

# Supporting a sustained recovery in manufacturing

Pre-Budget 2003 Representations to HM Treasury

## A modest upturn in prospect

After over two years of sustained economic and political turbulence, the economic situation is now starting to look a little better. However, there are still few concrete signs of recovery in manufacturing, while continuing underlying weakness in areas such as innovation, skills and investment threaten to undermine a sustained recovery.

This is not surprising given the severity of the downturn in the world economy with 2001 and 2002 the worst consecutive years since 1974 and 1975. The OECD forecasts suggest that growth in the world economy will be modest this year but a little better in 2004. This underpins our forecast of faster growth in engineering and manufacturing in 2004 and into the following year. However, the projected growth rates are modest in comparison with the large contraction that these sectors have experienced in the previous two years.

## Improving productivity but fundamental weaknesses remain

Along with the prospect of somewhat stronger growth next year, there are

some other signs of improvement. Both productivity growth and profitability have started to improve. Provided that output recovers as forecast and the euro retains its recent gains against the pound, we might hope to see further improvements on these fronts.

Significant underlying weaknesses in the performance of manufacturing do, however, remain. In this decade, the trade deficit has hit record highs. Clearly, the UK trade balance reflects many factors including the UK's rate of economic growth compared with other countries, the exchange rate and the level of household spending and is not simply driven by the competitiveness of our manufacturing sector. In addition, it is simplistic to suggest that surpluses are always a good thing and deficits are always bad.

Nonetheless a comparison with other OECD countries shows the UK 20th out of 30 member countries in the ranking for trade balances in 2003 with Spain and the United States the only major developed countries with larger deficits as a percentage of their national incomes. In addition, the OECD tables show that the UK has recorded one of the worst trade balance deteriorations since 1985. In this period, only Turkey, Portugal and Mexico have seen their trade accounts move faster into deficit.

## PRIORITIES

No rise in the business tax or regulatory burden

Introduce short term investment incentives

Extend and better fund Modern Apprenticeships

Deliver action on Employers Liability Insurance & Pensions

Extend Climate Change Levy Agreements

The weakness of investment also poses a considerable threat to a sustained improvement in productivity, competitiveness and growth. As a proportion of gross value added, manufacturing investment is set to hit its lowest level this year since statistics were collected. The latest EEF Business Trends show that only a fifth of companies (19%) expect to expand investment over

the next twelve months, with 55% pointing to them remaining the same, whilst 26% project further contraction.

Feedback from member companies suggests that pension problems will be a major constraint on any recovery in business investment. In many cases, any funds from improvements in profitability are likely to be diverted towards reducing their pension deficits instead of financing capital expenditure. [This reinforces the importance of tackling pension problems and, for example, accelerating progress on the replacement of the Minimum Funding Requirement \(MFR\) with a scheme specific standard. It also underlines the importance of avoiding any further rise in the business tax burden that could derail what is likely to be a modest recovery.](#)

## A worsening fiscal outlook

The proposals in this submission are framed against a fiscal outlook that is becoming more difficult. We believe that with the economic cycle likely to have run its full course by 2005/06 (as measured by the output gap), the Chancellor will soon have to take action to meet his fiscal rules which state that over the economic cycle:

- the government borrows only to invest and not to fund current spending. This implies that the government will run a surplus on current budget over the course of the economic cycle and is called the golden rule;
- the ratio of net public debt to GDP will not exceed 40% of GDP (though this level can be altered) – the sustainable investment rule.

The Treasury's current projections suggest these rules will continue to be met without the need for further tax rises or actions to curb spending. However, the Institute of Fiscal Studies is predicting continuing and widening current budget deficits with the gap between their and HM Treasury's projections reaching £13bn by 2007/08. These differences are explained by HM Treasury's more optimistic assumptions on economic growth, on the recovery in corporation tax receipts and control over government spending.

Important decisions will need to be made over public spending and potentially over taxation. Though the bulk of any tax rises could be postponed till 2005/06, it may be that a more gradual adjustment would be preferable to a larger later one. This might also take the pressure off the MPC to raise interest rates.

