-sets that are more easily available. This makes SME offshoring a viable possibility in the new accession states. The cost competitiveness of these skills in the A-10 allows SMEs to become more competitive, and will be increasingly necessary as competitors also take advantage of the potential of the new EU member states. Further, Eastern Europe has a number of benefits compared to other offshoring locations: similar time zones provide a better alignment of working hours; proximity to the UK allows for one-day business trips; and there is a closer cultural alignment to the UK.

There is anecdotal evidence amongst Intellect members, however, that UK SMEs are not taking advantage of this opportunity as fully as possible. As noted above, large companies are already active in the new states, understand the opportunities, and know how to take advantage. UK SMEs, however, are not as active. This is mainly due to a lack of knowledge on the part of UK SMEs of the benefits of offshoring, and of the opportunities open to them in the expanded EU.

Intellect recommends that information be produced and actively promoted to UK SMEs to increase awareness of the benefits of offshoring, the opportunities of the new EU member states, and how to take advantage of these. It will be important that any guidance produced helps SMEs to not only understand the benefits of offshoring, but assists them in identifying where offshoring would be appropriate for their business. Intellect is addressing this issue, and is actively engaging its SME members to inform them of the potential for outsourcing and offshoring as methods to improve competitiveness.

5. *The Long-Term View*

In the short to medium term there will be opportunities created by the A-10 states. In the long-term, however, the opportunities are less clear. Offshore locations present a threat as well as an opportunity, especially for software companies. Currently, demand will continue to drive both onshore and offshore development. It will be important in the long-term, however, for more focus to be placed on those sectors that are in direct competition, such as software, so that the UK can remain globally competitive in the face of lower-cost competition.

A comprehensive review of the software industry in the UK is required if the sector is to remain globally competitive in the long term. It will be necessary for investment in research, training and best practice dissemination in order for the sector to remain competitive. This will only be possible, however, once the landscape of the software sector is understood.

Intellect believes a review of this nature to be essential to the future development and competitiveness of the UK software sector. As well as the direct effective on the UK economy of a dynamic and competitive software sector, there is a significant indirect benefit to the economy through the improved performance of software-enabled industries. As the leading technology trade association in the UK, Intellect would be pleased to assist the Government in any review, and would be happy to manage the work, but would require Government support to be able to do so.

Conclusion

The accession of the new member states to the EU provides a significant opportunity to Intellect members and the UK economy. Offshoring can provide a competitive edge for both large and SME organisations, and there are also opportunities for providing corporate services to growing companies.

More needs to be done, however, to identify and disseminate the benefits of offshoring generally to the UK economy. It is also necessary, in order for UK business and SMEs particularly to take advantage of this opportunity, to promote the opportunities that exist, and provide support to those SMEs that want to offshore. This is a significant opportunity for UK businesses, and a pro-active approach must be taken to ensure that UK businesses benefit, and not international competitors.

In addition, in the long term we must ensure that those sectors of our economy that compete directly with services offered in the A-10 states, in particular the software sector, receive the necessary support from Government in order to maintain their global competitiveness. Intellect is keen to engage with the DTI to discuss the approach that should be taken to developing a comprehensive review of the software sector.

March 2007

Memorandum submitted by the London Chamber of Commerce and Industry (LCCI)

Thank you for letter of the 24th of April asking the LCCI to contribute towards the inquiry into the impact of the "new" EU Member States on UK business. Please find below our responses on a select number of questions. We would welcome future correspondence from your office regarding other relevant select committee inquiries.

RESPONSE FROM THE INTERNATIONAL TRADE COMMITTEE AND THE SKILLS AND EMPLOYMENT FORUM OF THE LONDON CHAMBER OF COMMERCE

1. *Is the UK exploiting the opportunities afforded by the accession of these countries to the EU?*

There has certainly been increased interest shown in the new members in general, and the central and eastern European states in particular. In part this may have been triggered by our actions for our members and customers in producing fact sheets on the new entrants, as well as focusing on a number of these markets in London Chamber seminars and increased coverage in our magazine London Business Matters. This does not however mean that the UK is fully exploiting the opportunities and there is the opinion within our International Trade committee that more could be done.

2. *What are the most promising areas for developing business? Is there potential for exporting more goods and services to these countries?*

There is large potential for exporting more goods and services to these countries particularly in retail, consumer goods, and services.

5. *Is there scope for the UK's educational establishments and businesses to build relationships with students and educational institutions in Eastern Europe? How could the UK and these countries pool their scientific and technical know-how to reap the maximum benefit for all concerned?*

There is scope for UK educational establishments and businesses to build relationships with students and educational institutions in Eastern Europe. The UK is well placed to develop a range of work in this field. One member, London Metropolitan University, is currently part of a project that looks at developing the capacity of Higher Education Institutes to build their own sustainable Knowledge Transfer expertise and to develop collaboration with economic enterprises and small and medium sized enterprises in the Russian context. Although Russia is not an accession country similar projects could prove beneficial to both the UK and Eastern European. It would allow for knowledge transfer on an intra- and inter- country basis and could lead to other fruitful collaborations for both education providers and businesses. A critical element of any such project should be Student Enterprise programmes, both named degree courses, usually in Business and Management Departments and faculties, and a programme of enterprise activities open to students from all disciplines, linked to mentors and coaches from entrepreneurs and businesses.

6. *What are the advantages and disadvantages of doing business there? Is it still easier to operate in Western than in Eastern Europe; and, if so, why? What barriers exist?*

To quote from one member's response:

> The advantages of doing business in these countries, is that if you know what you are doing, have the right partners and get into the market quickly ahead of your competition, you can establish very successful and profitable businesses. However, if you delay or do not know what you are doing, or find the wrong partners, then you can suffer major problems and losses. It is still easier to operate in Western markets, although some Central European Countries are becoming easier. However one should never consider the Bloc as a whole, as all the countries are in varying stages of development and therefore some are easier than others. However, the language, culture and ways of doing business are quite difficult for UK companies that have no experience of these markets. There are varying barriers to entry and the DTI has not helped in the last few years by reducing its help to potential exporters to this part of the world. The most important factor for SMEs is to find the right partner and this can be quite difficult compared to Western Europe.

7. *How could the UK exploit any synergies with the economies of these countries?*

It is suggested that the UK needs more missions to these markets, especially for potential new exporters. Yet the DTI is reducing rather than expanding its support for missions.

29 May 2007

Memorandum submitted by the Ministry of Economy of the Republic of Lithuania

Q1. *What are the most promising areas for developing business?*

As a fast growing economy, Lithuania offers exciting investment opportunities for foreign businesses across a range of industries. Its well-developed infrastructure, skilled labor force, and excellent geographic location make it an attractive place for locating production facilities.

Lithuanian attractive business sectors are:

> ITT, Biotech, Lasers, Machinery and Electric Equipment Manufacture, Metal Processing & Transport Equipment Manufacture, Plastics, Furniture, Wood Processing and Paper Industry, Textile and Apparel, Food, Real Estate, Services.

ITT. Lithuania's ITT sector is one of the most promising sectors of the country's economy. The extremely fast development of information technologies and telecommunications relies on the overall rapid economic development of the country as well as on the implementation of projects related to IT infrastructure development using assistance from the EU Structural Funds.

Lithuanian IT solutions and products have received high awards in international IT competitions organized by Microsoft Corporation, Software Development Magazine, etc. Lithuanian IT companies closely cooperate with world's IT leaders.

Lithuania's IT sector branches—Information technologies (computers, servers, PCs, network components, access devices, data transmission solutions, infrastructure solutions, CD, DVD etc.), IT services and complex solutions (Internet, programming etc.) and Telecommunications services (mobile communication etc.).

Biotech. Lithuania is widely distinguished among Central and East European countries as an absolute leader in the field of biotechnology. Lithuanian biotech companies are regarded as the most advanced in Central and Eastern Europe and successfully compete in Europe and North America. International experts at Ernst &Young declare that Lithuanian biotechnology companies hold immense future development prospects. Lithuania's biotechnology firms, mainly concentrated in Vilnius, export products to 42 countries around the world and are rapidly expanding with the help of foreign investments.

Lithuania's biotech sector branches: biotechnological products intended for fundamental research, biopharmaceutical products, biotechnological products intended for environmental protection and biotechnological products intended for animal feed.

Laser. Lithuanian laser companies have over 50% of the world market for high-energy pica-second lasers, are leaders in global production of ultra-fast parametric light generators.

Lithuania's laser producers export laser technologies and devices to nearly 100 countries, including EU members, the US, Japan, Israel, and Switzerland, mostly for universities and corporate laboratories for scientific research purposes, aiming to further integrate lasers into machine tools and industrial equipment. Research centers in Vilnius employ and train a wide spectrum of laser physics specialists, who work with local companies and international institutions, including those from other EU states, NATO, and beyond.

