eef The manufacturers' organisation

EEF's submission to Autumn Budget Statement 2018

Manufacturing continues to demonstrate resilience in the face of domestic and international risks and uncertainties. EEF's baseline forecast is for continued growth across the sector through 2019. But reasons to be concerned about the investment appetite amongst manufacturers are increasing, not least because of the potential long-term consequences for the UK's productivity performance. In addition to government driving ahead with its cross-department industrial strategy, this Budget should also begin the job of tackling other contributing factors to the UK's flat lining productivity.

Headline recommendations:

- **Bring forward a combination of grant support and accelerated depreciation to anchor investment, from companies large and small, in the UK.**
- **Ensure Total Carbon Price is restored to its autumn 2017 level as soon as possible to bring down electricity prices and help close the gap between prices here and Western Europe.**
- **Fulfil Manifesto pledge to implement an Energy Efficiency Scheme to stimulate investment in decarbonisation.**
- **Facilitate a more open discussion on the future of carbon pricing after Brexit and guarantee there will be no overall increase in costs for UK firms compared to EU competitors.**
- **Reform the apprenticeship levy and standards processes to drive greater industry engagement with apprenticeships.**
- **Deploy the Immigration Skills Charge where there are gaps in funding and commit to no increases or extension of the charge.**
- **In anticipation of future economic downturns the government should now develop a short-time working scheme, akin to those operating elsewhere in Europe, that will retain and upskill employees during recession.**
- **Government funding is required to stimulate the market for better and more widely available management and leadership training.**

Outlook for manufacturing

Growth in the UK economy has been subdued since the last Budget. This relatively weaker performance was in line with our expectations as a lack of real wage growth has put a cap on consumer spending and uncertainty has dented business investment growth. A number of other 'events', from weather-related disruptions to escalating trade policy tensions, have also added to the downside risks facing businesses across the economy.

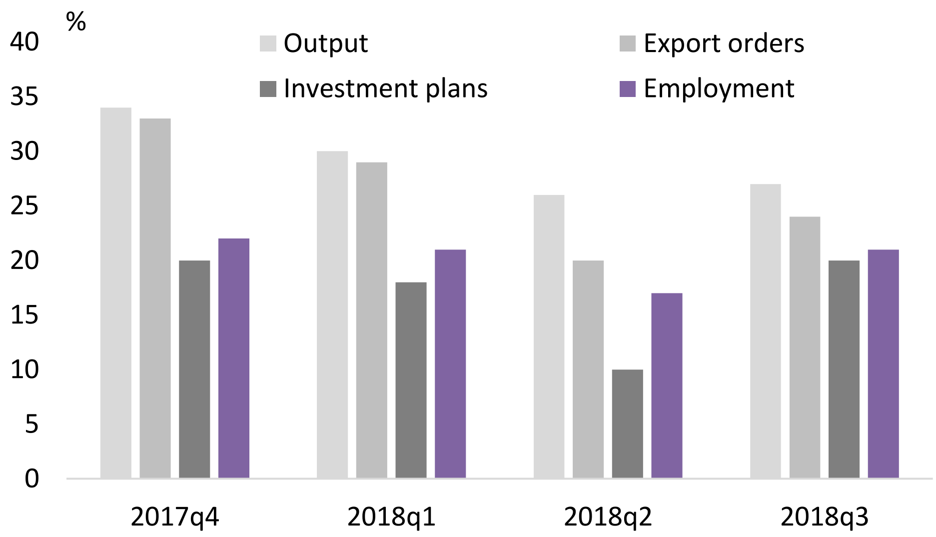
Sentiment across manufacturing has held up

EEF's regular *Manufacturing Outlook survey* continued to indicate a large degree of resilience across the industry. In the year to 2018q3, a positive balance of manufacturers continued to report growth in output levels and new orders, with overseas demand remaining an important driver of increased new sales.

However, our survey also notes that the fortunes of different manufacturing sub-sectors are diverging, with globally driven and investment-focused industries such as electronics riding high, while sectors reliant on construction, for example, planning for weaker trading conditions ahead.

Manufacturing activity in positive territory through 2018

% balance of change in the past three months



Source: EEF Manufacturing Outlook

Companies continue to have some confidence that trading conditions will hold, or even improve, over the next 12 months. This optimism has continued to drive recruitment and, in some industries, combined with looming capacity constraints and a reduction in margins pressure, is bringing forward some planned increases in investment.

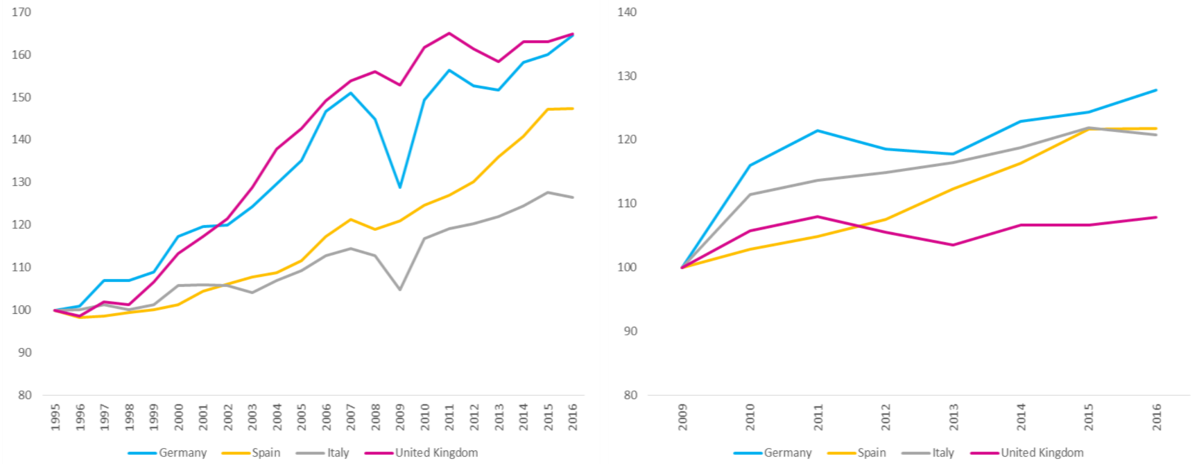
Our central expectation is for manufacturing to post growth this year and next, of 0.9% and 0.5% respectively. In line with growth across the economy as a whole, this looks set to be weaker than that forecast in the UK's major competitors. Furthermore, there is a possibility that downside risks, from sluggish domestic demand to escalating trade tensions, could mount further this year.

