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Stephen Evans

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Contents

Executive summary 4

Setting a higher ambition 6
- The importance of employer investment 6
- The need for change 7

Learning the lessons 11
- Falling short 14
- Key lessons 16

A new policy framework 18
- Long-term plans for growth 18
- Skills Tax Credit 19
- Broadening the Apprenticeship Levy 22
- Building a new ‘pay or play’ Skills Levy 24
- Supporting individuals to learn 25

Conclusion 26

Executive summary

Employer training has fallen in the last decade and those with the fewest qualifications are most likely to miss out. This holds back prosperity and fairness. We need a long-term plan for skills and growth, including a new Skills Tax Credit, reformed apprenticeship levy, and better support for people wanting to learn.

Employer investment in training includes spending on off-the-job courses, apprenticeships, and on-the-job training like coaching. It covers both employer use of publicly-funded training and employers' own efforts. Training is an essential part of improving growth and productivity, building successful businesses, and increasing opportunities for people.

Matching the EU average training spend per employee and narrowing training inequalities between groups would mean extra one million people getting training at work and employers investing an additional £6.5 billion in training per year.

We need to do better because training spend per employee has fallen 28% in real terms since 2005, from £2,139 to £1,530 per year, which is less than half the EU average. The proportion of people getting training at work has fallen 14% in the same time. These averages mask huge inequalities. People with degree-level qualifications are three times as likely to get training at work than those with no qualifications. These falls in investment coupled with longstanding shortfalls in the UK's skills base compared to other countries are holding back economic growth, business success and individual opportunity.

Put simply, we are sleepwalking to stagnation in skills.

There has been no shortage of public policy change, but the dial hasn't shifted. In part this is because behind the constant chop and change lies a consistency. Most policies have focused on involving employers in the design of qualifications and the publicly-funded skills system. There has been less focus on employer investment and use of skills as a whole.

There is up to £6.8 billion of public support for employer skills each year, through a mix of tax incentives (spending on skills can be deducted from Corporation Tax bills), direct provision and the apprenticeship system. But this increasingly passively follows or reinforces employer choices, with apprenticeship reforms leading to growth in higher apprenticeships but falls at lower levels. The argument is that employers will make the best choices for their business. But this supposes that there are no market failures and no public policy imperative or gain to be had from narrowing training participation gaps.

Policy isn't working as it should. We argue the aim should be to increase employer investment in skills and to support greater opportunities for those who would otherwise miss out. This can boost both prosperity and fairness but requires a clear balance of responsibilities between employers, individuals and the Government.

We need employer investment in and use of skills to be a key part of **long-term plans for growth**. We argue this could be kickstarted through new locally-led **Skills and Good Work Partnerships**, bringing together local partners. We make three other proposals to form part of this new long-term framework.

First, we should incentivise employer investment through a **new Skills Tax Credit**. SMEs would deduct 230% of the cost of accredited training and apprenticeships from their tax liabilities and claim a 14.5% credit if they are loss making. Large firms could claim a 13% credit. This would be modelled on the UK's existing Research and Development tax credit and build on similar skills tax credits in Austria, British Colombia and number of US states.

A **Super Skills Tax Credit** would allow businesses in 'levelling up' areas or those investing in essential skills like literacy, numeracy or digital to deduct 300% of the qualifying costs. Taken together, these credits could cost an additional £500 million per year, but potentially increase employer investment in skills by over £1 billion per year with an extra 250,000 people gaining qualifications each year.

Second, we need a better framework to engage more employers. The Government, employers and trades unions should agree how to **reform the apprenticeship levy.** This should: increase its scope by raising the contribution rate or the number of employers involved; widen the training eligible; and increase the focus on young people and those with the lowest qualifications. For example, raising the contribution rate from 0.5% of payrolls above an annualised £3 million to 0.6% would raise an extra £500 million per year from the 23,000 largest companies. Extending it to firms with payrolls above £2 million would engage an extra 17,000 firms. The flipside would be widening eligibility to qualifications other than apprenticeships, but requiring one half of the levy to be spent on young people. The effectiveness of reforms should be reviewed after three years.

Over time, the Government should consider replacing the levy with **a 'pay or play' Skills Levy through the tax system**. This would aim to simplify the current system where employers pass money to providers or other employers through a digital account. Instead, employers' tax returns would automatically calculate a Skills Levy minimum spend equivalent to 0.5% of payrolls above an annualised £3 million. Companies would report the amount they had spent on apprenticeships and accredited training (as they must already), potentially including minimum investments in young people. Where this was below the Skills Levy minimum, employers would pay a charge equivalent to the difference. HMRC would apply the same risk-based checks to ensuring employers have accurately reported as they do to other tax payments. The aim would be a simpler approach that encourages employers to invest more. If it is introduced, the Government should report annually on Skills Levy payments and how they have been invested.

Large employers would face the choice of spending the full amount themselves or paying the balance as a charge, but with less bureaucracy than now. This would require the Government to allocate budgets for apprenticeships at SMEs, in part funded by the charges large employers paid (where they have not spent the full amount themselves).

Third, we should explore how to **better support people to learn**. That could involve building on the role of trades unions, strengthening the right to request time off to train, and looking at new ways to support retraining. Forthcoming L&W research will explore this.

Falling and unequal employer investment in skills is holding back prosperity. We need a clear plan to change that to benefit the economy, businesses and people.

Setting a higher ambition

We should aim to increase total employer investment in skills, doing this in ways that improve employment and productivity and narrow opportunity gaps between groups.

Specifically, our ambition should be:

- an extra 1.2 million people to get training at work by increasing the proportion of all employees getting training at work to the level seen for graduates;
- increase employer investment in training by £6.5 billion by expanding access to training and raising training spend per employee toward the EU average; and
- ensuring that this training benefits people and employers.

Critically, this is not just about the number of people getting training or the cost of that training. The training needs to be high quality and benefit both the individual and the employer. That's why considering the impact on employment and productivity is as crucial as measuring participation in training.

The importance of employer investment

It is well documented that the UK's skills base lags that of many comparator countries and that this holds back economic growth and social justice.[1] Our skills base is the product of the education system and decisions and investment made thereafter by governments, individuals and employers. This report is focused on employer investment in skills.

What do we mean by employer investment in skills? This includes spending on formal off-the-job courses and qualifications, which can be provided by external providers or by employers themselves. But most investment tends to be informal training on-the-job, including learning from colleagues. The wage costs to employers of staff while they are undertaking training are sometimes included in estimates of employer investment. As well as time, employers also invest money (with some mandation or tax incentives, as well as direct government provision of training in some cases). The content or type of training can range from induction and health and safety through to job-specific training. Some training or qualifications are mandated requirements, like health and safety, from governments or sector bodies for particular roles or sectors.

Why does employer investment in skills matter? At its simplest level, because it can help people be more effective and productive at work. That leads on to people having a greater likelihood of being in work and progressing in their careers and earning more, and to employers being better able to compete and grow. Work-based learning has particularly strong employment and earnings returns and can benefit both people and employers.

[1] Time for action: learning and skills for economic growth and social justice, Evans and Egglestone, L&W, 2019.

Employer investment in skills is also important for long-term prosperity and wider policy goals. For example, the transition to net zero will create new opportunities but require new skills to make the most of these. Employer investment in skills will therefore be essential for businesses to make the most of future opportunities and adapt to change, just as with investment in capital. By opening up new career opportunities and giving scope for progression, access to training can also promote social mobility if everyone has fair access to these opportunities.

