

# **Skills in the UK: The long-term challenge**

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## **Interim Report**





LEITCH  
Review of Skills

# **Skills in the UK: The long-term challenge**

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## **Interim Report**

December 2005

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# EXECUTIVE SUMMARY

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## **Foreword from Lord Leitch**

At the end of last year, I was asked by the Government to consider what the UK's long-term ambition should be for developing skills in order to maximise economic prosperity and productivity and to improve social justice. This is my interim report with an analysis of the challenges that face us.

This is a formidable challenge. Skills matter fundamentally for the economic and social health of the UK. I have listened to key stakeholders at home and to eminent thinkers abroad. There is consensus that we need to be much more ambitious and a clear message that the UK must 'raise its game'. This is an urgent task.

Today the UK is in a strong position with a stable and growing economy. We have world-leading employment rates. However, we cannot be complacent and we cannot predict future economic conditions with certainty.

Demographic, technological and global changes present enormous challenges and brilliant opportunities. The population continues to age. Technological developments are occurring faster than we dreamed, dramatically altering the way that we work. Competitive pressures on all sectors of the economy are increasing. Manufactured goods, and increasingly services, are traded across the world. Developed nations are relying more and more on their capacity to innovate and drive economic growth. The ability to do this depends upon the skills and knowledge of their people.

Our nation's skills are not world class. We run the risk that this will undermine the UK's long-term prosperity. Productivity continues to trail many of our main international comparators. Much more needs to be done to reduce social disparities. Improving our skill levels can address all of these problems.

How is the UK placed to respond to this challenge? We have many important strengths – an excellent higher education system where more people than ever are studying for degrees; good reforms on vocational training; an increasingly effective school system; and a strong record of improvement over the past decade.

But we have considerable weaknesses. More than one third of adults do not hold the equivalent of a basic school-leaving qualification. Almost half of adults are not functionally numerate and one sixth are not functionally literate. This is worse than our principal comparator nations. Improving our schools will not solve these problems. Today over 70 per cent of our 2020 workforce has already completed their compulsory education. Our intermediate and technical skills lag countries such as Germany and France.

We have made enormous progress expanding Higher Education – and this is critical to becoming a high-skill economy. Over one quarter of adults hold a degree, but this is less than many other countries who also invest more. Our skills base compares poorly and, critically, other countries are improving. Being world class is a moving target.

Despite our weak performance, I am struck that too many of us in the UK do not perceive that higher skills are crucial to long-term prosperity. It is also clear from my analysis that, despite substantial investment and reform plans already in place, by 2020, we will have managed only to 'run to stand still'. On our current trajectory, the UK's comparative position will not have improved. In the meantime, the world will have continued to change and the competitive environment will be even harsher.

The scale of the challenge is daunting. Delivering on current plans will be difficult. Even then, it will not be enough to supply the skills that employers, employees and our nation needs in order to advance. The UK must become world class on skills – for all of our sakes.

We face critical choices on priorities if we are to achieve the high productivity and socially mobile society that we desire.

I will report back to Government in 2006 on the scale of ambition that we need and the policy implications of achieving these levels of change.

A handwritten signature in dark ink that reads "Sandy Leitch". The signature is written in a cursive, slightly informal style.

Lord Leitch

The Chancellor of the Exchequer and the Secretary of State for Education and Skills commissioned the Leitch Review to identify the UK's optimal skills mix in 2020 to maximise economic growth, productivity and social justice, and to consider the policy implications of achieving the level of change required. This interim report sets out the analysis of the Review.

### Overview of key findings

- The UK has a strong economy and world-leading employment levels, but its productivity trails many key comparator nations; poor skills are a key contributor to this problem as well as having wider impacts on social welfare.
- Over the last decade, the skills profile of working age people in UK has improved. For example, the proportion with a degree has increased from one fifth to over one quarter of the population.
- Despite these improvements, the UK still does not have a world-class skills base:
  - over one third of adults in the UK do not have a basic school-leaving qualification – double the proportion of Canada and Germany;
  - five million people have no qualifications at all; and
  - one in six do not have the literacy skills expected of an 11 year old and half do not have these levels of functional numeracy.
- Looking ahead to 2020, global, demographic and technological change will place an even greater premium on the UK's skills profile.
- New analysis conducted by the Review shows that, if the Government meets its current ambitious targets for improving the UK's skills, by 2020:
  - the proportion of working age people without any qualifications will fall to 4 per cent; and the proportion holding a degree will increase from 27 per cent to 38 per cent; and
  - this will have significant benefits for the economy – increasing annual productivity growth by 0.2 per cent with a net benefit to the economy of £3 billion a year, equivalent to 0.3 per cent of GDP.
- However, even if the UK can meet these targets, the nation's human capital will still fail to be world-class. Considerable problems will remain; at least 4 million adults will still not have the literacy skills expected of an 11 year old and 12 million would not have numeracy skills at this level.
- The Review has analysed more ambitious scenarios for 2020:
  - tackling the stock of low skilled adults without qualifications, basic literacy and numeracy;
  - investing more in intermediate skills; and
  - further increasing the proportion of adults holding a degree.
- In all of the scenarios, the analysis shows the significant economic and social benefits that would result from higher productivity and employment gained through improving skills.

