



House of Commons
Business and Enterprise
Committee

**Construction matters:
Government Response
to the Committee's
Ninth Report of
Session 2007–08**

**Tenth Special Report of Session
2007–08**

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The Business and Enterprise Committee

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Tenth Special Report

On 16 July 2008 the Business and Enterprise Committee published its Ninth Report of the current session, *Construction matters*. The Government response was sent to us on 4 November 2008 and is published as an Appendix to this Report. We were happy to allow the Department longer than the normal two months for a response because it had been exemplary in keeping the Committee informed about progress and policy announcements.

We wish to put on record our appreciation of this full and considered response. We are particularly pleased that the Government has accepted our central recommendation that there should be a Chief Construction Officer, tasked with ensuring that Government acts consistently in its roles of policy maker, regulator and major customer.

Government response

1. We welcome the close interest of the Business and Enterprise Committee in the construction industry and are grateful for the time and effort it has spent in carrying out this comprehensive and well-written review. We are grateful too for the time and effort individuals and organisations within the industry have spent in providing the Committee with such a rich source of information.
2. This response demonstrates the real steps in hand to address the issues relating to fragmentation of construction policy and procurement across government. We hope that the Committee will accept that there has been progress, but equally, that we accept that there is the potential to achieve much more.
3. That is why in October 2008 we announced our intention to consult on a potential new champion for the construction industry, in line with the Committee's recommendation that the position of a Chief Construction Officer should be created in Government. We will continue to engage with industry and public sector bodies on this proposal. Full details of the potential terms and scope of the role will be confirmed following engagement with both industry and public sector bodies as part of the Operational Efficiency Programme announced by the Chief Secretary to the Treasury in July 2008. We will keep the Committee informed of developments.
4. The Committee's Report is particularly opportune given that these are very difficult times in the global economy. The twin global shocks of the credit crunch and the surge in energy and food prices have hit every country in the world, including the UK. Families are feeling the effects of the credit crunch on their mortgages and have in addition, been hit by a big hike in world oil and food prices this summer.
5. The Government is determined to help families and businesses get through the tough times ahead—keeping the banking system safe for savers, supporting small businesses, jobs and helping families stay in their homes.
6. In terms of public finance, it is important for government to take action to support the economy, so the Government is protecting public spending during the downturn even though tax revenues are falling.

7. The Government is also working to tackle the causes of the problem in the banking system and in global financial markets. Government is working with our European partners and other global leaders to get banks lending again and to reform the international financial system.

8. We agree with the Committee's assessment of the vital contribution the construction industry makes to the UK—both directly through its contribution to GVA (Gross Value Added) and employment, and because it underpins economic activity generally while contributing significantly to the delivery of the Government's social and environmental objectives.

9. We agree with the Committee's analysis of the UK construction industry and of the challenge of dealing with this highly fragmented industry which works in an inherently project-based way. These challenges are amplified as construction can be a complex product with a significant impact and a long service life. The customer base is equally fragmented. In the public sector for instance, the Government has increasingly sought a devolutionary role with local government, allowing more room for local decision making and innovation. As the Committee has noted, the public sector is not very different from the private sector—in both sectors there are a relatively small number of large, repeat and experienced clients. Most clients buy construction infrequently or on a one-off basis and are not well placed to fully understand the industry and its processes. The Committee is right to point out that the key distinction is not between public and private clients but between experience and inexperience.

10. We welcome the Committee's support for the reform agenda on which we are working closely with the industry and for its recognition of the progress the industry has made. The Government has a part to play but the industry must continue to accept its responsibility for achieving targets and aspirations—for instance by sharing good practice and innovation and also challenging poor client performance. We agree that there is potential to achieve significantly more. In terms of demonstrating that potential, we are grateful for the Committee's endorsement of what the Olympic Delivery Authority (ODA) has achieved so far in terms of implementing good practice through construction procurement. The Olympic project offers the UK construction industry an unparalleled showcase.

11. We note the Committee's approval that the industry's new improvement targets reflect the need to promote economic, environmental and social sustainability. We also welcome the support for the joint industry and Government *Strategy for Sustainable Construction*.