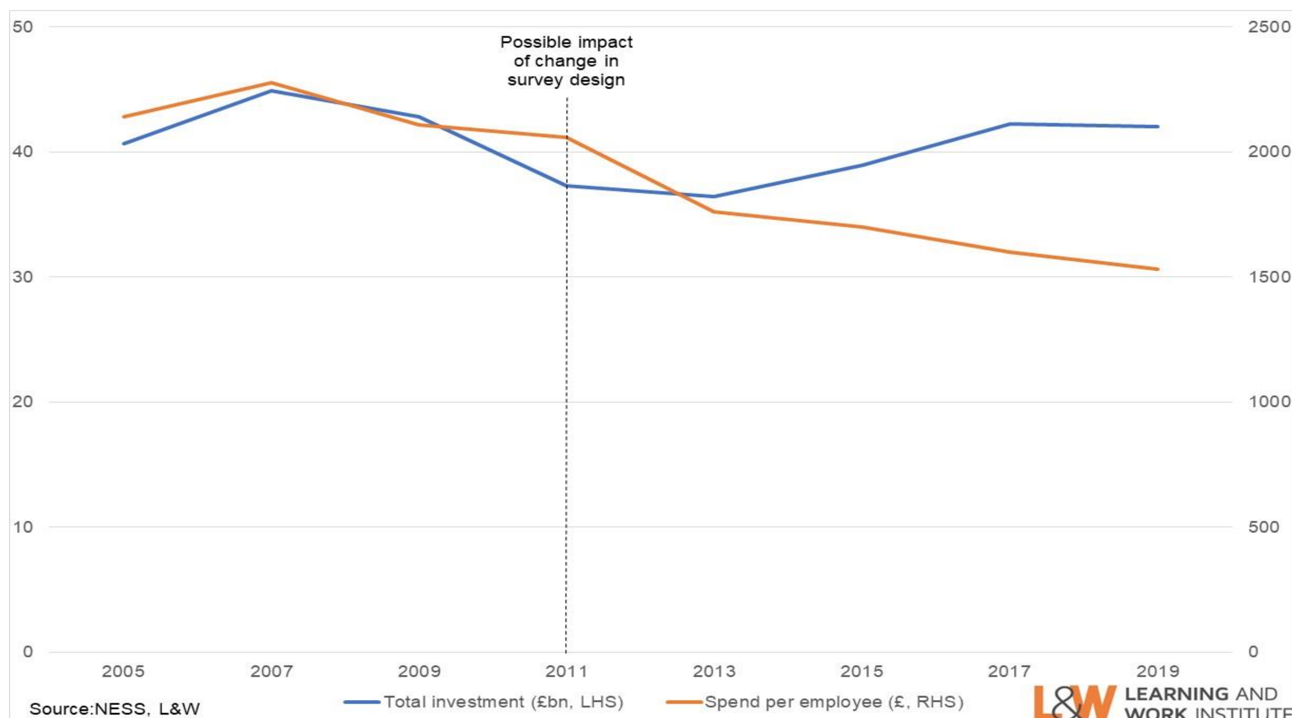
So the amount that employers invest, what they invest in, and who they invest in are all essential for individual opportunity, employer success and future prosperity and fairness.

The need for change[2]

Employer investment in skills has fallen over the last decade and is lower than in comparator countries, with concerns over the quality and impact of training.

Employers invested £42 billion (including the wage costs of those on training) in skills in 2019, roughly the same in real terms as in 2005. However, there are 3.5 million more people in work. This means training investment per employee fell 28%, from £2,139 to £1,530.

Figure 1: Employer investment in training, constant prices



The EU average invested in training per employee is double that in the UK. An extra £6.5 billion would be invested each year if investment per employee rose to the EU average. More than 1 in 10 employers providing training only provided basic induction or health and

[2] Learning at work: employer investment in skills, Clayton and Evans, L&W, 2021.

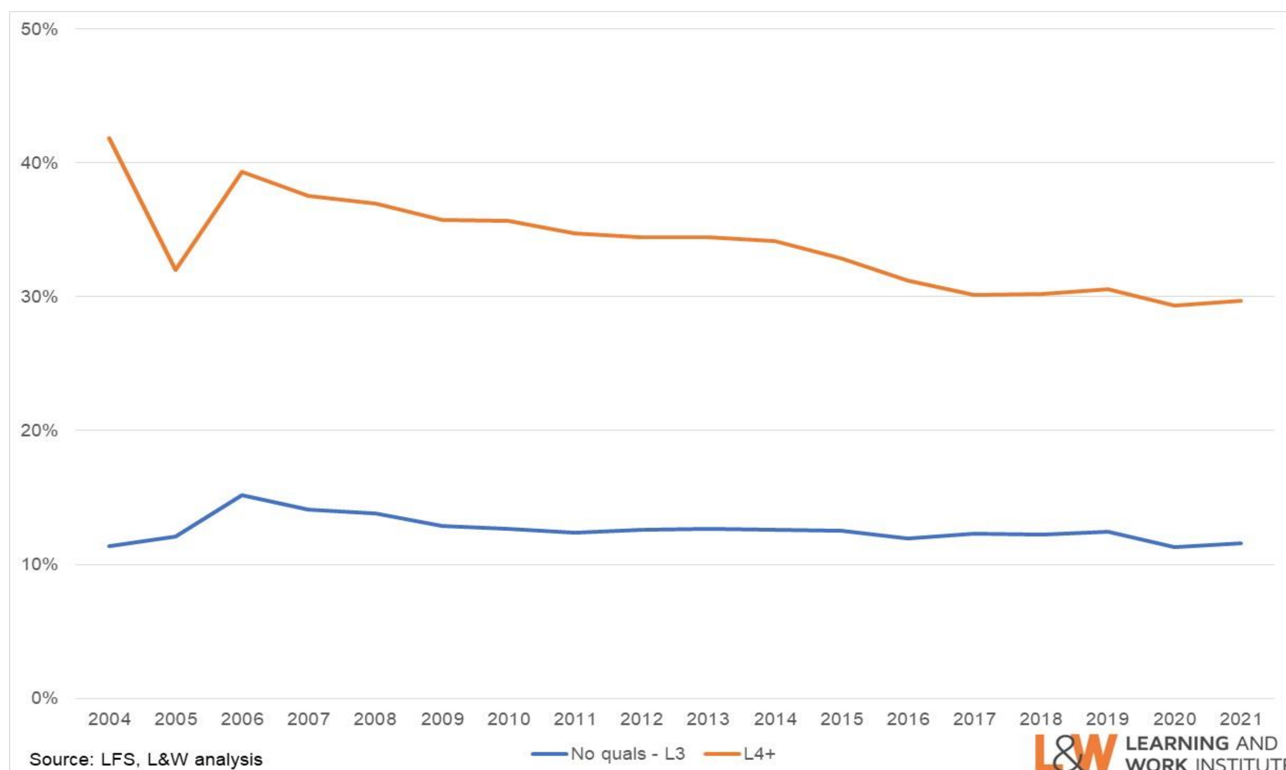
safety training, and fewer than 20% of all employers provide management training. This raises concerns about the quality and impact of employer training.

Total employer training in 2019 amounted to 99 million training days, with 61% of employers providing training, a higher proportion than in many European countries. However, this proportion has fallen since 2011 - there would be another 20 million training days if investment had stayed at 2011 levels.

