CBI RESPONSE TO THE GOVERNMENT'S CONSULTATION ON THE INTRODUCTION OF AN APPRENTICESHIP LEVY

1. The CBI is the UK's leading business organisation, speaking for some 190,000 businesses that together employ around a third of the UK's private sector workforce. We represent businesses of all sizes from all sectors, offering apprenticeships at all levels - from level 2 to level 7. This includes firms in industries with well-established apprenticeship schemes (such as construction or engineering for example), those in industries that have only recently started to offer apprenticeships (such as retail or banks), and those in industries with other routes into the profession (such as professional services). We also have members involved in supplying apprenticeships to businesses – among these are both private providers and colleges.

2. With 2 million additional jobs expected to require higher-level skills by 2022[1] it is clear that the UK has a huge skills challenge on its hands. The CBI's 2014 report *Better off Britain* noted that this challenge is particularly acute at the technical level – the level 4 and 5 skills required for roles in the "new middle" of our labour market[2]. While we do well at producing level 6 (and above) skills through our excellent universities – though we will require more STEM graduates in years to come – it is this gap at technician level that is at the heart of the UK's skills shortage.

3. Apprenticeships play a vital part in addressing this skills challenge. Through hiring apprentices, businesses are able to develop people from starts at level 2 or level 3 into great careers. This is fantastic for the people concerned, as it improves employability and raises future income. It also helps in addressing the UK's productivity challenge. Investment in skills is responsible for around a fifth of productivity growth[3]. The growth of apprenticeships over the last Parliament, and further business and political commitment to them is therefore to be welcomed.

4. The CBI and the government see eye-to-eye, therefore, on the necessity of growing apprenticeships. Apprenticeship starts have grown to 374,200 so far this year - a rise of 59,600 from last year[4] with half delivered by smaller employers. But the delivery challenges we face are significant, and we should be clear that the right outcome is an increase in training that is relevant to the business and the individual learner - whether young or old - not merely a tick-box process that delivers three million training interventions and reduces the call on Government funding. Given the weak record on delivery of reform in this area, the CBI is concerned that mistakes of the past will be repeated. This response argues that:

    - **We do not support a levy model, due to the risk that it will be unsuccessful**
    - **If a levy approach is taken, the system must be proportionate, with all money raised ring-fenced**
    - **A levy must give employers real control, uniting standards and funding in one body**
    - **A levy system must work for all businesses and in all sectors**

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1 Wilson R et al., *Working Futures 2012-2022*, UKCES, 2014

2 CBI, *A Better off Britain*, 2014

3 O'Mahony M, *Human capital formation and continuous training: evidence for EU countries*, 2012

4 SFR, data from August 2014 – April 2015

We do not support a levy model, due to the risk that it will be unsuccessful

5. Since the summer 2015 Budget the CBI has been vocal about the risks that moving to a levy model will create. This is not based on a lack of willingness among CBI members to pay their share for training – the CBI has, for instance, been a vocal supporter of employer cash contributions in the past. Instead, it reflects our concern that levies elsewhere have not resolved skills shortages and that a levy will drive a compliance rather than an ownership approach to skills in businesses. We fear that this will be repeated in this case, as Government focuses on numerical targets and loses focus on the main point of an apprenticeship – delivering high levels of skills that workers and businesses need.

6. Our concerns in this regard have already been offered some foundation since July. The consultation document is partial at best, failing to raise key questions about the levy structure. The consultation document itself presents data as if only off-the-job training time counted as training in an apprenticeship – which defies the very point of workplace training – and then claims that this shows a significant move away from quality training by firms. CBI members utterly reject this view. The data in fact partly reflects the technology enabled shift towards online, self-paced learning. Finally, discussions are already taking place about rebadging existing training spend as apprenticeships. Gaming the system like this suggests an overt focus on the numerical target at the expense of quality for workers and businesses.

7. Outside of Government too, there are big risks. Some CBI members report that the arrival of a levy may cause them to reduce apprentice numbers rather than increase them due to compliance costs. Even without this, it is clear that the arrival of a levy in 2017 may significantly chill the willingness of businesses to invest between now and 2017, despite half of the Government's target having to be delivered between now and then.