Lithuania's lasers sector branches—lasers and laser technologies, medical, precision, and optical instruments and related services.

Machinery and electric equipment manufacture. Today Lithuanian electronics companies have quickly re-established themselves on the world market. The average labor productivity in Lithuania's machinery and electric equipment production sector grew 19% in 2005. In the three last years, the volume of accrued FDI grew almost 3 times in the sector. More than 90% of production is exported; exports cover more than 20 European countries. Lithuania is No.1 in refrigerator and freezer production and the largest LCD-screen TV producer in the Baltic States. Lithuania's machinery & electric equipment sector branches—electric equipment and appliances, radio, television and communications equipment and appliances, medical, precision and optical equipment.

Metal processing and transport equipment manufacture. A key to the sector's success is the supply of specific products to large foreign and local companies as well as the active modernization of production. Lithuanian companies in the transport component manufacturing industry design, research, and manufacture new products, for example, gas (LPG) equipment for motor vehicles, speed controllers for transport, cable harnesses, ventilators, containers, agricultural machinery etc.

Lithuanian metal processing and transport equipment companies supply various transport parts to companies such as Volkswagen, Volvo, SAAB, Renault, Yazaki which are known as demanding top quality and value.

Plastics. Lithuania's export-oriented plastics manufacturers (almost 45% of production is exported), already being the leaders in the local industry, are also becoming leaders in the region with 3 large plants in the Klaipeda Free Economic Zone. A cluster is being developed by approx. 20 dominant Lithuanian companies of the sector.

A dense network of R&D institutions in Lithuania, related to the plastics industry, provide the infrastructure for the development of new products and technologies, develop new packaging technologies and equipment, as well as educate and train packaging specialists.

Within the several previous years the local wood, furniture and paper industry has demonstrated brisk growth towards leading positions. Experts forecast annual growth of 15-20% of the furniture sector during the coming two years. New factories are under construction and the domestic demand is accelerating; the number of people employed within the sector is in excess of 50,000 and is steadily growing.

Locally manufactured furniture, wood, and paper products meet EU quality and design standards and are at the same time offered at very competitive prices, as confirmed by companies like IKEA, Laura Ashley, Habufa, Smurfit Kappa Group, SCA Packaging, Stora Enso, Ochoco Lumber and others, which are working with Lithuanian wood product manufacturers.

Lithuania's textile and apparel industry, maintaining a centuries-old tradition, today is actively investing into own brands and design, developing higher value added products. Lithuanian producers co-operate with well-known European companies such as Marzotto, Laura Ashley, Marks & Spencer, H&M, Adidas and many other world-famous brands.

Lithuanian textile manufacturers produce high-quality protective clothing for military, police and civil application, which fulfil the requirements of EN, NATO and NIJ standards as well as gear for ballistic protection. The test laboratory at the Lithuanian Textile Institute is accredited according to LST EN ISO/IEC 17025 standard to carry out more than 60 physical and chemical tests to determine the qualitative, hygiene and environmental parameters of textile materials being developed. Tests are carried out for Lithuanian textile enterprises and for customers from foreign companies.

The food industry accounts for a major share of the value added (17.2% in 2005) created by the Lithuanian manufacturing industry. The exports accounted for nearly 60% of the increase in the overall sales of food industry in 2005.

The dairy sector is particularly strong as the majority of Lithuanian producers comply with EU standards. In 2005 sales of the meat and fish processing sector increased by 28% compared with 2004. Lithuanian beer is widely known and appreciated for its taste and quality, wins top awards in international competitions. Exports of beer grew almost 52% in 2005.

Lithuania's real estate market is booming. The years 2005 and 2006 have seen considerable growth in office and retail markets, with a new trend to develop property in regional towns and smaller cities. Further developments of the office market are projected with growing demand for office space. The retail market also has big potential for further development, as there is a growing demand for modern retail space. Lithuania's geographic position between the West and the East offers a lot of opportunities for warehouse/logistic projects, and many such projects are being implemented. Lithuania's free economic zones also offer excellent conditions for warehouse/logistic project development.

Due to the increased number of incoming business travelers and tourists and the growing demand for hotel services, more and more foreign hotel chains are starting operations in Lithuania.

Lithuania's service sector is growing very fast and comprises 61% of Lithuania's GDP.

Lithuania maintains a well-developed network of services to support the launch or development of foreign business activities in Lithuania. Local business service centers as well as representatives of world-known business, human resources consultants, legal firms, call centers, public relations and marketing specialists as well as logistic and transport services providers are available in all Lithuania's regions.

2005 was a year of success for commercial banks, and profits of most banks reached record highs. Profits in the 1st quarter of 2006 were 48% higher than those during the same period of 2005. Banks admit that such record-breaking results exceed their expectations by far. The successful growth of Lithuania's banking sector mainly is due to the impressive growth of the loan portfolio and the consistent level of interest rates. In 2005, Lithuanian banks issued 54% more loans to their customers than in 2004.

Lithuania, as the geographical centre of Europe, is becoming an increasingly attractive tourist destination. In 2009 Vilnius, the capital of Lithuania, will be announced the European Capital of Culture—first among the capitals of the new EU states, and in 2011 the European Men's Basketball Championship will take place in Lithuania, therefore the number of foreign tourists in Lithuania is expected to rapidly grow in the coming years.

Q2. *Is there potential for exporting more goods and services to these countries?*

United Kingdom is an important Lithuania's foreign trade partner. In Lithuania's foreign trade, among EU-25, in 2006 United Kingdom ranked 9th in turnover, 7th in export and 11th in import. United Kingdom and Lithuania's trade relationship is dinamic and constantly growing in all parameters of foreign trade, though there is a tendency that export increases less than import and thus trade balance decreases. To illustrate this in concrete numbers: in 2006, as compared to 2005, turnover increased 21,9%, export increased only by 8% and import increased by 44,4%, therefore trade balance decreased again, but still remained positive. Respectively, in 2005, as compared to 2004, turnover increased by 14,5%, export increased by 12,3% and import increased by 18,4%. This short analysis of trade statistics reveals that Lithuania is more receptive of United Kingdom's goods than United Kingdom is of Lithuania's goods. Based on statistical data of previous years, the following goods are the most potential for United Kingdom to export to Lithuania: products of the chemical and allied industries (mostly terephthalic acid and its salts, ethylene glycol), textiles and textile articles (mostly woven fabrics containing polyester staple fibres, mixed with viscose staple fibres, dyed woven fabrics of yarn containing polyester filaments, artificial filament tow), machinery and mechanical appliances (mostly transmission apparatus incorporating reception apparatus for radio broadcasting or television, parts of electrical apparatus for line telephony or line telegraphy), vehicles and associated transport equipment (mostly motor vehicles with spark-ignition internal combustion reciprocating piston engine, road tractors for semi-trailers), base metals and articles of base metals (flat-rolled products of iron or steel, sections of iron or non-alloy steel).

Q3. *What advantage might the UK draw form the existence of skilled workforce in these countries?*

In 2005–06 years, 783.4 thousand pupils and students were studying in 1664 establishments of formal education; 41.5 thousand students became graduates from professional colleges, colleges and universities, therefrom 363 graduates are specialists in physical science, 375—specialists in mathematics and statistics, 939—in computing, 4,032 students are specialists in engineering and engineering trades, 1030—in manufacturing and processing and 1,772 graduates are specialists in architecture and building. In consideration of given statistical data Lithuania is developing its population skill set to match investors labor force requirements.

UK might draw advantage in skilled workforce and cost ratio, as average month salary in Lithuania is 480 Euro. Average of monthly salary of Industrial worker is 305 Euro, Officers—528 Euro, IT specialists—568 Euro and Engineers—434 Euro. Advantage also can be seen in preparation of specialists, which usually require additional investment in their primary specific education or skills; most of Lithuanian graduates already have required primary education or skills.

Q4. *What are the advantages and disadvantages of doing business there?*

To start and develop business in Lithuania is easy, safe and profitable. Lithuania has a modern banking and financial system. The modern banking technologies, such as e-banking, etc. are fully implemented in Lithuania. The costs of commercial loans from Lithuanian banks are among the lowest in Europe, ranging from 5.5% to 6% per year.

Lithuania offers excellent infrastructures for foreign businesses. Lithuania has 4 international airports with direct routes to most European cities, best roads in the Baltics, an ice-free sea port and an efficient railway system. Fast Internet is available in all Lithuania's regions; the number of mobile telephone network subscribers is just the same as the population of Lithuania.

Lithuania is a full member of NATO and the EU, Lithuanian laws are harmonized with those of the EU, the country offers unrestricted movement of capital and dividends. Lithuania pursues a stable and effective monetary policy.

Lithuania is the least expensive country to do business in the new EU-10 states, according to the results of the survey carried out by DHL in 2004. The Price runner 2004 report also named Lithuania as the least expensive country in Europe.

