

Government's response to
Business & Enterprise Select
Committee's 'The Automotive
Industry in the UK' report

SEPTEMBER 2009



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Presented to Parliament by the Secretary of State for
Business Innovation and Skills

By Command of Her Majesty
September 2009

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The Government welcomes the Business and Enterprise Select Committee's report – The Automotive Industry in the UK.

This is a valuable contribution to the discussions now taking place about the best way to support this critical part of the UK's manufacturing sector now and in the future.

In 2008, the UK produced 1.65 million cars and commercial vehicles, and around 3 million engines, generating over £10 billion for our economy. The UK's automotive sector directly employs around 180,000 people, with another 200,000 employed supplying essential parts and services to the sector and 550,000 jobs supported in the car retail and service sectors.

This is a highly-skilled workforce which, backed up by the industry's major investment in R&D, helps drive innovation across the UK's manufacturing base and global supply chains. It has helped attract millions of pounds of inward investment to the UK, with some of the world's leading automotive companies locating key facilities in this country.

As a measure of the scale of the global vehicle market, in 2008 the global vehicle output was 70 million units, and this is expected to grow as markets such as China and India become more mature. That is why the Government has taken substantive action to ensure these high-value skills and strengths are not lost. In every country, the automotive sector has been one of those hardest hit by the global recession.

The industry is also at a turning point, with the need to invest in and develop ultra-low carbon technologies essential to its future global success.

The Government's dedicated Automotive Assistance Programme (AAP), alongside a range of wider business support initiatives, is working to help the UK's automotive industry get through this downturn and prepare for success in the future.

The Government thanks the Committee for their positive comments about this work and the commitment of Ministers and officials at the Department for Business, Innovation and Skills (BIS) to the UK's automotive sector.

The Government has also considered in detail the Committee's proposals for changes to certain measures. This report sets out our response in full.

Recommendation 1: If the problems identified by the NAIGT can be solved, then we believe UK industry could and should flourish. As well as the reliability, high productivity and good labour relations identified above, the UK industry is diverse, has globally competitive vehicle and power train R&D, and strong premium brands. But its long-term future depends on Government taking the right actions now to ensure that the industry is sustained through this period of crisis.

The Government's approach to industrial policy is to actively address market failures and create the best possible conditions in which UK businesses in leading global markets can thrive. In our *New Industry, New Jobs* strategy we outlined the Government's future approach to the challenges of market failures and market barriers. Strategic intervention from Government will help remove barriers to success and targeted support can drive innovation and access to markets in existing and new technologies. As outlined in the *Low Carbon Industrial Strategy*, launched on 15 July 2009, we need to ensure that British businesses and workers are equipped to maximise the job creation and economic opportunities of a transition to a low carbon economy.

The Government shares the Committee's belief that the UK's automotive industry has key strengths which will enable it to flourish in the future and is taking the right actions to sustain it through the downturn. We have put in place a comprehensive package of policies to support our vision for a low carbon vehicle future for the automotive sector:

- Created through the AAP, a £2.3 billion fund investment programme to help the sector produce the right cars to meet consumer demand. We want to make sure the downturn does not derail investment in innovation and change that will help the industry become a world leader in the development, manufacture and use of low carbon vehicles.
- Provided a short-term stimulus of £300 million for a scrappage scheme to kickstart sales and boost consumer confidence. The benefits of the scrappage scheme have been balanced with the needs of other sectors of the car industry such as the second-hand market, maintenance and repair businesses, and other industries that produce consumer durables.
- Allocated over £400 million to support the shift towards low carbon transport in the UK for consumer incentives, infrastructure development and R&D.
- To prepare our workers for these industry changes, the Train to Gain budget allocated to the automotive sector has been increased substantially to £100 million.

- Created a Low Carbon Economic Area based on ultra-low carbon vehicles in the North East. The area already has the world's largest electric van manufacturer, is participating in the low carbon cars demonstrator project and is investing in the infrastructure to support electric vehicles. It will now also include a skills focus on building and maintaining electric vehicles, investment in R&D, and the planned new Nissan battery plant. By creating this hub of expertise we can concentrate support and develop infrastructure to help compete on an international scale.

The New Automotive Innovation and Growth Team (NAIGT) report of May 2009 is an essential contribution to the Government's evolving approach to the sector. It is essential we look at the NAIGT proposals as a whole, although elements, such as the technology road map are already influential in industry and government. We are carefully considering the full recommendations of NAIGT report to Government, and discussions with the industry continue. We expect to publish our considered response during the Autumn.

