Education Report: Further advice on the Unified Funding System for Budget 2021

To:	Hon Chris Hipkins, Minister of Education		
Date:	11 December 2020	**Priority:**	High
Security Level:	Budget Sensitive	**METIS No:**	1246677
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Messaging seen by Communications team:	No	**Round Robin:**	No

Purpose of Report

The purpose of this report is to provide further advice on why additional funding is required to support the sustainability of vocational education in the future, and recommendations on how to seek that funding.

Recommendations

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

a. **agree** to seek funding to support the unified funding system of vocational education through a compounded 7 percent increase over the next three calendar years to the total amount of Government funding forecast to be spent on vocational education and training

Agree / Disagree

b. **agree** to forward this briefing to the Minister of Finance

Agree / Disagree

c. **agree** to proactively release this education report once Budget 2021 decisions, and decisions on the design of the unified funding system for vocational education, have been taken by Cabinet.

Agree / Disagree

Andy Jackson
Deputy Secretary, Graduate Achievement, Vocations and Careers
Ministry of Education

11/12/2020

Tim Fowler
Chief Executive – Tertiary Education Commission

11/12/2020

Hon Chris Hipkins
Minister of Education

12/12/2020

Background

The Reform of Vocational Education is well underway

1. As part of the Reform of Vocational Education (RoVE), Cabinet agreed to develop a unified funding system, applying to all provision at qualification levels 3 to 7 (excluding degree study) and all industry training.

2. In a draft March Cabinet paper, not lodged due to COVID-19, initial high-level estimates indicated that the unified funding system could require $150 to $250 million per annum in additional funding [METIS 1218370 refers]. We developed two bids for Budget 2020 to 'fast start' the unified funding system that were unsuccessful because of competing COVID-19 priorities. Cabinet agreed to $334.1 million to manage the cost of funding additional tertiary enrolments from 1 January 2021 to 31 December 2023, and established the Targeted Training and Apprenticeship Fund (TTAF) ($320 million) and Apprenticeship Boost ($380.6 million).

3. In July 2020, you agreed further policy decisions on the unified funding system and to undertake information gathering exercises with the wider tertiary education sector [METIS 1233742 and 1235409 refer]. In November 2020, you agreed that the Ministry would prepare a Budget bid to address past real-terms funding declines in Vocational Education and Training (VET)[1] [METIS 1244781 refers]. You also agreed to take a paper to Cabinet on the design of the unified funding system in early 2021.

Vocational education has been underfunded for the past decade

Underlying financial issues within the VET sector have been prevalent for some time

4. One of the factors leading to RoVE was the weak financial performance of institutes of technology and polytechnics across the economic cycle. Polytechnics have high fixed costs and pressure to retain loss-making programmes, making it hard for them to adapt throughout the economic cycle. You advised Cabinet on the financial issues within the vocational sector as part of the RoVE decisions [CAB-19-MIN-0009 refers].

