



House of Commons
Business, Enterprise and
Regulatory Reform Committee

**Europe moves East:
The impact of the
'New' EU Member
States on UK business:
Government Response
to the Trade and
Industry Committee's
Eleventh Report of
Session 2006–07**

**Third Special Report of Session
2007–08**

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The Business, Enterprise & Regulatory Reform Committee

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Committee staff

The current staff of the Committee are: Eve Samson (Clerk), David Slater (Second Clerk), Robert Cope (Committee Specialist), Ian Townsend (Inquiry Manager), Anita Fuki (Committee Assistant), Lorna Horton (Committee Secretary) and Jim Hudson (Senior Office Clerk).

Contacts

All correspondence should be addressed to the Clerks of the Business, Enterprise and Regulatory Reform, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5777; the Committee's email address is berrcom@parliament.uk

Third Special Report

The Trade and Industry Committee published its Eleventh Report of Session 2006–07 on 18 October 2007. The Government's response was received by its successor, the Business, Enterprise and Regulatory Reform Committee on 18 February 2008. It is published as an Appendix to this Report.

Government response

The Government welcome the former Trade and Industry Select Committee's (TISC) report into the impact of the new EU Member States on UK business. In particular, we are pleased to note that the Committee's findings are very much in line with the evidence submitted to the Committee by the Government and broadly supportive of Government policy on the trade and investment relationship with the A8/A2.

The Government's response to each of the Committee's conclusions and recommendations is as follows:

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)

3. The Government notes the concerns expressed by the Committee over the coverage of migration statistics. We are working to improve the available figures on all migration, including A2 and A8. The Inter-Departmental Task Force on Migration Statistics recommended that the 2011 Census should include questions that identify short and long-term migrants. The Office of National Statistics (ONS) is working with other interested departments to identify all the information needs of relevant policy departments from the census. More details of the recommendations of the Inter-departmental Task Force on Migration Statistics and the ONS implementation are detailed below in paragraph 11.

Impacts of Immigration

4. 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)

5. The Committee noted the British Chambers of Commerce survey into employers' reasons for engaging migrants workers that found that the majority of employers employed migrants to fill gaps in the workforce arising from skills or experience needed. The Government has conducted its own research into employers' motivations for using migrant workers in earlier years¹. This research found that the overwhelming majority of employers across sectors and regions started to recruit migrant workers because they could not get sufficient applications from UK workers for low-skilled jobs. Employers also reported that UK workers sometimes proved less reliable than migrant workers in some sectors. Other employers stated that they recruited migrant workers because of difficulties in recruiting UK nationals with the skills required.

6. Further work is underway to identify likely pressure points in the labour force, by sector and by region, where skills shortages may develop. The Migration Advisory Committee will also be considering where skills shortages in the UK labour market may sensibly be filled by managed migration, including from the A2 countries.

7. 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. (Paragraph 21)

8. The Government notes that there is some evidence that suggests that those from the A8 working in the UK move from low-skilled jobs into more highly-skilled jobs over time. This progression may reflect an initial period of work in a role for which the individual migrant may be overqualified in order to improve English language skills, or to complete a course of study before moving into more highly skilled work. If this is the case, it is likely that there will be a pool of A8 or A2 migrants willing to work in low-skilled roles as a stepping stone to more highly-skilled roles in due course.

9. The Government announced on 30 October 2007 that it would be retaining the current restrictions on migrant workers from Bulgaria and Romania. Therefore, in 2008 applications to the existing Seasonal Agricultural Workers Scheme (SAWS) will be

¹ Dench, J., Hurstfield, S., Hill, D. and Akroyd, K. (April 2006) *Employers' use of migrant labour, Main report*, Home Office Online Report

accepted only from Romania and Bulgaria – meaning a potential increase from 6,500 A2 migrant workers through this scheme this year to 16,250 next year. Nevertheless, the overall number of migrants coming to the UK through SAWS is unchanged. In 2007, the full allocation of SAWS places was taken up. Whilst the Government notes the concern from some parties that the decision to restrict SAWS to the A2 may lead to labour shortages, the Government believes that the supply of migrants from the A2 will increase to fill the number of SAWS places available. The Government will continue to monitor the uptake of SAWS places and the Migration Advisory Committee has been asked to review, if required, the Government's assessment of the demand for and desirability of low-skilled schemes for Romanians and Bulgarians to work in construction, social care and hospitality.

