FDF Budget Submission to HM Treasury: Driving Growth in Food and Drink

We welcome the Chancellor's four pillars of economic growth – Enterprise, Education, Employment and Everywhere. With a footprint in every region and nation in the UK, the food and drink manufacturing industry contributes £30 billion to the economy, employs nearly half a million people and has invested £21 billion through capital and R&D projects in the last five years.

As the UK's largest manufacturing sector (representing a fifth of the UK's entire manufacturing base), we are central to ensuring the functioning of the UK's food supply chain – so that nutritious, delicious and safe food and drink is available to everyone, everywhere, every day. More than that, our industry has huge potential for growth and for improving productivity right across the footprint of our UK operations.

We therefore welcome the Chancellor's vision for long-term prosperity and for the UK to be one of Europe's most innovative economies. Food and drink should play a vital role in this as one of the UK's advanced manufacturing sectors – underpinned by high-tech manufacturing processes and critical R&D, engineering and technical skills. However the industry continues to face some challenging headwinds due to the increased costs of ingredients, energy, packaging, labour, borrowing and moving goods in and out of the UK alongside the relative weakness of the pound. This has resulted in rising food and drink prices for the seventeenth consecutive month, to 16.9%. Ahead of the Spring Budget, we have set out some areas where our industry wants to work with government to drive economic growth, productivity and, within this, environmental sustainability and exports too, while easing inflationary pressures.

1. Boost productivity and stimulate business investment to create higher skilled, better paid jobs

The UK has long been a favoured destination for investment in food and drink, with global manufacturers choosing the UK for R&D hubs and to drive world-leading innovation. However, there are further opportunities to reinforce the UK's competitiveness by incentivising more companies to invest for growth. These points are founded in independent research conducted for FDF by the Centre for Economics and Business Research (Cebr) in October 2022:

- Make permanent the **100% first year capital allowance** (full expensing) to provide certainty for businesses who want to invest in vital plants and machinery and help with their cashflow. According to Cebr estimates, this would add an additional £3 billion to our industry's added value by 2025.

- Review the **R&D tax credit system** to broaden the eligibility criteria – to include, for example, recipe reformulating for well-loved brands to support healthy diets – and to include capital that will help businesses with significant upfront costs that can often prevent further investments in R&D.

- Reform the **Apprenticeship Levy** so businesses can spend more of their unspent levy funds, for example on shorter, modular training (particularly on digital and data skills). There is still potential to generate over £60 million in food and drink sector added value if unspent but still eligible Levy funds are spent within the sector[1].

- Incentivise companies to invest in product development and innovation to improve diets and tackle obesity, to drive **reformulation and healthier product development** – for example through a one stop shop where companies and industry bodies could see proposed and funded UK Research and Innovation (UKRI) projects to help join up academic research with company innovation.

- For small businesses in need of practical help, the Scottish Government funded **Reformulation for Health Programme** (at a cost of £100,000 per annum) has successfully supported the delivery of recipe changes in line with public health goals. The UK Government should establish a similar scheme to support smaller businesses to access technical support and trial new innovative solutions that can improve the health of products.

2. Reduce inflation by supporting the food and drink industry to help manage high energy costs, by reducing overly-burdensome regulation and tackling labour and trade issues

Food and drink manufacturers are under considerable pressure as a result of huge cost rises in ingredients, raw materials (e.g. packaging), energy and labour. The value of the pound has also increased the cost of essential imported inputs. While companies are doing all they can to limit price rises, and are squeezing their margins as a result, some price rises are having to be passed on. For example, food and drink manufacturers are seeing input costs increase by an average of 21% over the past 12 months, while selling prices increased by 15% on average for the same period.

In December 2022, food ingredients produced in the UK were 18.8% more expensive than a year ago and imported ingredients were 31.0% costlier. Prices of food on supermarkets' shelves will continue to see persistent rises throughout 2023. It takes up to a year for input cost rises to filter through to final prices on shop shelves and manufacturers have now seen costs climbing for over two years. An indication of how tough trading conditions are is that, during the first eight months of this year, there were more insolvencies in our industry than in the whole of 2019.