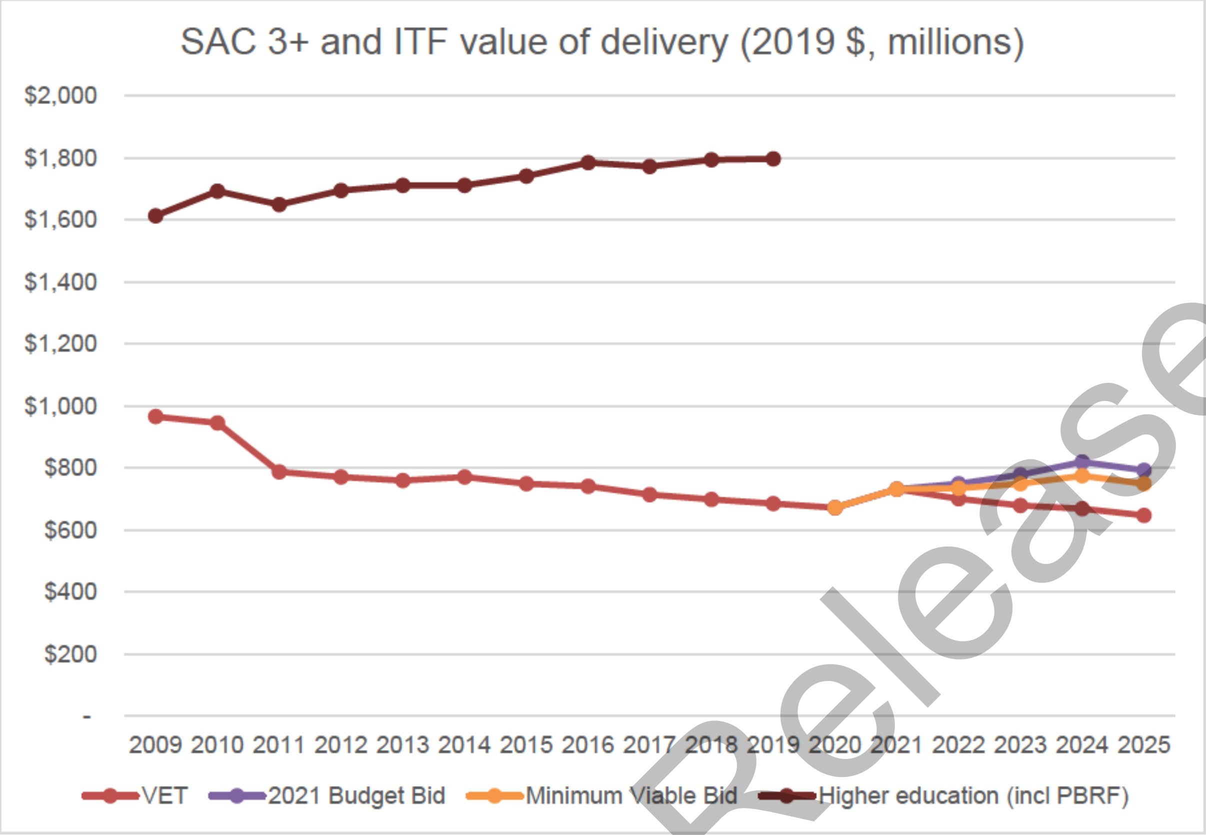
5. These financial pressures were raised during consultation on the RoVE (especially by polytechnics) and by the unified funding system Funding Reference Group, who considered that performing their current functions at a high quality is difficult with the level of funding they received.

6. VET requires substantially different delivery models to higher education. Good quality VET is often delivered in smaller 'class' sizes (as small as one in some workplaces), with more equipment, and higher student to training advisor/supervisor/teacher ratios. There are also costs involved in supporting learners all over the country, in many different workplaces, in small numbers.

Tuition subsidy rates have not kept up with costs of delivering tertiary education provision

7. Adjusted for inflation, overall government funding for VET through tuition subsidies decreased from 2009-2019. Our Budget 2021 proposal would bring funding back to the level it was in 2011.

[1] VET in this paper refers to all provision at levels 3 to 7 (non-degree) and all industry training. Higher education refers to all provision levels 7 and above (degree level). The objective of the Performance Based Research Fund (PBRF) is supporting world-leading teaching and learning at degree and postgraduate levels – and so supports higher education provision.



8. This decrease in Government funding on tuition subsidies is also due to decreases in the volume of learners. In 2011, a large amount of volume was removed due to it being low quality delivery. While this was positive in terms of outcomes for learners and efficient use of Government funding, it reduced providers' ability to cross-subsidise funding to support better quality provision.

9. Around 50% of VET funding currently lies with polytechnics. The majority of this provision lies within two funding rates: A1/J1 (arts, vocational training for industry, and business) and P1 (trades). From 2011 to 2020, these funding rates have only increased by 6.6%.[2]

10. Meanwhile, the consumers price index (CPI) increased by 13% between the first quarter of 2011 to the third quarter of 2020. Average hourly earnings increased by 30% in the same period. 61.8% of polytechnics' costs in 2019 was made up of pay costs, with 13.2% spent on depreciation and leasing costs. Government support has not kept up with the real costs of delivering tertiary education provision.

11. International enrolments increased in 2014 and 2015, which provided additional revenue. This masked the fact the cost of delivering tertiary education increased, and that domestic tuition subsidy funding did not keep up. However, as domestic volumes decreased from 2014, this cross-subsidisation was not sufficient to support tertiary delivery. This became increasingly prevalent from 2017.

12. Due to the impacts of COVID-19 and recovery initiatives such as TTAF and Apprenticeship Boost we expect volume to increase over the next few years. Our current forecasts and estimates are that Government spend on tuition subsidies for vocational education and training will peak in 2021. While the increase in volume will help providers maintain their financial viability in the short term, we do not expect this amount of volume to remain in the system long-term. This temporary volume increase will mask the unsustainable nature of the system over the next two years.

[2] There has been an agreed rate increase for 2021, increasing rates by another 1.6%.