10. 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. (Paragraph 26)

11. As the Committee recognises, evidence to date shows that migration from the new EU Member States has been broadly beneficial to the economy and there has been no discernible effect on levels of unemployment, or on levels of wage growth. Some sectors of the economy and some regions continue to experience skills and/or labour shortages which impact on UK competitiveness and productivity as well as quality of public services. There appears to be very little evidence of reduced wage growth in the whole economy or across the main industrial sectors since Accession. In May 2006, two years after the accession of A8 countries, the average earnings index excluding bonuses was up 3.9% on the year, the same as in May 2005.

12. 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)

13. Whilst there has been no increase in claimant unemployment, the level of vacancies has been around or over 600,000 since records began in 2001; in September there were over 660,000 vacancies. Anecdotal evidence suggests that migrant workers are either taking jobs for which there are no available British workers with the skills required, or jobs that British workers do not wish to take because of the nature of the work.

14. The Government recognises that our challenge is to do everything we can to help people take advantage of the opportunities that are out there and move into work. DWP's Welfare Reform Green Paper: *'In work, better off: next steps to full employment'* sets out our proposals for moving further towards our aspiration of 80% employment. They will

concentrate on helping the most disadvantaged individuals and families. Tackling inactivity, particularly amongst those on benefits, remains their top priority.

15. Over the next three years Local Employment Partnerships (LEPs) will help over 250,000 disadvantaged people into work. Jobcentre Plus met its target for 100 employers committed to LEPs by end September, and has surpassed its target of 200 by end December, with well over 250 employers committed.

Overall Impact

16. 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. (Paragraph 31)

17. 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)

18. The Government has decided to maintain the restrictions on the labour market access of migrants coming to the UK from Romania and Bulgaria (the A2) until at least the end of 2008. The UK had previously decided to limit access to its labour market following accession of Bulgaria and Romania on 1 January 2007.

19. These arrangements have been reviewed taking account of the needs of the UK labour market, the wider and social impact of the migration of accession state nationals and the positions adopted by other EU countries (as that affects possibility of alternative destinations to the UK labour market). We have looked for evidence of the benefits and impacts of A8 and A2 migration, which we have used to inform this decision.

20. It is still too early to tell the full impact of accession migration on the UK. While initial evidence shows a clear positive contribution to the economy, there are some reports of pressures in other related areas, including public services. In this context, we will continue our prudent approach to labour market access as we monitor the medium to long-term effects of accession migration.

Exploitative Employment

21. 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)

22. We are also aware that migrant workers may face difficulties in understanding and asserting their rights. We have offered to work with the governments of all the new Member States, to prepare bi-lingual “know before you go” leaflets, giving advice on questions to ask before leaving the country and on legal protections offered to workers including agency workers.

23. It is particularly important to reach workers in the host country before they leave as it is often much harder to help workers, who may not speak English and have no accommodation arranged, once they arrive.

24. To date we have produced leaflets in partnership with the Polish and Lithuanian Governments². These followed a similar leaflet we produced in partnership with the Portuguese Government, and benefited from input from the TUC, the CBI and other stakeholders. These have been distributed widely in both the workers’ home country and the UK. In Poland, for example, they have been publicised on television and our Embassy and the Polish authorities have worked hard to distribute them via job centres, recruitment fairs and other channels.

25. We have also produced a basic, one-page *‘Working in the UK: Know your rights and where to get help and advice’* leaflet, available in Bulgarian, English, Latvian, Lithuanian, Polish, Romanian and Slovakian³. Workers registering under the Worker Registration Scheme are sent information about their employment rights.