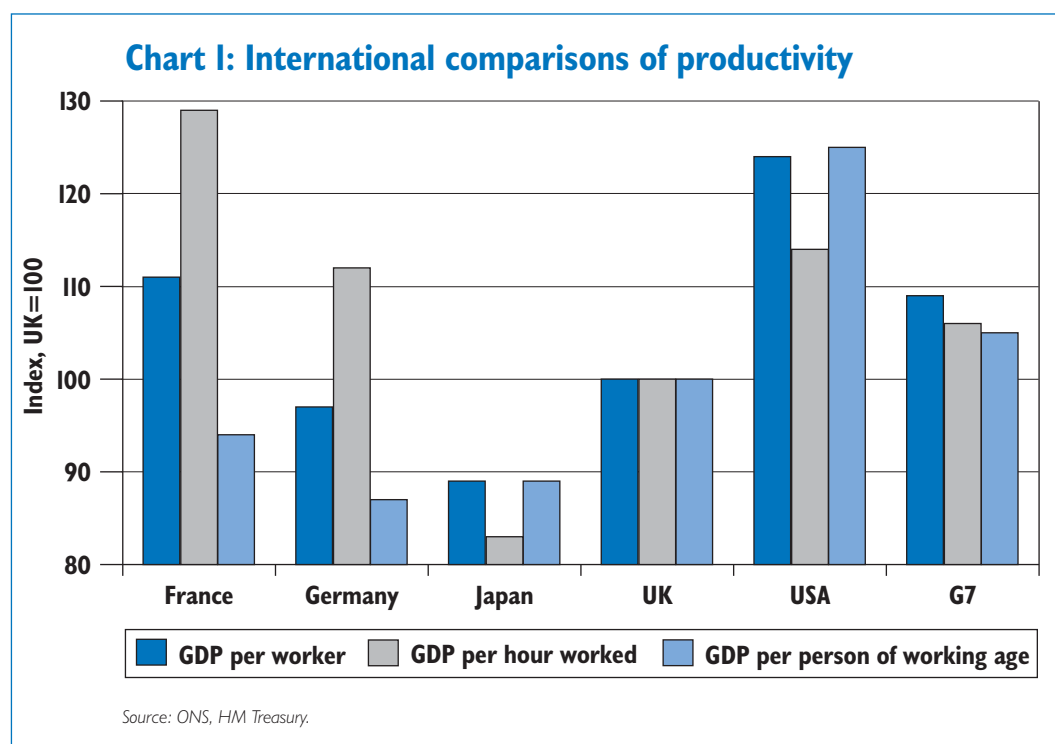
The Leitch Review believes that the UK must urgently raise its game and set itself a greater ambition to have a world-class skills base by 2020. The Review will report its conclusions and recommendations to the Government in 2006.

## THE INCREASING IMPORTANCE OF SKILLS TO THE ECONOMY AND SOCIETY

### UK has a strong economy but relatively poor productivity

**2** The UK starts from a strong economic position. It is the fourth largest economy in the world and has the highest employment rate in the G7 group of industrialised nations. Despite this strong performance, the UK today faces important economic challenges. In particular, despite some recent improvements, the UK continues to have relatively poor productivity performance which still trails some of the UK's main comparator nations. Output per hour worked is almost 30 per cent higher in France and more than 10 per cent higher in Germany and the USA than it is in the UK.

**3** Evidence shows that a significant contributory factor to the UK's relatively poor productivity performance is its low overall level of skills. For example, one fifth of the gap with France and Germany is a result of the UK's comparatively poor skills. Low levels of skills in the UK constrain growth and innovation in firms. Those with low levels of skills are far less likely to be in employment and, when they are, earn less than their more skilled contemporaries.



### Global, demographic and technological change put a greater emphasis on skills

**4** Improving the nation's skills base is already a key economic challenge for the UK. Looking forward to 2020, developments in the global economy will make this challenge even more pressing. Faster information flows and technological change accelerate the transfer of both low and high value economic activity to other regions such as Asia and Eastern Europe.

