Education Report: Further advice on the Unified Funding System

To:	Hon Chris Hipkins, Minister of Education		
Date:	6 October 2021	**Priority:**	High
Security Level:	In Confidence	**METIS No:**	1268057
Drafter:	Hayley Robertson	**DDI:**	s 9(2)(a)
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Messaging seen by Communications team:	No	**Round Robin:**	Yes

Purpose of report and summary

This report provides further advice on elements of the unified funding system (UFS), following up on your recent feedback on eligibility for tuition subsidies, the funding of extramural and online provision, and the design of the strategic and learner components. Your decisions on these elements will be reflected in the upcoming Cabinet paper.

The paper provides advice on three matters arising from earlier advice [Metis 1268057 refers]:

- Options to provide programme design funding for extramural programmes
- An exemption regime to allow some non-domestic learners in work-based learning to retain eligibility for tuition subsidies
- Access to the strategic component to support collaboration and consortia.

We will incorporate your feedback in this paper to the draft Cabinet paper, to be sent to you in mid-October.

Recommendations

The Ministry of Education and the Tertiary Education Commission recommend that you:

a. **note** that we do not recommend introducing *dedicated* funding for the development of extramural/online programmes alongside a lower per learner rate for the extramural mode

b. **agree** that extramural delivery should continue to be primarily funded by a subject-based per-learner funding rate, with the ability to apply for strategic component funding for programme development which responds to a national or regional skill need

Agree / Disagree

EITHER

c. **agree** that an exemption regime for tuition subsidy eligibility will **not** be established for non-domestic learners (**recommended**)

Agree / Disagree

OR

d. **indicate** your preferred option for an exemption regime:

Option 1	A narrow exemption regime that would target training necessary to unlock skills developed overseas	**Yes / No**
Option 2	A broader exemption regime that would seek to respond to a scarcity of skilled workers and sufficiency of training pipelines	**Yes / No**
Option 3	An exemption regime for workers with a visa status that demonstrates a long-term commitment to being in New Zealand	**Yes / No**

e. **agree** to a grandparenting arrangement for non-domestic learners with a training agreement at the time of the implementation of the eligibility changes to retain eligibility for tuition subsidies

Agree / Disagree

f. **agree** that the project-based portion of the strategic component should be open to consortia that include both providers and other organisations

Agree / Disagree

g. **agree** that, rather than entirely excluding universities and wānanga from the project-based portion of the strategic component, the decision-making criteria should include whether a provider could be expected to fund the activity from other sources

Agree / Disagree

h. **note** that we have set out our approach to a number of detailed funding allocation issues for the learner success component in Annex 2

i. **forward** this briefing to the Associate Ministers for Education

j. **agree** to proactively release this education report within 30 days of Cabinet decisions being made, with any redactions in line with the provisions of the Official Information Act 1982.

Agree / Disagree

Vic Johns
Policy Director
Te Ara Kaimanawa
Ministry of Education

06/10/2021

Gillian Dudgeon
Deputy Chief Executive – Delivery
Tertiary Education Commission

06/10/2021

Hon Chris Hipkins
Minister of Education

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Background

1. On 26 August, we provided you with advice on choices about the funding category component of the unified funding system (UFS) in order to support modelling [METIS 1268057 refers]. We have subsequently provided initial advice on different scenarios for funding rates for the UFS [METIS 1272025 refers] and expect to provide follow up advice refining your preferred approach, including transition options, in the next week.

2. As a result of your feedback on the 26 August paper, we have prepared further advice on a number of related decisions that will be required ahead of finalisation of the UFS Cabinet paper, in particular:

   - whether the UFS should separately fund upfront development costs for extramural delivery, alongside a lower per-learner funding rate
   - whether the new eligibility requirements for tuition subsidies should be accompanied by an exemption regime
   - whether the project-based portion of the strategic component should be open to consortia of providers and other organisations and whether universities and wānanga should be excluded entirely from eligibility for funding.

