Title: Proposals to bring Payments in Lieu of Training (PILOT) under the tonnage tax in line with actual training costs	# Impact Assessment (IA)
IA No: DfT00169	**Date:** 27/11/2012
Lead department or agency: Department for Transport	**Stage:** Final
Other departments or agencies:	**Source of intervention:** Domestic
	Type of measure: Secondary legislation
	Contact for enquiries: Stephen Eglesfield, Department for Transport, 020 7944 5121

Summary: Intervention and Options

RPC: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
-£9.36m	-£9.36m	£1.00m	No	NA

What is the problem under consideration? Why is government intervention necessary?

The training obligation in the UK tonnage tax scheme was designed to correct the declining numbers of UK-based maritime seafarers. It requires firms to train officer cadets or, where this is not possible for a shipping company and subject to DfT agreement, pay PILOT which should be at least equivalent to actual training costs. An independent review in 2011 demonstrated the ongoing need for Government intervention to support officer training, to help deliver the Government's commitment to economic growth and maintain the competitiveness of the maritime sector. In September 2012, higher education costs increased . PILOT would be significantly less than actual training costs unless an amendment to the current rate is made.

What are the policy objectives and the intended effects?

The objective is to bring PILOT rates more closely into line with actual training costs. The intended effects are to avoid (i) those tonnage tax companies which are meeting their training obligation through actual training facing higher costs than those paying PILOT and (ii) creating a perverse incentive for firms to pay PILOT rather than recruit and train officer cadets. This should then further the policy objective, which is to increase the number of UK officer cadets. The eventual ultimate aim is to increase the number of newly qualified UK officers to a level at which they replace those who leave the industry in order to maintain a pool of people with seafaring skills for service at sea and in the shore-based maritime-related sectors.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Do Nothing. There would be a significant difference between actual training costs and the PILOT rate, which would mean that companies training cadets would face higher costs than those paying PILOT, causing a perverse incentive for companies to pay PILOT rather than recruit and train cadets.
Option 1: Introduce Regulations to uprate PILOT in line with the Treasury GDP deflator. This would be insufficient to reflect the change in funding for higher education which has increased the costs of maritime training, so there would still be a disincentive for companies to train rather than to pay PILOT.
Option 2: Introduce the proposed Regulations to bring PILOT in line with actual training costs. This is the preferred option as it should result in those companies training cadets and those paying PILOT facing a similar level of costs and consequently incentivise tonnage tax companies, where possible, to provide training rather than to make PILOT payments.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 06/2013

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Stephen Hammond Date: 08/01/2013

URN 11/1109 Ver. 3.0

Summary: Analysis & Evidence   Policy Option 1

Description: Introduce Regulations to uprate PILOT in line with the Treasury GDP deflator

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -£0.68	**High:** -£0.43	**Best Estimate:** -£0.57

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	NA	NA	0.05	**0.43**
High	NA		0.08	**0.68**
Best Estimate	NA		0.07	**0.57**

Description and scale of key monetised costs by 'main affected groups'

Under a scenario where the number of trainee months met by PILOT remain constant relative to the Do Nothing scenario (Scenario A), the additional costs to shipping companies have been estimated at £0.05 to £0.08 million per year, with a Best estimate of £0.07 million per year. These additional costs represent the change in the value of PILOT payments that are paid by shipping companies to the Maritime Training Trust (MTT).

Other key non-monetised costs by 'main affected groups'

Alternatively, it is possible that the number of trainee months met by actual training could increase relative to the Do Nothing scenario (Scenario B) although this is uncertain. Under Scenario B, the additional costs to shipping companies would be the sum of the additional training costs and the change in the value of PILOT payments paid by shipping companies.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NQ	NQ	NQ	**NQ**
High	NQ		NQ	**NQ**
Best Estimate	NQ		NQ	**NQ**

Description and scale of key monetised benefits by 'main affected groups'

It has not been possible to monetise any of the benefits of Option 1 that have been identified in this impact assessment.

Other key non-monetised benefits by 'main affected groups'

Under Scenario A, the MTT would receive additional funds to use to promote seafarer training. The benefits would differ under Scenario B. 1.) Although the MTT would have less funds to use, the number of officers being trained by shipping companies would be higher. So, it is likely the number of trained officers available to work in the shipping industry in future years would be higher. 2.) The MTT has identified several other benefits to companies that train officer cadets rather than pay PILOT.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

1.) As there is uncertainty about whether the number of trainee months met by actual training would increase, and the extent of any increase, the costs and benefits for Scenario B could not be monetised. 2.) Due to lack of evidence, the benefits for Scenario A could also not be monetised. 3.) The estimates therefore reflect the costs for Scenario A only. 4.) They are sensitive to the assumptions made. 5.) The extent the costs for Scenario B would differ from these estimates is uncertain.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £0.06	**Benefits:** £0	**Net:** £0.06	No	NA

Summary: Analysis & Evidence

Policy Option 2

Description: Introduce the proposed Regulations to bring PILOT in line with actual training costs

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -£11.13	**High:** -£7.09	**Best Estimate:** -£9.36

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	NA	NA	0.82	**7.09**
High	NA		1.29	**11.13**
Best Estimate	NA		1.09	**9.36**

Description and scale of key monetised costs by 'main affected groups'

Under a scenario where the number of trainee months met by PILOT remain constant relative to the Do Nothing scenario (Scenario A), the additional costs to shipping companies have been estimated at £0.82 to £1.29 million per year, with a best estimate of £1.09 million per year. These additional costs represent the change in the value of PILOT payments that are paid by shipping companies to the MTT.

Other key non-monetised costs by 'main affected groups'

Alternatively, it is possible that the number of trainee months met by actual training could increase relative to the Do Nothing scenario (Scenario B) although this is uncertain. Under Scenario B, as the intention is for the rate of PILOT to be set in line with actual training costs, it is anticipated that the additional costs to shipping companies under Scenario B should be in line with the additional costs to shipping companies estimated for Scenario A.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	NQ	NQ	NQ	**NQ**
High	NQ		NQ	**NQ**
Best Estimate	NQ		NQ	**NQ**

Description and scale of key monetised benefits by 'main affected groups'

It has not been possible to monetise any of the benefits of Option 2 that have been identified in this impact assessment.