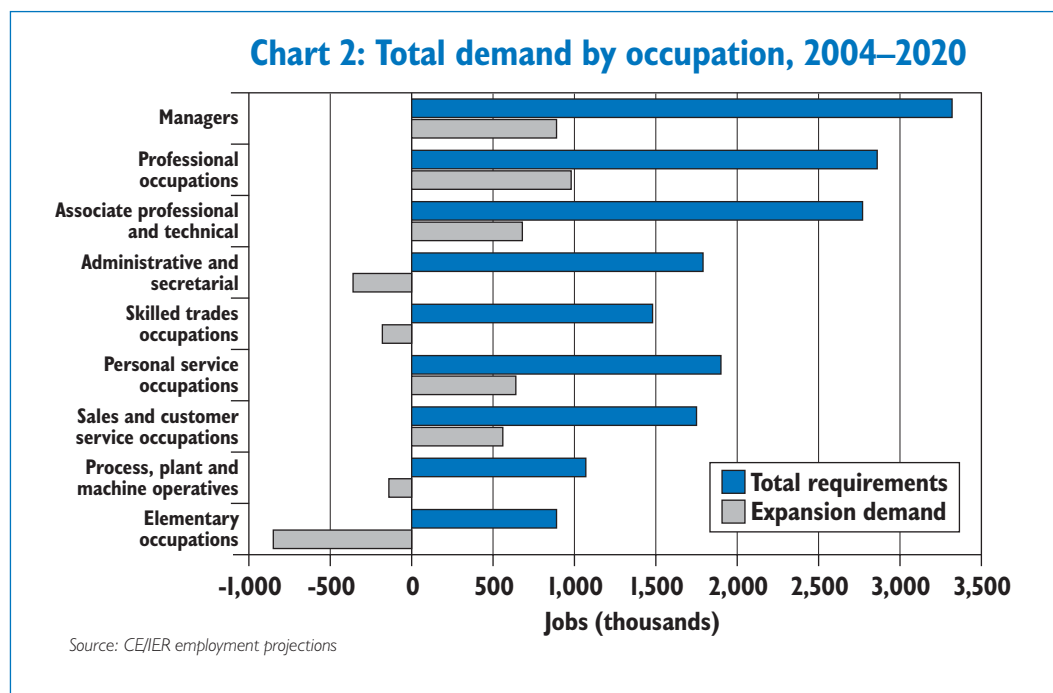
**5** This shift creates challenges that the UK must address and opportunities that it cannot afford to miss. For example, by 2015, China is likely to have become the third largest economy in the world – after the USA and Japan – contributing 19 per cent of global output. The shifting balance of economic activity provides significant opportunities and also serious risks for UK businesses; creating new markets and cheaper inputs for production, but also a more competitive environment.

**6** These global changes will mean that the UK is likely to have a decreasing share of output in the industries where other countries achieve comparative advantage. In order to maintain and improve its growth, the UK must manage the resulting domestic structural change effectively, allowing workers to shift to more productive and profitable sectors. These changes put an increasing premium on the UK's skills profile.

**The nature of jobs will continue to change**

**7** The nature of employment will continue to change. Most occupations already require greater levels of skills than in the past. Skills that were once seen as specialist and technical, such as in ICT, have increasingly become core requirements for most jobs. Analysis conducted for the Review suggests that there will be increased demand for more highly skilled occupations, such as managers and professional occupations, whilst lower and some intermediate-skilled occupations will account for a falling share of employment.

**8** Demographic factors are also important. In some intermediate jobs, such as skilled trades, demand will be significant over the next 15 years (as older workers retire), even if those jobs account for a decreasing share of employment. New analysis suggests that, by 2014, two-thirds of jobs will be filled by those with at least intermediate level skills. By 2020, more than 40 per cent of jobs could be filled by graduates, up from 30 percent in 2004.



**The UK needs a world-class skills base**

**9** To seize the opportunities and to counter the risks from developing global markets, the UK must develop a world-class skills base. We must have higher-level skills to drive innovation and growth as well as basic and generic skills to take advantage of technological change and the changing needs of employers as they respond to their competitive environment. The UK's workers must be able to develop their skills to support the necessary changes in the structure of employment. Employers need the managerial capability to harness the skills of their workforce. Failure to adapt means that growth will suffer and certain groups in society risk being left behind. Key comparator countries foresee similar needs and are investing in their skills base.