Productivity growth still flat lining

Neither the demand outlook, therefore, nor the pace of investment or recruitment activity planned in the coming quarter look set to significantly change the dynamic of one of the biggest, longer-term challenges facing the sector (aside from Brexit uncertainty) – flat lining productivity.

Since the financial crisis UK manufacturing has broken from its trend in the previous two decades of robust rates of growth in labour productivity, with all manufacturing sub-sectors contributing to that that positive performance. While more subdued rates of productivity growth have been a developed world phenomenon since the financial crisis, manufacturing's flat lining performance has seen UK industry fall further behind competitors.

UK manufacturing productivity growth has underperformed since 2009
Real GVA per hour, left chart 1995 = 100, right chart 2009 = 100



Source: Eurostat, OECD and EEF calculations

EEF has engaged extensively with manufacturers over the past year to unpack the factors that are weighing on the UK's performance. These are complex and can vary by sub-sector, but there are some common themes that industry and government need to try to tackle more aggressively together. The ongoing efforts to build a long-term industrial strategy as well as the proposals we set out in this submission ahead of the Budget, would be steps in that direction. These focus on additional actions to address skills shortages, proposals to prevent UK companies lagging competitors in investment levels and new technology adoption, supporting recommendations on retaining a competitive cost base and new thinking on the role of government in raising management capability.

Together these proposals can provide extra support for a sector that has the potential to step into the productivity driving seat and so ensure that it can manage the upcoming challenges of Brexit and the advent of the fourth industrial revolution.

Progress on building an industrial strategy

By the time of the next Budget it is likely that the industrial strategy white paper will be approaching its first anniversary. EEF and its members have been keen to see momentum build behind this strategy and for its core objectives to be reflected in actions and policy decisions right across government.

To a large extent, progress is underway, but with industrial strategy competing for bandwidth with Brexit, there remains a lot to do. This statement provides an opportune moment for government to re-energise or initiate some of the priorities that have been lagging.

The industrial strategy ball is rolling

One of the areas in which there has been a good deal of progress and focus is science and innovation support – primed with the additional resources allocated to the Industrial Strategy Challenge Fund (ISCF). Two waves of funding have already been allocated through the sector deal process and clusters, more advanced in their thinking on how they can contribute solutions to our grand challenges, are already beginning to benefit. The final wave of funding will also be important in supporting companies and the science base to develop and deploy solutions in areas of digital transformation, energy efficiency and new materials.

While the final decisions on funding allocations and successful bids sits with UK Research and Innovation (UKRI) and the Department for Business, the need to expand innovation activity in response to technical change, as part of meeting the productivity challenge and to remain competitive as we transition to a new relationship with the rest of the European Union, takes on a renewed importance.

The Budget should ensure there aren't more ISCF bids than money, subject to the recommendations of UKRI. **Resources should be made available to progress bids that have a strong innovation element and have an alignment with the industrial strategy's grand challenges. Furthermore, once bids are approved consortia should be in a position to move forward with funding allocations and the appointment of champions immediately, rather than delaying until the start of the new financial year in April 2019.**

In addition to the ISCF, industry has also welcomed the new five year funding settlement for the Catapult network, including the HVM centres, which continue to build a base of active innovators across manufacturing. We hope to see other centres with a manufacturing reach have their funding settlement confirmed in the coming months.

Awaiting progress

Some of the foundations of a 21st century industrial strategy are now in place, but a significant over-arching component is missing – the industrial strategy council and a clear set of measureable outcomes established across government. An independent council with the right focus could cement greater business confidence in the strategy through scrutiny of policy consistency and judgments on progress made on industrial strategy objectives.

EEF's consultation with members has indicated that companies are looking for the work of the council to underpin more effective policy making, ensuring that new decisions are taken with long-term impacts in mind, not least as a predictable business environment is even more important in the current Brexit policy backdrop.

Clarity on outcomes from government will also help to shape the important sub-national dimension of local industrial strategies. It is right that those areas with a strong mandate and clear engagement links with business, such as Greater Manchester and West Midlands Combined Authority are early movers in this process.

However, we still need a clear devolution framework to allow other parts of England to develop a local industrial strategy that has the potential to genuinely shape the local business environment in response to individual challenges and opportunities.