8. These are big concerns. In this response, we seek to offer advice to Government on how a levy approach may be made to work, if that is the course that has been chosen. While it is not what business would have done, there is a shared challenge in finally getting reform right. The UK has a long history of seeking to improve vocational skills development. Over the past 40 years this has involved the government playing a role as convenor (e.g. Industry Training Boards, Sector Skills Councils, and UKCES) and – increasingly – (e.g. 'Train-to-gain,' apprenticeships) as funder. The aim of these initiatives was to build a skills system that responds to labour market needs, but instead, they have consistently reproduced the current system, which has fed business frustration.

9. As our report *A Better off Britain* highlighted, skills mismatches have persisted – with providers in the UK less responsive to changes in the jobs market than those in countries like Germany and Sweden. The government has acknowledged the need to resolve this problem by handing control of standards to businesses. It has also made the system more employer-focussed by routing money to providers through business, and supporting direct contracts for larger firms. The Government has also set out plans for National Colleges and Institutes for Technology. We support these approaches and, as we set out here, it is essential that they are an integral part of the levy system.

If a levy approach is taken, the system must be proportionate, with all money raised ring-fenced

10. For the apprenticeship levy to successfully deliver relevant, quality apprenticeships that respond to the skills needs of employers whilst helping apprentices to find work, employer buy-in is essential. Two factors that will significantly impact employer buy-in are the cost and simplicity of the levy. This section looks at each of these two factors in turn.

The levy rate needs to be set independently at a level that is reasonable to the Government's aim

11. Businesses are committed to helping to deliver the skills that the UK needs to succeed in a global economy and as a result, already invest heavily in skills. In 2013 employers in the UK spent £42.9bn on formal training[5] —and whilst this was lower than in 2011, the decrease was due to a shift towards more workplace-based training. Formal training courses are now only responsible for around 10% of learning in companies, whilst 70% of learning happens through 'learning on the job' and 20% through mentoring and coaching – important training that the headline stats fail to capture. As companies increasingly invest in access-at-any-time training support delivered online, this trend is set to continue.

12. The apprenticeship levy, announced by the Chancellor in the Summer Budget, will now add a significant extra cost to large employers across the UK – many of whom are already investing in the skills of their workforce and will now be faced with extra bureaucracy. This measure is not being introduced in isolation, but rather it comes at the same time as the government announcing an 11% rise in the National Minimum Wage (NMW) for workers over the age of 25 in April next year through the introduction of a new National Living Wage (NLW), with likely year-on-year rises of 6% from its introduction until 2020. For apprentices, the apprentice NMW rate will rise by 20% this October. It is also coinciding with the end of government contributing financially to the delivery of apprenticeships in larger firms and the expansion of automatic enrolment. For many firms, changes to the corporation tax base will not offset this impact to any great extent.

Box 1 - Impact of the apprenticeship levy: CBI Member comments

"We are disappointed by the introduction of a levy as we are already very active on apprenticeships — including degree-apprenticeships - and we feel that we are already playing our part, both as a business and together as an industry. All of the big-players have apprenticeships, with no evidence of free-riding on training." — Head of Government Affairs.

*"The apprenticeship levy, combined with other measures announced in the budget, will cost our business up to **£1bn by 2020.**"* — Director

"*Our training budget is currently upwards of £20 million – with £3m of that spend on apprenticeships. We estimate that the apprenticeship levy could cost us up to £45 million. Not only will this impact on other forms of training, but it will put huge strain on infrastructure*" — Director of Government Relations.