13. From 2023 onwards, as costs continue to increase faster than tuition subsidy rates, volume begins to decline, and with limited international enrolments, we expect to see the system begin to struggle again. Providers have become more efficient in response to the limited subsidy increases, rising costs and falling demand. However, this financial situation does not support them to change their behaviour in ways that improve quality of teaching and learning to support better outcomes for learners and employers. The introduction of the unified funding system alongside additional investment in the vocational education providers will lead to better outcomes for these groups.

The system is ready for investment

The design of the unified funding system will ensure efficient use of current funding and additional funding

14. The unified funding system for vocational education will be implemented from 2023. The new system is designed to incentivise delivery that is beneficial for learners, employers and communities (Annex One provides an overview of the design of the unified funding system). Any additional funding will be used to support better quality delivery that meets this design principle.

15. The unified funding system will make efficient use of current funding as well as any additional funding. The integration of industry training with provider-led vocational education will create some economies of scale. Te Pūkenga is primed to improve quality and build a national network of provision, with savings predicted to be small as a proportion of total revenue.

16. The funding category component is designed to subsidise education delivery, in such a way that it incentivises work-integrated learning. You previously agreed to design a new funding system with a focus on fields of study (or subjects/disciplines) and modes of delivery (i.e. how education is delivered and the respective roles of employers and providers) [METIS 1210568 refers]. In July 2020, you agreed officials would develop four modes of delivery: provider-led, work-integrated for learners brokered into employment, work-integrated for learners who are employed, and employer-led (see Annex Two for more information on how each mode incentivises different behaviours in providers).

17. We are currently working with the sector to gather data about learner volumes and delivery costs across different modes. There is some potential for savings in employer-led training (where the employer takes on almost all the education and pastoral care responsibilities), and online education. However, these potential savings will not be enough to create the incentives needed to improve the quality of teaching and learning to support better outcomes for learners and employers.

Learner success and work-readiness are central in the design of the unified funding system

18. We are designing the unified funding system to incentivise providers to change their behaviour to better meet the needs of all learners and employers. We expect providers to perform enhanced functions to meet these needs - shifting from status quo modes of delivery and levels of support provided to learners. These behaviour shifts are supported by the structural changes, with the role of arranging training and the responsibility of supporting apprentices and trainees moving from industry training organisations to providers.

19. The new or increased behaviour we want to see providers undertake in the new system include:

a. brokering learners into employment, and supporting them to continue their training while working;

b. enhanced support for employers;

c. increased and improved success and support for all learners, especially Māori learners, Pacific learners and learners with additional support needs;

d. more specific support for disabled learners and learners with additional support needs;

e. increasing the number of work-integrated programmes;

f. more shifts to respond to national and regional skills priorities;

g. a strengthened and sustainable regional network of provision.

20. We expect to be able to see these shifts through existing monitoring mechanisms as well as through new feedback loops, such as accountability measures in the learner component, and feedback from Workforce Development Councils (WDCs) and Regional Skills Leadership Groups (RSLGs).

The RoVE structural changes leave the system primed to make these behavioural shifts

21. The creation of Te Pūkenga, WDCs, RSLGs, and the dissolution of industry training organisations, have set the stage for a more responsive, higher quality, and more equitable VET system. The system is investment ready, primed to make the behaviour changes incentivised by the unified funding system.

22. Business models have and will continue to shift as a result of RoVE. Current providers in the VET system are not the same as those who were failing before the RoVE. By the time structural changes are completed by 31 December 2022, the system will be ready to respond to funding incentives aligned with the other parts of the reforms.

23. Without strong incentives to change, we risk embedding the current status quo within new organisations. This would limit the effectiveness of the RoVE changes, leaving employers and learners worse off. The unified funding system allows the new structural changes to fully meet their potential, creating a better quality and more responsive VET system.

Additional funding is required for a viable VET system and behavioural shifts

24. As discussed above, VET has been underfunded for the past decade. There is currently also a large difference between the provider-based (SAC3+) and the apprenticeship and trainee (ITF) subsidy rates, which will need to be equalised in the unified funding system.

25. The 2021 subsidy rates for industry training are $3,310 for industry trainees and $5,379 for New Zealand Apprenticeships (NZA). These rates are respectively about 51% and 83% of the lowest SAC3+ rate ($6,511).

26. However, the majority of industry training is in the trades subject areas, which is not the lowest SAC3+ rate. The SAC3+ trades subject area rate is $10,758. The trainee rate is only 31% of this; the NZA rate is 50% of the trades rate.

27. New rates are likely to fall in between the current SAC3+ trades rate and the ITF rates – prioritising increasing support for trainees and apprentices. This will increase the cost of VET regardless of any increase in the volume of learners.