26. 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)

27. The Government would not in fact agree with the Committee that there are no similar arrangements in other sectors where intermediaries play a part in recruitment – in fact the Gangmaster Licensing Authority (GLA) licensing standards are very predominantly based on pre-dating legislation governing employment agencies (ie the Employment Agencies Act and the Conduct of Employment Agencies and Employment Businesses Regulations 2003).

28. These regulations govern the conduct of all employment agencies outside those sectors covered by the GLA and are enforced by the Employment Agency Standards Inspectorate (EAS) in the Department for Business, Enterprise and Regulatory Reform. The Inspectorate follows up every complaint it receives which indicates a possible breach of employment agency legislation, and undertakes spot checks in those sectors where, on a risk-based analysis, it considers that breaches of the legislation are likely to occur.

29. While most agencies are compliant with the law and the bulk of those who are not agree swiftly to correct their procedures and put matters right, the Inspectorate also has powers to prosecute where an agency refuses to comply and can also seek prohibition of

² The Polish leaflet, for example, is available from <http://www.berr.gov.uk/files/file27632.pdf>

³ The English version of the document is available from <http://www.berr.gov.uk/files/file37545.pdf>

persons considered unsuitable to operate an agency. During 2007, the EAS successfully prosecuted two agencies and prohibition orders were made against 5 individuals.

30. Every complaint received by the EAS Inspectorate is treated in confidence and the identities of complainants would only be given to the agency if the persons making those complaints gave their written permission. There is a dedicated EAS Helpline, which provides advice to workers, agencies, employers and other interested parties on the legislation and work of the Inspectorate. The helpline number is 0845 955 5105. BERR would advise anyone who has a problem with an agency in any sector covered by the EAS to contact the Helpline.

31. Following a consultation exercise last year on measures to protect vulnerable agency workers, Amendment Regulations to the Conduct of Employment Agencies and Employment Businesses Regulations 2003 were made last December. These are practical steps intended to address key abuses affecting vulnerable agency workers and will come into force on 6 April. We are also proposing measures in the current Employment Bill to increase penalties for offences against the Employment Agencies Act 1973 and to improve investigative and enforcement powers for the Inspectorate.

32. These additional rights will be backed by additional resources for enforcement. In September 2007, John Hutton announced plans to double the number of inspectors in the Employment Agency Standards Inspectorate and recruitment processes are in train. This will enable the Inspectorate to investigate a greater proportion of agencies in sectors where there is perceived to be a higher risk of breaches of the legislation.

33. The Government has no plans to extend the GLA's remit or to reintroduce a licensing regime for employment agencies outside the GLA-regulated sectors. The previous licensing arrangements governing all employment agencies, which were removed in 1995, did not provide an effective system. Only a small percentage (about 0.1%) of new applicants or licence renewals were rejected. Moreover, the then DTI Inspectors found many breaches of the legislation amongst those with licences. Replacement powers to apply for a prohibition order against those individuals the EAS considered unsuitable to operate as an agency were introduced when the licensing powers were repealed. Under a prohibition order a person can be prevented from operating as an agency for up to 10 years.

34. Although past experience has suggested that licensing is not effective, there was evidence of particularly widespread abuse in the agricultural sector and a cross-sector consensus (by labour providers, labour users and worker representatives) in favour of the introduction of licensing in the food processing and agricultural sectors. Given such a consensus, the UK Government has introduced licensing in agriculture, the processing of food, fish and shellfish and the gathering of shellfish as these are the sectors where the problem of illegal gangmasters is greatest. No such consensus exists outside these sectors.

35. The EAS and the GLA already work closely together to share information that might be of mutual interest and benefit. Moreover, the Government's Vulnerable Workers Enforcement Forum is currently considering how existing employment-related enforcement arrangements across the board can be made more effective through closer co-operation, information sharing and facilitating complaints from vulnerable workers.