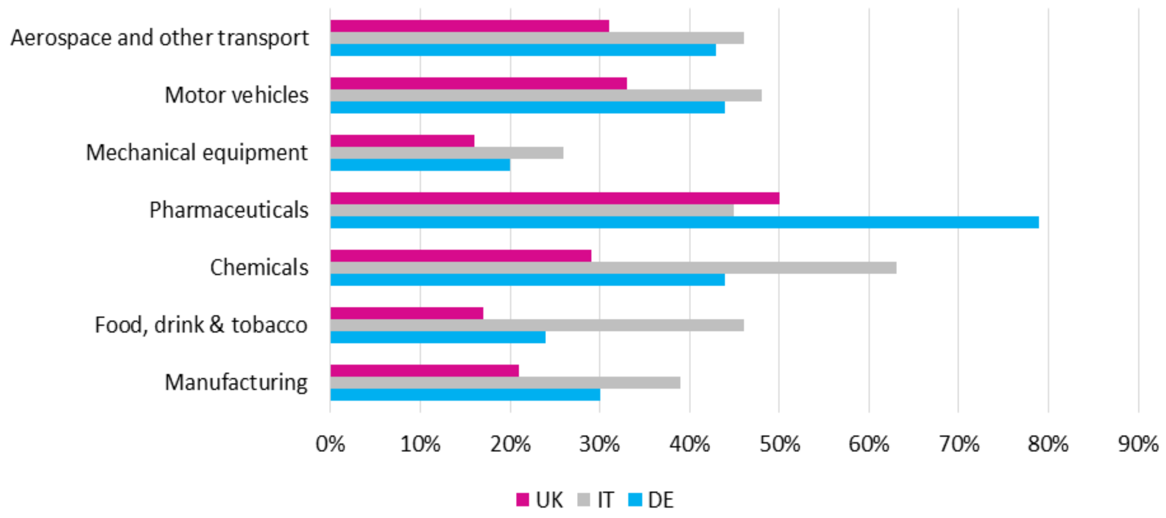
Supporting investment through Brexit

According to our latest *Manufacturing Outlook* report, investment plans have edged higher in the second half of this year. However, on any measure the recent path of business investment has disappointed, particularly in relation to growth in manufacturing last year and in comparison with rates of investment expansion in other countries.

EEF's productivity analysis[1] has shown UK companies have historically invested less, as a share of GVA or in relation to the compensation of employees, as shown in the chart below. Some of this may be explained by the different structure of business operations across UK manufacturing – for example, a number of UK sub-sectors derive a higher proportion of value-added from services such as installation, repair and maintenance, which are less capital intense.

The "capital gap" clearly evident at the sub-sector level

Consumption of fixed capital / compensation of employees – Average 1995 to 2015



Source: Eurostat

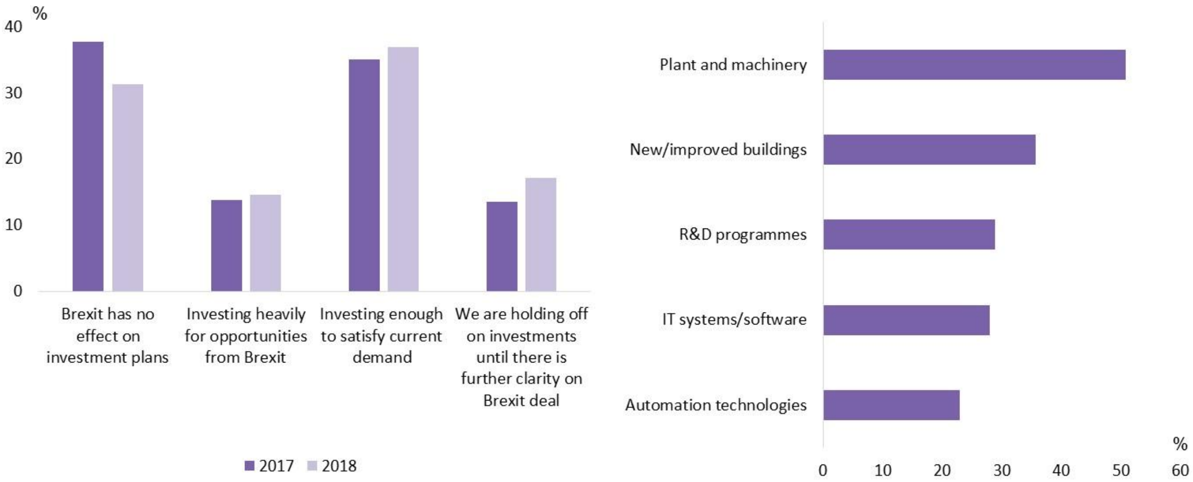
However, our analysis also reveals that there is a chasm in investment levels when domestic – and foreign-owned – businesses operating in the UK are compared, which cannot be explained by differences in business operations.

[1] EEF (2018) Unpacking the puzzle – getting UK manufacturing productivity growth back on trend

While these factors mean our starting point is already weaker than some of our competitors, the outlook from our forthcoming *Investment Monitor 2018/19* report points to the potential for a relative deterioration in the UK's position, at least until there is clarity about the UK's future relationship with the rest of the EU.

A slightly higher proportion of companies report a negative Brexit impact on investment plans than was the case a year ago. Moreover, the areas of investment most likely to be put on pause are large and more long-term spending on plant and machinery and new or improved buildings. Those areas such as R&D are far from immune with around 30% of companies that have put some element of investment on hold citing that R&D programmes are being affected.

Brexit impact a bit bigger than last year
% of companies citing impact of Brexit on investment plans (left chart) and area of lower investment



Source: EEF Investment Monitor 2018/19 (forthcoming)

Further evidence from our Monitor shows that there is not a lack of potential opportunities holding back plans for greater growth in capital expenditure plans, rather uncertainty – about political developments and order books – is now the major factor behind plans to cut or pause investment.