Other key non-monetised benefits by 'main affected groups'

Under Scenario A, the MTT would receive additional funds to use to promote seafarer training. The benefits would differ under Scenario B. 1.) Although the MTT would have less funds to use, the number of officers being trained by shipping companies would be higher. So, it is likely the number of trained officers available to work in the shipping industry in future years would be higher. 2.) The MTT has identified several other benefits to companies that train officer cadets rather than pay PILOT.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5%

1.) As there is uncertainty about whether the number of trainee months met by actual training would increase, and the extent of any increase, the costs and benefits for Scenario B could not be monetised. 2.) Due to lack of evidence, the benefits for Scenario A could also not be monetised. 3.) The estimates therefore reflect the costs for Scenario A only. 4.) They are sensitive to the assumptions made. 5.) The extent the costs for Scenario B would differ from these estimates is uncertain.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: £1.00	**Benefits:** £0	**Net:** £1.00	No	NA

Evidence Base (for summary sheets)

Section 1 – Background on the tonnage tax, the minimum training obligation and payments in lieu of training (PILOT)

1. By the beginning of the 1990s the forecast demise of the shipping industry and the loss of skilled UK seafarers became a reality. A number of deregulatory measures and support initiatives in the late 1990s helped to slow the decline of the UK fleet, but were insufficient to maintain a stable pool of seafaring experience.

2. The tonnage tax was introduced in 2000. It applies normal corporation tax to notional profits determined by the tonnage of the ships operated, and thereby provides certainty and clarity about tax liabilities. Shipping companies can opt into tonnage tax, or stay within the corporate tax regime. Tonnage tax regimes exist across the EU and internationally.

3. A key feature of the UK tonnage tax is the minimum training obligation (MTO). The MTO in respect of officers is for a company to recruit and train one officer cadet each year for every 15 officer posts in its fleet. The policy objective of this feature was, and remains, to increase the number of UK-based seafarers to meet both current needs at sea and future jobs onshore in the maritime services sector.

4. Companies which have elected into tonnage tax and which can show good reasons why they are unable to recruit or sponsor cadets may instead be permitted to make payments in lieu of training (PILOT). This is known as “planned” PILOT and will only be agreed by DfT in exceptional circumstances. On average, no more than 2% of the core training commitments are met through planned PILOT.

5. PILOT payments may also arise where there is a shortfall in the training which the company should have provided, or where there is an incremental training commitment as a result of additional vessels joining the fleet. This is known as “default” PILOT and it is expected that such payments are a short-term measure, for example in the period between a college’s intake of new cadets.

6. The number of PILOT payments between 2000/01 and 2010/11 is presented in Table 1 below.

Table 1 – Number of PILOT Payments (2000/01 to 2010/11)

	Number of company groups in tonnage tax	Number of Trainee Months[1]	Number of months met by making PILOT Payments	Number of months met by training[2]
2000/01	15	862	186	676
2001/02	42	4,689	1,142	3,547
2002/03	59	9,590	1,657	7,933
2003/04	59	13,043	2,457	10,586
2004/05	71	15,612	3,293	12,319
2005/06	77	16,549	4,066	12,483
2006/07	79	17,648	4,410	13,238
2007/08	86	18,805	3,021	15,784
2008/09	90	20,816	2,810	18,006
2009/10	90	21,909	3,929	17,980
2010/11	90	22,138	4,128	18,010

7. Where PILOT is paid, the monies are due to the Maritime Training Trust (MTT). This industry body uses the funds raised from the PILOT scheme to promote merchant navy training, with the scope of its activities adjusted annually in line with the amount of PILOT received. The purpose of this spending is to raise awareness about the benefits of a career at sea, and possible subsequent job opportunities. The impacts of MTT expenditure have been as follows[3]:

- Since 2002, a total of 320 officer trainees have been recruited, who will be available to the UK

[1] The number of trainee months is the total number of months in respect of which company groups were required to provide training.
[2] The number of months met by training is the number of trainee months less the number of PILOT payments made. Additional trainee months were achieved by those company groups who had more trainees than were needed to meet their training commitments.
[3] Source: The Maritime Training Trust.

shipping industry and indeed in due course the wider maritime cluster.

- The J.W. Slater Fund, which provides rating to officer conversion courses, has benefited from funding since 2002 from the MTT, such that over 300 ratings have achieved officer certification since the first awards were made by the Fund since the scheme was launched in 1997.
- It has enabled take-up of the Foundation degree officer training programmes since their inception in 2006, and assisted in the overall industry efforts to increase the take-up of officer training programmes in general from just under 500 in 2000 to over 900 in 2011/12.

8. Between 2000 and 2010, the PILOT rate was uprated for inflation each year, in line with the Treasury GDP deflator. The uprate is set annually through an amendment to the Tonnage Tax (Training Requirement) Regulations 2000 (S.I. 2000/2129).

9. In 2010 it became clear that the PILOT rate was falling significantly below the actual cost of training a cadet. Following a public consultation, the Department for Transport legislated for an above inflation increase which was staged over two years (2010/11 and 2011/12). It was also agreed that the PILOT rate should be regularly reviewed so that it is at least equal to the actual costs of training.

Section 2 - What is the problem under consideration? Why is government intervention necessary?

10. In 1999, Lord Alexander of Weedon QC produced a report for HM Treasury which considered the case for enhanced training incentives and for a lower rate ring-fenced tonnage tax. The report highlighted that the shipping industry had been in steady decline since the 1970s, that the supply of skilled seafarers was dwindling and that their average age was increasing and concluded that without a revival, especially of the number of trained officers, there would soon be a shortfall well below the needs of the shipping and shore-based related maritime industries. It concluded that a form of tonnage tax was a fundamental element of a package of measures to improve the competitiveness of the UK shipping industry.

