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## VET FEE AND FUNDING REVIEW

VOLUME I:

BLUEPRINT FOR CHANGE

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# REPORT STRUCTURE

This is the first volume as part of the Essential Services Commission's final report into Victoria's vocational education and training (VET) fee and funding model. The report comprises two volumes, as described below.

## VOLUME I: BLUEPRINT FOR CHANGE

This strategic overview document is structured as follows:

### I. The Victorian VET reforms

This section looks at Victoria's reform of the VET sector and provides a framework for assessing the most efficient form of policy intervention. The discussion establishes a clear delineation between subsidies, concessions and targeted demand-side interventions.

### II. Strategic directions for improving the VET fee and funding model

This section provides high level directions for improving the efficiency of the VET fee and funding model in Victoria. The discussion highlights the importance of transparency and establishing more dynamic feedback between the VET market and policy setting processes. Where relevant, it also highlights issues pertaining to Commonwealth arrangements. The nine strategic directions highlighted in this section draw on the recommendations to emerge from the technical analysis in Volume II of this report.

### III. Full list of the Commission's recommendations

This section lists all of the Commission's recommendations from the technical analysis in Volume II of this report.

### IV. How well is the current model meeting the objectives of the Victorian training system?

This section reconciles our recommendations with the objectives of the VET system, as articulated in our terms of reference.

### V. Suggested transition path for key reforms

This section outlines an indicative timeline for, and sequencing of, the implementation of the Commission's recommendations.

### VI. Conclusion

The concluding section provides a broad overview of the recommended key reforms to the Victorian VET system.

## **VOLUME II: TECHNICAL ANALYSIS**

The second volume contains the technical analysis that underpins our recommendations, and consists of seven chapters covering: (1) introduction; (2) the VET sector in Victoria; (3) stakeholder views on objectives; (4) eligibility criteria; (5) tuition fees; (6) funding; and (7) a more competitive pricing model.

Volume II also contains a number of technical appendices.

# THE VET FEE AND FUNDING MODEL: A BLUEPRINT FOR CHANGE

## I. The Victorian VET reforms

Enhancing the knowledge and skills base of the labour force is a key component of the Victorian Government's agenda to promote Victoria's competitiveness and boost productivity growth. This requires a dynamic and responsive training system to ensure the economy has the necessary skills needed to grow and to assist in structural adjustments arising from factors such as the resources boom and policy responses to climate change.

To this end, the vocational education and training (VET) sector in Victoria has undergone significant reform over the last few years. The establishment of the Victorian Training Guarantee (VTG) means there are no longer caps on the number of subsidised places available, but eligibility for a subsidised place is limited to students meeting certain criteria. The VTG, by creating a 'student entitlement' that follows the student, has opened up the provision of subsidised student places to all service providers, irrespective of ownership structure.

As a result, the supply side of the VET system has been transformed, with the inclusion of private registered training organisations, many of which previously did not offer subsidised places to students. Since the introduction of the VTG, there has been an almost 50 per cent increase in the number of training providers offering government subsidised places, which now stands at over 500.

The provision of VET courses under the VTG is paid through a combination of tuition fees paid by the student and government-funded subsidies. This 'co-contribution' arrangement is premised on the principle that VET produces both private benefits to the student (e.g. in terms of enhanced employment opportunities and earnings potential) and public benefits to society as a whole (e.g. a skilled labour force is conducive to economic growth and social cohesion).

The Essential Services Commission (the Commission) has been asked to review the fee and funding arrangements for government subsidised training in the Victorian VET system. In particular, the Commission has been asked to examine the extent to which the design of the current VET funding mechanisms and fee structures contribute to advancing the core objectives of the Victorian training system, including a system that:

- produces the skills needed by the Victorian economy;
- is competitive, efficient and student centred;
- assists the unqualified gain qualifications;
- helps the already qualified access qualifications that support their advancement in the labour market;

- encourages key cohorts to complete their qualifications; and
- caters for higher needs learners (e.g. equity groups, Victorians with low socio-economic status, and students with poor prior records of education attainment).

The Commission has also been asked to look at the effectiveness and efficiency of the funding mechanisms and fee structures, including in relation to:

- rationing mechanisms (i.e. eligibility criteria), concessions and income-contingent loan arrangements;
- relative funding levels for TAFEs and registered training organisations;
- prescribed minimum and maximum fee levels;
- the weighted training hour approach based on estimated costs of delivery;
- the balance between government, student and employer contributions; and
- funding structures for higher need learners.

The terms of reference for the review require that options presented by the Commission to be “affordable and prudent in the context of the State’s budget position”.

In undertaking this review, the Commission has engaged in a public consultation process, and has sought views from key stakeholders within the VET system, including training providers, students and representatives from the Government.

### *The many different interests in VET*

VET sits between, and alongside, the final years of schooling and undergraduate level higher education. It incorporates entry level training – including apprenticeships, traineeships, and basic literacy, numeracy and work skills; advanced vocational training (including training for paraprofessionals); and diploma and advanced diploma courses.

A distinctive characteristic of VET is its flexible course delivery compared to traditional classroom-based approaches to teaching and learning. The vocational emphasis of VET means that training often takes place in workplace environments as well as classrooms, and through combinations of work and formal learning.

In recent years, reforms to the VET sector at both the State and Commonwealth level have been driven by and an increasing recognition of the importance of skills and qualifications in enhancing future productivity and the achievement of broader social outcomes. More recently, concerns about shortages of skilled labour have influenced the reform agenda.

There are many different parties with an interest in the efficient operation of the VET sector. These include:

- **students** and potential students who are concerned about choice, accessibility to and navigability of the sector, and affordability;

- **providers**, public, not-for-profit and privately-owned, who are concerned that the system be administrable and not involve an unnecessary compliance burden. Providers require an efficient and effective regulatory environment and funding framework;
- **employers** who require skilled staff in order to maintain the efficiency and competitiveness of their operations. Employers require training opportunities for their staff that are cost effective, readily accessible and flexible; and
- **governments**, both State and Commonwealth, that are responsible for the prudent expenditure of public funds, and which require a VET system that promotes user confidence, delivers value for money and supports the broader 'productivity agenda'.

In light of the many interests in the VET sector, the primary goal of public policy must be to promote a VET sector that is as appealing as possible to as many people as possible. This suggests that the efforts of policy-makers and providers ought to be focussed on promoting relevance, innovation and efficiency in high quality service delivery and course design that will meet the skill needs of the economy.

One interest that is common to students, providers, employers and governments is reliable information and public disclosure about:

- the **cost** of providing and undertaking training in the VET sector;
- the **content** of the different qualifications on offer, including course design and mode of delivery; and
- the **quality** of the training and teaching, including student outcomes.

There are both private and public benefits arising from education and training. Government intervention in VET is also sometimes justified to pursue distributional and equity objectives:

- **Private benefits** accrue to individuals that undertake education and training in the form of improved labour market opportunities and/or higher levels of incomes. In addition, individuals can derive satisfaction from self-fulfilment and a greater sense of self-worth as a result of achieving qualifications. Private benefits can also accrue to employers through increased productivity (and hence profits) as a result of a more skilled workforce.
- **Public benefits** from education and training can emerge in the form of higher productivity and faster economic growth as a result of a more skilled workforce. Meanwhile, higher levels of educational attainment has been linked to a range of social and community benefits, such as greater social cohesion and lower crime rates.
- **Distributional and equity** considerations have led governments to intervene in the provision of VET on the basis of affordability, accessibility and 'fairness' grounds.

Each of the elements above is addressed most efficiently through a different form of policy intervention. For example, students are expected to pay a tuition fee to reflect the private benefit that arises from the provision education and training. Employers may also contribute to the cost of training their employees. Meanwhile, the broader public benefits to the economy, and society as a whole, justifies the provision of a subsidy for VET training. In practice, this involves some government funding of training providers. In the case of increasing the affordability and accessibility of VET to pursue distributional/equity goals, concessions can be used to ensure that income inequality is not a barrier to training.

With the increasing shift towards competitive provision of VET training, a further role for government may be necessitated by the potential for, or risk of, market failure. Typically, these market failures evolve from informational asymmetries whereby different parties – students, providers and employers – interact without being able to identify each others' relevant characteristics. In such instances, markets will not operate efficiently and may fail to deliver on governments' public policy objectives, in which case an additional form of intervention is warranted. These include:

- establishing regulatory structures designed to provide confidence to market participants. This may include: a regulatory framework for training providers; the provision of information about courses and providers; and mechanisms for complaints handling and dispute resolution; and
- **programmatic 'demand-side interventions'** designed to target particular cohorts, vocations, industries or regions that would otherwise be inadequately served by markets responding to competitive signals.