Within the limited fiscal wiggle room available at this juncture, support for investment must be prioritised, to ensure that UK companies do not fall further behind the developed world pack, thereby further depressing future productivity growth.

While there are a number of options available at this time we believe that two targeted interventions focused on small companies, who are likely to be investing below the £200k AIA threshold, and a measure for mid-cap companies and inward investors looking to accelerate their investments in areas that would see them keep pace with 4IR developments would offer the best value for money.

Support under the AIA threshold

According to the recent Office of Tax Simplification publication on the outcome of its review into depreciation and capital allowances, the majority of businesses are investing at levels below the Annual Investment Allowance (AIA) threshold. Yet many of these businesses are also likely to be in the tail of companies investing less per employee than competitors and seeing consequently lower levels of productivity. Our *Investment Monitor* also shows that these companies are also the most likely to have halted investment plans in response to Brexit uncertainty.

In the current climate of heightened uncertainty we do not anticipate that another adjustment to the AIA would send a powerful enough signal to spur additional investment in tangible assets. Not least as this would undermine the predictability in tax policy making that manufacturers have long sought.

A more effective mechanism, therefore, would be to reinstate the Regional Growth Fund with the ambition of leveraging private sector investment to the benefit of stronger local economic growth.

In the first instance we would recommend an initial tranche of £200m of funding to be allocated on the same basis as previous waves 4 and 5 (i.e. not delivered via LEPs and local authorities), with future waves considered on the basis of economic performance and in relation to the progress on Brexit negotiations at the spending review. One critical difference in reintroducing the scheme would be to lower the requirement for new job creation – this is neither necessary in context of the labour market, nor desirable given the need to drive ahead productivity gains.

Accelerated depreciation

For those mid-size and larger companies investment beyond the AIA limit, there is still a need to anchor their investment plans in the UK. These larger, and often foreign-owned, firms are vitally important for UK productivity. Indeed in recent years the productivity gap between foreign- and domestic-owned companies has widened, unlike in our European counterparts. Brexit adds a further risk of the next wave of investment drifting to other jurisdictions.

Furthermore, tax reform in countries such as the US, which offers a bonus depreciation to 100% in addition to reduced corporation tax rates, or the hyper depreciation of technology assets in Italy, make the UK a less attractive proposition for the marginal pound of investment.

This should be remedied by the introduction of accelerated depreciation of assets over the AIA threshold, with the main rate increased to 35% for the first two years of the investment. This policy should remain in place until the UK has ended the implementation period of exit from the European Union.

A competitive cost base

UK energy prices have risen substantially in recent months with wholesale gas prices up around 50% and electricity prices up 40% in the six months to early September[2]. There is a concern that this will feed through to industrial energy prices. The main factors at play are wider EU trends in gas prices and a rapid upswing in EU carbon prices from around £7 per tonne of carbon dioxide equivalent (tCO2e) at the start of the year to £18/tCO2e in early September. The cost of the Capacity Market is also beginning to make more of an impact on some consumers' electricity bills.

Rising electricity prices are a particular issue for energy intensive and trade exposed industries. The UK has some of the highest industrial electricity prices in Europe yet they cannot pass on the differential to their customers. Industrial sites here also struggle to compete internally for finance with sister plants in lower cost countries, reducing investment.

The electricity price relief introduced in recent years for energy intensive industries (EIIs) has helped but is not sufficient to fully level the playing field. The sudden rise in EU Emissions Trading System

[2] Baseload electricity and NBP gas prices from Marex Spectron

(ETS) prices has also left their compensation level (set using last year's data) considerably below that needed now.

There is an absence of consistent data exploring the extent of the electricity price disparity remaining after EII relief, which sectors are most affected, the causes and wider impacts. One of our repeated requests to government has been for more thorough analysis, as done by other EU countries[3]. However, figures compiled by UK Steel showed the disparity in 2017/18 for steel producers – a sector that is particularly energy intensive and trade exposed – to be £17/MWh compared with France and £18/MWh compared with Germany. This meant UK steel plants paid over 50% more for electricity than their key EU competitors, costing the sector as a whole £43 million/year. This is equivalent to 17% of steel company earnings that year. UK Steel is currently producing figures for 2018/19 but early indications point to a further increase in the disparity, with reports of differentials within individual companies of up to around £26/MWh.

There are further risks on the horizon. Ofgem is currently reviewing how electricity network charges are distributed between users, with significant increases possible for some companies. Ofgem's first, very indicative figures, released in late August show an increase of £9/MWh for one scenario. Price rises of this scale will add significantly to an existing disparity created by EII network charging exemptions in France and Germany. Likewise, if the UK leaves the EU Emissions Trading System after Brexit, it could opt to increase carbon costs for both generators and companies captured by the scheme on account of their direct emissions. Every €1 added to carbon prices results in a roughly £0.5/MWh increase in electricity costs.[4]

These concerns, many of which have stemmed from efforts to decarbonise our electricity supply, also have to be balanced against the opportunity low-carbon generation could offer to cut wholesale prices and as a market for UK manufactured goods and services. **From this perspective, it is also important that the government offers clarity on the route to market for subsidy-free renewable generation, plus its long-term view of the energy market and how it will align this with that of the regulator.**

A thorough response to last year's Cost of Energy (Helm) Review

Industrial electricity prices were much higher on the political agenda last year; manufacturers were pleased by the Manifesto commitment to try and achieve the lowest energy prices in Europe and the commissioning of Dieter Helm's Cost of Energy Review. Professor Helm made a number of proposals that we believe merit greater consideration. We are very concerned that nearly a year on there remains no proper response to the Review or the wide-ranging Call for Evidence that followed it.