11. The UK tonnage tax was introduced in 2000 and included a minimum training obligation (MTO). The tonnage tax has been a major factor in increasing the number of UK merchant navy officer cadets. In 2000/01, 91 new first year officer trainees entered training under the tonnage tax scheme. In 2010/11, the number of new first year officer trainees stood at 688.

12. Notwithstanding, evidence suggests that there will be a demand gap over the next decade for UK seafarers. In 2011, an independent review into the economic requirement for trained seafarers in the UK[4] was undertaken on behalf of the Department for Transport. The review identified a forecast gap developing between demand for, and supply of, trained UK seafarers, peaking in the 2016-19 period. By 2021 this gap is forecast to have reduced slightly to circa 3,500 in the case of deck and engine officers at sea and over 1,600 in the case of ex-seafarers in the maritime cluster. Those shortfalls are equivalent to 10% and 9% respectively of total projected demand in those sectors.

13. The independent review[5] concluded that “The demand gap for UK seafarers is unlikely to be filled by market forces alone, perhaps forcing shipping companies to adopt second-best solutions in the form of non-UK officers and technical ratings. Moreover, a lack of trained UK seafarers will result in a reduction in UK ex-seafarers available to the maritime cluster, reducing its competitiveness over time. Logically, on this basis, there appears to be a continuing rationale for a policy intervention to support maritime training.”

14. The independent review[6] reported that “Stakeholders from the shipping sector have indicated a strong preference for UK seafarers at the officer level, and there is also a strong preference for UK ex-seafarers in the maritime cluster.” In particular, the independent review explained that the reasons given included:

- “UK seafarers have fewer visa restrictions are more geographically mobile” compared to “some other nationalities;”
- “UK seafarers and ex-seafarers are more willing to relocate;”

[4] http://www.dft.gov.uk/publications/economic-requirement-for-trained-seafarers/

[5] http://www.dft.gov.uk/publications/economic-requirement-for-trained-seafarers/

[6] http://www.dft.gov.uk/publications/economic-requirement-for-trained-seafarers/

- “on average, UK seafarers are better trained and have better skills than many other nationalities;” and
- “they have the advantage of English as a first language.”

15. The independent review[7] also considered the rationale for government intervention in seafarer training and explained that the “free rider” problem is the most relevant market failure. An extract from the independent review is presented in the box below.

> **Extract from Deloitte and Oxford Economics (December 2011) ‘An independent review of the economic requirement for trained seafarers in the UK: Final Report to DfT and Review Panel’**[8]
>
> “The UK seafarer training model contains both classroom-based learning and an at-sea element. This latter element necessitates the participation of shipping companies in the training of cadets – they must accommodate cadets in a supernumerary capacity onboard as part of their officer training. Hence, shipping companies will incur the cost of accommodating cadets onboard for a specified period, during which they will also have to dedicate resource to training them, without any associated monetary return (at least in the short-term). Accommodating cadets in a supernumerary capacity will only be worthwhile for shipping companies if they are able to subsequently retain these cadets for a period afterwards to recoup their investment through the value generated by the cadets as they work for the shipping company
>
> However, a free-rider market failure occurs in seafarer training in the UK because cadets are not obligated to work for the shipping company that sponsored their original training – neither are they obligated to work in the maritime sector at all. It should also be noted that neither is the shipping company obligated to provide employment at the end of the training.
>
> If the newly qualified officer cadets choose not to work for the shipping company they trained with, the company that does recruit them will be able to enjoy the benefit of the increased skills and knowledge without having to contribute their fair share to the cost of this “common resource” – in essence, they will “free ride” on shipping companies’ contributions.
>
> Thus, if there is a significant probability that cadets will not work for the sponsoring shipping company (either by going to a rival company, moving to the maritime cluster or leaving the sector entirely), the original shipping company itself will not have any incentive to train the cadet (at least in the absence of financial or other assistance).
>
> This can ultimately create a vicious circle, whereby shipping companies are dis-incentivised to take on new trainees for fear of losing them to rivals, which in turn means cadets will find it harder to complete their training if the number of shipping companies willing to accommodate them on board in a supernumerary capacity declines.”

16. In addition, the independent review[9] assessed “the productivity differential between the average worker in the maritime sector and the UK productivity average for all workers” and found that the average worker in the maritime sector “generates approximately £14,500 in additional output relative to the output of a UK worker displaying average productivity”.

17. With over 90% of the UK’s import and export trade by weight transported by the maritime sector, the Government recognises the significant economic role played by the sector and the important contribution the shipping industry can make to the UK growth agenda. The Government therefore believes there is still a requirement for the tonnage tax scheme and a sound rationale for maintaining the MTO as a key measure of the scheme.

18. When the tonnage tax was introduced in 2000, the MTO was a key component of the scheme. As detailed in paragraphs 4 and 5, in a limited number of circumstances a tonnage tax training company may meet its training obligation through PILOT. In 2000 the level of PILOT was set in line with the actual costs of training. The intended effect was that companies would be encouraged to recruit officer trainees rather than to pay PILOT.

19. From September 2012, universities/colleges can charge up to £6,000 a year for higher education courses. Some will be able to charge up to £9,000 a year. The Department has been informed that

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[7] http://www.dft.gov.uk/publications/economic-requirement-for-trained-seafarers/

[8] http://www.dft.gov.uk/publications/economic-requirement-for-trained-seafarers/

[9] http://www.dft.gov.uk/publications/economic-requirement-for-trained-seafarers/

course tuition fees will be in the order of £4,000 to £6,000 per year over the three years of a 'typical' seafarer cadet programme. This is in addition to costs relating to medicals/vaccinations, uniform, subsistence and exams

20. The MTT and a number of training providers have expressed concern that if left unchanged or if only uprated in line with the Treasury GDP Deflator, the PILOT rate would be significantly below actual training costs for the training commitment year starting 1st October 2012. This would run counter to Government policy that PILOT should be at least equivalent to the actual costs of training.