Paras 24-27 suggest the UFS will treat all modes of delivery the same. They won't be.
Work integrated learning has a different cost structure to provider-based delivery. Distance learning has a different cost structure to classroom-based. The UFS will need to allow for this.
A problem with the current system is it funds the same delivery differently based on whether it is provider-supported or ITO-supported.

We recommend seeking a Budget bid in 2021

28. To sustain a viable system moving forward, and create the incentives required to shift behaviour, the unified funding system for vocational education needs additional ongoing investment.

29. Funding from the COVID-19 Response and Recovery Fund is short term funding, set to expire at the end of 2022. This funding will neither support the long-term viability of the sector, nor create the incentives to change behaviour within providers.

30. We discussed options for the amount of additional funding you could seek to support the unified funding system for vocational education in our previous advice [METIS 1244781 refers]. Options for additional funding ranged between an additional $100-$250 million per annum.

31. We recommend seeking this funding through increasing total VET funding by 7% per annum over the next three Budgets. This would be cumulative increase, based off the amount forecast to be spent on VET in the 2021 calendar year (around $751 million[3]). This would result in an additional $162 million of VET funding being able to be spent in 2024, compared to current forecasts.

32. Our minimum viable option is an increase of 5% per annum over the next three Budgets. This will allow for an additional $113 million of additional funding to be spent in the 2024 calendar year, compared to current forecasts.

(figures in millions)	**2021/22**	**2022/23**	**2023/24**	**2024/25 & outyears**	**Total**
Preferred Option	$25.482	$77.415	$132.782	$160.549	**$396.228**
Minimum Viable Option	$18.201	$54.938	$93.365	$112.452	**$278.956**

33. We would not recommend that funding increases be applied before the implementation of the unified funding system, as this would further embed status quo incentives. We would look to use the funding to accelerate changes to capability and capacity within the system to respond to the incentives around work-integrated learning, by bringing forward components of the unified funding system. We will provide you with further advice on this as the bid progresses.

Some providers will need to be supported through the transition and beyond

34. Wānanga are currently allocated around 14% of the total amount of funding in scope of the unified funding system. Each of the three wānanga has its own defining characteristics and priorities, but all three are established under section 268 of the Act, which characterises an approach to teaching and learning that has Mātauranga Māori at its core.

35. They are not established to be vocational providers, and are unlikely to be well served by a system that incentivises work-integrated learning. While a wānanga could choose to adapt its business model to take advantage of the incentives offered as part of the unified funding system, we must take care that the non-vocational activities funded through the unified funding system, particularly te reo Māori and Mātauranga Māori, are sustained through the funding reforms.

36. While Te Hono Wānanga will develop reform proposals through open dialogue with the wānanga sector that could result in a different legislative framework and new approach to funding, a targeted transition approach may be required. There are many forms a

[3] Not adjusted for potential inflation

transition approach could take, including moving wānanga outside the scope of the unified funding system, or developing alternate modes within the unified funding system that reflect a wānanga approach to teaching and learning. However, most are likely to require additional funding, or reduce the funding available for redistribution within the remainder of the unified funding system. We will provide you with further advice on the best transition solution to support the wānanga after further discussions with the wānanga.

There needs to be a greater degree of urgency around developing a more appropriate funding model for Wananga. It can't be dealt with as an afterthought.

Timeline and next steps

37. We will work with Treasury on this bid when Treasury releases more guidance on the 2021 Budget process.

38. We recommend forwarding this briefing on to the Minister of Finance, before you meet with him later in December.

Annexes

Annex One – an overview of the structure of the unified funding system

Annex Two – an overview of the activities within each proposed mode of delivery

Unified Funding System

Vision

A Unified Funding System that supports closer integration of work-based and provider-based learning, encourages more work-relevant and tailored support for learners, and enables new models of education delivery which are responsive to employer and industry demand.

Current state

Two disconnected, volume driven funding systems with a negligible amount of strategic/learner based funding

PROVIDER FUNDING SYSTEM

Equity (<1%)

Student Achievement Component (SAC) Level 3 and above (>99%) subsidises education delivery for learners enrolled with a tertiary provider

Student Achievement Component (SAC3+)

Funding is volume-driven with EFTS* rates based on the register level and subject area of the course (from $6,408 to $19,501).

In 2018 TEC allocated $529m to subsidise 65,804 EFTS of provider-based delivery at levels 3-7 (non-degree) for 130,162 learners.

Equity Funding

$3m pa tuition top up for priority learners (Māori, Pacific and learners with disabilities).