Table 1 provides a clear delineation between the different policy objectives that governments may pursue with regard to the funding of VET and the most efficient form of budgetary intervention.

Much of the content of this report is based on a clear demarcation between the design, funding, administration and on-going calibration of these three different forms of policy intervention.

Table 1: Policy objectives and interventions

Objective	Efficient form of intervention
<b>Public benefit</b> derived from individuals acquiring skills	Sharing the cost of training through <b>subsidies</b> paid to the provider
<b>Equity</b> concerns to ensure income disadvantage does not preclude access to training	Providing a <b>concession</b> to the student to assist in meeting some or all of the cost of training <sup>(a)</sup>
<b>Market failures</b> leading to an inadequate provision of training opportunities	<b>Programmatic</b> interventions designed at providing financial inducements or other incentives to students, employers and/or providers to deliver particular outcomes (e.g. by cohort, vocation, industry or region).

<sup>(a)</sup> As concessions are designed to address income disadvantage, they are best conceptualised as being paid to the student to assist in meeting the cost of tuition. In fact, concessions are currently paid directly to providers – in which case, it might be best to view this payment as one that has implicitly been ‘signed over’ to the provider by the student.

### Defining the ‘efficient price’ for VET

In an efficient fee and funding arrangement, the combined total of the tuition fee (which covers the private benefit) and the government subsidy (public benefit) would equal the remuneration required by a training organisation in order to provide a given course to an, as yet, unidentified student (that is, the amount required to provide the training is independent of whether the student is subsidised or full fee paying).<sup>1</sup>

This efficiency condition is illustrated below:

	<u>Private benefit</u>	<u>Public benefit</u>
<b>Price of VET delivery</b>	<b>Tuition fee</b>	<b>Subsidy</b>
=	+	
<i>Remuneration required by training provider to deliver a VET course to an, as yet, unidentified student</i>	<i>Paid by student (or by employer on student’s behalf)</i>	<i>Funded by the government</i>

<sup>1</sup> More precisely, in a competitive situation, the ‘price’ should equal the remuneration required by the *marginal* provider of a given course.

*Have the reforms to the Victorian VET system created the conditions for an efficient fee and funding arrangement?*

There have been two significant elements underpinning the recent reforms of the VET system:

- ‘student centred’ funding – this represented a very significant administrative reform that notionally attaches the government funding to the student (rather than the training provider) This allows public funds to ‘follow’ the **demand** for VET courses by students; and
- ‘open entry’ service provision – this was a significant economic reform that opened up the provision of subsidised student places to all service providers who met certain regulatory requirements, irrespective of ownership structure. As a result, the **supply** side of the VET system has been transformed with the introduction of private registered training organisations, many of which did not previously offer subsidised places.

The Victorian VET system seeks to allow a competitive market process to match supply by providers (encumbent and new entrants) with student demand for courses.

However, there are a number of features of the current fee and funding arrangements that limit the ability of ‘prices’ to adjust as they would in competitive markets to balance supply and demand. For example:

- the ability of training providers to adjust tuition fees is significantly restricted by numerous caps (both minima and maxima – see Box 1) that prevent fees adjusting to changing demand patterns; and
- the level of government funding (i.e. the subsidy) is set according to a formula that includes weightings which are based on ‘static’ parameters, insofar as they are based on historical costs and custom and practice, rather than current market conditions.

These limitations on the ability of fees and subsidies to adjust in light of extant and emerging conditions prevailing in the VET market means the efficiency condition for the pricing of VET services (shown above) may not be satisfied.

### Box 1: Tuition fees under the Victorian Training Guarantee

Tuition fees are calculated on the basis of the number of hours in which a student enrolls within a calendar year and the level (or 'category') of that course. **Maximum hourly rates** have been established for each of the six different course categories (i.e. foundation, skills creation, skills building, skills deepening, apprenticeships and traineeships). Within each course category, there are **minimum and maximum tuition fees** :

- Where the number of hours a student is enrolled is low (such that the fee calculated on an hourly basis would be below the specified minimum), the provider must charge the minimum tuition fee.
- Where the number of hours a student is enrolled results in a tuition fee that would be above the maximum for the course category, the fee paid by the student is capped at the maximum. Where a student enrolls in more than one course in the same course category, they pay no more than the maximum for the course category.

In addition to the maximum fees specified for each course category, there is also an **annual maximum tuition cap**, which applies where a student enrolls in courses in different categories. (The tuition fees are calculated separately but, when combined, must not exceed the annual cap.)

### *What happens if the 'price' is not efficient?*

Given these restrictions on the price-setting process, it is highly likely that the 'prices' being established in the VET system (i.e. the remuneration being received by training organisations) is being set too high or too low than would be the case in an 'efficient' market.

If the **price is set too high** – in other words, training providers are being over-compensated to deliver a particular VET course – it is most likely to be due to an overly generous subsidy payment (since there is a cap on tuition fees). In such circumstances, it might be expected that:

- tuition fees will be bid down to the allowable minima – and, in some cases, the minimum tuition fee might effectively be 'breached' by providers offering inducements to enrolment in the form of free gifts; and/or
- supplier-induced demand will emerge, whereby 'transient' training providers can be expected to enter the market in search of quick profits. Typically, such entrants do not aspire to being long-term market participants.

Under this scenario, the Government would be paying too much for too many students to undertake the training than is optimal.

If, on the other hand, the **price is set too low**, providers are being under-compensated for delivering a particular course. This can be expected to result in:

- cross subsidisation of these courses by the fees from other (more lucrative) courses or from full-fee paying students. Substantial cross-subsidisation cannot

be sustained for long, and it will undermine the financial viability of any provider who seeks to pursue this practice on an on-going basis; and/or

- insufficient training places being provided in the relevant courses, potentially giving rise to a 'thin market' problem (whereby the training needs of students – particularly those in remote areas – are not being met).

Such a situation is likely to produce under-investment in the skills required by the economy, thereby undermining the contribution of the VET system to supporting the Government's productivity agenda.

When prices within the VET system are not set at 'efficient' levels, this will result in resource misallocation, whereby public funds and training resources are not being allocated to where they can provide the greatest overall benefit. Meanwhile, students may be undertaking subsidised training in courses that are not in their best interests. As a result (and because of the current VTG eligibility criteria), students may lose access to subsidised training in more appropriate courses at a future date.

Highly competitive markets drive efficient pricing if there are no barriers to the expansion or withdrawal of services; there are no barriers to increases or decreases in prices; and all market participants are able to make well-informed decisions.

The Commission recognises that the conditions required to support a more competitive VET pricing model may not yet be uniformly in place in Victoria. These conditions include:

- demonstrable competition between providers,
- 'deep' markets, and no barriers to entry;
- quality-assured courses and course outcomes;
- high quality and readily accessible information; and
- sophisticated, price-aware customers.

Nevertheless, the Commission has found that more can be done to allow market forces to work harder in driving more efficient outcomes in the VET system. Moreover, there are ways to improve the operation of the market so it moves closer to the conditions required to support more efficient pricing.

## II. Strategic directions for improving the VET fee and funding model

In support of its finding that more can be done to promote efficient outcomes in the Victorian VET sector, the Commission has identified nine strategic directions for improving the fee and funding model.

### (1) *Improving price (and fee) disclosure*

The issue of price disclosure within the VET system is particularly concerning. The current complex system of tuition fee determination clouds price disclosure and price discovery. It is extremely challenging for a training provider to advise students up-front the subsidised fee they will need to pay when enrolling in a course because it will depend on the particular circumstances and history of each individual student, (as illustrated in Figure 1). The system of concessions further clouds the pricing picture.

Given that prices and fees are not easily discoverable, they are unlikely to help students in making decisions — nor are they promoting competition between training providers. Moreover, prices in the VET system are currently not informing the Government about where it might better direct its training subsidies.

The Commission is also concerned that, on the few occasions where providers publish both full-fee prices and subsidised fees, it has not always been possible to reconcile the two.