Recommendation 2: We agree that it is sensible to use Government support for the automotive industry to foster innovation, and that the emphasis on low carbon technology is appropriate. This approach is a key part of the package. However, it is not all that is required; other innovative technologies, such as those relating to safety, should also be eligible for support.

The future of the automotive industry relies on its ability to make the transition to ultra-low carbon technologies as quickly and cost-effectively as possible.

It is critical that investment in low carbon R&D remains a priority for the industry and the Government is pleased by the Committee's support for innovative and green solutions. We also agree that low carbon technologies are not the only factor important to this sector's success.

That is why our AAP scheme assesses the eligibility of individual cases against a range of criteria. This includes social, economic and environmental benefits across the automotive supply chain such as safety, the advancement of R&D activity, promotion of skills, training and innovation, resource efficiency and recycling of materials.

It is the Government's view that the current legislation on type approval in car manufacturing is sufficiently robust to raise standards in vehicle safety. For example, the introduction of compulsory seatbelts has helped make safety a key differentiator, or unique selling point between vehicles, with manufacturers seeking to offer more safety features than their competitors. This includes features such as increased fitting of airbags, widespread introduction of Anti-lock Braking System (ABS) and Electronic Stability

Control (ESC). This results in the increase of overall safety levels in the each new generation of car models.

In addition, the Department for Transport has commissioned R&D into road safety. While one of the Technology Strategy Board's (TSB) main streams of support is the Intelligent Transport Systems and Services (ITSS) Innovation Platform, which will develop intelligent transport plans to promote vehicle safety over the next 12 months.

We also believe that a system designed to reduce CO₂ output by moderating a vehicle's performance or adapting to road conditions can lead to safer drivers and safer vehicles. By reducing incidents, the improvements to traffic flow have a direct positive effect on vehicle efficiency, and thus reduce CO₂ emissions.

Recommendation 3: We understand the Government's initial concern that if eligibility criteria were set too low the scheme would be swamped. However, there is too great a gap between eligibility for the Enterprise Finance Guarantee Scheme, and eligibility for the Automotive Assistance Programme. We recommend that the loan guarantee threshold for the Automotive Assistance Programme should be lowered urgently to £1 million. Moreover, the Government has said that under exceptional circumstances it may make direct loans to automotive companies. There should be no lower limit on such loans.

As our witnesses made clear to the Committee, the Government continues to consider each applicant to the AAP on a case by case basis. No company's application would be declined without a discussion with the operators of the scheme.

We have considered, and will continue to consider, applications from companies seeking support (be it loans or loan guarantees) below the AAP's current £5 million threshold. We will revise promotional materials and our outreach activities to reflect this.

The AAP aims to support those projects that can make the maximum difference to the industry and its supply chain. At present the AAP pipeline contains projects worth a total of £2 billion seeking total Government support (guarantees and loans) worth £1.2 billion. 80% of the total sums requested through the AAP so far relate to 4 large projects from major automotive companies. With sums of this magnitude at stake we have to ensure that the assistance we offer is the right support to the right companies.

Therefore, it is important that the AAP does not devote too many of its resources to smaller projects and requests for support such as those under £1 million. These may already be eligible for other schemes, like the Enterprise Finance Guarantee (EFGS) or

support offered by Regional Development Agencies (RDAs). They also require a great deal of diligence and analysis, but offer proportionately smaller economic or strategic benefit.

As of 9 September 2009, the EFGS has over £775 million of eligible applications from 6,791 businesses that have been granted, are being processed or assessed. 5,105 businesses have been offered loans totalling £521 million, of which 4,006 businesses have drawn loans totalling £393 million.

Recommendation 4: Companies need to survive this recession in order to help produce the low carbon vehicles of the future. Some will need help with their current range of products. We expect the Government to show a pragmatic approach to ensuring the future of the industry; its help needs to be swift, and it needs to deal with current problems.

The Government is pleased that the Committee recognises BIS's work to publicise and promote the AAP and other schemes through direct communications across the supply chain, and supplier and manufacturer events.

We recognise that Government has a role to play in complementing industry's efforts: industry, Government and the regions working together can enable the UK to become a world leader in low carbon transport, at the forefront of the development, demonstration, manufacture and use of ultra-low carbon automotive technology.

Earlier this year, Government set out its *Low Carbon Industrial Strategy* to help ensure British businesses and workers are equipped to succeed in a low carbon future.