12. Our response is presented under 6 key themes which broadly reflect those in *Construction matters* and in the industry's Construction Commitments. These are client leadership, procurement and integration, people (for instance health and safety and skills and training), sustainability, regulation and innovation.

CLIENT LEADERSHIP

The role of the client

Increasingly, framework agreements are being used to develop longer-term relationships between customers and their suppliers. They can improve project delivery

in terms of time, cost and quality. However, many public sector clients are not yet managing their frameworks rigorously enough to achieve all their potential benefits. One of the functions of the Chief Construction Officer, in conjunction with the Department for Communities and Local Government and others, should be to ensure wider use and more effective management of frameworks, where they are appropriate, both at central and local government level. (Paragraph 42)

13. We welcome the Committee’s recognition of the important role that frameworks can play in the efficient procurement of construction. Frameworks are widely used within government. After being successfully introduced in South East England, the approach is now being rolled out within local government by the Regional Improvement and Efficiency Partnerships (RIEPs). Similar arrangements are now being introduced elsewhere in the UK.

14. We note the Committee’s comments about the effective management of framework projects. Together with CLG (Department for Communities and Local Government), BERR supported the production of a report by the Local Government Task Force called “Taking Advantage—how SMEs can become successful framework contractors”. This report captures developing best practice on framework contracts.

The Construction Clients’ Charter

The features of a ‘good’ client are the same whether they are frequent or occasional customers to the industry. They include setting clear and consistent objectives, appreciating the importance of value rather than cost alone, and active involvement throughout the project to manage risk. Following its extremely poor take-up, we welcome the industry’s intention to revise the Construction Clients’ Charter to reflect the new Construction Commitments. This should provide a comprehensive outline of what being a ‘good’ client entails. Once in place, we believe the Government should lead take-up of the new Clients’ Commitments and contribute to the Strategic Forum’s new target for client leadership by requiring all major public sector procurers of construction works in central Government to become signatories within the next two years. We expect local authorities to make a similar commitment, and look to the Local Government Association to encourage this, recognising the benefits this would bring to those authorities and their council taxpayers. (Paragraph 49)

15. We note the Committee’s support for the new Client Commitments. We are grateful for the work of the Construction Clients’ Group, which BERR has actively supported, both in developing them and in developing simple “how to” guidance on how to implement them. We look forward to the publication of this soon.

16. Implementation of the Client Commitments is one of the key targets of the Strategic Forum for Construction going forward to 2012. It is also one of the deliverables within the joint industry-government *Strategy for Sustainable Construction*. To demonstrate the public sector’s commitment all members of the Public Sector Construction Clients’ Forum have signed the Construction Commitments. Having established this base, we will explore with the Construction Clients’ Group and others how best to take forward this initiative with local authorities.

Helping the industry plan for additional capacity

If the construction industry is to have an incentive to improve its capacity to deliver in the long run by investing in training and new ways of working, it requires the security of a long-term flow of work. The public sector is beginning to acknowledge the role it can play in engaging early with the construction supply chain. It is setting longer-term investment programmes for public services, introducing a new approach to planning, and has clearly committed to ‘zero-carbon’ homes by 2016. However, it could still do more to improve the flow of information to the construction industry, particularly when programmes are delayed, amended, or abandoned. We believe that there is scope for greater co-ordination of major construction projects to mitigate the effects on construction price inflation and to ensure a steady workflow for the industry, although the industry must recognise that its health is only one of the factors the public sector has to take into account. Like any other client, different parts of the public sector will expect to arrange their construction projects to meet their own needs. (Paragraph 107)

21. Government is continuing with one of the largest investment programmes in recent times. The OGC, through its work with the PSCCF, gathers data on public sector future demand for construction as part of its econometric modelling. A summary version of this information is openly shared with industry. This should help suppliers to identify potential areas of opportunity and be in an informed position when planning strategically their own organisation’s investment in capacity and capability.

22. Specific responsibility for departmental investment programmes remains with the departments themselves. It is inevitable that priorities are likely to be reassessed or change over time.

23. Departments are required to take account of full Exchequer costs when they carry out economic appraisals of potential investments. The OGC has made its econometric model available to government clients to assist them in their appraisal process. On major programmes of activity the Major Projects Review Group expects to see evidence of such evaluation before programmes proceed.