21. The PILOT rate is expressed in pounds (£) per trainee month. It is made up of a 'basic' rate, plus an additional element in respect of the MTT's overhead costs. The MTT has written to the Department and proposed that the PILOT rate should be increased to £1,092 per trainee month. This comprises a basic rate of £1,020 and an additional element in respect of the MTT's overhead costs of £72. The MTT letter explains their justification for setting a basic rate of £1,020. It reports that the MTT have undertaken research to identify the approximate cost of a cadet training programme and that "it has been identified that the average cost of a 'generic' programme provided by a 'generic' company is £36,708" which corresponds to 36 monthly payments of around £1,020. MTT have said that they do not need an increase in overhead costs, so the additional element in respect of the MTT's overhead costs is unchanged from the current level. A copy of this letter is attached at Annex A.

22. The Department has sought information from a number of training providers to confirm the impact on the costs of the maritime cadet training programme in light of the changes to higher and further education funding. On the basis of all information received, we believe it is necessary to increase PILOT to bring it in line with the actual costs of training.

Section 3 - What are the policy objectives and the intended effects?

23. By seeking to increase the current level of PILOT to align it with the actual costs of training, we are seeking to further the overall policy objective, which is to increase the number of UK-based officer cadets. The eventual ultimate aim is to increase the number of newly qualified UK-based officers to a level at which they replace those who leave the industry, meeting the demand for seafarers at sea and ex-seafarers onshore in the wider maritime cluster.

Section 4 - What policy options have been considered?

4.1 Do nothing (the counterfactual)

24. Keeping PILOT at the rate currently applicable for the training commitment year October 2011-September 2012 would mean that there would be a significant difference between actual training costs and the PILOT rate. This would mean that those companies who are fulfilling their MTO through training would face higher costs than those companies who pay PILOT. This runs the risk that in the training commitment year 2012-13 companies would seek to pay PILOT rather than train, which runs counter to the policy objective of increasing the number of UK-based officer cadets. Therefore, this option is not consistent with the eventual aim of the policy intervention.

4.2 Policy Option 1: Introduce new Regulations to uprate PILOT in line with the Treasury GDP deflator

25. The Treasury GDP deflator for the calendar year 2012 is 2.5% above the 2011 base. This percentage increase would be insufficient to reflect the change in funding for higher education, effective from September 2012, which has increased the costs of maritime training.

26. As such, those companies who are fulfilling their MTO through training would still face higher costs than those companies who pay PILOT, and there would still a risk that companies would seek to pay PILOT rather than train.

27. To uprate PILOT but fail to bring it in line with the actual costs of training would therefore run counter to the intended principle behind PILOT and the policy objective of increasing the number of UK-based officer cadets.

4.3 Policy Option 2: Introduce the proposed Regulations to bring PILOT in line with actual training costs

28. This is the Department's preferred option. The justification is that it should result in those companies training cadets and those paying PILOT facing a more similar level of costs, and consequently incentivise tonnage tax companies, where possible, to provide training rather than to make PILOT payments for the reasons discussed in Section 2 above.

29. The PILOT rates under the Do Nothing scenario and each of the policy options are shown in Table 2. The PILOT fee is expressed in pounds (£) per trainee month. It is made up of a 'basic' rate, plus an additional element (which is currently roughly another 10%[10], rounded to the nearest £) in respect of the MTT's overhead costs.

Table 2: PILOT rates under the Do Nothing scenario, Option 1 and Option 2

Do Nothing	
Basic rate	£726
Overhead costs	£72 (10% to cover MTT's overhead costs)
Total PILOT per trainee month	£798
Policy Option 1	
Basic rate	£744
Overhead costs	£72 (MTT propose to freeze overhead costs at 2011-12 level)
Total PILOT per trainee month	£816
Policy Option 2	
Basic rate	£1,020
Overhead costs	£72 (MTT propose to freeze overhead costs at 2011-12 level)
Total PILOT per trainee month	£1,092

Section 5 – Cost and Benefits

5.1. Approach

This section assesses the additional costs and benefits of Option 1 and Option 2 relative to the Do Nothing scenario. Due to the limitations of the available evidence base, it has not been possible to monetise all of the additional costs and benefits of these policy options that have been identified in this impact assessment. Where it has not been possible to monetise a particular cost or benefit, a full qualitative description of the cost or benefit has been provided in this impact assessment.

<u>5.2. Groups and sectors affected</u>

An increase in the level of PILOT under Option 1 and Option 2 could potentially affect all shipping companies within the tonnage tax regime.

Companies elect into the tonnage tax for an initial period of ten years. Although they can exit the tonnage tax, they would suffer penalties as a result, and would be disqualified from re-entering for ten years. The number of trainee months a company has to meet is linked to the number of officer posts in its fleet.

Given that the core training commitment is a key measure of the tonnage tax regime and the benefits of electing into the tonnage tax regime, it is assumed that an increase in the level of PILOT would not influence the participation of companies within the tonnage tax regime, and that the number of trainee

[10] The MTT's overhead costs (covering their costs of administration) were set at 10% when the tonnage tax was introduced in 2000.

months that need to be provided under the minimum training commitment would therefore be the same as in the Do Nothing scenario.

However, it is possible that an increase in the level of PILOT could affect the number of trainee months that are met by actual training and the number that are met by PILOT. No evidence is available on this issue. Therefore, two scenarios are considered in this impact assessment to reflect the range of uncertainty.

Scenario A: If the number of trainee months met by PILOT remains constant, there would be a transfer of resources from shipping companies to the MTT compared to the Do Nothing scenario, which would increase the funds that the MTT has to spend to promote seafarer training. This would constitute a transfer payment as no good or service is received in return. The value of the transfer would be equal to the increase in the value of PILOT payments compared to the Do Nothing scenario.

Scenario B: If the number of trainee months met by actual training increases, three key impacts have been identified. Firstly, there would be a reduction in the number of PILOT payments from shipping companies to the MTT compared to the Do Nothing scenario; the change in the value of PILOT payments received by MTT and consequently the impact on the funds that the MTT has to spend to promote seafarer training is uncertain (see Section 5.3.2 below). Secondly, there would be a cost increase to shipping companies compared to the Do Nothing scenario; the additional costs to shipping companies would be the sum of the additional training costs and the change in the value of PILOT payments paid by shipping companies. Thirdly, as the number of officers being trained by shipping companies under the scheme would increase, it is likely that there would be an increase in the number of trained officers available to work in the shipping industry in future years.