## SKILLS IN THE UK TODAY

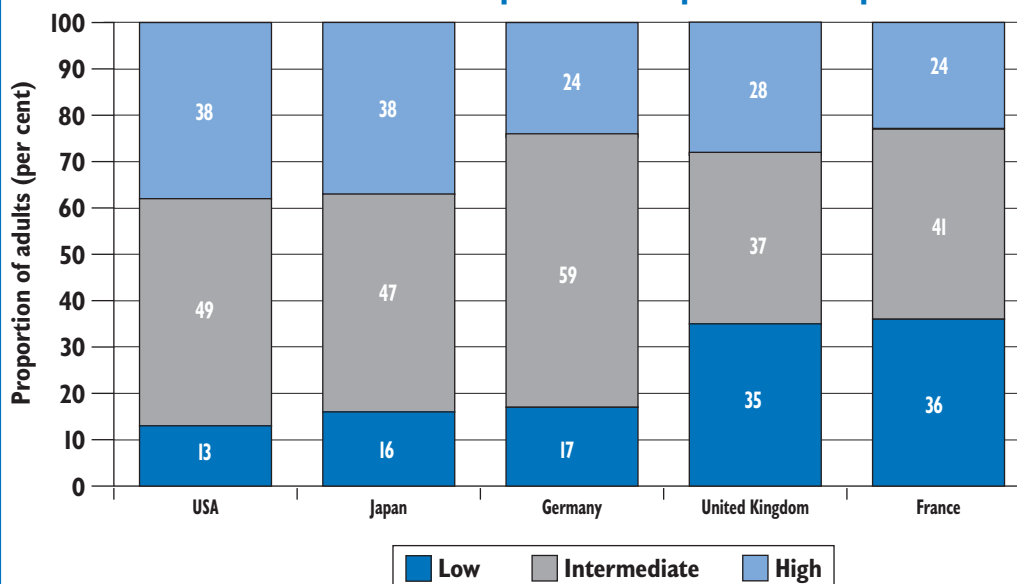
### The UK has a comparatively poor skills profile

Today, the UK's human capital is poor in relation to key comparator nations:

- the proportion of adults in the UK without a basic school-leaving qualification is double that of Canada and Germany;
- over 5 million people of working age in the UK have no qualification at all; and
- one in six adults do not have the literacy skills expected of an 11 year old. Almost half do not have these levels of functional numeracy; only half of adults who lack these functional skills are in work.

Although the position in higher-level skills is better, with over one quarter of adults in the UK holding a degree-level qualification, other countries such as USA, Japan and Canada are still in a superior position.

**Chart 3: International comparisons of qualification profiles**



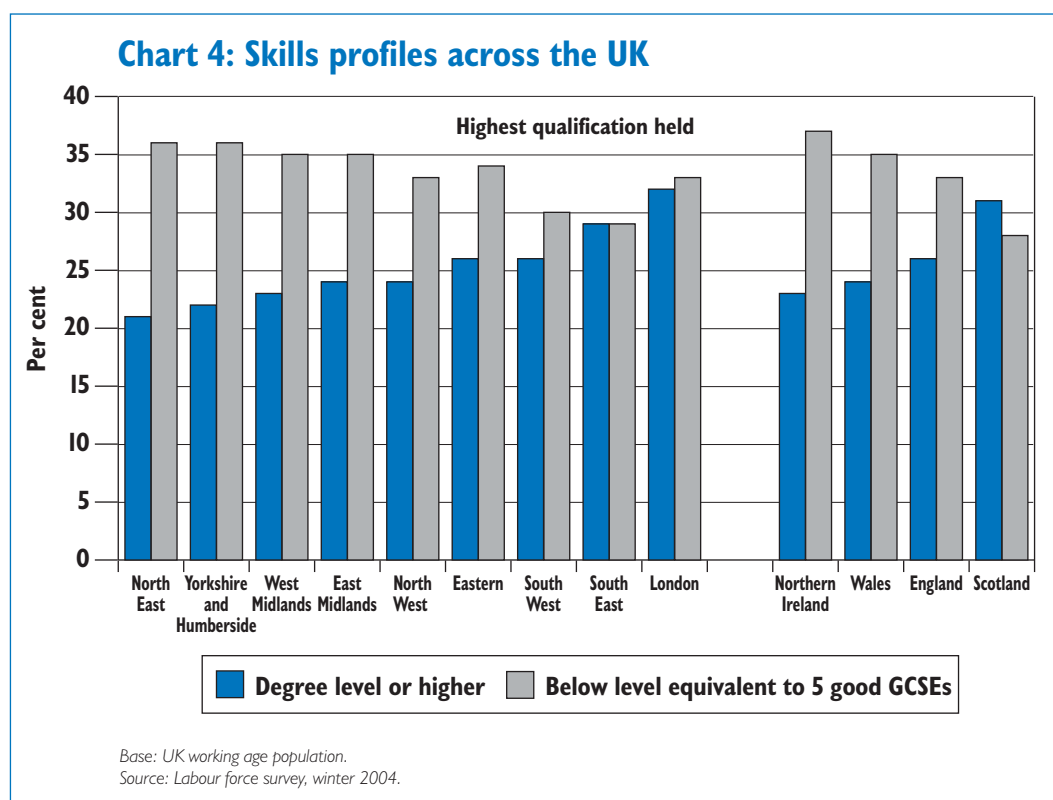
Base: Adult population aged 25-64.  
Source: OECD Education at a glance, 2005.