Access to training is highly unequal with low paid, low qualified workers less likely to have opportunities to develop their skills.

Smaller businesses and employers in lower wage, lower productivity sectors (including retail and hospitality) are less likely to provide training. Low paid and low qualified workers are less likely to access training, reinforcing disadvantage in the labour market and limiting opportunities to progress. The proportion of people qualified up to level 3 who say they have participated in job-related training in the last 13 weeks has stayed constant at just over one in ten since 2004 (the earliest comparable data available).

Figure 2: Participation in job-related training in last 13 weeks by qualification level



There has been a general downward trend in training for those qualified at level 4 and above, likely reflecting their increased share in the workforce and wider variety of jobs they are engaged in as higher education has expanded.

People qualified to graduate level remain three times as likely to get training at work. An extra 1.2 million people would receive training each year if people with low qualifications were as likely to participate in training as those qualified to degree-level.

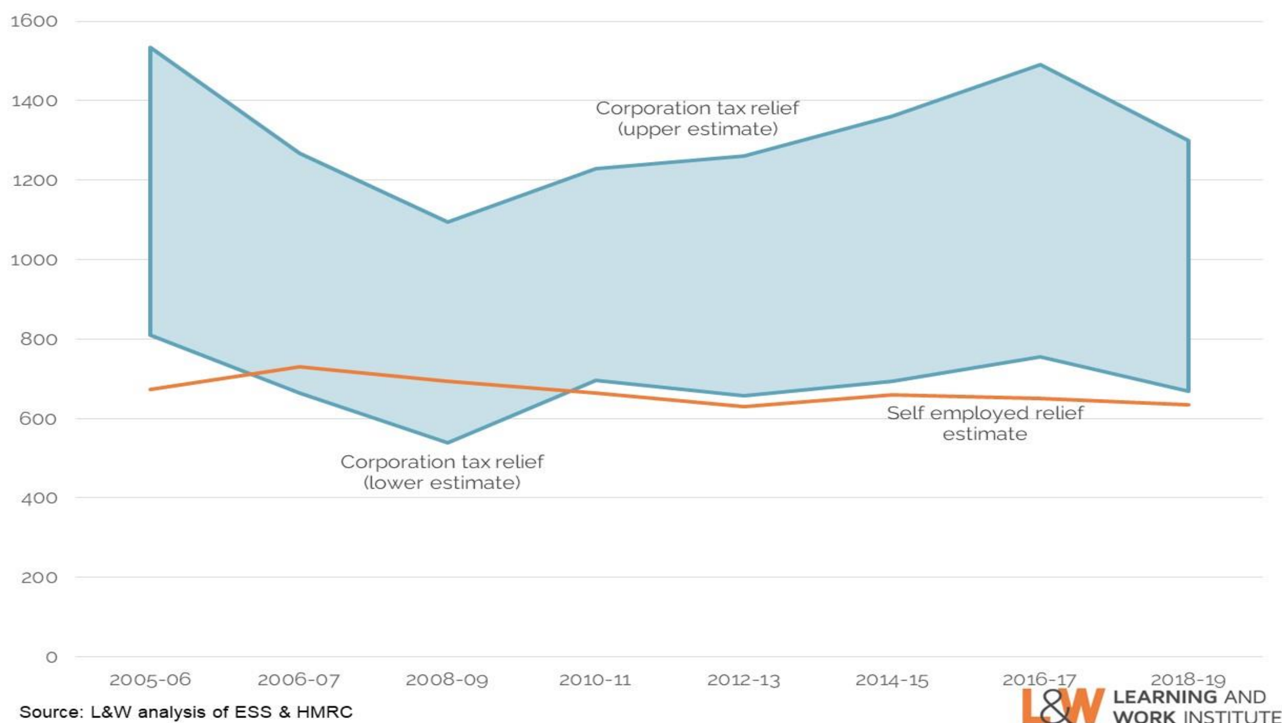
Employer investment in training fell during the pandemic – with low wage workers and young people likely to be particularly affected.

Employer investment in training is likely to have fallen more sharply during the pandemic than in the financial crisis, with consumer services firms (including travel and hospitality) twice as likely to report a decline in training expenditure than other service firms. The fall in apprenticeship starts disproportionately affected young people, though overall apprenticeship numbers are now starting to recover.

Government policy increasingly either passively follows or actively reinforces inequalities in training.

Government involvement in skills that can support employers amounts to up to £6.8 billion per year through: funding **training provision** through the £1.5 billion Adult Education Budget, up to £0.6 billion from European Social Funds and up to £0.6 billion National Skills Fund; setting the framework and rules for the £2.7 billion **apprenticeship** system; and **tax relief** of up to £1.3 billion on the costs of training for companies and self-employed people.

Figure 3: Tax support for investment in training

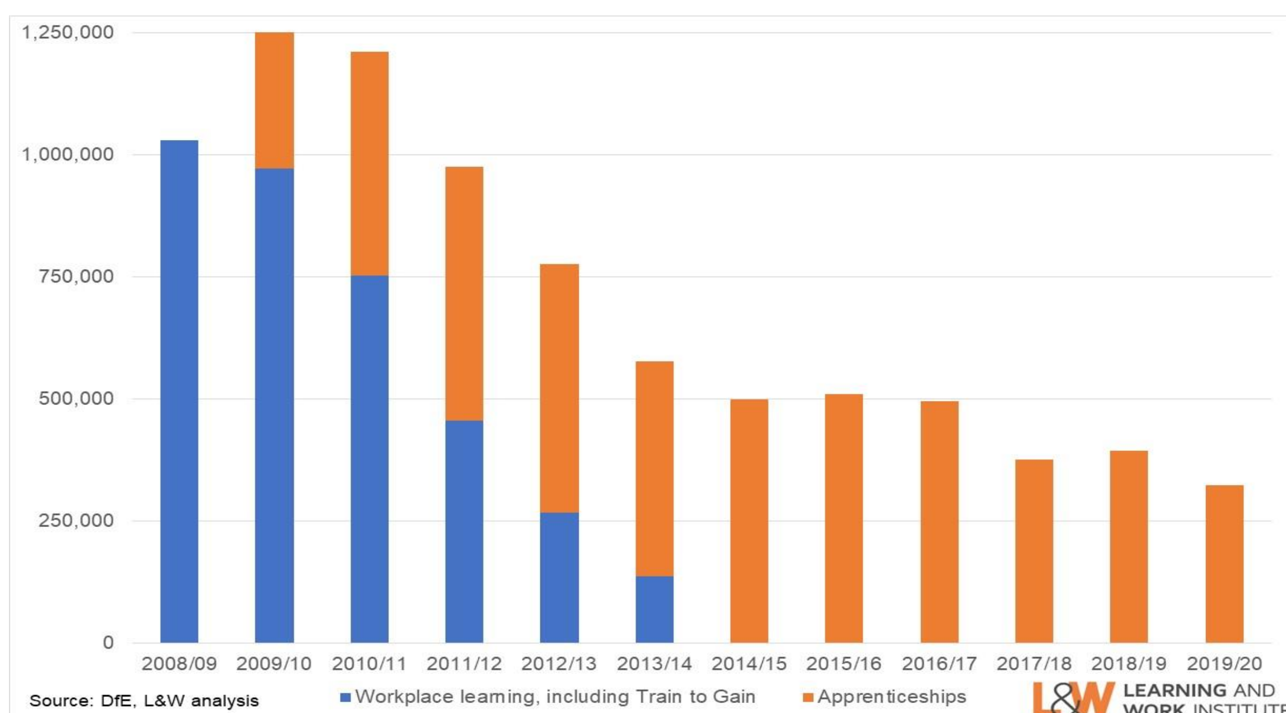


Through each of these channels, Government policy often passively follows or ultimately reinforces inequalities in employer training. For example, corporation tax relief simply follows employer investment decisions, meaning it is skewed toward the already-highly

skilled. Since the introduction of the levy and other reforms, apprenticeships for young people and at level 2 have fallen sharply. Government funded provision increasingly focuses on level 3, with falls in participation in essential skills learning and level 2.

