TOWARDS FLEXIBILITY AND PRODUCTIVITY

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APPRENTICESHIP LEVY 2.0

A CMI DISCUSSION PAPER

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1. CONTEXT

The UK is facing an urgent requirement for rapid upskilling to meet the needs of the economy and address skills mismatches at all levels. The Open University's 2023 Business Barometer found 73% of organisations are currently facing skills shortages and these shortages are leading to increased workload, reduced output, reduced long term growth plans and decreased staff morale and wellbeing.[1]

Employer investment in training, however, remains far too low. The latest comparable data shows that, out of the 30 European countries that took part, the UK ranked 9th in terms of the percentage of total labour cost enterprises spend on continued vocational training (CVT). In 2015, UK enterprises spent 1.8% of total labour costs on CVT compared to Denmark which spent 2.7% and France and Slovenia which spent 2.5%. In addition, Belgium (2.4%), the Netherlands (2.3%), Ireland (2.2%), Luxembourg (2.1%) and Malta (2.2%) all spend a higher proportion of total labour costs on CVT compared to the UK.[2] Recent data from the UK suggests spending has not proportionately increased since 2015.[3] This is despite the evidence that increasing human capital accounts for around one-third of productivity growth.[4]

Where employers do invest in training, they usually focus on the immediate needs of their business, not on longer-term strategic requirements, or broader economic needs. This is logical: businesses could be expected to focus on their own profitability and immediate productivity, rather than wider and longer term public policy considerations. Investment is also limited because - as the Skills and Productivity Board identified recently - the transferability of some skills such as management skills provide weak incentives for employers to invest compared to firm-specific skills.[5]

For example the Longitudinal Small Business Survey found 33% of SME employers had provided training for managers, but the vast majority of this training was for technical, practical or job-specific skills.[6] Only 13% of SMEs offered training to develop management skills and capabilities, a figure that remains unchanged since 2017. Even where employers do provide training, the Learning and Work Institute has shown that more than 1 in 10 only provided basic induction or health and safety training.[7]

The tendency of employers to focus on short-term challenges over longer-term, structural weaknesses is why the apprenticeship levy system was introduced. The purpose of the levy system was to encourage employers away from short-termism and toward longer-term, more strategic thinking when it comes to training. Employers want to fill immediate skills gaps; the public needs support for high-quality, long-term, productivity-focused training provision. The apprenticeship levy and the standards-based system was seen as a means of combining these two aims.

There has been significant criticism of the levy system, largely focused on the extent to which employers are using levy funding to support what some consider to be the 'right kind of training', as well as the perceived inflexibility of the system for employers. Of course, the system was designed with some inflexibility deliberately baked in: that is the mechanism by which the skills system is re-calibrated to incorporate longer term as well as immediate skills needs.

Public debate over the apprenticeship levy naturally focuses on the balance between short and long term, between what firms put into the system and what they can take out, and between the right balance of flexibility between different types of training funded by the levy. The problem is that none of these factors address the bigger challenge: how does the UK expand the long-term supply of highly skilled workers so that it can address its productivity challenge, the future of public services, greater social social mobility and green transition? It's time to shift the dial - and ask how the levy could support a massive expansion of high-quality, employer-led training all across the UK.

2. SO WHAT NEXT?

Public support for apprenticeships is at an all time high[8] but there is an opportunity now to improve the apprenticeship levy system for its second decade. Both government and opposition agree that the levy plays an important role in ensuring funding is available for training - and that it should be improved, rather than fundamentally changed or scrapped.

In designing the next iteration of the levy system - Levy 2.0, from 2025-2035 - it's important to move beyond the existing debate on input costs and qualifications to focus on what really matters: outputs and impacts.

Understanding the return on investment is important in order to make the long term case for increasing funding from both government and employers. CMI's Apprenticeship Economic Value Model[9] suggests ROI is currently high: apprentices completing now are estimated to be adding almost £700m a year to the economy per year and are projected to add £7bn to the economy in total by the end of the decade (for a cost of £2bn); a 300% return on investment.