3. Annex 2 also provides information on some detailed funding allocation issues for the learner component.

4. We are seeking your decisions on these matters by 11 October, so that they can be reflected in the version of the Cabinet paper that we are proposing to provide on 13 October.

Outstanding issues

Extramural: Programme development costs

5. You asked us to consider an approach to funding extramural delivery within the UFS that distinguishes between upfront development costs and lower per-learner marginal costs, and that this be considered in relation to the strategic component and role of WDCs [METIS 1267373 refers].

6. Te Pūkenga will be the dominant provider of extramural delivery within the UFS (around 60 percent of extramural provision – 8,300 EFTS in 2020). Te reo and tikanga provision by wānanga accounts for a further 20 percent of extramural provision (2,900 EFTS), which you have agreed will remain funded at its current funding rates while a broader review of te reo and mātauranga Māori funding is progressed. The remaining 20 percent of extramural delivery (around 3,000 EFTS in 2020) is spread across 42 providers – mostly PTEs, with some delivery by Massey University (400 EFTS in 2020) and Te Wānanga o Aotearoa (175 EFTS in 2020).

7. We explored the following options for separately funding development costs for extramural programmes:

Option	Key features	Advantages	Disadvantages
1: Establishing a dedicated part or proportion of the strategic component for the development of new extramural programmes	A portion of the Strategic Component would be designated to co-funding development and implementation of new extramural programmes Allocation based on application and business case, with funding prioritised against other applications Depending on scale, could be accompanied by a lower extramural per learner rate strategic component funding could be contingent on WDC support	Separates funding for programme development from volume-based funding reflecting lower marginal cost Clear source of funding for programme development	Lack of data on appropriate amount of funding to dedicate to programme development Would not provide certainty of funding for programme development Inconsistency with other programmes that may also have high upfront costs Incentivises providers to shift development costs to their extramural programmes, which could then be used to support intramural delivery Amount of strategic component funding may not be sufficient - would limit and/or challenge achieving other strategic component objectives
2: Strategic component able to be used to fund programme development (not solely extramural and no dedicated amount or proportion) **Recommended**	Most extramural programme development costs would continue to be met by per-learner funding. Providers could seek funding for programme development from the strategic component, but this would be prioritised against other applications (and other Strategic Component priorities and criteria).	Provides a potential source of funding for extramural programme development While funding would not be dedicated to extramural programmes, they may be able to present a stronger case for funding. Does not create an inconsistency with funding development costs for other programmes.	Funding for development costs would be on a by-exceptions basis, where providers can demonstrate that it is necessary to allow them to respond to regional/national skill needs. Eligibility for project-based funding may only extend to some subsectors (see the discussion in paras 31ff).
3: Applying the extramural mode only to Te Pūkenga alongside strategic component funding for development costs	Would fund all providers other than Te Pūkenga at 'main' rate for provider-based delivery, supplemented by prospect of additional funding for specific programme development costs	Provides higher funding to smaller providers who lack economies of scale. Reinforces incentives for Te Pūkenga to take a network approach to programme design, taking advantage of the economies of scale available to them.	Would introduce different funding rates for different sub-sectors, creating complexity and inconsistency Risk that providers (other than Te Pukenga) are incentivised to promote online learning ahead of work-based learning because it is funded at the full provider-based rate.

8. There are a number of challenges associated with a dedicated programme development fund for extramural programmes (Option 1). We lack robust information about the relative scale and appropriate balance of the two types of costs, and how development costs for extramural programmes differ to those for other programmes.

9. Our engagements with key providers of extramural learning (e.g. Open Polytechnic) highlighted that regular investment in both programme development and the enabling technology are necessary for high-quality extramural delivery, with volume being the key to both. There would be a risk of the separate funding being lower than an amount that would incentivise development of large-scale new programmes.

10. Dedicated programme development funding could also result in gaming and unintended consequences, including providers:

- relying on that funding rather than managing those costs as a core part of their overall operations (including capital investments)
- cross-subsidising overall programme development costs with funding intended for extramural programmes
- seeking funding for upgrades of existing programmes rather than the development of genuinely new programmes.