It's increasingly important, therefore, for our sector that government does everything it can to ease the cost of doing business in the UK – whether that's helping to manage the impact of high and volatile energy costs, action to ease labour market pressures, or providing regulatory certainty, including not introducing additional food taxes. Where new regulation is introduced, we ask that government works with business to ensure it is done with minimal red tape, increased costs and business disruption.

a. Support food and drink to invest in energy efficiency and decarbonisation

Manufacturers are under a great deal of pressure as they try to keep their heads above water while absorbing very high and volatile energy costs in order to keep the cost of everyday food and drink as low as possible for shoppers. Energy accounts for 22% of

[1] Cebr 2022

food and drink businesses' operating costs (up from 12% last year)[2]. Our industry does not use less energy in the summer than in the winter (we cook, bake, chill, freeze, bottle, transport and so on year-round) and some companies have already cut product lines to save money, and often these are those usually sold at more affordable prices, with implications for lower-income households. We therefore welcome the continued support for food and drink businesses following the closure of the EBRS at the end of March 2023 and want to remain in close dialogue with government as the situation continues to evolve throughout the year for which the support is being provided, given how fast-moving the energy situation has become. Further opportunities are also needed to incentivise investment in energy efficiency and decarbonisation:

- We welcome the inclusion of food and drink manufacturers as energy intensive within the new **Energy Bills Discount Scheme**. The support offered should help ease inflation, but we are very concerned about the omission of a number of food and drink subsectors from the EII support. For example coffee manufacturing is very energy and trade intensive due to the non-perishable nature of the products and being easily exportable, with only a few manufacturing facilities in the UK. Pet foods are also highly energy intensive with exposure to international trade, with processes similar to animal feed manufacturing which is recognised as trade and energy intensive through the CFD/FiT exemption schemes. Other anomalies include differential treatment between fresh and preserved cakes, and soft drinks whilst other beverages are included.

- A government decision to extend the current **climate change agreements**[3] for two years, to avoid a cliff-edge reduction in support and to encourage energy efficiency/fuel switching away from fossil fuels, would also be helpful. It would give time too to design a smarter replacement scheme which prioritises the industry's decarbonisation efforts.

- We welcome the spend deadline for project completion for the **Industrial Energy Transformation Fund** (IETF) to 31 March 2027. However as the current scheme closes to applications on 17 February 2023, we would like to see plans for a new Phase 3 scheme announced to help food and drink manufacturers invest in energy efficiency and decarbonisation.

- A government/industry partnership to **develop alternative CO2 supplies** – key in the production of many items of food and drink – to build true resilience into the system is critical. Supplies are currently threatened by high energy prices and as supply tightens in Europe. This is fuelling inflation and risks product shortages from fizzy drinks, packaged and minced meat products to bagged salad.

b. Prioritise regulatory reform

All too often businesses in our sector are grappling with regulation which is overly complex or risks failing to meet its stated aims. Our sector is highly regulated – rightly so – and as such British food and drink is prized for its quality and safety. However, shoppers end up paying the price for poor regulation when this drives up costs and those costs have to be passed on.

[2] fdf-state-of-industry-survey-q3-2022.pdf

[3] Around 750 sites participate in the Food and Drink Climate Change Agreement (FDCCA), and as a result receive relief of up to £70m on their energy bills in return for meeting energy efficiency targets

The policy agenda to achieve fundamental packaging recycling reforms is a case in point. **Extended Producer Responsibility (EPR)** is the set of policies that, if implemented correctly, will ensure manufacturers (or producers) take responsibility for managing their packaging waste and that the UK establishes a world-leading recycling system for plastics and packaging. Producers, therefore, have a clear interest in ensuring the system works – that is, in a way that's good for the environment, for businesses and consumers. But our sector is deeply concerned that the current policy proposals will not create an efficient and effective EPR scheme, nor attract investment, and will cost households around £2 a week. We are therefore urging government to work with industry to conduct an urgent review of EPR.

A well-designed EPR should effectively remove plastics and packaging from the refuse system and drive recycling – this has been the case in other countries where schemes have been successfully introduced. However, it needs to be accompanied by the right policy framework too. One of the missing components at the moment, for which HMT has responsibility, concerns chemical recycling.

