



Education Report: Unified Funding System for Vocational Education Budget Strategy

To:	Hon Chris Hipkins, Minister of Education		
Date:	18/11/20	Priority:	High
Security Level:	Budget Sensitive	METIS No:	1244781
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Messaging seen by Communications team:	No	Round Robin:	No

Purpose of Report

The purpose of this report is to provide advice on the amount of additional funding required to create the incentives needed to achieve the objectives of the unified funding system for vocational education. This paper comes in advance of our advice on policy priorities for Budget 2021 across Vote Education and Vote Tertiary Education. The proposals outlined here will need to be managed against those wider priorities.

Recommendations

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

- a. **discuss** the options of the amount of additional funding you could seek to support the unified funding system for vocational education
- b. **agree** that the Ministry will prepare a Budget bid based on your feedback on the options presented in this report

Agree / Disagree

- c. **agree** to take a paper to Cabinet on the design of the unified funding system for vocational education for implementation from 2023, in early 2021

Agree / Disagree

- d. **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

18/11/2020



Tim Fowler
Chief Executive – Tertiary Education
Commission

18/11/2020



Hon Chris Hipkins
Minister of Education

[21/11/2020](#)

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. In December 2019, officials met with you to discuss the high-level direction of the unified funding system [METIS 1210568 refers]. We developed two bids for Budget 2020 funding that were unsuccessful because of competing COVID-19 priorities. Cabinet agreed to \$334.1 million to manage the cost of funding additional enrolments from 1 January 2021 to 31 December 2023, and supported the Targeted Training and Apprenticeship Fund and Apprenticeship Boost. In July 2020, you agreed further policy decisions on the unified funding system, including information gathering exercises with the wider tertiary education sector [METIS 1233742 and 1235409 refer].
2. Officials are doing further detailed design work on a vocational education funding system with three components: a learner success component; a funding category component; and a strategic component. The three components together offer a set of incentives to support collaboration between providers and employers, a strong focus on tailoring education to better meet the needs of learners, and support innovation and regional needs (see Annex One for an overview of the structure of the new system).
3. 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].
4. This education report is a companion piece to our briefing 'Annotated Agenda – Financing tertiary education' [METIS 1244783 refers].

Current funding levels will not incentivise a change in behaviour

The design of the unified funding system encourages providers to change their behaviour

5. 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. The behaviour shifts will also support the structural changes, with providers taking on the role of arranging training from industry training organisations, supporting apprentices and trainees.
6. 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.

Government's current investment in vocational education will not support providers to change their behaviour

7. You advised Cabinet on the financial issues within the vocational sector as part of the RoVE decisions [CAB-19-MIN-0009 refers]. Government is the largest contributor to the vocational education and training system, through tuition subsidies and Fees Free payments. Public funding for vocational education and training from the Student Achievement Component levels 3 and above (SAC3+) and the Industry Training Fund (ITF) decreased in real terms by approximately 25% from 2010 to 2019. Vocational education revenue has gone backwards or remained flat over the past decade – and while volume decreases have been a significant driver of this, funding rates and fees have not helped either. Our briefing 'Annotated Agenda - Financing tertiary education' builds on the information you have already received on this subject [METIS 1244783 refers].
8. These financial pressures were raised during consultation on the RoVE (especially by polytechnics) and the Funding Reference Group, who considered that performing their current functions at a high quality is difficult with the level of funding they received. The loss of international student revenue due to COVID-19 has created additional immediate pressure.
9. There are some factors that will help. The integration of industry training with provider-led vocational education will create some economies of scale, as well as response initiatives such as the Targeted Training and Apprenticeship Fund. While there are some opportunities to reallocate funding (to better match the cost of delivery to the service offered), we do not expect this to offset the cost of the changes outlined in paragraph 6.
10. We also expect volume to increase over the next few years. Our current forecast is that volume will peak in 2022. 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, returning the system to an unviable state.
11. Therefore, we recommend that you seek additional funding through Budget 2021 to support the unified funding system.

