Engineering and Machinery Alliance

Agricultural Engineers Association
British Automation and Robot Association
British Paper Machinery Suppliers Association
British Plastics Federation
British Turned Part Manufacturers Association
Confederation of British Metalforming
Gauge and Toolmakers Association
Manufacturing Technologies Association
Printing Industry Confederation
Processing and Packaging Machinery Association
UK Industrial Vision Association

11 November 2011

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

Dear Chancellor

**Autumn Statement -- Engineering and Machinery Alliance Submission**
While quite honestly we don't envy you the task of guiding the UK through the current economic difficulties, we do see an opportunity emerging that will give your levers on the economy extra traction to inject growth and therefore create the new jobs that we all want to see.

First, there has been some considerable movement by some of the banks to offer SME finance at very competitive rates indeed (e.g. 3½ % fixed over three years and no admin fees). One might almost ask, will it ever be cheaper. But of course that doesn't mean that SMEs will automatically take it up.

Nonetheless, our monthly Business Monitor shows firms have an appetite to invest, albeit we conclude they are doing so from their own resources, not yet trusting the banks enough. So second, they need a reason to change behaviour to respond to the market offering.

Third, investment in many other EU economies has stalled and European Central Bank interest rates remain higher than the Bank of England's. If UK firms can be encouraged to take advantage of the current situation they will gain the benefits of very competitive prices for the goods they need allied to finance that may be as cheap as it's ever likely to be over a three or ten year fixed term. In addition, foreign investors will be able to realise the benefit of basing their businesses here, as the UK economy develops its position offshore the euro zone but inside the EU.

So the requirement is a catalyst that will overcome any lurking doubts about using any and all forms of financial provider.

But in addition we have to ensure that all Government Departments are pulling in the same direction to build competitiveness, growth and jobs, e.g. that UK electricity prices aren't so structured that they are uncompetitive and undermine manufacturing operations here.

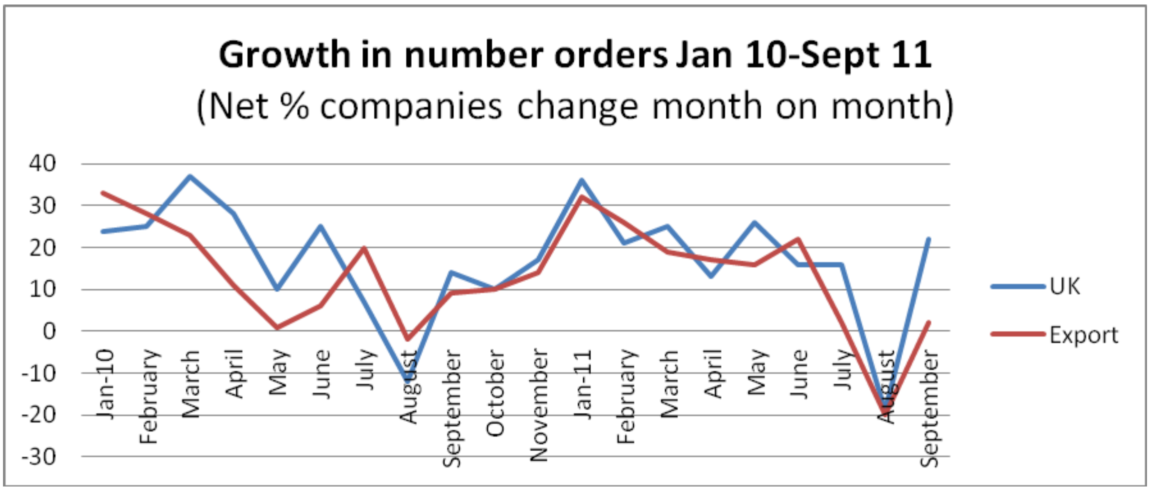
**Background to the Alliance and the sector**
The Engineering and Machinery Alliance (EAMA) is a self-help grouping of 12 independent trade associations (listed in our masthead) representing circa 1,700 firms in the mechanical engineering sector with sales of some £8 billion. They account for a quarter of the UK's mechanical engineering output, and according to HM Customs' data, sector exports account for about 70% of sector sales.

