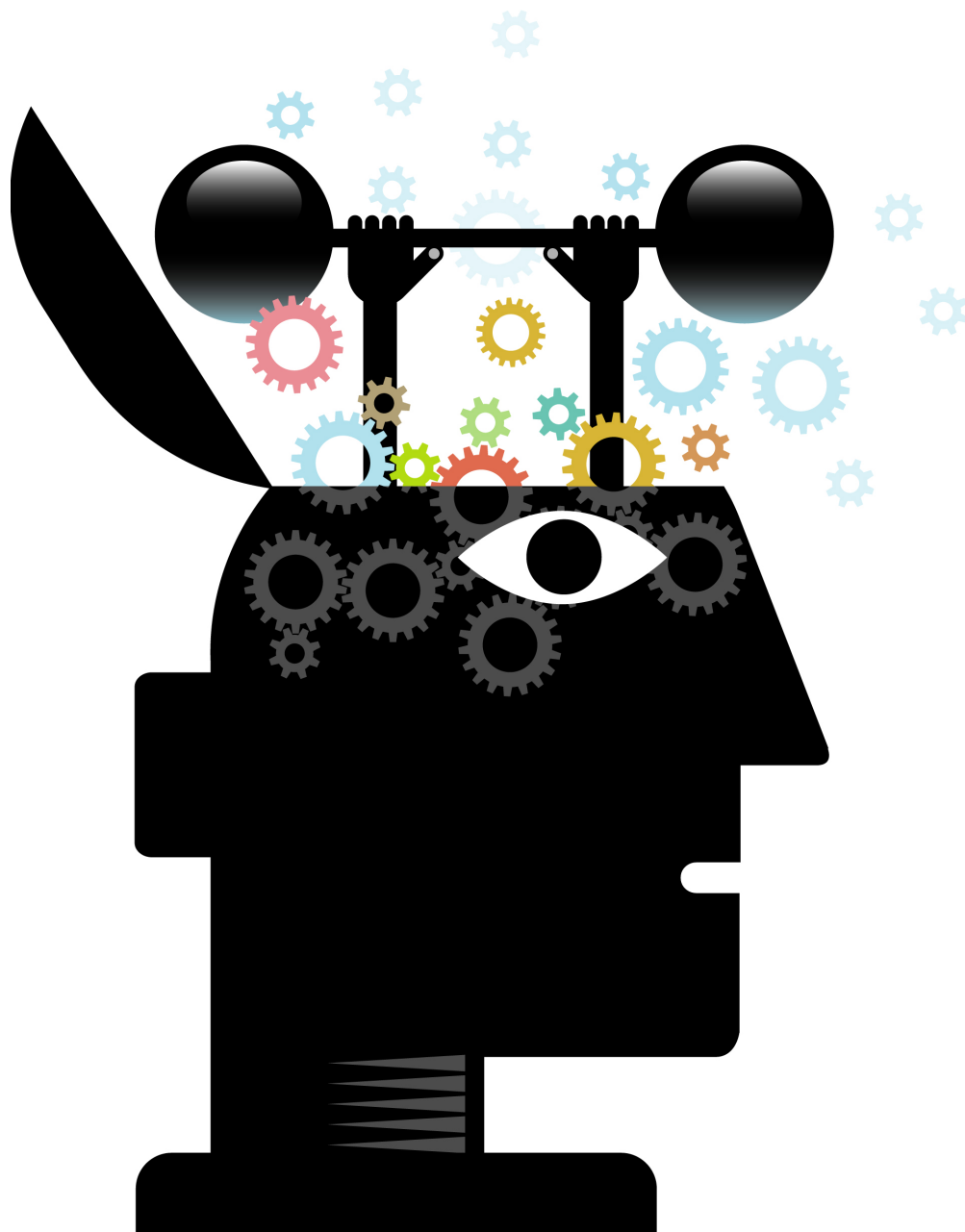


TRAINING DAYS

Models of Vocational Training Provision: Lessons from the Victorian experience

David Hetherington
Jarrod Rust



percapita



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About Per Capita

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Executive Summary

Few areas of Australian public policy have undergone such rapid change as vocational education and training (VET) in recent years. The introduction of private provision, known as ‘contestability’, has radically reshaped the VET sector. Contestability was first embraced in Victoria in 2009 in response to a widespread skills shortage, with other states since following suit. The objectives of contestability were to increase the supply of qualified trainees, while attracting greater private investment and improving quality through competition.

In a 2008 paper, Per Capita called for a new market design in vocational training based on contestability (Cooney, 2008). Now, five years on, we evaluate the experience of contestability in Victoria against its original objectives. We find that it has succeeded in one of its primary goals: dramatically lifting the supply of new trainees. However, there have been unexpected and damaging consequences elsewhere.

The ‘uncapping’ of the market has led to a bubble which has resulted in a \$300m p.a. blow-out in public spending on VET. This type of bubble is common in sectors where public funds are newly made available to private providers – employment services and household solar energy systems are two recent examples. A related feature of such bubbles is that new entrants offer variable quality. In the case of VET, employer groups report falling confidence in the quality of skills delivered by the training system.

The response of the Victorian Government to the blow-out has been to cut back annual spending by around \$300m; these cuts have fallen largely on TAFEs, the traditional public training providers. We believe this is a detrimental step as it undermines TAFEs’ ability to deliver their statutory community service obligations which assist disadvantaged and disabled students. In addition, it weakens the financial viability of TAFEs, which is particularly concerning in thin regional markets poorly serviced by private training providers.

