Title: Proposals to increase Payments in Lieu of Training (PILOT) under the tonnage tax **IA No: DFT 00327** **Lead department or agency:** Department for Transport **Other departments or agencies:**	Impact Assessment (IA) **Date:** 01/05/2015 **Stage:** Validation **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: EANCB Validated

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, Two-Out (OITO)?**	**Measure qualifies as**
-£0.47m	-£0.47m	£0.04m	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 Payments in Lieu of Training (PILOT) which should be at least equivalent to actual training costs. In order to maintain the incentive for firms to train officer cadets, it is considered that it is necessary to increase PILOT in line with the general level of inflation. 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.

What are the policy objectives and the intended effects?

The intended effects of increasing the rate of PILOT are to reduce the risk of (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 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)

The ‘Do Nothing’ scenario represents what would happen if no action were taken. The current PILOT rate is made up of a 'basic' rate plus an element in respect of the Maritime Training Trust (MTT)'s overhead costs, and the ‘basic’ rate is currently set equal to an estimate of average training costs produced by the MTT in 2013 and uprated for inflation in 2014.
Policy Option 1 is to increase the overall PILOT rate in line with the general level of inflation. It is proposed to increase the PILOT rate to £1,218 per trainee month. This is a very small nominal increase of 1.33%, in line with the HM Treasury GDP deflator. Compared to the 'Do Nothing' scenario, this should result in a stronger incentive for companies, where possible, to provide training rather than to pay PILOT. The MTT has advised that this is “felt to be an appropriate increase” as “there are no other reported factors that are impacting in any significant way on the costs of officer cadet training”.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 10/2016

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: Robert Goodwill Date: 11/08/15

Summary: Analysis & Evidence — Policy Option 1

Description: Introduce Regulations to increase the overall PILOT rate in line with the general level of inflation

FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -£0.56m	**High:** -£0.36m	**Best Estimate:** -£0.47m

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	NA	NA	£0.0m	**£0.4m**
High	NA		£0.1m	**£0.6m**
Best Estimate	NA		£0.1m	**£0.5m**

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 around £0.04 to £0.07 million per year in nominal terms, with a Best estimate of around £0.06 million per year in nominal terms. 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'

Given the limitations of the available evidence base which are explained in Section 5 of this impact assessment (e.g. no quantitative evidence is available on the value of the benefits of MTT activities), it has not been possible to monetise any of the benefits of Option 1 that have been identified in this impact assessment, although it would appear that recent increases in PILOT have had the effect of increasing the number of trainee months met by actual training rather than by paying PILOT (see Section 5.2).

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 (see letter at Annex A) 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 OITO?	Measure qualifies as
Costs: £0.04m	**Benefits:** NQ	**Net:** -£0.04m	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. As an alternative option for fulfilling the MTO, tonnage tax companies will from 1 October 2015 be allowed to recruit and train three able Seafarer ratings each year in place of one officer trainee. 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. For example, in the training commitment year 2013/14, less than 1% of the core training commitment was met through "planned" PILOT[1].

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 the 2000/01 and 2013/14 training commitment years is presented in Table 1 below. It should be noted that each training commitment year runs from 1st October to 30th September.

Table 1 – Number of PILOT Payments (2000/01 to 2013/14)[1]

Training Commitment Year (1 October -30 September)	Number of company groups in tonnage tax	Number of Trainee Months[2]	Number of months met by making PILOT Payments	Number of months met by training[3]
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
2011/12[4]	85	21,428	2,847	18,581
2012/13	81	21,139	1,918	19,221
2013/14[5]	76	20,199	1,581	18,618

[1] Department for Transport – Annual summary of Training Commitment and PILOT
[2] The number of trainee months is the total number of months in respect of which company groups were required to provide training.
[3] 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.
[4] Data for 2011/12 is incomplete – returns are outstanding from one group, although these will not alter the data greatly.