To address these issues, the Commission is recommending improvements to the transparency of the price and fee structure in order to allow prices to provide stronger market signals within the contestable VET market model. Most immediately, the Government should:

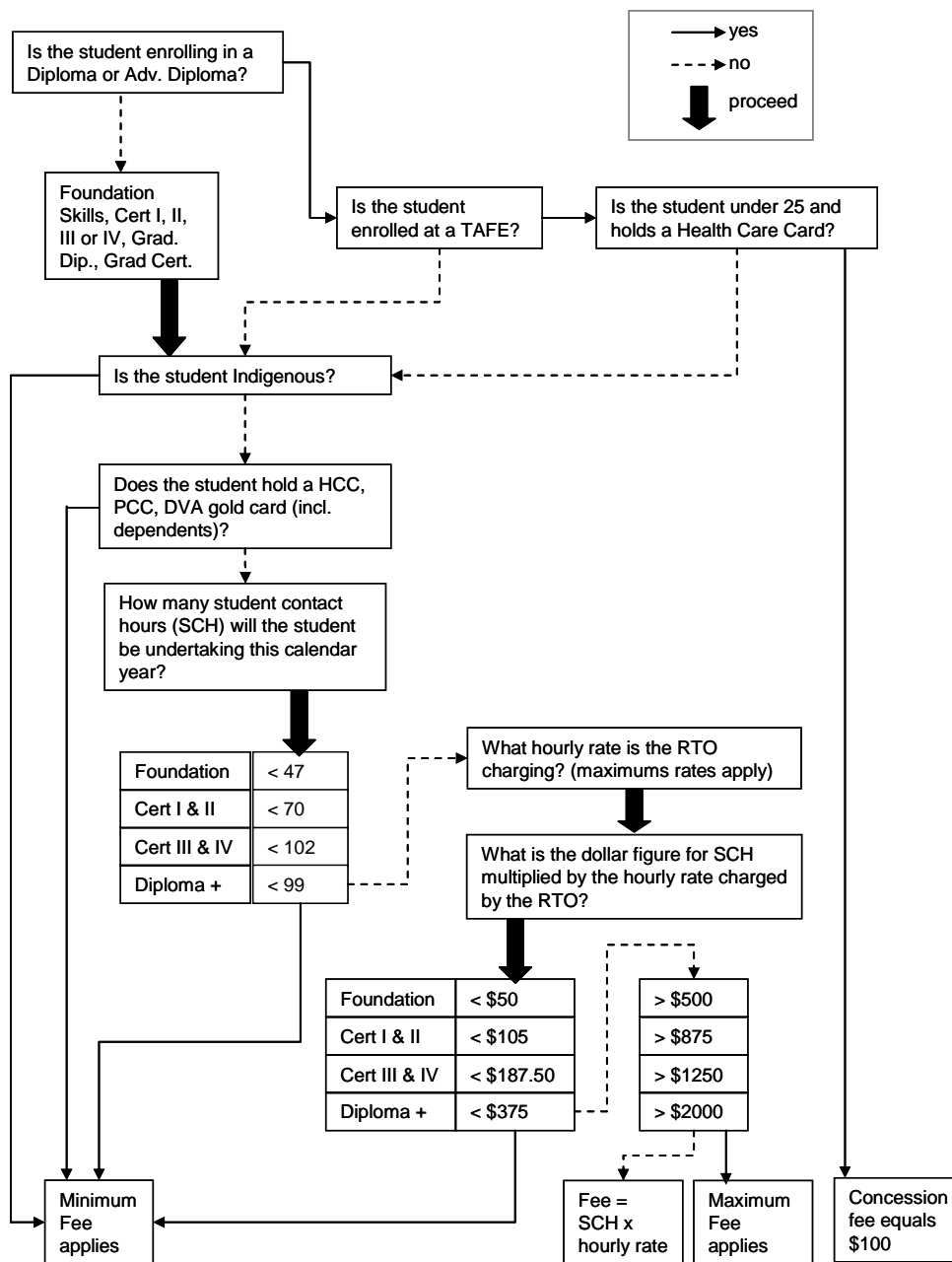
- impose a requirement that all providers publish the full fee-for-service price of ‘typical’ VET courses, along with the tuition fee for students who meet the VTG’s eligibility criteria;
- initiate an updating of parameters currently used in the funding model to determine government subsidies so that they are more reflective of current market conditions. This review should be undertaken independently (see below); and
- remove minimum and maximum category tuition fees, including the annual maximum tuition fee cap.

It should be noted that the Commission is recommending that the maximum hourly rate remain in place – at least in the short term – to protect any potential abuse of market power that might exist in the absence of sufficiently deep competition.<sup>2</sup>

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<sup>2</sup> Over time, hourly rates would be replaced by tuition and subsidy arrangements aligned with the ‘price’ of courses and units.

Figure 1 Overview of tuition fee arrangements



## *(2) Establishing independent oversight of the VET market to advise on pricing and competition issues*

Given it may take some time for the VET market to become competitive enough to support efficient pricing (and in some areas it may never be competitive), the Commission is proposing that an independent ‘market oversight body’ be charged with overseeing the market and advising the Government about the appropriate ‘prices’ of delivering VET courses.

Under the Commission’s proposed approach, the independent body would be responsible for monitoring the developments in the VET market and identifying a ‘benchmark price’ for different courses or category of courses. This analysis would be based on cost data (sourced from providers), as well as other forms of market intelligence.

For instance, the independent body would monitor the VET market to ascertain indicators such as:

- the current ‘price’ of different courses;
- tuition fees being paid by students for these courses;
- changes and trends in course enrolments; and
- the entry, exit, expansion and contraction of providers offering these courses.

Importantly, the independent body would *not* be responsible for determining the level of the government subsidy for VET courses. The size of the subsidy is a policy decision, and should continue to be determined by the Government according to its priorities and budgetary capacity. Nevertheless, in setting the subsidy, the Government would take into account the benchmark price and other market intelligence provided by the independent body.

### *‘Declaring’ particular markets to be competitive*

Over time, the VET market will continue to mature – although competition is likely to develop and deepen at varying speeds in different parts of the VET market. This differentiation may occur by location or type of course. The independent market oversight body would undertake reviews to assess whether individual courses (or groups of courses) were being provided in a sufficiently competitive manner. If so, the independent body would ‘declare’ such courses to be competitive – at which point, prices for those courses would no longer need to be regulated and would instead be set by the competitive market.

‘Declaring’ a course to be provided competitively has the following implications:

- It means that there would no longer be a maximum (hourly) cap on tuition fees that providers could charge. Fees would be determined solely in the competitive market place.
- The Government could still provide a subsidy to students enrolling in that course if it determined the public benefit warranted this investment.

There will inevitably be significant areas of the VET system where there will never be sufficient competition to support competitive market prices. (These are sometimes referred to as ‘thin markets’, and might exist by geographic area or by type of course.) In such cases, to avoid providers abusing their market power, government will still have a role in capping maximum hourly tuition fees – as well as providing subsidies – following the identification of a benchmark price by the independent body.

### *The importance of independence*

The Commission considers it important that the market oversight body be independent of government. This is because pricing (and market monitoring) is not a policy matter; it is a technical issue. As already explained, in the VET system, price reflects the remuneration required by a training organisation in order to provide a given course.

Placing this function within a government department runs the risk of confusing pricing with policy decisions; that is, technical issues with matters of policy discretion. It also creates the risk of the ‘politicisation’ of price setting, or even just perceptions thereof. It is for these reasons that the responsibility for determining prices in other areas of the economy have moved out of central government control and into the hands of independent specialist bodies (such as the Essential Services Commission, the Australian Competition and Consumer Commission, the Australian Energy Regulator and, in the case of interest rates, the Reserve Bank of Australia).

Non-pricing issues would remain with the relevant government minister and department. This would include: determining eligibility criteria, the level of subsidies, any remaining caps on tuition fees, exemptions and concessions policies, and content and quality controls.

### *Reviewing and indexing pricing parameters (including a productivity factor)*

As already noted, the Government should initiate, as soon as possible, an independent review of the pricing parameters currently used in the weighted training hour model that is used to determine government funding. This review would assess whether these parameters – which are currently based on historical data – still reflect current market conditions.

This information would then be used by the Government to re-value/re-weight subsidies for the commencement of the next funding period.

To reflect and offset rising costs in the VET sector, the Commission is also recommending that prices (i.e. both subsidies and any remaining fee caps) be indexed less an annual productivity factor (which would help to drive efficiency and innovation in the training sector). Indexation would occur automatically unless, in the meantime, the independent body undertook a review of prices for individual courses, groups of courses, or categories of courses.

### *Monitoring competition*

Victoria's market-based model for service provision of VET depends on the integrity of competition in that market and ongoing user confidence. To this end, the market oversight body could also be charged with monitoring and investigating anti-competitive behaviour by providers (and potentially employers). Such behaviours may include:

- predatory pricing by providers;
- collusion amongst providers (and potentially employers);
- manipulative or monopolistic behaviour by providers towards students; and
- anything else that may bring the market into disrepute and risks undermining user confidence.