One of the responsibilities of the Chief Construction Officer should be leading the Public Sector Construction Clients’ Forum’s work on capacity planning. The postholder should work with departments both to improve the flow of information on construction programmes, and to advise on their co-ordination. As the industry’s largest single client, the public sector ultimately benefits from such early engagement. (Paragraph 108)

24. This will be considered as part of our discussions on the wider potential roles and responsibilities of the proposed Chief Construction Officer.

Retentions

The practice of holding a retention against contractors as an insurance against defects undermines efforts to promote team-working and integrated supply chains in the construction industry. It also damages the cash-flow of smaller sub-contractors and reduces investment in training and innovation. Government has other means by which it can ensure the sector delivers good quality projects, for example where it has long-

term framework arrangements in place. Given that the practice is at odds with the Government's promotion of integrated working through the Common Minimum Standards and the Construction Commitments, we urge it to require all parts of the public sector to end retentions as soon as possible. (Paragraph 143)

25. We are fully aware of the Committee's view of the use of retentions on public sector projects. The Committee is aware of the Government's position following the then Trade and Industry Committee's inquiry into the general practice in 2002 and again in 2003 specifically regarding the role of the public sector as a client of construction. The Government continues to believe that the improvement of procurement processes and practices is fundamental to the achievement of a better quality product and considers that the implementation of better practices will allow a commensurate reduction in the use of retentions. Both outcomes are important and will be pursued. The Construction Commitments, which have been signed by all members of the PSCCF, stipulate that there should be no unfair withholding of retentions. Further, the OGC's Fair Payment Charter and guide to fair payment practices require that any client arrangements for retention should be replicated through the supply chain.

PROCUREMENT AND INTEGRATION

In the wake of the launch of the new industry-wide Construction Commitments, we recommend the Government reinvigorates the *Achieving Excellence* initiative by establishing new targets for public sector construction project performance. The OGC should also put in place performance measurement systems that collect data against all of these targets—not just some. (Paragraph 67)

26. Achieving Excellence (AE) is valued by clients as a useful tool in helping them to improve their performance in the procurement of construction. It is widely recognised within the industry. The OGC is planning to refresh AE within the next year to take account of developments in government and industry and to ensure that it continues to assist clients to strive for procurement excellence.

27. The OGC and the PSCCF have agreed to explore the concept of greater sharing of departmental management information in order to identify further potential opportunities for government as a whole.

The Common Minimum Standards

The Office of Government Commerce has set Common Minimum Standards for construction procurement, based on the *Achieving Excellence in Construction* guidance, which are mandatory across the public sector. Yet anecdotal evidence suggests their implementation, particularly at local authority level, has been patchy, due in large part to a lack of awareness. We believe the Government should now update the Standards to reflect the principles set out in the new Construction Commitments. The OGC should also work to promote greater awareness of the Standards; to measure their use across the public sector; and to enforce compliance by central government departments and their agencies. Local authorities, with the support of the Local Government Association, should also comply with the Standards in the interests of the communities they serve. (Paragraph 71)

28. The Common Minimum Standards (CMS) summarise government policy for construction procurement. The CMS will be updated and all relevant policy initiatives will be considered as part of that process.

29. The Local Government Task Force recommended that the CMS be applied to all construction procurement activity. The OGC, together with BERR, Constructing Excellence, the HSE (Health and Safety Executive), the ODA and the RDAs (Regional Development Agencies), ran a series of regional roadshow events to raise awareness and understanding of the CMS.

The Public Sector Construction Clients' Forum

We welcome the establishment of the Public Sector Construction Clients' Forum and its work to support the co-ordination of construction activity and initiatives across government. We urge all involved in its work to regard it as a permanent feature of the public sector's engagement with the construction sector. (Paragraph 72)

30. We welcome the Committee's recognition of the important step taken by the OGC in establishing the Public Sector Construction Clients' Forum. It is certainly intended that the Forum should continue and build on its successes to date.