7. Where PILOT is paid, the monies are due to the Maritime Training Trust (MTT), an industry body whose directors are drawn from the Chamber of Shipping and the maritime trades unions. The MTT transfers funds to its charity arm, the Maritime Educational Foundation (MEF), which has the same directors. The MEF 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/MEF expenditure have been as follows[6]:

- Since 2002, circa 155 officer trainees have achieved officer certification through the MEF, who will be available to the UK shipping industry and indeed in due course the wider maritime cluster. A further 116 officer trainees are currently in training, with another 45 to be recruited for the coming academic year.
- The J.W. Slater Fund, which provides rating to officer conversion courses, has benefited from funding since 2002 from the MEF, such that, since the scheme was launched in 1997, well over 350 ratings have achieved officer certification. Many applicants do not necessarily report to the Fund their success so the real figure is likely to be higher than this. Currently 211 students are in training, 56 were awarded scholarships in 2014 with a further 19 scholarships being awarded already in 2015.
- In March 2011 the Slater Fund agreed to fund a Maths@Sea e-learning programme which would be used primarily as a diagnostic tool and up-skilling course for Slater Scholars. This was rolled out from August 2011 and all applicants are expected to undertake the programme as part of the application process. A complementary programme; writing@Sea is also now available, with Maths@seaplus complete and available for seafarers with stronger maths skills and those aiming for higher certification.
- From June 2012 funding has been extended to include support for yacht crew and electro-technical officer (ETO) certification and a greater number of enquiries and applications are being received as availability, and particularly the new ETO certification requirements, continue to grow. The work of the Fund therefore clearly continues to benefit not just the individuals who are able to acquire skills but also the industry as a whole by increasing the supply of much needed Officers.
- 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 827 in the 2014/15 academic year.
- Funding continues to be provided to support a range of projects that meet the Foundation’s charitable objects, which includes various Sea Vision activities, support to the Marine Society and Sea Cadets towards a new sail training vessel, to Seafarers UK for a shipping careers awareness film aimed at school leavers, and for the re-development of the industry www.careersatsea.org website and related collateral and social media strategy delivery.
- The ongoing MEF strategy to be a centre of excellence for seafarer training and add value to existing seafarers’ certification and career progression opportunities is becoming embedded with the development of www.meftraining.org which provides information about the range of MEF funding support now available to individual ratings and officers, as well as to companies to support rating apprenticeship places and berths at sea for newly qualified officers to develop watchkeeping confidence. The strategy is being fully reviewed during 2015, to ensure it provides for effective and appropriate support to the industry.

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 training commitment 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.

[5] Data for 2013/14 is incomplete – returns are outstanding from four groups.
[6] Source: The Maritime Training Trust.

10. The PILOT rate again fell significantly below the actual cost of training a cadet when higher education fees were increased in September 2012. Following regulatory clearance, the Department for Transport legislated for two further above inflation increases which respectively took effect from February 2013 and October 2013.

11. The PILOT rate was most recently uprated for inflation, in line with the Treasury GDP deflator, in October 2014.

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

12. 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.

The UK tonnage tax was introduced in 2000 and included a minimum training obligation (MTO) – see Paragraph 3. The tonnage tax has been a major factor in increasing the number of UK merchant navy officer cadets. In the training commitment year 2000/01, 91 new first year officer trainees entered training at shipping companies within the tonnage tax scheme. In the training commitment year 2013/14, the number of new first year officer trainees that entered training at shipping companies within the tonnage tax scheme stood at 802.

13. 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[7] 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.

14. The independent review[7] 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.”

15. The independent review[8] 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;”
- “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.”

16. 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.

[7] https://www.gov.uk/government/publications/an-independent-review-of-the-economic-requirement-for-trained-seafarers-in-the-uk

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'[7]

"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."

17. In addition, the independent review[7] 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".

18. With around 95% of the UK's import and export trade, by volume, transported by shipping[8], 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.

19. 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.

20. The overall 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. For the current PILOT rate, the 'basic' rate of PILOT has been set equal to an estimate of average training costs produced by the MTT in 2013[9] and uprated for inflation in line with the Treasury GDP deflator in October 2014. The overall PILOT rate has been set on this basis with the intention that, on average, the overall rate of PILOT is at least equivalent to the actual costs of training in order to reduce the risk of (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.