Indeed the number of people taking part in government-supported workplace learning has fallen by 74% since 2009/10. The Government would argue, with some justification, that there is likely to have been an improvement in quality given changes to apprenticeships such as a one year minimum duration and that evaluation showed Train to Gain was often displacing employer training.[3] Nonethless, this is a stark fall with the largest drops coming at level 2 and below.

Figure 4: Number of people participating in government-supported workplace learning



This is an implicit policy decision. There may be reasons to support it, arguing that employers are best placed to decide where to invest and there is no market failure in training, therefore the inequalities in training are justified and trying to tackle them wouldn't benefit employers or people.

But we would argue that there are clear market failures and the evidence is clear that training at all levels can benefit us all, particularly if we want a high productivity, high skill, high pay future. That is why we have articulated a vision of increasing total employer investment and doing so by levelling up opportunity for those that too often miss out today.

[3] Train to Gain: developing the skills of the workforce, National Audit Office, 2009.

Learning the lessons

Concerns about the UK's skills base are nothing new. In 1882, the Royal Commission on Technical Education (the Samuelson Report) diagnosed relatively poor technical skills development as a cause of the UK's eroding competitiveness.[4]

The 140 years since have seen a galaxy of initiatives to try and tackle this, including increasing the education participation age and a dizzying array of efforts to 'reform' technical education, resulting in an alphabet soup of often short-lived policies and institutions – many of which have aimed to ensure skills policy meets employers' needs and to encourage employers to invest more in skills. City and Guilds found that since 1981 there had been 61 Secretaries of State responsible for skills, skills had changed departments in England 10 times, and there had been 13 acts of parliament.[5]

To pick a few edited highlights from recent decades, efforts to encourage employers to invest (time and money) in skills in England include:

- **Industrial Training Boards, 1965.** Groups of employers designated by the Government to organise training provision in their sectors, including the power to introduce training levys. Largely abolished in the early 1980s.
- **Manpower Services Commission, 1973.** This sought to give employers more leadership of the skills system, reasoning that this would increase the impact of public investment and encourage employers to invest more. Reforms included introducing new vocational qualifications intended to better reflect employer needs. Took on many of the functions of Industrial Training Boards.
- **Training and Enterprise Councils, 1990.** These replaced the Manpower Services Commission and administered publicly-funded training programmes, including the Youth Training Scheme and Modern Apprenticeships. There were intended to be local and employer-led and there were around 82 by the time they were abolished.
- **Investors in People, 1991.** A national standard of good practice for training and development for employers.
- **Modern Apprenticeships, 1994.** The Government argued that combining work and gaining a vocational qualification would better meet the economy's needs. Modern Apprenticeships sought to develop apprenticeships in sectors (like many service industries) that now dominated the economy.
- **National Traineeships, 1996.** Launched to provide a progression route to prepare people for apprenticeships, and later to become Foundation Apprenticeships.

[4] Royal Commission on technical education: Samuelson Report, 1882.

[5] Sense and instability: three decades of skills and employment policy, City and Guilds, 2014.

- **Learning and Skills Council, 2001.** Non-departmental body which replaced the Training and Enterprise Councils and Further Education Funding Council, responsible for planning and funding post-16 education.
- **Modern Apprenticeships reforms, 2001.** Based on the Cassells report, including national frameworks and a new technical certificate.
- **Sector Skills Councils, 2002.** Replaced National Training Organisations and sought to look at raising skills demand and utilisation, as well as looking at qualifications and skills supply.
- **Apprenticeships taskforce, 2004.** Response removed the upper age limit and introducing Young Apprenticeships for 14-16 year olds.
- **Train to Gain, 2006.** This funded level 2 training and provided wage compensation for small firms for the time employees were off on training. Over 500,000 people gained qualifications although there were concerns over deadweight (the Government paying for training that would have happened anyway).
- **Leitch Review of skills, 2006.** Argued that adult skills funding should be more demand-led by individuals and employers, including expanding apprenticeships and Train to Gain, and a greater role for employers in qualification design.
- **UK Commission for Employment and Skills, 2008.** Established to try and provide an independent social partnership (for example, involving trades unions and employers) guide for the employment and skills systems, underpinned by the existing network of Sector Skills Councils.
- **National Apprenticeship Service, 2009.** Set up to encourage apprenticeships and join up support.
- **Skills Funding Agency (later the Education and Skills Funding Agency), 2010.** Replaced the Learning and Skills Council.
- **Right to request time off for training, 2010.** Right for employees to request time off for training that employees feel is relevant for their work, though employers do not need to pay for the training or time off. Evaluation showed awareness was low and didn't find evidence of a significant impact on employer investment in training.
- **Richards Review of apprenticeships, 2012.** Argued apprenticeships should be focused on new jobs, require attainment of level 2 literacy and numeracy, and preferably be funded by employers through the payroll system.
- **Employer ownership of skills pilot, 2013.** Run by the UK Commission for Employment and Skills, this aimed to match fund employer investment in skills where employers bid in. The evaluation showed this was largely deadweight.
- **Apprenticeship Levy, 2016.** A payroll tax on large employers sitting in a ringfenced digital account that can only be used for apprenticeships. New apprenticeship standards, designed by employer groups, were also introduced with the process overseen by the Institute for Apprenticeships and Technical Education

(established in 2017). Apprenticeships have fallen significantly since these reforms with a shift from entry level apprenticeships for young people to higher apprenticeships for older members of the existing workforce. There are few incentives to change this balance, with the Government arguing it is down to employer choice.

- **Institute for apprenticeships and technical education, 2017.** Set up to ensure employer leadership of apprenticeship standards and technical education.
- **Skills Advisory Panels, 2018.** Local partnerships bringing together employers and skills providers to determine skills needs.
- **Local Skills Improvement Plans, 2022.** Local skills plans developed by employer bodies designated by the Department for Education. Being introduced under the Skills Bill and likely to replace Skills Advisory Panels.

In short, there is a long history of short-lived efforts to ensure the skills system meets employers needs. Many have been variations on a theme of employer involvement in qualification design and aiming to match employer choice more closely, whether through funding or involvement in skills planning. A key aim has been to increase the impact of public investment and the number of employers engaging in that system. There has also been changes in focus over time between voluntarism (giving employers leadership and incentives to engage in training) and compulsion (requiring them to do so, in particular through sectoral or national levies).

However, there has been less focus on how to increase employer investment and skills utilisation or on the wider context of promoting growth and productivity. For example, the shortlived Industrial Strategy was relatively separate from Skills Advisory Panels. The focus has more been on increasing employer demand for publicly-funded skills, but less on increasing employer demand for and investment in and utilisation of skills as a whole (with some exceptions noted above).