The focus to-date on headline costs is unhelpful because the levy funding model should be about delivering a return on investment. If a course costs £5,000 but the business makes £8,000 as a result of that training, there is a monetary/financial gain to that business, and to the Exchequer. And if the benefits accrue to that business, then it is right that they should contribute something towards the training that delivered those benefits.

As part of the 2016 reforms which included the introduction of the levy, apprenticeships based on 'standards' were expanded (and are now the vast majority of current apprenticeships). The thinking behind this reform was that, whilst formal recognition and qualifications were important, individuals should demonstrate that they can translate their knowledge, skills and behaviours into their day-to-day working lives. Significant impact is derived where learning is practised and reflective, working on real-world problems that impact learners' day to day roles.

The downside of this change was that standards-based apprenticeships are inevitably more challenging for apprentices and employers alike. CMI has argued that deep applied learning is essential to see real improvements to long term economic goals. Inevitably, alongside concerns amongst large employers that they put more in than they can take out through the levy, concerns have grown about the reduced ability to use funds for shorter, less demanding, or less structured training than standards-based apprenticeships. So it has proved. The problem is that the answer to this - to provide far greater flexibility within the current system structure - risks harming quality, focusing levy funds on larger employers to an even greater extent than present, and diminishing long-term positive impacts. We would get a more flexible system but not a higher quality, more impactful one where more is invested in critical skills for the future.

When there was an underspend on the levy these choices were less likely to be mutually exclusive. Now the levy is close to being fully used, the choices become more acute. **Within the next Parliament there may need to be a more fundamental system rethink**.

This paper asks: how can we better meet short-term skills needs, retain investment in high quality apprenticeships and increase investment overall? It lays out possible options for the next Parliament, mindful of public spending constraints.

3. INCREASING FLEXIBILITY

Apprenticeships are only one part of the UK education and training system; they tend to be very intensive and long term, and as such they will not meet all up- and re-skilling needs. Given the positive economic impact of continual upskilling and reskilling - on individuals, businesses and the wider economy - it makes sense to seek to replicate the successful elements of the apprenticeship model to a wider range of courses and training opportunities. It is important to note, however, that increased flexibility without wider changes brings its own challenges:

- **Less for SMEs:** There is a risk that, with more flexibility over what large businesses can spend apprenticeship funds on, the remaining funding to support SMEs to recruit and train apprentices is greatly reduced.
- **More deadweight:** Increased flexibility also risks increasing the chance that employers spend their levy money on training they would have paid for anyway. This 'deadweight' is precisely what the original levy was designed to avoid.
- **Less quality:** The current apprenticeship system has been modelled around high quality standards. Increased flexibility should not result in the spending of precious levy funding on lower-quality training that doesn't meet equivalent quality and assurance standards.
- **Less additionality:** CBI research[10] shows 19% of levy-payers say the levy has increased their investment in non-apprenticeship training, and 60% say non-apprenticeship training investment has remained the same.

A flexible levy without additional funding means a loss of apprenticeships - and all the benefits they deliver to the UK economy.

Flex within the levy for other forms of training	No. of apprenticeships starts	Apprenticeships at risk
0%	349,190	N/A
20%	279,352	69,838
35%	226,974	122,216
50%	174,595	174,595

Based on 2021/22 figures from HMG Education Statistics

Below, we map out how a levy system could be designed to address more skills mismatches (within firms, within local areas, or nationally) without losing the rigour and quality that are essential to firm-level performance, regional economic growth, national productivity and return on investment for all.

4. THE FOUNDATIONS OF THE CURRENT SYSTEM

The apprenticeship model is a good one to build on: employers have been required to fund apprenticeships, but in return employers develop the apprenticeships they need and choose the standard that works for them. Whilst not all employers are able to use their levy funds directly, unused funds are distributed into the system for wider upskilling, benefiting all employers indirectly (and sometimes, for example through levy transfer, almost directly as sector skills are improved). Major levy-paying employers have told CMI that they place high value on the quality and rigour that modern apprenticeships have brought to the system.