Long-Term Impacts

36. 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)

37. The Government recognises that migration flows are likely to change over time, not least as the economies of the new accession countries grow and living standards in those countries improve. Migration has an important role to play in a flexible labour market in meeting short-term demand for labour and/or for particular skills. It cannot, however, replace the Government's ongoing commitment to develop the skills of the UK workforce. The recent publication '*Opportunity, Employment and Progression: making skills work*' sets out how the Government will meet the challenge of increasing skills across the UK population and make further progress on getting people into sustainable work and to progress in work, through the creation of an integrated employment and skills system. This system will build on the success of Welfare to Work and ensures that all have the skills not only to survive, but to prosper in today's global labour market.

38. The National Statistician established an Inter-departmental Task Force on Migration Statistics that reported in December 2006⁴. The task force recommended:

- Obtaining more information about migrants as they enter or leave the country;
- Obtaining more comprehensive and timely information about migrants living in this country;
- Using linkages between statistical studies to obtain better information relating migrants' intentions at entry to the UK to subsequent events, such as employment, having a child and when they leave the country;
- Providing more timely, robust key indicators of migrant numbers, and;
- Bringing together all the statistics collected across Government on migration and migrants in a single UK-wide report, as there is currently no single official source.

39. The Office of National Statistics has estimated that the cost of implementing the Task Force's recommendations is £48 million. Work is underway to implement these recommendations, with key priorities being:

- Enhancing port surveys, including maximising the use of e-borders and landing cards to gain more comprehensive coverage of migrants as they enter and leave the UK;

⁴ Report available from <http://www.statistics.gov.uk/about/data/methodology/specific/population/future/imps/updates/downloads/TaskForceReport151206.pdf>

- Developing a communal establishments module for household surveys, as a large proportion of migrants live in communal households and are not interviewed currently;
- Making best use of the information generated by the new Points Based System for migration from outside the European Economic Area;
- Developing coverage, access to and linkage of key administrative sources to allow for improved estimates of where migrants are in the country;
- Producing local authority estimates of short-term migrants and other key migrant indicators, including impacts, and;
- Engaging a migration expert group on key proposals and findings.

40. 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)

41. The Government agrees that migration to the UK offers strong opportunities for developing UK trade. Research commissioned by the Department for International Development has found that migration creates trade bridges between communities of origin and host communities. Recent migration from the newly acceded member states offers the opportunity for UK businesses to develop their trade with economies likely to grow significantly over coming years. More broadly, enlargement is a benefit to the UK far beyond simply labour. Access to new and growing markets has benefited UK consumers and businesses. UK exports to the eight east European new member states totalled £6.4 billion in 2005, up 151% since 1995. Exports to Romania and Bulgaria were just over £1 billion in 2005, up 250% over the same period.

42. The UK Trade and Investment (UKTI) Five-Year Strategy, *‘Prosperity in a Changing World’*⁵ sets out plans to target advanced economies on behalf of innovative and R&D-intensive UK companies and for high-value inward investment, and to support inexperienced exporters in taking their first steps in internationalising their businesses. At the same time, UKTI will focus a greater proportion of its resources on the emerging markets that will be major sources of both trade and FDI in the future. UKTI’s overseas network resource will reinforce UKTI’s focus on China and India and achieve a step

⁵The UKTI Five-Year Strategy is available from <http://www.uktradeinvest.gov.uk/ukti/fileDownload/UKTIstrategyJuly2006.pdf?cid=391741>

change in the UK's profile in Brazil, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, Turkey and UAE.

43. UKTI supports British businesses seeking to export to the A8 countries through a network of International Trade Teams based in the nine Regional Development Agencies. As the economies of the recently-acceded countries develop and investment in their infrastructure continues, there will be increased opportunities for UK businesses to sell their expertise into these growing markets. In Romania, for example, UKTI is supporting a sector visit by British Water in March to investigate export opportunities in the water and wastewater sector.

