



House of Commons
Treasury Committee

**Globalisation:
prospects and policy
responses:
Government Response
to the Committee's
Fourteenth Report of
Session 2006–07**

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

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The Treasury Committee

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The current staff of the Committee are Colin Lee (Clerk), Sian Jones (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jon Young and Jay Sheth (Committee Specialists), Lis McCracken (Committee Assistant), Michelle Edney (Secretary), Tes Stranger (Senior Office Clerk) and Laura Humble (Media Officer).

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Fourth Special Report

The Treasury Committee published its Fourteenth Report of Session 2006–07, *Globalisation: prospects and policy responses*, on 16 October 2007, as House of Commons Paper No. 90. The Government response to this Report was received on 13 December 2007, and is appended below.

Government response

The Government welcomes the Treasury Committee's timely and informed report, *Globalisation: prospects and policy responses*.

1. There are signs of increasing protectionist sentiment, in Europe and, not least, in the United States of America. In the long-term, open markets best serve the interests of the global economy, and an increase in protectionist measures, and a retreat from multilateral trade agreements, would endanger the progress of globalisation and have an adverse impact on economic development in the United Kingdom and other nations. (Paragraph 15)

The Government recently published “Long Term Challenges and Opportunities for the UK”, “*Global Europe: Meeting the Economic and Security Challenges*” and “*Globalisation and the UK*” which set out the UK vision of the domestic, and European, response to globalisation. The UK has a longstanding commitment to open markets and in the face of rising protectionist sentiment the Government recognizes that the UK must continue to make the case for open markets and multilateral trade so that all can continue to benefit from the opportunities globalisation provides, not only to the UK, but also to the EU and US.

2. The Government is correct to note the risks to globalisation that would arise from a disorderly unwinding of global imbalances. While the probability of such a disorderly unwinding may seem low, its impact on the global economy, and on that of the United Kingdom in particular, would be very considerable. (Paragraph 17)

3. Convincing evidence is emerging that an inexorable shift in economic power from West to East is underway. It is unlikely that any national economy will follow a steady and predictable growth path over a twenty to fifty year period, but there is a strong likelihood that western economies, including that of the United Kingdom, will play a diminishing role in the global economy over time, and that China, India and other emerging nations will play a growing role. This will have policy implications because of different operating regimes in those countries. Although much public and political attention has centred on China, in the longer term, India is especially well-placed to be a powerhouse of the global economy in the middle part of the twenty-first century. The shift in economic power from West to East poses fundamental challenges for economic policy-makers in the United Kingdom in relation to communities and their economic prosperity and employment prospects. (Paragraph 28)

4. Evidence highlights the competitive advantage United Kingdom businesses potentially enjoy in establishing business relationships with Indian partners. The Government should examine how this advantage may be retained and deepened. (Paragraph 30)

The Government agrees that both China and India are well placed to build further in the middle part of the twenty first century on their recent strong growth and increasing importance in the world economy. While it is important to recognize the uncertainty in long-term projections, the Government highlights that it will be important for the UK to engage with these countries to ensure continued prosperity for all out of this growth process. Close historic ties with India provide a strong foundation to further build a close business relationship. Similar institutional arrangements, the use of the English language and the large population of Indian expatriates and British nationals of Indian descent underpin our links. The Government supports deepening relationships and in early 2007 established the UK-India Economic and Financial Dialogue which provides a forum to discuss topics of relevance to our economic relationship and financial services. As the increased role of emerging economies in the global economy also brings with it new responsibilities, it will also be important for these countries to engage actively and constructively through IFIs and multilateral fora.

5. Globalisation is having a profound effect on the United Kingdom economy and is likely to have a greater effect in coming years as the global economic landscape changes dramatically within a 10 to 20 year period. The economic impact of globalisation is likely to be felt unevenly across the economy, and not always in predictable ways. The notion that globalisation will have the greatest impact upon low-skilled employment is no longer appropriate. International competition will have a growing impact on highly-skilled areas of the labour market. Some low-skilled areas that are not tradable are unlikely to be greatly affected. The adverse effects of globalisation on individuals in the United Kingdom may in many cases be more tangible and immediate than the wider benefits for society and the economy as a whole. The policy challenges for the Government will relate to maximising the benefits of globalisation, and public understanding of those benefits, while seeking to minimise the adverse effects and ensuring that economic and social policies are suitably responsive in the face of such adverse effects. In particular, public policy needs to respond to the likely intensification of the impact of globalisation upon highly-skilled sectors of the labour market. (Paragraph 41)

The Government agrees that the challenge for public policy is to both maximize the benefits from globalisation, minimize costs, and ensure public understanding of these. The latter is especially important given, as the Committee points out, the ease with which transitional costs can often be perceived to have more tangible effects, despite the wider benefits to individuals and society from greater global integration.