Taken together, this is an unacceptable state of affairs. For the economic and social health of Australia, it is critical that we get this system of human capital investment right. While it is commendable that supply has increased and government has reined in overspending, Australia cannot afford to settle for declining quality in its training sector and the dilution of the distinctive community services offered by TAFEs.

To address this situation, this report proposes four principles that should underpin the next stage in the market design of the VET sector in Victoria. First, we recommend the retention of uncapped public subsidies in skills shortage areas only. Capping should be returned in other areas.

Secondly, we call for a streamlined subsidy structure which removes the extraordinary complexity of the current regime and delivers the highest subsidy to skills shortage areas courses. Thirdly, we demand the reinstatement of dedicated public funding to TAFEs to allow them to deliver their community service obligations. This could be paid for by tightening eligibility for Recognition of Prior Learning programs and foundational courses. Finally, we call for an independent Ombudsman to oversee the regulation of the sector. This role would replace the current undesirable structure in which government acts as purchaser, provider and regulator.

We are confident these principles offer a sustainable, high quality future for the VET sector, both in Victoria and in the other states currently redesigning their training provision. Australian trainees and their employers deserve nothing less.



Introduction

The vocational education and training (VET) sector in Australia has undergone transformational change over the last five years. In 2009, the Victorian government introduced 'contestability' reforms, which ensured a publicly funded training place for anyone meeting the eligibility criteria and allowed private providers to deliver training using that public funding.

The policy rationale for these reforms was that the introduction of competition for access to public funds would increase quality and improve public value-for-money. These goals were particularly important at a time when Australia was facing a skills shortage of an estimated 240,000 places over the period 2006-16 (Shah and Burke, cited in Australian Government 2008: 2).

Although Victoria has been the trailblazer, other states are following in its footsteps. South Australia has just completed a major redesign of its VET provision, while New South Wales and Queensland are currently developing VET reform packages.

While greater supply at higher quality is one motivating factor, it is clear that the reforms are also driven by the straitened finances of state and territory governments. In a period of low consumer confidence and a sluggish housing market, states' revenues from GST and stamp duties are under significant pressure and governments are responding by trying to slow the growth in public spending. As VET has been an area of rapid spending growth, it is a natural target for reform.

Against the backdrop of the rapid push to reform, the continuing flux in the Victorian VET market, and the fact that additional states are embarking down this path, this paper sets out to evaluate the impact of contestability on the VET market to offer lessons for policymakers around the country. As the Victorian example is the most advanced, we use it as a case study to develop lessons for future policy reform.

We begin by examining the background to the introduction of contestability, and outlining the detailed policy measures undertaken by various states to date. We then examine the impact of contestability in Victoria on the supply and quality of training provision by assessing today's outcomes against the objectives of the original reform. In light of this track record, the third section of the paper identifies four principles we believe should inform future contestability reforms, and proposes specific policy responses under each of these headings.

Our conclusions are that while the Victorian reforms have been successful in part, they have also brought unintended detrimental effects. The most notable element of their success has been the overall increase in skills investment, over \$300 million per year, which has seen the annual number of new trainees in Victoria nearly double in four years. Given our belief in the importance of investing in human capital - the skills and capabilities that drive our economy and give meaning to individual lives - this is a noteworthy achievement.

However, we believe that the reforms have also brought a decline in the average quality of training outcomes. Employer groups say that overall quality in the system has fallen since the introduction of the reforms: it is clear that at least some new private providers are delivering poorer quality training than established public providers.



In one sense, the reforms are a victim of their own success. The rapid growth in spending under the Victorian Training Guarantee has seen the Coalition government cut VET funding, with the cuts overwhelmingly concentrated on the public TAFE providers. We argue that this is a false economy, as important capabilities that reside only in the TAFE system are being lost. Instead, we suggest that government restores funding for TAFE's community service obligations and finds new savings by further cutting subsidies for the Recognition of Prior Learning (RPL) program and addressing the enrolment of overqualified students in foundation courses.

In 2008, Per Capita's then Policy Director Michael Cooney wrote a research paper on the potential impact of contestability in Victoria (Cooney, 2008). Cooney broadly welcomed the reforms as an important measure to address the deep skill shortages that existed at the time. However, he counseled that the system must recognise the distinct operating structures of public TAFE providers and ensure that they maintained sufficient financial autonomy to sustain these structures.

This Per Capita paper is in one sense a follow-up to Cooney's 2008 publication: having welcomed the redesign of the VET system then, it is worthwhile to revisit the topic five years on to assess its success.



Section I: The Background to Contestability in Vocational Training

Contestability for government subsidised training was first introduced in Victoria in 2009. The driving force behind Victoria's reform of the vocational education system was a growing recognition of the current and impending skills shortages facing the state. One aspect of the problem was that it had become increasingly difficult to find quality applicants in traditional sectors such as construction, aged care, and engineering. Employers were calling for an increase in the number of school-leavers undertaking vocational training, preferably at the higher levels of Diplomas and Advanced Diplomas.

Furthermore, the Victorian government recognised the need to anticipate the skills that would be required to drive growth into the future. With the service-based sector contributing an ever greater share of economic output, industries such as finance, health, and tourism would need a considerable boost in the number of suitably trained professionals joining their ranks. Monash University estimated that between 2005-2015 there would be an estimated shortfall of 123,000 Diploma- and Advanced Diploma-qualified workers based on existing trends (Australian Government, 2008: 8). Across the entire economy, these trends amounted to almost 240,000 jobs that would not be filled by appropriately skilled workers should trends have continued (Australian Education Union Victorian Branch, 2008: 2).