INDUSTRY TRAINING FUNDING SYSTEM

JVAP (<2%)

Industry Training Fund (>99%) subsidises industry training organisations to support work-based learning

Industry Training Fund (ITF)

Funding is volume-driven with two STM* rates: $3,200 for trainees and $5,200 for apprentices.

In 2018 TEC allocated $182m to subsidise 44,873 STMs of workbased learning for 128,877 learners.

Joint Ventures Ammalgamation Projects (JVAP)

$3.4m pa for collaboration on innovative projects

Possible future state (for discussion)

UNIFIED FUNDING SYSTEM

Learner success component (Approx 10-20%)

Category component (Approx 70-85%) Will subsidise education delivery, and support to work-based learners

Strategic component (5-10%)

The new learner success component will:

- Recognise different learner needs
- Improve performance for underserved learners
- Encourage equity of access, achievement, and outcomes

Upcoming design choices:

- The basis for allocating funding
- What monitoring and accountability should accompany learner-based funding?
- How, if at all, should learner based funding be linked to performance?
- 9(2)(f)(iv) [redacted]

The new funding category component will set funding rates for different types of provision to:

- Recognise broad variations in delivery costs across subject areas and delivery modes (e.g. provider-led, work-integrated, employer-led)
- Enable and encourage responsive, new and innovative delivery models – including shifts to work-integrated learning
- Be simple and transparent

GOVERNMENT SUBSIDY RATE FOR ALL EDUCATION PROVISION = SUBJECT RATE × MODE RATE

Upcoming design choices:

- To what extent should we seek a price neutral funding system which aligns government subsidy rates to differences in costs, and/or to directly incentivise work-integrated delivery models?
- How best to balance funding to support upskilling of existing employees, with funding to build the future skills pipeline, and support smoother transitions into work with ongoing training?
- The relative size of subject versus delivery-mode based funding categories.

The new strategic component will:

- Encourage innovation and increase responsiveness to national and regional skills priorities
- Support the NZIST to invest in long-term capability to address regional skills priorities in geographically isolated areas and ensure access to vocational education in all parts of New Zealand
- Complement related government funding support for wānanga capability and investment in te reo Māori and Mātauranga Māori.

Upcoming design choices:

- The relative priority to be placed on funding predictability versus responsiveness to changing skills priorities
- The period of funding allocation and the balance of provider-neutral versus NZIST-specific funding

Related work areas

Current Initiatives

You announced as part of the COVID-19 recovery in Budget 2020 the following initiatives to support the vocational education system:

- **Targeted Training and Apprenticeship Fund**
- **Apprenticeship Boost**

Potential further work

There is further potential work to consider the financing of vocational education and training, in light of RoVE, including work on:

- **Fees**
- **Employer contributions and incentives**

What We Are Buying From The Provider In Each Mode

<table>
<tr><th></th><th>Provider-led</th><th>Work integrated learners brokered into employment</th><th>Work integrated for learners who are employed</th><th>Employer-led</th></tr>
<tr><td>BROKERING LEARNERS INTO EMPLOYMENT</td><td></td><td>Provider works with employers to transition learners into work. Provider supports learner to establish their work and learning</td><td></td><td></td></tr>
<tr><td>DEVELOPING EMPLOYERS CAPACITY TO TRAIN</td><td></td><td colspan="2">Providers support employers to develop their capability to deliver teaching and learning, and learning support and pastoral care</td><td></td></tr>
<tr><td>TEACHING AND LEARNING</td><td>Deliberate acts of teaching and learning undertaken by providers at an education delivery site or via technology enabled delivery</td><td colspan="2">Providers support employers to deliver teaching and learning</td><td></td></tr>
<tr><td>LEARNING SUPPORT AND PASTORAL CARE</td><td>Provider responsible for providing learning support and pastoral care</td><td colspan="2">Provider is responsible for ensuring learner receives learning support and pastoral care.</td><td></td></tr>
<tr><td>PROGRAMME DEVELOPMENT</td><td>Providers working with employer bodies and the community to develop programmes to meet regional and national skills priorities</td><td colspan="2">Providers working with employer bodies and the community to develop programmes to meet regional and national skills priorities.
This may also include employer specific skill development</td><td>Employers have developed programmes to meet their skill requirements. Providers work with employers to map this training to NZQF and have the training accredited</td></tr>
<tr><td>ASSESSMENT</td><td colspan="4">Provider is responsible for the quality of assessment.
They may undertake the assessment, purchase it from an external assessor, or support employers to assess</td></tr>
</table>

KEY

MOST PROVIDER ACTIVITY → LEAST PROVIDER ACTIVITY