Under both of these scenarios, the additional costs to shipping companies would solely fall on those companies that would meet their minimum training commitment through paying PILOT under the Do Nothing scenario.

There would be no additional costs to shipping companies that would meet their minimum training commitment through training under the Do Nothing scenario. However, there is the possibility that there could be some indirect impacts on these companies if the difference between the cost of actual training and the cost of paying PILOT is sufficient to impact on competition under the Do Nothing scenario. This potential impact is discussed in the Competition Assessment below. Furthermore, there is the potential for all shipping companies to benefit from an increase in the number of trained officers that are available to work in the shipping industry in future years.

Therefore, the policy options presented in this impact assessment have the potential to impact on shipping companies, the MTT and training providers.

5.3. Costs of Option 1

5.3.1. Compliance Costs to Shipping Companies

Scenario A – The number of trainee months met by PILOT remains constant

Under Option 1, Table 2 shows that the increase in PILOT would be around £18 per trainee month relative to the Do Nothing scenario. For the purposes of this impact assessment, it is assumed that the level of PILOT would remain at this level in future years in 2012 prices.

Since the majority of PILOT payments are “default” payments, it is not possible to provide any robust forecasts of future trends in the number of PILOT payments and as such the number of PILOT payments in a given year is uncertain. Therefore, in order to estimate the additional costs to shipping companies over the 10-year appraisal period, it is necessary to make a number of assumptions about the number of PILOT payments that would be made each year. Firstly, under this scenario, it is assumed that the increase in the level of PILOT would not influence behaviour of firms and that the number of PILOT payments would be the same as under the Do Nothing scenario. Secondly, on the basis of the number of pilot payments in the last 5 years for which data is available (see Table 1), it is assumed that the number of PILOT payments would be around 2,800 to 4,400 per year in the 10-year appraisal period under the Do Nothing scenario, with a Best estimate of around 3,700 (the mean average of the last five years).

On the basis of the above assumptions, the increase in the level of PILOT has been estimated to result in an additional cost to shipping companies of approximately £0.05 to £0.08 million per year under this scenario, with a Best estimate of £0.07 million per year. The appraisal period is 10 years. Over the 10-year appraisal period, the present value of the additional costs to shipping companies has been estimated at around £0.43 to £0.68 million under this scenario, with a Best estimate of £0.57 million.

Scenario B – The number of trainee months met by actual training increases

There would be a stronger incentive for shipping companies to undertake actual training rather than paying PILOT under Option 1 compared to the Do Nothing scenario. PILOT is either planned or default. It is highly improbable that those companies that would have planned PILOT under the Do Nothing scenario would be in a position to switch to training officers in the face of increases in PILOT under Option 1. However, there is the possibility that other shipping companies could be incentivised to increase the number of trainee months that are met by actual training.

The extent that additional costs to shipping companies under Scenario B would differ from the estimates that are presented above for Scenario A under Option 1 is uncertain. This would depend on the additional costs associated with meeting the minimum training commitment through actual training rather than paying PILOT under Option 1, and the number of additional months that would be met by actual training under Option 1.

Given the limitations of the available evidence base, it has not been possible to monetise the costs to shipping companies under Scenario B.

5.3.2. Impacts on the MTT

The value of PILOT payments received by the MTT is equal to the PILOT fee multiplied by the number of PILOT payments.

Under Option 1, the value of PILOT payments to the MTT would increase if shipping companies continue to pay PILOT (Scenario A). This impact is discussed in Section 5.4.2 below.

However, if a greater number of trainee months are met by actual training (Scenario B), the number of PILOT payments would decline under Option 1 compared to the Do Nothing scenario. As the PILOT fee would be higher than the Do Nothing scenario but the number of PILOT payments would be lower, the change in the value of PILOT payments received by MTT is uncertain. This would depend on the extent that the number of PILOT payments would decline under Option 1 compared to the Do Nothing scenario. If the decline is significant enough, it is possible that the value of PILOT payments received by the MTT could potentially decline under Option 1 compared to the Do Nothing scenario, which would reduce the funds that the MTT has to spend to promote seafarer training. As no evidence is available on this issue, it has not been possible to estimate the change in the value of PILOT payments that would be received by the MTT. Nonetheless, on the basis of feedback from the Regulatory Policy Committee, a decrease in the value of PILOT payments received by the MTT is not treated as a cost to the MTT in this impact assessment because the MTT spends the funds it receives to promote seafarer training.

5.3.3. Familiarisation Costs for shipping companies

The Regulations introduced under Option 1 would amend the extant Regulations simply to amend the level of PILOT and revoke the extant Regulations. No change is required to the reporting process and the training forms which must be completed by tonnage tax companies would remain the same. Therefore, it is anticipated that any familiarisation costs associated with Option 1 would be negligible.

5.4 Benefits of Option 1

5.4.1. Impacts on the market for officer training

Under Option 1, shipping companies would face a greater incentive, where possible, to provide actual training rather than paying PILOT in comparison to the Do Nothing option. However, given that Option 1 would continue to see PILOT fall short of actual training costs, it would continue to present an incentive to pay PILOT.

If a greater number of trainee months are met by actual training (Scenario B), although the funds that the MTT has to spend to promote seafarer training could potentially decline (see Section 5.3.2), the number of officers being trained by shipping companies under the scheme would increase. Therefore, it is likely that there would be more trained officers available to work in the shipping industry in future years.

The 2011 independent review[11] into the economic requirement for trained seafarers in the UK predicted a shortfall equivalent to 10% of total projected demand in the case of deck and engineer officers and 9% in the case of ex-seafarers in the maritime cluster by 2021. An increase in the number of trained officers would help to offset this shortfall, supporting the competitiveness of the UK shipping industry and the wider maritime sector. Whereas the shortfall could be met in part through the employment of foreign seafarers, evidence from the independent review showed that shipping companies have a preference for UK-trained seafarers at the officer level and amongst companies in the maritime cluster there is an even stronger preference for UK trained ex-seafarers. In particular, as discussed in Section 2, the independent review explained that the reasons given included:

- “UK seafarers have fewer visa restrictions are more geographically mobile” compared to “some other nationalities;”
- “UK seafarers and ex-seafarers are more willing to relocate;”
- “on average, UK seafarers are better trained and have better skills than many other nationalities;” and
- “they have the advantage of English as a first language.”