EU Funding

44. 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)

45. The Committee correctly identifies that the excellent opportunities made available for UK companies across a wide spectrum of activities through European funding in the A8/A2 countries. Funding being provided to these Member States is specifically aimed at increasing their economic development and UK companies should be looking to maximise the opportunities that their increased wealth will bring.

Labour market

46. 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)

47. Evidence shows that the A8 economies are continuing to grow strongly and that this is leading to increases in wage rates. The Government agrees that on wage costs alone, emerging economies such as China, India and other Asian countries have a strong competitive advantage. However, decisions on where to base production are based not only on wage costs, but also on wider labour market, economic and regulatory issues.

48. The EU has agreed the Lisbon Strategy for EU economic reform to improve the competitiveness of European economies, enabling the EU to meet the challenges of globalisation and helping businesses to thrive and employment levels to increase.

49. The success of the EU's economy is crucial for the UK because Europe is our most important market. Although evidence suggests that the recent economic upturn in Europe is largely cyclical, there are indications to suggest that the Lisbon Strategy has also been a contributing factor. Nonetheless, the EU is still not living up to its potential, which is why we need to reinvigorate the economic reform agenda.

50. 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. (Paragraph 56)

51. The Government recognises that the accession of the new member states to the European Union has led to significant migration within the EU as a result of the free movement of workers. This has had an impact on some of the accession countries in particular sectors. To alleviate some of the most acute labour shortages experienced by accession countries, some are putting in place schemes to encourage migrant workers to return. It is anticipated that much of the current migration flow will be temporary, with migrant workers returning to their countries of origin.

52. In fact, 57% of those registering with the Worker Register Scheme have indicated on their application form in the twelve months ending September 2007 that they intended to stay in the UK for less than three months (though extra care should be taken when such data as the applicants' intentions can change). Increasing employment rates and salary levels will help to attract migrants back to their home countries.

53. The Government is aware of concerns expressed about labour shortages in A8 countries; however, these labour shortages are caused not only by emigration to Western Europe, but also by strong rates of economic growth in some of the A8 countries, relatively flat population growth and investment in infrastructure. We note concern, for example, around labour shortages in the Polish construction industry caused by a combination of emigration to the UK and other Western European countries, and by major infrastructure projects for the World Expo and European football championships to be held in Poland in 2012.

Transparency and Corruption

54. We commend the work being done by UK embassies in the 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).

55. Through the work of our Embassies, we clearly recognise the importance of combating corruption in the A8/A2 countries. We will also continue to work through established structures in international fora such as the OECD, United Nations, the Council of Europe and enforcement agencies in support of efforts to reduce corruption.

Ease of Doing Business

56. 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).

57. Whilst there have been problems in the A8/A2 countries with overly bureaucratic systems, inconsistent application of legislation and inefficient legal processes, progress has been made on addressing some of these problems and we agree that there no significant barriers to trade and investment.

Size of Market

58. 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)

59. As mentioned in the evidence provided by the Department of Trade and Industry to TISC earlier this year (Figure 1 – updated here below), growth rates for each of the A8/A2 have been well above the EU15 average growth over 1997-2006.

Figure 1: Real GDP growth rates (%)

Country	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Average (97-06)
EU 15	2.6	2.9	3.0	3.8	1.9	1.1	1.2	2.3	1.6	2.8	2.3
Bulgaria	-5.4	4.0	2.3	5.4	4.1	4.5	5.0	6.6	6.2	6.1	3.9
Czech Rep	-0.7	-0.8	1.3	3.6	2.5	1.9	3.6	4.5	6.4	6.4	2.9
Estonia	11.1	4.4	0.3	10.8	7.7	8.0	7.2	8.3	10.2	11.2	7.9
Latvia	8.4	4.7	3.3	6.9	8.0	6.5	7.2	8.7	10.6	11.9	7.6
Lithuania	8.5	7.5	-1.5	4.1	6.6	6.9	10.3	7.3	7.9	7.7	6.5
Hungary	4.6	4.9	4.2	5.2	4.1	4.4	4.2	4.8	4.1	3.9	4.4
Poland	7.1	5.0	4.5	4.3	1.2	1.4	3.9	5.3	3.6	6.1	4.2
Romania	n/a	n/a	-1.2	2.1	5.7	5.1	5.2	8.5	4.1	7.7	4.7 ⁶
Slovenia	4.8	3.9	5.4	4.1	3.1	3.7	2.8	4.4	4.1	5.7	4.2
Slovakia	5.7	4.4	0.0	1.4	3.4	4.8	4.8	5.2	6.6	8.5	4.5