### *How might market oversight work in practice?*

To better understand how independent market monitoring could be used to inform subsidy arrangements and other policy settings, Table 2 considers four scenarios that the independent market oversight body might observe in relation to changes in course enrolments and tuition fees. It shows how changing market circumstances might be used by government to:

- adjust subsidies;
- adjust caps on tuition fees (where they still apply); and
- identify circumstances that might warrant the use of demand-side interventions, which the Commission is recommending should be independent of the VET fee and funding model (discussed below).

While the analysis is necessarily stylised, it demonstrates the opportunity for a much more dynamic relationship between changing market conditions and the policy-making process.

Our recommended arrangements will allow the government subsidy (reflecting the public benefit of VET) to be shifted to those courses (and categories of courses) where it is most required. Importantly, however, in keeping with the market philosophy of the Victorian VET system, these shifts are determined by the market rather than by processes whereby governments seek to influence the market.

Table 2: **Changing market conditions and potential policy implications**

Tuition fees	Enrolments	Implications
<b>Increasing</b>	<b>Increasing</b>	<p>This course is in great demand, such that demand is probably outstripping supply (at least in the short term).</p> <p>This course should be put ‘on watch’ to see if supply increases (via incumbent providers expanding or new entrants).</p> <p>The government may want to: (i) facilitate the entry of new providers; and (ii) decrease the subsidy slightly.</p> <p>The government should not cap tuition fees.</p>
<b>Increasing</b>	<b>Decreasing</b>	<p>Providers are probably exiting the market, lessening competition amongst remaining providers. This may be allowing remaining providers to extract some form of ‘rent’. If so, government should cap the tuition fee paid by students.</p> <p>The government should be wary of raising the subsidy as the increase may be ‘captured’ by remaining providers – that is, students would not benefit through lower tuition fees.</p> <p>However, the government should investigate the cause for the exit of providers. If it is due to an increase in the cost to providers of delivering this course, then it may need to increase the subsidy (and possibly the tuition fee as well).</p> <p>If rising costs are not the reason, then government may want to facilitate an increase in the number of providers offering that course (but not by increasing the subsidy). This might include a demand-side intervention, whereby providers are paid for every student they successful enrol/graduate in that course.</p>
<b>Decreasing</b>	<b>Increasing</b>	<p>This course is in great demand and providers are ‘competing hard to try and attract students. In doing so, they are bidding down the price.</p> <p>The strong student demand (i.e. reflecting high private benefit) suggests that there is scope for the government to reduce its subsidy for this course.</p> <p>The government should not cap tuition fees.</p>
<b>Decreasing</b>	<b>Decreasing</b>	<p>There is little student interest in this course and providers seem to be, in effect, following students out of the market.</p> <p>The government should not cap tuition fees as this might hasten withdrawal of providers – though it may want to increase the subsidy (potentially until it equals the ‘price’ – implying a tuition fee of zero).</p> <p>Declining student interest could be reflecting the decline in economic relevance of this particular skill (a ‘dying industry’), in which case there is probably little that government can do to forestall the inevitable.</p> <p>Alternatively, it may reflect that there are other impediments in the market meaning that students are not enrolling in this course although these skills may be sought after by industry (this is the ‘skill shortages’ problem). Such impediments might be informational, wage-related or reputational. This may suggest that a higher subsidy will not be sufficient to overcome these market failures, in which case the government may want to pursue targeted demand-side programs to stimulate enrolments.</p>

### **(3) Improving transparency regarding the quality of VET training**

Quality was an issue that was raised repeatedly during the review consultations. Concerns were expressed about the quality of teaching and training; course content, design and delivery; and student outcomes.

Although a detailed examination of quality issues falls outside the scope of this review, transparency about such quality parameters is essential to a competitive, market-based system for delivering VET services. Market participants – as well as the Government as a funder of VET – gain confidence through robust ‘product disclosure’.

Like other markets for complex services, consumers of VET services may have insufficient knowledge, and may face what economists refer to as ‘information asymmetries’, whereby the provider has much better information than the student about the quality of provision. This makes it difficult for the market to discern the value of training and thereby drive competitive pricing. Put another way, a lack of transparency about the nature of the product being purchased (in this case, training) hinders the ability of students, employers and governments to make optimal decisions about what to buy and how much to pay.

The Commission notes that the existing upfront focussed regulatory framework (at both the state and national levels) appears to be based on the premise that, if the operational policies and procedures of training providers are approved and audited, then good quality outcomes will necessarily follow. While we have not investigated the efficacy of this approach, it seems *a priori* to be too indirect.

The Commission believes that enhancing the information that is publicly provided on course outcomes would be more meaningful to students in making their choices about VET courses and providers. This might include: completion rates, student satisfaction measures, and post-study outcomes.

### **(4) Re-examining the question of eligibility**

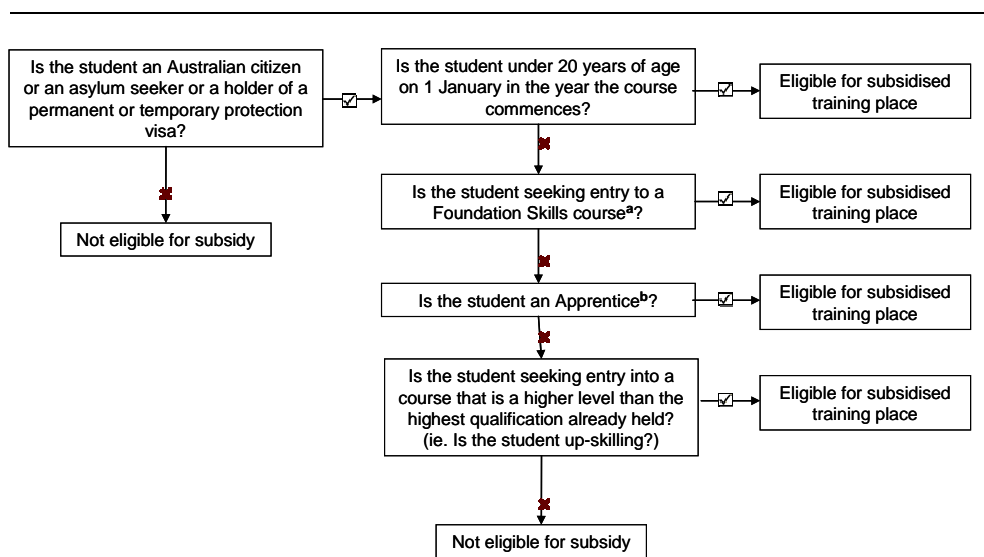
In relation to non-pricing issues, the Commission has been asked to examine the current eligibility criteria under the VTG. Given that government funding is ultimately constrained, the eligibility criteria represent a mechanism for rationing the number of subsidised training places.

As illustrated in Figure 2, in order to be eligible for a government-subsidised place, students must be:

- under 20 years old;
- enrolled in a foundation skills course;
- enrolled in an apprenticeship; or
- up-skilling (that is, enrolling in a course that is at a higher level than the highest qualification level held by the student).

Such ‘black and white’ criteria are necessary to ensure that the rationing mechanism works properly. Nevertheless, they can lead to unintended, unexpected, and undesirable responses by providers, students and employers.

Figure 2 Eligibility criteria under the Victorian Training Guarantee



<sup>a</sup> Only specified courses are included in the Foundation Skills category. <sup>b</sup> See Chapter 4 in Volume II of the report for the definition of an apprentice.

Source: Skills Victoria.

The eligibility criteria also invariably lead to outcomes for some students which, by some other measure, may appear ‘unfair’. Examples presented to the Commission during the review’s consultation process include:

- older workers in declining industries;
- mothers returning to the workplace with out-of-date qualifications or other changed circumstances; and
- those over 20 years of age who made inappropriate training choices when they were younger.

Meanwhile, the up-skilling criterion may, at times, conflict with the broader productivity agenda because it does not provide access to subsidised places to those workers seeking to retrain in line with the evolving skill needs of the Victorian economy (unless the retraining involves moving to a higher qualification level).

It would be easy for the Commission to recommend a broadening of the eligibility criteria to address these concerns. However:

- the Commission is cognisant that the terms of reference for this review require us to be ‘prudent’ in the context of the state budget; and
- new criteria will inevitably create new circumstances whereby other individuals will just miss out on eligibility to a subsidised training place; this will merely shift the problem to other individuals or groups in society.

Nevertheless, the Commission believes there is some room for broadening the existing eligibility criteria to address some of the concerns raised. It is therefore proposed that the Government consider:

- revising the operation of the VTG so that VCE, VCAL and VET undertaken in school is not taken into account for the purpose of determining whether a student is up-skilling;
- allowing people whose highest qualification is between 7 and 15 years old (and therefore likely to be somewhat outdated) access to a partially subsidised training place for enrolment in a qualification at an equivalent level; and
- expanding the VTG to provide people whose qualification is greater than 15 years old access to a fully subsidised training place for enrolment in a qualification at an equivalent level.