Having established the background for reform, the Victorian government presented a discussion paper in April 2008 entitled "Securing our future economic prosperity", inviting submissions from relevant stakeholders within the education system. The final report, "Securing Jobs for Your Future: Skills for Victoria", was released in August of the same year, detailing how and when the pledged \$316m would be spent over the following four years.

This represented a radical change of direction, moving from a supply-driven model in which a limited number of places were offered, to what was termed a "user-focused" one, whereby any student eligible to enrol would be guaranteed a place, and business and industry would have a greater say in directing priorities.

The major policy changes included:

- *The Victorian Training Guarantee* – an initiative to subsidise the training of any eligible student aged 20 or under, and to continue to do so for as long as they seek higher levels of training;
- *Skills for Growth* – providing expert advice to businesses in order to establish their training needs;
- A vastly expanded and clarified user information database; and
- Strengthened capacity in the form of IT infrastructure and teacher funding.



By far the largest share of spending was dedicated to increasing the number of places available to students. This was done by allowing privately operated Registered Training Organisations (RTOs) to access government funds, with the intent of increasing competition within the sector. Between 2008 and 2011, almost 200 such providers entered the market, and without a cap on enrolments, student numbers grew rapidly. From 2008, the last year of a supply-driven model, to 2011, there was a 68% increase in government-funded student hours, which placed an unexpected and unwelcome burden on the state budget. Having expected to spend \$855m in 2011/12 on vocational education and training (VET), the figure ended up being over \$1.3bn (Department of Education and Early Childhood Development, 2012: 3).

South Australian VET reform

South Australia has implemented by far the most interesting reform program, having learned from the experiences of its Victorian neighbour. The architects of the plan have gone to great lengths to protect the place of TAFE SA, with \$240m promised in infrastructure funding alone. Subsidies to public providers will be much higher than those to private RTOs (although this gap will close over time), and in the first instance some courses will only be subsidised through TAFE campuses. In terms of its approach to skills shortages, all Foundation, Certificate I, and Certificate II courses are fee-free for students, as are some other courses identified as priorities. Periodic reviews are undertaken to identify course oversubscription, and as of April 2013, 19 courses have been prohibited from taking on any new enrolments, with many more having their subsidies reduced by up to 50%. Furthermore, in contrast to other states, students are eligible to receive subsidies for multiple qualifications at the same level, while the unemployed are unrestricted in their access to equal qualifications.

The National Partnership Agreement

In April 2012, the Commonwealth and all States and Territories agreed upon a National Partnership Agreement (NPA) on Skills Reform, with a view to the creation of a “productive and highly skilled workforce which contributes to Australia's economic future” (Council of Australian Governments [COAG], 2012: 1). In an attempt to harmonise the skills reform initiatives already underway in some states, the NPA laid out a number of objectives which the states were committed to, although a number of these were flexible in recognition of jurisdictional differences.

The centrepiece of the NPA was the “national training entitlement”, which meant that all working-age Australians (not already holding a qualification of Certificate III or above) were guaranteed a government-subsidised place at an institution of their choosing, public or private (COAG, 2012: 23). Beyond this minimum responsibility of the states, the NPA also included a commitment by all parties to increase access to income-contingent loans, recognition of the importance of public providers, measures to improve transparency for students and governments alike, and an assurance to monitor the quality of training outcomes. On this final point, it is



interesting to note the refusal of Victoria and Western Australia to sign up to the 2011 Intergovernmental Agreement (IGA) for Regulatory Reform of Vocational Education and Training, which created the Australian Skills Quality Authority (ASQA). While both states have their own regulatory bodies covering quality outcomes, they are also the two states which have shown the most resistance to a national approach.

Queensland VET reform

The Queensland government's VET reform package is scheduled to be rolled out selectively from July this year, with full entitlements offered as of July 2014. It offers some interesting comparisons to other states. While there will be no initial restrictions on enrolments, at the level of Certificate IV and above there will be three subsidy levels of 0%, 50%, and 90% in order to steer students and providers towards skill shortage areas. Besides that specific provision, it is likely that the state will follow in the footsteps of South Australia, with an evolving system of caps and subsidies to react to areas of oversupply. The government plans to undertake a study of TAFE base funding, so that essential services may be retained and TAFE can continue operating as a viable public entity. The reform plan also includes considerable support for the consolidation or amalgamation of existing TAFE campuses. The Queensland Skills and Training Taskforce final report suggests that the current 82 campuses could possibly be reduced to just 44.

While the agreement makes overtures to the notions of equity, efficiency, and responsiveness, the only concrete target is an increase in national completions by 375,000 during the term of the NPA (which expires in mid-2017), and a promise of \$1.75bn in federal funding towards this goal (COAG, 2012: 7). 65% of this figure is provided partially in advance and partially upon completion of structural reform milestones, while the remaining 35% is released in the final two years of the NPA contingent on training outcomes (COAG, 2012: 10).