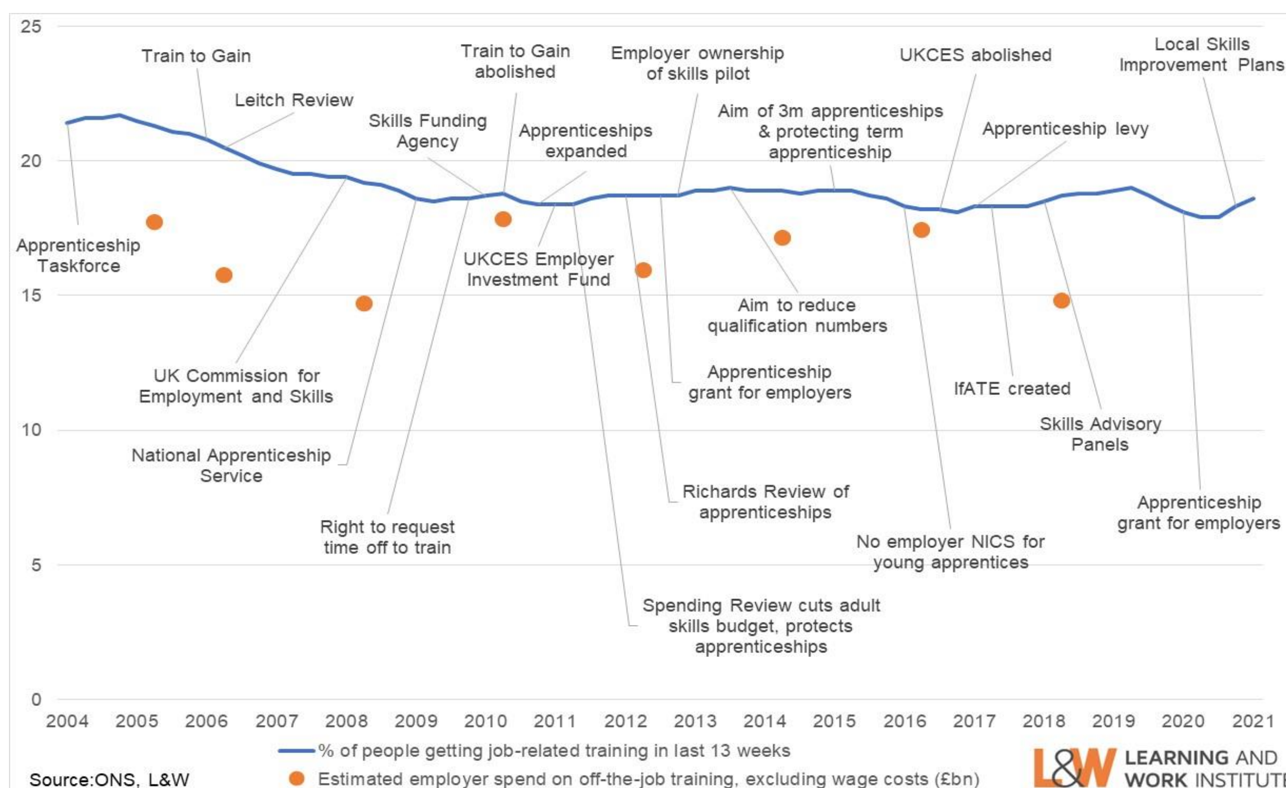
Yet public funding for training is only two thirds of total public support for training (or 20% if apprenticeships are considered employer investment). And employers in England invest £6.5 billion themselves in the direct costs of off-the-job training (£42 billion including on-the-job training and wage costs).[6] We must take account of this bigger picture and tackle the twin challenges of chop and change and blinkered focus.

[6] Learning at work: employer investment in skills, L&W, 2021.

Falling short

Despite the well-intentioned efforts of policy, the proportion of people who have received job-related training in the last 13 weeks has fallen 14% (3.1 percentage points) since 2004 (down from 21.7% to 18.6%) and employer investment in training has fallen in real terms.

Figure 4: Employer investment in training and the proportion of employees getting job-related training in last 13 weeks



Why, then, has policy not led to increased employer investment in training and more equal access to training for different groups?

In part it is because, as discussed above, the main focus of many initiatives has been trying to make sure the publicly-funded skills system better meets employer needs. This has been through mechanisms for employer design of qualifications, employer involvement in identifying skills priorities and planning, and a range of reforms in apprenticeships.

All of this is important, but it is not enough. The main reason employers invest in skills it to meet business need and deliver their business strategies. For this reason, skills policy needs to be an integral part of efforts to improve UK productivity including through investment, infrastructure and innovation, rather than a separate policy which Government tries to 'join up' with other policy, not least as policies interact with each other. Similarly, low economic growth and high uncertainty seen since 2008 are likely to have dampened employer demand for skills, limiting employers willingness to take the 'risk' of new investment.

But even in their own right current skills policies have significant flaws, as we explored in our previous report setting out the current state of play.[7] Here we pick out two in particular: intention and design.

Employers have historically focused training investment on those with the highest qualification levels. Traditionally policy sought to counterbalance that, focusing public investment and encouragement on those with the lowest qualifications but with attempts for employers to lead the design of this process, and arguing that existing patterns of investment represented a market failure.

However, in recent years this has changed. The Corporation Tax relief by definition passively follows employer investment decisions and doesn't seek to influence what they invest in. This means the greatest value is targeted on those with the highest qualifications (as they are more likely to be trained by their employers and receive on average more expensive training).

The Apprenticeship Levy system follows the same pattern. Previously public funding for apprenticeships was focused on levels 2 and 3. Apprenticeships have now been developed at level 4+ and it is for employers to decide which they wish to choose. There are relatively few financial incentives for employers to prioritise investment in levels 2-3 or for new employees.

So the intent of policy has switched from focusing public investment on skills at lower and intermediate level and incentivising greater employer investment there too, to being much more neutral and following employer choices.

The creation of higher apprenticeships is an excellent development and gives people new ways to develop higher skills. However, the inevitable consequence of the Government's reforms has been a rapid growth in higher apprenticeships at the expense of intermediate apprenticeships, with most apprentices already working for their employer before becoming apprentices. Indeed, our research showed many levy-paying employers had a focus on maximising their use of the levy and for many it had displaced their training budgets.[8] This is not to say that there aren't many brilliant apprenticeships, nor that there shouldn't be more higher apprenticeships. However, there are other approaches to workforce development beyond apprenticeships that have value, and this growth should not be at the expense of opportunities at lower levels and for new starters.

Why did this happen? This is where changes in intent (a shift to being neutral about what employers invest in) intersect with issues in policy design.

The apprenticeship policy created a ringfenced budget that could only be spent on apprenticeships (or it would expire and return to the Treasury after two years), during a time of weak economic growth which limited employers' willingness to invest more in

[7] Learning at work: employer investment in skills, L&W, 2021.

[8] Levy paying employer decisions and accounting for prior learning, L&W, Department for Education, 2020.

training, at the same time as higher apprenticeships were being developed. The Government has chosen to be neutral on which apprenticeships employers choose and employers have replicated their longstanding preference for investing in already highly skilled workers. This is in stark contrast to previous policy which, for all its flaws, attempted to redress perceived underinvestment in those with fewer qualifications. The result is employers replicating their previous patterns of training investment, not increasing overall investment in training, and hence a reduction in entry-level opportunities. To an extent, policy has distorted employer training investment rather than increasing it.