Source: Eurostat

60. However, given the low levels of per capita GDP in these less mature economies, this growth rate would be expected to moderate in the long run as these countries reach income levels similar to the rest of Europe.

61. However, as set out in Figure 2 below (an updated version of that previously provided as part of evidence submitted to TISC in March this year), despite significant improvement in GDP per capita for each country over the last 10 years – measured in purchasing power standards – their levels remain well below the EU average.

Figure 2: GDP per capita in Purchasing Power Standards (EU-27 = 100)

Country	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
EU 15	115.4	115.4	115.3	115.2	114.8	114.2	113.7	113.1	112.8	112.1
Bulgaria	26.5	27.0	27.0	27.9	29.4	31.1	32.6	33.6	35.2	37.1
Czech Rep	73.2	70.7	69.8	68.7	70.6	70.8	73.8	76.1	77.0	79.3
Estonia	41.2	42.3	41.6	44.8	46.3	50.1	54.6	57.0	62.8	67.9
Latvia	34.7	35.7	36.2	36.9	38.9	41.4	43.5	45.5	50.2	55.8
Lithuania	38.3	40.3	38.9	39.4	41.6	44.2	49.2	51.1	53.8	57.7
Hungary	51.7	52.9	53.7	56.3	59.1	61.7	63.6	63.9	64.8	65.3
Poland	47.0	48.0	48.8	48.5	47.8	48.5	49.1	50.8	51.0	52.9
Romania	n/a	n/a	26.1	26.0	27.6	29.4	31.5	33.6	34.4	37.6
Slovenia	75.9	76.9	78.8	78.9	79.0	81.3	82.5	85.0	86.6	88.8
Slovakia	51.5	52.2	50.7	50.3	52.5	54.3	55.7	57.0	60.4	63.6

Source: Eurostat

⁶ Average for Romania covers period 1999-2006

62. It is important to put this growth into a wider perspective, as even compared to other major European economies these countries are not yet of significant size. For example, the economies of the A8/A2 are now collectively around one-third of the size of the UK economy and are therefore quite small on a global scale.

63. The reference in the report to Poland's economy being larger than that of the Netherlands appears to be based on the World Development Indicators database⁷, which currently (as of data from 14 September 2007) place Poland (at 22nd) two places below the Netherlands (at 20th). This comparison is based on a PPP (Purchasing Power Parity) measure, which may present a slightly misleading picture – for example, data on GDP per capita (comparable to that presented in Figure 2 above⁸) for the Netherlands in 2006 is 132.2, which is significantly above Poland's level of 52.9.

64. Nevertheless, the UK's combined exports to the A8/A2 currently outstrip UK exports to either India or China and therefore they are - and will continue to be - important trade partners for the UK in the future.

The Future

65. 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 GlaxoSmithKline'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 know how. (Paragraph 69)

66. The scope for working in partnership with these countries to help them develop high value-added sectors, and at the same time realise opportunities for UK companies, is well understood. Through partnering with UK firms, overseas companies can gain access to world-class, leading edge technologies, processes and innovation. It is part of UKTI's strategy to help R&D intensive UK companies penetrate overseas markets.

UK Trade and Investment with the A8/A2 Countries

67. It is regrettable that the UK retail banking sector has failed to establish a presence in the A8/A2 markets (Paragraph 79).