Maintain the Total Carbon Price at its current (autumn 2017) level until coal is off the grid

The unexpected increase in EU ETS prices this year means the Total Carbon Price has already reached around £36/tCO2e, breaching Treasury's new limit of around £25/tCO2e. Similar prices are being offered for forward contracts for December 2021, indicating a reduction in Carbon Price Support (CPS) is needed after 2021.

However we remain concerned about prices during the interim period, especially given suggestions that EU ETS prices could reach €35-€40/tCO2e by 2020.

[3] See for example PWC/CREG, 2017, A European comparison of electricity and gas prices for large industrial consumers

[4] Based at current exchange rates and using the marginal grid intensity factor in EU state aid rules

Bearing in mind that the new Total Carbon Price model could take a different price setting approach, we would ask government to consider changing the rules in a number of ways:

- Setting an upper limit for the next three years of £30/tCO2 – the most that generators could've expected even if CPS had not been frozen at £18/tCO2e – and intervening if that looks to be breached. (This means dropping the CPS to £0 if EU ETS prices go above £25/tCO2e.)
- Setting CPS rates for the post-2021 period in the year before they apply. This should not have a considerable impact on generators as they still have the certainty provided by the Total Carbon Price.
- Setting out in 2020 what the approach will be after coal comes off grid bearing in mind the outlook for carbon prices and future generation mix might look different by then and investors' need for clarity.

These proposals could cut electricity prices for all consumers from next April without undermining the stable signal for low-carbon investment. The effect would be particularly significant for trade exposed EIIs as the CPS is a unilateral cost only faced by UK consumers.

The Capacity Market's impact on bills should be tracked as part of the Control on Low-Carbon Levies and exemptions considered for EIIs

The Capacity Market (CM) became operational in 2017/18 meaning costs are beginning to appear on customer bills over the winter period. In total, this year's subsidies to suppliers will add £0.7bn to the approximately £10bn of levies supporting low-carbon generation. This will rise to around £1bn next year.

The CM should theoretically help reduce wholesale costs. However analysis by Ofgem of the 2017 early auction suggests it reduced costs for consumers by only around £150m compared to the £380m in payments it committed to suppliers.[5]

Given this, the CM's currently growing impact on bills, and that the need for it is partly driven by other decarbonisation measures, **it seems sensible to track the implications for electricity consumers alongside that of measures such as Contracts for Difference (CfDs). Government should also consider its impact on EIIs specifically and whether exemptions might be necessary to preserve competitiveness.** Although not a major component of some sectors' bills it is an area where government could act to help reduce disparities between UK and EU electricity prices.

Introduce an Energy Efficiency Scheme

We continue to believe an industrial energy efficiency fund is necessary, as per last year's Manifesto pledge. This would help shorten payback periods, the biggest barrier to investment in this area in the manufacturing sector. By highlighting opportunities to invest, it could also help draw board level attention to energy efficiency opportunities and help overcome internal competition for finance, two other common hurdles.

We know for instance in the steel sector that an investment by government of around £60m could help unlock substantial energy savings.

It is also notable that the UK has lower rates of energy efficiency funding at €6.9 per capita than 20 other countries such as Germany (€24.6), France (€12.9) and Italy (€19.1).[6] And that is assuming that

[5] See Ofgem's annex to State of the Market report 2017
[6] Figures are for 2014 and taken from Ecofys, 2016, Public funding for energy efficiency in the EU

the discount provided by Climate Change Agreements is equivalent to a grant, subsidy or loan, which some might question.

Finally, it goes without saying that energy efficiency remains one of the cheapest route to decarbonisation and that industry has borne the cost of very considerable subsidies to the electricity sector while receiving little similar support itself.

If government is too financially constrained for a fund at present, **we would recommend a pilot is implemented in the first year, followed by a broadening of the scheme the next year.**

Future UK participation in the EU ETS and possible alternatives

More than two years on from the UK's vote to leave the EU, the government is only just beginning to have a more detailed discussion with EU ETS participants on its strategy. The delay has given companies no possible scenarios against which to begin planning, impacting investment plus internal competition for funds and EU ETS allowances. It has also prevented officials and stakeholders having the kind of open discussions needed for effective policymaking and frustrated the EU to the point that it decided to implement its own emergency measures late last year.

Given the lack of detail available at this stage on the possible options, we do not have a preference on the approach taken. We would be very hesitant about remaining in the EU ETS without a strong incentive to do so, especially with no say in decision making. However, the relative benefits of a carbon tax or some form of UK emissions trading system depend on the final carbon price they will impose on manufacturers and how this compares to those faced by foreign competitors. Other important considerations include the administrative complexity and support available for carbon savings either directly or through parallel measures.[7] We would also ask for a comprehensive approach that considers ways to reduce the complexity of the wider regulatory landscape around energy and carbon while achieving the same overall goals.

As a minimum government must ensure that individual industrial installations see no increase to their overall carbon costs compared to those faced by comparable sites in the EU. This potentially means no costs at all for direct emitters operating at benchmark level other than that equivalent to the cross-sectoral correction factor and post-2020 reductions to EU benchmarks.

In a 'no deal' situation, we would also ask government to consider a pause in regulation to allow a more thorough review of all the options and better long-term outcome for the environment and industry.

Finally, it is important under all scenarios that industry continues to receive compensation for indirect emissions. Under a 'no deal' scenario, the rules around this should also be reviewed to see if there is a case for broader access.