New South Wales VET reform

The NSW government is currently developing new VET reforms, the details of which are not yet fully clear. It is expected that the government will be supporting a shift to an uncapped model, with some conditions. While most Foundation, Certificate II, and Certificate III skills will be entitled to public funding, regardless of provider, only certain skills at Certificate IV and above (determined by a priority skills list) will be treated the same way. Community Service Obligation (CSO) payments to TAFE NSW will be retained, while a loading will be available to all providers in rural areas, and to those who cater to disadvantaged students. One notable aspect of the NSW reforms is that there will be a set fee per qualification, rather than per year, to the benefit of part-time students.

Interestingly, distribution of funds under the NPA is determined by total state population, not by number of student enrolments, which disadvantages states like Victoria with a higher percentage of their population enrolled in VET institutions. It remains to be seen whether or not this imbalance will correct itself over time as more students in states with lower enrolments enter the VET sector.

VET reform in other states and territories

As signatories to the National Partnership Agreement, all states and territories are required to pursue VET reform agendas. In Tasmania, a Policy Statement was released in 2009, with little action taken since except for the creation of TasTAFE, a single statutory body comprising the former Tasmanian Polytechnic and the Tasmanian Skills Institute. Western Australia has received COAG support for its Implementation Plan which promises to tightly regulate access to government funding. There are strong indications that WA is reluctant to change what they view as a highly functioning system. The NT VET sector faces particular challenges due to a thin client base and a dispersed population. Despite not having TAFEs, there are two providers which approximate their role, and the extension of the market to include more private RTOs is not seen to be a major challenge, subject to quality assurance. Finally, the ACT plans to redesign existing access programs to fall in line with the National Partnership Agreement, while ensuring that its sole provider maintains its public provider status.

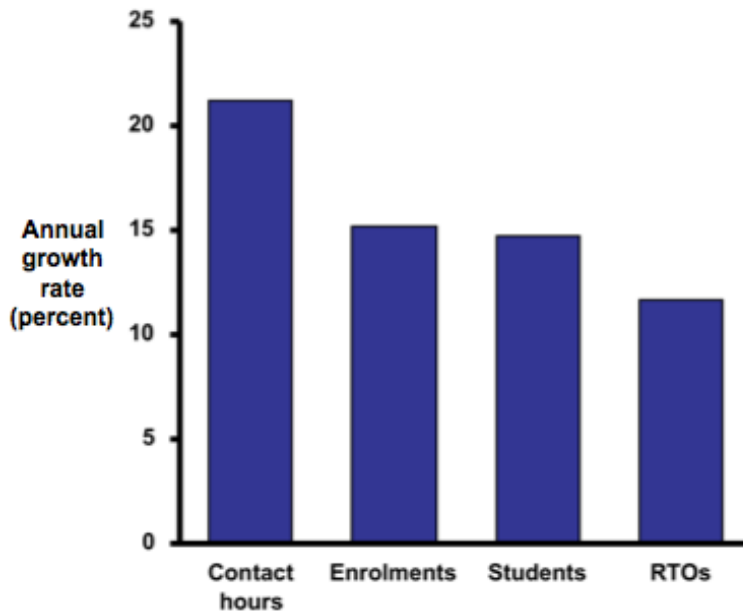
Section II: Objectives and Outcomes of 2008 Victorian Reforms

The Victorian reforms announced in 2008 set out to achieve three principal objectives:

- to address a pressing skills shortage;
- to reduce cost of provision and improve quality through contestability; and
- to reduce 'churn' amongst lower-level qualifications.

While a 2006 report forecast a national skills shortfall of 240,000 places over the coming decade, the training sector in Victoria alone increased its annual provision by almost 300,000 enrolments over the period 2008-12, an annual growth rate of 15.2%. Over the same period, student numbers have grown by 14.7% per annum, contact hours have grown by 21.2% per annum, and the number of private providers offering government subsidised training has doubled (Department of Education and Early Childhood Development, 2013b). This in itself is a remarkable achievement (see chart below).

Growth rates in Victorian VET sector (2008-12)



Sources: DEECD, Victorian TAFE Association



However, skills shortages have not been uniformly addressed across the board. While there are high numbers of new hospitality and leisure trainees, shortages persist in other highly demanded trades. For example, North Melbourne TAFE cannot meet the level of demand for plumbing enrolments, a key skills shortage area in which it remains oversubscribed.

On the second objective of lowering cost and improving quality, the results are mixed. Despite large increases in overall VET funding, the public subsidy per hour of training delivered has fallen considerably, from around \$9.15/hr in 2008 to around \$6.89/hr in 2012¹. However, while costs have fallen as intended, quality has not improved. There have been several high profile closures of private training providers, leaving students out of pocket.

More importantly, employer groups say that the overall standard of qualified trainees has fallen markedly. Megan Lilly, Director of Education and Training at the Australian Industry Group, observes “falling confidence amongst employers that they are actually getting the skills delivered as described by the qualification”. Admittedly, quality is hard to measure. Many observers, such as the Productivity Commission, assess quality by teacher qualifications, but this is a measure of inputs rather than outcomes. The National Skills Standards Council assesses quality by the content of Training Packages, rather than trainee performance. However, employers argue that newly certified trainees are arriving in workplaces with skill levels considerably below those expected of their certification level. Given this, this second objective is at best partially achieved and has, in an important sense, made the training system worse.

The final objective was to reduce ‘churn’ at lower levels of qualification, where students were undertaking multiple training courses using public subsidies without advancing to higher qualification levels. Under the rules of the new reforms, this objective has been met by definition. The Victorian Training Guarantee requires that recipients of public funding (except those aged 20 and under) enroll at a certification level higher than their existing qualification. This has evidently prevented churn occurring, although we would question whether this is always desirable, given the potential need for retraining in brand new areas resulting from structural changes in the economy.