Skill deficiencies are reflected in employers' experiences. In survey evidence from across the UK, employers report significant skills shortages within their own workforce and in the pool of labour from which they recruit. Recent evidence shows persistent recruitment difficulties across the skills spectrum, in low skilled service jobs as well as in skilled craft jobs. This affects the ability of firms to grow and become more productive and profitable. Almost one third of firms who report skills gaps in their workforce say that these gaps prevent them from modernising their business to move into higher value added – and more productive – economic activity.

### Skills are unequally distributed

Skill levels have an important impact on employment and social welfare. For example, only half of those people with no qualifications are in work compared to 90 per cent of adults qualified to at least degree level. Low skills levels are particularly pronounced in certain groups. For example, over 40 per cent of people with a disability have no qualifications at all. The unequal distribution of skills has adverse affects on income equality and constrains social mobility, which has deteriorated in the UK over the past two decades. Evidence suggests that skills gaps exacerbate social deprivation including poverty, poor health and crime.

**14** The skills profile of the workforce also varies widely between areas of the UK. Over 35 per cent of working age adults in Northern Ireland, North East England and Yorkshire and Humberside do not have the equivalent of five good GCSEs. Scotland is the only country or region in the UK with a greater proportion of the population holding a degree than the proportion without a basic school leaving qualification. There are even greater differences between the skills profile of areas within these regions. This unequal geographic distribution affects regional prosperity. For example, income per capita in London is more than double that of Liverpool.



**The UK has started to make good progress**

**15** Over the last decade, the UK has made real improvements to its skills profile. The proportion of the working age population with a degree has increased from one fifth to over one quarter. The proportion of adults who hold no qualifications has fallen by one third, from one fifth of the working age population to 14 per cent.

#### Growing numbers of graduates in the UK

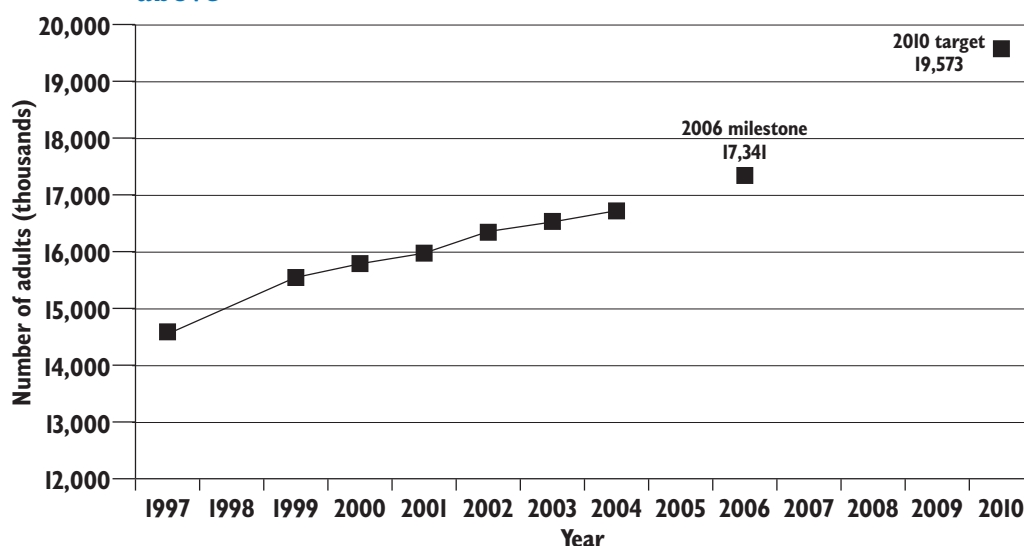
Today, adults with a degree are paid around 20 per cent more than those without. Over the past 10 years, the proportion of adults in the UK holding a degree or equivalent level qualification has increased from 19 to 26 per cent in 2004. Over this period, the wage returns acquired by people with a degree have remained relatively stable. These returns to developing skills reflect the additional value that employers attach to the productivity of people skilled to these levels. Stable wage returns provide clear evidence that employers do not see degree level qualifications as reducing in value. However, despite the substantial increase in the number of people participating in higher education, the UK is still only just above the OECD average with approximately a quarter of adults holding a degree level qualification. In Canada and the USA, around 40 per cent of adults are qualified to this level and China and India together produce four million graduates annually, compared to 250,000 in the UK.