Tiered approach to widening EII exemptions from low-carbon levies

As set out in our response to BEIS's recent consultation on this issue, we remain concerned about competitive distortions at international, as well as UK, level. Besides requesting a broader study into this issue, we suggest **wider access to relief but via a tiered approach. This would also allow additional support, up to the maximum permitted by State Aid rules, to be offered to sectors at most extreme competitive disadvantage, as is the case in some competitor countries like Germany.**

[7] For more information on manufacturer's criteria for a new regime, please see the paper shared by the MCCG with government in August 2017

Manage the impact of Ofgem's Targeted Charging Review (TCR) on vulnerable sectors

Although a matter for Ofgem rather than central government, the TCR will increase energy costs for some sectors, as noted earlier, and affect the business case for investment in technologies such as CHP and batteries, and demand management more widely. Industry remains limited in what it can do to prepare and give feedback because of the sparse information it has had from Ofgem on possible impacts of the type of approach likely to be recommended this autumn.

Besides making the case for an aligned approach between the regulator and government, we would also ask government to ensure that ameliorating measures are planned for any situation in which there is an impact on very trade exposed sectors.

A healthy, productive workforce

Manufacturers continue to face recruitment difficulties with the number of hard to fill vacancies in manufacturing due to skills shortages at 29%.[8] Reducing this figure will be particularly challenging given the low levels of unemployment in the UK and fewer EU nationals coming to the UK to work. Boosting the skills of the domestic workforce is paramount to mitigating these challenges and improving productivity; more than a fifth of manufacturers point towards investment in workforce skills development as having a significant and positive impact on productivity.[9]

Reform the apprenticeship levy and standards processes

Manufacturers remain committed to supporting the government's plans to create more quality apprenticeships. The apprenticeship levy has the potential to achieve this, but to be successful, changes are needed. The current rules around the spending of the levy and the continued delays in approving apprenticeship standards are preventing growth in apprenticeships amongst manufacturers. Some 11% of manufacturers have delayed or cancelled an engineering apprenticeship for an existing employee and 8% for a new recruit since the introduction of the levy.[10] Government should therefore:

1) *Increase the lifetime of apprenticeship funds from 24 months to 48 months*

An overwhelming 79% of manufacturers say government should increase the lifetime of funds to improve the Levy.[11] Increasing the lifetime of the funds will ensure that those employers that recruit every 2-3 years (which tend to be SMEs) are not penalised. It will also alleviate some of the impacts of the delays to apprenticeship standards.

2) *Lift the current cap on the maximum amount of spend on an apprenticeship and empower the Institute for Apprenticeships (IfA) to determine the maximum funding cap based on evidence*

The maximum amount an employer can currently spend on an apprenticeship does not reflect the true cost of training. This is one of the reasons why four in ten manufacturers say colleges and

[8] Department for Education (2018) Employer Skills Survey 2017
[9] EEF (2015) Productivity: The State of the Manufacturing Nation
[10] EEF (2018) A Levy Price To Pay? The Apprenticeship Levy One Year On
[11] ibid

providers haven't been either willing or able to deliver their chosen apprenticeship standard.[12] The current model is deterring providers from delivering higher cost apprenticeships. The maximum funding band should be removed with the IfA determining funding levels based on evidence of delivery cost.

3) *Speed up the process of approving standards and ensure transparency and priority when signing off standards*

54% of manufacturers say apprenticeship standards have not been ready for delivery.[13] This is a major bottleneck for manufacturers wanting to offer apprenticeships and a key reason behind those citing delays to starting apprenticeships. The process of signing off standards must be quicker. In addition, the IfA should immediately publish data on standards that have been put forward, any delays and the reasons for these delays. In addition, the IfA should be tasked with identifying where the gaps are now and which standards should be prioritised based on the economy's needs and aligning to the government's industrial strategy.

Together, these recommendations will support manufacturers to create quality apprenticeship opportunities. Individuals undertaking an apprenticeship enjoy higher wage premiums with a Level 3 Apprenticeship adding a 16% wage premia.[14] For engineering the benefits are increased further, with a level 3 engineering apprenticeship adding additional lifetime earnings of over £110,000.[15] Higher wages drive consumer spending therefore boosting the economy.

Deploy the Immigration Skills Charge where there are gaps in funding and limit its extent

The government has been collecting the Immigration Skills Charge (ISC) since April 2017, with an estimated £250m being collected each year. Whilst the Skills Charge was earmarked to fund UK apprenticeships, the introduction of the levy made this objective redundant. To prevent the charge being regarded as a tax alone, government must:

1) *Immediately announce how the Immigration Skills Charge will be deployed, focusing on supporting training where there are gaps in funding streams*

Government should immediately announce how the Skills Charge will be deployed, with a focus on training where there are funding stream gaps. Whilst training per employee in manufacturing has remained the same (£1,200 in 2017 and £1,200 in 2015[16]) this may fall as the Levy consumes training budgets (a third of manufacturers say they will absorb the cost of the Levy within their training budget[17]). The ISC should include support for employers to up-skill and retrain their existing workforce with skills needed to keep pace with rapidly advancing digital technologies and techniques.

In addition, in light of recent findings suggesting that many employers are unlikely to offer T Level placements in their current form, the ISC should be deployed to support employers offer work placements with a further £50m, doubling the size of the current commitment to support providers.