The Engineering & Machinery Alliance, 62 Bayswater Road, London W2 3PS
Tel: 020 7298 6450 Email: eama@mta.org.uk W: www.eama.info
Company number: 5974924; Company limited by guarantee

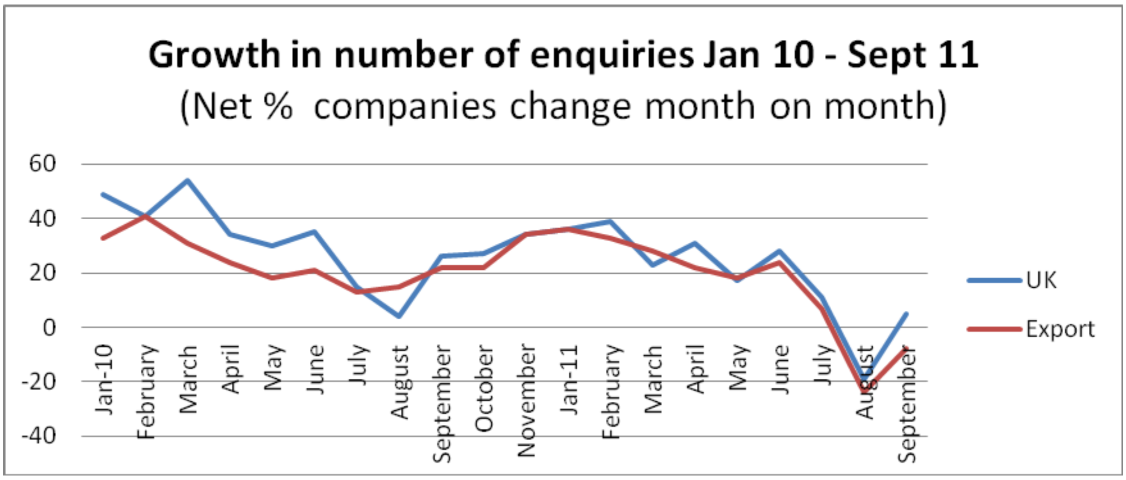
Typically, our companies supply 'enabling technologies' to other sectors (e.g. automotive, aerospace, medical, power, printing and food industries) in the form of machinery or packages combining services and products. Some of our members make machines that make machines.

In the UK much, but by no means all, of this is carried out in small and medium sized niche or specialist companies (SMEs) -- innovative, entrepreneurial companies pushing the boundaries of factory performance, extending the envelope of the physically feasible to new levels in terms of speed, precision and migration into novel technologies and materials.

**Current business environment**
EAMA's monthly Business Monitor (gains minus falls) showed strong and consistent business gains across the first and second quarters, followed by some expected weakening over the holiday period in the third.




However, the sharp falls in August's UK and export inquiry levels balances (important as lead indicators) were the first declines in two years (since August 2009). Worryingly, the export inquiry balance fell further in September, while the UK balance as expected went up as did company confidence which had shown some weakness over the summer.

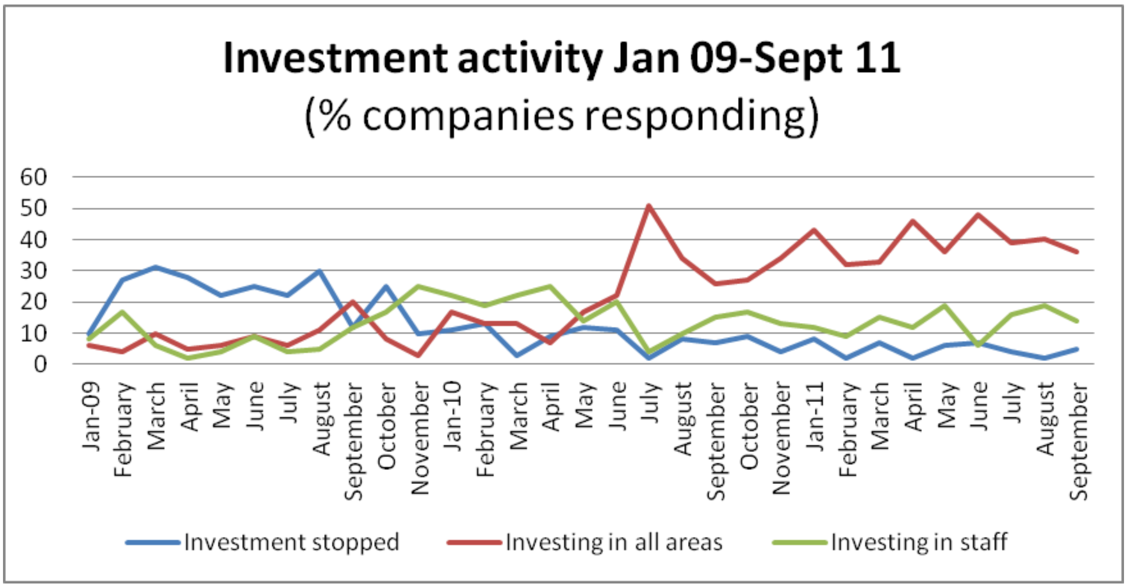



Orders have held up as expected. Member associations monitoring company performance year on year, report survey gains averaging 10-15% year on year (which for our sector compares with an average across Europe according to our European

Federation's data of +10%). Outlook for the year ahead is modest growth (3% at the European level).