The Government notes that globalisation, and other wider technological changes, will also have a differential impact over time on the economy. These impacts can be both of a positive, complementary nature for the UK, or may provide greater competition in the future. Competition itself, also brings benefits both through increased innovation and price effects in the economy. However, it is also the role of policy to ensure that any transitional impact is dealt with flexibly and minimises adjustment costs.

The Government accepts the ambition set by the Leitch review that the UK should aim for a world-class skills base by 2020. In July 2007, the Government published an implementation plan for the Leitch review which sets out how the Government will take forward its recommendations within available resources. The Government is committed to the successful implementation of the plan, and this, alongside other policies, should ensure that the UK will be well-placed to both make use of the complementarity of international high-skilled labour, take advantage of any opportunities from increasing global high-skill demand, as well as deal with the social and economic impact of increased competition as smoothly as possible.

Economic policy challenges

6. We welcome the Government's endeavours to analyse globalisation and its implications for the United Kingdom's economy and Government economic policy. In order to promote understanding of the impact of globalisation on jobs and communities, we consider that there needs to be an annual analysis on a consistent basis of new developments affecting the Government's assessment of the impact of and prospects for globalisation, reflecting the dynamic nature of the changes arising from globalisation and its increasing importance in policy formation. We recommend accordingly that the Government publish an annual review at the time of the Pre-Budget Report covering prospects for the globalisation, evidence on the impact of globalisation on jobs and communities and the Government's economic policy response. (Paragraph 43)

The Treasury Committee is right to emphasise the importance of ensuring public understanding of the impact of globalisation on the UK. The Government already reports on the effects and expected impact of globalisation domestically in its annual Budget and Pre-Budget reports. Additionally, the Government regularly produces reports considering in-depth the links between globalisation and particular policy areas. For example, reports produced include *“Long Term Challenges and Opportunities for the UK”*, *“Global Europe: Meeting the Economic and Security Challenges”*, *“Globalisation and the UK”*, *“Financial services in London: Global opportunities and challenges”*, and *“Building on progress: Britain in the World”*.

The Government will continue to pay strong attention to the issue of globalisation in the PBR and Budget annual publications, and regularly produce separate reports as required, which should cover the Committee's recommendations for annual reporting on particular areas of interest.

7. We referred earlier to signs of increasing protectionist sentiment and the risk that an increase in protectionist measures, and a retreat from multilateral trade agreements, would endanger the progress of globalisation, and pose a threat to both developed and developing economies. A successful conclusion to the World Trade Organisation negotiations would be of crucial benefit to globalisation, to developing nations and to the United Kingdom, and promotion of such a conclusion should continue to form an important element in the Government's economic policy response to globalisation. Without such a conclusion, all nations, and developing nations in particular, face a more uncertain future. (Paragraph 44)

The Government agrees with the Treasury Committee that a successful conclusion to the World Trade Organisation negotiations would be of crucial benefit to all. The conclusion of the Doha Development Agenda negotiations continues to be a foremost priority in the Government's economic policy response to globalisation. An ambitious, pro-development outcome is crucial to securing the benefits of increased global trade for the world economy with the potential to deliver global growth. It is vital that the EU, US and key emerging economies demonstrate the political will and flexibility in their negotiating positions to secure an ambitious outcome.

8. The success of the International Monetary Fund in coming years will undoubtedly be judged in relation to its performance of its core and critical function in ensuring that global imbalances are properly addressed. We welcome the Government's efforts to secure reforms to the International Monetary Fund's surveillance and we recommend that it provide an update on the progress of those efforts in its response to this Report. (Paragraph 45)

The UK has been at the forefront of promoting reform of the IMF's surveillance function—the means by which the institution promotes better global policy-making—to allow the institution to better prevent crisis and promote the economic stability essential for global prosperity. This led to the first modernisation of the formal surveillance framework for 30 years in June this year, and, in August 2007, to agreement on a UK proposal for a statement of Surveillance Priorities and Responsibilities. This will form a remit against which the Fund's advice can be measured to provide focus and accountability.

At the Annual Meetings this year the Chancellor also called for stronger financial sector surveillance, so that the Fund, working closely with the Financial Stability Forum, is better equipped to act as an early warning system in the event of financial turbulence. The UK is continuing to promote this reform through the EU, G7 and G20, as well as at the IMF's Executive Board.

Finally, in relation to governance reform, the Government has proposed that the selection process for the Heads of both International Financial Institutions should be open and transparent, leading to the appointment of the best person regardless of nationality. The UK is also a strong supporter of the process of quota and voice reform and at the Annual Meetings promoted methods of enhancing the voting share of the poorest countries, including through a tripling of basic votes at the IMF.