[8] DfT (2013) Maritime factsheet https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/70280/maritime-statistics-factsheet.pdf

[9] For more details, please see Annex A of the Impact Assessment for the "The Tonnage Tax (Training Requirement) (Amendment) (No. 2) Regulations 2013" which is available to download at http://www.legislation.gov.uk/ukia/2013/131/pdfs/ukia_20130131_en.pdf.

21. The MTT has written to the Department in February 2015, and proposed that the PILOT rate should be increased to £1,218 per trainee month in line with the latest HM Treasury Gross Domestic Product (GDP) Deflator for the 2015/16 financial year[10]. This proposed increase, which has been agreed by the employer and trade union directors of the MTT, comprises a 'basic' rate of £1,134 and an additional element in respect of the MTT's overhead costs of £84. The HM Treasury GDP Deflator can be viewed as a measure of general inflation in the domestic economy[11]. The MTT has advised that this is "felt to be an appropriate increase" as "there are no other reported factors that are impacting in any significant way on the costs of officer cadet training".

22. Given that the current PILOT payment level came into force on 1 October 2014 and the new PILOT payment level would come into force on 1 October 2015, HM Treasury's latest forecast of the GDP Deflator for the 2015/16 financial year (1 April 2015 to 31 March 2016) is considered to be an appropriate measure of the general level of inflation in this period. This forecasts that the GDP Deflator will increase by 1.4% on average between the 2014/15 financial year (1 April 2014 to 31 March 2015) and the 2015/16 financial year (1 April 2015 to 31 March 2016).[12]

23. The MTT's letter explains that the MTT, last year, estimated that the average cost of a 'generic' training programme provided by a 'generic' company was around £40,267. Applying the above GDP deflator increases the average cost of a 'generic' training programme provided by a 'generic' company to around £40,830. This equates to around £1,134 per month over the 36 months of the training commitment. This represents an increase of around £15 per month compared to the average cost of training estimated by the MTT in 2014[7].

24. We believe that it is necessary to increase the basic rate of PILOT in line with the general level of inflation in order to maintain the incentive for firms to train officer cadets.

25. When the tonnage tax was introduced in 2000, the element of PILOT which was in respect of the MTT's overhead costs was set at 10% of the basic rate. It has not been found to be necessary to routinely increase it in line with that percentage, so it now stands at only around 7.5% of the basic rate. The £1 increase now proposed by the MTT appears to us to be reasonable in the light of the general level of inflation.

The proposed increase in the overall PILOT rate is therefore £16, which is in line with the general level of inflation.

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

26. By seeking to increase the rate of PILOT, 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)

27. The current PILOT rate is made up of a 'basic' rate plus an element in respect of the MTT's overhead costs, and the 'basic' rate is currently set equal to an estimate of average training costs produced by the MTT in 2013 and uprated for inflation in line with the Treasury GDP deflator in October 2014. In order to maintain the incentive for firms to train officer cadets, it is considered that it is necessary to increase PILOT in line with the general level of inflation. Doing nothing would lead to a higher risk that those companies who are fulfilling their MTO through training would face higher costs than those companies who pay PILOT in the training commitment year 2015-16, and a higher risk that companies would seek to pay PILOT rather than train in the training commitment year 2015-16, which would run counter to the policy objective of increasing the number of UK-based officer cadets. Therefore, it is considered that this option is not consistent with the eventual aim of the policy intervention.

4.2 Policy Option 1: Introduce new Regulations to increase the overall PILOT rate in line with the general level of inflation

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[10] https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-march-2015-quarterly-national-accounts

[11] https://www.gov.uk/government/publications/gross-domestic-product-gdp-deflators-user-guide/gdp-deflators-user-guide

[12] https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-march-2015-quarterly-national-accounts

28. Compared to the ‘Do Nothing’ scenario, increasing the overall PILOT rate in line with the general level of inflation would reduce the risk that those companies who are fulfilling their MTO through training would face higher costs than those companies who pay PILOT in the training commitment year 2015-16, and the risk that companies would seek to pay PILOT rather than train.