The MTT have also identified a number of other benefits to shipping companies that train officer cadets rather than paying PILOT (See Annex A). For example, the MTT consider that a company training officer cadets will benefit as officers trained by a company will gain knowledge of the company (such as its operations and policies), and it would not need to recruit equivalent officers externally, which could have the benefit of avoiding crewing agency fees, the need for language training and the need to check the regulatory certification of seafarers being recruited.

Furthermore, it is also possible that an increase in the number of officer cadets in training could result in a net benefit to training providers, although it should be noted that no evidence is available on this issue and the extent that a net benefit to training providers would represent a net benefit to the UK is also uncertain.

Due to the uncertainty surrounding whether there would be an increase in the number trainee months that are met by actual training, and the extent of any increase, it has not been possible to monetise any of the above benefits in this impact assessment.

Compared to Scenario B, it is likely that the benefits would be less if shipping companies paid the increased level of PILOT fees (Scenario A). While the MTT would have more funds to spend on the promotion of seafarer training, in the long run, this is likely to have lesser benefits to the case discussed above as it is likely that there would be fewer trained officers available to work in the shipping industry in future years than under Scenario B, and the benefits of training officer cadets compared to paying PILOT identified by the MTT would not be realised. No quantitative evidence is available, for example, on the value of the benefits of MTT activities, so it has not been possible to monetise these benefits under Scenario A in this impact assessment. However, the available evidence on the impacts of past MTT expenditure is discussed in Paragraph 7 in Section 1 above.

5.4.2. Impacts on the MTT

If shipping companies continue to pay PILOT (Scenario A), the value of PILOT payments received by MTT would increase. This would increase the funds that the MTT has to spend to promote seafarer training. Under this scenario, the increase in the value of PILOT payments received by the MTT would be equal to the additional costs to shipping companies that are discussed in Section 5.3.1 above. On the basis of feedback from the Regulatory Policy Committee, an increase in the value of PILOT payments received by the MTT is not treated as a benefit to the MTT in this impact assessment because the MTT spends the funds it receives to promote seafarer training.

[11] http://www.dft.gov.uk/publications/economic-requirement-for-trained-seafarers/

If the number of trainee months met by actual training increases (Scenario B), the number of PILOT payments received by MTT would be lower than under Scenario A, but as discussed in Section 5.3.2 above, the change in the value of PILOT payments received by MTT is uncertain. As discussed earlier in this section and in Section 5.3.2 above, an increase or decrease in the value of PILOT payments received by the MTT is not treated as a benefit or cost to the MTT in this impact assessment.

5.5. Summary of Costs and Benefits of Option 1

If shipping companies continue to pay PILOT (Scenario A), the Best estimate of the present value of the additional costs to shipping companies over the 10-year appraisal period is £0.57 million (see Section 5.3.1). Given the limitations of the available evidence base, it has not been possible to monetise any of the benefits. Therefore, on the basis of the Best estimates of the monetised costs, the Net Benefit to the UK has been estimated at -£0.57 million under Scenario A.

If there is an increase in the number of officers trained under the scheme (Scenario B), the additional costs to shipping companies are uncertain (see Section 5.3.1). In terms of the impacts on the market for officer training, the MTT would have less funds to spend to promote seafarer training than under Scenario A, but the number of officers being trained by shipping companies under the scheme would be higher than under Scenario A. Therefore, it is likely that there would be more trained officers available to work in the shipping industry in future years than under both Scenario A and the Do Nothing scenario. Furthermore, the MTT have advised that they would welcome a fall in the number of shipping companies paying PILOT, and have also identified a number of benefits to shipping companies of training officer cadets compared to paying PILOT (see Section 5.4.1). Nonetheless, given the limitations of the available evidence base, it has not been possible to monetise any of the costs and benefits under Scenario B.

5.6. Costs Option 2

5.6.1. Compliance Costs to Shipping Companies

Scenario A – The number of trainee months met by PILOT remains constant

Under Option 2, Table 2 shows that the increase in PILOT would be around £294 per trainee month relative to the Do Nothing scenario. On the basis of the assumptions in Section 5.3.1, the increase in the level of PILOT has been estimated to result in an additional cost to shipping companies of approximately £0.82 to £1.29 million per year under this scenario, with a Best estimate of £1.09 million per year. Over the 10-year appraisal period, the present value of the additional costs to shipping companies has been estimated at around £7.09 to £11.13 million under this scenario, with a Best estimate of £9.36 million.

Scenario B – The number of trainee months met by actual training increases

There would be a stronger incentive for shipping companies to undertake actual training rather than paying PILOT under Option 2 compared to the Do Nothing scenario and Option 1. There is the possibility that shipping companies could be incentivised to increase the number of trainee months that are met by actual training. However, given the limitations of the available evidence base discussed in Section 5.3.1, it has not been possible to estimate the change in the number of trainee months that would be met by actual training. Nonetheless, as the intention is for the rate of PILOT to be set in line with actual training costs, it is anticipated that the additional costs to shipping companies under Scenario B should be in line with the additional costs to shipping companies estimated for Scenario A above.

5.6.2. Impacts on the MTT

Under Option 2, the value of PILOT payments to the MTT would increase if shipping companies continue to pay PILOT (Scenario A). This impact is discussed further in Section 5.7.2 below. However, if a greater number of trainee months are met by actual training (Scenario B), it is possible that the value of PILOT payments received by the Maritime Training Trust could potentially decline under Option 2 compared to the Do Nothing scenario (see Section 5.3.2). As discussed in Section 5.3.2 above, a decrease in the value of PILOT payments received by the MTT is not treated as a cost to the MTT in this impact assessment.

