BRIDGING THE GAP: NEXT STEPS FOR THE APPRENTICESHIP LEVY

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Table of contents

Executive summary 4

Where are we now? 6

Options for change 11

Toward the longer-term..19

Executive summary

Apprenticeships are a great way to combine learning with earning, helping people build their careers and enabling employers to meet their skills needs. They have enjoyed a renaissance in England in recent years, but this has been accompanied by concerns over the quality of some apprenticeships and how to ensure they meet employer need.

In 2017, the government introduced the apprenticeship levy. Employers pay 0.5% of their payrolls above £3 million per year. In England, this is topped up by a further 10% public contribution and ringfenced in a digital account to be spent on apprenticeships. If levy funds are not used within two years, they expire. The system is based on an expectation that many employers will not spend all their levy funds. These unspent funds cover most of the costs of apprenticeships for small employers who do not pay the levy.

The government pays 95% of the cost of apprenticeships for non-levy payers and for levy payers who have already spent their levy budget and take on more apprentices.

The government has also introduced new apprenticeship standards which are replacing the existing frameworks. Designed by employer groups, these standards are intended to more robustly establish the skills and competencies an apprentice is expected to achieve.

The number of apprenticeship starts has fallen by around 20% since these reforms, with a particularly large decline in the number of level 2 apprenticeships and rises in higher levels. There is a live debate about the extent to which this represents a rise in quality and active employer choices, or a reduction in opportunities due to flaws in the system.

What is clear is that apprenticeships look much different now, with growth in higher and degree-level apprenticeships which tend to cost more. Many apprenticeship standards cost more than frameworks, largely because they involve a longer period of training and robust end point assessment. **The net result is that we are on course both to miss the government's target of three million apprenticeships by 2020 and bust the budget**.

The shift to more expensive apprenticeships could mean the apprenticeship budget is overspent, possibly by more than £1 billion. In practice, this is creating a growing squeeze on the funding available for apprenticeships at smaller employers. £133 million paid into the levy during its first four months expired unused two years later, 22% of £598 million paid. This is less than the government expected, leaving less money for SMEs, with reports of providers having to turn away SMEs that want to recruit apprentices due to lack of funding. **It could mean the loss of 75,000 apprenticeships in SMEs.**

This represents a hidden and unplanned policy choice to have a creeping rationing of apprenticeships for small firms. It would be better to make active choices about apprenticeship funding, so that employers can have clarity, providers can have certainty, and we can maximise the productivity and social justice impacts of apprenticeships.

This report sets out the choices for tackling the growing funding gap. There are broadly four potential options, which could be used in combination:

- **Restricting the use of levy funds** on some types of apprenticeships. We estimate that restricting apprenticeships to those aged under 25, as many countries do, would save up to £1.5 billion. Restricting levy funding to apprenticeships at level 3 and below would save around £740 million. Restricting levy funding to employees earning below £33,000 could save £330-500 million;
- **Requiring levy payers to top up** the cost of training for some types of apprenticeships or apprentices. This could involve employers having to 'top up' levy funding to reduce the pressure on the levy budget;
- **Increasing the levy or expanding its scope** so that employers make larger contributions and/or smaller employers are required to pay the levy too; and
- **Providing additional public funding** to top up the apprenticeship levy.

There is no perfect answer and many employers will argue they should have freedom to choice how to spend their levy funding. But it is better to be open about the trade-offs involved, and to make active choices about funding, informed by clear priorities.

To focus on productivity and social justice, we argue for a balanced approach:

- **investing an additional £150 million public funding per year for apprenticeships for SMEs, moving toward a guaranteed non-levy apprenticeship budget of at least £1 billion**
- **funding apprenticeships for 16-18 year olds from the education budget, in line with other education routes for this group, requiring an additional £400 million per year for the current level of around 100,000 apprenticeships**
- **requiring employers to provide top-up funding of 50% of apprenticeship costs at levels 4-5 for those aged 25 and over, and 75% for levels 6-7 for this age group. This would reduce levy spending by around £318 million per year**
- **looking at other measures, such as removing the 95% contribution to the cost of apprenticeships for levy payers who have spent their levy funds and ending the 10% top up that levy payers receive to their levy contributions.**

This would both prioritise limited apprenticeship funding on young people and ensuring funding for apprenticeships at SMEs. Employers would only contribute more for training employees in whom they are most likely to invest in any case – their existing, older, better paid or qualified workers. Consideration should also be given to how existing higher education funding routes could also support learning at these levels for older age groups.

We also need to consider the ultimate purpose of the levy and apprenticeship system. There is a strong case for a more flexible approach, a 'skills levy' that allows employers to invest in other forms of high-quality training. But this would need extra funding, either from widening the levy to more employers or raising contribution rates, or from government. These are issues Learning and Work Institute will be returning to. In the meantime, we must tackle the immediate funding challenge in a way consistent with a long-term vision.

Where are we now?

