



Rt Hon Alistair Darling MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Friday 25 September 2009

Dear Mr Darling,

Our organisations represent a significant part of the manufacturing industry. We are writing to you ahead of the Pre-Budget report to highlight ways in which the government can provide a stable and supportive business environment for manufacturers as the sector moves from recession to recovery.

Summary

UK manufacturers have experienced very difficult conditions over the past 12 months and the consensus view is of an anaemic recovery. EEF's analysis suggests that an upturn is unlikely to gain momentum until well into 2010 and there are a number of factors – both domestically and in the wider global economy – that could keep manufacturing output well below pre-recession levels for a sustained period.

As companies move from recession to recovery, the need for stability in the business environment remains critical. Manufacturers have moved from crisis management to ensuring they are positioned to take advantage of an eventual recovery in demand. Strategies have returned to focusing on value adding strategies, with innovation central to maintaining a competitive position. However, continued pressure on cashflow and ongoing credit constraints may well hamper these efforts.

The stimulus measures and lending guarantees announced in the Pre-Budget report 2008 and Budget statement earlier this year helped the UK economy avoid some of the worst effects of the global recession. Although there have been consequences for the public finances. While the UK needs to move to more sustainable fiscal position, there are clear risks of rapidly reversing the support for the economy before recovery has taken root. Equally, we must ensure that policy continues to support the shift to a more balanced economy.

In order to support manufacturing through the early stages of recovery we recommend:

- 1. The 40% first year capital allowances should be extended for an additional 12 months, until April 2011.**
- 2. The rate of corporation tax for small companies should be frozen until April 2011.**
- 3. The UK should initiate dialogue with EU authorities to extend the Letter of Credit Guarantee Scheme to developed economies.**
- 4. Ensure R&D tax credit rules reflect the intention of the credit.**
- 5. Provide clarity on the future funding for skills programmes.**
- 6. Delay the introduction of regulation that adds to the burden on businesses.**

Moreover, the Pre-Budget Report also provides a timely opportunity to outline greater detail on how government can support companies' efforts to move into and exploit new and emerging markets and technologies, as part of a long-term strategy for the UK economy. A framework which sends strong signals to the private sector about the priorities for the economy and those industries in which UK companies are well placed to become world leaders, must be accompanied with measures to ensure that we do not lose the advantage to our competitors. We therefore recommend:

- 7. Subject to state aid rules, a temporary extension of a payable R&D tax credit to large companies engaged in low-carbon innovation projects.**
- 8. The government brings together the various schemes – the new regional venture capital funding, the Enterprise Capital Funds, the Innovation Investment Fund, the Grant for R&D and the regionally delivered proof of concept funding – into a single and easily accessible source of finance, such as a Bank for Industry.**
- 9. A new national skills strategy should set out a stable and responsive framework designed for the next decade.**
- 10. The government must build on its recent initiatives to establish a framework that sets out its priorities for the economy and what it will do to achieve them.**

The Pre-Budget report must also signal how the UK is to move to a more sustainable fiscal position. Supporting growth and productivity across the economy must continue to be a priority as the competitive pressures we face will once again intensify as the global economy returns to more normal growth. Equally important is that companies planning long-term investments have some certainty about the direction of future tax changes that are inevitable if the significant budget deficit is to be addressed.

For manufacturing to play an important part in the recovery of our economy and contribute to the UK's long-term prosperity, it needs continued stability in the near term, a strong signal of the government's strategic priorities and clarity over how stability in the public finances will be regained in the long-term.

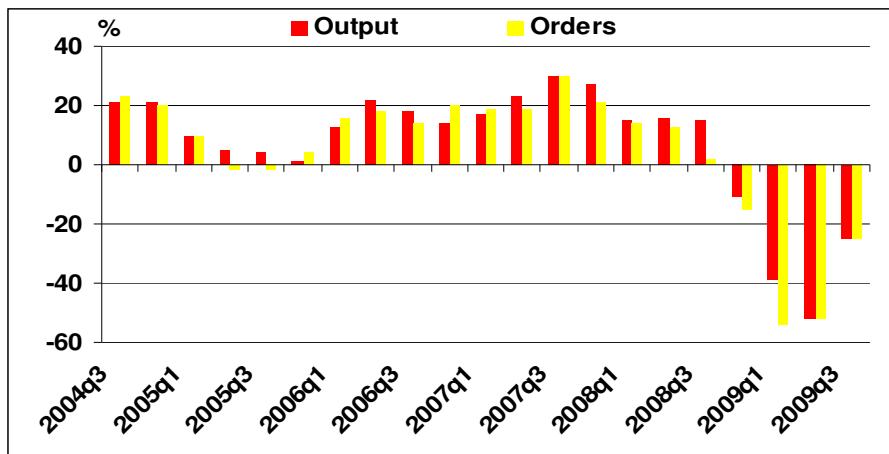
Outlook for manufacturing

Over the past 12 months manufacturing has suffered sharp falls in production levels as the effects of the global recession hit and world trade flows collapsed. The combination of UK manufacturers' exposure to global markets and the weakness in the domestic market has contributed to the significant deterioration in business conditions since last Autumn.

EEF's regular business trends survey illustrates the extent of the decline in activity across manufacturing (chart 1). Little more than a year ago many companies were continuing to report robust growth, but in the first half of this year they were reporting some of the most difficult trading conditions in the history of our survey. A significant majority of companies saw orders in both the domestic and export markets contract rapidly, with consequences for both output and employment levels. Despite the improvement in output and orders balances in the third quarter of this year, responses remain below the levels seen during the recession in manufacturing earlier in the decade.

Chart 1 Manufacturers report further falls in output and orders

% balance of change in past three months



Source: EEF Business Trends Survey

In addition official statistics show output levels remain significantly below pre-recession levels. Our survey also suggests that confidence among manufacturers' remains muted, with most believing that a rapid return to growth is not imminent. Our forecasts suggest that recovery for UK manufacturing is likely to be slow and halting.