9. The United Kingdom's influence in relation to international action against climate change, and the relationship between such action and the progress of globalisation, is likely to be affected by the appropriateness of the domestic policy response to climate change. That policy response, and its linkage to international developments, are matters we will explore further in our Report on Climate change and the Stern review. (Paragraph 46)

An international approach is essential if climate change is to be tackled efficiently and effectively, and if all countries are to make their contribution to alleviating a global concern. The UK is playing a leadership role at both the EU and international level with the aim of making real progress. Domestically, the strategy for achieving reduced emissions

was set out in the document, *‘Moving to a global low carbon economy: implementing the Stern Review’*, published alongside this year’s Pre-Budget Report.

10. We may explore the role and effectiveness of Research and Development tax credits in a separate inquiry in due course, examining the linkages to levels of innovation in the economy and to the wider system of business taxation, as well the levels of R&D tax credit and its administration. (Paragraph 50)

Research suggests that tax incentives are an effective way of encouraging additional R&D although the full effects may only appear in the long term. In 2006 the Government commissioned a study by independent economic consultancy Oxera into the feasibility and the methodology of a future evaluation of the scheme. This study concluded that it is still too early to undertake a full and robust evaluation of the R&D tax credit scheme, but that this will be possible in the future as more years of data become available. Furthermore, as was noted by the Committee, improvements have recently been made to the administration of the scheme following close consultation with industry.

Given the results of the feasibility study, and in order to allow time for the recent improvements to the administration of the scheme to bed in, it may still be too early to undertake a separate enquiry into the role and effectiveness of the scheme. The Government will continue to monitor the scheme on an ongoing basis and is committed to undertaking a full evaluation of the Research and Development tax credits as and when the data allows.

11. We expect to explore the Government's ambitions to make public procurement more supportive of innovation as part of our Sub-Committee's regular scrutiny of the work of the Office of Government Commerce. (Paragraph 51)

As set out in *Transforming government procurement* (TGP) the Government recognises that innovation can support, and has supported, the delivery of high quality public services at good value for money. Through its implementation of TGP the OGC aims to improve the capability of the procurement function across departments, so that they are better equipped to take advantage of the benefits innovation can offer and manage the risks.

12. Analysis of the global competitiveness of United Kingdom businesses and of the United Kingdom as a business location has an important role to play in decisions about corporate tax rates and about the administration of the business tax system. Globalisation has enhanced incentives to develop a competitive corporate tax system, while at the same time enhancing the challenge associated with ensuring that all businesses pay a fair share of overall taxation. Simplicity is likely to be crucial to the effectiveness of a corporate tax system in an increasingly globalised economy. We consider that the Government should provide a more thorough and systematic analysis of these matters and of the effectiveness of its measures to create a simpler and better administered tax system—not least through the annual review on globalisation that we recommended earlier—and we expect to bear these factors in mind in our continuing scrutiny of tax policies and tax administration. (Paragraph 54)

The Government is determined to maintain the overall competitiveness of the UK business tax system while benefiting from continued globalisation and international competition in a fair and transparent manner. Surveys by respected international bodies consistently show

that the UK is successful at providing a business friendly environment and competitive tax system. For example, the World Economic Forum's Global Competitiveness Report (Oct 2007) ranked the UK ninth out of 125 countries in its measure of international business competitiveness. The World Bank's study of 145 countries—'Doing Business in 2008' (Oct 2007)—placed the UK sixth in the world for ease of doing business.

The UK's attractiveness as a business location is partly a consequence of having a business-friendly tax environment which has seen the Government take a number of key steps since 1997 to support businesses facing global pressures. These include cutting the main corporation tax rate from 33 per cent to 28 per cent (from April 2008), the lowest ever UK rate of corporation tax, and currently the lowest in the G7; and the introduction of an internationally competitive tax credit system to support R&D.

The Government is also committed to further maintaining UK competitiveness by simplifying the tax system where it can and reducing the admin burdens faced by business. The major simplification package announced at PBR 2007 builds on existing work at Budget 2007, and is part of an ongoing process of reform.

It is however important to note that tax is only one of a number of considerations in location decisions for businesses. There are many non-tax factors which further enhance the appeal of the UK as a location for international businesses including the stable macroeconomic environment the UK provides; the availability of skilled labour; good international transport links, and benefits from access to a well developed capital market.

13. We recommend that the annual review of globalisation by the Government which we have already proposed include an assessment of the specific roles of regulation generally, and the level and operation of planning controls and environmental regulatory standards specifically, in relation to the United Kingdom's global competitiveness. (Paragraph 58)

Like other Departments, Defra reports regularly on its plans for regulatory simplification. During 2005/6 the administrative burden that Defra's regulations imposed on business was assessed in a cross-Whitehall measurement exercise undertaken by PriceWaterhouseCooper (PwC). Only 362 of Defra's 700 plus regulations that were in force in May 2005 were judged to impose such a burden. This was calculated to be £528 million per year, excluding business as usual (that is, those things which businesses would do whether regulations were in place or not). Of that burden, £122.1m (less than 25%) arose from environmental regulation.