Transforming government procurement

We welcome the *Transforming government procurement* initiative and in particular the OGC's new focus on implementing best practice across the public sector. We are, however, seriously concerned that the Office has been provided with neither the resources nor the powers it needs to achieve this task. We recommend that the OGC's staffing levels are reviewed. We also recommend that the Government reviews the means by which the Office can better perform the role of 'enforcer' of good practice across the public sector. Several potential institutional levers exist already for it to achieve this, but more may be needed. It should involve taking advantage of its position as an office of HM Treasury. It should also include greater engagement at permanent secretary or ministerial level with other government departments. (Paragraph 78)

31. Resources will be an integral consideration in the proposed appointment of a Chief Construction Officer. The OGC's role includes, where necessary, challenging procuring organisations in what they do. That challenge may, on occasions, involve escalation of issues to departments' senior management so that they are in a position to take any enforcement action necessary.

Raising performance through integrated teams and supply chains

The fragmentation of the construction industry has contributed to its poor performance on delivery to time and cost. Integrated working not only improves value for the client, but also allows time for firms in the supply chain to develop business relationships with each other, creating an environment that encourages investment in capacity and innovation. Despite the potential benefits for all involved, progress in adopting integrated working has been slow. We welcome the new targets for the period 2008 to 2012. We are encouraged that the industry bodies have recognised their responsibility. The Government should also play its part through, for example, effective

framework arrangements; engagement with the industry on its long-term construction programmes; and departments' compliance with the Common Minimum Standards. (Paragraph 118)

Early engagement with the supply chain

Government is not doing enough as client to engage with the supply chain early on—a key feature of integrated working. As a result, the public sector is missing out on efficiencies that would deliver a cheaper and better quality end-product. (Paragraph 120)

Improving economic sustainability

Overall, integrated team working can provide the way out of the vicious cycle of adversarial relationships and poor performance that have characterised the construction industry for so long. Paragraphs 23 to 32, above, have outlined a number of ways in which this can be facilitated. However, it requires a culture change by all the sector's participants—clients, contractors and sub-contractors. As the single largest construction client, government should be taking the lead in tackling that challenge. (Paragraph 162)

Response to the above three recommendations

32. The Committee draws a number of specific conclusions and makes a number of recommendations about integrated working and the role of government.

33. Promoting more integrated working practices is the cornerstone of the industry's improvement agenda and we are grateful for the Committee's support for the Strategic Forum's new targets in this challenging area. We are also grateful for the emerging work of the Strategic Forum's Integration Task Group which is seeking specifically to articulate better the business case for more integrated working. As that group and the Committee have acknowledged, there are potential benefits for all involved—it is important that we do not lose sight of that.

34. In partnership with the industry, Government is seeking to play its part in promoting more integrated working practices in its construction supply chains (see also paragraphs 15 and 16). As we have previously mentioned, members of the PSCCF have signed the Construction Commitments—a key component of which is procurement and integration—and we will be seeking to build on this to ensure that the high-level commitment works through into practice on the ground.

35. Early engagement with the supply chain is a key feature of integration and we are keen that modern procurement practices, such as framework agreements, play their full role in delivering more integrated working practices. Collaborative procurement is one of the five initial themes under the Operational Efficiency Programme.

36. The Strategic Forum for Construction is a member of the PSCCF and is engaged in the discussion about long-term construction programmes. In addition, the move towards longer-term framework contracts and larger procurement programmes (such as Building Schools for the Future) has introduced greater transparency into spending plans.

37. Compliance with the Common Minimum Standards is clearly an important issue both for Government as it seeks to ensure value for money and for the industry as it seeks to secure culture change and promote more modern and efficient ways of carrying out its business. The Common Minimum Standards align with the Construction Commitments and we will do further work to ensure that alignment is even closer. In this regard we are greatly helped by the members of PSCCF who are already working to deliver the principles in the Commitments on the ground.

38. However, we would not want to unduly raise expectations. Integration is not a tap Government, or any single sector of the industry, can simply turn on. Widespread adoption of integration across the industry involves significant culture change and will take time. We accept that there is still some distance to go but we believe that Government is taking important steps to promote integration more widely. We intend to continue to build on that.