In summary, we would say that the Victorian reforms have succeeded on two of the three principal objectives – increasing supply and reducing churn. On the third, success is only partial: while unit cost has fallen, this appears to have been achieved at the expense of a marked fall in training quality. What’s more, while the objectives of the 2008 reforms have largely been met, these reforms have created important unintended consequences, to which we now turn.



Section III: The Consequences of Contestability

By any measure, the growth in the vocational training sector in Victoria has been extraordinary. In government-funded training over the period 2008-12, enrolments have increased by 76%, student numbers have increased by 73% and contact hours by 116%. The number of private RTO's active in the sector has doubled, from 201 to over 400.

What has sustained this growth? At one level, it is a desired response to chronic skills shortages. At the time the contestability reforms were conceived in 2008, it was widely agreed that the economy was facing damaging shortages in important skills areas. The growth in training completions in Victoria has clearly contributed to closing this shortfall.

On another level, however, there are other forces at play. The explosive scale of this growth is more than a response to the skills deficit. The growth in enrolments in Victoria in the last five years alone is more than enough to close the forecast national shortfall of 240,000 places.

This growth is something else – a bubble. A bubble is defined as “trade in high volumes at prices that are considerably at variance with intrinsic values” (Smith et al, 1993: 183). Under this definition, a bubble has two features – high volumes and prices detached from true ‘value’.

There is no doubt that Victorian training sector has seen trade in high volumes. What about price? Prices in the system are ‘fixed’, so they haven’t increased spectacularly over the course of the bubble. But do they reflect intrinsic value? This is a difficult question which we can only answer incompletely. This partial answer is to be found in the current market design of the VET sector.

In a private sector market, all the critical components - supply, demand and price - are variable. Supply and demand move in response to external stimuli, and price moves to balance supply and demand. In a private sector bubble, demand is driven by ‘irrational exuberance’ rather than underlying economic fundamentals, and price increases accordingly.

In a quasi-public market like vocational training where government is the primary purchaser, at least one of these critical market components is fixed. In the case of a capped market, demand is fixed and in the case of a subsidy per unit, price is fixed. In the case of the Victorian training sector, price has been fixed since 2008 – the government is willing to offer a fixed subsidy per student with no limit on the number of students.

This is the market feature that leads to the bubble. Because demand is effectively unlimited and price (the public subsidy) cannot fall in response to increased supply, suppliers have every incentive to stimulate demand as long as the price remains above their cost of provision. The result is the enormous growth in volume that we have seen since 2008 – the bubble.

Up to a point, this growth reflects the chosen market design delivering a desired policy objective: addressing a long-term skills shortfall. However, beyond some point, the payment of a fixed, uncapped subsidy does not deliver public value, particularly in those areas where there is no skills shortage.



This bubble-like growth can be seen in other quasi-public markets where governments have outsourced delivery of publicly funded services, such as employment services and solar panel installation. What demonstrates the bubble-like character of these markets is the collapse in supply after the market has been running for some time, or when the subsidy is limited. The initial subsidy announcement draws in vast numbers of new providers, some of whom see a short-term profit opportunity but are unable to compete sustainably over the long-term.

When public employment services were outsourced in 1998, 300 private and non-profit providers entered the Job Network market. By the end of the first three year contract round, only 200 providers remained. Today, in the fifth round, only 90 providers remain in the system (now called Job Services Australia). The majority of those who have exited are smaller non-profit providers. The remaining providers are getting bigger, and expanding overseas. The biggest provider, Maximus, is owned by a US private equity fund.

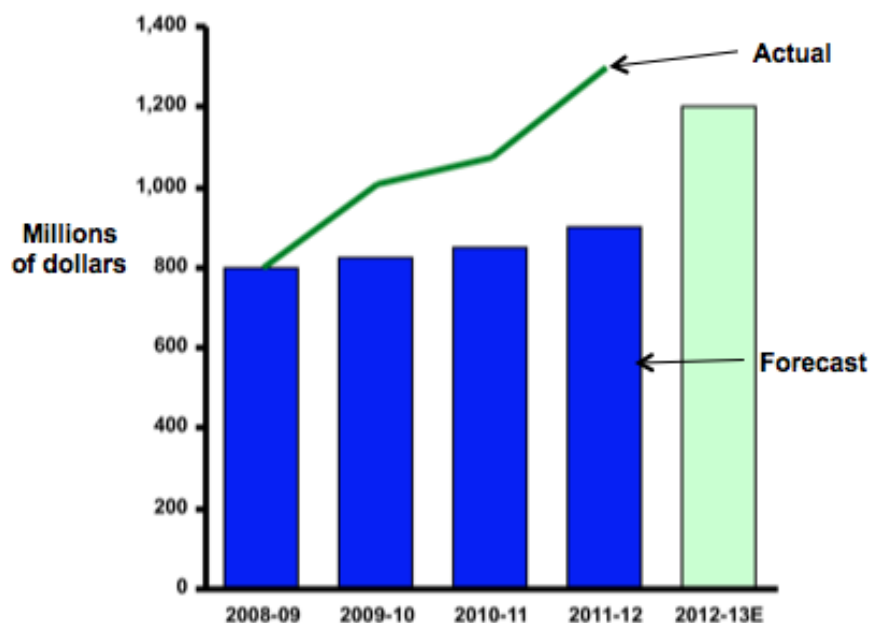
When the Federal Government's solar energy rebate subsidy was cancelled in 2012, suppliers found themselves facing a collapse in demand which many could not survive. From the mid-2000s, Federal and State governments began offering households attractive rebates on the installation of solar energy panels. The NSW scheme, originally forecast at \$362m, is estimated to have cost \$1.75b before it was cut in April 2011. From a planned budget of \$28m, the WA scheme costs blew out to \$180m before the scheme was capped in May 2012. The Commonwealth cut its \$320m scheme in February 2012. The solar industry has claimed that many providers will be left unviable by the reductions in government support.