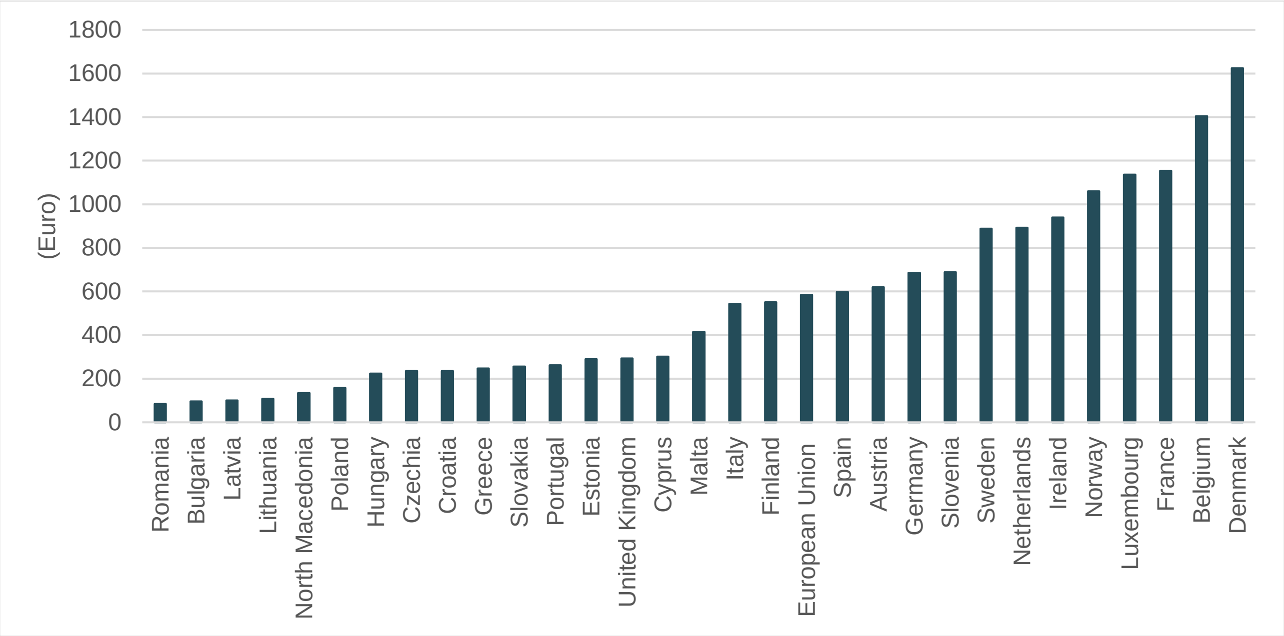
The apprenticeship levy and wider apprenticeship reforms

At their best, apprenticeships can provide fantastic opportunities for people to earn while they learn. Blending on the job learning with off the job training, apprenticeships can help people develop the skills, knowledge and experience they need to master a role, and to progress in their career. In England, apprenticeships can be used both for young people looking to take their first steps in the labour market, and to help people already in the workforce to retrain or upskill.

For employers, apprenticeships can be an important way of meeting their skills needs and developing a workforce that is fit for the future. Apprenticeships can benefit the economy too, by addressing skills gaps and helping to boost productivity.

However, employer investment in training in the UK has long been lower than in many countries. The latest EU-wide survey of employer investment in training in 2015 showed that the proportion of employers providing initial vocational training, including apprenticeships, is in line with the EU average, but that both employer investment and employee participation in continuing vocational training (CVT) were well below the EU average.

Figure 1: Employer investment in continuing vocational training per employee in the EU (Euro), 2015



Source: https://ec.europa.eu/eurostat/data/database

In recent years there has been an increased focus on apprenticeships, with the government making apprenticeships the key route for workforce development. This included reforms to the apprenticeship system to boost investment and improve quality.

In the 2015 budget, the government announced its plans to introduce an apprenticeship levy. The then-Chancellor said that too many large employers were failing to invest in skills and free riding on the system.[1] The levy, he argued, was a radical but necessary step to help Britain raise its game, to ensure businesses train up the next generation, and to meet his government's target of delivering 3 million apprenticeships by 2020.

The apprenticeship levy came into force in April 2017. Under the levy, employers with an annualised pay bill of over £3 million have 0.5% of their payroll costs above that threshold deducted on a monthly basis. They can use these funds – along with a 10% top-up from government – to cover the training and assessment costs of apprentices on apprenticeship standards. Employers are now also able to transfer up to 25% of their apprenticeship funds to other employers, either in their supply chain or elsewhere. If funds remain unused two years after they have been deposited into their account, they expire and are no longer available to the levy-paying employer.

The levy was also intended to fund the wider apprenticeship system, replacing most of the previous public spending budget. Funds that remained unspent by levy-paying employers would be used to 'co-invest' with non-levy paying employers who recruited apprentices. Under this system, small and medium sized employers who do not pay the levy would only have to cover 10% of the costs of training and assessment for apprentices they employed, a figure later reduced to 5%. Similarly, levy-paying employers who exceeded the funds in their levy account would only have to pay 10% of any training and assessment costs over and above the funds they had available, reduced to 5% this year.

Wider reforms were also made to the apprenticeship system. These included:

- the introduction of **apprenticeship standards** which are gradually replacing apprenticeship frameworks. Designed by employer groups, apprenticeship standards are intended to be more robust in establishing the skills and competencies that an apprentice must achieve to complete their apprenticeship;
- the introduction of '**end point assessment**' whereby apprentices undergo an assessment on completion of their apprenticeship by an independent organisation to ensure they have achieved the required level of occupational competence;
- the requirement that apprentices spend at least **20% of their time on off the job training**; and
- that apprenticeships last a **minimum of 12 months**.