Lithuania pursues a low-tax policy. Lithuania's tax-to-GDP ratio in 2004 was 28.7%, the lowest in the EU. Corporate tax is only 15%. There are long tax holidays in Lithuania's Free Economic Zones.

Lithuanians are well known for their diligence and are praised by foreign business people for their high qualifications, loyalty and strong motivation. Lithuanian labor productivity / labor cost ratio is the highest in the Baltics and three times higher than the EU-15 average.

Lithuania promotes itself as an "investor ıfriendly" environment by supplying incentives and support network.

Lithuania's 2 Free Economic Zones are located in the country's economically important centers—Klaipeda and Kaunas—and provide extremely favorable conditions for developing business activities by offering prepared industrial sites with physical and/or legal infrastructure, support services, and tax incentives. Incentives in Lithuania's Free Economic Zones do not apply corporate tax for the first 6 years and a 50% corporate tax reduction for the next 10 years (applicable for investments exceeding EUR 1 million), road and real estate taxes and extensive application of 0% VAT.

The Government of Lithuania and the respective municipalities have selected 8 industrial sites which shall apply for EU Structural Funds to develop physical infrastructure (electricity, gas, sewerage, roads, etc). The industrial parks will be ready for businesses' use in 2008–09.

The size of the industrial parks will range from 50 to 210 ha and will be subdivided into smaller parcels corresponding to the investor requirements. The land will be leased to the investors for long-term periods at favorable prices. Infrastructure will be brought to the investor's land plot free of charge.

There is also a great interest in opportunities to afford business relationship in areas in which there is substantial benefit from business which is co-operated in R&D or innovations.

Lithuania's Science and Technology Parks seek to provide a comfortable environment for commercializing R&D activities and integrating business, science, and research by supporting knowledge transfers leading to the exploitation of research results and to the development of marketable products and services. Science and Technology Parks also seek to develop favourable infrastructure for the establishment of new innovative businesses in Lithuania and encourage the growth of existing ones engaged in the development of innovative technologies.

There were also established the Business incubators and other institutions for the support of small and medium business working in R&D and innovations. There are many of such companies which would be interested in cooperation with the companies from EU countries including also the United Kingdom. Please find useful links about business possibilities in the area of R&D or innovations: http://www.ukmin.lt/en/industry/innovations/links.php

Investment and Business Guarantees, INVEGA, a company established by the state, provides guarantees on bank and credit union loans as well as administers loan interest subsidies for small and medium-sized enterprises in need of business financing.

Both local and foreign businesses, having decided to expand their activity to the Lithuanian market, can apply for EU Structural Funds support. Support is provided to three categories of projects submitted by either public or private applicants: public projects, business investment projects and companies, research and technological development projects.

In comparison with the EU financial support for the years 2004-2006, when Lithuania received EUR 895 million, support for Lithuania for the period of 2007-2013 is more than 6 times bigger—EUR 5.981 billion.

The main impediments for the business in Lithuania might be: domestic market is relatively small, base of domestic suppliers is narrow. Also, the issues still to be solved for the further business development cover mainly lack of investment plots (industrial parks) with fully developed infrastructure, also investment incentives are still slightly applied, and the problem of bureaucracy is also in the agenda.

March 2007

Memorandum submitted by the Republic of Slovenia
Ministry of the Economy
Directorate for Foreign Economic Relations

CASE OF THE REPUBLIC OF SLOVENIA

Business Opportunities in Slovenia

Slovenia has a high-income developed economy which enjoys the highest GDP per capita of the newly joined EU countries, namely around 86% of the EU average. The country's relatively high rate of inflation declined to 2.3% by 2006 and is now comparable to the average of the European Union. Slovenia's economy has started to grow strongly in the last few years (5.2% in 2006, 4.0% in 2005, 4.4% in 2004, 4.8% 2007 forecast), after relatively slow growth in 2003 (2.7%). Overall, the country is on a sound economic footing.

In the economic structure of Slovenia in the year 2006, services hold 63.3% share, followed by industry and construction with 34.1% share, whereas agriculture represents 2.5% of GDP. Manufacturing activity has been performing with high dynamics, mainly deriving from export oriented sectors. On the other hand, among services domestic trade has been on the upward trend in the last period.

In 2006, Slovenian exports of goods totalled 16.8 billion euros, and imports amounted to 18.3 billion euros. Slovenia mainly exports motor vehicles and parts for them, machinery, electrical and electronic equipment, furniture and beddings, pharmaceutical and chemical products, paper and pulp products.

Table 1

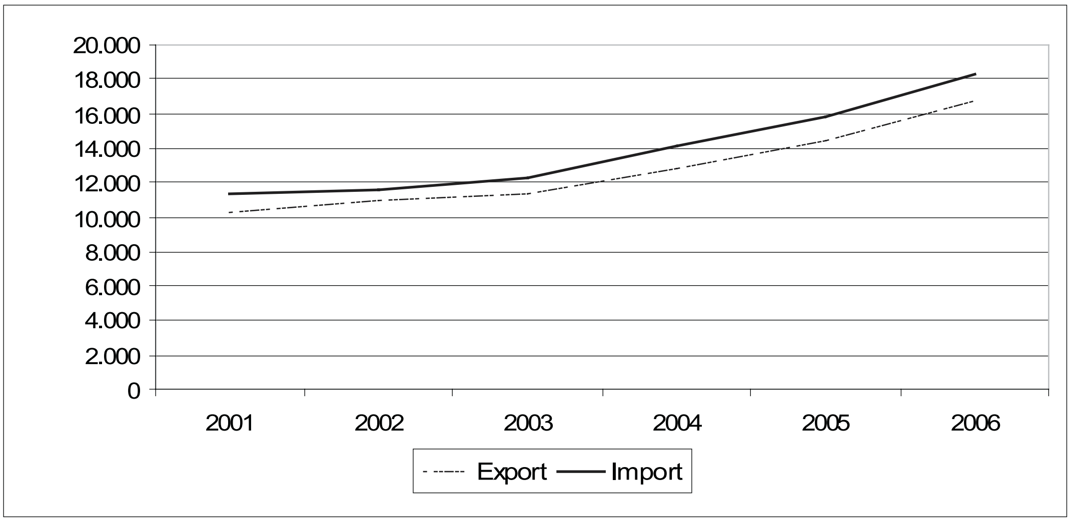
EXPORT AND IMPORT OF SLOVENIA (mill EUR)

	2001	*2002*	*2003*	*2004*	*2005*	*2006*	*I 06/05*
Export	10.347	10.962	11.285	12.783	14.397	16.761	116,4
Import	11.344	11.574	12.239	14.143	15.805	18.312	115,9
Sum	21.691	22.536	23.524	26.926	30.202	35.072	116,1

Source: SURS

Graph 1

Export and Import of Slovenia (mill EUR)



Due to the relative smallness of the Slovenian market, the Slovene economy has always been export oriented. Index of openness of the economy, measured by exports and imports of goods and services relative to annual gross domestic product, ranges at around 130% and is among the highest in Europe. The Slovene trade flows have been largely aimed at the EU-25 (around 68%) particularly Germany, Italy, Austria, and France, but in addition, Slovene economic relations are becoming increasingly diverse. Since Slovenia's membership in the EU we noticed increased exports to other EU member states which were not traditional and important export partners of Slovenia in the past. It is important to mention strong co-operation with the countries of the former Yugoslavia, to where more than 16% of total Slovene exports are directed, substantially larger presence in the markets of the United States and increasing co-operation with the countries of the former Soviet Union. With individual products, Slovenian companies have also opened the door to markets outside of Europe, especially in Asia.

During 2000, privatization was seen in the banking, telecommunications, and public utility sectors. Restrictions on foreign investment are slowly being dismantled, and foreign direct investment (FDI) is expected to increase over the next few years. Total size of FDI to Slovenia amounted 5.98 billion EUR on 31.12.2005. Main investor to Slovenia is Austria, followed by Switzerland, the Netherlands, France, German, Italy and Croatia. The UK was ranked 10th among main foreign investors to Slovenia at the end of 2005.