11. Overall, we consider it likely that the lower marginal costs are primarily driven mostly by volume and investments in the infrastructure underpinning extramural delivery. As such, dedicated funding for programme development may not target the dominant driver of higher upfront costs and lower marginal costs of delivery.

12. For these reasons, we recommend Option 2 i.e. the funding for the development and delivery of extramural programmes would remain primarily driven by the subject-based per-learner funding rate for the extramural mode. This would be supported on a by-exception basis by strategic component funding for programme development if it responds to regional and/or skill needs identified by RSLGs and WDCs. While this funding would not be dedicated for extramural programme development, the higher upfront costs associated with this delivery may better support a case for strategic funding, in comparison to intramural delivery.

13. To generate the most value from the strategic component investments, we recommend that funding for programme development be an option reflected in decision-making criteria for the component – rather than a designated portion of it being exclusively for programme development. This would mean that funding for programme development would be prioritised against other potential strategic component investments. As in our previous advice, we also recommend that the Qualification Development Fund (which is only $800,000 per year) be discontinued as part of establishing the strategic component.

14. As the reformed system matures – including the role of WDCs in relation to programme development and endorsement – funding for the development of extramural programmes could become a stronger focus for the strategic component, potentially supported by increasing the scale of the strategic component as a proportion of total UFS funding.

Eligibility: approach to exceptions and grandparenting

15. You have agreed [METIS 1267373] to align eligibility for work-integrated training with current SAC eligibility. As part of this, you agreed to remove eligibility to public

subsidies for non-domestic apprentices and trainees, but asked us to investigate a narrow exemption based on national interest.

16. The stakeholders we engaged with about the eligibility proposals suggested that some employers will not yet be ready, nor in some cases willing, to respond nimbly to either build domestic workforce skills and/or to invest in training unsubsidised learners.[1] These stakeholders do not support the removal of eligibility for non-domestic learners, and are likely to advocate for substantial exemption.

17. In contrast, MBIE advised against any exemption, in light of their experience of operating such regimes, which shows that they have high transaction costs and are difficult to target clearly to national interest.

We have considered several options for the design of an exemption regime

18. We considered several options for the design of an exemption regime, including:

- A narrow exemption regime that would target training necessary to unlock skills developed overseas, and which would also benefit domestic workers and industries (Option 1)

- A broader exemption regime that would seek to respond to a scarcity of skilled workers and sufficiency of training pipelines, informed by workforce development plans and skills shortage list (Option 2)

- A visa-based exemption regime for workers with a visa status that demonstrates a long-term commitment to being in New Zealand (e.g. those on a partnership visa) (Option 3)

19. Our analysis considered alignment with UFS aims, as well as with immigration policy aims to ensure employers meet the costs of recruiting from overseas. We also considered the national interest concerns raised by stakeholders, including the risk of losing training capability. Finally, we considered the administrative burden of any regime, and any risks of gaming.

We do not recommend introducing an exemption regime

20. After considering the above options, we have not identified a compelling case for an exemption regime. Through our discussions with stakeholders, we were unable to identify any really strong examples of public benefit that differentiated one area of delivery from another. Examples provided by stakeholders tended to presume that employers will be unable or unwilling to invest in the full cost of training non-resident workers. Stakeholders considered that this may then compromise their access to the skills mix they require at the time they need it.

21. We are not convinced by this argument and consider that employers that rely on non-resident workers due to a shortage of relevant skills in the New Zealand labour market should have sufficient incentives to pay the full cost of any training that is necessary for them to fulfil their roles. Unlike domestic workers, there would not appear to be the kinds of spill-over benefits to the New Zealand economy and society that would justify subsidisation.

[1] We received views on the impacts of these two eligibility proposals from transitional Industry Training Organisations (BCITO, Primary ITO, Competenz, Skills Org, Skills Active, Careerforce, and Service IQ), Business New Zealand and the New Zealand Council of Trade Unions.