The balance of the components informs costing

All three components must be balanced to create incentives to shift behaviour

12. In July 2020, we provided you with our advice on the relative size of each component within the unified funding system [METIS 1233742 and 1235409 refer, also see Annex One]. In order to create the right incentives, the components should be balanced. We based our proposal off our best judgements of how the balance of the components would shift behaviour. We proposed that the funding category component should receive at most around 85% of the total amount of funding per annum allocated to the unified funding system, the learner component at least 10% (not including support for disabled learners and those with additional learning support needs), and the strategic component at least 5%. This represents the minimum proportions for the learner success and strategic components we would recommend– either over time, or with extra investment, these proportions should grow.
13. We are currently working with the sector to gather information to inform detailed modelling and costing work. We expect to be able to model the effects of the change in late 2021. The analysis below is based on the current available information.

The minimum proportions of the components contribute to our estimate of additional funding

14. The **funding category component** is designed to subsidise education delivery, in such a way that it incentivises work-integrated learning. You previously agreed that further work to design a new funding system should 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 to further work to develop the four modes: 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). We intend to provide you with further advice on online provision before Christmas.
15. 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. But it is likely that higher funding rates will be required to build more teaching and learning into work-integrated learning activities, increase support for employers, and to support stronger brokerage of learners into work-integrated learning.
16. A key challenge in setting the incentives will be the currently large difference between the SAC3+ and the ITF subsidy rates. The 2021 subsidy rates for industry training are \$3,310 for industry trainees and \$5,379 for New Zealand Apprenticeships (NZA). These rates are about 51% and 83% respectively of the lowest SAC3+ and above rate (\$6,511). However, the majority of industry training is in the “trades” type subject areas – for which the SAC3+ (P1 - trades) rate is \$10,758. The trainee rate is only 31% of this; the NZA rate 50%. New rates are likely to fall in between the current SAC3+ trades rate and the ITF rates – prioritising increasing support for trainees and apprentices.
17. At this stage, we recommend maintaining existing investment (\$746 million allocated in 2020) within the funding category component. This figure could increase as we gather more information about these activities and model the effects of different funding rates.
18. The **learner success component** is aimed at placing learners at the centre of providers’ decision-making. This aim is aligned with the aim of the Equity Index: highlighting socio-economic factors that require the system to be resourced in a way that gives all learners an equitable chance of success. Our expectation is that this component will enable providers to tailor educational delivery and support for their learners, and that this will generate significant gains for learners who are traditionally underserved by the system. In the work-integrated space, we expect that providers will provide more pastoral care for those individuals learning on the job.
19. We estimate that this component should receive at least 10% of the total amount of funding in the unified funding system per annum. Therefore, if the funding category component (\$746 million) per annum is 85% of the overall spend on vocational education, we would recommend the learner component to receive at least \$88 million per annum (10% of overall spend), to ensure that the incentives are balanced.
20. We are still undertaking work on how best to support disabled learners. 9(2)(f)(iv) [REDACTED]
[REDACTED]
[REDACTED]
21. The **strategic component** ensures that the system is primed to respond to emerging Government needs and priorities identified by workforce development councils and regional skills leadership groups. It also helps to ensure a strengthened and sustainable regional network of provision is available. We recommend that this attracts at least 5% of the funding allocated to the unified funding system, around \$44 million per annum.

We have costed two proposals using component proportions

22. As well as implementation with the current pool of funding (Option 1, presented below (paragraphs 33 – 35)), we have costed two scaled proposals for additional funding based on the preceding analysis. The first uses the minimum proportions recommended for each component to provide a minimum viable amount of additional funding. The second acknowledges the currently unknown cost of rate standardisation in the funding category component, and uses higher proportions for the learner and strategic components. Both proposals recommend seeking additional funding.
23. If the funding category component uses only the current amount spent on tuition subsidies (\$746 million allocated in 2020), additional funding is required to support the learner success and strategic components. With work still underway on accurate modelling for the funding category component, and initiatives to support disabled learners and learners with additional support needs, our high-level minimum viable estimate of additional funding required to support the unified funding system is between \$100 - \$150 million per annum.