**16** These changes are primarily due to younger, better-qualified people flowing into the workforce, while older and less well-qualified people retire. One in ten 25-34 year olds has no qualifications compared to one in four 55-64 year olds. Over the last decade, there has been a significant decrease in the proportion of people who lack a qualification at the equivalent level to five good GCSEs, falling by almost one half from 43 per cent to 23 per cent.

**Current ambitions will make further improvements, but targets are challenging**

**17** The Government has set ambitious targets to further improve the skills profile of the UK. These include addressing the stock of adults who lack basic literacy and numeracy skills; reducing the stock of adults without the equivalent of a good school-leaving qualification; and increasing the numbers of young people with a degree. Meeting these targets will bring significant improvements to the stock of skills in the UK. However, the Review believes that, on current trends, achieving these targets will be extremely challenging.

**Chart 5: Economically active adults qualified to Level 2 and above**



Note: Level 2 is equivalent to 5 GCSEs at grades A\* – C.  
Source: LFS autumn quarters.

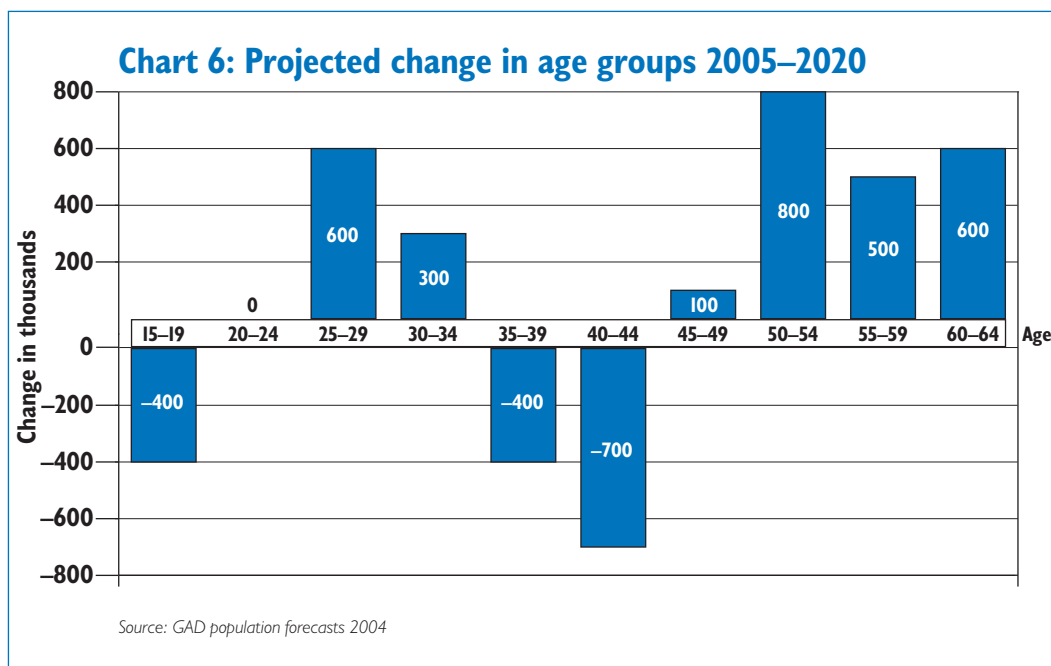
## LOOKING FORWARD TO 2020

**Further improvements must be made to the skills of adults**

**18** As stated, improvements in the skills of young people over recent years have contributed positively to the overall picture in the UK. However, even if further improvements are successful, the skills of young people alone will not improve the UK's overall skills profile significantly enough by 2020 because:

- 70 per cent of the working age population in 2020 have already completed their compulsory school education; and
- half of the working age population in 2020 is already over 25 years old. This is beyond the age when people are likely to participate in the traditional education route from school through to university.