22. MBIE has noted that an exemption process would not align well with the aims for investment in skills sought through the Immigration rebalance. The rebalance aims to incentivise businesses to develop local workforces before seeking to source labour from overseas and to lift working conditions, improve the skills training and career pathways for workers, and contribute to greater productivity by encouraging investment in higher skill levels and technology.

23. In addition, most options for an exemption process would have high administrative costs associated with both establishing and maintaining an exemption process, as well as creating a potential avenue for ongoing lobbying by affected sectors.

24. While we are unconvinced by stakeholder concerns about skill availability, there is some uncertainty as to how employers, learners and providers will respond to these eligibility changes. We propose to monitor these factors as the UFS is introduced and would provide advice if there is a clearer case for exemptions in the future.

Should you wish to proceed with exemption, we would recommend focussing on unlocking skills in the New Zealand context

25. Of the options we analysed, we consider that a narrow exemption regime (Option 1) would have the clearest link to the national interest. Under this option, an exemption could be issued to workers already trained in a similar field of work overseas for the additional training needed to enable them to use that training within a New Zealand context. In this sense, an exemption would “unlock” those workers’ existing skills for use in New Zealand. This training may have broader benefits to New Zealand, although their employer would seemingly still have sufficient incentives to pay for any truly critical training on an unsubsidised basis. Only two examples 9(2)(g)(i) [redacted] were provided from stakeholders that we would consider applicable to this exemption option.

26. A broader exemption regime (Option 2), for example connected to workforce development processes, would be more administratively complex to implement and would encourage ongoing lobbying by affected sectors. While Workforce Development Councils could inform any exemption decisions, requiring them to act as gatekeepers would place them in an invidious position with their industries. Again, if the skills created by training were truly critical to addressing a skills shortage, then employers should have a sufficient incentive to pay the whole cost of this training.

27. An exemption regime based on visa status (Option 3) would not support particular sectors or areas of national interest, although it would support employment opportunities for people intending to stay in New Zealand in the long-term, opening up employment options that require workforce training. MBIE advises that the partnership visa is likely to be the only category which would not compromise the principles underlying the Immigration rebalance approach, and that this would still be unusual.

28. Should you wish to proceed with an exemption process we would reflect this at a high level in the November Cabinet paper and work with the TEC to provide you with advice on refined exemption criteria based on your preferred approach.

Grandparenting arrangements should be provided for those learners already enrolled in training

29. We consider that it is important for fairness reasons that non-domestic learners who have already commenced their training on the date that the UFS is introduced continue to be subsidised. This mitigates the risk that the learner and/or employer would

become liable for unanticipated fees and that they would choose not to complete their training.

30. We recommend the continuation of eligibility through to the end of their programme of study for tuition subsidies for those learners with a training agreement at time of implementation. Tuition subsidies would be paid at UFS rates (i.e. we would not grandparent the industry training rates, just the eligibility). We will provide you with further advice on the details of these arrangements, including any time limitations.

Design of the strategic component

31. You agreed-in-principle that the strategic component should be made up of two elements [METIS 1267373 refers]:

   - Funding for Te Pūkenga to support it to meet its charter obligations to build a sustainable national network and to meet regional and national skills priorities.

   - Project funding support for PTEs to meet national and regional skills priorities.

32. We have subsequently considered the implication of the second decision for the overall design of the strategic component. One potential concern is that limiting project-based funding to PTEs could limit the ability of strategic funding to support and incentivise consortia of providers and other organisation to respond to skill needs. For example, we had envisaged that providers may seek to partner with businesses and/or community organisations to develop innovative responses to skill needs and that strategic funding be used across the consortia.

33. Limiting the availability of project-based funding to PTEs may also limit the incentives for other types of providers to engage in these sorts of activities.