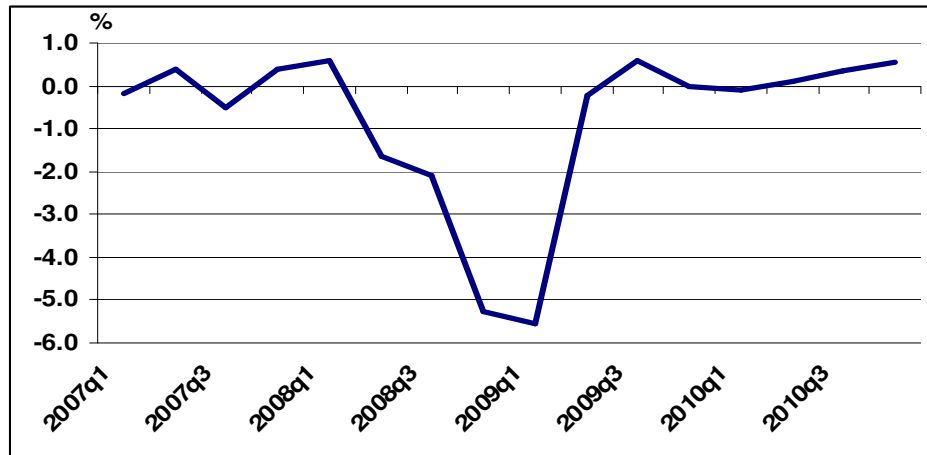
The outlook for engineering and manufacturing growth in 2009 remains mixed. There are significant concerns about the strength and sustainability of any turnaround as signs of growth in Europe, Asia and the US are tentative and uncertain. Any small bounce from restocking could prove temporary if world trade does not sustainably rebound or if global economic stimulus is withdrawn too rapidly.

The latest official data estimate that manufacturing output contracted by 2.1% year-on-year in 2008, and we expect manufacturing to fall by 10.2% this year before posting moderate growth of 1.1% in 2010. In engineering, output is forecast to fall by 15.7% this year and by 0.2% in 2010. The annual numbers, however, mask a renewed dip in manufacturing and engineering output after a brief return to growth in 2009q3.

Despite the efforts of companies to retain employees, our assessment of the employment outlook has weakened, reflecting the risks and uncertainties inherent to the recovery. Although we expect fewer jobs to be cut than in previous recessions, the sector could see the largest decline in employment levels for six years in 2009 and further job losses in 2010.

Chart 2 Long road to recovery forecast

% quarter on quarter change in manufacturing output

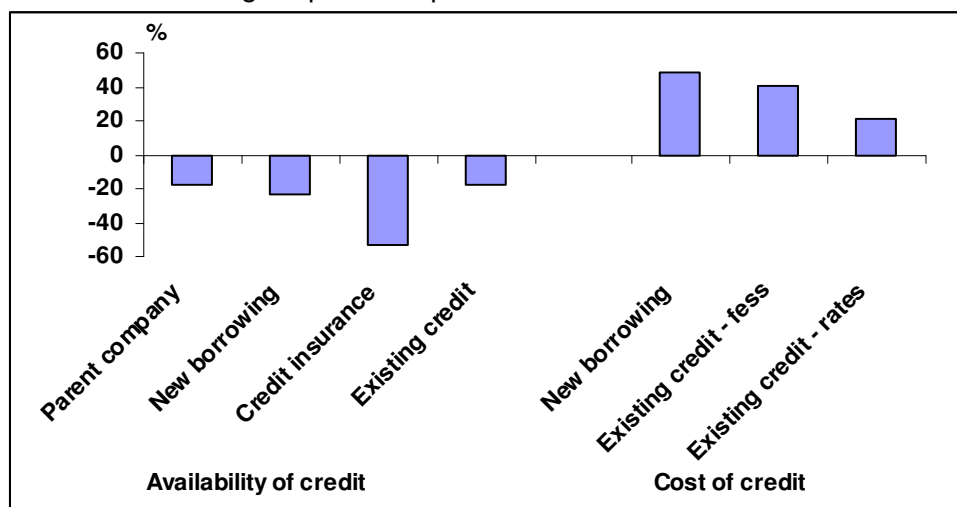


Source: EEF

Aside from the risks associated with key markets, there are additional factors that could hold back growth and pose additional challenges for companies, beyond those felt in a normal recession. Over the past year EEF has been monitoring credit conditions across manufacturing – as shown in chart 3. Despite interest rates at historic lows and efforts to increase the supply of credit, firms continue to report an increase in the cost of the finance and an ongoing squeeze in availability. If these conditions persist they could limit firms' ability to respond to the upturn in demand when it comes.

Chart 3 Conditions in credit market show few signs of improvement

% balance of change reported in past two months



Source: EEF Business Trends Survey 2009q3

From recession to recovery

Since the global recession took hold last year governments and central banks around the world have acted swiftly to minimise the fallout from the financial crisis. Targeted and temporary support, directed towards the areas of the economy that were most vulnerable to the extraordinary events in financial markets and ensuing contraction in demand, has limited the long-term economic damage.

In the UK the package of measures outlined in last year's Pre-Budget report, and the Budget statement earlier this year, will have prevented domestic demand from falling as far as it otherwise might have done. In addition, HMRC's introduction of the Time to Pay arrangements and the postponed increase in the small companies rate of corporation tax have limited additional cost burdens on business at a time when profit margins and cashflow were under increasing strain, providing some breathing space for businesses. And, while steps to improve access to credit have taken longer than hoped to show real benefits, they were nevertheless necessary to prevent further damage to the UK's manufacturing base.