Collaborative contracts

Integrated team-working needs to be underpinned by contracts that foster collaborative rather than adversarial relationships between clients, their contractors and their sub-contractors. Unfortunately the industry does not seem able to do this for itself. As a result clients must take the lead. There are useful standard contract forms such as the NEC3 Engineering and Construction Contract, recommended by the Office of Government Commerce for all public sector construction projects. Despite this, a large proportion of government construction is still let using a variety of traditional contractual arrangements. Led by the OGC, departments should work towards the use of collaborative contracts as a matter of course, and ensure they are adopted throughout their supply chains. (Paragraph 132)

39. The use of collaborative forms of contract is a key element of the Achieving Excellence in Construction initiative and the OGC recommends the use of NEC3. A number of the larger central government construction procurers have already moved to NEC3 and a number of others are now considering doing so. The OGC has just completed a further review of standard forms of construction contract for compliance with the principles of Achieving Excellence. Further advice will be issued in due course.

Project insurance

Integrated Project Insurance provides single cover for the entire project team, and could foster integrated working by encouraging the collective ownership of a project's target budget. It is an emerging concept, but one that could deliver benefits for all members of the project team. We encourage the OGC to set a target for the approach to be piloted across a range of departmental construction projects so it can be properly evaluated. (Paragraph 136)

40. Both the OGC and BERR assisted with the development of the Project Insurance product. The OGC is now working with a number of public sector clients to identify projects to pilot the use of project insurance.

The 'Fair Payment' Charter

We welcome the introduction of the 'Fair Payment' Charter. The OGC should ensure all central government construction clients have affirmed their adoption of the Charter by the end of 2009. The Office should then aim for all local authorities to have signed up to it by the end of 2010. The OGC's monitoring of implementation should ensure that clients are adopting the principles of the Charter throughout the construction supply chain, and not simply between themselves and their main contractors. Where construction firms believe their client is not abiding by the principles of the Charter, we urge them to make representations to the Minister and to the OGC. (Paragraph 146)

41. BERR and the OGC have encouraged suppliers to government to draw their attention to any instances where government's practice falls short of the 'Fair Payment' Charter.

Project Bank Accounts

Both the Office of Government Commerce and the National Audit Office have endorsed the use of project bank accounts as a means of improving payment practices and facilitating integrated working. Central government procurers should now start to make use of project bank accounts, where practicable and cost-effective. The OGC should monitor take-up and evaluate the benefits. (Paragraph 149)

42. Government has supported the development and use of project bank accounts in the construction industry. Their use is increasing and it is anticipated that key government clients will make further announcements on their introduction in the near future.

43. The OGC has already committed to, and established, arrangements to measure the implementation of fair payment best practice through to 2010. Similarly, the OGC will work with departments to evaluate benefits flowing from the adoption of fair payment principles.

Constructionline

The Government must reduce the burden that multiple public sector prequalification schemes impose on construction firms, particularly SMEs. Constructionline was set up to address this, but it has proved unsatisfactory for the industry. The Government should either make it work, or abandon it. If the consensus is that Constructionline cannot work as intended, then the Office of Government Commerce should consider how it might develop core criteria and mutual recognition between schemes. (Paragraph 276)

44. The main aim of Constructionline is to reduce burdens on contractors and tendering organisations. It does this by providing proof of prequalification for all the core questions relating to financial stability, certification, insurances etc. It does not attempt to supply tender-specific information. Most other prequalification services focus on 'added value' functions in addition to prequalification, such as searches for work opportunities, or tailored prequalification for specific organisations.

45. Constructionline is expanding steadily. There have been increases in the number of users in the last year to date of 1,500 suppliers and 1,800 buyers. The past year has also seen

a 40% increase in usage of the system by buyers, who made over 160,000 enquiries of the database.

46. The new Constructionline contract, let this autumn, should see the numbers of buyers and suppliers double over the four-year term, encouraged by incentives in the contract which allow the contractor to reduce overhead expenses as membership and usage by buyers grows.

47. BERR is working with the OGC to make sure that there is better alignment of core criteria (the common questions everyone should ask). The 'Successful Delivery Toolkit' prequalification section links directly to Constructionline with a recommendation that purchasers should consider using the service. We will continue to work with Constructionline, the OGC, the HSE, the Equality and Human Rights Commission and others to ensure proper alignment across the board, to provide an effective standard. (As part of the Government's work to simplify industry prequalification schemes, the HSE is working with the Safety Schemes in Procurement (SSIP) towards achieving mutual recognition of Stage 1 of the CDM 2007 core criteria.)