This raises fundamental questions about public policy. If it is simply to provide financial incentives for employers to invest in training along the lines they always have, but for more of it to now be apprenticeships, then the current framework is a success (though there may be better ways to achieve the same goals).

However, as we argued in the previous chapter, we think there is a need to substantially increase employer investment in training and for this increase to be particularly focused on those with the lowest qualifications. This goal needs to be explicitly stated as the intention of policy and underpin policy design. Similarly, employer training is about more than apprenticeships and other publicly-funded training: policy needs to recognise this and understand its wider impacts, including the risk of displacing or distorting other activity.

Key lessons

Defining success is crucial both overall and for each policy. For example, is the aim to increase total employer investment in skills and to narrow participation gaps in training? When Train to Gain was abolished there was a roughly equal increase in the number of apprenticeships, meaning the volume of employer engagement in publicly-funded training was unchanged (though the Government would argue it was higher quality). Similarly if the introduction of the Apprenticeship Levy has, to a large extent, displaced previous employer training budgets then overall employer investment will not have increased (though, again, it might be argued the investment may be of higher quality).

Financial incentives are important, but not enough on their own. Employer decisions about whether and how to invest in training are a complex product of regulatory requirements, business strategies, employer, sector and national culture, and more. However, financial incentives have a role to play both in their own right and as an incentive to support change in this wider ecosystem of influences on employer's decision making.

Training and workforce development are at least as much about employer investment as about public policy and funding. The majority of employer investment in training is outside of publicly-funded programmes. As noted below, there are limits to the role of policy in individual employer decisions. However, policy inevitably sets a framework and incentives. An understanding of the impact of public investment and policy on wider employer investment (for example, the impact of the apprenticeship levy on other forms of training) is crucial to the success of policy.

A collaborative approach to policymaking is more likely to avoid unintended consequences. Many outcomes of policy decisions were predicted at the time by employer groups and others. A more collaborative approach to policy making in advance (as opposed to consulting on the mechanics of implementing a pre-determined approach) might mitigate some of these.

Policymakers must decide where to draw the line. In general, it is for employers to run their organisations and policymakers don't try and get involved in individual decisions. However, policy sets a framework and set of incentives (intended or not) that influence employers' decisions about a range of things, including whether and how to invest in skills. It is important to think about these wider set of incentives and influences.

A new policy framework

We propose five steps to a new policy framework for employer training:

- **Focus on employer investment in and use of skills as part of long-term plans for growth, including trials of new locally-led Skills and Good Work Partnerships**
- **Introduce a Skills Tax Credit, with a Super Skills Credit for levelling up areas and essential skills, at an additional cost of up to £500 million per year**
- **Broaden the apprenticeship levy to increase the number of firms covered and allow investment in essential skills and accredited qualifications**
- **Explore plans to replace the current levy with a tax-based 'pay or play' Skills Levy to reduce administration costs for employers**
- **Look at ways to support people to learn and to retrain, including considering maintenance support and expanding rights to time off for learning**

We argue that Government policy should aim to increase employer investment in skills, narrow gaps in access to training between groups, and do this as part of a strategy for growth and productivity. In practice we think this means that Government should focus on creating a framework, targeting incentives, and then employers making decisions within this framework. That should include trying to ensure that the public training budget meets employer (and individual) needs, but go beyond this considering training in the round.

Our five policy proposals are aimed at: making employer investment in training part of the bigger picture of boosting growth; incentivising investment in training, particularly for those with lower qualifications; building a better training levy system so more employers invest and supporting individuals into training and learning.

Long-term plans for growth

Financial incentives and skills policy alone will not be enough. Employer decisions to invest in skills are largely the product of their business strategies, which also help determine the extent to which skills are utilised. Focusing on skills policy alone would be like starting a football match with only a goalkeeper.

Macroeconomic policy is important in this, including policy stability and the extent to which fiscal and monetary policy are promoting growth. But microeconomic policy matters too and in particular how strategies to increase investment, improve innovation and infrastructure, and matching employment and skills support as part of this, come together. The Government has recognised this in its Levelling Up White Paper, as have a range of devolved areas within England and governments across the UK.[9]

[9] Levelling up the United Kingdom, Department for levelling up and communities, 2022.

We need employer investment in and utilisation of skills to be a central part of a long-term plan for growth and productivity. This needs to get beyond the short-term chop and change of initiatives we have seen over previous decades. A clear policy framework jointly developed across political divides and in a social partnership is more likely to stand the test of time, but also clearly more challenging to develop.

One way to kick start this process would be to build local partnerships, for example led by local government areas invited to make proposals for greater devolution in the Levelling Up White Paper. These **Skills and Good Work Partnerships** would bring together the key partners in an area, such as key employers, higher education institutions, colleges and others. These would not be intended as an additional layer or new set of geographic boundaries. Rather they would be led by existing geographies, like Combined Authorities, and form part of their existing work. The partnerships would agree how the key tools at their disposal – such as employer and public investment in skills, infrastructure, existing economic strengths etc – can work together to promote inclusive growth and good work.

In some ways, this is taking a further step in the existing place-making role of local government and the ambition many have for devolution deals. Part of the added value is seeing employer investment in skills as a central part of that and looking at it through the lens of good work (in addition to local economic growth). In this and other ways it would therefore be much broader than the planned Local Employer Skills Partnerships, which are focused on developing local skills plans that publicly-funded providers must pay regard to. Other governments across the UK should consider adopting a similar approach.

Skills Tax Credit

We recommend the introduction of a **Skills Tax Credit** modelled on the existing Research and Development Tax Credit (see Box 1). The aim is to incentivise employer investment in training, particularly in training for those with the lowest qualifications. These sort of financial incentives will not be enough on their own, but could make a difference as part of a wider strategy.

The case for the R&D tax credit is that individual firms will underinvest in R&D because it has wider benefits for society and productivity that they don't directly capture themselves in increased profits, coupled with the risk that such investment brings (not every R&D project pays off) and the fact some firms face credit constraints (they may not have the money or be able to borrow sufficiently).

The fundamental argument for a similar approach in skills is that employers (and society) underinvest in training as a result of market failures. These include the externalities of training (benefits to the economy beyond those for the individual firm or worker): a better trained workforce can generate more ideas and inspire other firms too. Uncertainty also potentially limits employers' investment in skills. Employers don't know if investing in skills, along with the rest of their business strategies, will pay off and they face the risk that employees may leave before their investment in training pays off.

Box 1: The R&D tax credit

These reliefs cost £6.3 billion in 2018-19, of which around 60% went to SMEs. Small and medium-size firms (those with fewer than 500 employees and a turnover of under £100m or balance sheet of less than £86m) can deduct 130% of their qualifying costs from their yearly profit, on top of the normal 100% deduction. This reduces their liability for Corporation Tax. Loss-making companies can claim a tax credit of up to 14.5% of their qualifying spend. There is a specific definition of what counts as R&D and also what costs can qualify as R&D expenditure (e.g. staff working on the R&D project, software etc). The credit can be claimed through the Company Tax Return, with evidence provided that the project and costs meet the requirements.

Large companies, and SMEs sub-contracted to large firms on an R&D project, can claim the R&D Expenditure Credit. This allows businesses to claim a credit of 13% of qualifying expenditure to reduce tax liability or as a tax credit if the firm is loss making. Definitions of R&D and qualifying expenditure are similar to the small firms scheme.