[1] Chancellor George Osborne's Summer Budget 2015 speech, HM Treasury, 2015

The principles of the apprenticeship levy and the wider apprenticeship reforms were sound. Action was needed to stimulate more employers to invest in the skills of their workforce, given that employer spending on training has fallen and is low compared to other advanced economies. Other reforms, including the minimum duration and minimum amount of time spent on off the job training, are in line with other countries' rules, though there are always ways to improve the way rules are designed and implemented.

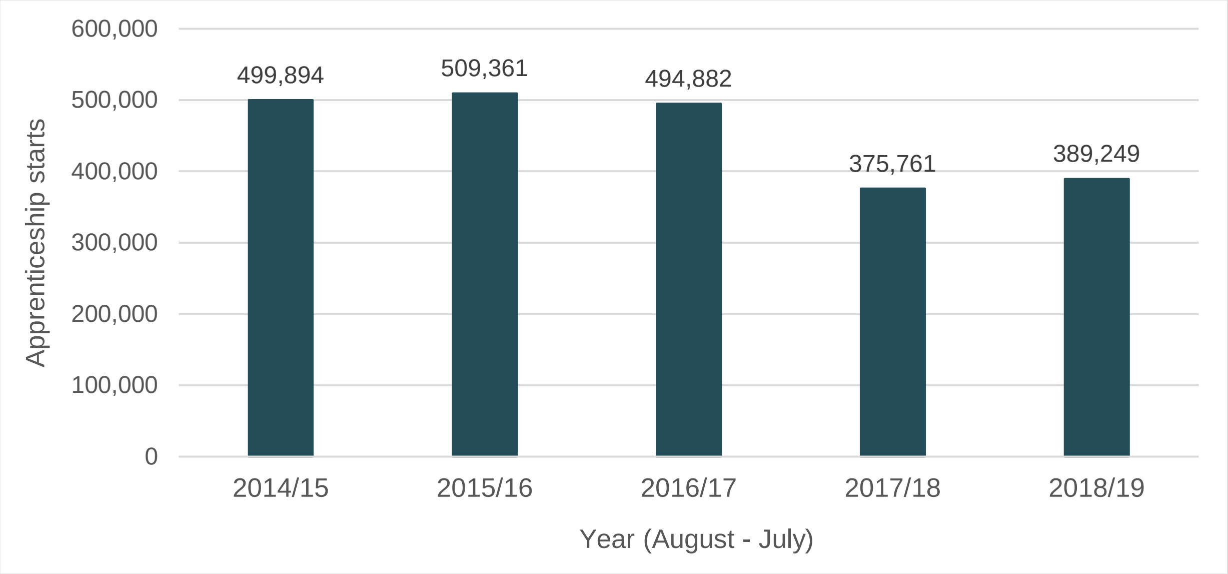
However, employers have expressed concerns employers about how the apprenticeship levy works, and there remain issues around quantity, quality and access. Over the last year, there has also been growing concern that the funds raised by the apprenticeship levy will be insufficient to meet demand, and that the fund will be overspent. The government has said it would review the levy, but it must also look at what could be done now to address this major concern for employers.

The impact of the apprenticeship levy and wider reforms

The number of apprenticeship starts has declined significantly following the introduction of the apprenticeship levy and the wider apprenticeship reforms.

The number of apprenticeship starts declined from a peak of over half a million in 2015/16 to 376,000 in 2017/18. The number of starts increased slightly in 2018/19, but the figure remains a fifth below the level seen before the introduction of the apprenticeship reforms.

Figure 2: Number of apprenticeships started in England per year



The fall in apprenticeship starts means that the government will miss their target of 3 million starts between 2015 and 2020. With four of the five years gone, there have been just 1.8 million starts.

In addition to the decline in apprenticeship starts, there have been three key changes to the composition of apprenticeship starts in recent years:

- **Age.** Apprenticeships are increasingly a route for upskilling adults, with less focus on giving young people a route into the labour market. In 2002/3, 58 per cent of apprenticeship starts were among young people aged under 19 and none were aged 25 or over. By 2018/19, just 25 per cent were aged under 19, and 30 per cent were aged 25 and over.[2] Apprentices at levy payers are more likely to be older workers: 56 per cent of apprentices at levy payers are aged 25 and over, compared to 37 per cent of apprentices at non-levy payers. This is likely in part due to large, levy-paying employers seeking to recoup their apprenticeship levy funds through investing in the skills of existing older workers, rather than using them mainly for new recruits and young people just starting out in the labour market. We need to increase training for people of all ages, but the current approach risks high levels of deadweight – rebadging of existing training, rather than increasing training;
- **Level.** There has been an increase in the proportion of apprenticeship starts at higher level. In 2014/15, just 4 per cent of apprenticeship starts were at level 4+. In 2018/19, one in five apprenticeships (19 per cent) were at this level. Levy-supported apprenticeship starts are particularly likely to be delivered at a higher level. One in four (25 per cent) levy-supported apprenticeships were at level 4-7, compared to just over one in ten (11 per cent) of non-levy supported apprenticeships. While this is in part due to the increasing availability of higher and degree level apprenticeship standards, it is also the result of levy paying employers choosing to use a rising proportion of their funds to support the upskilling of existing workers; and
- **Standards and frameworks.** The rollout of standards has inevitably led to an increase in the proportion of apprenticeships on standards rather than frameworks. Two in three (63 per cent) apprenticeship starts in 2018/19 were on standards, compared to just one in 20 (5 per cent) in 2016/17. Use of standards is higher at levy-paying employers. Three in four (74 per cent) levy-supported apprenticeships were on standards in 2018/19 compared to just one in two (49 per cent) non levy supported apprenticeships.