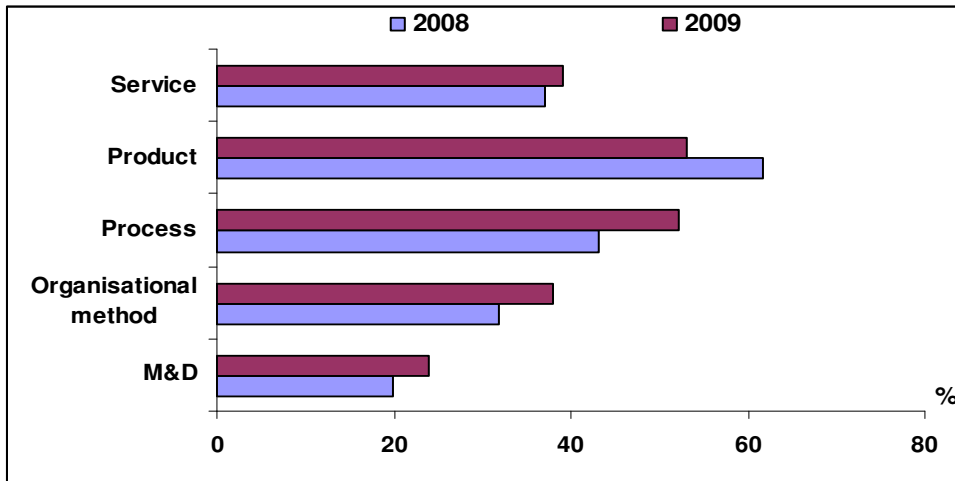
Companies have been acutely aware of the need to maintain a focus, not just on day-to-day management through the recession, but also on the factors that will help maintain their longer-term competitive advantage. A survey¹ of EEF members earlier in the year showed that over half of manufacturers had concerns about retention of skills; their ability to finance investment and having the right mix of products and services. Moreover, a significant majority of companies were worried that these pressures were even greater further down their supply chains.

Manufacturers have therefore drawn on a range of supporting measures as they look to an eventual recovery in demand and seek to ensure they are adequately equipped to compete when demand returns. For example, the increased flexibility and additional resources directed through Train to Gain have supported companies' efforts to upskill and reskill employees both to raise productivity and to support innovation activities.

They have also sought to keep innovation on their agenda during the downturn. Findings from our *Innovation Monitor* (see chart 4) show that, over the past 12 months, companies have tried to make a virtue of more limited resources in the downturn, by focusing on in-house improvements, with plans to shift emphasis towards new product and service innovations in the next few years. Their ability to do this will, however, depend on them being able to overcome the financing constraints that have hampered business over the past year.

¹ EEF Business Trends Survey 2009q2

Chart 4 Companies continue to innovate through the recession,
 % of companies introducing type of innovation in past three years



Source: EEF Innovation Monitor

Re-balancing in the recovery

There is a growing consensus that the UK economy is unlikely to return to business as usual growth following this recession. Putting the UK on a more sustainable footing will require a shift in our economic make up with a greater role for sectors such as manufacturing. Recent strategies from government, such as *New Industry, New Jobs*, outline a more active approach to supporting and developing the UK industrial capabilities.

Access to skills and finance, increasing innovation and having the right supporting infrastructure will continue to be critical components of the right business environment as UK companies' competitive strategies focus on investment-intensive production, design and services. But for many manufacturers, the economic situation and outlook will remain their primary focus. On the back of these coordinated efforts, most of the major developed economies have stopped shrinking and some have experienced a little growth.

Nevertheless, our analysis of the latest economic situation suggests that both globally and in the UK it has improved but that currently lacks the strength to sustain itself. As the UK economy emerges from recession new challenges and opportunities for manufacturers will arise. Their own efforts to position themselves to respond have been supported by policies to minimise cost burdens and support investment in skills and new equipment. The period of recovery following an economic downturn can be just as uncertain as the recession itself. Supporting companies through the recovery and ensuring the longer term competitiveness of manufacturing in a more balanced UK economy will require:

- stability in the business environment;
- a strategic framework for the future; and
- a shift to a more sustainable fiscal position.

Stability in the business environment

If, as we expect, the road to recovery is long and uncertain the need for a stable business environment will be just as important during the upturn as it was when we were in the grip of recession. This should also include the aspects of support that were implemented to fend off the worst effects of recession and prepare companies for future growth opportunities.

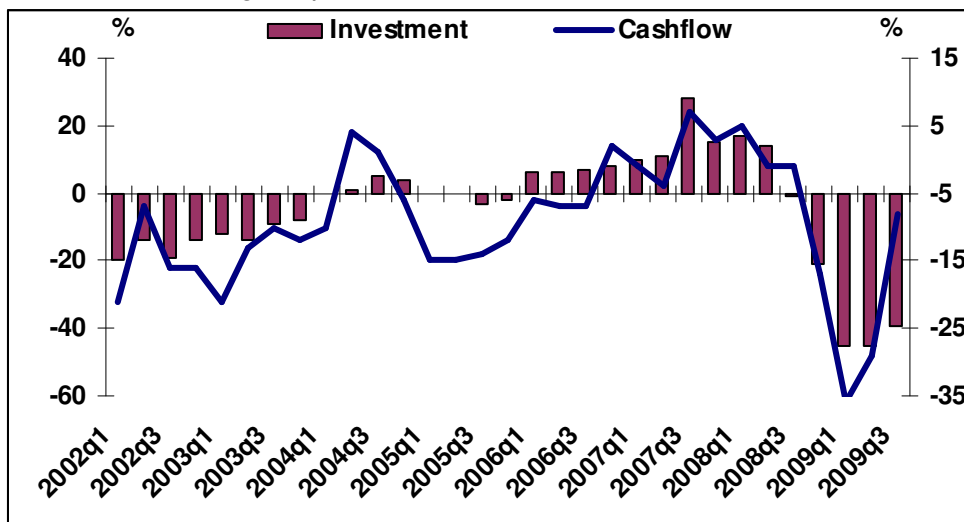
We recommend ongoing stability in this policy framework, particularly in areas that are central components of future competitiveness – training, capital investment and innovation. Creating a climate of certainty during what is likely to be another 12 months of instability for manufacturers, will allow companies and the economy as a whole to make the investments necessary to take advantage of growth in global markets. We are therefore not proposing a raft of new interventions, rather a continued emphasis on helping companies prepare for growth.

