

## Levies

This note explains why a national statutory training levy (perhaps at 0.5% of payroll costs) on employers is a rational response to current skills shortages, planned public spending cuts and the shortcomings of alternative measures to engage employers. Training levies are used successfully in many other advanced countries and could be introduced in England by 2018. We have written this note to inform the Budget on 8 July and the subsequent spending review. We would be happy to do more work on this, subject to resources, if that would be helpful.

### The case for action

1. The UK has a recovering economy and record numbers of people in work but there are a number of related productivity and skills challenges:
  - productivity is no higher than it was in 2008).<sup>1</sup>
  - there is evidence of growing skills shortages.<sup>2</sup>
  - The numbers of people entering the workforce with science, technology, engineering and maths (STEM) skills is insufficient and there are looming shortages because of retirement and the industrialisation of service jobs.<sup>3</sup>
  - Countries such as Australia and Germany have many more apprentices at Level 3 than England.<sup>4</sup>
  - The amount of training whilst in work appears to have fallen by 50% over the last 15 years and employer spending has been in decline since 2005<sup>5</sup>.
  - 44% of adults had below Level 2 literacy in the most recent national survey and 78% below Level 2 numeracy.<sup>6</sup>
  - 1-in-5 adults lack basic digital skills<sup>7</sup> - an obstacle to the Government's digital strategy for the public services.
  - The population of 50 to 70 year olds will grow substantially in the next 15 years and the state pension age will rise to 67 by 2028. Yet the employment rate for 55-64 year olds is only 60%.<sup>8</sup>

### Sources of funding

<sup>1</sup> Bank of England governor Mark Carney inflation report speech, May 2015

<sup>2</sup> Prince's Trust report, *The Skills Crunch*, August 2014

<sup>3</sup> BIS, Professor John Perkins Review of Engineering Skills, February 2014

<sup>4</sup> Boston Consulting Group "Towards a real revolution in apprenticeships" 2013

<sup>5</sup> Green, F., Felstead, A., Gallie, D., Inanc, H. and Jewson, N. (2013) *What Has Been Happening to the Training of British Workers?*, Centre for Learning and Life Chances in Knowledge Economies and Societies, <http://www.llakes.org>

<sup>6</sup> BIS "Skills for Life Survey" December 2012

<sup>7</sup> BBC "Media literacy. Understanding digital capabilities follow-up" reports that 19% of UK adults fall below the digital skills threshold

<sup>8</sup> DWP "Fuller Working Lives, A framework for action" July 2014

2. Money isn't everything but it makes a difference. The three main sources of funds are Government, individuals themselves and employers. Government revenue spending on adult skills (including 19+ apprenticeships) was cut from £3 billion in 2009-10 to £2 billion in 2015-16<sup>9</sup>. There will be further spending cuts as a result of plans to secure a balanced budget by 2018. The Conservative manifesto identified a requirement for £25 billion cuts to deliver this aim, half of which would come from benefit savings<sup>10</sup>. The student loan scheme was extended outside higher education in 2013 but currently operates on a modest scale with just 120,000 people taking Level 3 courses in the first two years.
3. In future, individuals and their families will need to take on more responsibility for their own learning and training. People already commit significant amounts of time and money to learning but participation is variable. 41% of adults participated in learning in the last three years but 33% have not done so since leaving full-time education<sup>11</sup>. With five million people earning less than the living wage and competing pressures on time, it is unlikely that individuals alone will take the steps to tackle the issues set out in this paper. In every other advanced country, funding from employers and employment training play an important role.
4. Governments of all political persuasions have spent decades trying to encourage employers to invest more in workplace training with varying degrees of success. For example:
  - Training and Enterprise Councils (1989 to 1999) which were intended to energise employers but which ended up managing government unemployment training programmes.
  - Train to Gain (2006 to 2010) which was intended to encourage employers to invest in training their higher skilled employers by providing government funds for the lower skills but which ended up replacing employer spending.
  - Repeated reforms of vocational qualifications (1986 onwards) to give more control to employers over what is taught but which have resulted in more government control and less public respect.
  - Employer ownership pilots (2002 to present) which were designed to leverage more investment by giving employer groups more control over public funds but which have resulted in a small amount of innovation and not much activity.
5. In light of the above facts, there is a case for considering levy systems to bring a step change in training. France, the Netherlands, Germany (for

<sup>9</sup> AoC calculations from Skills Funding Agency accounts and grant letter

<sup>10</sup> Conservative party manifesto, Page 8

<sup>11</sup> NIACE "Annual participation in learning survey" 2015

construction), Denmark, South Korea, Singapore and a number of Latin American countries all have levy systems<sup>12</sup>. Perhaps there is something England can learn from and adopt

### **The role of levy/grant systems**

6. Levies are a common way to support training across the world<sup>13</sup> and could have a transformative effect on training in England. To quote Baroness Alison Wolf in a paper for the Resolution Foundation:

*"A half per cent levy on payroll could realise £2.5 billion a year – considerably more than the whole combined current apprenticeship and adult skills budget. Apprenticeship levies of this type are used all over the world. They are not new and they are not unusual. They remove the free-rider problem: if you have an apprentice, you get subsidies, and if you don't, your levy goes to help support the training of other people's"<sup>14</sup>.*

7. A recent UK government study identified three main arguments for levies in terms of failures in training market<sup>15</sup>

- Poaching externalities (firms avoid training costs by recruiting already trained workers).
- Informational imperfections (firms and individuals overestimate the costs of training and underestimate the benefits).
- Credit constraints (lenders are unwilling to provide funds for training).