The Commission does not have the capacity to cost these recommendations. While they are clearly expansionary in terms of budget impact, we expect this will be offset by some of the other recommendations made in this review (e.g. applying a productivity factor in VET sector funding).

Although we have not recommended any further changes to the eligibility criteria, we expect that, over the longer term, these too can be adjusted in light of changing supply and demand conditions in the VET market.

#### ***(5) Replacing exemptions (from the eligibility criteria) with a better targeted concessions policy***

Through a system of exemptions, the Government funds a limited number of subsidised places for students who do not meet the up-skilling requirements of the VTG. These exemptions are funded separately from subsidies, and are allocated to providers by Skills Victoria. Providers then have discretion to give a student who is not up-skilling one of their allocated exemption places if the student is:

- seeking training in a specified area of critical skill shortage; or
- unemployed as a result of a redundancy or retrenchment; or
- disadvantaged in the labour market because of factors that constitute a barrier to employment or re-employment.

The total number of exemptions is determined by available funding, and is a small fraction of the overall number of subsidised training places. During the course of its consultations, the Commission has learned that some providers – particularly those serving small communities – are reluctant to allocate the exemptions offered to them because they find it too difficult to decide which of their students are the most worthy beneficiaries of an exemption.

Other providers appear to allocate them to students on a ‘first come, first served’ basis, rather than determining who is most deserving. This risks creating ‘waiting lists’ for subsidised training positions. In the Commission’s view, the current system of administered exemptions lacks clarity, transparency and accountability. Although some recommendations are made about how this might be improved, it is

proposed the underlying policy concern would be addressed more efficiently as part of a targeted concessions program.

It would seem from the evidence proffered to this review (albeit anecdotal) that exemptions are required because individuals can find themselves in circumstances whereby they cannot gain employment, yet they are 'locked out' of subsidised (re)training by the eligibility criteria. Moreover, these individuals typically have no capacity to self-fund their (re)training.

In summary, exemptions from the eligibility criteria are often required because of circumstances that are related to matters of income or employment history (which, ultimately, is also related to income). As noted above, issue of income disadvantage are most efficiently addressed through concessions policies.

For this reason, the Commission recommends current exemptions arrangements should be removed as soon as practicable and the underlying policy concerns addressed more directly via better targeted concessions arrangements. In addition, the Commission recommends that the administration of concessions be separated from the administration of concession payments. This will provide Government with greater transparency and discretion about the policy objectives (see Table 1) to which it directs funding.

The Commission also notes that income and employment issues are most efficiently addressed through the tax and welfare systems. These systems are administered by agencies that reside wholly within the Commonwealth jurisdiction (most notably Centrelink and Job Services Australia providers). It is therefore recommended that the State Government should commence negotiating with the Commonwealth Government about the Commonwealth assuming responsibility for the administration of concession arrangements pertaining to students enrolling in VET.

The Commission considers the exemptions provided for the purposes of skills shortages should be replaced by more targeted interventions (see (7) below).

#### **(6) *Getting the balance right: consistency and flexibility***

The VET system contains a great degree of heterogeneity in terms of the outcomes it is seeking to deliver – ranging from skills such as numeracy and literacy that are fundamental to economic participation, but also offering highly technical and specialised qualifications such as a Diploma of Telecommunications Photonics. It does so against a background where the needs of the economy are changing continuously; technological developments are often changing practices in the workplace; and new regulatory requirements are introduced intermittently which affect the obligations of employers (and maybe training providers).

Despite this high level of heterogeneity in the VET sector, and the changing nature of the economy on which it rests, the Commission is concerned that the VET fee and funding model contains inconsistencies that are not necessarily justified on the basis of these uncertainties. The Commission is also concerned that the notion of 'flexibility' in training packages may, if left unchecked, become deleterious to signalling the value of qualifications and to the administration of public funding arrangements.

### *Consistency*

Currently, the fee and funding arrangements generally shift the cost of training towards greater student contributions as students progress to higher qualifications. This design feature is intended to reflect the typically greater private benefit that is assumed to accrue to the student as a result of obtaining higher level qualifications.

While the Commission acknowledges that the relationship between higher qualifications and greater earning capacity does not hold universally, broadly speaking, it is a reasonable starting position for the fee and funding model. We are confident that our recommended approach to determining subsidies in light of changing market conditions, as well as the use of target programs (or demand-side interventions), can be used to address any gross misalignments between higher qualifications and earning potential.

However, we are concerned that the fee and funding model is not necessarily transparent or consistent in how it currently determines: the split between student fees and public subsidies at different course levels; the fee caps that apply at different qualification levels; and the availability of concessions at different course levels. Moreover, inconsistencies also exist in the eligibility criteria for subsidised training.

The Commission sees value in a clear articulation of the principles by which parameters in the fee and funding model are determined, and these principles being applied transparently and consistently across the entire spectrum of VET qualifications.

### *Flexibility*

During review consultations, it became apparent that flexibility in the design of training packages was viewed favourably across the sector. This is largely reflected in current arrangements whereby students (and providers) are given greater choice and diversity in the design of their VET qualifications. The level of flexibility tends to be lower in areas involving licensed trades.

The Commission supports flexibility in training packages as an appropriate response to the varying needs of students and employers. Flexibility also supports competition by enabling providers to differentiate their offerings within the VET market. However, the Commission also notes without prejudice that, in the qualifications-based VET system, as supported by the Victorian and national regulatory arrangements, flexibility has implications for the design and administration of public policy.

If funding arrangements are to retain their focus on training outcomes, as they should, *unchecked* flexibility risks creating uncertainty about the outcomes delivered by the VET system. Therefore, the Commission encourages policy-makers to review whether there is a 'maximum' or 'optimal' level of flexibility that should be allowed in the design of training packages.

### **(7) Targeting participation in VET using demand-side interventions**

Where market failures emerge, policy makers may want to intervene in the VET (and employment) market to promote participation in the VET sector. In other words, the government uses its funding capacity to stimulate demand for vocational training. Such payments may be made to students, providers or employers. Examples of programmatic demand-side interventions include:

- attracting particular cohorts of students into training (for example: youth, disengaged youth, or higher need learners);
- encouraging students to enrol in particular types of training. This might include programs that are targeted at addressing specific areas of skill shortage in the economy;
- encouraging employers to enrol employees in VET; and
- structural adjustment assistance to specific regions – for example, following the closure of a major local employer.

As highlighted in Table 1, these targeted objectives differ markedly from the broader, public benefit objective motivating subsidised training; as well as the income-related issues motivating concessions policies. Given the different objectives being pursued, the Commission feels that demand-side interventions are best dealt with through a stand-alone system of ‘incentive payments’ to induce the desired behaviour. The level of funding for such payments need not be related closely to the ‘price’ required by the provider nor the tuition fee paid by the student. Instead, it is determined by the quantum needed to alter students’, providers’ or employers’ behaviours in favour of the Government’s targeted policy objective. Incentives targeted at students could include non-cash inducements, such as vouchers to purchase tools of the trade or required clothing.

In this regard, ‘demand-side interventions’ differ markedly from subsidies in that:

*Subsidies ought to be led by changing circumstances in the market for VET services, while demand-side interventions seek to lead the market towards targeted outcomes.*

The Commission notes that State and the Federal governments already administer such programs. These include: the *Skills for Growth* program administered by Victoria’s Department of Business and Innovation and the Commonwealth’s *National Workforce Development Fund*. We advocate for the continued separation of these types of programs from the funding of subsidised places.<sup>3</sup>

### **(8) Removing inconsistencies between VET and higher education**

For a range of reasons, there are increasing areas of overlap between the VET and higher education systems. The Commission has found no reason to suggest

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<sup>3</sup> The independent market oversight body would not be involved with demand-side interventions, although it could be asked to review the efficacy such programs from time to time.

that this overlap is undesirable. However, we are concerned that decisions by students may be distorted by State and Commonwealth governments' policy and funding decisions. In the Commissions view, it would better if students' decisions were based on a matching of their preferences with the opportunities offered by training providers and education institutions. We are also concerned that dual-sector providers are facing financial incentives that may be distorting their decisions about which courses to offer (VET or higher education).

#### *Ensuring competition is fair and not distorted by policy*

During our consultations, it became apparent that higher education providers are increasingly offering courses that 'compete' for students who would have traditionally enrolled in VET. New Commonwealth funding arrangements mean that:

- students may face a lower tuition fee and have easier access to income-contingent loans;
- dual sector providers (i.e. those that offer both VET and higher education qualifications) receive greater funding under the higher education arrangements than under VET arrangements for courses at the same level.