It is possible, even likely, that the vocational training market will experience a similar wave of provider exits in coming years as the sector matures and the less sustainable private (and potentially public) providers exit.

So while market design in the VET sector has met one of its primary policy objectives – increased training completions – it is now getting poor value for its public investment as funds are directed to private providers in areas of skills surplus.

The upshot is that the system has left the Victorian government with a set of uncapped liabilities which have cost far more than forecast. As a result of a fully contestable market, the state's budget liability for training became open-ended. The uncapped, fixed-price subsidy resulted in hundreds of new private providers entering the market. The government's annual expenditure grew by 17.6% p.a. from 2008-09 to 2011-12. In 2011-12, it was \$400m above the originally provisioned sum (see chart below).

Victorian Government Spending on VET (2008-09 - 2012-13E)



Sources: DEECD

In order to slow the rate in spending growth, government has cut approximately \$300m p.a. from TAFE providers. In mid-2012, Victoria’s Baillieu government submitted a 2012/13 budget which made deep cuts to VET funding, overwhelmingly felt by Victoria’s 14 TAFE institutes and four dual-sector universities. The Victorian TAFE Association estimated that the cuts would strip nearly \$300m from their budgets, despite TAFE enrolments only increasing by 4% over the 2008-2011 period (Victorian TAFE Association, 2013). While some disciplines were granted increased funding, around 80% of TAFE courses saw their subsidies cut significantly, to the tune of \$130m per year. Furthermore, a provision of \$170m, which TAFE received annually in recognition of its role as a “full service provider” (comprising its community service obligations), was stripped entirely from the budget.

The response of TAFEs has been to increase their course fees to students (i.e. lift the portion of the fee that is unsubsidised). The danger is that this drives trainees out of the training system, and particularly affects those students from lower socio-economic backgrounds who are more likely to attend TAFEs. The enrolment data for Quarter 1 2013 suggest that such a decline is occurring, particularly in the Southern and Eastern metropolitan areas and in regional Victoria (DEECD, 2013c: 8).

The current market design in Victoria, based on contestability and involving uncapped public liabilities, is clearly unsustainable. The question is therefore what are the design principles that would lend financial sustainability, while ensuring quality and adequate supply to meet ongoing demand? The next section addresses this question.

Section IV: New Approaches for VET Market

To address the flaws in the Victorian model while sustaining quality and supply, we are proposing four principles that we believe should underpin new market design for vocational training in Victoria and other Australian states pursuing VET reform. These principles are::

- A semi-capped market where only skills shortage areas are uncapped;
- A streamlined regime for eligibility and subsidies
- Quarantined funding for public provider obligations
- An independent statutory regulator

A semi-capped market

In order to recapture financial sustainability for state and territory governments, we must reinstate some form of capping. The rationale for uncapped markets is to stimulate new supply, but this rationale only extends to those areas facing skills shortages. Therefore, we believe that capping should be reimposed on those course areas not considered to be experiencing skills shortages.

This raises two questions:

- 1) How do we assess areas of skills shortage; and
- 2) What is the appropriate mechanism for capping?

Our initial approach to addressing skills shortages is to base shortage assessments on the existing system of Bands, which classifies each course between Bands A and E. These bands reflect the level of subsidy provided for each course which is reassessed annually by the Victorian Department of Education and Early Childhood Development (DEECD).

In the short term, we believe these can be used as a proxy for 'skills shortage'. We propose that Band A only is left uncapped, and that capping is reinstated for Bands B-E.

In this way, the only uncapped public investment - and by extension, the lion's share of investment – is being directed into areas with the highest public return.

We recognize that the Band A-E approach is not the ideal long-term method of assessing which areas should be deemed in shortage. The Victorian Department's current method for assessing shortage areas through its Market Monitoring Unit is something of a 'black box'. It lacks transparency for market participants, it has minimal employer input since the dissolution of the Victorian Skills Commission and the Industry Training Advisory Boards, and it makes no provision for regional variability in labour markets.

However, we also believe that too much change in a short period of time has been disruptive for market participants, and that further large-scale change will be even more challenging. Therefore we feel it advisable in the short-term to use the existing banding system as a proxy for skills shortage. In the medium-term, we believe a new approach should be developed which is more transparent, involves greater employer input and incorporates some recognition of the distinct employment challenges in different regional markets.

A separate question concerns the capping method used to place a ceiling on public subsidies for courses in non-shortage areas. The conventional method is to cap by volume: limiting the number of government-subsidised places in each course. This was the uniform national approach prior to the introduction of the Victorian Training Guarantee.

An alternative method would be to cap by value: to limit the total quantum of government funding to non-shortage areas. The total public subsidy would be split equally across all students within a given subject areas, and providers would need to calibrate enrolments and student fees accordingly. The advantage of this approach is that public investment could be spread across a greater number of students.