Backed up by over £400 million of investment, the Government is working to establish the right infrastructure, incentives and conditions for R&D to secure the UK's share of growing global market for ultra-low carbon vehicles. This includes £230 million to incentivise the uptake of ultra-low carbon vehicles, £30 million to put a charging infrastructure in place, £140 million to encourage R&D in low carbon automotive technologies and a £25 million programme to trial over 340 ultra-low carbon vehicles on UK roads, which will begin in the next six to 18 months.

The Government has also created a Low Carbon Economic Area based around the development of ultra-low carbon vehicles in the North East. The area, which is already home to the world's largest electric van manufacturer, is participating in the ultra-low carbon cars demonstrator project.

It is investing to develop the infrastructure to support electric vehicles and boost our skills and R&D base to build and maintain electric vehicles. It will also be home to the planned new Nissan battery plant.

Recommendation 5: The premium car sector and its supply chain is likely to be the source of many of the innovations which, used more widely, will aid the transition to low carbon vehicles. The fact the United Kingdom has the second largest premium car industry in the world should be seen as a key strategic strength. Jaguar Land Rover has already secured funding for its future technology investments; all that is under discussion is the Government's guarantee. As at 7 July 2009 there has been no indication that there will be such a guarantee: we are astounded that it has taken so long to arrange this, particularly since the support needed is so limited.

The Government has worked closely with Jaguar Land Rover (JLR) over several months to ensure it is appropriately capitalised. We have also offered bridging finance to the company via the Automotive Assistance Programme.

On 11 August, Tata announced that it had secured private sector funding to meet the companies' financial needs and that UK Government support was no longer needed. This is good news for the company, and a clear sign of market confidence in its products and the wider automotive sector. It reflects increased liquidity and confidence in the bank and debt markets generally.

The funding provides support on a commercial basis to JLR, and enables the company to launch its new XJ saloon on schedule and updated Land Rover models later this year.

The Government will continue to maintain a positive dialogue with Tata and JLR, as one of our leading car manufacturers, and stands ready to offer support again, if required and appropriate.

Recommendation 6: It is clear that the Government has taken a number of sensible steps to make the AAP successful. It is working with a wide range of people within the industry, it has not forgotten the need to reach the supply chain, and it is trying to involve the banks in the scheme. However, we cannot discount the industry's complaints about the delays in agreeing support measures, and we are profoundly disappointed that to date not one single penny has been advanced through the scheme. We hope that this will change rapidly.

The Government appreciates the Committee's recognition of our work to ensure the Automotive Assistance Programme operates successfully.

We are pleased to inform that the first award of support under AAP was announced on 18 September. This is a £10 million loan to Tata Motors European Technical Centre (TMETC) to support the production of electric vehicles in Coventry.

During the inquiry, the Government explained to the Committee the reasons for the slow progress of awards under the scheme. These included companies delaying investment plans as a result of the current downturn; concern from businesses that any premature approaches to banks could damage their relations with existing lenders; the lack of appetite from the banking sector to lend to automotive companies even with the provision of Government guarantees, and the challenge for some companies to prepare business plans for analysis and due diligence by potential lenders and Government.

It should also be noted that support for JLR, through guarantees for European Investment Bank (EIB) loans, was agreed in principle in April 2009 and discussions on terms and conditions were ongoing until Tata announced that it no longer needed Government support.

The AAP team continues to do everything it can to progress cases as quickly as possible, with a large number of companies. At present the AAP pipeline contains projects worth a total of £2 billion seeking total Government support (guarantees and loans) worth £1.2 billion.

Recommendation 7: Despite its relatively late introduction, there are encouraging signs that the Scrappage Scheme has been effective, and we welcome its success.

The Committee's positive endorsement of the scrappage scheme reflects its success so far. The Government has committed £300 million, and to date, nearly more than 205,000 orders have been received via the scrappage scheme, providing a much needed boost to the industry in the medium term and protecting an estimated total of 4,000 manufacturing and 2,000 car sale jobs in the UK.

The scheme has proved popular with the industry and current estimates suggest that new car sales would have been 21% lower had there been no scrappage scheme. The scheme has also proved very popular with both users of the scheme and the public more generally. It has accelerated vehicle replacement and encouraged some people to buy new cars when they would not otherwise have done so. It has enabled a number of consumers to purchase a new (as opposed to second-hand) vehicle for the first time.

The SMMT Chief Executive, Paul Everitt, has said "The impact of the scrappage scheme is clear and we are encouraged by the positive impact it has had, increasing new car registrations for the first time since April 2008."

