Engineering and Machinery Alliance

Agricultural Engineers Association
British Automation and Robot Association
British Compressed Air Society
British Fluid Power Association
British Paper Machinery Suppliers Association
British Plastics Federation
British Turned Part Manufacturers Association
Gambica
Gauge and Toolmakers Association
Manufacturing Technologies Association
Printing Industry Confederation
Processing and Packaging Machinery Association
Solids Handling and Processing Association
UK Industrial Vision Association

31 January 2017

The Rt Hon Philip Hammond Esq MP
Chancellor of the Exchequer
HM Treasury
1 Horseguards Road
London SW1A 2HQ

Dear Chancellor,

Engineering and Machinery Alliance Spring Budget Representation
I write briefly updating our position since your Autumn Statement.

The Alliance's 14 trade associations represent circa 2,000 companies, mostly in mechanical and electronic engineering, with sales of £10 billion into the main user supply chains (including automotive, aerospace, food medical, defence, oil & gas, offshore and onshore wind), providing equipment, components and services. According to ONS data roughly 65% of sector sales are derived from exporting.

Summary
- Despite current and future commercial uncertainties (Sterling exchange rate, Brexit outcome and the possible demise of frictionless trade with a market of some 500 million), business activity in our sector generally remained strong to the end of the year and looked well set for the First Quarter 2017.
- So far, we have benefitted from the opportunity 'window' that precedes the various negotiations when the current 'unknowns' will be more clearly identified.
- However, as recent experience has shown, Sterling is currently clearly vulnerable to comments and even more so when discussions open and positions firm up. Also, most manufacturing commentators expect Brexit withdrawal to make it more difficult for UK manufacturers
- In the current situation therefore, it's not unreasonable for businesses to look and plan forward on a monthly or quarter by quarter basis.
- Unfortunately, among the inevitable results that flow from this are, a cooling of longer term investment activity and increasing concerns round cash flow and customer payment terms as margins tighten.
- So, the last thing our member companies need from the forthcoming Budget is anything that leads to an increase in operating costs of any sort.
- In these circumstances, we see your decision to revert to a once a year Budget Statement as helpful.

Current economic environment
- Despite the challenges and the little time there has been to make progress, the Alliance's monthly Business Monitor has our sectors on a strengthening trend with more companies reporting enquiries and orders up and fewer reporting declines. The overall balances are strongly positive, confidence levels are very good (+34) and the mood seems well set for the first quarter of 2017.
- Even reported investment activity strengthened at the end of the year with a surprisingly high proportion of firms reporting investment in all areas of the business (60%).
- We see this reflecting SMEs' tendency to invest in their businesses when their order books are healthy. We therefore interpret this improvement quite narrowly, as more to do with subcontractors and consumer facing segments than with large companies placing new business with complex international supply chains.

Productivity and investment

- Your announcements in the Autumn Statement of a £23 billion Productivity Investment Challenge Fund and the formation of the Productivity Council were both very welcome.
- But if policy's end objective is to raise national wealth, then for manufacturing the productivity metric also needs to be yoked to another suitable measure such as total GVA, otherwise it will mislead the country just as it has in the past and still seems to when observers refer to UK's outstanding performance prior to the 2008 financial crisis.
- Please see the table below which refers to a period when the UK was thought to be catching up with French and German manufacturing productivity, which indeed it was, but as the table clearly shows, in the UK it wasn't harnessed to real sector growth (increased GVA output) in the way it was In Germany, the Netherlands, France and the USA.

Manufacturing value added constant 2010 national currencies 1998 -- 2007

	1998			2007			% change 1998-2007		
Country	**Sector billion**	**Nos employed millions**	**Per employee '000**	**Sector billion**	**Nos employed million**	**Per employee '000**	**Sector GVA**	**Nos employed**	**GVA per employee**
Germany	420	7.8	54.1	545	7.3	74.9	+30	-6	+38
Netherlands	55	0.9	63.0	70	0.8	90.6	+27	-11	+44
France	176	3.5	52.3	217	3.1	72.3	+23	-11	+38
UK	**151**	**4.1**	**37.0**	**155**	**2.8**	**55.0**	**+3**	**-32**	**+49**
USA	1363	20.6	73.4	1879	17.2	126.3	+37	-17	+64

Source: AMECO On-line ECFIN revised 5 May 2015
Note: Germany, France and Netherlands in Euros, UK in GBP and USA in USD