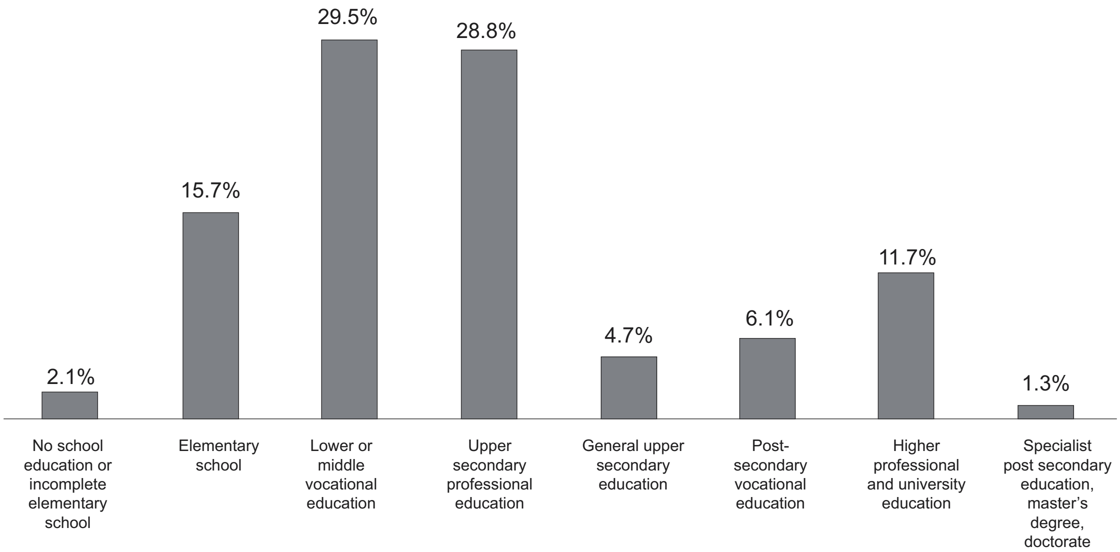
The largest recent FDI inflows are the post-privatization takeovers (Goodyear) or classic takeovers (Lek-Novartis, Simobil-Mobilkom, SKB-Societe Generale, NLB-KBC etc). Among foreign investors to Slovenia we would also like to mention well-known names such as BSH Bosch, Danfoss, GKN Driveline, Dunlop Tires Europe, Hella, Henkell, Johnson Controls, Renault, Sandoz (Novartis), Bank Austria, Hypo Alpe Adria Bank, Societe Generale, KBC, San Paolo IMI, E. Leclerc, Eurospin Italia, Lidl International, Spat, MOL, ÖMV, Debitel, Dloitte & Touche, DHL; Ernst & Young, Gfk, Micorsoft, Oracle, PriceWaterhouseCoopers, Schenker, . . .

Characteristics of the Workforce

The school system and post-compulsory educational opportunities equip Slovenia's labour force with vocational skills and knowledge to perform particularly well in the higher value-added activities that utilize skilled technicians and engineers at a somewhat lower cost than in the developed West. Some 100,000 students at four universities and higher educational centres guarantee a stream of highly educated labour. Structural unemployment is addressed through measures to create a dynamic environment capable of re-allocating labour and capital between regions and industries are in place facing changing external demand and production patterns. Analysts are confident that Slovenia's average national unemployment rate of 6.5% by ILO definition will gradually drop to well below 6% in 2007. The regions bordering on Hungary and Croatia exceed that figure by roughly 50% therefore providing an attractive labour base as they end reliance on the traditional industries.

ICT has changed the way we live and work and computers are as frequent in Slovenian offices and homes as they are in the most developed countries, while good command of language skills promises low risk of getting "lost in translation". English is the most widespread foreign language in Slovenia followed by Croatian and Serbian. French is "in vogue" and German and Italian are largely spoken in the regions bordering on Austria and Italy respectively. The Slovenians foster a culture of pride in work, reliability and corporate loyalty. Given the country's productivity performance, productivity growth neutralises average collectively agreed pay increases of 3% in 2005 (EU-15: 3%) and should not threaten its competitive position vis-a-vis countries with still lower cost.

Workforce aged 15-65+ by level of education, August 2005



A comparison of overall productivity in 2004 shows that Slovenia is the most productive of EU-10 new member states. The productivity of Slovenian workforce exceeds the least productive member state, Portugal, and very nearly reaches that of Greece.

A cutting edge of Slovenian workforce is command of foreign languages. International studies rank Slovenians at the European top. 89% of population can communicate in at least one world language. English is the most popular foreign language in Slovenia followed by German, Italian, Croatian and/or Serbian, French and Spanish language. Schools in Slovenia are obliged to offer at least two foreign languages: the first as a compulsory subject and the second as a core curriculum option.

Slovenia is the economic front-runner of the countries that joined the European Union in 2004 and was the first new member to adopt the euro as the country's only currency on 1 January 2007. Moreover, Slovenia will also be the first new member state to hold the Presidency of the Council of the European Union in the first half of 2008.

Economic Relations Between Slovenia and United Kingdom

Goods

From 2003 onwards trade between Slovenia and UK has been increasing. In 2006 Slovene exports of goods to UK reached a value of 469.7 million EUR (in 2005 this value was 354.9 mill. EUR), while imports of goods from UK amounted to 302 million EUR (236.7 million in 2005).

Table 2

EXPORT AND IMPORT OF GOODS BETWEEN SLOVENIA AND UK (mill EUR)

	2001	*2002*	*2003*	*2004*	*2005*	*2006*	*Index 2005−06*
Export	290	268.1	252.2	288.5	354.9	469.7	132.4
Import	292	278.4	226.2	242.8	236.71	302.0	127.6
Sum	582	546.5	478.4	531.3	591.61	771.7	130.4

Source: SURS

In 2006 Slovenia's exports to UK mainly consisted of the following goods: cars, furniture, car seats, car tires, medical drugs, refrigerators, electro motors, paper and pasteboard.

The Slovene companies with the largest shares in exports to the UK are as follows: Revoz, Sava Tires, Johnson Controls-NTU, Krka, Gorenje, Adria Mobil, Iskra-Avtoelektrika, Goodyear Engineered Products Europe, Cimos, Impol, Hella Lux Slovenia, Julon, Roto Lo☆...

The structure of goods imported from UK in 2006 is as follows: electricity, computers, cars, medical drugs, car parts, synthetic rubber, parlour and gambling games, plastic.

The largest Slovene importers from the UK are: HSE, Julon, AC-Mobil, Acroni, Johnson&Johnson, Revoz, Avtera, Summit Avto, Lama, Krka, Johnson Controls-NTU, Sava Tires, Hidria Rotomatika...

Services

From 2001 onwards (with the exception of 2003) trade of services between Slovenia and United Kingdom has been constantly increasing. In 2006 Slovene exports of services to UK reached a value of 164.9 million EUR, while imports of services from UK amounted to 158.9 million EUR.

Table 3

EXPORT AND IMPORT OF SERVICES BETWEEN SLOVENIA AND UK (mill EUR)

	2001	*2002*	*2003*	*2004*	*2005*	*2006*	*Index 2006–05*
Export	93.8	98.5	93.6	111.8	141.6	164.9	116.5
Import	100.7	120.4	102.5	114.2	128.6	158.9	123.6
Sum	194.5	218.9	196.1	226.0	270.2	323.8	119.8

Source: Bank of Slovenia.

The biggest share in export of services to the UK represent travels, followed by other business services, transport services and computer and information services.

On the other hand, services imported from the UK to Slovenia, consist from transport services, other business services, travels, computer and information services and others.

Investments

Although United Kingdom is one of the biggest investors on the World, Slovenia remains relatively uncovered territory for British investors. As regards Slovenia as an investment location it should be taken into account the advantages of Slovenia and its location also as a spring board to neighbouring countries of the EU and especially to the markets of Southeast Europe. Slovenian companies have long term experiences and knowledge of the market so Slovenia could be a good starting point for the companies that are not familiar with the business practices, language and culture of Balkan countries. Slovenia could thus become a bridge for UK investments in those regions.

On the 31.12.2003 British companies had 140 mill. EUR investments in Slovenia, which represented 3% of all foreign direct investments in Slovenia, on the 31.12.2004 106.2 mill. EUR investments in Slovenia and in the year 2005 94.3 mill. EUR investments in Slovenia.

On the 31.12.2003 the foreign direct investment of Slovenian companies in United Kingdom reached the amount of 11.3 mill EUR, on the 31.12.2004 the amount has risen to 13.4 mill EUR, and in the year 2005 reached 16 mill EUR. On the 31.12.2006 the foreign direct investments of Slovenian companies in United Kingdom reached an amount of 20.1 mill EUR, on the other hand foreign direct investments of British companies in Slovenia in the year 2006 reached 114 mill EUR.

Slovenian companies, which have a subsidiary or representative office in the United Kingdom are: Gorenje, Adria Airways, Iskra UK, Kompas, Iskraemeco, Unior, Trimo, Sava Print in Savatech, Nova Ljubljanska banka, Lama, Comet, Adria Mobil, Hermes Softlab, and Riko in Hidria Perles.

Tourism

Cooperation in tourism sector has increased from the year 2004, particularly because of establishment of additional daily airway connections between London and Ljubljana (Adria Airways and Easyjet). In the year 2006 almost 91,000 tourists from United Kingdom has visited Slovenia and created around 319,000 overnight stays.