Table 1: Minimum viable additional funding required

Funding category (\$746 million per annum = 85%)	Learner success (\$88 million per annum = 10%)	Strategic (\$44 million per annum = 5%)
- 2020 allocation for tuition subsidies is \$746 million	- Calculated as a proportion of the total amount allocated to vocational education, using the funding category component as a base - 9(2)(f)(iv) [REDACTED]	- Calculated as a proportion of the total amount allocated to vocational education, using the funding category component as a base
- No additional funding	- \$88 million additional funding per annum	- \$44 million additional funding per annum
\$132 million per annum (plus funding to support disabled learners)		
<u>Recommendation:</u> \$100 - \$150 million additional funding per annum		

24. The funding category component could require additional funding to standardise rates – potentially an additional 5% on top of current levels of investment (\$37 million per annum). That would mean the funding category component would be \$783 million per annum.
25. With a larger learner success component (12.5%, \$122 million per annum) and strategic component (7.5%, \$73 million), this would amount to a high level estimate of additional funding between \$200 - \$250 million per annum.

Table 2: High level estimate of additional funding required

Funding category (\$783 million per annum = 80%)	Learner success (\$122 million per annum = 12.5%)	Strategic (\$73 million per annum = 7.5%)
- An increase of 5% on the current amount of funding allocated to tuition subsidies	- Calculated as a proportion of the total amount allocated to vocational education, using the funding category component as a base	- Calculated as a proportion of the total amount allocated to vocational education, using the funding category component as a base
- \$37 million additional funding per annum	- \$122 million additional funding per annum	- \$73 million additional funding per annum
\$232 million per annum		
<u>Recommendation:</u> \$200 - \$250 million additional funding per annum		

Transition risks

26. The unified funding system is a substantial change to the current funding system. It is designed to incentivise new behaviour within providers. Some providers have business models that are better placed to respond to these incentives. Others will require time to pivot their business models to respond. Not all provision captured within the scope of the unified funding system is well aligned to the objectives of RoVE.
27. The ability to pivot differs across sub-sectors of the vocational education system:
- a. We would expect **Te Pūkenga** to be well placed to respond to the incentives we have designed into the new system. It has received additional funding from the Crown to help set up its new infrastructure and processes. However, during a time of great change for subsidiaries, without strong incentives it would be easier for the subsidiaries to continue to reinforce the status quo. We have worked closely with Te Pūkenga throughout its establishment and will continue to do so as it develops its operating model.
 - b. **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.
 - c. 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, are sustained through the funding reforms.
 - d. 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 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.

- e. In light of the agility and business focus of many **private training establishments** (PTEs) (including those who already work with ITOs), the PTE sector will have an important contribution to make to the reformed vocational education and training system. PTEs house experts in teaching skills relevant to niche industries which provide high value to New Zealand. They also play a crucial role in the RoVE – providing accountability and an alternate choice for employers. However, PTEs also have a relatively narrow focus to their business, and we will need to examine the scale of the effects and provide time for them to adapt through the transition.

Options for future funding

We recommend seeking new investment

28. We are advising you to seek funding through Budget to support the implementation of the unified funding system from 2023. Without additional funding, the new system will not be able to drive the behavioural changes within providers that we want to see. This risks failing to achieve the objects of the unified funding system. A new funding system is an essential element of the reformed vocational education system.

We recommend securing additional funding before 2023

29. We recommend asking Cabinet for additional funding in 2021, in order to give providers the largest amount of time to pivot their provision, and send strong signals about the incentives in the new system. It would also provide some certainty as providers redesign their operating models to incorporate responsibilities for apprentices and trainees. This means the behavioural shifts will begin earlier, benefiting learners and employers. While we can signal shifts without guaranteed funding, providers are less likely to move from the status quo until material benefits are probable.
30. Final figures used to model the impact of the unified funding system will not be available until late in 2021 – likely in time for Budget 2022. However, because of the benefits of early signalling, we recommend seeking additional funding in 2021, to be held in contingency while the costing work is completed. If it is not possible to secure all the funding by Budget 2022, there may be some elements that could be gradually increased from Budget 2023 onwards.
31. 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 2022, at around \$763 million (compared to \$746 million allocated in 2020). While this will help the system, we do not expect this amount of funding will sufficiently support the behaviour shifts required by RoVE.