SMEs benefiting from management apprenticeships

BROADLEY SPEAKING

~30 employees, Business Services, Tavistock, South West

The agency's Director spoke about the profound effect of an employee's apprenticeship on all aspects of the business. Through the apprenticeship, the employee has been instrumental in generating over £200k additional revenue for the business and is well positioned to deliver on succession planning.

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DIAMOND HARD SURFACES

<10 employees, Manufacturing, East Midlands

Chris, the CEO and Director of Diamond Hard Surfaces Ltd, shared the positive impact of an employee's apprenticeship experience at Level 5 and 6. New ways of operating, identified through the apprenticeship, resulted in the company growing by 60% in 2020-21.

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To retain the quality and impact of the apprenticeship model there are certain foundational principles that should be safeguarded if a decision were taken to widen the scope of the apprenticeship levy to allow its use to pay for other forms of training. Funded courses or programmes should include:

- Retaining a clear link to the labour market, strong employer endorsement and/ or involvement with key skills mapped to occupations and/ or competencies (as relevant to role/ company/ career).
- Work-based application of learning, with on the job **and** dedicated learning time (though not necessarily off-site as appropriate).
- Independent accreditation and assessment.
- Co-investment - employers and government (and learners in some circumstances) share the costs (as they do the benefits).
- Content that addresses both base level competencies (i.e. core management skills - problem solving, communication, decision-making, team work) and the technical requirements of the job e.g. engineering, green tech, advanced manufacturing.
- Establishing up front clear aims, criteria and methodology for measuring return on investment.

CASE STUDY

OVERCOMING BARRIERS FOR SMES TO BENEFIT FROM TRAINING LEVIES IN IRELAND

In Ireland the business approach to employer investment in training is very different to the UK. Employers have committed to a significant amount of co-funding in order to meet current and future skill needs.

ABOUT THE IRISH LEVY SYSTEM

The National Training Fund (NTF) in Ireland was established in 2000 as part of the National Training Fund Act. It is a key part of Ireland's skills strategy, designed to ensure that Ireland has a skilled and adaptable workforce, which is essential for economic growth. As noted above Irish employer investment in continuing vocational and technical training is considerably in excess of the UK's.

The NTF is financed through an employer levy which is collected through the pay related social insurance (PRSI) system. The scope of Ireland's employer levy is much wider than in the UK. Employers contribute 1% of 'reckonable earnings' - basically gross pay - for most employees. This has increased in recent years from 0.7% and is much higher than the UK's 0.5%. Some employers/ employees are exempt.[11]

In 2022 the NTF raised around €765m for enterprise-related training including apprenticeships. This amount is increasing every year, with figures from the Department estimating this will rise to over €1bn annually by 2025.[12] Relative to the UK working population that is the equivalent of raising £8.3 billion. Funding for apprenticeships and enterprise-focused Higher Education provision currently totals around €354m a year which is the equivalent of £3.8 billion in the UK.[13]

The NTF is managed by the Department of Further and Higher Education, Research, Innovation and Science. It funds apprenticeships in both Further Education and Higher Education as well as a wide range of high quality qualifications and programmes developed with employers and based on need. The majority of employers can benefit from the schemes the NTF funds.

DRIVING ENGAGEMENT WITH SMALL BUSINESSES

One of the recipients of the NTF is Skillnet Ireland - an agency with a dedicated responsibility to be a leader in workforce development, particularly in SMEs. It acts as a skills hub/ accelerator, working closely with businesses, industry bodies, and training providers to identify skill needs, design training programs, and deliver targeted training solutions.[14]

Skillnet Ireland uses the NTF funds to establish and support a network of Skillnet Business Networks. These networks are sector- or region-specific and provide training and upskilling opportunities to businesses of all sizes, but with a particular focus on supporting small and micro-enterprises. Small businesses are critical to the Irish economy, employing more than two-thirds of the workforce, but as we know, they require additional support to access training. Evaluations suggest Skillnet has had a significant impact on businesses in Ireland. In 2022 Skillnet received €53 million from the NTF and according to its website it, along with its 70+ Skillnet Business Networks, currently supports over 22,000 businesses and 86,000 workers annually. 82% of enterprises benefitting from Skillnet Ireland's support are classified as small and micro-enterprises. Relative to the working population in the UK that is the equivalent of engaging with 1 million SME workplace learners.[15] This suggests a reach three times greater for the Irish system over the UK system.