1. Extend 40% first year capital allowances

Capital investment in manufacturing has been a casualty of this recession. The latest official data showed the biggest quarter on quarter contraction in business investment on record – in line with EEF's Business Trends Survey, which indicated that investment intentions hit historic lows in the first half of this year. Despite the measures announced in the Budget to encourage companies to carry on investing, factors such as cashflow pressures, uncertainty about demand and credit constraints have more than outweighed the increased level of capital allowances. Chart 5 shows that in the past three months a majority of companies continued to scale back investment plans for the next 12 months.

Chart 5 Manufacturers scale back investment plans

% balance of change in past three months



Source: EEF Business Trends Survey

Comparisons with previous recessions in the 1980s and 1990s show that when manufacturing business investment falls following the onset of recession, it takes almost four years to return to growth. There are clear dangers that, if investment follows previous patterns, there will be long-term damage to the productive capacity of the sector. In addition, there are some tentative signs that investment in new capital equipment is beginning to pick up in competitor countries.

While our preferred mechanism to support investment in advance of the Budget was to increase the Annual Investment Allowance, consistency of policy is also desirable. **The 40% first year capital allowances should, therefore, be extended for an additional 12 months, until April 2011.**

2. Continue to postpone the increase in the small companies corporation tax rate

Last year EEF showed that small companies, in particular, have faced a great deal of uncertainty about the direction of tax policy in recent years. Cuts to the small companies rate of corporation tax, followed only five years later by year on year increases, have added to cost increases and an unpredictable tax system. Given the economic climate, we recommended that the small companies rate of corporation tax should not be increased until April 2010 at the earliest.

Small and medium sized enterprises (SMEs) play a key role in the economy and in job creation. With recovery likely to be weak, an increase in business taxation at this point in the cycle could undermine it and the longer- term competitiveness of this important sector. **We therefore recommend that the rate of corporation tax should be frozen until April 2011.**

3. Support for export credit insurance

The withdrawal of credit insurance has been plaguing manufacturers and their supply chains since last Autumn. In the two months to August, nearly 60% of companies continued to report a reduction in the level of cover or complete withdrawal. Government has acknowledged the problem and the difficulties that this is causing across the sector. The introduction of a top-up scheme for companies that have seen the levels of cover reduced on domestic sales, and the subsequent extension of criteria for support was a welcome intervention, even if take up has been extremely limited.

That said, a significant problem still remains for companies that have seen insurance cover reduced on sales to export markets. Efforts by the Export Credit Guarantee Department (ECGD) to bridge this gap have concentrated on exports to developing and emerging markets, which still account for only a small proportion of UK exports. A return to growth in world trade flows could provide growth potential for many manufacturers, but barriers to accessing these will prevent exports from contributing to an export-led recovery.

The government's response to the ECDG consultation on guaranteeing letter of credit arrangements (LCGS)² recognised the need for swift action on export credit insurance. It also left open the possibility of an intervention on exports sold on short-term credit to developed countries – subject to EU sanctions. Companies have been grappling with this issue for some months and the potential lead time involved in progressing such an intervention is likely to be long. Other European competitors, including Germany, have already put government guarantees in place. **The UK should, therefore, initiate dialogue with EU authorities to extend the Letter of Credit Guarantee Scheme to developed economies.**

4. Ensure R&D tax credit rules reflect the intention of the credit

² Export Credits Guarantee Department (2009) Government Response to the Public Consultation on the Introduction of a Product Guaranteeing Reimbursement of UK Confirming Banks under Letter Of Credit Arrangements

We have highlighted the significance of innovation for manufacturers. Over the past decade the tax system has recognised this with a tax credit for R&D. The R&D tax credit has taken some time to generate additional R&D among firms. Research from the Institute of Fiscal Studies suggests that the benefits of R&D tax credit, whether volume-based or incremental, are only accrued in the long run. More recent evidence suggests that it is now delivering lower R&D costs for businesses or having a positive impact on R&D activity. Feedback from EEF's members suggests that the seven specialist centres have improved the administration of the R&D tax credit.

However, recent changes to the way that HMRC is interpreting guidelines devised in 2004 by the then Department of Trade and Industry is creating uncertainty for industry. Changes to the interpretation of the rules (see annex) to exclude any R&D that results in the production of goods and services would rule out eligibility for most manufacturers. No UK-based manufacturing company could survive if it conducted R&D to create a product or service that was not intended or did not have the prospect for supply to customers. **Rather than interpreting the guidelines to restrict the eligibility of the R&D tax credit, HMRC staff should abide by the original intention of the legislation and the guidelines.**

5. Provide clarity on the future funding for skills programmes

In a high labour-cost economy, where innovation makes a growing contribution to performance, attracting and developing the right skills can make a difference right across the production spectrum. The increased success of Train to Gain suggests that companies are finding the programme more accessible and relevant to needs. However, that same success has put question marks over future funding levels.

The skills funding system is due for further restructuring from April next year as the Learning and Skills Council is replaced with a Skills Funding Agency and a National Apprenticeship Service. In the interim companies are coming up against a number of uncertainties about the availability of funding for some training, including for apprenticeship training for people aged over 19 years. Apprenticeships require a lengthy commitment from both manufacturers and training providers. **The Pre-Budget should provide clarity about future funding for skills programmes, particularly apprenticeships.**

6. Delay the introduction of regulation that adds to the burden on businesses

It is also vital that poorly timed and costly regulation does not hit struggling businesses. As the economy moves towards recovery and orders and production levels begin to improve, companies will need to maintain maximum flexibility, particularly with regard to managing workforce levels. A forthcoming survey from EEF shows that companies have maintained positive employee relations during the downturn as firms have communicated strategies to manage sharp reductions in activity and implemented innovative solutions to keep job losses to a minimum. **We recommend that the following, forthcoming regulations be postponed (see annex for details):**

- **The Temporary Agency Workers Directive, until December 2011**
A forthcoming survey from EEF shows that companies have maintained positive employee relations during the downturn as firms have undertaken strategies to manage sharp reductions in activity and implement innovative solutions to keep job losses to a minimum. Implementing the Directive as the economy starts to

recover next year would be detrimental to manufacturers. Companies are likely to be cautious about the likely strength of the upturn in demand and adding to the regulatory burden of taking on Agency workers could mean they are reluctant to recruit, limiting the available capacity to respond to an increase in demand.