2) *Publicly state that the Immigration Skills Charge will not be increased and not be extended to EU nationals post-Brexit*

[12] EEF (2018) A Levy Price To Pay? The Apprenticeship Levy One Year On
[13] ibid
[14] BIS (2015, updated in 2017) Measuring the net present value of further education in England
[15] EEF (2018) A Levy Price To Pay? The Apprenticeship Levy One Year On
[16] CEBR (2015) Productivity and lifetime earnings impacts of engineering education & training
[17] Department for Education (2018) Employer Skills Survey 2017

The cost of recruiting non-EU nationals is already significant with companies paying a minimum salary, visa costs, the health surcharge and the immigration skills charge as well as the time spent navigating the complex system. Therefore government must not increase the reach or cost of the skills charge. Moreover, in light of an already falling number of EU nationals coming to work in the UK, the skills charge must not be extended to EU nationals post-Brexit; with three-quarters of manufacturers having at least one EU national in their business[18], the impact of any extension would be significant.

Interventions to support a healthy workforce

Every year, employee ill-health negatively impacts UK businesses, despite the fact that much of it is preventable. In 2016/17, 1.3 million workers suffered from work-related ill-health, which equated to 25.7 million working days lost.[19] This has been estimated to cost £522 per employee[20], and up to £32 billion per year for UK business.[21] Furthermore, turning up to work while sick, and suffering from reduced productivity as a result, can cost up to a further £15 billion every year.[22]

Reductions in long term sickness absence will only be achieved if the government recognises that fiscal incentives are likely to be the route which will secure SME engagement in the funding of well-being programmes, medical interventions, rehabilitation or workplace adaptations reducing reliance on the NHS.

EEF members said[23] that they would be incentivised to pay for employee health (including people with longer-term health conditions) and well-being programmes (physical and mental) if the government were to introduce a range of fiscal incentives including, for example, employer/government matched funding, health tax credits for employers, lower National Insurance rates or employer allowable business expenses.

Government should test the impact of fiscal incentives in driving this agenda by initially looking at incentives in relation to workplace physical activity. This could be done by expanding the current salary sacrifice scheme (which applies to the popular Cycle to Work scheme) to include a broader range of physical activity opportunities, memberships and accessories, such as gym memberships, equipment and activity trackers.

Expanding the existing Salary Sacrifice arrangements could result in an increased uptake in activity participation among the UK workforce. This expansion is projected by UK Active[24] to lead to cost savings to the NHS, improved workplace productivity, and reduced premature mortality, which in sum would generate £240m a year to the UK economy and a cost-to-benefit ratio of 2.6 to 1. In particular, it would see 209,000 currently inactive Britons take up physical activity.

Preparing for every workforce eventuality

During the financial crisis UK-based manufacturers felt at a competitive disadvantage to the majority of European competitors due to the absence of a scheme to support short-time working. These

---

[18] EEF (2017) Lifting the Lid on the Levy
[19] HSE, Health and safety at work: Summary of statistics for Great Britain 2017
[20] CIPD, Absence Management 2016: Annual Survey Report
[21] PwC (2011), Absenteeism costing UK business £32 billion a year, with workers taking almost double the number of 'sick' days as US counterparts, says PwC
[22] British Heart Foundation & ERS Research & Consultancy, Health at Work: Economic Evidence Report 2016
[23] EEF (2018) - Employee Health – Making Industrial Strategy work for Britain - EEF Health, Work, Well-being and Sickness Absence Survey 2017
[24] Workout from Work scheme: a cost benefit analysis March 2017 – Saffery Champness, Chartered Accountants

schemes, some of which were in place before the crisis and others were implemented quickly in response, were designed to prevent viable businesses from insolvency through the provision of a public subsidy for a component of employment costs.

Many schemes comprised some form of wage subsidy and provided support for retraining or upskilling while activity levels remained depressed. In most cases short-time working schemes operated on a temporary, fixed term basis.

The evidence, post-crisis, suggests that while there was clearly a short-term hit to productivity, growth in output per hour is likely to have rebounded more strongly in countries, such as Germany, which operated a successful short-time working scheme, as firms were better placed – with the support of government – to hold on to vital skills and develop new ones.

A best guess is that the UK economy is closer to the next recession than it is from the last one, and with the productivity lessons learned from the last crisis, government should now consult on proposals to develop and put in place a UK 'Kurzarbeit' scheme, while the economy is growing.

There are inevitably a range of lessons that must be learnt from equivalent schemes operating across Europe, but we would see the principles as being:

- the scheme if operational only in a severe, economy-wide recession,
- the scheme is temporary – up to a possible maximum time limit of one year, and
- the scheme supports retraining and upskilling.

World class management practices

The factors behind the stagnation of UK productivity are all interconnected, but one area stands out as needing significant attention – management practices and capability. This is of particular concern as weak management practices impact on investment levels, innovation efforts, the ability to scale and grow, and the appetite for internationalisation – all factors attributed to higher levels of productivity.

Management practices include more than just people management to encompass operational management, performance monitoring and continuous improvement.

In addition, given that UK manufacturing firms are more likely to be providing ancillary services (compared to international counterparts), there is the need to ensure the best management practices are being used in all parts of manufacturing firms. This is to make sure efficiencies are being achieved across all the different sources of revenue for the firm.

Despite its importance, UK manufacturers are not adopting best in class management practices which is likely to be placing a block on activities associated with productivity growth. The productivity challenge is now so stark and there is large agreement that management is part of the problem, that government must get involved to fix it.