Slovenia is developing new tourist programs mainly specialized in active and tailor-made holidays which could be of interest for British tourists as well. One of the fast developing areas of tourism is also wellness tourism, combining active holidays, wellness and beauty programs and health programs.

Due to its size and natural beauties, we want to preserve, Slovenia is not a place for massive tourism but a place for individual (smaller groups) tourist enjoying discovering natural beauties, relaxation and sport activities combined with excellent food and Slovene wine.

Why to Invest to Slovenia

Foreign investors pick up Slovenia for a great variety of reasons. The most important are high business ethics and commitment to quality work, good ties with markets in Western and South eastern Europe, a central position in Europe and excellent infrastructure, and last but not least quality of life.

The legislation in line with EU standards, simple setting up a business, low taxes, the unrestricted transfer of profit and capital repatriation, the Government's pro-investment stance etc. have created a pro-business climate.

Clusters of related industries and ready-made network of suppliers available in Slovenia are behind many investment choices.

The advantage that Slovenia offers with its favourable geographic location on the cross-roads of main transport connections (roads and railways) between south and north as well as east and west of Europe and good knowledge of the markets, culture and languages of C and SE Europe has not been fully used by the UK companies and this could represent a new opportunity for the UK companies. Slovenia can be used as a logistic and distribution centre for whole C and SE Europe but also as a manufacturing or service location. With membership in the EU and introduction of Euro in 2007 Slovenia become a part of big EU market, not limited with the size of its own market.

Priority sectors for foreign direct investments (FDI)

Slovenia has a long industrial tradition. In the 20th century, manufacturing industries were most developed: primary metal manufacturing, forestry industries, textiles and footwear. In the early 1990s the industries based on technology and know-how flourished: electronics, chemicals and pharmaceuticals, ICT, automotive and tool-making alongside service industries enjoyed strong growth.

Manufacturing industries and technologies account for over one-quarter of Slovenia's GDP, 80% of total exports, and employ about one-third of active workforce.

Priority sectors for FDI are:

— Automotive.

— Chemicals & Pharmaceuticals.

— Electronics & Electrical.

— ICT.

— Distribution & Logistics.

— Machining & Metalworking.

— Financial sector.

Slovenia also wants to attract the foreign direct investment in tourism. Slovenia today does not present more then 0.3% of the tourist visits in Europe. But still the tourist activity contributes more then 9.0% of GDP and employs around 52,000 people. Tourist exchange inflow is somewhat below EUR 1.2 billion and presents around 10% of Slovene exports and services. In the last ten years the Slovene tourism experienced relative business and development stagnation. This has been caused by the Balkan war and unstable political relations in our vicinity, ownership process and denationalization, exceeded institutionalization of tourist activities and unsuitable development tourist policies, crumbling and underdeveloped tourist infrastructure.

The Slovene tourism is planned to become one of the leading branches in the Slovene economy. Basic quantitative aim of the Slovene development tourism is to increase the annual tourist turnover up to EUR 1.6 billion, the number of overnight stays up to 9.5 million tourist and the number of beds in the hotel offers up to 4000 beds. Planed is also the development of farms with the overnight stays capacity and increase of the overnight stays capacity number in other forms of placing.

Incentives for FDI

The creation of a stimulating investment environment has been a challenge to Slovenia's economic development. Grant aid is a common feature of EU Member States and has also been a tool of regional policy in addition to an adequate legal framework and a stable macroeconomic environment.

Slovenia has developed an incentive system in an effort to give impetus to foreign direct investment expected to boost the country's economic development: the creation of new jobs, the transfer of new technologies and know-how, and outsourcing opportunities where the local companies would get new business partners. The instruments of the Government's pro-active stance to investment policy also serve to motivate the foreign investors who are already running operations in Slovenia to expand or upgrade their capacities. After all, Slovenia's track record clearly shows that foreign investors who have discovered this "right mix of qualities" are here to stay and as a rule take every opportunity to expand their operations in Slovenia.

Incentives are analyzed in three groups. The first group is fiscal incentives, which consequently reduces the tax burden of investors. The main components of fiscal incentives are: general corporate tax rate is set at 23%, loss carried forward, tax relieves for investments, depreciation allowance, allowances for implementation of practical work during professional education, allowances for employing disabled people, allowances for voluntary supplementary pension insurance, allowances for donations.

The second group is financial incentives given directly to investors. The Grant Scheme in place since 2000 aims at motivating and facilitating investment. It is in line with national and EU state aid legislation. The aim of these incentives is to lower the cost threshold for new entries into the manufacturing and service sectors that allows them to compete in international markets.

Government FDI Cost-Sharing Grant Scheme

Foreign companies making direct investments in Slovenia may apply for financial grants. The purpose of the Invitation for Applications is to boost attractiveness of Slovenia as a location for foreign direct investment by lowering entry (start-up) costs to the investors whose investment will have a positive impact on new employment, knowledge and technology transfer, facilitation of balanced regional development, and will foster alliances between foreign investors and Slovenian companies.

Grants are available for investments in:

— Industry.

— strategic services (Customer Contact Centres, Shared Services Centres, Logistics and Distribution Centres, Regional Headquarters).

— R&D.

In the year 2007, there are allocated approx. EUR 5.8 million.

Planned FDI Cost-Sharing Grant Scheme for 2007

Activity	*Value of Investment*	*Number of New Jobs created in 3 years' time*	*Estimated Grant per new job created*
Manufacturing projects	€1 million	25	€2,500–8,000
Strategic Services	€0.5 million	10	€3,000–11,000
R&D	€0.5 million	5	€7,500–20,000

Source: JAPTI, 2007

These investment projects and new jobs shall remain located in the Republic of Slovenia for no less than 5 years for large-sized companies and no less than 3 years for small- and medium-sized companies.

Other incentives are local and employment incentives.

POSSIBILITIES FOR CO-OPERATION BETWEEN SLOVENIA AND UNITED KINGDOM IN THE FIELD OF TRANSFER OF KNOWLEDGE AND TECHNOLOGY

Area in which we think there could be substantial benefit from closer co-operation is an area of entrepreneurship and competitiveness. We've found interest in establishing of appropriate infrastructure in geographic areas in Slovenia where there is a critical mass of know-how or knowledge institutions, economic development and concentration of enterprises per person. Creation of such platforms is linked to crucial co-operation between the government institutions, regional and municipal public institutions as well as, of course, enterprises and knowledge institutions. Economic development logistics platforms in the form of infrastructure include a very wide range of various entities, networked in a specific area (region) into an integrated whole. The economic development logistics platforms as an infrastructure of national significance in addition to the aforementioned excellence centres and technological centres also include the following:

(b) Technological parks.

(c) Network regional business incubators.

(d) University (college) incubators with offices for transfer of technology.

Ad (a) *Technological parks* provide for space concentration of activities of new high technology companies and R&D departments of large corporations entering into technological parks because of specific beneficial environment, facilitated exchange of information and know-how, and specifically set up infrastructure as well as concentration of development and knowledge at a single point. Technological parks offer high technology companies adequate spatial capacity with all pertaining infrastructure and links with the knowledge institutions. An important part of technological parks is also the incubator enabling incubation of early-stage high technology companies. Such companies come as incubated companies via university incubators or as individual entrepreneurial initiatives of residents of the Republic of Slovenia, or spin-offs from individual enterprises and other institutions. The incubation period of incubated companies in technological parks is generally four years. An important criterion for establishing technological parks is, due to their specifics regarding high technology and needs of companies, interconnection of parks with geographically close universities and higher education institutions providing adequate number of such institutes and institutions in the field of technology.

Ad (b) *Business incubators* offer the environment with favourable conditions to start a new company and provide appropriate infrastructure and joint services. In general, business incubators represent the regional supporting environment, intended primarily for medium technology and non-technological enterprises in the region. Because of specifics of business incubators it is advisable that they be placed in business industrial or crafts zones as they will thereby combine the newly established entrepreneurial (including crafts) initiatives with the existing ones. Similarly to technological parks, business incubators also offer the environment with favourable conditions to start a new company and provide appropriate infrastructure and joint services. The incubation period is generally three years. Similarly to technological parks, incubated companies have for the purpose of ensuring system efficiency the option of transfer from the location of an existing business incubator to a location of another entity of such supporting environment.