A recent evaluation[16] conducted in 2018 shed light on the positive impact of Skillnet Ireland's initiatives:

- High Satisfaction: Over 90% of participating enterprises expressed satisfaction with the training provided by Skillnet Ireland, demonstrating the quality and relevance of the programs.
- Relevance to Growth: More than 80% of enterprises agreed that Skillnet network activities focused on delivering skills crucial for growth and competitiveness within their sector or region. This ensures that training aligns with the specific needs of SMEs.
- Positive Business Performance: Approximately three-quarters of enterprises believed that Skillnet Ireland's training had a positive impact on their long-term business performance and the quality of their products or services. This indicates improved productivity, customer satisfaction, and overall business success.
- An independent evaluation conducted by Indecon in 2019-2020[17] further confirmed the significant impact of Skillnet Ireland's programs. This support empowered small businesses to invest in their workforce, resulting in enhanced skills, improved productivity, and business growth.

By offering tailored training programs, fostering collaboration, and supporting business growth, Skillnet Ireland has played an important role in empowering SMEs, enhancing their competitiveness, and contributing to the overall economic development of the country.

5. CAN REFORM OF THE LEVY AID GREATER FLEXIBILITY ALONGSIDE PRODUCTIVITY?

Below is one possible approach that can deliver a skills and training system that increases funding and private investment, and retains high standards, while delivering flexibility where employers and the wider UK economy need it.

1. Increase volume of training

- Increase the levy amount. This would increase funding available to pay for work-based training and is administratively simple because it builds on the existing apprenticeship levy system.[18]
- Levy payers could then draw against this levy for both apprenticeships and a wider range of training interventions. This benefits employers who devote significant investment in training as long as it is structured in accordance with the principles set out above.
- Small and medium businesses out of the levy scope would continue to be non-levy payers, but would be incentivised to take up apprenticeships through interventions such as local or sectoral apprenticeship accelerators (as recommended in previous research from CMI and UVAC).
- Under this system any levy incurred above 0.5% of the wage bill would be considered 'open' spend and available for a wider range of high quality flexible training, while current levels of investment as a proportion of levy-payer wage bill continues to support standard-based apprenticeships. Unspent levy funds would support an improved workforce across sectors, regions and all employers.
- One of the major barriers to investment is fears that if the workforce is mobile, the benefits may not be captured by the current employer. If an apprentice leaves the employer either during or within two years of completion, the employers' levy account should receive a credit.
- It could be an explicit aim of Levy 2.0 to double funding per employee to £3,000 per employee per annum - the current European average (compared to the current UK average which is £1,500 per employee per annum - according to the Learning and Work Institute).[19]
- All money raised by the levy should be made available for the apprenticeship and skills budget. Under the current system the amount taken by employers at source by HMRC is more than is allocated to the total apprenticeship programme budget.[20] This should not be the case.

2. Retain quality

- The current apprenticeship system is designed to ensure quality - Standards are developed by employers and approved by IFATE, delivery is monitored by Ofqual and Ofsted, and there is a rigorous, independent endpoint assessment regime at the end of the process. However, there are understandable concerns about the low and variable achievement rates.

- Any moves to increase flexibility must retain a clear focus on understanding why people don't complete and what success measures are fit for purpose for work-based learning. It is also important to ensure that best practice is spread and shared systematically in order to embed system improvements that deliver the best outcomes for learners, employers and the wider economy.