Let's explore a hypothetical example. The Certificate IV qualification in Hospitality is subsidised at \$5/hr according to the 2012 DEECD course subsidy list. If the course requires 400 contact hours, then the government contribution would be \$2000 per student over its duration. In order to avoid 'overinvestment' of public money, government might decide that only \$1m will be allocated to this particular qualification in the coming year, equivalent to supporting 500 students at \$5/hr. If providers actually enrol 1,000 students in that year, the \$1m pool is diluted so that the subsidy per student is reduced to \$2.50/hr for the 400 contact hours. Given the reduced subsidy available to them, it is likely that providers would offer less places in subsequent years, better matching supply with demand.

Under either approach, by volume or by value, capping could be assessed at the level of individual courses, ANZSIC industry codes or Bands B-E.

Streamlined subsidy/eligibility regime

The second principle of the proposed market design is a simpler approach to subsidy price-setting and course eligibility. The existing structure for course subsidy levels in Victoria is extraordinarily complex. There are 1,056 individual price points for course subsidies which are revised each year. Each price point is accompanied by a concession rate, which varies even between courses with the same subsidy level. The administration costs of managing this complexity, for both providers and the Department, are undoubtedly high.

This pricing structure should be vastly simplified, perhaps into the five Band levels A-E. Under a simplified arrangement, public and private providers would receive the same subsidy level for each course. (This is similar to the initial Victorian approach in 2009, although the bands were called Skills Deepening, Skills Building, Skills Creation and Foundation.) The existing loading levels for regional and disadvantaged students would remain. An important consequence of fewer price points is that there would be far less volatility in subsidy levels from year to year. This approach would reduce administration costs considerably, and allow for improved business planning on the part of all providers.

Another area that should be streamlined is eligibility for the Training Guarantee. At present, students aged over 20 are only eligible for the Guarantee if they are enrolling for a certification level higher than any qualification they currently hold. We believe this restriction is unnecessarily limiting in the context of a volatile labour market, especially in areas of skills shortage. Increasingly, workers will need retraining in different skill sets throughout their careers and at times this will involve undertaking new qualifications at lower certification levels.



For this reason, we feel that a revised eligibility structure should offer all Victorians aged 16 and over access to the Training Guarantee in skills shortage areas only, regardless of existing qualifications. In non-shortage areas, the current arrangements would remain, with the primary objective of avoiding student 'churn' at lower qualification levels. This approach both meets the public value test and recognizes the increasing volatility of labour markets.

Quarantined funding to meet public provider obligations

There are distinctive features that mark the operating arrangements of public training providers. Often they are teaching the 'costly-to-deliver' courses that are avoided by for-profit providers. Regional TAFEs are frequently the only training option for students living in non-metropolitan areas. Furthermore, TAFEs have legislated community service obligations to address the needs of disadvantaged students. Finally, because as public entities they operate under public sector industrial relations and human resources policy arrangements, they necessarily carry higher workforce costs than their private counterparts. Industry participants suggest that new enterprise agreements might lead to productivity increases of up to 10%, but that this is still insufficient to close the cost gap with private providers.

The ability of Victorian TAFEs to meet these distinct obligations has been vastly reduced in the wake of the government's \$300m annual funding cut to TAFEs from July 2012. Of the \$300m cut, approximately \$130m comes from reduced course subsidies, around \$130m is borne through workforce costs and the remaining \$40m falls on community service obligations. Offsetting this, the Government has announced an extra \$50m per annum over four years in restructuring funding for TAFEs, available upon application, but it is clear that these funds are intended as transition money to prepare the public training sector for a round of consolidation through TAFE mergers and shared services efficiencies. This is consistent with Recommendation 2 of the TAFE Reform Panel which suggests merging the governance of eight regional TAFEs into four new governance structures.

The \$300m cut clearly means that public providers will be unable to meet the range of distinct service obligations they carry. For this reason, a revised market design approach should incorporate four particular features that address each element of public providers' service obligations.

First, government should agree with TAFEs a precise definition of 'community service obligations' and provide dedicated funding to support these. This was a clear recommendation of the TAFE Reform Panel (Department of Education and Early Childhood Development, 2013: Recommendation 18), which expressed concern that no definition of TAFEs community service obligations existed, despite a legislative requirement that they provide them.

Secondly, government should provide clarity on its expectation that TAFEs continue to operate under the longstanding public sector industrial relations arrangements. Since the removal of the subsidy differential between public and private providers, TAFEs have been expected to provide the most costly-to-deliver services with reduced funding and a higher wage structure. If government expects TAFEs to continue as public entities with publicly employed staff, it should provide discrete funding for the public sector wage supplement.



Third, the government should reinstate the \$1.80/hour public provider supplement for Band A courses only. 82% of Band A courses are provided by public providers, and these are typically the most expensive to deliver, so subsidy cuts affect the provision of courses in these shortage areas unduly. The reinstatement of the Band A subsidy, either directly or through an increase in Band A course payments, would ensure that public providers are able to continue existing levels of provision in these critical skills areas.

Finally, the loadings for regional and disadvantaged students should be retained for both public and for-profit providers. Given the pressure on VET funding, it is possible that governments will seek to remove these loadings. However, these are exactly the type of service obligations that require transparent and quarantined funding. Without this, it is inevitable that tailored support for regional and disadvantaged students will disappear.