29. The PILOT rates under the Do Nothing scenario and Policy Option 1 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 in respect of the MTT's overhead costs.

Table 2: PILOT rates under the Do Nothing scenario and Policy Option 1 (all values are expressed in nominal terms)

Do Nothing	
Basic rate	£1,119
Overhead costs	£83 (to cover MTT’s overhead costs)
Total PILOT per trainee month	£1,202
Policy Option 1	
Basic rate	£1,134
Overhead costs	£84
Total PILOT per trainee month	£1,218

Section 5 – Cost and Benefits

5.1. Approach

This section assesses the additional costs and benefits of Option 1 relative to the Do Nothing scenario. Due to the limitations of the available evidence base, it has not been possible to monetise some of the additional costs of Option 1 and any of the additional benefits of Option 1 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.

The monetised costs of Option 1 are assumed to remain constant each year in nominal terms and would therefore decline in real terms each year over time. Where relevant, these costs have been converted from nominal terms to real terms using the HM Treasury GDP Deflators published in March 2015[13] for the period to 2018, and the Bank of England’s annual inflation target as a general deflator for later years in line with the HM Treasury Green Book[14].

The appraisal period is 10 years. It is assumed that the introduction of the policy will be on 1 October 2015, and hence the appraisal period is from 1 October 2015 to 30 September 2025. The appraisal period therefore spans 11 calendar years. To be consistent with the Impact Assessment calculator[15] , the monetised costs of Option 1 during the 10 year appraisal period have been split over these 11 calendar years.

It has been assumed that in 2015 only 1/4 of the annual monetised cost of Option 1 in nominal terms would be incurred, as the appraisal period would only cover the last three months of the year (i.e. 1 October to 31 December 2015). In 2025, 3/4 of the annual monetised cost of Option 1 in nominal terms would be incurred, as the appraisal period covers the first 9 months of the year (i.e. 1 January to 30 September 2025). For the rest of the years (i.e. 2016 to 2024), 100% of the annual monetised cost of Option 1 in nominal terms would be incurred in each of them, since these years would be fully covered by the annual period (e.g. 1 January to 31 December 2016).

13 https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-march-2015-quarterly-national-accounts

14 https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent

15 https://www.gov.uk/government/publications/impact-assessment-calculator--3 (note - the version published on 2 July 2014 has been used for the purposes of this analysis).

5.2. Groups and sectors affected

An increase in the level of PILOT under Option 1 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 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. The only evidence for this is in Table 1, which shows that in 2012/13 (the last year for which full figures are available), the number of trainee months met by actual training increased and the number of trainee months met by PILOT payments decreased. The increase in the number of trainee months met by actual training compared to earlier years seems to suggest that an increase in the level of PILOT may encourage companies to train rather than pay PILOT, although this is uncertain, because the reduction in the number of companies in tonnage tax in the immediately preceding years means that the figures for 2012/13 and earlier years are not directly comparable. 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 effects 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 effects 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 effect 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, Option 1 has the potential to affect 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 £16 per trainee month relative to the Do Nothing scenario in nominal terms. For the purposes of this impact assessment, it is assumed that the level of PILOT would remain at this level in future years in nominal terms.

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 full data is available (i.e. 2006/07 to 2010/11 - 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 five years to 2010/11; as the figures for 2011/12 to 2013/14 are incomplete, these have not been used).

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 £0.04 million to £0.07 million per year under this scenario in nominal terms, with a Best estimate of around £0.10 million per year in nominal terms. Over the 10-year appraisal period, the present value of the additional costs to shipping companies has been estimated at around £0.36 million to £0.56 million under this scenario, with a Best estimate of around £0.47 million (2014 Price Base Year, 2014 Present Value Base Year).

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. However, if these costs are in line with the estimated average training costs presented in Paragraph 23, the additional costs to shipping companies under Scenario B would be less than the additional costs to shipping companies estimated for Scenario A. This is because the rate of PILOT comprises the estimated average training costs plus an additional element in respect of the MTT's overhead costs.