Ad (c) University (college) incubators together with the office for transfer of technology represent the environment for implementation of entrepreneurial initiatives within universities thereby assisting in transfer of innovative potentials, technologies and inventions as innovations to the market. The task of university incubators is therefore to assist in generation of innovative ideas and the fastest possible transfer of research into new products and services. They are focused on the target group of professors on universities, higher education institutions and institutes, researchers, assistants and graduate and postgraduate students. The task of such environment is also informing, consulting and encouraging by promotion related to entrepreneurship and innovations. The incubation stage for individuals or groups of entrepreneurs, which can be realized in newly established companies, lasts up to 4 years. The tasks of the office for transfer of technology on universities is to link research teams with businesses, transfer technology to the business sector, search for partners in scientific institutions and businesses for joint projects, international co-operation, assistance and intermediation in protection of intellectual property, etc. It must therefore act in complete synergy with the incubator. An important task of universities (higher education institutions) is also to include and implement the so-called "design thinking" concept in their pedagogical and other processes, university incubators and offices for transfer of technology. Such concept as an example of good practice can be seen at the Stanford University (D-School) including activities of pedagogic programs, interdisciplinary approach, co-operation with businesses, and active inclusion of offices for transfer of technology and university incubators. Such concept can result in strong involvement of universities (higher education institutions) in the business sector and the related acquiring of funding (not being state aid) or creation of spin-off companies. Universities can obtain additional funds with effective operation of offices for transfer of technology, notably in marketing of inventions within the university (higher education institution) and in intermediation as a part of business projects. Therefore, the government's task regarding entrepreneurship is to direct universities (higher education institutions) in such activities, assist in setting up of appropriate infrastructure, which can also be implemented within the infrastructure of university (college) incubators within the framework of the D-School concept, offices for transfer of technology and incubation, for the purpose of rationality and one-stop-shop concept.

21 June 2007

Memorandum submitted by Research Councils UK

Introduction

1. Research Councils UK (RCUK) is a strategic partnership set up to champion the research, engineering and technology supported by the eight UK Research Councils. Through RCUK the Research Councils are working together to create a common framework for research, training and knowledge transfer. RCUK was launched on 1 May 2002 and further details are available at www.rcuk.ac.uk

2. This evidence is submitted by RCUK on behalf of one of the Research Councils, and represents their independent views. It does not include or necessarily reflect the views of the Office of Science and Innovation.

Evidence

2. The inquiry touches on building relationships with educational establishments and asks how the UK and the new Member States from Central and Eastern Europe could pool their scientific knowledge.

3. The UK Research Councils work with their Eastern and Central European counterparts to explore the opportunities for collaborative research and innovation through a variety of well established European forums. These include:

— The European Strategy Forum on Research Infrastructures: ESFRI brings a coherent approach to policy-making on large research infrastructures in Europe, and acts as an incubator for international negotiations about research infrastructure initiatives. It has recently produced a pan-European Roadmap for new research infrastructures covering all scientific areas including environmental sciences, energy, materials sciences, astrophysics, astronomy, particle and nuclear physics, biomedical and life sciences, social sciences and the humanities, computation and data management. The Research Councils represent UK interests on ESFRI and work alongside representatives from all of 2004 Central and Eastern European Member States (bar Lithuania, whose representation is pending). More information is at: http://cordis.europa.eu/esfri/home.html

— The European Heads of Research Councils: EUROHORCs brings together the heads of the major public national funding organisations across Europe. It is an active player in the field of European research policy, aiming to promote and enhance inter-country cooperation and serving as advisory body for the European commission. EUROHORCs seeks to enhance the role of the national research funding organisations in Europe through creating a platform for discussion, initiating joint activities and strengthening their influence on European research policy. The Research Councils represent the UK and other members include the Czech Republic, Estonia, Hungary, Poland and Slovenia. More information is at: http://www.eurohorcs.org/

— The European Science Foundation: ESF supports high quality science at a European level. It aims to act as a catalyst for the development of science by bringing together leading scientists and funding agencies to debate, plan and implement pan-European initiatives. Many of the new EU Member States are represented on its governing Council alongside the UK, and include the Czech Republic, Estonia, Hungary, Lithuania, Poland and Romania. More information can be found at: http://www.esf.org/

4. The mobility of students and researchers between the UK and the new Members States will be an important factor in tapping into the skills available in Central and Eastern Europe and in building effective research collaborations. Research Councils UK is a partner in the European Network on Research Careers (ENRC). This network currently encompasses representatives of national Research Councils with a strong attendance from eastern European countries (in particular the new Member States of the EU). Research Councils UK, through its Research Careers and Diversity Unit, has played a strong role in developing the network. Other leading partners are Germany, Ireland, and Hungary.

5. The key aim of the ENRC is to support European Research Councils on research careers issues in the European Research Area. There is currently a proposal to formalise the network as an ESF Member Organisation Forum. This forum will serve as a joint platform for the exchange of views and experiences and for the development of strategy concepts. It will involve national experts, the European Research Council, the European Commission, and the European University Association. The long-term goals will be to create or improve programmes aimed at promoting different career stages and to work on marketing campaigns to raise the international visibility of the ERA in the global competition for research talents.

6. Since the UK is widely recognised as a leader in issues relating to research careers and in particular the management of research staff in universities our influence in Europe is potentially significant. Effective dialogue within the current ENRC network and the proposed ESF member forum will support the aspirations of the eastern European countries as they re-develop their higher education sectors. At this stage the priority is to be influential in developing a common understanding of research careers in Europe built on the foundations of the Bologna Process.

7. The tasks of the ENRC go beyond what is already taking place, ie the exchange of views and experiences. Seen in the long term, the network is expected to develop into a think tank for advice on research career policies. It will also lay the foundations for more shared activities between the different participating organisations. The new Forum will consider the different career stages from doctoral training through to various types of employment in innovative research.

8. In addition, the Research Councils have identified a number of research issues of relevance. For example, open borders between Member States could have animal health impacts, allowing diseases such as avian flu to spread more easily. Also, there are real opportunities in social sciences for collaborative research between the UK and Central and Eastern European countries. Annex 1 provided by the Economic & Social Research Council (ESRC), summarises these opportunities and the need in particular for language skills development.

Annex 1

IMPACT ON UK BUSINESS OF THE ACCESSION OF THE TEN CENTRAL AND EASTERN EUROPEAN MEMBER STATES IN 2004 AND 2007—EVIDENCE FROM ESRC

1. ESRC commissioned an expert report in 2005 on social science in the wider Central and East Europe (CEE). It suggested that looking forward, notwithstanding a number of challenges, there was likely to be a rich research agenda for social scientists and considerable scope for building a range of scientific collaboration with countries of CEE. There could also be scope for collaboration in training in research methodologies.

2. As a first step in promoting scientific collaboration with CEE, ESRC is funding two workshops this year focused on important issues of mutual scientific and policy interest. The first of these, on energy transformations, took place in January and brought together 30 researchers and policy makers from the UK and Eastern Europe; the second, planned for September will focus on population change. We feel that this type of activity offers an effective way of facilitating further scientific collaboration.

3. ESRC is also an active partner in NORFACE, an EU supported network of 10 funders of social science research across Europe, including Slovenia and Estonia, and which aims to increase co-operation in research and research policy.

4. In terms of future capacity building, ESRC is supporting two new centres, in collaboration with the HEFCE, AHRC, and the Scottish Funding Council (SFC), the aimed at creating a world class cadre of researchers who will enhance our understanding of Eastern Europe, as part of a joint £25 million language-based area studies initiative. The two centres, the Centre for Russian, Central and East European Studies led by Mr Richard Berry at the University of Glasgow, and the Centre for East European Language Based Area Studies led by Professor George Kolankiewicz at University College, London are developing the necessary language skills alongside an in depth understanding of the region. The ESRC believes that an improved understanding about other areas of the world is of cultural, political and economic importance to the UK.

March 2007

Memorandum submitted by the Society of Motor Manufacturers and Traders Limited (SMMT)

1. Introduction

1.1 The Society of Motor Manufacturers and Traders (SMMT) is the leading trade association for the UK automotive industry. SMMT provides expert advice and information to members as well as to external organisations. It represents some 500 member companies ranging from vehicle and engine manufacturers, to component, material and service suppliers and design engineers. Our industry is a key sector of the UK economy, generating a manufacturing turnover of around £45 billion and supporting over 200,000 jobs.

1.2 SMMT welcomes the opportunity to contribute to the Committee's inquiry into the impact of "new" EU Member States on UK businesses, and also highlights our responses to your recent inquiries into The Reasons for Success and Failure in the UK Automotive Industry (June 2006) and The future of manufacturing industry in the UK—Skills Shortages (September 2006). In both of these responses we stressed the diversity of the automotive sector in the UK, its global character and the crucial contribution of manufacturing to the UK economy.

1.3 In this response, SMMT outlines general sectoral experience, and presents examples of the experiences of some automotive companies. SMMT's International Department aims to support and foster counter-trade and global business links to enable SMMT members to take advantage of, and adapt to, commercial opportunities in the global automotive industry. In addition, the Automotive Academy (a former division of SMMT), and SMMT Industry Forum (the business improvement arm of the organisation), both support opportunities for businesses to improve and maintain their competitiveness. As a trade association, SMMT can only help its members to take their own actions on the best course for their business strategy and operations that are relevant for them. Therefore, SMMT's submission has limitations with regard to specific commercial experience of operating in "new" Member States. Commercial decisions lie with companies, not their trade association. However, we are able to provide expert contacts, knowledge and advice and provide a forum for sharing experiences of operating in these "new" Member States.