The amount of additional funding sought impacts the amount of behaviour change expected by providers

32. Below, we provide you with three options of the amount of additional funding you could seek to support the unified funding system.

Option 1: Implementation with the current pool of funding

33. The unified funding system could be implemented within the current pool of funding devoted to vocational education (\$746 million allocated in 2020). However, it would be challenging to achieve the changes sought from RoVE at this funding level. The tuition subsidy rates with the funding category component would be reduced to create the

learner and strategic components. The learner and strategic components would be smaller proportions of the total funding, blunting the incentives, and delaying shifts in providers' behaviour.

34. In transitioning to the new system, there would likely be providers who would have large fluctuations in their funding levels. For those who would receive less funding, it would limit their ability to change their behaviour to respond to the incentives in the system which would benefit their learners and local industries. This risk is likely more prevalent for wānanga and PTEs, however we cannot yet model these effects accurately.
35. One way to mitigate the impact of adding no additional new funding could be to transfer funding from other parts of the system. Cabinet agreed that any underspends on funding from the COVID-19 Response and Recovery Fund will be returned to that fund. Transferring funding without underspends would have significant impacts on the rest of the sector (e.g. deprioritising existing provision).

Option 2: a lower amount of additional new funding is added (\$100 - \$150 million per annum)

36. To create the incentives required to shift behaviour, and to support the new functions desired, the unified funding system needs additional ongoing investment.
37. This option reflects our first set of costings outlined above (Table 1). These are based on our early estimate of the minimum viable amount of additional funding required to see some impact from the incentives designed as part of the unified funding system. This amount of investment would allow the incentives in the unified funding system to be set up initially, driving providers to shift their behaviour earlier. These shifts would accelerate as investment increased over subsequent Budgets.

Option 3: a larger amount of additional new funding is added (\$200 - \$250 million per annum)

38. We are designing the unified funding system to incentivise providers to change their behaviour to better meet the needs of learners and employers. To ensure that we do not embed the status quo, sharp incentives are required. A large amount of additional investment would allow the new system to be embedded from a position of strength, and have a strong impact on providers' behaviour.
39. Table 2 above outlines the high-level costings for this option. This option allows for additional funding to support the standardisation of funding rates, as well as an increased learner success and strategic component.

Cabinet paper

40. We recommend that you take a paper to Cabinet early in 2021 on the high-level design of the unified funding system for 2023. Cabinet has not engaged with the unified funding system since agreeing to the RoVE proposals in July 2019. This will allow us to communicate clearly to the sector the high-level design of the system from 2023. It would also support the recommended Budget bid. With your agreement, we will work on draft content for the Cabinet paper.

Timeline and next steps

41. Treasury has yet to release guidance on the 2021 Budget process. We expect a Budget strategy paper will be presented to Cabinet in the next few weeks. Every indication is that Budget 2021 will be focused on unavoidable cost pressures and manifesto commitments, especially those in the fiscal plan.
42. It is likely new initiatives will be by invitation only. There is the possibility of a bilateral meeting with the Minister of Finance in December - this is an avenue for discussing the big picture priorities and challenges in education. Plans are being made for a Budget

strategy session with yourself and other Education Ministers in the first week of December to discuss Budget priorities before you meet with the Minister of Finance later in December.

43. We intend to provide you with a paper by the end of the year that will include an update on the unified funding system sector engagement and on operational and implementation design work currently underway. This paper will also set out several further design decisions on the unified funding system, including on broader tertiary system issues such as recognition of prior learning.

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

Proactively Released

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 Amalgamation 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)

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

$$\text{GOVERNMENT SUBSIDY RATE FOR ALL EDUCATION PROVISION} = \text{SUBJECT RATE} \times \text{MODE RATE}$$

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

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

KEY



MOST PROVIDER ACTIVITY → LEAST PROVIDER ACTIVITY