Sue Robinson, the director of the Retail Motor Industry Federation said, "Car dealers are reporting that the scrappage scheme is continuing to provide a halo effect for overall car sales, and is helping increase footfall into showrooms by general buyers as well as scrappage buyers."

While the RAC spokesman, John Franklin, has said "The uplift in new car sales is a welcome boost for the industry, and shows that incentives such as the scrappage scheme can have a beneficial effect."

Recommendation 8: Over twice as many people are employed in automotive retail as are employed in automotive manufacturing. We appreciate the difficulties in setting in place a scheme to support automotive finance. However, we also note that the French Government already appears to have provided a €2 billion refinancing facility for automotive finance companies. Once again the Government has held out the possibility of action but has not yet delivered. We seek clarification of the Government's intentions.

The Committee is right to highlight the important issue of automotive finance. Currently, the Government is continuing work related to the Sterling Asset Backed Securitisation (ABS) of automotive loan portfolios as a source of funding for automotive finance companies. This includes detailed discussions on funding for the finance arms of 8 major vehicle manufacturers.

But while the sub-investment grade companies are clearly under some strain, the Government continues to believe that none of the finance companies has an immediate need for funding. This provides time to fully consider the issues involved in any access to finance scheme.

Since March 2009 state aid rules have been a very significant barrier to the deployment of an automotive access to finance scheme as industry providers of finance and investors must have legal certainty that any Government intervention complies with binding state aid regulations.

This matter is complex. The Commission has indicated that they believe that the 'pricing' of any proposed automotive-ABS scheme should follow the same principle as the Residential Mortgage Backed Security (RMBS), which was launched at Budget 2009. This means that the guarantee fee should be equal to the Credit Default Swap (CDS) spread of the originating finance provider plus a margin.

This is a significant issue as the CDS spread of the originator may be considerably higher than the default risk of the security being guaranteed.

The automotive access to finance scheme that the Government is currently considering has a different structure to the existing RMBS scheme. Unless the Commission can be persuaded that this proposed scheme should be 'priced' in a manner that reflects the economic risk that the Government will bear, Government will not be able to make a commercially attractive offer.

It is not for the Government to comment on the merits of schemes in other countries. Our understanding is that the French government's refinancing facility operates as follows. A new entity, 'Société de Financement de l'Economie Française' (SFEF), benefits from a government guarantee to issue new debt with terms up to 5 years and lends the proceeds to banks with operations in France using as collateral French mortgages, consumer loans, corporate loans and such like. The French automotive companies, such as Renault and Peugeot, can use this funding source because they have banking licences.

In the UK, similar schemes have been established as part of our response to the financial crisis, such as the Bank of England's Special Liquidity Scheme (SLS) and the Debt Management Office's Credit Guarantee Scheme (CGS). However, in common with

the approach taken by other Member States, these schemes are only open to deposit taking banks and there are no automotive companies that operate deposit taking banks in the UK.

Recommendation 9: We accept that Government financial support for short time working is not an integral part of the United Kingdom welfare system, and that help is forthcoming through Train to Gain. Nonetheless, we also note that some countries have increased the level of support they offer through their schemes, or are considering introducing such support. If British industry is to remain competitive, it will need to retain skilled workers. The Government should be doing far more to help it do this. We do not believe the tax credit scheme is the way to support short time working. We believe there is scope for more ambitious and innovative approaches, like the ProAct scheme adopted by the Welsh Assembly Government.

The Government appreciates that some EU countries have introduced wage subsidies schemes to help retain workers in jobs during the current recession. We believe that each country must adopt policies and programmes that best suit their economic, employment and social security frameworks.

In the UK, skills and training policy is a devolved administration responsibility. This enables England, Scotland, Wales and Northern Ireland to tailor their training provisions to best meet their own business needs, supported by the UK Commission for Employment and Skills to ensure world-class provision in all four nations of the UK. It is therefore not appropriate for the UK Government to comment on the merits of training initiatives being undertaken by the devolved administrations such as the Welsh ProAct scheme.

The UK Government has however examined the economic case for general UK wage support for all employers in-depth. Our conclusion is that this is not a feasible, cost effective or sustainable option for us.

We also know, based on our experiences of the 1970s, that these schemes can create distortions and prevent companies taking necessary action to restructure or retrain to ensure their survival and success in the future, leading to failure and redundancies when the subsidy is removed. They can also provide perverse incentives for other sectors and companies to 'bargain' for subsidies.

Britain's future success depends on the skills of its workforce, and next year, in England, the Skills Funding Agency (SFA) will replace the Learning and Skills Council.