Missing the target and blowing the budget

While the number of apprenticeship starts has declined since the introduction of the apprenticeship levy and other reforms, there is growing pressure on the levy budget. First

[2] The result of removing the cap that prevented over 25 year olds taking apprenticeships, the ending of other training routes for this age group like Train to Gain, and changes in funding incentives.

reported in FE Week in 2018, and later highlighted in the National Audit Office's report on the apprenticeship system, the levy risks soon being overspent.[3]

Both missing the target for apprenticeship starts and blowing the budget at the same time may seem paradoxical, but is explained by the changing composition of apprenticeships:

- The shift towards higher level apprenticeships is increasing average costs, as they are more expensive than intermediate and advanced level apprenticeships; and
- The shift towards apprenticeship standards is increasing costs, as they are more expensive than apprenticeship frameworks, given they tend to last longer and require more training, plus the requirements of end point assessment.

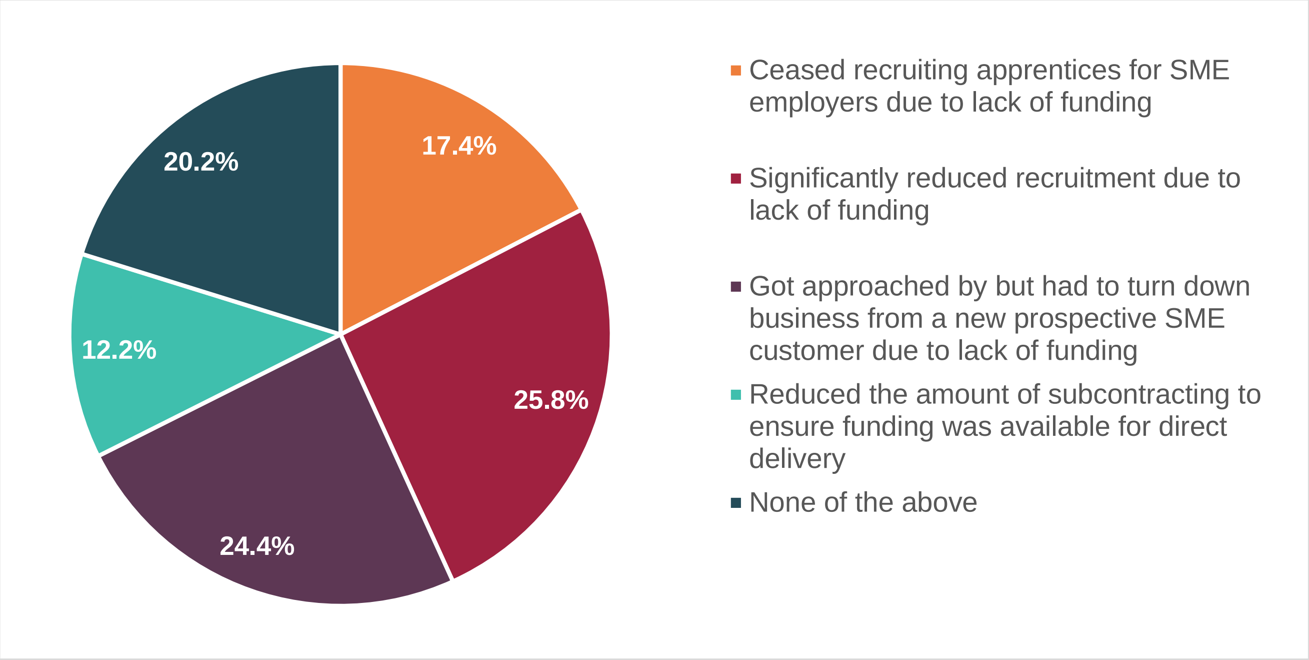
As the government has not published data on the apprenticeship levy budget, it is difficult to determine the extent to which it will be overspent. However, based on available data, we make the following calculations:

- **The apprenticeship levy budget.** The Office for Budget Responsibility projects the apprenticeship levy will raise £2.9bn in 2019/20.[4]
- **Non-levy apprenticeship demand.** We estimate that the total non-levy apprenticeship budget is currently between £900m and £1.2bn.[5]
- **Levy-paying employer use of levy funds.** Based on these estimates of the total amount the levy will raise, levy payers would need to spend around 60-70 per cent of their levy funds in order to ensure a £900-1,200 million budget for non-levy payers. However, of around £598 million raised by the levy in its first four months (to August 2017), only £133 million (22 per cent) had expired two years later meaning levy payers had used 78 per cent of their funding.[6]
- **Implications.** All else equal, we estimate that this would mean there would be only £500-700 million available for non-levy paying SMEs. This is a shortfall of 25-50 per cent, or up to £700 million. It could mean a reduction of up to 75,000 apprenticeships per year at non-levy paying SMEs. Given the continuing increase in higher apprenticeship numbers, this is in line with reported estimates of a potential overspend of up to or more than £1 billion in the coming years.