In the coming months before making our Budget submissions, we will be consulting members on the various options, posing the following questions:

- What should be the balance between increases in taxation and reductions in public spending growth?
- If taxes are to be increased, what would be the best way to raise them, taking into account both the needs of manufacturing but also the wider health of the economy?
- Should fiscal policy be seeking to rebalance the economy or should other measures take on this role?
- Do the fiscal rules need revisiting?
- Would the proposals for a more active fiscal policy if the UK adopted the single currency make for a better economic environment for business?

## Investment starting from a bad position

Our submissions on investment are hardly made against a promising background. Manufacturing investment has shrunk 40% from its peak of five years ago. Comparing manufacturing investment over the previous three recessions shows that it followed a very similar downward curve over the three periods, but past experience suggests that it should now be at least levelling off. The data for the second quarter together with survey information on

investment intentions suggest that the outlook for manufacturing investment is worse this time.

Clearly, a range of factors has been responsible for the weakness of manufacturing investment, particularly the state of world trade. In addition, survey and anecdotal evidence suggests that the need to address pension deficits is also diverting resources from investment. Nonetheless, we believe that there is a need to address our longstanding weakness in manufacturing investment if we are to make sustained improvements in productivity.

As part of its work on US/UK manufacturing productivity, an EEF survey of manufacturers in 2001 found just over half of firms that had cut investment felt that this had hindered their performance. In addition, those firms that had significantly increased capital investment over the previous twelve months were more likely to see strong growth in productivity and profitability.

A range of factors explain our longstanding weakness on investment. These include the pattern of ownership in the UK which tends to encourage higher dividend payouts and the fact that financial markets have shunned investment in manufacturing in recent years. This may have been a rational decision by city investors but has made it harder for manufacturers to fund the investment required to improve returns.

UK firms are also far more dependent on internal finance (retained earnings and depreciation) to finance investment than German (and Japanese) firms. This makes investment in the UK more sensitive to changes in the availability of internal finance. The significant deterioration in the profitability of UK firms in recent years as a result of Sterling's overvaluation has undermined investment to a greater extent than in some of our key competitors.

In 2001 manufacturing profitability was one of the lowest of the sixteen countries covered in an analysis by National Statistics. The average profitability in previous years was also very low by international standards. This has reduced the availability of internal finance and the attractiveness of manufacturing to external finance.

### Getting the environment for investment right

If we are to turn around the UK's weak performance on manufacturing investment, we must tackle a number of different issues. Policy framework must endeavour to deliver:

- macro-economic stability on growth, inflation and the exchange rate;
- micro-economic stability in terms of the environment in which firms operate, not least in terms of the costs burdens on firms;

- training and education that equips the workforce with the skills required by modern manufacturing;
- an environment for innovation so that firms can make the best use of capital equipment and are enabled to incorporate the latest technology.

The recent IPPR report, 'Manufacturing in the UK' came to similar conclusions, suggesting that 'given the role that uncertainty plays in retarding investment, the government should strive to match its commitment to macro-economic stability with a period of micro-economic policy stability.'

### Specific support for Investment

The aspects mentioned above are themselves difficult to deliver on their own, but even if they were in place, investment in UK manufacturing would still be undermined by its dependence on internal finance and the squeeze on that finance. The EEF has argued in the past that the most direct way to tackle this problem is through the tax system and in particular through permanently higher capital allowances.

They have the advantage of being directed right at the issue of the squeeze on internal finance and help to ease cashflow problems. In addition as they are already part of the taxation system

no legislation is needed and they are well understood by business. Our preferred option is a more generous writing-down in the first year for the current SME capital regime and we would like to see it opened to leased assets, if capital allowances continue in broadly their present form.

However, we accept that, whilst the Treasury has targeted first year allowances for investment in information and communications technologies and, in energy efficiency in relation to the climate change levy, it has not to date been convinced by arguments for higher capital allowances for a broader definition of investment. In addition, we accept the scope for more generous capital allowances is currently constrained by the potential reform of corporation tax.

The government's current tighter fiscal position is also seen as a constraint on increasing capital allowances, although this has not prevented the US government recently introducing measures to make allowances for investment more generous. Indeed, there are already signs that this is helping to accelerate the recovery in US investment.

There are, however, other concerns about capital allowances which lead us to consider alternatives to increased first year allowances which we are currently developing in more detail.