Of course, it is important to recognize that governments are genuinely squeezed for funds as a result of the decline in the national tax take. If the approach we have recommended involves restoring funds for TAFEs, it is incumbent on us to suggest where offsetting savings might be found.

One area is in Recognition of Prior Learning (RPL). In recent years, RPL enrolments have grown rapidly as RTO's were able to access a full subsidy for an RPL assessment as though they had delivered the entire course. Last year, the Victorian government reduced the subsidy to 50% of the applicable course fee for most courses, and removed it for foundation courses. We believe 50% is still likely to be too high, and would recommend the government consider reducing this subsidy further.

A second area is in the enrolment of overqualified students and staff in foundation courses, including some with postgraduate qualifications (Preiss, 2013). Clearly this is a questionable use of public money. To find further savings, the government should remove subsidies for foundational courses where the trainee has tertiary qualifications, and should consider removing subsidies for those with diploma or advanced diploma qualifications.

Taken together, this combination of savings would go some way to offsetting the cuts to TAFE funding in community service obligations and reduced course subsidies.

An independent statutory regulator for the VET sector

One of the policy challenges created by government outsourcing is that it introduces a new set of commercial and legal arrangements that require oversight and regulation. When government tenders out provision of particular activities, as in the case of employment services, this creates new purchaser-provider relationships between government and the external service providers. Government is the buyer and therefore is not in a fair position to regulate the buyer-seller relationship.

This situation is made more complex when some provision remains in public hands, as is the case with VET. In this instance, the government is the funder of all services, the purchaser of some services from the private sector, and the direct provider of services in competition with the private sector. This creates multiple potential conflicts of interest in which government is regulating its suppliers and its competitors.



Given these relationships, it is desirable to separate the role of regulator from the government's purchaser and provider roles. We believe this can be achieved through an independent statutory Ombudsman for the VET sector.

While the Ombudsman's role could encompass a number of different responsibilities, we believe the primary ones should be:

- To offer dispute resolution between purchaser, providers and potentially students
- To receive and investigate complaints from students
- To monitor and ensure quality standards for all providers (ideally within the framework of ASQA)

Two responsibilities that should not lie with the Ombudsman are the allocation of budget funding and the setting of course subsidy levels. These are legislative prerogatives which properly reside with the government of the day.

A final, open question concerning regulation of the VET sector is whether public TAFE providers themselves should be given statutory independence. A case can be made that if TAFEs were allowed full control over their balance sheets and wage structures, they would have more flexibility to compete with private providers that enjoy complete financial autonomy.

The counterargument is that, even if TAFEs become statutorily independent, governments will not be able to resist the temptation to override management decisions if they are seen to carry a political cost. This is a debate that will continue to play out in coming years, but one that is increasingly important if funding continues to be withdrawn from the public component of the VET sector.

Taken together, we believe these four principles form the basis of a sustainable VET market design which is responsive to changing skills needs of the economy, promotes quality and diversity, and delivers public value-for-money. This approach is designed to capture the benefits of contestability – innovation, new supply, and improvements in cost and quality – without the imposition of an open-ended liability on the public purse. We have specifically identified two potential opportunities for cost savings through the further restructure of the RPL regime and the tightening of enrolments in foundation courses.

We are particularly conscious of the unique role played by public TAFE providers, especially in regional areas and costly-to-deliver courses, and we believe this role should be maintained and appropriately funded.

We would welcome discussions with all interested stakeholders – public and private providers, employer groups and policymakers – on the ideas contained in this paper.

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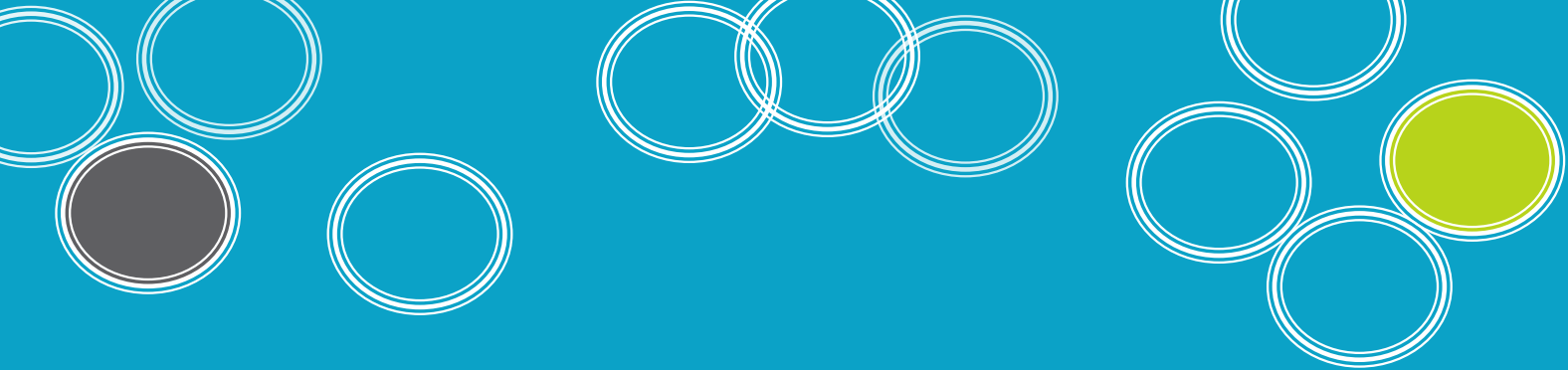
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