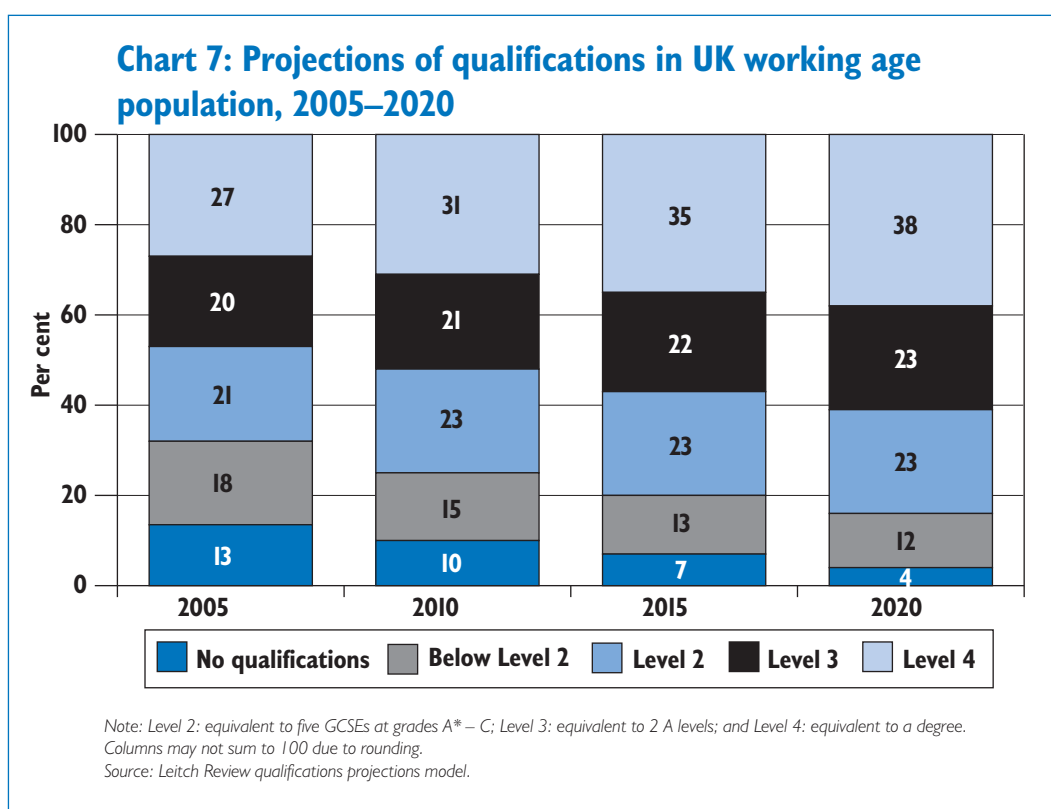
**19** By 2020, there will be about 3.5 million more people in the working age population and the population will have aged significantly. Adults aged 50 – 65 years will account for 60 per cent of the growth in the working age population. The contribution of older people to the labour market will become increasingly important. By 2020, 30 per cent of the working age population will be over 50, compared with 25 per cent today. These demographic changes make it essential to improve the skills of older groups in the workforce.



**If current ambitions are met, skills will improve significantly by 2020**

The Review has undertaken new analysis to assess the UK's current trajectory in developing its skills profile and the likely stock of skills in 2020 *if all current targets are met*. The most marked changes over the next 15 years will occur at each end of the skills spectrum:

- by 2020, the proportion of working age adults without any qualifications will fall to 4 per cent;
- the proportion without qualifications at the equivalent level to five good GCSEs will halve from 31 per cent today to 16 per cent in 2020; and
- the proportion holding a degree or better would increase from 27 per cent to 38 per cent of the working age population.



**21** The Review's analysis suggests that the economic benefits from meeting these current ambitions would be substantial. Productivity could be 3 per cent higher compared to what it would otherwise be and the employment rate could increase by 0.75 per cent. This is a net benefit to the economy of an average £3 billion each year – equivalent to 0.3 per cent of gross domestic product (GDP). One fifth of this benefit is due to increased employment; the rest is due to adults who are already in work improving their skills further and becoming more productive.