These distortions create a risk that students and dual sector providers will abandon the VET system in favour of the higher education system. As a result of students favouring higher education courses, some VET providers may find that student numbers for some courses become unviable. These impacts would be as a result of differences between the two funding arrangements rather than because of underlying changes in market conditions. This is a concern if, as has been suggested in some of our consultations, the courses being undertaken in the higher education sector by potential VET students are less aligned to the skill needs of the economy than the competency-based VET qualifications.

This is an issue that, once again, falls outside the scope of the terms of reference for this review, but the Commission nevertheless suggests that the Victorian and Commonwealth Governments need to investigate better (non-distortionary) policies in this area of service delivery 'overlap'.

#### *Income contingent loan arrangements do not appear to be working well in the VET sector*

Under an agreement with the Commonwealth Government, VET students enrolling in a diploma or advanced diploma who are eligible for a government subsidised training place may be able to access the Commonwealth Government's VET FEE HELP scheme.

VET FEE HELP operates like HECS/HELP for tertiary fees in that eligible VET students can take out a loan from the Commonwealth Government to cover part or all of the cost of their VET tuition fees. The Commonwealth Government pays the student's tuition fees upfront to the training provider and allows a student to defer repayment of the loan until their income reaches a threshold level in the future, at which time deductions are taken through the taxation system.

However, two years after VET FEE HELP was made available to government subsidised diploma and advanced diploma students, it seems that, in practice, it may not be widely accessible to students training at this level. In submissions to the review, many providers have cited the high administrative burden of the VET FEE HELP arrangements as a key reason why they have ceased offering it to their students. It appears that the scheme has been designed for the more 'regimented' higher education sector, and cannot cope with the flexibility inherent in the VET system.

The Commission is therefore recommending that the Victorian and Commonwealth Governments should consult with training providers to improve the flexibility of VET FEE HELP arrangements. We also believe that VET FEE HELP should be expanded to a broader range of VET qualifications to assist with the affordability of training.

### *(9) Reviewing the funding arrangements for TAFEs*

Under the current arrangements, TAFEs receive a higher funding rate than other registered training organisations for every hour of training that they deliver. The justification for this is at best vague. It appears to be based on the premise that public sector providers have additional social and community obligations compared with other types of training organisations.

In the Commission's view, there is no obvious policy reason for the favourable treatment afforded to public providers, and is proposing that the VET funding model's weighting parameters for TAFEs be brought into line with those for private providers over a four-year transition period.

This is likely to necessitate a broader review of the TAFEs' funding and governance arrangements; and a clearer articulation of the role of publicly-owned providers. The review will need to also consider whether direct funding should be provided for any community service obligations that are determined to be provided by TAFEs.

### **III. Full list of the Commission's recommendations**

The 43 recommendations below are listed in the order they appear in the report, and they need to be understood in the context of the discussion in respective chapters in Volume II of this report. In addition, matters for further consideration are summarised.<sup>4</sup>

A suggested 'transition path', which outlines an appropriate sequencing of key reforms to the VET fee and funding model, is provided in the final section of this document.

#### ***Chapter 4: Eligibility for a government subsidised training place***

##### **Recommendation 4.1**

The Government should collect data on all domestic students undertaking VET qualifications (including from providers that offer only full fee-for-service courses) to provide decision makers with a more complete picture of the sector and the training being undertaken.

##### **Recommendation 4.2**

The Government should improve the availability of information to students on career paths, training outcomes, employment opportunities, and skill shortage areas. In doing so, the Government should consider the accessibility of information, how it could be improved and the appropriate roles of industry, training providers, employers and the government. Information coordinated and available at a national level should also be considered.

##### **Recommendation 4.3**

The Government should improve the availability of information to students on the VTG, including the difference between subsidised and full fee places, and the consequences of training for future access to subsidised places. In doing so, the Government should consider the accessibility of information, how it could be improved, the timing of information provision, and the appropriate roles of training providers, employers, agencies like Job Services Australia and the Government.

##### **Recommendation 4.4**

The Government should monitor and publish information on the training being provided to identify trends and work with industry to identify any areas of skills under- or over-supply.

##### **Recommendation 4.5**

The Government should treat trainees and apprentices consistently with other students under the VTG.

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<sup>4</sup> Some of these matters fall outside the scope of the terms of reference which is why the Commission has not made recommendations.

#### **Recommendation 4.6**

The Government should review the courses and qualifications on the foundation skills list after the national foundation skills training package has been developed.

#### **Recommendation 4.7**

To be able to assess the impact of the VTG on VET participation the Government should conduct a survey during the next peak enrolment period (end of 2011 to start of 2012) to gather information on those people who are ineligible under the VTG, including the demographics of this group, whether they enrol in study, and what were the reasons they were seeking to enrol in the qualification for which they were ineligible.

#### **Recommendation 4.8**

The Government should revise the operation of the VTG so that VCE, VCAL and VET undertaken in school is not taken into account for the purpose of determining whether a student is up-skilling.

#### **Recommendation 4.9**

The Government should consider allowing people whose highest qualification is between 7 and 15 years old access to a partially subsidised training place for enrolment in a qualification at an equivalent level.

#### **Recommendation 4.10**

The VTG should be expanded to provide people with a VET qualification that is greater than 15 years old access to a government subsidised training place for enrolment in a qualification at an equivalent level.

#### **Recommendation 4.11**

The pool of available eligibility exemptions should be allocated directly to students by Skills Victoria. However, should the Government decide that providers should retain administration of exemptions, the Government should provide additional guidance on how they should be allocated (e.g. by clarifying the objectives of the exemptions process).

#### **Recommendation 4.12**

If the exemptions continue to be administered by providers, exemptions should be allocated twice a year — reflecting peak enrolment periods (in proportion to enrolment numbers between these two periods).

#### **Recommendation 4.13**

If the exemptions continue to be administered by providers, the available funding should be allocated to providers based on market share of training in the preceding 12 month period.

#### **Recommendation 4.14**

If the exemptions continue to be administered by providers, the Government should move toward allocating exemptions to training providers based on value, rather than a defined number of places. Appropriate data reporting and tracking systems would need to be in place.

#### **Recommendation 4.15**

As soon as is practicable, the Government should remove the VTG's exemption arrangements, and replace them with better targeted concession arrangements.

### *Chapter 5: Tuition fees*

#### **Recommendation 5.1**

Hourly tuition fees should continue to be set on the basis of a lower government subsidy for higher level courses, unless an independent cost and pricing review indicates a more suitable basis for revising the fee structure (see Recommendation 5.2).

#### **Recommendation 5.2**

The maximum hourly tuition fee rates and the fee structure should be revised (in conjunction with any appropriate revision of subsidy rates) following an independent cost and pricing review to determine the cost of provision (see funding recommendations).

#### **Recommendation 5.3**

The Government should adjust the maximum tuition fees for apprentices and trainees with the aim of creating greater consistency and alignment with the fee structure that reflects public/private benefit and is based on qualification level.

#### **Recommendation 5.4**

Maximum hourly tuition fee rates should be retained only while there is limited competition in the VET sector. Over time, in areas/courses where greater competitive provision can be verified, the maximum hourly rate should be increased and eventually removed (see Recommendation 7.1).

#### **Recommendation 5.5**

After the expiration of the current tuition fee schedule at the end of 2012, maximum hourly tuition fees should be indexed, annually.

#### **Recommendation 5.6**

Maximum and minimum category fees and the annual cap should be removed.

### **Recommendation 5.7**

Concession fees should be based on a maximum hourly rate that is a specified percentage of the maximum tuition fee rate. Providers should be free to compete on price and charge all students below the maximum hourly rates specified.

### **Recommendation 5.8**

The Government should reconsider the need for concessions where students have access to VET FEE HELP.

### **Recommendation 5.9**

The Victorian Government should commence negotiating with the Commonwealth Government about the Commonwealth assuming responsibility for the administration of concession arrangements for students enrolling government subsidised VET.

### **Recommendation 5.10**

The Victorian and Commonwealth Governments should consult with providers to improve flexibility of VET FEE HELP arrangements.

### **Recommendation 5.11**

The Victorian Government should consult with the Commonwealth Government about the extension of VET FEE HELP to vocational graduate certificate and graduate diploma students.

### **Recommendation 5.12**

The Victorian Government should consult with the Commonwealth Government about extending VET FEE HELP to Certificate IV qualifications (subsidised and full fee) or alternatively nominated Certificate III and Certificate IV qualifications.