[3] FE Week https://feweek.co.uk/2018/12/03/levy-budget-bust-government-agency-warnsof-imminent-apprenticeship-over-spend/; NAO https://www.nao.org.uk/report/the-apprenticeships-programme/
[4] Economic and fiscal outlook, Office for Budget Responsibility, 2019.
[5] The 2018 Autumn Statement estimated the cost of reducing SME contributions from 10% to 5% would be £60m a year in 2018/19, which suggests the total budget was £1.2bn. Parliamentary Question 268543 confirmed the non-levy budget was about £1.1bn, likely to have fallen since due to the funding squeeze.
[6] Information taken from Parliamentary Question 290935, HM tax receipts data and Freedom of Information responses showing employers in England paid £598 million into the levy in this time.

The impact of the growing pressure on the apprenticeship levy budget is already visible. A recent survey by the Association of Education and Learning Providers found that three in four (74%) of providers delivering government contracts for apprenticeships at non-levy paying employers said that funding levels were insufficient to meet projected employer demand for apprenticeships. This led to one in three (32%) providers saying they would focus more on delivering apprenticeships to levy-paying employers.[7]

Figure 3: Provider responses to the squeeze on the non-levy apprenticeship budget



Source: AELP member survey

There are also anecdotal reports of providers having to scale back their engagement of SMEs, or even turn employers wanting to take on an apprentice away, due to lack of funding. The current funding crunch is leading in practice to a creeping and unplanned rationing of apprenticeships for SMEs.

All of this also raises questions about the purpose of the levy and the incentives it created to rebadge existing training as an apprenticeship even where this is not optimal. Ultimately the choices we make on both the short-term funding challenge and longer-term policy focus need to be clear about what they seek to achieve. The UK needs to increase its investment in adult skills, that should include, but not be limited to, apprenticeships.

[7] Levy shortage starving small firms of apprenticeships poses early test for Johnson campaign pledge, AELP, 2019.

Options for change

There is an important debate about the purpose of the apprenticeship and workforce skills system, and the structure and design of the apprenticeship levy. However, the impending funding crunch means there are also urgent decisions which must not be avoided.

The growing pressure on the apprenticeship levy budget is leading to rationing in practice of apprenticeship funding for SMEs. This group of employers are more likely to take on young apprentices and train people with lower qualification levels. However, currently this rationing is happening more by default than choice – we need to help employers of all sizes to improve their skills.

We should make explicit choices about how to respond to limited funding, rather than a creeping system of 'hidden rationing' through growing restrictions on non-levy providers and funding. In this way, short-term decisions can be consistent with a long-term vision.

This must start with a clear view about the purpose of apprenticeships: unless you know what you are trying to achieve, how can you know what to do?

We argue that apprenticeships and the levy system should prioritise:

- **raising productivity by increasing investment in workplace training and ensuring this is of value to workers and employers; and**
- **improving social justice by reducing inequalities in access to learning at work and increasing opportunities to progress to higher levels of learning.**

Compared to many countries, England has a large proportion of apprenticeships, and an even larger proportion of apprenticeship funding, for people over the age of 25 learning in their current jobs, rather than for young people starting their careers or adults changing career. This is, in part, due to the absence of an alternative workforce development route (though of course employers could invest in their employees outside of apprenticeships).

Options for prioritisation

Learning and training has value for people of all ages and qualification levels. We need more and different investment from people, employers and government. However, in the short-term we need to make decisions about priorities in the current apprenticeship system.

Many employers will view their levy payments as 'their' money to spend on any apprenticeships they wish, and so argue against any restrictions. However, there are already restrictions (funds can only be spent on apprenticeships) and ultimately we have no choice but to choose one or more of the four options we have identified.

Box 1: Estimating the impact of different apprenticeship options

Estimating the potential impact of changes to apprenticeship funding rules requires the following data and assumptions:

- **Number of apprenticeships by age and level.** This is taken from Department for Education apprenticeship data
- **Average length of apprenticeships.** This is taken from Department for Education data, which shows the length of apprenticeship by age and by level. This allows an assumption about the cost of apprenticeships in any given year and the number of apprenticeships that will cover more than one financial year.
- **Cost per apprenticeship per level.** The Education and Skills Funding Agency publishes the maximum price per standard. An estimated average cost per level is then calculated, with greater weight given to the most popular standards.
- **Behavioural impact.** Any changes to funding rules are likely to lead to changes in employer behaviour. Assumptions made about this are spelled out under each option.

Option 1: Restricting use of apprenticeship levy funds

There are three main forms of funding restrictions that could be introduced:[8]

1. **By age.** One option is to restrict apprenticeships to people aged below 25, as many other countries do. Employers would still be able to provide other forms of work-related training for people aged 25 and over, and the National Retraining Scheme (NRS) would focus on this age group once fully rolled out and adequately funded. This would reflect the different approach that most adults looking to change careers or update their skills will need compared to young people early in their career.