"*This will totally alter the profile of our workforce towards using self-employed individuals, or off-shoring business.*" — Director

"*Our experience of industrial partnership has been that BIS lawyers blocked every attempt to introduce real employer ownership and we need to ensure that the same mistakes are not repeated, with money being siphoned off into a cottage industry of 'assurance,' administration and infrastructure rather than practical delivery of training on the ground*." — Director

13. Against this backdrop, proportionality of the levy is therefore key – not only to its success, but to continued employer commitment to apprenticeships. As a first step, Government should re-commit to its view that **the levy is not a tax, but a ring-fenced fund that can only be drawn on by levy-payers to fund apprentice training**. Part of this will be ensuring that the levy is seen by the Treasury as AME spending rather than within DEL. No levy system could command wide-spread support without this, as the risk of money being diverted away from the levy fund would reduce focus on the quality and business-relevance of the training provided via the levy. If the levy fund is underspent, that is a case for reforming the skills it provides to ensure these deliver for business as much as apprentices, not diverting the money away as if it were general taxation revenue.

[5] UKCES, *UK Commission's Employer Skills Survey 2013: UK Results*, Jan 2014 (includes staff costs of trainers and those being trained)

14. The Government has proposed a levy to fund apprenticeships and that is what it should introduce - a levy that *funds apprenticeships*. Evidence from other successful business levy models, including the Pensions Protection Fund, shows that success for the fund and broad business support is best delivered by independence from the wider Government budget.

15. Secondly, **the levy rate must be set at a level that is proportionate to the ability of firms to deliver apprenticeships** and continue to train workers with shorter programmes, including vital health and safety training. For instance, some high-cost, high-quality training that employers currently provide could not be re-badged as an apprenticeship because of an apprenticeship being defined as training lasting for at least 12 months and including one day of training off-the-job per week. The introduction of a levy will affect employers' capacity to continue such valuable training. For example, Virgin Atlantic funds 12 cadet pilots at £120,000 each alongside level 3 engineering apprenticeships. Preserving the ability to spend on training like this is vital.

Box 2 - *"The levy will in fact reduce the number of apprentices we are able to take on by a third."*
One CBI Member, operating in the utilities sector, indicated that their current organisational budget for apprenticeships is £2.5million —including salaries, training costs and equipment. At a rate of 0.5% of payroll, the fund raised by the levy would be higher than current apprenticeship training spend and would have to be offset somewhere else in the the apprentice budget; salary costs are by far the biggest proportion of that budget and modelling shows that a 0.5% levy will mean a 30% reduction in apprentice numbers for this employer.

16. A levy at a rate of 0.5% of payroll – as has been suggested in some discussions with Government – is far too high. CBI members who have looked at the implications of this rate have concluded that it would not be possible to recover the entire fund levied from them — something the government wants to make sure is possible. This modelling has indicated that the expected levy obligation would in most cases represent the entirety of existing formal training budgets – often far in excess. The existing mandatory levy in the construction sector at 0.5% of payroll funds illustrates this. It funds an extremely wide array of training activities, not simply apprenticeships (for further information on the Construction Industry Training Board see Box 6). So a levy at this level would likely lead to less money available to spend on training other staff. This is something that must be avoided. **The CBI believes that a payroll-based levy would need to be significantly lower than 0.5% to be effective.**

17. CBI members have also been clear that a levy of this scale would mean that they would have to offer fewer apprenticeship starts — contrary to the government's aim of creating 3 million new apprenticeship starts over the course of this Parliament. This is because training costs represent only a small part of the overall cost of training an apprentice — which also include other expenses, including management and trainer time spent supervising apprentices and of course apprentice pay, which is typically significantly higher that the apprentice rate of NMW in larger companies.

18. To ensure the levy is set at a rate that supports businesses to train apprentices while developing their existing staff, **it is therefore crucial that the levy rate is set based on sound evidence. The CBI believes this should be done by a politically independent Levy Board**. This Levy Board could be designed around the blueprint of the LPC (see Box 3), which effectively introduced the National Minimum Wage. Independent of government, and able to set political views in the context of strong economic evidence, the Board could recommend an appropriate level for the levy, taking into account the concerns we have raised above.

19. A board would also be able to take into account in its recommendation the complexity of understanding the true cost of apprentice training. For instance, most countries with a levy system have an allowable expense regime. The Government does not seem to have addressed this yet, but it has a material impact on what the level of the levy should be. Allowable expenses include capital costs for training centres, salary costs for trainers and apprentices when off the job and administration of the levy itself for the firm.