1.4 Attached to this submission is the joint SMMT and UK Trade & Investment (UKTI) report on the Relocation of supplier manufacturing in Europe: evaluation of implications and opportunities for the UK's automotive industry. This report aims to help UK companies to evaluate how to take advantage of these Central and Eastern European developments the most appropriate. For this inquiry, the detailed report should be considered, alongside SMMT's previous submissions to the Committee in 2006 and the additional submission comments below.

2. Comments

2.1 The UK is home to the most diverse range of vehicle manufacturers in the world and our industry is a significant contributor to the economy and the labour market. Automotive manufacturing businesses and their supply-chain generate value-added and jobs, driving and attracting major domestic and inward investments. A number of factors impact on UK automotive manufacturing (listed below, and further detail in the following comments and attached report):

- Higher relative operating costs.
- New technologies (both vehicle and manufacturing) and R&D intensity.

- — Market and manufacturing growth in emerging (low-cost) markets, eg China.
- — Central and Eastern Europe offer opportunities for growth.
- — Heavy regulatory burdens.
- — Skills gaps in UK manufacturing.

2.2 UK manufacturing is a significant driver of innovation, investment, trade and employment. With an extensive number of businesses involved in the manufacturing supply-chain and the transport services sector, automotive manufacturing is linked very closely to the UK's overall prosperity as a trading nation. In recent years the sector in the UK has accounted for almost 10% of annual total manufacturing turnover value, an export value of £20 billion (10% of total UK export value) and net capital investment of £1.9 billion.

2.3 However, manufacturing in the UK continues to face challenging trading conditions both domestically and particularly in an increasingly competitive global market. Its role within the UK economy has changed. It accounts for a smaller share of value-added and employment—this trend is expected to continue. Businesses in the automotive sector have had to respond to the commercial realities of operating within a global manufacturing market, particularly the increased intensity of competition from abroad—including Central and Eastern Europe. Competition is also increasing from Asian markets, which is forecast to grow twice as much as East and South-East Europe.

2.4 As market pressures increase in the UK, automotive manufacturers of all sizes are subject to several options for their individual business strategy, which include: acquisitions, exiting the UK market whether through relocation or closure, restructuring, diversification, joint ventures, outsourcing and off-shoring. Manufacturing business strategies must address the increasingly difficult issues of sustainability, survival and profitability.

2.5 Business and plant restructuring have been persistent features of the automotive manufacturing business model, reflecting the global nature of the sector, persistent cost pressures and pursuit of competitive advantages. The long-term challenge for the industry in the UK (within the global market) will be to focus on high added-value processes and products and to utilise the UK's significant strength in automotive design and innovation, research, testing and development facilities and its skilled, flexible labour force. Sustainable growth in export activity will be a key challenge. Competition on the basis of low cost, semi-skilled workers and low value-added/volume processes will be increasingly unviable. As globalisation deepens with firmer international economic integration of lower cost countries, such as "new" Member States, there will be a consistent challenge to established markets, firms and goods traded across the world economy. Also the continued strong exchange rate and market location outside the Euro zone impacts on trade flows.

2.6 Cheaper wages and lower costs are increasingly leading many companies to relocate to Central and Eastern Europe. These factors, among others, are making it more attractive for UK manufacturing to move abroad—particularly to Central and Eastern Europe, due to its proximity to the UK. Passenger car production doubled in Central and Eastern Europe in the 8 years to 2005. Many automotive suppliers have relocated here to be closer to customers (both vehicle manufacturers and their new car buyers), to reduce manufacturing costs to avoid outsourcing, and also benefit from lower freight costs and improved accessibility. Commercial vehicle assembly growth has been the greatest in Eastern European states, but passenger car assembly growth is concentrated in Asia-Pacific countries.

2.7 OEMs and major suppliers now increasingly source a range of components from plants in developing nations and new EU Member States. A major casualty of low cost sourcing is Small and Medium Sized Enterprises (SMEs); such businesses often who lack the resources or connections to effectively develop offshore outsourcing themselves. It must be emphasised that exiting the UK in favour of Central and Eastern Europe is an increasingly appealing option for many UK automotive businesses and is a likely continuing trend. Relocation is also facilitated by the liberalisation of "new" EU Member States' markets and the ease of transferring manufacturing processes, there are levels of risk related to relocation (company and product specific). Opportunities and trends for automotive manufacturing supply are outlined in greater detail in the attached SMMT-UKTI report.

2.8 Counter-trade (bilateral) opportunities and joint ventures with other companies in "new" Member States or the UK are a practical business option for many automotive companies. They offer diversification, shared-risk investment, and in some cases, the opportunities of sourcing or locating to countries with much lower costs, whilst maintaining a strong base in the UK. Joint ventures are viable for all size companies, but are only feasible if the company has the capital to jointly invest and is clear about all its options. An initial investment to outline and research the opportunities for an individual business is an additional cost-burden.

2.9 Diversification for automotive manufacturers into manufacturing products for other sectors is an option available to some companies. However, appropriate skill and investment levels are needed for this. R&D and innovation have been a long-term source of investment in UK automotive manufacturing and the supply-chain, and continues to be so. Several automotive component manufacturers have used the low costs of Central and Eastern Europe to shift their volume manufacturing out of the UK and utilise UK R&D opportunities and skills to develop niche products. Several automotive component manufacturers are viewing the low costs of Central and Eastern Europe as a benefit rather than the "death nell" of their UK bases. In one typical case, a UK engine component manufacturer that has relocated some of its already fully developed high volume production components to the Czech Republic is now able to utilise their limited UK factory space for more R&D, prototype development and new niche markets, which they previously could not pursue. This also led to increased capacity for handling niche production orders. The result of this is no loss of UK staff, an increased overall financial turnover and more satisfied customers in Central Europe who have their "competitively priced" supplier close to the assembly location.

2.10 UK manufacturing has persistent challenges to recruit appropriately skilled staff. This is due to many factors, including the course content and qualifications provided in Higher and Further Education. One example presented by an SMMT member company was a shortage of appropriately skilled degree-level electrical engineers. Other factors are the perception of manufacturing careers in the UK, the perceived decline of manufacturing industry and low wage levels. SMMT hopes that the National Skills Academy for Manufacturing will be able to begin to address these issues and skills shortages. Some UK-based automotive companies have attempted to bridge the gap for manufacturing jobs through greater recruitment from Central and Eastern Europe. Some manufacturers in the automotive sector recruit directly in these states. This direct recruitment of skilled workforce has eased some pressures from wage costs and immediate skill shortages. However there are wider migratory and economic impacts to consider and it is not yet clear that this is a permanent or sustainable solution to wage cost and skill needs. The ability to recruit, both in and to the UK, a lower-cost, well-skilled workforce, is an opportunity for "new" Member States, as well as for automotive businesses situated in Central and Eastern Europe. Also, a number of UK companies seeking to set up manufacturing plants in "new" Member States are beginning to report difficulties in obtaining and retaining local skills as demand and thus availability for skilled workers is affected by other inward investing companies.

2.11 Regulatory differences between the UK and abroad can be another cost and operational barrier for UK automotive companies. As commented earlier, higher operating and regulatory compliance costs in the UK can make relocation to Central and Eastern Europe more attractive. However, for many businesses it is the overall intensity of regulation that matters, not just better compliance and its rationalisation. The automotive industry fully supports the focus on better regulation both in the UK and the EU. A risk based, co-ordinated approach must be taken forward in the UK to deliver maximum quality achievements on the better regulation initiative. SMMT and its members regard a lean and pro-competitive regulatory framework in the UK and EU as one of the key determinants for the competitiveness of our industry. A comment regularly made by automotive companies is the ease at which it is possible to consolidate companies in the UK and resulting production shifts to lower-cost emerging markets.

3. Conclusion

3.1 UK automotive manufacturing faces many challenges in an increasingly competitive global market. Individual firms must address the commercial impact of the "new" EU Member States as well as other growth markets on their own business operations and strategies. "New" EU Member States represent an opportunity and a threat. They can strengthen the sustainability of UK operations or they can promote diversification, outsourcing, even exiting the UK market. The threats and opportunities presented by Central and Eastern Europe are addressed differently by different businesses. However, smaller supply-chain companies continue to find it especially difficult to survive with competitiveness squeezed as their customer's source from cheaper markets and they have to match low product costs from a high UK operating cost base, increased freight and distribution costs, and with a consistently strong exchange rate. The attached document outlines many of and gives greater detail on the implications and opportunities for UK's Automotive Industry.