- **The planned start of the Carbon Reduction Commitment, until April 2011**
While EEF supports the intention of the CRC to improve efficiency and reduce emissions, there are administration and cashflow implications for manufacturers. In addition, there is still significant amount of confusion amongst organisations of how the Scheme will affect them. Starting the scheme in 2011 will remove the complication and cash-flow implications of requiring organisations to purchase allowances for actual 2010-2011 emissions and forecast 2011-2012 emissions. This would have little impact on the scheme objectives as data is still being gathered and reported.

- **Waste controls: duty of care, waste carriers and brokers**
Delays in the publication of guidance for controls on handling, transfer and transport of waste mean companies are finding it difficult to assess the potential additional cost of the regulations. Simplifying waste regulation and making it more proportionate to risk is a priority, but changes must come after adequate consultation and give companies sufficient time to prepare.

Strategic framework for the future

A stable business environment for companies as they plot a course for recovery is one important element that will help the UK's future competitive position. In addition, as part of its active industrial policy the government has identified potential future growth sectors and markets on which the UK is well placed to capitalise.

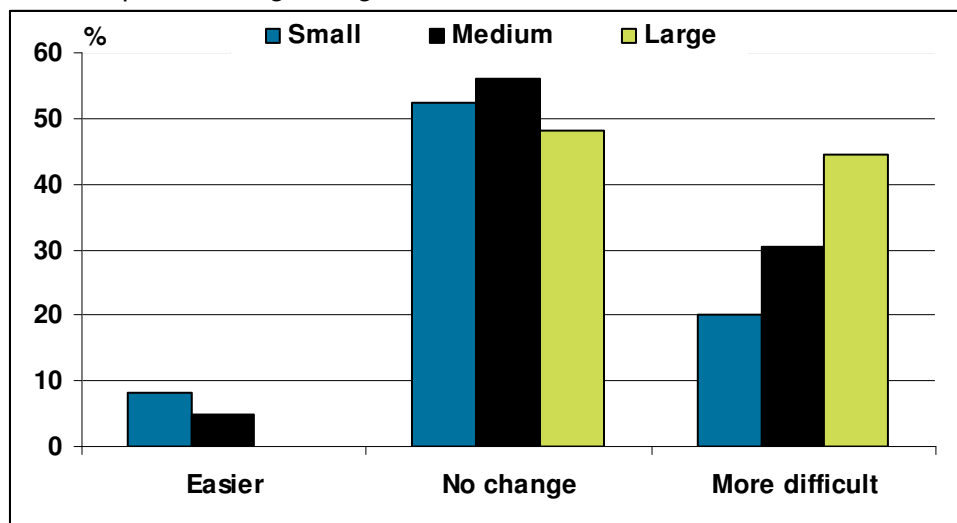
Many manufacturers have made some inroads into markets such as renewable energy supply and low-carbon goods and services. However, there are both short- and long-term barriers to the UK becoming a significant market player in new sectors and markets and ultimately in becoming a more balanced economy. We therefore recommend the following:

7. A time-limited extension of the payable R&D tax credit for larger companies

EEF's latest *Innovation Monitor* shows that companies have maintained their focus on innovation. but large companies were most likely to cite a lack of appropriate financing as a barrier to successful innovation and also to report increases difficulties accessing internal funds for investment in the past 12 months (see chart 6).

Chart 6 Finance for innovation more difficult to find

% of companies citing change in access to internal funds for innovation



Source: EEF Innovation Monitor

If cashflow constraints persist, UK companies could lose ground to competitors in developing new products. The R&D tax credit can make a difference for companies in getting internal approval for innovation expenditure and can also impact on the speed at which companies get results from their innovation activity. There is a clear need for companies to continue their innovation efforts during a downturn to avoid losing ground to competitors when the recovery comes. The transition to a low carbon economy presents some considerable opportunities for UK companies, but international competition in these markets will continue to be significant. **Subject to state aid rules, we recommend a temporary extension of a payable R&D tax credit to large companies engaged in low-carbon innovation products, solutions and processes.**

8. Financing future growth

While companies are currently experiencing problems with the cost and availability of credit as a consequence of the global financial crisis, there are also some longer-term factors at play. The private sector has moved away from providing the finance that growing, capital-intensive companies need. The finance gap has proved intractable because existing support has been spread too thinly and hasn't been targeted effectively. The government needs to send clear and effective signals about how it intends to fill that gap.

Rather than relying on multiple yet ineffective mechanisms, the government should consolidate and concentrate its resources. **We recommend that the government brings together the various schemes – the new regional venture capital funding, the Enterprise Capital Funds, the Innovation Investment Fund, the Grant for R&D and the regionally delivered proof of concept funding – into a single and easily accessible source of finance, such as a Bank for Industry.**

This Bank would have three funding priorities: providing finance for companies wanting to make a transformational change; financing capital-intensive development of new technologies; and lending for investment in intangible innovation. Rationalising the various schemes should not mean centralising decision-making. The single funding pot should be backed by a diverse and wide network of experienced investors and advisers capable of making informed investment decisions.

9. Developing a simpler and more responsive skills system

Businesses need a predictable skills system, which responds to the demands of companies and individuals. This must be matched with a funding system that allows companies to make decisions about training and skills priorities are vital, especially in the current climate. The current skills system is currently going through a process of transition with the creation of a new Skills Funding Agency. Concurrently, the UK Commission for Employment and Skills is finalising recommendations on the simplification of the current skills architecture.