Defra has a target to reduce this regulatory burden by 25% by 2010. Defra's latest simplification report, *Maximising outcomes, minimising burdens*, which was published in December 2006, showed that the regulatory burden had already reduced by around £55 million per year, and set out plans to further reduce the burden by around 30% by 2010. The latest Defra simplification plan, *Cutting red tape*, was published on 11 December and shows that the Department is on course to meet its 30% target.

Kate Barker's Review of Land Use Planning and the subsequent Planning White Paper set out how planning is key to responding to the challenge of globalisation, and making the most of opportunities arising. Through reforms proposed in the planning bill on major infrastructure projects, and new policy statements on economic development and town

centre policy, the Government is reforming the planning system to help ensure it contributes effectively to the UK's global competitiveness.

Alongside these reforms the Government is proposing reforms to increase the efficiency of the planning process. The Planning White paper proposed to reduce the number of minor applications for planning authorities, streamline the information requirements for all applications and improve the speed and efficiency of the appeals process.

The Government will continue to monitor the effectiveness of these reforms.

14. The Government is right to place its policy on skills at the centre of its economic policy response to globalisation. There remain a number of unresolved issues about the best way forward for such a policy. There is firm evidence of some of the beneficial effects of inward migration for the United Kingdom economy, but we remain to be convinced that sufficient analysis and debate has taken place on the economic effects of migration and on the role inward migration might play in enhancing the skills base of the United Kingdom which faces skills shortages and an ageing population. We expect to undertake further work relating to the economic effects of migration later in this Parliament. (Paragraph 63)

The Government recently published a comprehensive report on the economic impact of immigration¹. That report recognises the impact that migrants have on skills. In general, migrants have a higher level of education than non-migrants. It is also true that in some of our most productive sectors, such as the finance and pharmaceutical industries, British industry is competing in a global labour market to attract talent to the UK. The Government has recognised the importance that migrants have in providing skills in this manner. This is why we are introducing a new objective points based immigration system, with advice from an independent body of economists (the Migration Advisory Committee) on where migration can help to alleviate pressure in particular sectors. Additionally, as noted previously, the Government is investing in the skills of existing UK citizens and workers to ensure the economy is able to respond to the opportunities and challenges from globalisation.

15. The need to respond to globalisation and to its adverse effects may be a factor in welfare policy and other social policies, although it is not immediately evident how far that need can be separated from other policy considerations. We recommend that the Government, in its response to this Report and in the annual reviews on globalisation that we earlier recommend, set out its views on the links between globalisation and the formulation of welfare and other social policies. (Paragraph 64)

It is recognised that globalisation raises both significant opportunities and challenges for economies. The Government acknowledges that while the benefits from globalisation are positive overall, these benefits can be accompanied by transitional costs and that these may not be evenly distributed. Policy's role is to maximise the benefits, ensure these are equitably distributed and minimise the costs through promoting rapid economic adjustment. The challenge for the UK is to ease the transition for individuals, businesses and regions affected by structural changes which may result in the demise of unprofitable

1 'The Economic and Fiscal Impact of Immigration' -<http://www.homeoffice.gov.uk/documents/economic-impact-of-immigration>

firms or sectors which in these circumstances could lead to an increase in unemployment, and the wider social impacts associated with loss of income.

The best way that Government can support the transition in these circumstances is by playing an active role in helping individuals adapt to changing circumstances, so that they are ready to make the most of new opportunities that arise. Rather than subsidising or propping up firms or sectors detrimentally affected by increased competition, and locking-in local economies into potentially low-growth future areas, the Government has a responsibility to create a sustainable economic environment. This requires supporting individuals both through the welfare system -thus providing economic security in the first place- and also by having wider policies in place to provide individuals with the ability to respond efficiently and quickly to change, by adapting and improving their skills. The UK aims to do this both through existing labour market policies such as the national minimum wage, and provision of social security, as well as through wider reforms such as the implementation of the recommendations of the Leitch Review. Strong productivity growth is essential both if UK companies are to make the most of opportunities of globalisation, and also to help pay for the adjustment costs as globalisation intensifies structural changes.

These linkages and the role of Government policy are set out in further detail in the policy document, “Social Bridges—meeting the challenges of globalisation”, published jointly with the Swedish Ministry of Finance in April 2006, which highlights that the role of Government policy is not to support unsustainable positions, but to support smooth and rapid adjustments best ensured through having flexible labour, capital and product markets. The UK performs well on all these measures, and the Government will work to ensure this remains the case.