- Consideration should be given to paying apprentices the national living wage for their age in the first year of the apprenticeship, and the Department for Education should partner with a combined or county authority to pilot whether this would be detrimental to employer demand for apprentices.

- In addition a sum should be top-sliced from the increased levy budget to fund hardship support for those most in need (e.g. for help with travel costs or apprenticeship support services) and to target SMEs not yet engaged with the system with HR, coaching, and system navigation support. These funds would be run through a network of apprenticeship accelerators operating on a regional and/or sectoral basis in partnership with Combined and County Authorities, business representative organisations, high quality training providers, and major sectoral employers.

3. Balancing private and public funding

- If employers pay into an employee's lifelong loan entitlement (LLE) using the 'open' spend element of the levy, Government should match their contribution up to £500. This would reward employers who invest in their employees and hopefully drive employer demand for training through the LLE. This additional incentive could be extended to non-levy payers and should be used within 3 years. This could also support the early stage introduction of Higher Technical Qualifications.
- An employer's apprenticeship levy contribution could be used over 3 years - rather than 2 as at present - giving some more time to spend the funds on the training needed.
- An employer's open levy must be spent in-year.
- This approach retains the progressive 'use it or lose it' principle of the existing apprenticeship levy. Under this system businesses that underinvest in training will also continue to pay more into the system than they are taking out.
- Levy funds should be made far more transparent with clear annual data published on expenditure, employers, geographical distribution of investment, impacts on wages and skills levels, and demographics of apprentices. The apprenticeship 'databank' should be overseen by Government and employers.

Three possible approaches to Apprenticeship Levy 2.0

	Existing Apprenticeship Model	A Flexible Status Quo	The Increasing Investment Model
Summary	As now.	The existing funding pot is diluted by allowing a wider range of skills interventions, reducing resources available for SME apprenticeships and increasing deadweight.	Building on the success of the levy in driving up the quality of workplace training, this model provides employers with more flexibility through a wider range of standards-led qualifications, in return for a greater contribution towards the cost of the program.
Funding	As now.	As now.	An increase in levy contributions or widening of the scope of those who pay.
SME Access	Redistribution to SMEs from large businesses (although challenges with take up among target groups).	Limit on redistribution to SMEs from large businesses, as more of levy-payers funds are utilised.	Retains principle of redistribution to SMEs from large businesses. + Protection for employer investment in individual employees.
Deadweight	Limited.	Increased. More of the levy is used by larger employers able to spend more of their levy on existing training needs and fewer long-term value adding courses.	More Limited. 'Open' portion of the levy captures wider employer spend on quality training.
Employer need	Meets longer term skills needs.	Meets immediate employer needs.	Better adjustment to a wider range of business or skills needs through a broader range of training funded by the levy without creating trade-offs that the 'diluted pot' will create.
Economic need	Productivity enhancing.	More limited ability to meet longer term economic needs. Short term business needs crowd out more strategic investment in economically impactful courses.	Productivity enhancing - impact of current apprenticeship model is retained and encourages investment in short term needs also.

6. CONCLUDING COMMENTS

In conclusion, we acknowledge the concerns that employers have regarding the existing levy system. We also recognise that the UK needs to increase employer investment in skills in the long and short-term if it is to match investment levels of leading comparable economies. In this paper we have illustrated a model that could respond to both these challenges. The alternative model outlined here offers the opportunity for levy payers to reclaim any additional costs as long as they make high quality flexible investments in their staff.

Our intention in laying out these alternative pathways for the next phase of apprenticeship investment in the UK is to seek to focus discussion on the overarching challenges facing our ability to meet long-term needs and, therefore, improve productivity, support growth, and improve the quality of public services. Much of the current debate about apprenticeships and levy that funds them is driven by narrow short-term cost-benefit calculations of a variety of players within the system. There is a need for wider engagement with core issues such as our inadequate investment in high quality training across the board. We hope the broad options we have laid out make a contribution to meeting this wider, urgent need.

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