Over the long run, simplification should be based on removing the barriers businesses face in accessing training provision and on helping them to invest in workforce development. **The new national skills strategy should set out a stable and responsive framework designed for the next decade.**

10. An overarching framework for the economy

Looking beyond this recession, manufacturers need the government to set out a plan that gives them the confidence to invest in a better balanced economy. Government influences market outcomes on a daily basis, through taxation and regulation and as a customer and investor. **The government must build on recent initiatives to establish a framework that sets out its priorities for the economy and what it will do to achieve them.** This framework also needs to recognise the diversity of the UK's manufacturing base and the markets it serves. It is this diversity that allows UK manufacturing to take advantage of a wide range of ideas, expertise and technologies. And the improved competitive position of the sector before recession hit was a result of the focus on new products, processes and services. Earlier this

year EEF set out what it sees as the key principles that should underpin such a framework³.

Send signals: New and developing markets are potentially more uncertain and volatile. Companies investing in these markets will look for business environments with the least political risk and highest expected return on investments. Businesses therefore need a clear signal about the government's long-term priorities. Only then will manufacturers have the confidence to invest. Government must signal the importance that government attached to specific technologies, markets or investments and the steps it will take to help them succeed.

Overcome obstacles: A critical part of acting before markets fail lies in identifying and addressing the obstacles to developing new markets, or significantly scaling up existing ones. Government must work with business to identify and overcome obstacles to the growth of new and developing markets, for example skills shortages, infrastructure requirements or bottlenecks in the planning system.

Be a collaborative customer: Government is a major customer for business. If deployed effectively its £175 billion budget offers significant purchasing power in new and emerging markets. But government must engage more closely with industry to convey its needs and support innovation in these areas. This will require significant culture change if the public sector is to focus on value for the economy rather than short-term cost savings.

Target investment: Manufacturers could not succeed in competitive markets unless they prioritised investments based on a clear and consistent strategy. The same rule applies to economies. Government invests in markets directly and also in areas such as skills and innovation that support these markets. With the squeeze on public spending set to tighten, the government must be bold and strategic in its investment decisions. This approach will require government to become better at balancing risk and communicating its decisions against a set of clearly understood criteria.

³ EEF (2009) Manufacturing. Our Future.

Sustainable public finances

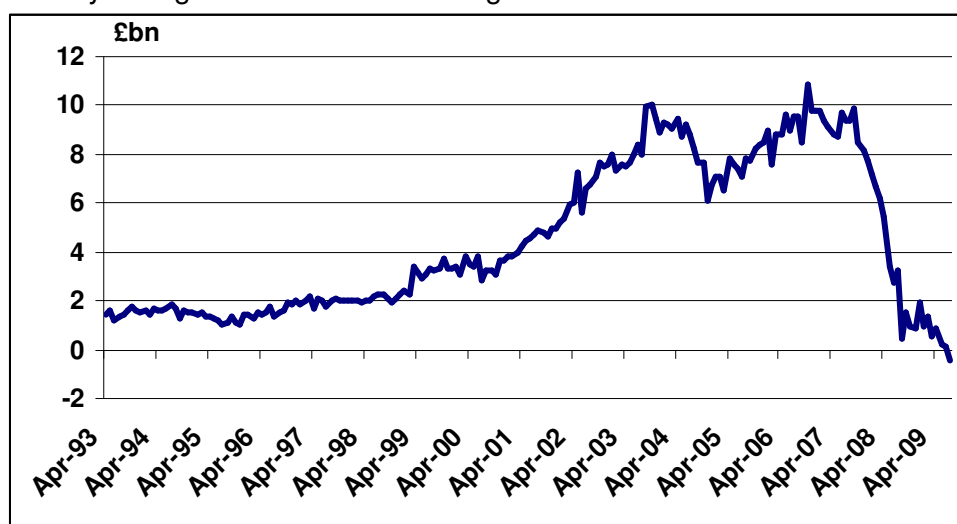
This submission focuses on our priorities for the Pre-Budget and moving towards next year's Budget. However, we also set out some thoughts on the broad principles that the government should follow in its forthcoming Spending Review, ahead of our more detailed submission later this year.

Tackling the public sector deficit should be a priority for the government. Failure to do so will ultimately lead to escalating interest payments on the debt and rising taxation. Tackling the deficit will avoid this and also provides the opportunity to tackle long-standing issues such as the rising cost of public sector pensions and a renewed impetus to drive up public sector efficiency. And it provides an opportunity for government to rethink what it does. However, we are concerned that too fast a timetable for reducing public sector borrowing risks pushing the economy back into recession and making things worse.

The experience of other economies that have experienced credit crunches in the past, particularly Japan in the 1990s, suggest that it is unwise to take recovery for granted. In a situation where households and businesses are reluctant to borrow and banks and other financial institutions not inclined to extend credit, the government takes on an important role as the spender of last resort.

The credit constraint facing manufacturers and the muted levels of confidence about an imminent rebound in activity are mirrored in the wider economy. For example, the consumer confidence survey compiled by GfK/NOP hit new lows in its 34 year history at - 39 in July last year. It has since improved to its current reading of -25 but this is still one of the worst readings on record. Similarly, chart 7 shows that net mortgage lending has declined substantially over the past two years and turned negative for the first time since this series started in 1993 in July.