COMMITMENT TO PEOPLE

'Bogus' self-employment

The widespread practice of wrongfully classifying directly employed workers as self-employed, otherwise known as 'bogus' self-employment, creates significant costs for construction workers, clients, the wider industry, and the Exchequer. To tackle the problem, HM Revenue and Customs' Construction Industry (tax) Scheme (CIS) now places a greater onus on contractors to verify the employment status of their subcontractors. The success of this new approach will depend on the collective 'buy-in' of contractors. Government must also ensure HMRC has the power and resources to monitor and enforce compliance. (Paragraph 177)

48. We accept that the level of "bogus self-employment" is a problem, resulting in a significant loss to the Exchequer in addition to other negative consequences. Enforcement is important and in recent years HMRC has both increased and restructured the resources it deploys on this. These are commensurate with the risk presented by the construction sector compared to other sectors. HMRC is also working with other government departments and external stakeholders to explore ways to encourage greater voluntary compliance and more effectively to detect and take action against non-compliance. Changes introduced to the new CIS with effect from April 2007 will also help HMRC to better tackle the problem of false self-employment.

We welcome the setting up of the Vulnerable Worker Enforcement Forum and look forward to its recommendations. We hope it will give particular attention to whether the Gangmasters Licensing Regulations should be extended to cover construction workers. More generally, the public sector as client has a major role to play in providing long-term security of work for construction firms, which departments should actively take advantage of. Among the benefits this would bring is a real encouragement for contractors to take on more direct employees. (Paragraph 178)

49. The Vulnerable Worker Enforcement Forum published its final report containing the Government's conclusions on 5 August 2008. There was discussion in the Forum, although no agreement, on whether the Gangmaster Licensing Authority's licensing regime should be extended to other sectors, including construction. Employment agencies providing labour to the construction sector (and all other sectors not covered by the GLA), are regulated by the Employment Agency Standards Inspectorate (EAS). Government does not currently intend to change these arrangements. We will prioritise effective enforcement of the existing law by taking steps to strengthen the EAS and ensure that it develops a significantly higher profile amongst agency workers and agencies themselves—building on the stronger investigative and penalty powers being legislated for through the current Employment Bill.

ConstructionSkills and the Levy

The structure of the construction industry and the nature of its work create disincentives for many employers to invest in training and skills. The CITB-ConstructionSkills Levy provides an effective means of tackling this problem, which has the support of the majority of those who pay it. The Levy provides a vital means of funding for training, which contributes to the long-term skills needs of the sector. We support its continued use. (Paragraph 185)

50. DIUS, as the Construction Industry Training Board (CITB) sponsor department, will continue to support levy proposals where these enjoy the support of the majority of employers.

Training routes into construction

Given that migrant labour is unlikely to provide a stable long-term solution to the skills needs of the construction industry, it is vital to attract more domestic recruits to the sector. The initial take-up for the now abandoned Construction GCSE suggests there is an appetite within schools to engage with the industry early on. We support the development of the new Construction and Built Environment Diploma and hope that it will provide a credible qualification and entry route for those considering a career in construction, as well as meeting the skills needs of employers. Given the importance of developing skills in this vital sector of the economy, its effectiveness must be rigorously and regularly reviewed. (Paragraph 189)

51. The Diploma in Construction and the Built Environment, which has been available to 14-19 year olds in England since September 2008, should have a positive effect on boosting the numbers of young people choosing a career in construction. Employers from the sector have been closely involved in every stage of the design and development of the new qualification, and the development process is led by five Sector Skills Councils. The Diploma will provide learners with the knowledge and skills that employers seek from their new recruits.

52. We agree that it is vital to monitor and evaluate the impact and effectiveness of the new qualification. All Diplomas will be subject to a rigorous three-year evaluation period, with an annual evaluation report being produced. Two reports, on the development and on the implementation of the Diploma programme, will be published in January 2009.