Rather against trend in other surveys, the Monitor continues to flag strong job opportunities. However, companies say consistently they can't find people with the skills they need, and too often the only candidates with the right work ethic are the more mature, over 30 year-olds.

The sector has been investing (in capital and skills), but they are relying on their own resources, because they don't trust the banks not to change their loan conditions over night as they did in 2008/09.




Basically there hasn't been any significant change in terms of companies' access to finance since February, although just this last month there was some slight easing on working capital, but no change on investment finance.

**Introduction**

So in this submission, we focus on six initiatives to help inject growth and jobs in the current situation, rather than as part of a rounded long term strategy. The key aims from our perspective are to:

1. increase recruitment flexibility round skills support,
2. kick start further private sector investment across manufacturing (and elsewhere),
3. improve access to finance,
4. strengthen UK's response in support of exporting,
5. enable companies to protect their legitimate cash flow before demanding tax payments, and
6. raise awareness more generally of all the private sector investment that is going ahead and therefore where the jobs are to be found by sector and by region.

**Skills**

We welcome the Government's commitment to apprenticeships, its efforts to raise UK training and skills levels generally and the introduction of the Talent Retention scheme. Members are enthusiastic about it, but its viability depends on it being populated with a very full list of candidates as quickly as possible.

In the current environment, with rebalancing meaning that people losing jobs with one employer, need a clear path to find work in a different company, maybe even in a different sector, where they may need some training, additional skills development or orientation (e.g. on health and safety).

But recent changes with regard to implementing the Agency Workers Regulations mean that temporary staff are entitled to the same rights as permanent employees after 12 weeks. This reduces the incentive to take on temporary staff because it increases the costs associated with their employment at a time of great economic uncertainty.

In addition government supported apprenticeship schemes understandably focus particularly on the younger workers and school leavers (up to age 24), but we understand there are plans to reduce support for those aged 24+, which is the age group that is going to make up a large proportion of those having to change jobs.

*Recommendations*:

- A strong push to ensure that the Talent Retention database is populated with a broad cross section of candidates, bulking up the coverage and numbers to a critical mass so that the website proves itself and gain long term users.
- Ensure that employers are fully aware that under IR35 it's down to the freelance/contract worker to ensure that he/she has completed the necessary HMRC forms.
- Institute a full review of the Agency Workers Regulations to examine their impact on the employment of temporary staff across different sectors.
- Ensure that Government support for apprenticeships for 25+ age range is at least maintained at the current 50% level, not reduced.

**Investment**

Our members welcomed your move to double short life asset eligibility to eight years. You may also recall EAMA members believe the UK should develop a long term investment friendly framework based on significant annual investment allowances.

With all advanced economies relying on their exporting industries, it is vital that UK improves its productivity across the board, so that it is internationally competitive. And the case needs to be addressed urgently to 'break' the current 'avoid risk at all costs' mindset.

***Action to kick start growth***

Direct action on investment now can kick start broad, private sector investment, inject growth and further rebalance the economy.

Under the current system, the capital cost of assets cannot be treated as an allowable expense to be set off against taxable profits. A company has to claim a 'capital allowance' (CA), which is then offset against the company's profits like an allowable expense. CAs range from 0% to 100% depending on what the company is investing in.

*Recommendation*:

- The introduction of 100% first year capital allowances for a period of two years only. This puts the UK on a par with the USA, where many of the UK's foreign direct investors are headquartered. It will enhance cash flow, strengthening the companies and embed good business practice.

***R&D Tax credits***
We have heard that R&D Tax Credits are up for review. We believe the current structure works pretty well because members understand it. Once agreed with HMRC, the framework encourages firms to continue to develop and refine new products and processes, because it enables the company to claim the reliefs efficiently as part of its embedded overall business practice rather than having to make a costly, resource-intensive new claim every year.

***Red tape affecting UK R&D***
Government's push to reduce the number of immigrants working in the UK has directly affected the R&D work.

For example, at a recent meeting with your officials, two of the four firms we brought along had taken on foreigners. They had come to the UK for their second degrees and having qualified were therefore here, keen to find a job where they could further develop their now enriched skills.

The Home Office intervened at both companies, reducing the number of permitted licences, fighting appeals and even in one case insisting the salaries of those allowed to remain be increased.

Members naturally wonder what business it is of the Home Office to determine how much an employee is paid as long as it is above the statutory minimum. But we put that aside as the real issue is about access to skills required to be competitive.

*Recommendation*

- Foreigners studying for second degrees here should be encouraged rather than constrained from working here as a rapid way to fill the gaps the UK education system has thrown up in STEM subjects at advanced levels.