An alternative worth consideration is an investment tax credit. Unlike capital allowances, this would benefit firms whether or not they were in profit. An investment tax credit could be designed so that the firm gets the benefit in subsequent years when it is in profit or even that it receives a payment in the first year. A number of countries already use this type of fiscal incentive – France and state-tax credits in the US. One option could be a credit against tax liability of an agreed percentage of the amount invested by a qualifying company. In this way it could be restricted to qualifying business activities.

While alternative approaches might help to address some of the other perceived shortcomings of capital allowances, it is imperative that they are implemented without adding further administrative burdens to companies.

## Raising our game on innovation

It is now widely accepted that we need to raise our game on innovation both to compete with our established competitors in Europe and the United States but also against lower cost countries from Eastern Europe and large parts of Asia. Currently, the evidence illustrates a worrying gap with our competitors on innovation performance. Measures such as increased science spending, efforts to increase the supply

of research scientists and engineers into industry and the introduction of R&D tax credits are welcome and likely to bear fruit in time. However, we also believe that current approaches need to be re-evaluated and the two government reviews on innovation are therefore timely.

A lower rate of innovation than our competitors has been a longstanding weakness for UK manufacturing. This is reflected in:

- a lower level of R&D spending per worker than any other G7 country except Italy;
- a fall in the level of R&D per worker between 1988 and 1998 compared with rises in every other G7 country except Italy;
- significantly lower contributions of new and renewed patents to turnover compared with the EU average;
- lower rates of patent activity than our major competitors

The regional performance of manufacturing over the last decade illustrates these problems. In the 1992-96 periods when the exchange rate was favourable, the variation in performance was not particularly large. Since 1996 all regions have seen a weaker manufacturing performance but the tail off has been much greater in the East Midlands, Yorkshire and Humberside, Wales and Scotland. The areas of the UK

where the more traditional sectors of manufacturing are located have been more sensitive to swings in currency values. This suggests that manufacturing in these areas has failed to move upmarket and become less price sensitive.

In this section we look at the mechanisms through which the government can help manufacturing to become more innovative and focus more on adding value

### R&D tax credit

The EEF and other parties to this submission welcomed the introduction of R&D tax credits for first smaller and then larger firms. This helps to close the gap with the UK's competitor countries in terms of financial incentives for R&D expenditure. It also starts to address one of the important constraints on innovation in the UK. The results of the most recent EC Innobarometer survey show that financial resources were regarded as a key 'unsatisfied need' by UK-based companies with the proportion citing it well above the EU average.

Though the tax credit is helpful, many businesses find it difficult to understand and to make claims. Our submission has focused on the need to make it easier to claim the credit by greater use of pre-filing discussions, more sector specific guidance and a shift in focus from the outcome of innovation to the process of innovation itself.

### Improving networking and collaboration

With few companies having the resources to undertake all the activities involved in developing a new product or process or improving existing ones, universities have become important partners for many firms. Interviews with member companies show that they derive a number of benefits from collaborating with universities including staff development, access to specialised equipment, exposure to new ideas, solving problems and making incremental improvements. Working with universities enables many companies to undertake projects which simply would not have been possible given their resource constraints.

However, there are also significant weaknesses in the way that firms collaborate both with each other and with universities in the area of innovation, many of which have been echoed in the interim findings of the Lambert Review.

These include insufficient networking between companies which means that they are missing out on opportunities to collaborate with each other on research projects and in sharing information on potential research partners in universities and their own experiences. Related to this is inadequate information on availability and quality of university research partners.

We believe that the success of programmes such as the Manufacturing Advisory Service holds out some important pointers for whatever mechanism is developed.

In several parts of the country, the EEF has played a key role in the delivery of this service, making amongst other things, for a business friendly front-end.

The science and industry councils being developed by some Regional Development Agencies (RDAs) have a potentially useful role to play. However, our conversations with members as part of evidence to the Lambert Review revealed a strong belief that the most effective way to introduce firms to potential partners and to educate them in working with universities was through their peers rather than government organisations such as Business Links or RDAs, though the latter could still play an important role in providing information.

