



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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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 9(2)(f)(iv) 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]. 9(2)(f)(iv)
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 9(2)(f)(iv) before Christmas.
15. 9(2)(f)(iv)
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. 9(2)(f)(iv)
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. 9(2)(f)(iv)
20. We are still undertaking work on how best to support disabled learners. 9(2)(f)(iv)
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. 9(2)(f)(iv)

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. 9(2)(f)(iv)

Both proposals recommend seeking additional funding.

23. 9(2)(f)(iv) our high-level minimum viable estimate of additional funding required to support the unified funding system is between 9(2)(f)(iv) per annum.

Table 1: Minimum viable additional funding required

Funding category 9(2)(f)(iv)	Learner success 9(2)(f)(iv)	Strategic 9(2)(f)(iv)
9(2)(f)(iv)		
9(2)(f)(iv)		

24. 9(2)(f)(iv)

Table 2: High level estimate of additional funding required

Funding category	Learner success	Strategic
9(2)(f)(iv)	9(2)(f)(iv)	9(2)(f)(iv)
9(2)(f)(iv)		
9(2)(f)(iv)		

9(2)(f)(iv)

9(2)(f)(iv)

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. 9(2)(f)(iv)

9(2)(f)(iv)

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. 9(2)(f)(iv)
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 9(2)(f)(iv) 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 9(2)(f)(iv) 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. 9(2)(f)(iv)

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 9(2)(f)(iv).

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.

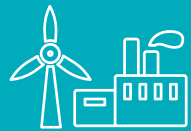
Equity Funding

\$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 Amalgamation Projects (JVAP)

\$3.4m pa for collaboration on innovative projects

Possible future state (for discussion)

UNIFIED FUNDING SYSTEM

Learner success component
9(2)(f)(iv)

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?
- What, if any, additional funding approaches may be required for learners with disabilities or additional learning support needs?

Category component 9(2)(f)(iv)
Will subsidise education delivery, and support to work-based learners

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.

Strategic component
9(2)(f)(iv)

The new strategic component will:

- Encourage innovation and increase responsiveness to national and regional skills priorities
- 9(2)(f)(iv)
- 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
- 9(2)(f)(iv)

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

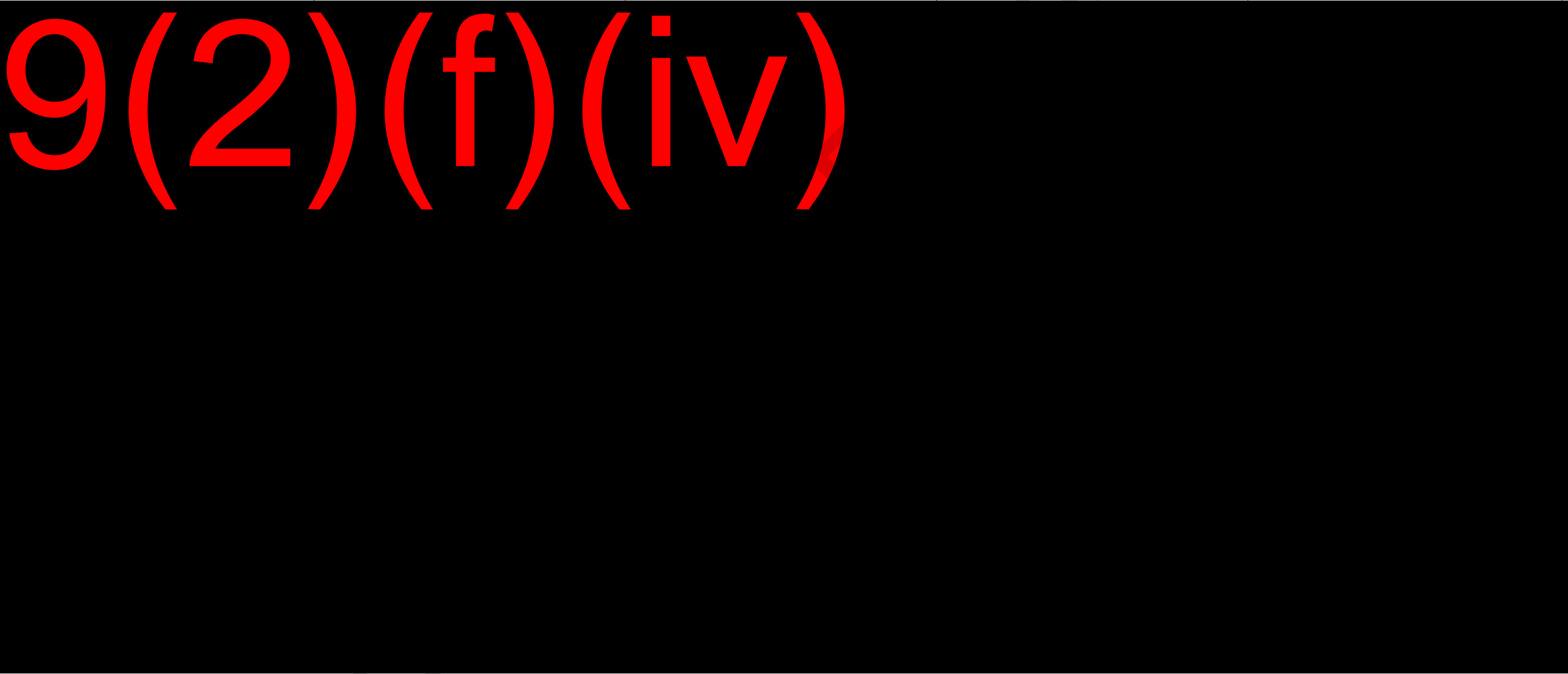


Potential further work

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

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
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KEY

MOST PROVIDER ACTIVITY → LEAST PROVIDER ACTIVITY