March 2007

Memorandum submitted by TESCO

Europe moves East: The impact of the "new" EU Member States on UK business

Background

Tesco first entered Central Europe in 1994 through its investment in Global TH, a food retailing company operating 43 stores in the North West of Hungary. Since then, we have moved into Czech, Slovak and Polish markets. The main focus of Central European activities has been based on a hypermarket format. More recently, we have developed new formats, including smaller compact hypermarkets.

Our focus has been on organic growth combined with some selected acquisitions. Today, we operate 101 stores in Hungary, 86 stores in Czech Republic, 111 stores in Poland, 48 stores in Slovakia and we are market leader in Poland, Hungary and Slovakia—three out of our four central European businesses.

Our presence in Central Europe therefore stretches over more than a decade. We have experienced the transition period of EU accessions and now benefit from higher levels of certainty as a result of EU enlargement. This lowers the potential risk for investors.

We are consequently now in an extremely competitive position as a retailer that has gained significant knowledge operating within the region during this extensive time period.

Strategy and Vision

Over the last 10 years we have developed our Central European business in line with six guiding principles:

— Each country is unique and we have developed a flexible approach and tailor our offering according to the specific country.

— We ensure take a locally focused approach. This means working to understand local customers, local cultures, local supply chains and local regulations. We also deliver our local offer through local management and staff.

— We maintain focus and establish our position in key markets that we know that we can both add value to and gain value from.

— By drawning on our experience operating multiple store formats in the UK— from convenience stores to hypermarkets—we are able to meet a range of customer needs, access smaller regional communities and provide employment opportunities in areas otherwise beyond the reach of foreign investors.

— Our aim has been to develop capability—people, systems and processes—concentrating on developing and sharing skills between markets.

— We make a long-term commitment to building the brand in each market and developing lasting relationships with our local customers

Benefits to our business

Investing in the region has benefited Tesco both in terms of growth and knowledge. Over the past five years store numbers have more than doubled, with a total of 319 stores now operating in Central Europe. Retail space has grown by nearly 150% to 15.7m sq ft with current sales turnover at £32m. We also now employ over 62,500 members of staff, or double the number of people we employed in the region in 2003. Our presence in these markets has therefore enabled us to remain internationally competitive and make us one of the fastest growing retailers in the world.

Access to Central Europe has provided Tesco with a real opportunity to learn from new and world class competitors and benefits customers and staff in the UK. For example, our experience operating hypermarkets in Central Europe is reflected in the design and operation of our UK Extra stores. We have also been able to extend our offer by taking advantage of international sourcing opportunities, particularly in non-food, where UK customers now have access to a wide range of products such as homeware and textiles. In return, UK suppliers have been provided with the opportunity to grow with us. Many now supply across our international business.

This transfer of knowledge has been two way process and our experience competing in the highly competitive UK market has enabled us to compete effectively in Central Europe. For example we have been able to draw on world leading processes and capability built in the UK—in customer insight, developing our brand, product development, retailing services (such as personal finance)and supply chain processes— to enhance our competitiveness in Central Europe.

The whole of our business is consequently benefiting from the experience, leading to the transformation of Tesco from purely a UK retailer to becoming a truly multi-national business.

Developing Capability

Operating in Central Europe has also provided an invaluable injection of talent—both in terms of Tesco staff and management and our supply chain. As a result, in each country, all hypermarket directors and senior marketing, HR managers, commercial directors and senior retail directors are local, including many who started as graduate trainees with Tesco. We continue to draw from and develop local capabilities, for example, appointing our first native CEO in Poland last year. By taking advantage of local knowledge we can also provide employment opportunities for regions otherwise neglected. For example, in Poland we have been voted "Best Retailer of the Year" by Newsweek Magazine in 2004 for creating 1,500 jobs mainly in rural areas of Poland where unemployment is very high. We have also been awarded the best hypermarket chain in Slovakia in 2006 by Moderni obchod magazine.

We also benefit from local supplier, distribution and sourcing opportunities and we work in partnership with more than 6000 local suppliers across the region. This provides us with new and exciting sourcing opportunities and enables suppliers to work in partnership with Tesco to develop the competitiveness of their offer and access new markets.

March 2007

Supplementary evidence submitted by TESCO

Annual Gross salary	*2,740*	*4,110*	*5,479*	*13,699*	*27,397*	*41,096*
Gross salary/12	**228**	**342**	**457**	**1,142**	**2,283**	**3,425**
Direct employment related taxes and fees	0	0	0	0	0	0
Social security contribution—pension fund (21%)	48	72	96	240	479	719
Social security contribution—healthcare fund (8%)	18	27	37	91	183	274
Payroll tax (3%)	7	10	14	34	68	103
Education fee (1,5%)	3	5	7	17	34	51
	76	**115**	**153**	**382**	**765**	**1,147**
Total cost of the company	**305**	**457**	**610**	**1,524**	**3,048**	**4,572**
Total cost of the company*12	**3,658**	**5,486**	**7,315**	**18,288**	**36,575**	**54,863**
Indirect employment related taxes and fees (paid by the employee)	0	0	0	0	0	0
Personal Income Tax (PIT)	41	62	95	341	752	1,163
Supplementary personal income tax	0	0	0	0	30	75
Tax credit	−25	−25	−4	0	0	0
Supplementary tax credit	−6	−1	0	0	0	0
Social security emplyoee's contribution—superannuation fund	18	27	37	91	183	274
Social security emplyoee's contribution—state pension fund	1	2	2	6	11	17
Social security emplyoee's contribution—healthcare fund	16	24	32	80	160	240
Employee's contribution	3	5	7	17	34	51
	49	**95**	**168**	**535**	**1,170**	**1,821**
Net salary	179	248	289	606	1,113	1,604
Net salary*12	2,154	2,976	3,463	7,277	13,359	19,249
Net Salary/Gross Salary	79%	72%	63%	53%	49%	47%
Net Salary/Total Company cost	**59%**	**54%**	**47%**	**40%**	**37%**	**35%**

Memorandum submitted by the National Farmers' Union (NFU)

NFU—Seasonal Labour Survey 2008

UK farmers and growers have become increasingly reliant on migrant labour, as the domestic work force becomes less willing and able to perform many of the tasks associated with seasonal fruit and vegetable production. Whilst for a number of years there was a readily available pool of suitable workers from Eastern Europe, the rapid economic growth of many of these countries, and for many their accession to the EU, has meant that this work force is now able to find employment in their home countries or in other sectors of the western European economy.

During 2007 it has become apparent that farmers and growers are struggling to find not only the number of seasonal workers they require, but also those of suitable skills. Given the current plans to restrict the Seasonal Agricultural Workers' Scheme (SAWS) to Bulgaria and Romania in 2008, it is very likely that this situation will worsen rather than improve.

To help quantify the severity of this problem the NFU surveyed SAWS operators during July 2007 asking them what work force they would require in 2008, and what given the current economic climate and SAWS restrictions, what they expected to achieve. This survey covered 97% of the seasonal labour provided to UK agriculture under SAWS; a list of those who provided information is given in the appendix.

Shortfall

Current estimates provided by SAWS operators show an expected shortfall of close to 5,150 workers (or 17%) for 2008. This shortfall is predominantly driven by the reduced number of workers available from "other" sources, a result of reduced supplies from the A8 countries (ie Poland, Slovakia, Baltic States etc). In some cases, such as Poland, this situation appears to have been encouraged by tax advantages offered by governments to factories/plants which help retain labour within national boundaries.

Number Workers—2008	*SAWS*	*Other*	*Total*
Required	16,045	14,185	30,230
Expected	15,570	9,530	25,100
Difference	**−475**	**−4,655**	**−5,130**
Difference%	−3%	−33%	−17%

Whilst the figures suggest that SAWS operators will be able to source suitable numbers from Bulgaria and Romania to fill their SAWS allocations, there was great concern that this would come at the expense of reduced quality and at much higher recruitment costs—Many of the operators who recruited labour on behalf of other farmers and growers said they would be making no guarantees on the workers provided in 2008.

The situation was summaries by one SAWS operator:

> "We are struggling greatly to recruit from Bulgaria and Romania, and having been on the recent Home Office Jobsfair in Razgrad the quality of people is well below standard. This year, so far, has provided us with a good insight into the future and that is, a high turnover and severe lack of good workers".

There was great frustration at the loss of workers and infrastructure in countries such as Russia and the Ukraine, which during 2007 will have filled up to 60% of the SAWS allocations. In many cases there were good workers who wished to return in 2008, but would not be allowed under existing 2008 plans.

Recommendation

Given that availability of labour from the A8 countries is likely to continue declining, and that Bulgaria and Romania are unlikely provide "quality" of workers required (even if they are able to provide the numbers)—the following recommendations are made.

(1) Increase the SAWS allocations available by 5,200—to make up for the reduced supply available from "other" sources

(2) Maintain the current 40% Bulgaria and Romanian, 60% Non EEA nationals spilt of SAWS allocations—to ensure workers are of suitable skills/ability.

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