8. There are two main categories of system:

- Levy-grant systems which collect a levy on all the firms in a sector (generally in proportion to payroll) and distributing this as training grants (generally to the same firms).
- Levy exemption systems in which a firm either proves it is training or pays ("train or pay").

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<sup>12</sup> UKCES Evidence report 47, July 2012 Gospel H and Casey P "Understanding training levies"

<sup>13</sup> World Bank Dar A, Canargarajah and Murphy P "Training levies; rationales and evidence from evaluations" 2003 counts 30 countries as having or having had training levy schemes

<sup>14</sup> Alison Wolf "Beyond the Degree Delusion" in Resolution Foundation "Paying our way" March 2015

<sup>15</sup> UKCES Evidence report 47, July 2012 Gospel H and Casey P "Understanding training levies"

## Existing training levies in England

9. A national system of training levies was created by the Conservative government in 1964 (in its last year of office) and ran until the early 1980s. There was no formal evaluation of the scheme but there were some obvious drawbacks. Levies can be administratively expensive, can create unfairness at boundaries, can support training that would have happened anyway ("deadweight") and can provide incentives for the wrong sort of training.
10. The legacy of the ITB initiative are two statutory levy-grant schemes in the UK for construction (the Construction Industry Training Board) and engineering construction (ECITB). In addition there is one voluntary scheme run by Skillset for the film industry which was intended to become statutory. The experience of these schemes has demonstrated the limitations of voluntary levies:
  - The construction industry scheme relies to a significant extent on Government funding for apprenticeship training yet, despite covering a sector with almost two million workers trains less than 20,000 apprentices<sup>16</sup>. There are boundary issues with related sectors like plumbing and electrical installation.
  - The film industry scheme is very small with payments from fewer than 50 films into the scheme each year (amounting to less than £1 million).

## Current government policy

11. Any decision to move ahead with levies needs to take account of existing Government promises on national insurance, apprenticeships and levies:
  - The promise of no increases in national insurance rates.<sup>17</sup>
  - Employer's national insurance will be eliminated for apprentices under the age of 25 from April 2016.<sup>18</sup>
  - A new system to route government funding via apprenticeships will be introduced by 2018.<sup>19</sup>
  - There will be a Home Office consultation on a levy on employers who wish to use highly skilled visas.<sup>20</sup>

## Options

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<sup>16</sup> UKCES Evidence report 47, July 2012 Gospel H and Casey P "Understanding training levies"

<sup>17</sup> Conservative party manifesto, April 2015

<sup>18</sup> Decision announced in Autumn statement, December 2014

<sup>19</sup> BIS information on apprenticeship funding model, March 2015

<sup>20</sup> PM's speech on immigration, May 2015

12. If levies are considered a sensible way forward, there are several options for implementation
  - Government support for new voluntary schemes.
  - New statutory levy-grant schemes in areas of skills shortages.
  - Geographically based levy-grant schemes.
  - A national statutory levy.
13. Government support for new voluntary schemes would be the easiest, most cost-effective way forward. When it abolished Industrial Training Boards in the 1980s, the Conservative Government left in place arrangements for employers to create new levy schemes if there is evidence of support and need. The Labour Government's skills strategy in 2003 encouraged Sector Skills Councils to consider this option<sup>21</sup>. Apart from the very small film industry scheme, this has not happened. There is anecdotal evidence both that the legislation is too complicated and that employers are insufficiently organised.
14. A stronger approach might be to develop new statutory levy schemes in areas where there are skills shortages. The Home Office will consult shortly on a new Tier 2 visa levy to support apprenticeships which may create a new statutory scheme but, on its own, this may result in an ad hoc approach. The funds raised will depend mainly on individual supply and demand of highly skilled migrants. The focus will partly be on deterring migration so there is a risk that this would be the focus rather than wider skills issues. One option that the government could consider is to continue the Coalition's work on industrial strategies to identify areas where rising skills needs coincides with a likely shortfall in workforce supply. This may be a sensible approach in certain well researched sectors but may require a greater deal of workforce planning than currently exists within government. Any sectoral scheme involves boundary issues and may involve high administration costs if the sector is relatively small.
15. An alternative approach might be a geographically based levy perhaps operated by a combined authority with Local Enterprise Partnership support and linked to an HM Treasury deal on business rate retention. There would be considerable obstacles in this approach, not least of which is the mobility both of firms and workers in England and the relatively small size of local government areas. It is possible to conceive of a geographical levy in a country such as the USA or Australia but not here.

### **A national statutory levy**

16. The option that deserves most consideration as an alternative to muddling through with the existing voluntary arrangements is a national statutory levy, perhaps existing alongside employer's national insurance. Involving

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<sup>21</sup> HM Govt "21<sup>st</sup> century skills" 2013 Page 57

every employer would reinforce an “all in it together” message while avoiding boundary issues and ensuring that a small % levy on payroll could raise a substantial sum. Using HMRC to collect funds and involving the Skills Funding Agency in their distribution would keep administration costs low and assurance high. If this approach is taken, a key part of any scheme would need to be employer control of the funds. It might be helpful to segment the funds so that the money raised by employers in a sector was spent mainly in that sector.

17. The Government’s priority is apprenticeships but these involve full-time jobs with a focus on young people. The challenges listed in this paper also require career changing, re-training and those working in part-time roles. Existing Government plans already involve the elimination of employer’s national insurance for apprentices under the age of 25. In addition there is a firmer expectation that employers will pay some of the costs of training as well as apprentice pay and supervision costs.
18. An announcement in the Budget on 8 July that levies are being considered could be followed by a more detailed consultation launched at the end of the spending review. Consultation, legislation and design would take some time but April 2018 is a reasonable target date.

Association of Colleges  
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