The case for public investment and focus varies by skill level. Employers and individuals are more likely to capture the benefits of investment in high level skills (though there are still often spillover benefits), whereas the UK's relatively poor level of essential skills (one in five adults have low literacy, numeracy or digital skills) may hold back lots of other investment in skills and training given they are a foundation stone for other learning.

In addition, it can be argued the investment in skills is too low as a result of shortfalls in overall economic policy leading to excessive short-termism in parts of the economy and a 'low road' approach to delivering a given level of economic output. For both the general economic and specific skills reasons, there are arguments for government intervention and public investment directly in skills and to increase employer investment.

The case for a skills tax credit is therefore similar to that for R&D, and it should (as with R&D) increase employer investment in training. There is an additional potential benefit. The current Corporation Tax deduction is open to any form of training that meets the rules, and this means that most of the value supports training for already-highly skilled workers (as they are more likely to be trained by their employer and have more expensive training) and it supports training that may only be of benefit to the current employer.

A Skills Tax Credit would allow this taxpayer investment to be more focused on those with the lowest qualifications (who are least likely to be trained by their employer today) and on accredited provision that can offer more portability for employees.

We suggest the design of the Skills Tax Credit follows that of the R&D tax credit to keep it as simple as possible. As with the R&D tax credit, it would apply across the UK. The general deduction of training costs from Corporation Tax liabilities would be changed in line with the definitions of qualifying training and costs below:

- **Qualifying training would be apprenticeships and accredited qualifications.** The Government could consider limiting this to qualifications up to and including level 3, depending on the balance between cost and complexity, to target public investment. Retraining at the same qualification level would qualify
- **Qualifying costs would include direct spend on materials and course fees and staff time** while on those courses, as with the current Corporation Tax allowance
- **Companies could deduct 130% of these qualifying costs** (on top of the existing 100%) from their tax liability, and claim a 14.5% credit if they were loss making.

This is similar to the approach proposed by the Centre for Social Justice.[10] Similar training tax credits already operate in a number of other places, including:[11]

- **Austria.** The Training Tax Allowance allowed employers to deduct 120% of eligible costs of external training (and internal training in some specific circumstances). The scheme was introduced in 2000, but ended in 2015.
- **British Colombia.** The Training Tax Credit allows employers who employ apprentices in an Industry Training Authority to claim a tax credit of 20-50% of eligible wage costs up to a maximum amount that varies by level of study.
- **Georgia.** Tax credit of 50% of a company's direct training expenses, with up to $500 credit per full-time employee, per training program. Maximum annual credit per employee of $1,250.
- **Kentucky.** Tax credit of up to 50% of eligible training.
- **Mississippi.** The Skills Training Income Tax Credit grants a 50% credit to employers on the costs (including instructors and equipment) of training via a Community College, up to $2,500 per employee over a three year period. The credit is focused on basic skills and retraining and businesses in manufacturing, processing, distribution, wholesaling, R&D, and warehousing.
- **New York.** The Employee Training Incentive Programme gives a credit of up to $10,000 per employee of eligible training costs. Businesses must submit a plan to be eligible and it is targeted on businesses in 'strategic industries' that are making capital investments to create jobs or improve productivity.
- **Rhode Island.** Tax credit of 50% of training expenses for all employees, capped at $5,000 per employee.
- **Virginia.** Tax credit of 30% of training costs (if through community college) or $200 annually (if through private schooling) for employers who participate in worker retraining efforts.

There is little robust evaluation of their impacts, though evaluations of the similar research and development tax credits suggest they lead to increased investment. For example,

[10] The long game: how to reboot skills training for disadvantaged adults, Centre for Social Justice, 2020.
[11] Worker Training Tax Credit: Promoting employer investments in the workforce, Aspen Institute, 2018; Financing adult learning database, Cedefop.

evaluation suggests that for every pound invested in R&D tax credits, between £2.40 and £2.70 is additionally invested in R&D by firms.[12] The OECD has also found a significant effect across countries.[13] Given expenditure on the credits of £2.4 billion in 2017-18, this may have led to £5.8-6.5 billion extra R&D investment in that year.

We propose a **super rate of the new Skills Tax Credit, allowing 300% of eligible training expenditure for employees in low skill areas of the country to be claimed** and for **investment in accredited literacy, numeracy and digital qualifications for those that need them anywhere in the country**. This would provide additional support for employers in the lowest income parts of the country that are priorities for 'levelling up' and for employees everywhere who need to improve their essential skills.

As noted above, it is difficult to estimate the cost of a Skills Tax Credit, in part because there are no formal estimates of the cost of being able to deduct training costs from Corporation Tax liabilities currently. There were 2.9 million employees working toward a recognised qualification in 2019.[14] This tax credit would incur costs relating to these employees (a 'deadweight' cost) but would hopefully also lead to an increase in these numbers and, because we would be narrowing the definition of eligible training, would mean some existing training would no longer be tax deductible. So in part our aim is for public subsidy to be better targeted in line with public policy objectives.

Based on our previous assessments of the cost of the current deduction, it is plausible that the new approach would be cost neutral and hopefully lead to more effective and better targeted use of the current investment. However, to err on the side of caution and allow for a more generous super rate, a cost of up to £500 million per year should be earmarked.[15] Based on the R&D tax credit (which may or may not be a good comparator) that could increase employer investment in training by £1-1.5 billion per year. A 10% rise in employees studying for a qualification (not implausible when considering potential growth in essential skills training) would equate to almost 250,000 more people each year.

Broadening the Apprenticeship Levy

A number of organisations have argued the Apprenticeship Levy should be broadened into a wider Skills Levy.[16] Most argue that employers should have greater flexibility in what their current levy payments can be spent on, such as including pre-apprenticeship training or some of the wage costs of apprenticeships. The common theme that, while apprenticeships can be of great value, other forms of training have value too.

[12] Evaluation of the Research and Development Expenditure Credit, HMRC Working Paper 20, HMRC, 2020.
[13] The effects of R&D tax incentives and their role in the innovation policy mix, OECD, 2020.
[14] Employer skills survey 2019: summary report, Department for Education, 2020.
[15] This would allow for a 50% increase in the cost of claims, based on our previous estimate that the cost of the current corporation tax deduction could be up to £1 billion per year.
[16] See, for example: Apprenticeship levy reform needed, British Retail Consortium, 2022; Apprenticeship levy press release, CIPD, 2021.

However, there are two challenges to consider. The first is that allowing employers to pay for *any* form of training or wage support for trainees raises the question of why you have a levy at all. The risk is the creation of a bureaucratic process whereby the Government collects money from employers who then spend it in the way they would have in any case.

The second challenge is that, for a fixed levy, this is a zero sum game. The levy currently raises about £2.7 billion per year. So any use of this on other forms of training inevitably means less resources for apprenticeships. Similarly, widening the activity allowable for levy funds is likely to mean large employers spend more of their levy. Given that apprenticeships for small employers are largely funded through unspent levy funds, this would mean fewer apprenticeships in small firms.

This comes back to a point made earlier in this report. We need to be clear about the objectives of public policy, with policy choices flowing from this. We have argued that policy should aim to increase total employer investment in training, and narrow the gaps in training between groups.