Chart 7 Sharp declines in mortgage lending continue
monthly change in net secured lending to households



Source: Bank of England

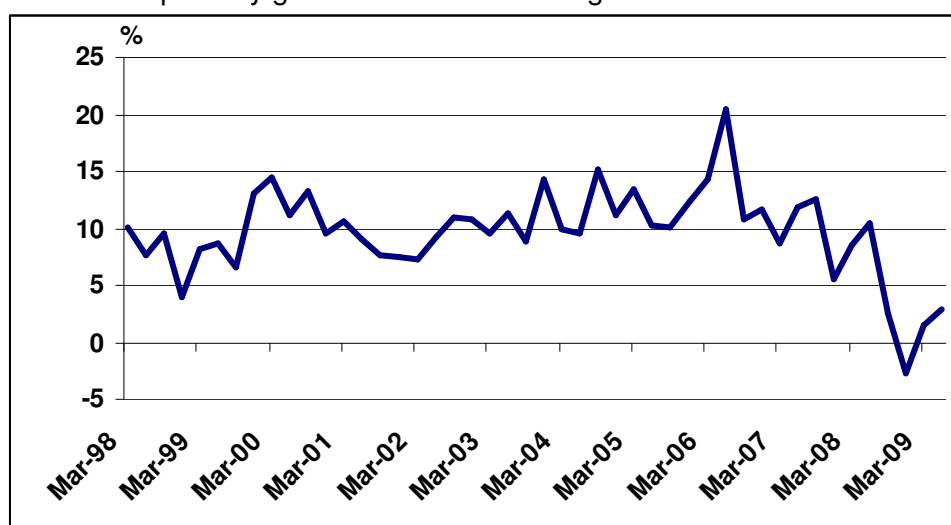
The problems facing the UK are summarised by chart 8, looking at the Bank of England's preferred indicator of growth in the broad money supply – M4. The measure presented in the chart looks at annualised changes in the money supply, excluding intermediate other financial corporations, whose actions are seen as unlikely to influence asset prices. These show that the money supply has started to

expand again after contracting in the last quarter of 2008. However, the current rate of growth of 2.9% is well below the range of 8-11% seen in the previous 11 years.

These indicators and a range of other surveys of lending conditions, of activity in the housing market and of the money supply suggest that the UK economy does not yet have the strength to support itself and that withdrawal of existing support or a tightening in fiscal policy could well push it back into recession. In these circumstances, it is vital that the government adopts a flexible approach to balancing its budget, paying particular attention to surveys of lending conditions and the key monetary indicators.

Chart 8 Lending growth to remain below normal levels

annualised quarterly growth rate of M4 lending



Source: Bank of England

Priorities for manufacturing

There is clearly a need to balance the need to move to more sustainable fiscal position with the ongoing support needed by the economy. Nevertheless, there will be tough decisions ahead on spending priorities and delivering greater value from the resources available. For manufacturers the priorities will remain the programmes which support growth and productivity, which provide opportunities for the industrial base and which deliver efficiency gains to the longer term.

Productivity and growth

In line with government's aims to increase productivity across the economy and create the conditions for growth, future spending commitments should continue to support the programmes that support the drivers of growth and productivity. As we have highlighted in this submission already, skills and innovation remain vital components of the UK's future competitiveness. In recent years we have seen increased resources directed towards both training and innovation activities. We recognise that the squeeze on public finances will put these budgets under pressure, but in both cases there may also be opportunities to deliver more front line support through simplification of the structures that surround these programmes – this is particularly true of the skills system.

However, we also recognise that prioritization of budgets will be needed. Ensuring that funding for apprenticeship programmes for all ages is maintained may inevitably require eligibility for other training programmes to be scaled back. Achieving this

balance will require close consultation with employers and the bodies that represent them to keep the system responsive to the needs of businesses and individuals.

An efficient transport network is critical to manufacturers moving goods around the country and across borders. A long period of underinvestment means the UK still needs further upgrading to road and rail infrastructure, yet the planned cuts to capital budgets mean future plans in this area could be hit. A plan for future transport investment with sufficient resources behind it would also benefit UK manufacturers in terms of future orders.

Opportunities for the industrial base

The defence budget is expected to be the subject of cutbacks in future years. Although one has been promised, the lack of an up-to-date Defence Industrial Strategy, or indeed the money to support one, has placed a great deal of uncertainty around future orders for manufacturers. This will ultimately undermine companies' investment plans in the UK and our capacity to meet future needs with domestic capabilities. Some fairly quick and definitive decisions are needed on the UK's strategic defence and security priorities.

Similarly, commitments to reduce carbon emissions across the UK will need more rapid progress on cost effective decarbonisation of our energy supply. Again there are potentially significant business opportunities for UK companies – some of which were outlined in the Low Carbon Industrial Strategy. However, these need a long-term commitment of resources from government.

Efficiency gains

Many of the shortcomings of the UK's public procurement system have been identified through a series of reviews. The pressure on departmental budgets is set to continue beyond this spending review, accelerating the need for change in the way in which government works with the private sector. It is not just the outcomes of public procurement that need to greater longer term value for money, but also the process which need to become less bureaucratic and more cost effective.

Finally, looking at the long-term health of the public finances will also require action to reduce the costs of government. The cost of public sector pensions, for example, is rising and will become an increasing burden on the public purse. The private sector has significantly reduced costs and had to work closely with employees to achieve this, both before and during the recession. Government will need to be seen to be taking similarly difficult decision to limit additional costs.

Certainty over the direction of tax changes

Identifying areas of public spending that need to be re-prioritised, scaled back or completely withdrawn is only part of the process of moving to a more sustainable fiscal position. Addressing the public sector deficit will also require difficult decisions on potential tax increases. To date, there has been some indication of future tax increases – such as the forthcoming increases in National Insurance contribution and income tax for higher-rate tax payers.

While these tax rises will make some inroads into tackling the UK's future deficit position, the possibility of further tax increases on businesses remain. Providing clarity over the future direction of tax policy, including where the burden of additional taxes will fall is critical for companies planning longer term investments. Additional tax changes need, therefore, to be announced in the context of an overall strategy for the rebalancing of the UK economy.

Yours sincerely,



Gilbert Toppin,
Chief Executive, EEF



Michael Ankers
Chief Executive,
Construction Products
Association



Michael Johnson
Chief Executive,
British Printing Industries
Federation



Steve Elliott
Chief Executive,
Chemical Industry
Association



Paul Everitt
Chief Executive,
Society of Motor Manufacturers
and Traders



Peter Davis
Director General,
British Plastics Federation



Graham Dewhurst
Director General,
The Manufacturing Technologies
Association



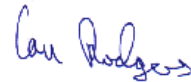
Rob Oliver
Chief Executive,
Construction Equipment
Association



Melanie Leech
Director General,
Food and Drink Federation



Tom Wills-Sandford
Deputy Director General.
Intellect



Ian Rodgers
Director,
UK Steel

Annex 1 – R&D tax credit

Recent changes to the way that HMRC is interpreting guidelines devised in 2004 by the then Department of Trade and Industry is creating uncertainty for industry

According to the 2004 guidelines, to qualify for R&D credits an activity has to resolve a scientific or technical uncertainty. Yet, HMRC has selected paragraph 24 of the 2004 DTI guidelines, “Activities which do not directly contribute to the resolution of scientific or technological uncertainty include... the production and distribution of goods and services” to argue that any R&D that results in anything being sold is production activity and therefore does not qualify.