Regionally-based organisations such as the EEF could therefore play an important role in developing mechanisms that reduce the reliance of companies on personal networks and helps companies to develop better knowledge of the opportunities for collaboration that are available.

A good example of the type of service that could be provided is the National Metals Technology Centre (NAMTEC) which has been established to facilitate innovation in the metals industry.

NAMTEC aims 'to be the hub of a world-class network for metals technology, demonstrably enhancing the UK metal industry's competitiveness'. It seeks to do this by providing the following services:

- a focus for metals in the UK by networking across industry, academia and government;
- promotional and foresight activities;
- collating and disseminating metals information by knowledge transfer processes;
- signposting industrial companies to the UK science base.

Significantly, NAMTEC has become highly involved in the whole range of activities involved in managing projects from identifying funding opportunities and partners to co-ordinating the preparation of proposals and managing projects once they have been initiated. These services are in particular demand for projects involving European public money where arrangements can be highly complex.

## Manufacturing Advisory Service

The EEF has strongly welcomed the introduction of the Manufacturing Advisory Service (MAS) and has been playing a key delivery role in several parts of the country. However, we are

concerned that access to assistance from the MAS is restricted in some parts of the country. While we welcome the increased flexibility that the RDAs now have in how they use their budgets, we do not believe that it is helpful for some of them to restrict access solely to smaller firms. Many medium-sized firms would also benefit from the information and advice that the MAS provides and could make a contribution on a sliding scale if resource constraints lie behind the restrictions applied by some RDAs.

*We believe that the potential widening of the activities covered by the MAS to include areas such as innovation and design needs to be carefully handled.*

The MAS has developed a good reputation quickly and a business-friendly front-end. Therefore it may well make sense to group other sources of advice, information and assistance under this one heading. However, in some cases, the actual service may be better provided by a separate but related organisation. Though it has been successful so far, the MAS is at a very early stage and could lose focus if its resources are spread too wide. We also believe that the Innovation and Growth Teams have started to make a positive contribution and that there may well be scope for extending their coverage by sector.

## Regional Selective Assistance

Along with a variety of policies being developed by the RDAs, tools such as Regional Selective Assistance (RSA) need to place a much greater focus on projects that will increase value added.

Statements in the 1998 Competitiveness White Paper indicated that there would be a greater emphasis on the following criteria - wage levels relative to sectoral and regional averages, creating highly skilled sustainable employment and the quality and content of research and development and training. *A reshaped RSA must apply these criteria more rigorously with a much more explicit link to the government's productivity agenda.*

## Regional Development Agencies

The increased budgetary flexibility provided to Regional Development Agencies (RDAs) and their greater focus on innovation is welcome. However, there is a need for a clear national direction, which can be filtered down regionally in a flexible manner with RDAs, business and universities playing an active and constructive role. The government can facilitate this by further consolidating regional agencies such as the Small Business Service, Business Links, Government Offices for the Regions under the auspices of RDAs. This would prevent duplication of activities and give

the RDAs the lead role on regional innovation policies.

## Supporting Modern Apprenticeships

The low proportion of the UK workforce with intermediate and advanced level technical skills is a serious concern for engineering and manufacturing.

Intermediate skills are critical for manufacturing as they include craftspeople, and technicians. These skills are in greatest demand and are crucial to the production process. While we broadly support the government's drive to raise basic skills such as numeracy and literacy and have welcomed the recommendations of the Roberts Review to increase the supply of research scientists and engineers into industry, we believe that the intermediate and advanced technical skills agenda requires urgent attention.

Key to the sustained improvement in intermediate and advanced level skills is the Modern Apprenticeship programme, particularly at Advanced and Graduate levels. The combination of vocational education, on-the-job training, linked with rigorous workplace assessment, and employed status, is a well-recognised and respected route to development of high-level skills within industry. However, the numbers of participants in the Modern Apprenticeship system in the UK does not compare favourably with the equivalents in Germany and France. This

is due to the perceived low status of apprenticeship training in the eyes of young people, and a lack of systematic and unbiased careers advice at ages 16 and 18.

We recommend a number of actions to be taken with immediate effect, which would help alleviate the situation, and send a clear message that government is as serious as industry is about tackling the skills shortage.