**Current ambitions do not go far enough**

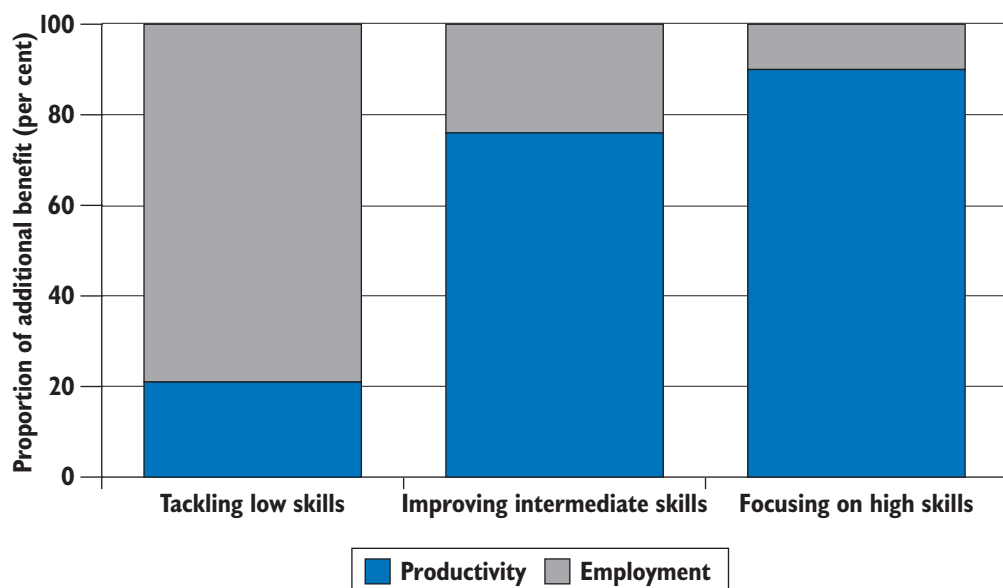
**22** Even if the Government's current ambitious targets were met, significant problems would remain with the UK's skills base in 2020. At least 4 million adults will still not have literacy skills expected of an 11 year old, at least 12 million will be without numeracy skills at this level (equivalent to three in ten adults) and 6.5 million adults will not have qualifications at the equivalent level to five good GCSEs. In comparative terms, the UK will continue to be an 'average performer' – positioned at best, in the middle of the OECD ranking. It will continue to have smaller proportions of intermediate and higher-level skills than key comparator countries such as France and the USA.

**The benefits of even greater change by 2020**

**23** New analysis conducted by the Review quantifies the social and economic benefits of going beyond current ambitions on the UK skills. The Review has modelled some additional, even more ambitious, scenarios for 2020. These include training an additional 3.5 million adults to gain a qualification at the equivalent level of five GCSEs at grades A\*-C; up-skilling the same number of adults to an intermediate level (equivalent to two A levels); and increasing the number of adults with at least degree level qualifications by 3.5 million (the equivalent of increasing the attainment rate of 19 – 30 year olds to 65 per cent).

**24** The analysis shows the net benefits to be gained by investing in different levels of skills – driving growth through a combination of greater employment and productivity. Investing in a reduction of the stock of adults with lower level skills has a significant impact on inequality. These benefits are also more robust to any variations in the wage premiums that employers pay their workforce.

**Chart 8: Source of additional economic benefits from alternative scenarios**



**25** Tackling low skills, through upskilling an additional 3.5 million adults from the lower end of the skills spectrum, could deliver an average annual net benefit – on top of current ambitions – of 0.3 per cent of GDP. Most of this benefit comes from an increase in employment of 375,000-425,000. Improving intermediate and higher end skills deliver average annual net benefits of 0.4 per cent and 0.45 per cent of GDP respectively. These benefits largely result from improved productivity. However, as policies to improve higher level skills are more expensive, the Review's analysis suggests that overall the three scenarios each give similar 'value for money'.

**Building on joint  
responsibility**

**26** There is already substantial effort and investment by employers, individuals and the Government, but it is clearly not enough to deliver the skills improvements that the country needs. The Government has already established a Skills Strategy and has an extensive framework in place to improve the UK's skills. Estimates suggest that employers currently invest around £23.5 billion annually in training activity. It will be essential to build on this joint responsibility in order to achieve an even greater ambition for 2020.

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## NEXT STEPS FOR THE REVIEW

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**27** The analysis presented here shows that the UK needs to be far more ambitious. Current targets will be difficult to achieve but can bring significant improvement. This current ambition will not go far enough to improve the UK's comparative skills base or ensure that the economy is well positioned to operate in increasingly competitive global markets. It will not go far enough to improve social justice.

**28** The UK must confront the challenges identified and set a much higher ambition for skills if it is to become world class. The next phase of the Review will consider:

- the skills profile that the UK should aim to achieve in 2020 in order to drive growth, productivity and support social justice over the longer-term;
- the appropriate balance of responsibility between Government, employers and individuals for the action required to meet this level of change; and
- the policy framework required to support this.

**29** The Leitch Review will report its conclusions and recommendations to the Government in 2006.