The SFA has been created to ensure a skills and training system that can equip our workforce for success in the 21st century. This includes delivering our successful Train to Gain programme. As part of this programme, businesses with fewer than 50 employees can now receive a contribution to wage costs to release eligible employees for training.

Increasing numbers of employees and employers in the UK are benefitting from this and the other training support measures available via Train to Gain, and funding allocated to the automotive sector through this programme has been increased to £100 million.

The Government is also addressing the specific training needs of the automotive industry through the sector compact, agreed in May 2008, with the Sector Skills Council for Science, Engineering and Manufacturing Technologies (SEMTEA).

The UK tax credit system is designed to provide flexible support that can reflect people's changing circumstances, and is well-placed to help people who find themselves living on a lower income due to short-time working. It does not aim to provide wage subsidy support, neither should it do so in the future.

Recommendation 10: It is important that the entire Government shares a strategic approach to the UK automotive industry. This means that matters such as taxation, environmental targets and support measures should be considered together to ensure they do not inadvertently conflict.

Recommendation 11: The danger is that without a clear Government strategy, and sufficient support, valuable skills and capacity will be lost to countries which more clearly demonstrate their readiness to support the industry. In some cases this will be as much about rhetoric and perception as about real levels of support, but the effect will be the same.

We share the Committee's view that it is important for the Government to take cross-departmental action to help the UK automotive industry strengthen its position in an increasingly competitive global economy.

In *New Industry, New Jobs*, Government sets out a more active, strategic approach to UK industrial policy, focusing on those hi-tech, high-value industries that can drive innovation and growth in the future, and helping our people get the skills and experience they need to prosper.

As part of that agenda, Government has also created the new Office of Low Emission Vehicles (OLEV) in July. It will coordinate action across Whitehall to accelerate change, working to encourage demand, complement supply and make it possible for people to use these vehicles on a day-to-day basis.

Government continues to work hard to build the best possible environment to support business success. We do not agree with the Committee's comment that there is a conflict between taxation policy, environmental targets and other support measures.

The Government introduced a system of banding by CO₂ emissions into Vehicle Excise Duty in 2001, and into the Company Car Tax in 2002, to provide a clear signal to motorists of the environmental impacts of their potential choice of vehicle.

These reforms are designed to encourage the development and uptake of more fuel-efficient, lower-emitting vehicles in company car fleets and individual car purchases.

Changes to rates and bandings in the taxation of vehicles are aimed at responding to rapid advances in vehicles technology and the regulatory environment – and further promote more environmentally-friendly vehicles, helping to reduce UK CO₂ emissions from the transport sector.

The Government is also working to ensure that the European Regulation of CO₂ from New Cars takes full account of the diversity of automotive manufacturing in the European Union.

To this end, the Regulation has allowances for small and medium sized manufacturers which will provide them with CO₂ reduction targets that take account of their circumstances. These allowances will be of specific benefit to a number of manufacturers of premium vehicles in the UK.

The Government continues to work to ensure that European legislation provides certainty, achievability and treats all manufacturers equitably.

The BIS-led Vehicle Industry Policy and European Regulation (VIPER) group continues to provide a forum for industry and a wide range of government departments to discuss regulatory developments to help us ensure that regulations that may affect the automotive sector are proportionate, practicable and appropriate.

AAP supports the strategy and development to maintain investment in low carbon technology in the automotive industry during the downturn. Ensuring that automotive manufacturers in the UK can continue to develop the skills, technologies and capabilities needed to transition to a low carbon economy.

Recommendation 12: We believe the Government is committed to the future of the automotive industry in the United Kingdom. It has provided substantial assistance to the industry, and we welcome the fact that the Minister told us he was ready to intervene to help companies in difficulties. Nonetheless, the help given has been slower than in other countries. Worse still, there are perceptions that the Government does not have a coherent and supportive policy for the industry. This is not just a problem during the current economic difficulties; government support for the industry will determine its long term success. The Government must not only support individual companies, but be seen to support the industry as a whole, and act with more urgency and consistency than it has done so far.

The Government is pleased that the Committee recognises our commitment to the future of the automotive industry as a very important part of the UK's manufacturing sector. The Government has put in place support both for the sector as a whole and, where appropriate, has been willing to support individual companies. We believe that the package of measures we have implemented so far, such as the AAP, the scrappage scheme, and initiatives on access to finance, together with our much wider strategic approach to low carbon vehicles and consideration of the recommendations from the NAIGT report, do demonstrate a rapid and coherent response to the problems confronting the sector, both for the short and longer term, that sets the right direction for its future development and prosperity.



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