- **Age restrictions on MA funding.** The funding of Modern Apprenticeships for post 25 year olds continues to be a problem for engineering and manufacturing. The recent Skills Strategy White Paper gave some hope that there would be a lifting of the funding restriction on those who do not complete the framework before the age of 25. However, it failed to provide the unequivocal signal from government that all those who are post 25 years who are capable of completing an MA, and who have an employer willing to make the commitment, would receive the required funding. We call on the government to fund Modern Apprenticeships for all ages at the nationally agreed 16 to 18 rate (currently around £13,500 for an Advanced MA).
- **Level 4 qualifications within the MA framework.** Currently, the Technical Certificate element of the MA framework is funded through the

Learning and Skills Council (LSC). However, funding support is limited to level 3 qualifications. This means that valuable level 4 qualifications such as HNC/HND (and in the future, Foundation Degrees) are excluded from the LSC funding stream. Any company or training provider wishing to offer such level 4 qualifications is forced to approach the Higher Education Funding Council for funding support. This creates an administrative barrier for employers and training providers, as they must now engage with another funding agency with its own protocols and audit requirements, which is expensive. This in many cases prevents employers offering the most appropriate framework to their apprentices, and makes the MA less attractive to high-achieving students. The White Paper on the future of Higher Education has identified this lack of co-ordination between the funding bodies as an area for attention if the government's higher education agenda is to proceed.

- **Careers advice and guidance.** We are not convinced that the Connexions Service is sufficiently focused on the wider cohort of young people. Its work is currently centred on disaffected young people yet industry requires all young people to receive timely, accurate and unbiased advice about engineering and manufacturing opportunities. Each student currently

receives on average less than 20 minutes guidance per year. This must be increased, and the quality of the advice improved, otherwise, young people will rely on teachers, parents, and other students when making their choices, and may not be aware of the range of routes to high level occupations. Vocational education and, in particular, the Modern Apprenticeship will not achieve the reputation its equivalents have in other European countries unless it is supported, recognised and promoted in schools and colleges.

- **Changing perception in schools.** Secondary schools have the key role in preparing young people for their working lives and it is therefore essential that they provide students with equal opportunity to pursue academic or vocational routes. The new GCSE in Engineering is a very positive development which the EEF has supported through the development of teaching materials. A number of Engineering Specialist Schools have also become established. It is important that the government continues to support and promote these developments. At present there is no incentive for schools to encourage pupils to consider the vocational route where it would take them away from the school's own sixth form. Government must consider mechanisms which remove such bias against vocational and work based education post-16.

Education–business links are an important way of raising students' awareness of different occupational options and helping them to make more informed career choices. Yet there is a confusion of initiatives and organisations operating in this area. We are in dialogue with DfES to improve this situation and look to government to support appropriate solutions.

- **Group Training Associations and small firms.** In engineering and manufacturing, Group Training Associations (GTAs) play a pivotal role in supporting company training, particularly in small firms. They provide cost-effective demand-led training, as well as managing apprenticeships and helping companies improve their training performance. Although the Skills Strategy recognises their importance in the post-16 training landscape, it is imperative that the contribution of GTAs is not sidelined by funding which focuses solely on other providers, such as FE colleges.

*In the wider skills context, we propose that the Employer Training Pilots are universally extended to include Level 3 practical skills where the major shortages in science, engineering and manufacturing technologies exist. This should form part of a general improvement in the provision of technical and practical skills training available to employers, tailored to their needs and provided in a timely and appropriate manner.*

## Extending Climate Change Levy Agreements

In previous submissions, we have highlighted numerous anomalies and market distortions arising from the current design of the climate change levy (CCL) and presented survey evidence on the impact of the levy. EEF's joint survey with the CBI illustrated the importance of carrots to complement the stick of higher energy costs. The survey showed that firms with access to Climate Change Levy Agreements (CCLAs) were far more likely to use the various incentive measures included in the levy and to be taking action to increase energy efficiency. Action should concentrate on widening access to CCLAs and certainly not on increasing the rate of the levy. Nor would this be justified in the current climate when margins are severely squeezed.