34. s9(2)(g)(i), s9(2)(f)(iv) [redacted]

35. For these reasons, we recommend that the project-based funding from the strategic component should be available to consortia that include both providers and other organisations, and that it should not explicitly exclude wānanga and universities from being eligible for funding. Instead, we would suggest that the criteria for assessing funding applications include consideration of whether providers should be expected to fund these activities from other sources, for example due to their economies of scale or due to the availability of other funding sources for these activities 9(2)(f)(iv) [redacted] This may in

[2] Based on the definition in the legislation that a "wānanga is characterised by teaching and research that maintains, advances, and disseminates knowledge and develops intellectual independence, and assists the application of knowledge regarding ahuatanga Māori (Māori tradition) according to tikanga Māori (Māori custom)."

practice mean that universities and wānanga are less likely to be successful in seeking strategic funding, but it would be more flexible and lower risk than making them entirely ineligible.

Funding allocation for the learner success component

36. We recently provided you with advice on performance measurement and consequences for the learner component [METIS 1268057 refers]. Annex 2 sets out some further detailed funding allocation issues for the learner success component and the approach we are taking for each. We have set these issues out so you can see the detailed methodology we intend to take to calculating learner success component funding for each TEO. We will provide advice later this year or early in 2022 about:

- how to apply the learner success component for those PTEs that would receive a very small amount of funding from the component
- an interim approach to identifying disabled learners for the purposes of learner success component funding (in advance of improving data collection about disabled learners in all tertiary education).