To that end, we suggest that any reforms to the apprenticeship levy should combine:

- **Widening reach.** For example, increasing the rate at which it is paid by 0.1% of payroll (it is currently 0.5%) would raise an additional £500 million per year. Analysis suggested that reducing the point at which firms must pay the levy would raise relatively little. For example, reducing the threshold from annualised payrolls of £3 million to £2 million would increase the number of firms paying the levy from 23,000 to 40,000, but only raise an additional £100 million per year.[17]

  However, this is not just about raising extra money, there could be benefits to encouraging a greater number of firms to engage by increasing the number that pay the levy. The debate is whether smaller firms can be engaged in other ways, though of course a range of other approaches have been tried over recent decades. *We suggest considering extending the levy, perhaps at a lower rate, to smaller firms and considering a small increase in the proportion of payroll that current levy payers contribute as economic conditions allow*;
- **Broadening scope.** There is value in training beyond apprenticeships and so we think the levy should be able to cover the costs of accredited courses too. The Government may want to consider limiting this to courses up to and including level 3 to focus more on expanding opportunities for those with lower qualifications, or reviewing this after three years of the reformed levy. Doing so would, of course, not stop employers investing themselves in higher level learning, as they did before the levy. *We suggest making accredited training eligible for the levy, considering the case for limiting this to learning up to and including level 3*; and

[17] Increasing the levy’s scope not the solution to solving apprenticeship funding difficulties, new analysis finds (aelp.org.uk)

- **Encouraging focus.** The current levy system has relatively few incentives for employers to invest in training for young people or those with the fewest qualifications. One way to change this would be to ringfence part of the levy for investment in young people, with a House of Lords committee arguing this should be two thirds.[18] Another would be to increase payments for apprenticeships and training for young people, either by having a lower funding rate for those aged 25+ or by allowing part of the levy to be spent on wage costs for young apprentices. *We would favour ringfencing half of the levy for spending on younger people and exploring allowing some of this to be spent on wage costs for young apprentices.*

The reformed approach would therefore seek to: allow more than apprenticeships to be eligible for funding; be better targeted on people more likely to miss out on training; and engage more firms either through raising more money from existing levy payers and using this to expand training support or expanding the levy to more firms. The balance of this deal is something that Government, employers and others should discuss, and ensure it fits with existing levies in sectors such as construction.

We have suggested the outline of an approach could be increasing the proportion of payroll paid into the levy by large employers by 0.1% (raising an additional £500 million per year) as economic conditions allow, potentially extending the levy to an extra 17,000 firms with payrolls between £2-3 million per year, allowing greater flexibility for this to pay for accredited qualifications as well as apprenticeships, but requiring around half of the levy to be spent on young people. The apprenticeship levy is paid by employers across the UK, with a share of contributions devolved outside England. It would be for devolved governments to decide how to spend any increased contributions in their country.

The Government should set out a clear process by which it will discuss with employers, trades unions or others how the apprenticeship levy should be reformed. It should also conduct a review of the operation of the reformed levy with the same partners after three years, to determine whether the changes are having the anticipated effect and whether further changes are needed.

Building a new 'pay or play' Skills Levy

One of the challenges highlighted earlier is the constant chop and change in initiatives. So there are good arguments to build on the existing levy framework in the ways described above, given it has only been in place since 2017. However, we wanted to explore a more radical option, albeit one built on similar principles.

The current systems involves employers paying money into a digital account that they can then transfer to providers to pay for apprenticeships or, up to a certain limit, to other employers. We propose exploring replacing that with a new Skills Levy operating through companies' annual tax returns.

[18] Skills for every young person, House of Lords youth unemployment committee, 2021.

The Skills Levy would calculate employers minimum skills investment in the same way as the current apprenticeship levy: 0.5% (or an increased level of 0.6%) of payrolls above an annualised £3 million. In their tax returns, companies would state the amount they had spent on apprenticeships and accredited training. As with proposed reforms to the levy described above, this could include minimums for investment in young people. If total eligible spend was at or above their Skills Levy minimum, then no charge would be payable. If it was below their Skills Levy minimum, then they would need to pay a charge equivalent to this difference. The Government would report each year on Skills Levy payments collected and set out how it was investing this in other skills opportunities, for example to fund apprenticeships for small firms or new essential skills programmes.

Why might this be a better system? The aim would be to reduce bureaucracy. Currently employers have to pay a certain amount each month into a digital apprenticeship account, and then use this to direct payments to apprenticeship providers or other firms. A number of firms have reported concerns that the levy transfer system in particular is complex.

The Skills Levy system has the potential to be simpler. Companies would instead report in their annual tax returns how much they had spent on eligible training and apprenticeships. The return would then automatically calculate whether an additional payment was needed (because firms had underinvested) or not. HMRC would take a risk-based approach in ensuring that companies made accurate returns, as they do with the tax system as a whole already. This would be a significant change, so the Government should explore its pros and cons with business groups and others.

Supporting individuals to learn

Work-related learning isn't just about employers. Employees need to engage in learning and apply their skills, self-employed people need to invest in their learning, and many people also need to retrain and switch careers too.

That requires thinking about how to ensure training engages people and how they can fit learning around home life and their work responsibilities. It also means supporting people to raise training with their employers. That could be through the Right to Request Time Off for Training, though awareness of this is low and employers are not required to agree or to fund the training itself or the time off. It could be through trades unions where these are present, with our research showing union learning can have a significant positive impact.[19]

Finally, it means new thinking about how we help people to retrain and switch careers. For example, that could mean thinking about expanding and strengthening the current right to request time off for training, thinking about maintenance support or how apprenticeships work for career switchers, or new forms of support such as Learning Accounts.

We will be exploring this topic in further detail in a forthcoming research report.

[19] Levelling up skills after coronavirus: the role of trades unions and social partnership in workforce training, L&W, 2020.

Conclusion

Employer investment in skills is a central component of economic growth, business success and individual opportunity. But it has fallen over the last decade or so, and those with degree-level qualifications are three times as likely to get training at work as those with no qualifications.

There has been no shortage of skills policy aimed at employers. But most has focused on how to make sure the publicly-funded skills system better meets their needs, including through employer involvement in qualification design and skills planning. This means policy has only focused on part of the issue and new iniatives risk displacing, rather than increasing, training.

We have argued for two clear measures of success:

1. **Is employer investment in skills increasing?** Specifically we have suggested aiming for a £6.5 billion per year rise to match the EU average spend per trainee and targeting an increase in the proportion of workers saying they took part in training in the last 13 weeks.
2. **Are gaps in training between groups narrowing?** Specifically we have noted that eliminating training gaps between those with degree-level qualifications and those with no qualifications would mean an extra 1.2 million workers getting training each year.

Delivering these ambitions requires a different approach. We need employer investment in skills to be a fundamental part of long-term growth strategies, making sure that collective efforts to improve infrastructure, investment, innovation and skills add up to more than the sum of their parts. We suggest new locally-led Skills and Good Work Partnerships could be trailblazers for this approach in devolution areas.

We should also incentivise greater investment in training through a Skills Tax Credit, including a super credit rate allowing businesses in areas targeted for levelling up to deduct 300% of their training costs from Corporation Tax bills. This would give firms a greater incentive to invest in skills, and particularly focus efforts on apprenticeships and formal qualifications. In addition, we argue for reform of the apprenticeship levy so it engages more employers, offers them more flexibility in what they can invest in, but ensures this is better targeted on young people and those with fewer qualifications. Over time this could be replaced by a tax-based 'pay or play' system.

Lastly, we should look at how best to support people to engage in training, including how best to encourage their employers to invest and better support retraining. This will be the subject of a future Learning and Work Institute research report.

The best employers invest in people to the benefit of all of us. We need to build on that so even more employers and people benefit from training and skills.