We therefore welcome the government's review of eligibility criteria for access to CCLAs. The use of the IPPC-based criteria does not fully account for all the energy intensive sectors of industry, and we support the principle that any new criteria should include a measure of energy intensity.

*We are working with HM Treasury and Customs and Excise to identify companies with energy intensive processes, and look forward to a successful outcome with an announcement in the Pre-Budget report that these sites can now enter CCLAs.*

Some companies face a triple increase in energy costs as a result of the CCL, the Renewables Obligation and the EU-Emissions Trading Scheme. Therefore the Treasury should abolish the levy for those installations also covered by the EU-ETS. The Pre-Budget Report must clearly indicate the government's intentions on this issue if companies are to make informed decisions on whether to opt out of the first phase of the EU-ETS.

### A fair and effective landfill tax

HM Treasury is currently conducting the second stage of its consultation with industry on a proposal to increase the landfill tax to a potential maximum of **£35 per tonne over this decade**. Though we support the aims of this measure, any increase in business tax is clearly unwelcome in the currently climate. It is therefore important that:

- firms are given time to make the necessary investment to adjust the rise in landfill costs;
- 'revenue neutrality' is defined in such a way that it does not penalise manufacturing in the way that the climate change levy does;
- the landfill tax is directly linked to a strategy to improve the waste management situation in the UK, particularly increasing recycling schemes. To date, its effectiveness in

promoting waste reduction and increased recycling activity has been limited by the failure to reinvest its proceeds in methods to encourage industry to reduce waste generation.

The majority of the revenue raised should be returned to business in the form of capital allowances and grants for investment in waste treatment and minimisation equipment. A balanced package should also include additional resources for relevant programmes such as Envirowise (advice to companies on waste minimisation) and WRAP - the waste resources action programme - which seeks to stimulate markets for recycled materials. We do not favour recycling revenue via employers' national insurance, business rates or corporation tax, as this will create anomalies, and not encourage a link between the economic instrument and changing behaviour regarding waste management.

### Easing pensions costs - accelerating MFR replacement

The EEF/Aon Consulting Pensions Survey (December 2002) revealed a rapid acceleration since 1999 in the number of manufacturing companies that had closed their defined benefit occupational pension scheme to new members. The latest anecdotal evidence from EEF members suggests this trend has continued during 2003.

The steep increase faced by employers is the key factor driving the trend towards closure to new members. A combination of factors is raising costs of which some, such as demographic changes and increasing longevity, are outside the government's control.

However, it does have control over a number of other important factors, such as the continued existence of the Minimum Funding Requirement (MFR). In his report on "Institutional Investment in the UK", Paul Myners recommended replacing the MFR with a scheme-specific funding requirement. In its recent response to the consultation exercise on the Pensions Green Paper, the government announced for at least the fourth time in the last couple of years that it would be implementing this recommendation.

Whilst on this occasion the government provided some further information about this scheme-specific funding requirement together with an indication of its likely implementation date, the detailed legislation has yet to be published. **Until this occurs, employers are inevitably facing a period of further uncertainty about how this change will affect the operation and funding of their occupational pension scheme. These delays make it difficult for employers to plan with confidence for the future.**

## Pensions Protection Fund – avoiding unintended consequences

The government has compounded these problems with further announcements that will affect the cost of running occupational pension schemes. For example, the proposed introduction of a Pensions Protection Fund (PPF) will provide greater security for pension scheme members and help to rebuild employee confidence in occupational pension schemes. However, there is a real danger that the PPF could have unintended adverse consequences by imposing additional costs on employers that are not offset elsewhere.

When finalising the details of the PPF, the government should allow employers to recover at least part of the PPF costs from pension scheme members as they will benefit from these new insurance arrangements. Moreover, we feel that the “cap” on the maximum pension that will be protected by the PPF should be increased from the proposed final eligible salary of between £40,000 and £60,000 per annum to, say, the level of the earnings cap. In this way, more senior managers will see that they will benefit from the introduction of the PPF and therefore have more of a vested interest in retaining their company’s occupational pension scheme.

## Concerns over simplification

The HM Treasury/Inland Revenue consultation document on simplifying the taxation of pensions provides a number of helpful proposals. We welcome particularly those simplifying the multiplicity of different tax regimes and supporting the introduction of more flexible retirement arrangements. However, we have concerns about some of the government’s more detailed proposals and feel that they need to be reconsidered.