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 in relation to the impact assessment for 'The Tonnage Tax (Training Requirement) (Amendment) Regulations 2013' (DfT00169), 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 simply amend the level of PILOT. 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.

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[78] 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 of 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 in relation to the impact assessment for 'The Tonnage Tax (Training Requirement) (Amendment) Regulations 2013' (DfT00169), 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.

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 around £0.47m (2014 Price Base Year, 2014 Present Value Base Year) (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 around -£0.47m under Scenario A (2014 Price Base Year, 2014 Present Value Base Year).

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.

Section 6 – One-In, Two-Out

Option 1 is considered to be an "Operation of periodic adjustments to a pre-existing regulation or regulatory regime that are intended to maintain the current level of regulation in the face of general wage and price inflation – the adjustment must be provided for in existing legislation" (Better Regulation Framework Manual, Paragraph 1.9.8 (viii)[16]). In this regard, paragraph 29 of Schedule 22 to the Finance Act 2000 provides for the Secretary of State to make regulations relating to payments in lieu of training,

[16] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf

which are “to be calculated on such basis as may be prescribed”. The Regulatory Policy Committee has previously given its view that only uplifts to PILOT above price or wage inflation should be considered in scope of One-in, Two-out (OITO). As this policy is to increase PILOT in line with general inflation, Option 1 is therefore considered to be out of scope of OITO.

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 for Option 1 in accordance with the OITO methodology using the Impact Assessment Calculator. The Equivalent Annual Net Cost to Business (EANCB) has been estimated at around £0.04m per year under Option 1 (2009 Price Base Year, 2010 Present Value Base Year).

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, there is a risk that shipping companies that carry out actual training could 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, which would increase the costs of shipping companies paying PILOT compared 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. 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. However, there is currently no available evidence that there would be a significant impact on competition under Option 1. The total international revenue of the UK shipping industry in 2013 was around £8 billion, and in that context any impact of Option 1 on the likelihood of shipping companies training more or less officers or on the competitive position of the companies seems likely to be small.

7.2. Small and Micro Business 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 October 2015. When the regulations are laid, the Department will inform all affected parties of the change.

THE MARITIME TRAINING TRUST

The Rt Hon John Hayes MP
Shipping Minister
Department for Transport
Great Minster House
33 Horseferry Road
London
SW1P 4DR

20 February 2015

Dear Minister

PAYMENT IN LIEU OF TRAINING WITHIN THE TONNAGE TAX SCHEME – ANNUAL UPDATE

As you are aware, the Maritime Training Trust (MTT) has a responsibility to ensure that the arrangements for default 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 monthly PILOT payments from September 2015 need to be increased to £1,218, in line with the current GDP deflator for 2014 of 1.4%.

Justification for PILOT increase

Increasing the PILOT rate for the training commitment year beginning 1 October 2015 in line with the GDP deflator would mean that PILOT would continue to reflect the current cost of training. The level of PILOT would therefore be 36 monthly payments of £1,218. This is felt to be an appropriate increase, given that there are no other reported factors that are impacting in any significant way on the costs of officer cadet training. The above figure includes an updated administration charge, likewise in line with the GDP deflator.

The above figures are based on the average cost of a 'generic' programme provided by a 'generic' company, which last year had been identified as £40,267. Applying the GDP deflator increases this cost to £40,830, which is a monthly charge of £1,134, over 36 months of the training commitment. To this would need to be added the updated administration charge, which would increase to £84 per month (from the current £83), making a total monthly charge of £1,218.

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 – for at least another year – PILOT would not reflect the true cost of courses that shipping companies which are taking on new trainees as required under the tonnage tax regulations would be paying,. To charge those companies that fail to meet their training obligation at a lower level than those which are so doing would be both unjust and unacceptable, since that would put those 'playing by the book' at a 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 case of default.

The MTT recognises that the proposed increase in PILOT could lead to a reduction in PILOT income. This would in fact be welcomed by Directors as that would mean a fall in the numbers of companies paying PILOT as a result of 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.

<u>Financial benefit of training as opposed to paying PILOT</u>

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

Mike Jess
Chairman