**Access to finance**
We are working with the British Bankers Association to create a better understanding and where possible to resolve the issues member firms have with their banks.

We welcome initiatives such as the business mentoring scheme and the Business Growth Fund in particular as it has been structured to help firms grow rather than grow the funders, which is more typical of venture capitalists' approach.

In these regular exchanges we have come to understand the banks' flight from risk and their cultural cleaving to short term commitments when dealing with manufacturing SMEs in particular.

To effect change and embed it in the near term we suggest:

- A framework that positively reinforces 'good' financing behaviour by allowing the banks to offset their loans to manufacturing businesses against their existing tax exposure.

This will transform the way banks view such activity from a risk into a positive contribution to the bank's growth and encourage some to continue with their recently discovered more competitive approach to financing SMEs..

## Exporting

***ECGD's new products***

We welcome ECGD's new products. They are helpful and at least begin to put UK-based manufacturers on a more equal footing with international competitors, if the products are made available.

The weakness in the scheme is that they are only available through the banks.

Unfortunately there may be some limited evidence of banks not offering them. We accept the products were really only launched in June (rather than March) and that even then some fine tuning was needed to enhance the offer for SMEs.

It is therefore still too early to say for sure, but we recommend HMT hold off from judging ECGD's success or otherwise for some time yet, not to be suckered into dismissing the schemes as not having enough demand to warrant the effort.

We need to establish whether or not the banks are promoting the products as actively as they might.

We suggest Government could help in this as an independent party:

- By ensuring that the products are visible on all relevant public facing websites such as the new Business Link online information service
- and working with some trade bodies to arrange 'mystery shopper applications' to test the system directly.

***Export licensing***

Export licence advice is another area where red tape is causing difficulties for exporters.

As overseas customers become more sophisticated in their dealings round contracts for hi-tech products, they are asking whether the goods they want will receive all the necessary clearances as part of their pre-qualification process before awarding the contract.

Government offers an advisory service to help guide exporters as to whether a particular contract is likely to encounter problems. This service is now taking over six months to respond (making it impossible for firms involved to tender as they don't have the necessary information) and seems to have got worse just as the service issuing export licences has improved its performance.

*Recommendation*

- It's vital that cutbacks don't affect the efficiency of services vital to exporters.

## Cash flow

We welcome the Government's commitment to reduce Corporation Tax for all sizes of companies. However, manufacturers' cash flow is still being squeezed.

*Recommendations*

- It's therefore important to iron out the unnecessary tax wrinkles, for example a technical amendment to accounting standard FRS 5 so that firms servicing Just-in-Time contracts aren't subject to Corporation Tax liability when work in progress and stocks are grossed up and added as 'forward' sales. Currently under FRS 5 companies are therefore paying CT on sales a year before they are actually recorded in their accounts.

- Re-affirm the Government's commitment to the flexibility afforded by delay to VAT and other tax payment schedules as soon as possible.

***SME financing***

Government may have some room to help ease Basel III requirements on the banks, through action by the FSA or HM Treasury in the following areas:

- *SMEs in large company supply chains:* Most large OEMs depend on SMEs in their supply chains. If the OEMs highlighted these suppliers to their banks, the banks would be able to grade them as a lower risk, warranting easier terms and therefore reducing the level of interest that the banks would need to charge.
- *Premature default:* Strict adherence to the Capital Requirements Directive triggers default "90 days past due". It can do so for relatively paltry sums. It would be more sensible to place more importance on the sums involved and their significance to the company owed the money.
- *SME loans:* Banks would be able to lower their rates if the losses associated with default could be reduced, e.g. through some insurance scheme or bond as per ECGD.

**Profile**

There's so much gloom in the daily news it's not surprising that the positive news involving private sector investment is lost in the mix.

Some headline grabbing conferences could be staged with a linking theme of growth and jobs, e.g.:

- Even though construction is in the doldrums there are sectors with significant planned year on year growth:
  - Rail double digit growth (10-20% each year) over the period 2011-2014.
  - Energy (nuclear and renewable) 17% to 22% year on year growth beyond 2015.
- Automotive currently achieving 80% export sales with big commitments to the UK from Nissan (exported to Japan), JLR (Tata Motors), GM, BMW, Honda and Toyota. According to consultancy AutoAnalysis, 'general economic uncertainty aside, the UK has some excellent medium to long term prospects (perhaps even better than Germany and France)'.

Promoting better understanding and knowledge in schools and more generally will also help spread potential career interests more widely.

With best wishes

Yours sincerely

*(signed electronically 11 November 2011)*

Martin Walder
Chairman

cc Mark Prisk MP – Minister of State, BIS
Katherine Green, Matthew Little, Jaya Choria – HMT
Brian Greenwood, Ivan Youd -- BIS
Member associations