5.6.3. Familiarisation Costs

These are unlikely to be materially different to under Option 1 (see Section 5.3.3).

5.7. Benefits of Option 2

5.7.1. Impacts on the market for officer training

This potential benefit relates to the potential to increase the number of officers in training, which is likely to mean that there would be more trained officers available to work in the shipping industry in future years. Under Option 2, shipping companies would face a greater incentive, where possible, to provide actual training rather than paying PILOT in comparison to the Do Nothing option and Option 1. As the incentive to provide actual training rather than paying PILOT would be greater under Option 2 than Option 1, the increase in the number of trained officers available to work in the shipping industry under Scenario B and the associated benefits are likely to be higher under Option 2 than under Option 1 (see Section 5.4.1). As for Option 1, if shipping companies paid the increased level of PILOT fees (Scenario A), these benefits would be less than under Scenario B (see Section 5.4.1). In addition, under Scenario B, the other benefits to shipping companies that train officer cadets rather than paying PILOT identified by the MTT and the potential benefits to training providers would also apply under Option 2 (see Section 5.4.1). For the reasons explained in Section 5.4.1, it has not been possible to monetise these benefits in this impact assessment.

5.7.2. Impacts on the MTT

If shipping companies continue to pay PILOT (Scenario A), the value of PILOT payments received by MTT would increase. This would increase the funds that the MTT has to spend to promote seafarer training. Under this scenario, the increase in the value of PILOT payments received by the MTT would be equal to the additional costs to shipping companies that is discussed in Section 5.6.1 above. As discussed in Section 5.4.2 above, an increase in the value of PILOT payments received by the MTT is not treated as a benefit to the MTT in this impact assessment.

If the number of trainee months met by actual training increases (Scenario B), the number of PILOT payments received by MTT would be lower than under Scenario A, but as discussed in Section 5.3.2 above, the change in the value of PILOT payments received by MTT is uncertain. As discussed in Section 5.3.2 and Section 5.4.2 above, an increase or decrease in the value of PILOT payments received by the MTT is not treated as a benefit or cost to the MTT in this impact assessment.

5.8. Summary of Costs and Benefits of Option 2

If shipping companies continue to pay PILOT (Scenario A), the Best estimate of the present value of the additional costs to shipping companies over the 10-year appraisal period is £9.36 million (see Section 5.6.1). Given the limitations of the available evidence base, it has not been possible to monetise any of the benefits. Therefore, on the basis of the Best estimates of the monetised costs, the Net Benefit to the UK has been estimated at -£9.36 million under Scenario A.

If there is an increase in the number of officers trained under the scheme (Scenario B), it is anticipated that the additional costs to shipping companies should be in line with the additional costs to shipping companies estimated for Scenario A above (see Section 5.6.1). In terms of the impacts on the market for officer training, the MTT would have less funds to spend to promote seafarer training than under Scenario A, but the number of officers being trained by shipping companies under the scheme would be higher than under both Scenario A and the Do Nothing scenario. Therefore, it is likely that there would be more trained officers available to work in the shipping industry in future years than under Scenario A. Furthermore, the MTT have advised that they would welcome a fall in the number of shipping companies paying PILOT, and have also identified a number of financial benefits of training officer cadets compared to paying PILOT (see Section 5.4.1). Nonetheless, given the limitations of the available evidence base, it has not been possible to monetise any of the costs and benefits under Scenario B.

Section 6 – One-In, One-Out

On the basis of feedback from the Regulatory Policy Committee, this measure is considered to be out of scope of One-In, One-Out (OIOO) as it is a fee/charge where there is no change in the level of regulatory activity.

On the basis of the best estimates of the direct impacts that it has been possible to monetise in this impact assessment, the ‘Direct impact on business (Equivalent Annual)’ has been estimated. These estimates are presented on the summary sheets. It should be noted that these estimates are in 2009 prices.

Section 7 – Wider impacts

The tonnage tax has had a significant, positive impact on the UK shipping industry since its introduction in 2000. A competitive shipping industry, coupled with a strong maritime skills base, contributes to the Government’s growth and skills agendas.

7.1. Competition Assessment

Under the Do Nothing scenario, shipping companies that carry out actual training would face higher costs than those paying PILOT, which could potentially create a competitive disadvantage for shipping companies that carry out actual training and a competitive advantage for shipping companies that pay PILOT. The level of PILOT would increase under Option 1 and Option 2, which would bring the costs of shipping companies paying PILOT closer to the costs of shipping companies that carry out actual training. Therefore, shipping companies, to the extent that they pay PILOT rather than carry out actual training under the Do Nothing scenario, would face an increase in costs under Option 1 and Option 2. Compared to the Do Nothing scenario, this could potentially increase the competitiveness of shipping companies that carry out actual training and reduce the competitiveness of shipping companies that pay PILOT. The extent that there would be an impact on competition would depend on the relative importance of these costs. To the extent that there would be an impact on competition, it is likely that the impact on competition would be higher under Option 2 than Option 1 as the increase in the level of PILOT would be higher. However, there is currently no available evidence that there would be a significant impact on competition under either of these policy options.

7.2. Small Firms Assessment

The minimum tonnage tax training requirement is calculated in proportion to the number of officer posts in a company's fleet. It is considered that this ensures that the burden on any firms would be proportionate to the size of the operation and would avoid placing an undue burden on any small firms. Furthermore, it should be noted that all of the companies in tonnage tax were aware that they would be subject to the minimum training obligation before they entered the regime.

It is considered that the types of companies operating ships internationally and operating under the tonnage tax regime are unlikely to qualify as small firms. The Department is unaware of whether any of the businesses which have elected to the tonnage tax are micro businesses, although we think it unlikely that many, if any, are. The fewer personnel a company employs, the less likely it is that the company is engaged in the seagoing trades that the tonnage tax regime was designed to support. It should be noted that none of the responses to the previous consultation (see paragraph 9) were in relation to the impacts on small firms.

7.3. Equalities Assessment

It is considered that there are no race, gender or disability equality impacts to these proposals.

7.4. Environmental Assessment

It is considered that there is no environmental impact to these proposals.