20. Any recommendation from the Levy Board should take into account the economic environment, the number of required apprenticeship starts, the need for training spend on other members of staff, and the fact that the level of the levy must be appropriate for businesses across all sectors — not just those that traditionally employ large numbers of apprentices (see also Section 3 below). **The Board might also recommend the introduction of a cap on the total levy paid by an individual business if deemed appropriate.**

Box 3 - The Low Pay Commission could provide a blueprint for the Levy Board

An independent Low Pay Commission is widely regarded as one of the most successful policies of our time. Its evidence-based approach has enabled the wages of the lowest paid to rise as far as possible without creating unemployment. The LPC is a non-departmental public body set up to advise the government on the level at which the UK's different pay floors should be set. It is made up of a Chair and eight other Commissioners appointed by the Secretary of State. Commissioners are appointed so that there is a balance of experience and interests in:

- Trade unions or matters relating to workers
- Employer associations, or matters relating to employers more broadly
- Other independent areas such as academic experience in labour markets

We believe that this model provides a suitable blueprint for a Levy Board, as the LPC is takes an *independent*, *evidence-based* approach to exploring the issues within its remit and is not subject to interests other than those of workers and employers. The evidence is comprised of data analysis by the Commission, a call for written and oral evidence from interested stakeholders and a programme of visits to hear first-hand from people and businesses impacted.
Following its evidence gathering phase, the LPC submits a detailed report of its findings to the government along with a recommendation for future increases in each of the UK's pay floors.

The Levy Board could: recommend the level of the levy; provide quality assurance; and ensure worker and employer value for money.

The levy needs to be simple, avoiding unnecessary bureaucracy and cost

21. To ensure the levy system works effectively, it is also important that it is as simple as possible, avoiding unnecessary bureaucracy and cost. Simplicity is also important as complexity can act as a deterrent to employer engagement.

22. Given that the levy is funded exclusively from employers' own pockets, the case for such bureaucracy is even less justified. Red-tape and government interference must be minimised, if not eliminated completely. If employers pay – the money must deliver results, not bureaucracy.

23. Minimising bureaucracy also means that the cost of delivering the levy must also be as low as possible. BIS officials' working assumption that system costs for Government would be 25p in every pound levied – equating to around £500m – is far too high, and would deliver poor value for money on businesses' spend. In line with our view that it is crucial that as much money as possible raised by the levy is spend on training apprentices, this is not a sustainable approach. It also emphasised the importance of taking the new system outside of current departmental structures as far as possible, via the Levy Board, which should ensure value for money in administration, if appropriate looking to tender the administration of the levy system to a third party.

A levy must give employers real control, uniting standards and funding in one body

24. As well as ensuring that the levy is proportionate and simple, a critical step will be to ensure that the market that employers can spend their levy funds in is aligned to their needs and the needs of their employees. For too long, the skills system – in England in particular – has seen government as the client. This must now change to viewing businesses and their employees as the clients of the system.

25. To its credit, the Government has shown commitment to this agenda already. Successful elements of the Employer Ownership of Skills pilots and the nascent Trailblazer programme have shown the way – though both have been dogged by over-interference by Government, which led to the failure of some EOP initiatives in particular.

26. If a levy approach is to be taken, and it is to deliver, quality and funding have to be linked. **While it will be necessary to sign off new standards, set time rules on spending and maximum prices for different frameworks in a system with a levy, this can no longer be a job for Ministers.** Instead, the independent Levy Board should be tasked with ensuring this work takes place, independent of politics.

27. Handing control of these measures over to the Levy Board will ensure that an evidence-based approach is used to assess what the levy will fund, and ensure quality is delivered as well as quantity. Having independent businesspeople involved will also help build business confidence in the stability and long-term nature of the new model and will help to deliver the real employer control that both the Government and the CBI want to see.

Firms must be free to deliver expensive frameworks as well as less expensive ones

28. Firms should be able to spend their levy funds on the apprenticeships that make most sense to their business. In practice, this means that should a business opt to spend its levy funds on more expensive, higher-level apprenticeships, it must be supported in doing so. There must not be any restrictions on the amount employers can spend per apprenticeship, or the number of apprenticeships at any given level.