### **Recommendation 5.13**

The Government should move toward fully reimbursing concessions based on the actual fees charged by providers to non-concession students. Under this arrangement, providers would invoice the government for the amount of revenue foregone.

## ***Chapter 6: Funding VET delivery***

### **Recommendation 6.1**

The Government should retain the existing mechanisms of Student Contact Hour, Weighted Training Hour and base hourly funding rates to allocate funding to providers under the Victorian Training Guarantee.

### **Recommendation 6.2**

A cost and pricing review (including a survey of TAFEs, ACFE providers and for private for-profit RTOs) be undertaken as soon as practicable to update the parameters used in the current Student Contact Hour Model (including base funding rates and Weighted Training Hour funding models).

### **Recommendation 6.3**

Base hourly funding rates should be indexed after the final 2012 funding schedule has been implemented, with an appropriate indexation factor (including productivity adjustment) to be determined following further review of costs and market developments.

### **Recommendation 6.4**

The base funding model should continue to be based on outputs (i.e. the Student Contact Hour).

### **Recommendation 6.5**

The cost and pricing review (Recommendation 6.2) should include an assessment of the cost structures faced by training providers to assess whether funding payments could or should be better aligned to the costs incurred.

### **Recommendation 6.6**

The current system of funding in arrears should be retained, while Skills Victoria provides training providers with more administrative guidance in order to address their concerns in relation to receiving payments on time.

### **Recommendation 6.7**

The cost and pricing review (Recommendation 6.2) should attempt to identify the spread of costs that are associated with teaching students of different capabilities (including higher needs or disengaged learners).

### **Recommendation 6.8**

The issue of thin markets should be addressed outside the fee and funding model - for example, by using a system of incentive payments (see Recommendation 7.5).

### **Recommendation 6.9**

The gap in base rate funding rates between TAFE and non-TAFE providers should be progressively closed over the next four-year funding agreement.

### **Recommendation 6.10**

A review be undertaken of the funding and corporate arrangements of publicly owned training providers (including TAFEs, CAE and AMES). This review should: (i) provide a clearer articulation of the role of publicly-owned training providers; (ii) consider how funding and corporate arrangements might be changed to promote greater transparency and accountability of funds; and (iii) consider whether direct funding should be provided to fund any community service obligations met by public providers.

## *Chapter 7: A more competitive pricing model*

### **Recommendation 7.1**

A market oversight body, independent of government, be established to monitor the degree of competition within different sections of the VET market (by course and/by region).

- Where the independent market oversight body ‘declares’ a market (or sub-market) to be competitive, there would no longer be a maximum cap on tuition fees, and providers would be free to compete on price.
- Where markets are not declared, the independent market oversight body would determine a ‘benchmark price’ for VET courses.

Under both scenarios, the level of subsidy would continue to be determined by the government – although the independent body could provide advice to inform the Government’s decision making.

### **Recommendation 7.2**

All providers operating within the Victorian Training Guarantee should be required to publish: ((i) the full price of the course – i.e. the full fee-for-service price that would be paid by a student who does not qualify for a subsidy; and (ii) the tuition fee for students who meet the VTG’s eligibility criteria. In addition, providers should be encouraged to provide information and links about additional forms of assistance (e.g. concessions).

### **Recommendation 7.3**

To support efforts to improve the quality of outcomes within the VET system, the Government should investigate options to improve publicly available information on course outcomes (e.g. completion rates, student satisfaction measures, and post-study outcomes), taking into account new Commonwealth arrangements through the Australian Skills Quality Authority.

### **Recommendation 7.4**

The Government should review the most efficient form of arrangements to resolve disputes between students and providers in the VET system, and to ensure that students are adequately protected. This should include an assessment of an industry-funded, complaints-based, industry ombudsman-like scheme.

### **Recommendation 7.5**

Demand-side interventions designed to promote participation in VET (e.g. attracting specific cohorts, or encouraging students to undertake specific types of training) should be addressed through a system of incentive payments that are independent of the VET fee and funding model.

### ***Matters for further consideration***

- There would be value to a clear articulation of the principles by which parameters in the fee and funding model are determined, and for these principles to be applied transparently and consistently across the entire spectrum of VET qualifications.
- The role of the proposed independent market oversight body could be expanded to include monitoring and investigating anti-competitive behaviour by providers.
- Policy-makers should review whether there is a 'maximum' or 'optimal' level of flexibility that should be allowed in the design of training packages.
- The Victorian and Commonwealth Governments need to investigate better (non-distortionary) policies in the service delivery 'overlap' between the VET and higher education sectors.

#### IV. How well is the current model meeting the objectives of the Victorian training system?

Table 3 summarises the Commission’s observations (which have been informed by stakeholders during the consultation process) about the impact of the current VET funding mechanism and fee structures on the core objectives of the Victorian training system (as outlined in terms of reference). The table also highlights which of the Commission’s recommendations should help strengthen the ability of the fee and funding model to meet the identified objectives.

**Table 3 Meeting the objectives of the Victorian training system**

<b>Objective A: Producing the skills needed by the Victorian economy</b>	
<b>Impact of the current fee and funding model on objective?</b>	<b>Recommendations that will strengthen link to objectives</b>
<ul style="list-style-type: none"> <li>• Preliminary data suggest a sharp increase in VET enrolments since implementation of reforms, which is consistent with raising level of skill acquisition across the economy.</li> <li>• However, the nexus between courses being undertaken and the needs of the economy (particularly in terms of addressing areas of skill shortages) is not clear. Students may not have adequate information to make informed choices.</li> <li>• Concerns have been raised about the quality of outcomes under the VET system.</li> </ul>	<ul style="list-style-type: none"> <li>• Gain a better understanding of the training being undertaken (Rec.4.1)</li> <li>• Improved labour market information (including identification of areas of skill shortage) (Recs. 4.2, 4.4).</li> <li>• Review foundation skills courses (Rec.4.6).</li> <li>• Clarifying purpose of VTG exemptions, which can be used to grant subsidised places in courses in skill shortage areas (Rec. 4.12).</li> <li>• Better measurements of quality of course outcomes (Rec. 7.3).</li> <li>• A system of incentive payments could be used to encourage training in areas of skill shortage (Rec. 7.5).</li> </ul>

<b>Objective B: Competitive, efficient and student centred model</b>	
<b>Impact of the current fee and funding model on objective?</b>	<b>Recommendations that will strengthen link to objectives</b>
<ul style="list-style-type: none"> <li>• Current system of price controls (minimum and maximum fee caps) limits price competition between providers.</li> <li>• Lack of quality measures means it is difficult to know whether providers are competing on quality.</li> <li>• Anecdotal evidence suggests administrative burden associated with fee and funding model is impacting on efficiency of service delivery. There are also concerns about the timeliness of funding payments to providers.</li> <li>• Unclear why apprentices and trainees are treated differently.</li> <li>• Concession fee arrangements bear no or little relationship to amount of training undertaken or to private benefit received from training.</li> <li>• Justification for TAFEs receiving higher base funding rates is unclear.</li> </ul>	<ul style="list-style-type: none"> <li>• Trainees and apprentices should be treated consistently with other students under the VTG (Recs. 4.5, 5.3).</li> <li>• Retain existing mechanisms of Student Contact Hour, Weighted Training Hour and base hourly funding rates (Recs. 6.1, 6.4) and system of lower government subsidy for higher level courses (Rec. 5.1), but review and update the price and cost parameters in fee and funding model (Recs. 5.2, 6.2).</li> <li>• Removal of price caps (Recs. 5.4, 5.6), and indexation of maximum hourly rate (Rec. 5.5).</li> <li>• Concession fees should be based on a maximum hourly rate (Rec. 5.7), and should be fully reimbursed to providers based on revenue foregone (Rec. 5.13).</li> <li>• Productivity factor in funding model (Rec. 6.3).</li> <li>• Retain system of funding in arrears until better understanding of RTO cost structures is available (Rec. 6.5), but improve administrative guidance to reduce process errors (Rec. 6.6).</li> <li>• Close gap in funding rates between TAFEs and non-TAFEs, and review the role, and corporate and funding arrangements of public providers (Recs. 6.9, 6.10).</li> <li>• Move to a more market-based, competitive model, with better information (including quality) and forms of student protection (Recs. 7.1, 7.2, 7.3, 7.4).</li> </ul>