The proposed introduction of a £1.4m lifetime limit on the value of an individual’s pension fund at retirement that can attract favourable tax treatment has a retrospective impact and could have a similar adverse effect on occupational pension provision as the earnings cap has had. This has resulted in an increasing number of senior managers becoming disengaged from their company’s occupational pension scheme and therefore having no real vested interest in its retention. One way in which this problem could be addressed would be to allow employees to have a higher lifetime limit of, say, £2.8m but only in respect of benefits accrued from their membership of an occupational pension scheme that is open to all employees on the same terms.

The rules of many occupational pension schemes provide members with a guarantee of five years’ worth of their

pension. If members die within five years of starting to draw their pension, their widow or widower receives a lump sum payment equivalent to five times the member’s pension less the pension that has been paid before death.

This lump sum payment is currently paid free of tax but the HM Treasury/Inland Revenue consultation document has proposed that it should be taxed. We strongly urge the government to amend this part of its tax simplification proposals. Manual workers are more likely to die within five years of retirement and the widows or widowers of these lower paid workers are likely to suffer disproportionately from this change.

## Reforming Employers’ Liability Insurance

The rising cost of insurance is imposing a severe burden on business at a time when profitability and cashflow are under severe pressure.

The interim report from the Department for Work & Pensions (DWP) contains some useful measures and indications of short-term goals that will be covered in more detail in the final report expected in the Autumn. We welcome the focus on raising service standards, particularly the establishment of 21 day renewal notice periods. Currently, many firms face unacceptably short notice periods that leave them forced to accept huge increases in premiums in order to obtain

any cover at all. The development of self-assessment packages to assist companies in providing information to insurers will also be helpful. However, this will only really benefit firms if the review is able to accelerate progress towards risk premiums that more closely reflect the risk profile of individual firms.

The review will also set out a number of longer-term goals and it is here that we have greater concerns. None of the issues listed below are easy to resolve and we should not expect to see quick-fix solutions. However, we believe these difficulties must not be used to delay the urgently required reforms. The government must also recognise the vital role that it has to play. The much improved dialogue between insurers, employers and unions that is intended to lead to the creation of stakeholder groups can only help to bring a solution closer. The government must recognise, though, the market alone will not deliver answers to these complex problems. In particular, we believe that there is a need to:

- put rehabilitation at the heart of a revised system;
- reduce the need for litigation as under current arrangements legal costs represent a significant component (40%) of the current settlements;
- consider faster and more cost effective dispute resolution procedures;

- investigate the case for separating long-term occupational diseases from accident risks.

The government could also help to reduce the level of insurance pay-outs and therefore premiums in a number of ways. It could, for example, introduce a stricter set of tariffs that would govern the level of claims payable for specific injuries. Alternatively, payments could be made to claimants in stages, covering needs as they arise, rather than the current system of lump sum payments (usually annually). By improving the cash flow of insurers, this could help to moderate increases in premiums.

### Recovering NHS costs – an unfair business burden

We are also strongly opposed to proposals to recharge employers for the recovery of costs incurred by the National Health Service as a result of workplace accidents. Such a proposal is totally inappropriate at a time when employers are suffering a large increase in the costs of Employers' Liability Insurance (ELI) and other forms of insurance and when the operation of the ELI system is being fundamentally reviewed. We also reject the suggestion that this will only hit 'bad' employers with a higher accident rate. If this aim was to be achieved under the current system, it would be necessary for the insurer to recharge the individual

company for health costs incurred. In this way the 'polluter pays' objective, stated for this policy, could be met. Under the current proposals the far more likely outcome is that all premiums will rise, reflecting the increasing risk of bearing NHS costs. We welcome the fact that a decision on this has been postponed until Spring 2004 but remain very concerned at this potential further increase in the business cost burden.

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## About EEF

EEF, the manufacturers' organisation, has a membership of 6,000 manufacturing, engineering and technology-based businesses. Comprising 12 regional Associations and UK Steel division, it is one of the UK's leading providers of business services in health, safety and environment, employment relations and employment law, world class performance, education, training and skills.

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