Level 2 English and Maths work reflects a failure in the school system and should still be Government's business

29. Quality apprenticeships exist at all levels, whether that is Level 2, 4 or 7. Business rejects the idea the Level 2 training investment, where there are clear routes to further progression, lacks value. However it is important that levy payers do not pick up the bill for clearing up the failures of the school system on English and Maths. Level 2 achievements must be a route to a good career and remedial training in these subjects must remain the responsibility of government. It must remain outside of the remit of levy funds. This is an area where the Levy Board should play a role. It must be employers that determine what quality training looks like, from level 2 to level 7.

Employer ownership means that money must not come with Government strings attached.

30. A system that was appropriate under a system of government co-funding is no longer appropriate under a system that is wholly funded by employers. Government must learn lessons from the Employer Ownership of Skills Pilot (see Box 4) and ensure that requirements based on political needs of Government are eliminated to the fullest possible extent and that assurance processes are as simple as they can be. Experience of unnecessary bureaucracy that accompanied government funding in the pilots resulted not only in the growth of an assurance industry, but acted as a major disincentive to employers wanting to commit more fully. It is business and the Levy Board that must determine what quality provision is —not government.

Box 4 - Government must learn important lessons from the Employer Ownership of Skills Pilot

The Employer Ownership of Skills Pilot was a great initiative – and was met with enthusiasm from employers. Despite this, many employers withdrew from the pilot as a result of government bureaucracy. This was partly as a result of government changing the rules mid-flight which made the project no longer viable for some and led to lower returns for those who remained in the pilot. Some of the challenges identified in EOS pilot round one were that:

- Administrative requirements evolved and **became more burdensome** over the course of the pilot
- Funding model rules were often misunderstood, or were **unclear**. This sometimes included the structure of training – for example, the necessity for trainees to complete all elements of an apprenticeship framework, even if the employer felt some elements were of no use to the employee or their business.

Source: *Evaluation of the Employer Ownership of Skills Pilot, Round 1: initial findings*, Department of Business, Innovation and Skills, March 2015

31. Time-limited vouchers that can only be spent with government approved providers could see the emergence of such an assurance industry. This could risk more money being diverted away from equipping apprentices for the world of work. Employers should not need to repurpose effective and rewarding existing apprenticeship training programmes to meet a new and more bureaucratic system in order to avoid paying twice. As far as possible, therefore, the new system should accommodate what is already working well for larger employers.

32. Employers should also be allowed to spend their levy on training outside the company – for instance in their supply chain if they choose to. Many businesses train apprentices for their partners or the wider supply chain —Toyota, for example, operates a 'co-operative model' of apprenticeships with its suppliers and local businesses. Microsoft is another good example (see Box 5). Flexibility in how employers are allowed to spend "their" vouchers is therefore important and will allow this current good practice to continue.

Box 5 - "*Flexibility is the only way to ensure a fair return on the levy.*"
For over 5 years the business has leveraged its brand to encourage its partners and customers to offer apprenticeships. Over **8,000** apprentices have started their career in IT, with a further **4,500** starting over the next 12 months in programmes specifically designed by, and developed for, these companies by Microsoft and its Training Partners. Microsoft's own internal apprentices will only ever represent a very small fraction of this much bigger footprint. The Levy would therefore run a significant surplus for Microsoft meaning it would be difficult to realise a fair return unless there was greater flexibility in how the levy was spent. This could include older learners looking to career change into Microsoft itself, development of higher level programmes or utilising the surplus to increase its work in attracting companies and individuals to apprenticeships.

Reform must be harnessed in Scotland, Wales and Northern Ireland too

33. Reform to make our apprentice systems more relevant to businesses should cover the whole UK, as the levy will. Money raised through the levy, whether in Belfast, Cardiff, or Edinburgh, is employers' money to be spent on vocational training, not just money distributed through the Barnett Formula. While the offsetting of levy money against BIS cuts in the Comprehensive Spending Review may not lead to much additional cash reaching devolved authorities, the principal of employers funding the system will. With this in mind, we call on governments in Edinburgh, Cardiff and Belfast to take steps to improve employer voice and control in their respective apprenticeship systems, reflecting this new reality. To the extent that devolved authorities do receive additional funding from the levy, this should be ring-fenced for apprenticeships, in the manner already set out above for England. We also want to see clearer guidance provided by the UK government for firms with operations in the devolved nations.