   There were 155,000 apprenticeships for those aged 25 and over in 2017/18 and provisional figures estimate 178,000 for 2018/19.[9] This **suggests a current annual cost of £1.5 billion**.

   However, restricting in this way would not reflect the greater need for retraining and changing careers that longer working lives and a rapidly changing economy will bring. Apprenticeships can help to do this and in practice the NRS is not yet fully developed.

2. **By level of learning.** Another option would be to restrict apprenticeships to those learning at level 3 or below, as many other countries do. Learning above this level could be funded by employers (outside of the Apprenticeship Levy) or individuals (through existing higher education funding routes).

[8] These estimates are based on assumptions set out in Box 1 and would apply to all employers, large and small. They will change as the pattern of apprenticeships changes. For example, further growth in higher apprenticeships means restrictions on these could reduce spending by more than estimated.

[9] Apprenticeship and traineeships current data, Department for Education, 2019.

Provisional figures show there were 74,300 higher apprenticeships in 2018/19, of which around 23,000 were at level 6 or 7. This is up from 48,150 for the whole of 2017/18. This **suggests a current annual cost of £760 million for higher apprenticeships, of which £300 million is for those at level 6 and 7, both growing over time.**

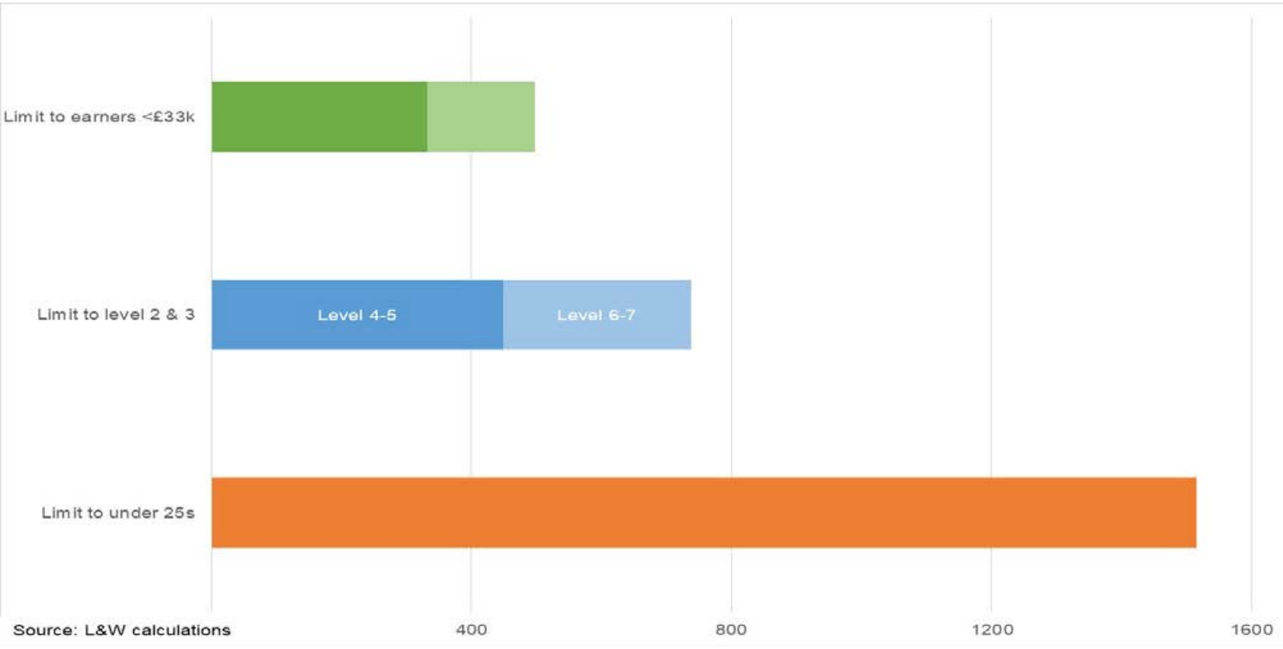
However, higher apprenticeships have the potential to provide a valuable route to higher level qualifications and high-skilled jobs for people, in addition to traditional higher education and university routes, and it provides opportunities for progression for those already in work. Degree apprenticeships may also help increase prestige of apprenticeships among employers.

3. **By salary.** The rationale would be to target apprenticeship funds on those with lower incomes on the basis that they are less likely to get training from employers and that those on higher incomes are more able to fund learning separately if they wish to.

   Data on the salary level of apprentices is not available. The Apprentice Pay Survey relies on self-reporting and dates from before the recent changes to the apprenticeship system. However, if the 33% of taxpayers earning over £33,000 per year are between one third and one half as likely to do an apprenticeship as those on lower pay, this **suggests a current annual cost of £330-500 million.**[10]

   However, this is likely to add to bureaucracy and the checks required of providers and the Education and Skills Funding Agency and may not be well targeted. For example, poor leadership and management skills hold back productivity.[11] Many managers are not well qualified, but are more likely to be higher paid.

Figure 4: Estimated annual levy saving of apprenticeship restrictions, £millions



[10] Survey of personal incomes 2016/17, HMRC, 2019.

[11] Time for action: skills for economic growth and social justice, L&W, 2019.