Section 8 – Implementation Plan

It is proposed that the amended regulations will come into force on 1 February 2013. The Department has already informed all shipping companies within the UK tonnage tax scheme of the intention to increase the rate of PILOT in line with actual training costs. When the regulations are laid, the Department will inform all affected parties of the change.

Section 9 – Explanation of changes made to the impact assessment in response to the assessment of the Regulatory Policy Committee

The Regulatory Policy Committee (RPC) issued a ‘Green’ rating for the ‘One-in, One-Out (OIOO) Assessment’ that is presented in the impact assessment (IA). However, the RPC had two comments on the overall quality of the analysis and evidence presented in the IA. This section explains the changes that have been made to the IA in response to the RPC's comments. A small number of minor drafting changes have also been made when finalising this IA.

Firstly, the RPC commented that "The IA should provide greater assessment of the likely impact of the monies spent by the Maritime Training Trust (MTT), as this will determine the benefit of the proposal. This should draw on any evaluation evidence on the effectiveness of PILOT to date."

In response to this comment, further information on the impacts of past MTT expenditure has been added to Paragraph 7 in Section 1 and Section 5.4.1 has been amended to take this into account.

Secondly, the RPC commented "The IA says "The Treasury GDP deflator for the calendar year 2012 is 2.5% above the 2011 base. This percentage increase would be insufficient to reflect the change in funding for higher education, effective from September 2012, which will increase the cost of maritime training" (paragraph 25). However, Option 1, described as uprating PILOT in line with the GDP deflator, increases the basic PILOT rate by over 12% in table 2. Although this option is not the one proposed, the IA should explain this increase to provide confidence that the cost of this option has not been overestimated."

In response to this comment, the Department has identified an error with Table 2 which has been subsequently corrected and the analysis for Option 1 has been updated accordingly.

MC1

THE MARITIME TRAINING TRUST

Mr Mike Penning MP
Parliamentary Under Secretary for State
Department for Transport
Great Minster House
33 Horseferry Road
London
SW1P 4DR

RECEIVED ON
22 MAY 2012
PRIVATE OFFICE

21 May 2012

Dear Minister

INFORMATION REGARDING PAYMENT IN LIEU OF TRAINING WITHIN THE TONNAGE TAX SCHEME

The Maritime Training Trust (MTT) has a responsibility to ensure that the arrangements for Payment in Lieu of Training (PILOT) within the tonnage tax scheme are appropriate and current with regard to the actual cost of training. For that purpose the MTT has identified that the PILOT payments from September 2012 need to be increased to approximately £1,092. It is appreciated that this is a considerable increase from the current figure: the justification for the increase is provided below, along with information for the impact assessment regarding MTT income and details of the financial benefit of training as opposed to paying PILOT.

Justification for PILOT increase

As you will be aware, DfT officials and the MTT directors are required during the course of the year to agree any arrangements necessary to increase the rate of PILOT. This has usually involved increases in line with the GDP deflator. However, the MTT directors have been aware that cadet training course costs will rise from September 2012, as a result of planned increases to fee levels, for both higher and further education institutions. The detail of the increases has been difficult for the institutions to identify, due to a host of factors, although most are now clarifying the actual fee levels for each type of cadet training programme in use within the industry. The MTT has therefore undertaken an exercise to identify the approximate cost of training a new entrant officer to first certificate level, using information available from two of the four main training colleges; across the range of programmes in both deck and engineering disciplines; and from three sponsoring companies of different size and type. Given that PILOT will relate to a 'generic' training programme, provided by a 'generic' shipping company, the figures are felt to be suitably robust to provide a true indication of the current required level of PILOT.

From the research, it has been identified that the average cost of a 'generic' programme provided by a 'generic' company is £36,708. The level of PILOT, rounding the total programme cost up to £36,720 would be 36 monthly payments of £1,020. An agreed updated administration charge would also need to be included alongside this figure.

The MTT considers it very important that PILOT should be set for September this year based on this figure. If this were not to happen, then PILOT would not reflect the large course fee increases, that shipping companies would be paying, for at least another year. To charge those companies that fail to meet their training obligation at a significantly lower level than those which are so doing would be

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both unjust and unacceptable, since that would put those 'playing by the book' (ie actually training) at a significant cost disadvantage. It would also be likely to deter compliance and encourage default, which again would be in no-one's interest.

Impact assessment regarding MTT income

It has always been an acknowledged principle that tonnage tax companies should fulfil their training commitment by the practical training of seafarers rather than the payment of PILOT and that, except in exceptional circumstances, PILOT should not be 'planned' but arise only in cases of default.

The MTT recognises that the proposed increase in PILOT could lead to a reduction in PILOT income. MTT directors would in fact welcome it if the increase were to lead to a fall in the number of companies paying PILOT. That would mean companies were adhering to the practical training commitment. There would be no impact on existing MTT training contracts, as these monies have already been accounted for. Neither would it impact on any future MTT plans, which are formulated as necessary on the basis of available monies, rather than any predicted incomes.

Financial benefit of training as opposed to paying PILOT

The financial benefit to companies of training officer cadets as opposed to paying PILOT can be recognised from the following:

i) the shipping company will effectively be 'growing its own' officers of the future. The company will have the benefit of employing junior officers into its fleet of vessels and possibly in due course through to its shore-based management, depending on individual career pathways;
ii) the company's future officers, trained as a result of tonnage tax, will know and understand the company, its operations, activities, policies; company loyalty will have been gained - these attributes are all of considerable value;
iii) 'growing one's own' officers means that the company will not need to seek equivalent officers through the usual route of a crewing agency, with the resultant agency fees that would be imposed and the wide-ranging international mix of officers that are likely to be supplied. This would mean that issues such as language training would not be required, neither would there be any need for the necessary, time-consuming and possible costly checks regarding regulatory certification of the seafarers supplied by the agency.

I trust the above provides the information that the Department requires in order to progress the identified increase in PILOT from this September. Please let me know if we can be of any further assistance.

Yours sincerely

pp Glenys Jackson

Mark Brownrigg OBE
Chairman
dictated by and signed in my absence

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