The levy system must work for all businesses and in all sectors

34. The target of 3 million new apprenticeship starts requires a strong contribution from firms either-side of the decided threshold of 'large,' and the system must therefore deliver for all. Funds levied from large businesses should only ever be used to fund apprenticeship training for levy-paying firms. Businesses' funds must not be used to cross-subsidise apprenticeship provision in smaller firms, who should continue to benefit from Government support.

35. There is a strong case for support for smaller firms to continue. Small and medium sized businesses are crucial to growing the number of apprenticeships delivered, so it is important that government retains the current system of co-funding for these firms, alongside introducing a levy for large firms. Meeting the government's 3 million target will require a strong contribution from smaller firms - with 50% of apprenticeships already delivered by firms with < 250 employees.[6]

[6] From discussions with BIS Officials

36. If “large” is to be defined as a firm with ≥250 employees – and the CBI has no strong reason to advise the Government to choose any other level than this widely-accepted measure – it may also be important to avoid a cliff edge. The introduction of a levy should not make it less attractive for medium sized firms to grow their business as a vibrant “Mittelstand” is crucial for the UK’s future growth prospects. To avoid a cliff edge, the Levy Board will need to give careful consideration of the rate of the levy as the higher the levy rate, the bigger the disincentive to grow beyond the decided threshold, and on the need for any intermediate or introductory level. **The CBI believes that the independent Levy Board should be tasked with making recommendations on these issues.**

37. Designing a levy that works also means the levy must work harmoniously with existing levies –for example in engineering construction and construction, where training boards collect a levy (ECITB and CITB respectively). Both have to demonstrate regularly that they command the broad support of levy payers and are recognised as making a valuable contribution — beyond simply providing apprenticeships. It is crucial that the introduction of the new apprenticeship levy doesn’t lead to a “double whammy” in these sectors. The shorter training schemes and health and safety training, for example, that are currently funded must not be lost.

<u>Box 6 - The Construction Industry Training Board plays a valuable role for the industry</u>

CITB was established in 1964, as one of 26 Industrial Training Boards, to provide support to employers and encourage training. The support and funding that CITB provides helps employers to improve skills, increase competitiveness and to recruit the best talent for their sector.

Soon to be simplified, the levy and grant system is a collective solution that supports skills and training in the construction industry. The levy was set up to help address the training needs of the building industry’s mobile workforce. CITB collect levy funds (at **0.5%** of payroll) from those eligible to pay, and then invest the money back into the industry. The levy is used not just for apprenticeships, but a large share is spent on other training, such as health and safety training – meaning charging a similarly high percentage for the apprenticeship levy would not be appropriate.

Over 75,000 employers are currently registered with CITB and all are required to complete an annual Levy Return, however only those with a wage bill that is £80,000 or more per annum (including payments to labour-only sub-contractors (LOSC)) will be required to pay a levy. Employers with total PAYE and LOSC payments of £80,000 or more, but below £100,000, receive a reduction of 50% in their levy bill.

Levy income in 2014 was **£161.1m*** (2013: £169.7m)
***This was supplemented by income from charitable trading to return £180.2m to employers in 2014**

38. A proportionate levy system would allow remaining training boards to operate alongside the new apprenticeship levy, to support training in smaller construction firms – whether that is through apprenticeships or other forms of training – and other training in larger firms who could pay a lower percentage than the current 0.5% paid to CITB to avoid a “double whammy”. What this ‘hybrid’ model would look like in practice will need to be a decision for the industry itself, however, government must facilitate this through agreeing sensible transitional arrangements with the sector. It might be agreed for example, that the levy currently paid to CITB may continue until the three years of the current Levy Order expires (Spring 2018).

Employment, Skills & Public Services Directorate
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