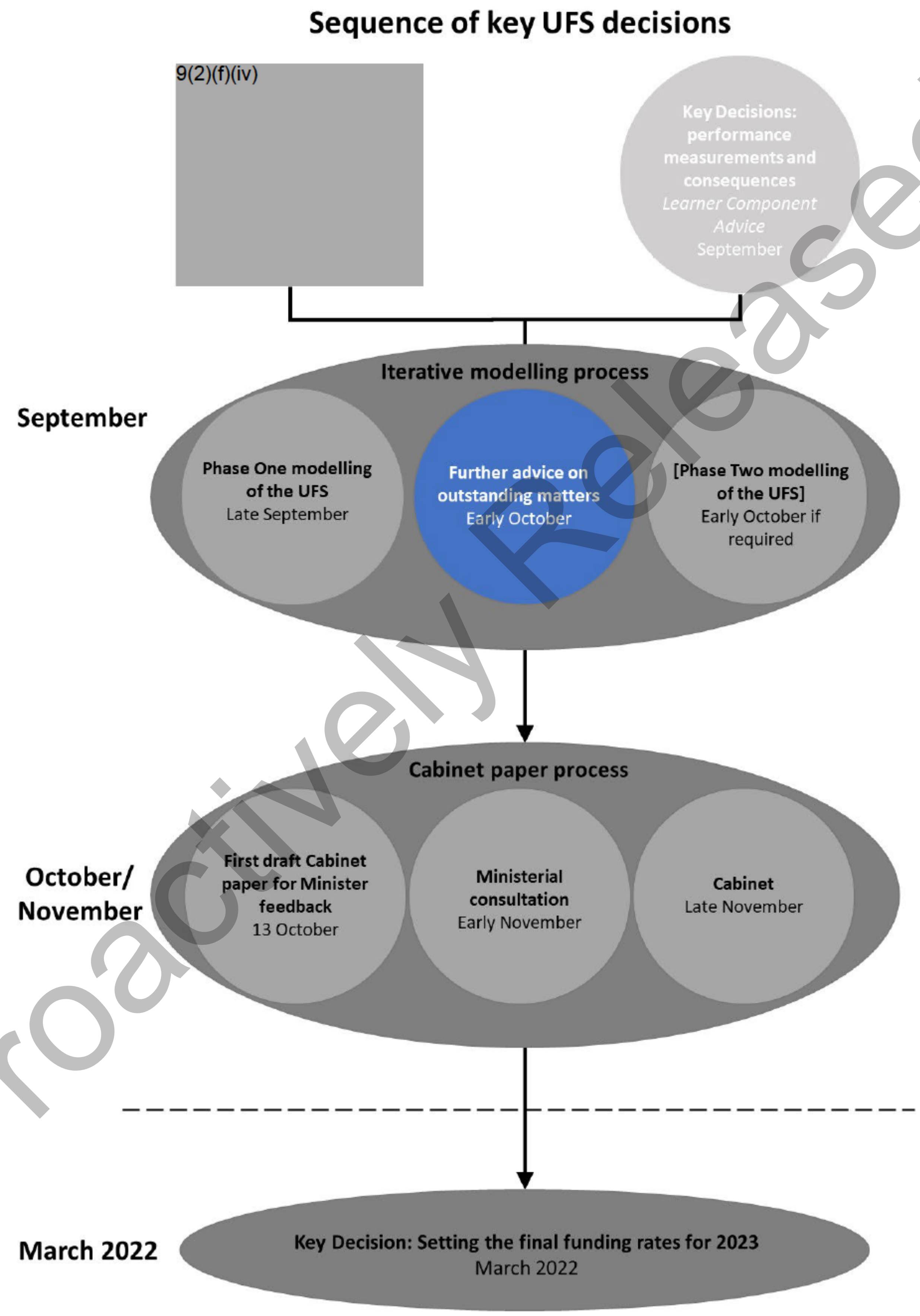
Next steps

37. We seek your feedback on this paper by 11 October to reflect in the draft Cabinet paper for ministerial consultation, which we expect to provide on 13 October.

Annexes

Annex 1: Sequence of key UFS decisions

Annex 2: Detailed funding allocation issues for the learner success component


Sequence of key UFS decisions
9(2)(f)(iv)
Key Decisions: performance measurements and consequences
Learner Component Advice
September
Iterative modelling process
September
Phase One modelling of the UFS
Late September
Further advice on outstanding matters
Early October
[Phase Two modelling of the UFS]
Early October if required
Cabinet paper process
October/ November
First draft Cabinet paper for Minister feedback
13 October
Ministerial consultation
Early November
Cabinet
Late November
March 2022
Key Decision: Setting the final funding rates for 2023
March 2022

Annex 2: Detailed funding allocation issues for the learner success component

38. Based on your previous decisions about the learner success component, funding for each TEO will be allocated as follows (METIS 1263885 refers):

$rate x (EFTS/STMs of learners with low prior achievement and disabled learners) *this rate is to be determined as part of whole-of-UFS modelling*	+	$137 x (EFTS/STMs of Māori and Pacific learners except NZQF level 7 non-degree) *or* $329 x (EFTS/STMs of Māori and Pacific learners at NZQF level 7 non-degree)	=	total learner success component funding available per TEO

39. This approach will be a proxy for actual learner need at TEOs. TEOs' funding will be calculated based on enrolments of these learners, but TEOs will be expected to identify and support the needs of *all* their learners and allocate their funding accordingly.

40. We have applied the same learner success component rate for disabled learners and learners with low prior achievement across all modes, subjects and levels. The only exception is the assessment and verification mode – you have previously agreed that the learner success component will not apply to this mode (METIS 1267373 refers).

41. We have taken the following approach for learners with multiple eligible characteristics:

- learners who are disabled *and* have low prior achievement are funded only once
- learners who are Māori *and* Pacific are funded only once
- learner who are disabled and/or have low prior achievement *and* are Māori and/or Pacific are funded twice, once at each rate.

42. This approach is simple, in keeping with the current approach to Equity Funding, and reflects that multiple disadvantages can have a compounding effect on learners.

43. Our count of learners with low prior achievement includes some learners for whom we have no records of prior achievement. We get data about prior achievement from SDR and NZQA records, but this does not give us a complete picture of prior achievement. There are three groups of learners for whom we have no record of prior qualification: learners who achieved qualifications in NZ before 2003, learners with overseas qualifications, and learners who have no qualification. For 2020 enrolments, we have no records of prior qualifications for approximately 18% of all VET EFTS/STMs.

44. Because we cannot determine the reason a learner has no record of prior achievement, we are assuming all of these learners have low prior achievement for funding purposes. Since learners with low prior achievement are a proxy for actual learner need at TEOs, perfect accuracy is not necessary.