These options are not mutually exclusive. For example, individuals and employers could be required to fund higher apprenticeships for those aged 25 and over, removing public and levy funding.

Option 2: Requiring additional employer co-investment

Another approach would be to require additional employer contributions to the cost of some apprenticeships from outside of their levy funds. As with option one, these contributions could be required on apprenticeships at a particular level, for apprentices of a certain age, or for high-earning apprentices.

For example, rather than preventing employers from using public funds on apprentices aged 25 and over, or at level 4 and above, the government could restrict public funding to one half of the cost for training and assessment for these apprentices – with the remaining one half of the cost having to be additionally contributed by employers. This could apply both to large employers who can currently use their levy funds, and small employers who can currently get a 95% public funding contribution to apprenticeships.

This would both reduce the funds spent on these groups, and potentially reduce demand for these apprentices relative to other groups. The savings this would make would be proportionate to the savings identified in option one, depending on the impact on employer behaviour. For example, a 50% employer contribution would save the levy budget at least half of the saving identified in option one, possibly more if employers reduce their demand for the affected apprenticeships as a result.

Option 3: Increasing or expanding the apprenticeship levy

Options one and two would restrict costs to avoid exceeding the budget. An alternative option would be to increase the apprenticeship levy budget by increasing the employer's contribution rates and/or expanding the number of employers who need to pay it.

For example, increasing the apprenticeship levy from 0.5% of payroll to 0.6% would, all else equal, generate an additional £600m of funding in 2020-21– or £3.6bn in total – which could help to ensure that the levy has sufficient funding to meet current demand.[12]

Alternatively, the annualised payroll threshold at which employers start to pay the levy could be reduced from £3 million. This would both increase total contributions to the apprenticeship levy – so increasing the total budget – and also reduce the number of employers reliant on the non-levy budget – so reducing the pressure on that budget. The risk is that this does not alter the incentives in the system or give more flexibility.

[12] L&W calculation based on *Economic and Fiscal Outlook, OBR, 2019*. The levy, set at 0.5 per cent of payroll above £3m, is set to raise £3.0 billion in 2020/21. It is assumed that an increase from 0.5 per cent to 0.6 per cent would increase the income from the levy by 20 per cent.

Option 4: Additional public funding

Options one and two would involve restricting employers' use of their apprenticeship levy funds, and option three would require additional contributions from employers into the levy.

An alternative option would be for government to provide additional public funding to prevent the budget being exceeded. This would mean that levy-paying employers would retain the current level of flexibility over the use of apprenticeship levy funds, and that non-levy paying SMEs would still be able to recruit the apprentices that they need.

However, it would come at a cost to government, requiring up to £1 billion more per year to cover the shortfall the National Audit Office has warned we may face. It would also move the policy away from the current system which is largely self-financing. With multiple demands on the education budget – not least the need to increase investment in adult education following a decade of significant cuts – the government would also have to consider whether this would represent the best use of public funds.

Each approach has downsides. However, doing nothing means implicitly choosing to restrict apprenticeships in SMEs. It is better to make an active choice.

A way forward

We argue for a balanced package of up to £550 million new government funding and £318 million saved by requiring greater employer contributions for some higher apprenticeships for older workers in England.

Figure 5: Proposed apprenticeship changes

Source: L&W calculations

This would consist of:

1. **Full funding apprenticeships for 16-18 year olds: Around £400m extra per year to support 100,000 apprenticeships.**

   Other education options, such as sixth form or college, for 16-18 year olds are funded from the main education budget. Funding apprenticeships for this age group from the education budget too would ensure consistency and reduce pressures on the levy budget, as levy-paying employers could take on apprentices in this age group without using their levy funds. It could also increase the number of apprenticeships for this age group, which have fallen by around 15% for since 2017. It would better reflect the increased employer investment of time that apprenticeships for this age group are likely to require compared, for example, to an existing employee aged 25 or over – currently both are funded at the same rate, which was not the case before the 2017 reforms, albeit with an additional £1,000 incentive for taking on apprentices aged 16-18 (or 19-24 with an Education, Health and Care Plan).

2. **Increased employer contributions for higher apprenticeships for those aged 25+: saving more than £318 million per year.**

   Employers would not be able to use public funding (either their levy funds if they are a levy payer, or the current 95% public contribution to apprenticeships for SMEs) to cover the entire costs of higher level apprenticeships for adults aged 25 and over. Instead, they would have to contribute 50% of the cost of level 4-5 apprenticeships for those aged 25+, and 75% of the cost for level 6-7 apprenticeships for this age group from outside of their levy funds. Higher apprenticeships for young people below this age would continue to be funded as now.

   Given the pressure on the apprenticeship levy budget, restricting the amount that can be spent on higher and degree apprenticeships for older age groups is the most sensible place to start. Employers are more likely to invest in those with higher skills or pay anyway – those with degrees are around more than three times as likely to get training at work as those with no qualifications – so employers are likely to invest in this group in any case.[13] Individuals would also be able to invest via current higher education funding routes. Public and levy funds would be focused on younger people learning at all levels and older people at intermediate and lower learning levels.