⁷ http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf

⁸ Also taken from Eurostat

68. Several British Banks are showing an interest in the Polish market and one, HSBC, has established a presence in the market. The takeover of ABN Amro by a consortium headed by the Royal Bank of Scotland (RBS) gives RBS a presence in Romania.

69. 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)

70. The Government will be submitting evidence to the Committee's inquiry into the future of trade and investment relations with Turkey.

71. 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)

72. The A8/A2 countries are clearly important to UK businesses seeking to grow through overseas trade and UKTI fully recognises the importance of ensuring that businesses are aware of their potential. Across the ten markets, UKTI has over 100 experienced commercial officers who continually raise awareness of the markets within the UK business community and of trade and investment opportunities. This is done generally through UKTI's website; and through the provision of reports on sectors of opportunity in each market. As part of the annual business planning round, industry sectors are made aware of sectoral areas of opportunity in individual markets as presented by UKTI's trade teams overseas. More specifically, trade officers regularly visit the UK and spread knowledge of markets and opportunities in their contacts with companies and multipliers. They also provide market reports tailored to the prospects for the products and services of individual companies to help businesses address market opportunities. In sum total, all of this effort is designed to build companies' confidence and capability to compete and trade successfully in the markets.

73. 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)

74. The Prime Minister's recent visit to China and India with a delegation of senior business people is a good example of our use of high level visits in support of our commercial objectives in overseas markets. £10 billion worth of contracts in the pipeline were announced during the India leg. The Minister for Trade and Investment's programme of overseas visits, in particular, is extensive in the number of visits and their country coverage and other Ministers are well focused on the value of overseas visits in support of our commercial interests. The point raised about Ministers on trade missions not having to return to the house to vote, other than in the most exceptional circumstances is a parliamentary issue and not for the Department to comment on. UKTI is also working across Whitehall to ensure that, in their scheduling and purpose, visits by Ministers in all departments are able to give better support to the UK's commercial objectives in overseas markets.

75. Since the publication of the TISC report, further proposals have been made for Lord Jones to visit Hungary and Slovakia this year (in addition to a visit to Poland in the autumn). As well as Ministerial visits, the UK also benefits from the work of HRH The Duke of York who has been the UK's Special Representative for International Trade and Investment since 2001. As part of this role, he undertakes an extensive programme of targeted engagements both in the UK and overseas to promote the interests of UK business and the UK as a whole. In this capacity, His Royal Highness has visited several A8 countries in recent years.

Trade Promotion

76. We are concerned that UKTI has adopted a one-size fits all approach to European Member states - cutting back on resources in the A8/A2 at a similar rate to the resources in the EU15. The A8/A2 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)

77. UKTI does not adopt a one size fits all approach to European Member states or other parts of its overseas network. The level of resource in each commercial section takes into account a mix of factors including customer demand; ease or difficulty of doing business; UKTI strategy priorities; and performance in delivering results.

78. The accession states are clearly important to UK businesses seeking to grow through overseas trade and UKTI recognises this in resource deployed. By way of example, the three largest A8 markets combined (Czech Republic, Hungary and Poland) are comparable to Sweden in the value of UK exports in 2006 yet UKTI deploys four times the level of resource across these three markets as it does in Sweden, in recognition of their growth potential and demand for UKTI services. UKTI has as much resource in Poland alone as in

Austria, Belgium and Finland combined. It keeps its network of resources fully under review to ensure they are deployed effectively in supporting UK companies.

Relocation

79. 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)

80. 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)

81. We welcome the Committee's interest in the impact of relocation on the UK economy. Whilst there are problems with data, there has been considerable analysis of the impact of relocation abroad. As well as the studies mentioned in the Report, earlier analysis⁹ also found no consistent pattern between relocation overseas and employment growth at broad sectoral levels in the UK or other countries. Analysis by the ONS¹⁰ found that in the UK, even in the service occupations regarded as most vulnerable to global sourcing - IT and contact centres - employment rose more than twice as fast between 2001 and 2004 than it did for the economy as a whole (8.3% versus 3.8%).