<b>Objective C: Assists the unqualified gain qualifications</b>	
<b>Impact of the current fee and funding model on objective?</b>	<b>Recommendations that will strengthen link to objectives</b>
<ul style="list-style-type: none"> <li>• The VTG allows all those without qualifications to gain access to a subsidised place.</li> <li>• The VTG allows unlimited access to foundation level courses.</li> <li>• Concession arrangements are in place to address affordability issues, although VET FEE HELP does not appear to be suited to the VET sector.</li> </ul>	<ul style="list-style-type: none"> <li>• Improved arrangements for VET FEE HELP (Recs. 5.8, 5.10, 5.11, 5.12).</li> <li>• Concession arrangements are better dealt with by the Commonwealth Government (Rec. 5.9).</li> </ul>

<b>Objective D: Helps the already qualified access qualifications that support their advancement in the labour market</b>	
<b>Impact of the current fee and funding model on objective?</b>	<b>Recommendations that will strengthen link to objectives</b>
<ul style="list-style-type: none"> <li>• The VTG up-skilling requirement does not grant a subsidised place to those who want to re-skill (at same qualification level). This might not be consistent with re-skilling that is required to adapt to structural change in the economy.</li> <li>• While a limited number of exemptions are available to those who do not meet the up-skilling requirement, there are some inadequacies in how they are administered.</li> <li>• Some students (particularly the young) may make training choices that might prevent access to a subsidised place in a more appropriate course at a later date.</li> </ul>	<ul style="list-style-type: none"> <li>• Gain a better understanding of those who are ineligible under the VTG (Rec. 4.7).</li> <li>• VCE, VCAL and VET undertaken in school should not be taken into account in determining up-skilling requirement (Rec. 4.8).</li> <li>• Better information on consequences of training on future subsidised places (Rec. 4.3).</li> <li>• Full or partial subsidies should be given to those with outdated qualifications (Recs. 4.9, 4.10).</li> <li>• Improved system of exemptions (Recs. 4.11, 4.12, 4.13, 4.14, 4.15).</li> </ul>

<b>Objective E: Encourages key cohorts to complete their qualifications</b>	
<b>Impact of the current fee and funding model on objective?</b>	<b>Recommendations that will strengthen link to objectives</b>
<ul style="list-style-type: none"> <li>The VTG up-skilling requirement can have unintended consequence of encouraging students not to complete qualifications (since it might prevent access to a subsidised place in the future).</li> </ul>	<ul style="list-style-type: none"> <li>Proposed relaxing of up-skilling requirement (Recs. 4.8, 4.9, 4.10) could help to mitigate the perverse incentives not to complete qualifications.</li> <li>Where government is seeking to promote participation of key cohorts in VET, incentive payments could be used (Rec.7.5). Payment could be made on completion of qualification.</li> </ul>

<b>Objective F: Caters for higher need learners</b>	
<b>Impact of the current fee and funding model on objective?</b>	<b>Recommendations that will strengthen link to objectives</b>
<ul style="list-style-type: none"> <li>The funding model includes weightings for Indigenous, corrections and students under 20 without VCE.</li> <li>Higher need learners are a diverse and poorly-defined group of students, which is broader than though inclusive of the categories of students to which a higher student weighting for funding is applied.</li> <li>It is challenging for the system to cater to the specific requirements of different types of higher need learners within a single policy.</li> </ul>	<ul style="list-style-type: none"> <li>Better understanding of costs of higher need learners to inform funding model (Rec. 6.7).</li> <li>Use of incentive payments to attract higher need learners into training (Rec. 7.5).</li> </ul>

## V. Suggested transition path for key reforms

The move to a more market-based and competitive VET system will clearly take time, and require a staged implementation of recommended reforms to establish the conditions that are necessary for more efficient pricing. As such, the Commission envisages there will be a transition path to a competitive, market-based fee and funding model. This will require the appropriate *sequencing* of reforms identified in this review.

Figure 3 attempts to summarise, at a very broad level, some indicative phasings of the key reforms identified in this review. The reforms have been categorised into:

- those dealing with pricing issues (i.e. fees and funding);
- those that address issues of eligibility (including the process of exemptions);
- measures to improve market information; and
- areas of 'structural change' to VET arrangements.

Figure 3

Indicative timelines for recommended key VET reforms

	Fees	Funding	Eligibility	Market Information	Structural Changes
<b>Immediate 2011-12</b>	<p>Adjust apprentices and trainees fees to be consistent with other qualifications (Rec 5.3)</p> <p>Remove max &amp; min category fees and annual fee cap (Rec 5.6)</p> <p>Concession fees set as fixed percentage of max rate (Rec 5.7)</p>	<p>Cost and pricing review to update funding model parameters and inform other aspects of subsidy arrangements (Rec 6.2, 6.5, 6.7)</p>	<p>Treat apprentices and trainees consistent with other students (Rec 4.5)</p> <p>Improve the process of allocation of eligibility exemptions (Rec 4.11, 4.12, 4.13, 4.14)</p>	<p>Collect data on all domestic VET students (Rec 4.1)</p> <p>Improve training outcome and job opportunities info available to students (Rec 4.2)</p> <p>Improve VTG info available to students (Rec 4.3)</p> <p>Publish info on areas of skills under and over supply (Rec 4.4)</p> <p>Gather info on students ineligible under VTG (Rec 4.7)</p>	<p>Improve VET FEE HELP arrangements (Rec 5.8, 5.10, 5.11, 5.12)</p> <p>Establish independent market oversight body to monitor competition in training markets (Rec 7.1)</p> <p>Undertake review of publically owned training providers (Rec 6.10)</p>
<b>Short Term 2012-13</b>	<p>Revise max hourly fees and fee structure, align with cost of provision (Rec 5.2)</p> <p>Index max hourly fees annually (Rec 5.5)</p> <p>Fully reimbursed providers for concessions (Rec 5.13)</p>	<p>Index hourly funding rates annually, including productivity adjustment (Rec 6.3)</p>	<p>Ensure that high school education does not count as prior qualification under VTG (Rec 4.8)</p> <p>Expand VTG to include students with 'outdated' qualifications (Rec 4.9, 4.10)</p>	<p>All training providers should publish full fee and subsidised prices (Rec 7.2)</p> <p>Improve information on quality of course outcomes (Rec 7.3)</p>	<p>Begin negotiations with Commonwealth over responsibility for concession arrangements (Rec 5.9)</p> <p>Determine appropriate student protection processes (Rec 7.4)</p>
<b>Longer Term Beyond 2013</b>	<p>'Declare' training markets to be competitive and remove price controls; determine benchmark price for non competitive markets (Rec 7.1)</p>	<p>Progressively close gap between TAFE and non-TAFE providers (Rec 6.9)</p>	<p>Remove exemption arrangements and replace with better targeted concession arrangements (Rec 4.15)</p>		<p>Use incentive payments to support specific cohorts and courses, independent of fee and funding model (Rec 7.5)</p>

## VI. Conclusion

This report makes a suite of recommendations and observations that complement Victoria's market-oriented reforms of the VET sector over the last two decades. Our recommendations will allow markets to operate more competitively where this can be sustained, while maintaining an appropriate level of government involvement where there is inadequate provision of competition in course delivery.

Without doubt, high quality information about course cost, content and quality is essential for the efficient operation and administration of the VET sector. This observation holds true irrespective of the precise fee and funding model that is to be implemented. For this reason, we suggest that the highest priority area for reform is implementing greater transparency in 'product disclosure' so that all relevant parties – students, employers, providers and government – can make better informed decisions.

As the Victorian market for VET continues to mature and deepen, and better quality information becomes publicly available and easily accessible, there will be scope for government to adopt a less interventionist approach to the pricing of courses and qualifications. The independent market oversight body that we are recommending will support an impartial assessment of market conditions. This will include identifying the level of competitiveness in course provision and impartially determining benchmark prices for different courses in different markets.

This analysis will ensure government is more fully informed about where and how to direct public funds into the VET sector via the fee and funding model for state subsidies. Active monitoring of the VET market will support more dynamic calibration of the fee and funding model to reflect shifting patterns in student demand for training and course provision by VET providers. For example, where student demand is strong, but tuition fees are observed to be lower than expected, government may elect to redirect subsidy payments to courses where demand is high, but training providers are reluctant to enter the market.

Importantly, this report distinguishes between three different forms of policy intervention: subsidies, which represent a co-contribution to the cost of training; concession payments, which seek to ensure that income disadvantage is not a barrier to training; and targeted demand-side interventions which seek to correct for market failures affecting particular cohorts, vocations, industries or regions. A central premise of this report is that these three forms of intervention must not become obscured or confused within the fee and funding model for VET subsidies. In some areas, this will involve closer policy and program coordination between the State and Commonwealth governments.

The next steps that we are recommending for the reform of the Victorian VET market will take time to implement; but once in place, they will support the more efficient allocation of training resources and public funds across the VET sector.