3. **Supporting SMEs: £150m extra per year, plus savings from changed contribution rates (see above) to restore SME apprenticeship annual budget to £800-1,000 million and preventing the loss of around 50-80,000 apprenticeships.**

   Additional investment of £150 million per year, combined with the savings from changing employer contribution rates detailed above, would help maintain the money available for apprenticeships in SMEs at roughly pre-reform levels. SMEs are least likely to be able to find additional funding themselves, and more likely to take on new recruits or young people as apprentices. So it makes sense to protect this budget. Not doing so would put at risk 50-80,000 apprenticeships each year if the SME budget were squeezed to deal with what would otherwise be an overspend in the overall apprenticeship budget as Levy payers spend more than expected.

Our proposals involve additional Government investment of around £550 million per year, for 16-18 year olds and SMEs. Employers would still be able to invest their levy funds in any apprenticeships for any age group, but would need to contribute additional funding for a small group of older workers studying at higher levels. Without this additional investment,

[13] Characteristics and benefits of training at work: 2017, ONS, 2019.

and in the absence of additional restrictions on how levy-payers can invest their funds, funding for SMEs to employ apprentices would be squeezed.

This would require more radical decisions, such as reducing or removing the 95% public funding contribution for apprenticeships at levy payers who have spent all of their levy funds (unknown saving), removing the 10% top up to levy funds that levy payers receive when taking on an apprentice (unknown, but likely relatively small, saving), ending all public funding for higher apprenticeships for those aged 25 and over rather than the phased reduction proposed above (saving an additional £170m per year), and/or restricting apprenticeships for SMEs (perhaps by around £250m per year).

It may also be possible to increase the efficiency of the system, in ways that may not have a large impact on spending but that may still have value. For example, the Government's original intention was that employers would negotiate prices for each apprenticeship below the maximum of the funding band given. In practice this has not happened as employers have no incentive to do this where they are focused on getting what they view as 'their' apprenticeship levy funding back and many employers will hopefully be most focused on quality rather than saving money on the price. Alternative arrangements could include:

- **Cutting funding rates.** The Institute for Apprenticeships and Technical Education reviews funding rates for existing standards and decides the rate for new standards. Funding rates for some standards could be cut if either the current rates are more generous than needed for delivery or to alter the incentives employers face. However, ultimately funding must be sufficient to deliver high quality training, decisions made transparently, and while some standards may require lower rates others might need greater funding.
- **More rigorously enforcing prior learning rules.** Providers are required to adjust apprenticeships to account for any prior learning apprentices have. However, the extent to which this is happening in practice is unclear and the ESFA does not undertake checks or compliance activity. In addition to the lack of enforcement, there is limited incentives in the system for employers to ensure that providers adjust the cost of apprenticeships downwards to account for prior learning, given levy payers will pay for training costs out of their levy funds, and non-levy payers cover only 5% of the cost. These rules could be enforced more robustly which could reduce the cost per apprenticeship on average, although there would be challenges of working out how to do this in practice.

The changes proposed in this report would seek to protect and promote apprenticeships at all levels for young people and within SMEs. They would mitigate the risk of losing 30-75,000 apprenticeships in SMEs per year, supporting higher apprenticeships for young people but requiring greater contributions to learning at this level for older age groups from employers and individuals. Additional public investment would be targeted on SMEs, to ensure they are still able to recruit apprentices, and on young people.

Toward the longer-term

Our analysis has show a pressing need for action, given the apprenticeship levy is likely to be overspent and the creeping rationing of apprenticeships for SMEs.

Alongside addressing this immediate challenge, the government should also consider the medium-term future of the levy and wider apprenticeship and training policy. Just over two years on from a major reform, with the apprenticeship levy and wider changes still bedding in and built on sensible principles, now is not the time for another revolution in policy. However, there is a strong case for an evolution of the current policy to ensure it better meets the needs of employers and workers, and delivers on the dual aims of driving productivity and social justice.

One option would be to broaden the apprenticeship levy into a ‘skills levy’. This would allow employers greater flexibility over how they can use their funds, including on high quality training other than apprenticeships. Such a move would have a number of advantages. It could boost other forms of work-related training, including shorter and more flexible courses, and it could ensure the levy works better for employers. It could also reduce the incentive to ‘re-badge’ existing training as apprenticeships in order to make it eligible for the use of levy funds. There is growing support for such a move, with organisations such as CBI, CIPD and REC backing a more flexible skills levy.

However, while employers will unsurprisingly back greater flexibility, we would have to be clear-eyed about the potential risks and tradeoffs involved. Given the levy fund is already under significant and growing pressure, allowing greater flexibility could increase the likelihood that the levy would overspend. So it would have to come alongside clear rules that prioritise some forms of learning over others, higher employer contributions, and/or a broader levy which includes some small and medium sized employers too. It would also have to balance the respective roles of national and local government, and employer leadership versus policy priorities. Any changes to the scope of the levy would have impacts across the UK, however how the money raised is spent is devolved.

As well as addressing the immediate pressure on the apprenticeship funding system, the government should engage with employers and other stakeholders in a fundamental review of the purpose and operation of the levy. This should examine the impact of the levy and the wider reforms, and set out how we can ensure that the levy and wider training policy is fit for the future, and focused both on boosting productivity and social justice. Learning and Work Institute will be developing its ideas for doing this to help shape the debate.