In response to criticism from industry, HMRC is adding, “with the prospect of” to paragraph 24. As described in a Q&A document HMRC is writing to address concerns, “Activity with the prospect of producing goods or services for supply to customers is specifically excluded from the scope of R&D for tax purposes by the DTI guidelines”

But this interpretation of paragraph 24 stand in direct contrast to paragraph 9 of the 2004 guidelines:

“A project which seeks to, for example:

1. extend overall knowledge or capability in a field of science or technology; or
2. create a process, material, device, product or service which incorporates or represents an increase in overall knowledge or capability in a field of science or technology; or
3. make an appreciable improvement to an existing process, material, device, product or service through scientific or technological changes; or
4. use science or technology to duplicate the effect of an existing process, material, device, product or service in a new or appreciably improved way (e.g. a product that has exactly the same performance characteristics as existing models, but is built in a fundamentally different manner), will therefore be R&D.”

Creating products and services is inherent to three of the four examples. No UK-based manufacturing company could survive if it conducted R&D to create a product or service but was not intended or did not have the prospect for supply to customers.

The change in interpretation by HMRC officials, therefore, goes against the intention of guidelines. Manufacturers need clarity from BIS and HMT about the purpose of the R&D Tax Credit, the interpretations of the guidelines. Rather than interpreting the guidelines to restrict the eligibility, HMRC staff should abide by the original intention of the legislation and the guidelines.

Annex 2 – Delaying regulation during the downturn

There is mounting evidence that the UK has passed the worst of the recession and a nascent recovery could be on its way. This upturn is sure to be fragile and could be killed off before it has begun if government makes the mistake of hitting struggling business with poorly timed and costly regulation. We are therefore calling for delay in the introduction of the following, forthcoming, regulations.

- The planned start of the Carbon Reduction Commitment, until April 2011
- The Temporary Agency Workers Directive, until December 2011
- Waste controls: duty of care, waste carriers and brokers

Carbon Reduction Commitment

The Carbon Reduction Commitment (CRC) scheme will start in April 2010, with the Regulation likely to be finalised only at the end of this year.

EEF is broadly supportive of the government's desire, through the CRC, to increase energy efficiency and reduce emissions in the large non-energy intensive sector. However, in discussions with our members it has become clear that there is a widespread lack of awareness amongst business about how the scheme will affect them. The formulation of the Performance League Table in particular needs to be better communicated. Government also need to reconsider the cash flow implications of CRC and in particular the holding of auction revenue for six months in the context of the current economic backdrop. In addition, the scheme as it is currently structured could impact negatively on growth.

More needs to be done to provide clear and concise information about the Scheme and EEF recommends a postponement to the start of the scheme to April 2011.

Temporary Agency Workers Directive

The Regulations implementing this Directive will introduce legislation giving agency workers the right to equal treatment on pay and working conditions with comparable employees in the company were they are working. It will therefore require both companies that use agency workers, and the agencies themselves, to understand their new legal duties and responsibilities as well as consider the practical implications of this legislation. It will take them some time to do this once the final text of these Regulations has been approved by Parliament and guidance on these Regulations produced by the government. In some cases, this may require companies that have historically used agency workers as an integral part of their business model to review their operational arrangements and make alternative arrangements.

In his speech to the TUC conference in September 2009, the Prime Minister said that it is the government's intention to get this proposal on to the statute book before Parliament is dissolved. However, there is a difference between this and when the proposal will actually come into effect. We are concerned that if the latter comes too soon it will coincide with, and potentially hamper, the economic recovery.

It will be at this point that companies may be thinking about increasing the size of their workforces. However, they will understandably be very cautious about the future and, therefore, they will probably want – at least initially – to use agency

workers rather than recruit permanent employees. If at that time employers felt that the costs and administrative burdens associated with using agency workers were increasing, it could lead to them putting off their plans to increase their workforce and potentially slow down the pace of any economic recovery.

The Directive contains a provision requiring all Member States to transpose this Directive into their national legislation within 3 years of it being published in the Official Journal of the European Union, i.e. by 5 December 2011, and it has been the government's normal practice not to implement EU Directives before the end of their transposition period. As a result the government should delay the Temporary Agency Workers Directive from taking effect until, at least, December 2011.

Waste controls: duty of care, waste carriers and brokers

In its Waste Strategy 2007, the government committed itself to reviewing the controls on handling, transfer and transport of waste by October 2008.

The objectives of the review were to:

- Comply with EU law by bringing more businesses into the scheme
- Reduce unnecessary administrative burden on business by modernising the regulation in accordance with better regulation principles & introducing a risk based approach,
- Provide greater powers to the Environment Agency to help tackle waste crime (fly-tipping etc)

The revised regulations were initially planned for October 2008, then pushed back to April 2009 and are now expected for December 2009. Draft Regulations were published as part of the consultation, but without guidance on some of the key definitions ("lower tier" & "upper tier" waste carriers and "regularly and normally"). As a result it is impossible to assess whether the Regulations will lead to greater costs or benefits to business.

Government must not miss this crucial opportunity to simplify waste regulation and make it more proportionate to the risk. In the past, poorly framed waste regulations have not only led to unnecessary administrative and cost burden on business but have been posing as a barrier to greater reuse and recycling of waste.

With this in mind, whilst we are concerned that this proposal has taken longer than planned already, another round of consultation and impact assessments will be required to ensure that the review fully fulfils its aims.