Without large scale **chemical recycling** taking place, it will be impossible to supply sufficient recycled packaging content to the market. HMT and HMRC need to urgently approve the 'mass balance accounting' methodology needed to unlock the potential of chemical recycling and immediately introduce this measure rather than delaying for several years. Without chemical recycling, companies cannot source sufficient recycled materials, especially flexible plastics. As a result, they have to keep buying virgin plastic. Government policy is therefore working against government's own ambitions to recycle more.

The **Plastics Packaging Tax (PPT)** makes this situation worse. When companies cannot source sufficient recycled materials, which is too often the case in the UK because of the scarcity (and therefore, the price) of recycled materials, then they must use virgin plastic and pay the PPT. But the tax is hugely administratively burdensome, particularly for SMEs. So even where companies can source recycled materials, they are paying the tax anyway because proving compliance or exemption is too costly. The tax therefore needs urgent review given the fact that it is failing to achieve its purpose in changing behaviour and imposing a burden to comply with PPT rules.

Drink manufacturers are committed to ensuring a successful **Deposit Return Scheme**. However, huge costs and inefficiencies are going to be driven into bottle return schemes given each of the UK's four nations are imposing their own scheme. Undermining the UK's internal market in this way will set a costly and concerning precedent. The UK government has also complicated the system by deciding to apply VAT to its own landmark environmental scheme, which will divert essential investment and risks higher prices for consumers.

c. Ease the labour market

The unique footprint of food and drink means no one need leave their local area to get a good job – and build a great career – in our industry. But we are facing sustained and severe labour shortages – all of which are making food and drink production more expensive, holding back our sector's ability to grow and increase productivity, and represent millions of pounds in taxes forgone. Vacancies have now reached 7%, around 50% higher than in other manufacturing sectors and more than double typical levels pre-pandemic. Shortages are particularly acute in engineers, food scientists, butchers and production operatives. Boosting labour supply is central to our industry as well as for raising the UK's economic growth. We would like government to:

- **widen the scope of the Shortage Occupation List review** to include acute shortages at all skills levels and greater flexibility on the salary thresholds to help ease immediate pressures; and

- **work in partnership with the industry on building a pipeline of skills and talent** for our industry's future workforce, in the medium to longer term.

d. Improve trade facilitation

The EU is by far the UK's biggest trading partner for food and drink and business is continuing to adapt to the changes imposed by the Trade and Cooperation Agreement (TCA). We are also anticipating further disruption when checks and controls on imports from the EU are introduced this year. We therefore urge the government to consider options to reduce the burden of agri-food movements and checks with our most trusted trade partner, including by considering the option of a veterinary agreement. We recognise that delivering improvements to the TCA will to a large extent depend on securing a mutually agreeable outcome on the Northern Ireland Protocol. We urge the government to continue talks aimed at resolving UK-EU differences quickly.

We have identified a series of actions, detailed in our recent Trade and Investment Strategy, where we think the UK can unilaterally act to drive substantial improvements for businesses at the border, boosting the competitiveness of our exporters and ensuring access to the ingredients and raw materials businesses need to import. We are calling on government to:

- **design a Single Government Border Approach to underpin the Single Window:** the government should ensure simplified approaches to systems are backed by a single approach to its presence at borders.

- **create joint customs offices with key trusted trading partners:** the government should look to create single customs offices and integrated Single Windows with trusted trading partners.

- **expand risk-based approaches to customs enforcement:** this should include looking to remove trusted businesses from customs border requirements and develop an open, risk-based and permissive sample import system. This is crucial for innovation investment in product development.

- **develop a strategic plan for UK port capabilities:** while the best UK ports can be among the world's most efficient, there is scope to improve surge capacity, automation and AI to expedite clearance times.

- **ensure ongoing reform of the UK's import tariff for food and drink:** an ongoing review should seek to eliminate on an applied basis any tax on food and drink imports that cannot be justified as supporting food security or another clear policy rationale.

- **commit to consult on and introduce new temporary duty suspensions every six months:** businesses urgently need a reliably agile duty suspension scheme to be put in place with suitable transparency on reasons for the rejection of applications.

Food and Drink Federation
1 February 2023