- While the others basically weren't as successful as the UK in driving up productivity per employee, they all increased the size of their respective manufacturing sectors considerably more than the UK, and those increases fed directly into extra added value in their national economies, taxes, wages and consumer spending – in short to improved living standards.
- A key cause is the UK's poor record of investment in equipment. The EU Commission's 2014 Competitiveness Report (SWD 2014/278 figure 1.1.16) shows the UK's weak position, well behind the other EU countries and the EU average when comparing investment in equipment as a percentage of GDP:

UK 3	***Germany 6.5***	***Netherlands 6***	***EU average 6***	***France 5***

- UK manufacturing productivity and sector GVA will rise when the UK has settled long term policies and a tax regime that encourages long term investment to make things and then trade them frictionlessly, rather than a seemingly endless set of quite radical changes that feed uncertainty.
- For the sorts of improvements this type of investment can bring, please see Barclays Bank's report *"Future-proofing UK Manufacturing"* (https://www.barclayscorporate.com/content/dam/corppublic/corporate/Documents/research/automation-report.pdf) comparing UK and German attitudes.
    - It concludes a moderate increase of £1.24 billion in automation could raise UK manufacturing GVA to the economy by £60.5 billion over the next decade -- plus, "accelerated investment in automation and robotics would have an indirect impact on the supply chain and on the wider economy" which could amount to an extra £2.5 billion a year by 2020 and £3.9 billion by 2025.
- Please also refer to how France is incentivising SMEs (http://www.robotstartpme.fr/) to invest in digital manufacturing productivity through their automation and robot investment tax credit (40%), with a subsidy (13%) paid to firms setting up an automation cell.
- Other actions to encourage broader investment:
    - Raise the Annual Investment Allowance very substantially (to £1,000,000) until 2020, indicating that at that time the intention will be for it to revert to a lower level.
    - Exclude new plant and machinery from business rates. CBI estimates the cost at £1.3 billion by 2020/21.

Skills and training

- All EAMA subsectors report skills shortages. It's our firms' number two priority. As customers increasingly want to buy outcomes our members have to have skilled workers to service their customers' needs over the life of the product, increasingly through whole-life in the circular economy.

- The only way to provide the required skills (managerial and technical) now is to bring them in from outside the UK. In practice that may mean from outside the EU because every other EU member state is targeting similar objectives and seeking similar resources in the internal market. We recognise this sits uneasily with the immigration goals. But if the firms can't get the people they need they'll close and move or go out of business.
- The UK needs a change of training culture, but we also need to protect the gains we have made. We therefore found the Prime Minister's comments recognising the domicile status of EU workers here very much to be welcomed.
- We welcome the thoughtful approach in the Industrial Strategy.

Innovation/R&D

- It is imperative that the R&D tax credit scheme continues to benefit SMEs. They can struggle to engage with shifting complexity and we would therefore strongly argue against changing the structure of the scheme as it relates to SMEs.
- As the UK negotiates its way out of the EU, it will be vital that the Tax Credit structure is maintained and expanded.
- Combined with an AIA at a significantly enhanced rate would make the UK stickier during the two year Brexit transition period when companies assess how to position their innovation investments.

Exporting

- Italy has three times more SMEs than the UK involved in exporting. Why not examine Italy's programme supporting their SME exporters for possible lessons?
- With Sterling now at a very competitive rate, this is an ideal time to incentivise SMEs into exporting. HM Treasury could 'test' the concept of offering a tax credit on certain SME export sales to break first move inertia (e.g. one contract, new to export minimum of £30,000).
- Consider setting a three-year rolling cycle of activity focused specifically on raising exports in markets agreed with business so that export partners can plan activities in line with local capital equipment procurement practice, rather than according to HMG's budgeting cycle.
- It would be very helpful if UKEF could be encouraged to develop products and services to specifically meet SME needs (speed, high responsiveness, little paper work, simple system), rather than adapting products that were originally designed to support big contracts for big companies.
- Risk is an inherent ingredient in SME exporting. Recent developments only strengthen the belief that those risks will grow. We need to learn how to manage them competitively and positively by making sure UKEF's hugely increased risk appetite to £5 billion and its improved range of products have a higher profile and there's much more interaction between UKEF and the UK's SME exporters. EAMA is very ready to help in that.

With best wishes

Yours sincerely

(signed electronically 31 January 2017)

Martin Walder
Chairman

cc Nick Hurd MP – Minister of State, BEIS
Rt Hon David Davis MP – Secretary of State, DExEU
Rt Hon Greg Hands – Minister of State, DIT
Matthew Ahmed, Matthew Wicks -- HMT
Clare Marett – BEIS
Caroline Jackson, Michael Essex -- DIT
Member associations