Management practices and UK manufacturing

Our *Unpacking the Puzzle*[25] report highlighted the strong correlation between management practices and labour productivity. Drawing on research conducted by ONS and others, it highlighted that UK manufacturing firms were below average on management practices with a broad spread from best in class to worst in class. Since then our additional evidence gathering from manufacturers has highlighted:

- Almost a third of manufacturers (28%) don't measure productivity anywhere across their business.
- Given the prevalence of services as a source of revenues, only 30% measure productivity in this space (note this excludes those who say measuring services was 'not applicable' for their business).
- A small majority are employing best practices on people management, but are weaker in other areas such as regularly reviewing KPIs, and sharing targets across the business. Our survey[26] also confirms previous work done by ONS which shows foreign owned firms score higher than domestic owned firms.
- Manufacturers are not doing enough management training and our feedback through manufacturing forums shows that they can't find access to the right supply which is holding back those who do want to fix the challenge.

Tackling these challenges requires the different facets of management practices to be disaggregated into their component parts to be addressed individually. For EEF these parts include: continuous improvement and benchmarking, functional professional development and organisational transformation – our recommendations on fixing the challenge in each of these areas is set out below.

Continuous improvement and benchmarking

Firms find it difficult to compare and benchmark their productivity externally, particularly where they make bespoke products or provide services associated with production. While benchmarking against competitors will be difficult for some firms, there are alternative ways of benchmarking the productivity performance of a business such as benchmarking individual units within a business to drive best practice.

Resourcing organisations such as Growth Hubs and Be The Business with a Productivity Benchmarking Fund is one intervention that can help to drive up demand from businesses to benchmark their productivity. This Fund should be matched by intermediaries with trusted access to businesses, such as trade associations, this will allow tailored benchmarking approaches to be developed for different types of firm, and that knowledge to be disseminated rapidly across sectors.

Functional professional development

EEF's survey[27] show 43% of firms say their productivity would be even better 'if middle managers took more responsibility for productivity improvements', the second highest choice across a range of options (beaten only by 'if we were more innovative in our use of technology'). Despite this, a large minority of manufacturers in our survey do not have a formal process for management training.

While there may be limited training being undertaken, early anecdotal evidence from EEF members highlights that the supply of training provision is limited. As it is difficult to instruct the supply side, there needs to be a demand led approach to develop a functioning market for management training.

[25] EEF (2018) Unpacking the Puzzle – getting UK productivity growth back on trend
[26] EEF, July 2018, results to be published
[27] EEF, May 2018, results to be published

This approach needs to encourage both a firm level response and encourage individuals to take more responsibility for their own functional management training. Our recommendation is for a two pronged attack:

1. Utilising the framework and principles behind the Apprenticeship Levy to incentivise management training. For every 4 apprentices trained by firms using the Apprenticeship Levy, firms should be able to use their levy funds to train one manager, up to a maximum of five managers. To encourage this government should top up the levy pot by £30m – which should be ring fenced for the provision of management training.
2. Creating a Continuing Professional Development account scheme for individuals. This will drive demand on the individual front for management training by incentivising training in more functional management areas such as financial management, operational efficiency or new appraisal methods for technology investment. Government should start off with a £27.5m fund, to be matched by individuals through their CPD account.

Using the Apprenticeship Levy framework will encourage firms to continue to increase their investment in apprenticeship training, with the added benefit of unlocking management training, particularly useful for first line supervisors stepping up to their first management role and often managing their peers. This will also show apprentices that there is an attractive path beyond technical capability to include future management training.

Alongside this, the CPD account could provide a step change in how professionals keep their management practice competencies up to date by encouraging individuals to take action through a matched fund from government.

Both approaches from government will help to stimulate demand for the different types of management training required to engender a more productive manufacturing firm covering the spectrum from people management through to organisational efficiency and continuous improvement.

Organisational transformation

Government sponsored intervention already exists for significant transformation across manufacturing firms through the well regarded Sharing in Growth scheme. However this is primarily targeted at automotive and aerospace manufacturers where supply chain integration is strong. Scaling this intervention effectively across other sectors could be a challenge particularly where OEM presence is weaker or supply chains are less vertically integrated. Despite this, government can still set the conditions to help Sharing in Growth to scale.

Our recommendation to scale Sharing in Growth is for firms to access the scheme through a government repayable grant. Companies will receive a grant to undertake a Sharing in Growth intervention, on successful completion (i.e. pre-agreed tracked productivity improvements are delivered) companies repay the grant. Companies who drop out of an intervention would also have to repay the grant. Only firms who don't meet the targeted productivity levels would not be expected to repay.

Given the success of Sharing in Growth in helping firms to achieve a step change in their competitiveness and the intensive, multi-annual nature of the intervention, Sharing in Growth will not be for every firm. But there are firms in sectors beyond automotive and aerospace who would benefit from an intervention who are currently missing out. A repayable grant approach filters the pool of potential firms to those ready to take on an intervention at this scale, helping to boost productivity of firms with the potential to be world beating.

About EEF

EEF, the manufacturers' organisation, is the representative voice of UK manufacturing, with offices in London, Brussels, Wales, and every English region.

Collectively we represent 20,000 companies of all sizes, from start-ups to multinationals, across engineering, manufacturing, technology and the wider industrial sector. We directly represent over 5,000 businesses who are members of EEF. Everything we do – from providing essential business support and training to championing manufacturing industry in the UK and the EU – is designed to help British manufacturers compete, innovate and grow.

From HR and employment law, health and safety to environmental and productivity improvement, our advice, expertise and influence enables businesses to remain safe, compliant and future-focused. More information at www.eef.org.uk

FOR FURTHER INFORMATION CONTACT:

Lee Hopley
Chief Economist
020 7654 1537
lhopley@eef.org.uk

Follow us online:

Blogs: EEF Economics Blog: www.eef.org.uk/blog
Twitter: @EEF_economists
LinkedIn: http://www.linkedin.com/company/eef