82. On balance these studies suggest that the net impact of relocation overseas on UK employment has been limited. The jobs lost directly through relocation seem to be compensated for either by increased growth through improved competitiveness, or through increased opportunities elsewhere.

83. The impact of relocation overseas also needs to be considered in the context of the overall UK labour market. Employment is currently around record levels, with nearly 29 million people in employment. Every month around 200,000 people join and leave the UK unemployment claimant count. So the number of jobs relocated overseas only amounts to a fraction of the turnover in national employment.

⁹ For example Amiti & Wei, (December 2005) "Service Offshoring, Productivity, and Employment: Evidence from the United States", *International Monetary Fund Working Paper*, and Amiti & Wei (April 2005) "Fear of Outsourcing: Is it Justified?", *Economic Policy* issue, pp. 308-348.

¹⁰ Gawain Heckley, "Offshoring and the labour market: the IT and call centre occupations considered", *Labour Market Trends*, Office for National Statistics, September 2005.

84. The Department has published a research report¹¹ providing new estimates of UK jobs gained and lost through trade. This was launched at a BERR conference on ‘Globalisation and the Labour Market’ held in London on 13 December. Its main findings were:

- The number of jobs needed to produce imports domestically relative to the number of jobs associated with exports has risen significantly since the middle of the 1990s. However, the paper did not try to estimate the impact on the UK labour market of the potential absence of international trade as this would have required much more extensive analysis of the wider benefits of trade.
- UK imports tend to be more labour intensive than UK exports. So, if UK trade was in balance, 0.4 million more jobs would have been required to produce imports than exports in 2004. However, this wouldn’t mean that employment in the UK would necessarily increase by 0.4 million if the UK were to give up the wider benefits of trade, since the cost of these imports would generally be higher if produced in the UK. As a consequence demand for products would fall, moderating any increase in employment.
- Jobs created in the UK from trade were increasingly higher quality and higher paying jobs. This reinforces the importance of building the skills of UK workers.

85. The Department is actively considering a pilot employer survey on the relocation of work in 2008-09. If this survey proceeds, it would provide estimates of the extent of offshoring in the UK.

Conclusions

86. 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)

87. The Government agrees; the accession of the A8/A2 to the EU has been strongly beneficial to the UK economy through both migrant workers and the increased size of the European market. Enlargement also offers opportunities to exploit the relationships developed through migrant workers and work is ongoing to consider how the UK can make the most of the opportunities that will arise.

88. 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

¹¹ Rebecca Riley, (December 2007) *The Jobs Content of UK Trade 1995-2004*, National Institute for Social and Economic Research, for Globalisation and Labour Market Conference, December 2007

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)

89. Prior to accession, UKTI supported a series of business road shows around the UK to alert companies to the trade and investment opportunities which accession would generate. Companies did take note. Between 2002 and 2006, UK exports grew from £6.3 billion to £9.7 billion, an increase of around 54%. Last year alone UKTI teams in the accession states delivered nearly 500 market reports tailored to the needs of individual companies and produced 55 reports on sectors of opportunity to help companies make appropriate decisions on whether the A8/A2 countries were necessarily the right market for their products and services.

90. 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)

91. We recognise that for the economy to prosper the UK has to have a skills base that meets current and future needs. This is made all the more important by the fact that the mobility of skilled workers has increased in recent years due to the expansion of the knowledge economy, the progressive globalisation of markets and companies, the growing demand for scarce skills, and wider political and economic issues.

92. In 2004, Lord Leitch was asked by Government to identify what the UK's optimal skills mix would need to be in 2020 to enable the nation to maximise economic growth, productivity and social inclusion, and to consider the policy implications of achieving the level of change required. Lord Leitch's final report was published in 2006 and the Government has accepted the analysis and committed to achieving the ambitions for 2020. *World Class Skills: Implementing the Leitch Review of Skills in England*, published in December 2006 sets out how, working with our partners, Government will deliver its ambition, building on the existing Skills Strategy and Further Education reform programmes.

18 February 2008