the Front Project

FUNDING MODELS AND LEVERS FOR EARLY CHILDHOOD EDUCATION & CARE

The purpose of this paper is to provide an overview of potential funding types, levers and models available to the Australian early childhood education and care (ECEC) system.

Funding models and levers play an important role in supporting systems to achieve their objectives. In the case of the ECEC system, these objectives include:

- Accessibility: supporting appropriate access to early education and care, including for children likely to be experiencing vulnerability, and supporting workforce participation for parents
- Affordability: ensuring that financial barriers to accessing services are minimised to ensure the participation of children and families from all socioeconomic backgrounds.
- Quality: supporting provision of a sufficient standard of quality.

These objectives should be supported by a sufficiently sized and capable workforce.

In addition to supporting the realisation of policy objectives, well designed funding arrangements support the sustainability, responsiveness, transparency, efficiency and accountability of the system by influencing the way in which funders, service providers and system participants interact with each other.

Importantly, funding models cannot achieve these objectives in isolation but must work with all components of the broader system architecture (including policy, regulation, sharing of evidence, monitoring and evaluation, and governance structures) to produce an environment which enables – and ideally drives – the desired outcomes.

This paper provides an overview of the most common funding types employed in human service delivery systems. Each is presented in turn, providing a description of how the funding is designed, how it is estimated, in what circumstances is it likely to be more or less effective, and general advantages and disadvantages associated with its use.

The key funding types are:

Block-based: a method of funding whereby governments fund service providers directly with lump sum payments.

Activity-based: where funding is determined by methodically classifying, counting and defining the cost of certain activities.

Individualised: a consumer-controlled funding scheme, where consumers of services receive funding and have the autonomy to select their own service providers.

Needs-based: recurrent resourcing which is targeted to consumers and service providers based on characteristics of demonstrated need.

Outcome-based: a funding strategy which allocates funding based on a provider delivering specified outcomes.

Programmatic: bespoke funding made available for targeted investment by the government for specific purposes and needs.

In practice, these funding types are most often used in combination to allow for different components of the overarching funding model to meet different needs. Similarities between activity-based, individualised, needs-based and outcomes-based funding types mean that these are more often paired with a combination of block-based and programmatic funding.

Section 1 below outlines the different funding types; section 2 provides a brief overview of the key inputs required to effectively parameterise funding models, and section 3 provides additional information on combining different funding types to meet multiple objectives.

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1. Funding types

Block-based funding

Overview: Block-based funding is a method of funding whereby governments fund service providers directly with lump sum payments. Typically, providers are required to meet certain requirements in order to be eligible for ongoing funding. Funding does not necessarily have to be attached to the level of activity, making it most useful for providers where costs are relatively fixed.

For example, block-based funding is often used for small, regional services where economies of scale cannot be achieved as enrolments or where use may be low but a requirement for the service exists. In this case, the block-based funding model allows certainty of provision (as activity based/individualised funding would not render the service sustainable), regardless of demand for the service. Funding is often capped from a fixed budget appropriation that is indexed annually.

In alignment with the desired ECEC policy principles, block-based funding can be an important lever in supporting accessibility of services but can hold risks for quality if not underpinned by a strong performance framework.

How is it estimated: Block-based funding typically aims to cover the cost of delivery for services, including the wages necessary to deliver a sustainable service. However, it can be complemented with other specific funding streams for select cohorts of children or programs. It is typically estimated using detailed cost data to identify the efficient cost of providing the service, irrespective of activity or utilisation levels, for a service provider across various characteristics such as size, location and type of service.

How it is distributed: Funding is provided directly to providers, often on a three or five yearly basis, with indexation applied each year.

Current use:

Block-based funding can be used in any sector where funding is required to deliver community service programs. However, in the last decade, there has been a shift away from block-based funding towards a combination of activity-based, individualised and programmatic funding.

- One example of block-based funding is observed in how small rural hospitals are funded across Australia. Approximately 370 small rural hospitals operate with a mix of block funding and activity-based funding (IHPA, 2022). Block-based funding is delivered for multiple years at a time, with payments indexed to a combination of factors, including healthcare cost inflation, population and demographic changes, and higher demand for services resulting from better technology.

Conditions for success:

- A block-based funding model is most effective where services face relatively consistent costs across time and/or where access must be assured in the face of low and variable levels of demand.
- An understanding of how costs vary with service characteristics (e.g. size, location and the type of services) is required to ensure that funding provided is adequate to ensure services are able to operate sustainably.
- Strong performance frameworks are often required by Governments as funding is not tied directly to activity or outcomes.

Advantages:

- Provides certainty for providers, relative to other funding types.
- Provides assurance of minimum levels of access, especially in thin or variable markets, which is important in the ECEC sector where a key aim is near universal participation.
- Opportunity to reflect real wages / labour costs.
- Ensures a service can be provided in locations where other funding types may not support sustainable delivery.
- Can provide flexibility for providers in how funding is allocated (as not tied to certain activities).

Disadvantages:

- There is the potential for inefficiency as funding is not tied to activity (e.g. enrolments or attendance) or outcomes.
- There is limited flexibility or responsiveness if variable costs change quickly.
- There is limited capacity for innovation or flexibility outside funding parameters from the perspective of government.

Activity-based funding

Overview: Activity-based funding (ABF) is an approach that relies on the classification and delivery of funding in line with the cost of certain activities. Under this method, funding is directly proportional to the level of activity (e.g. enrolments, or surgical procedures) that providers experience or deliver. It can also vary by the level of investment or support required for each activity. It is commonly used in the health sector for public hospital funding, recognising the number and mix of patients treated and scale of delivery achieved. It is usually financed via a demand driven legislative instrument where all eligible activity is funded.

In respect to the ECEC policy principles, ABF holds some risks to accessibility if safe guards are not put in place to support service viability in thin markets. ABF can be more efficient than block-based funding and depending on how it is parametrised – support quality delivery through specified activities. However, quality can be compromised if the ABF is designed in a way that incentivises volume over quality of delivery or universal access.

How is it estimated: ABF is based on the estimation of the unit cost of defined activities. This differs to needs-based funding, which has regard to both activities as well as the type and number of consumers.

How it is distributed: Service providers are paid according to the number of times the service is provided. This may be estimated and provided in advance and then adjusted in the period that follows.

Current use:

- ABF is the predominant funding mechanism within Australia's public hospital system (Victorian Department of Health, 2021; IHPA, 2019). ABF is used to fund hospitals through paying for the number and mix of patients they treat. ABF takes into account varying complexities in treating different patients. The scope of eligible services that are funded using ABF are determined by a series of published criteria based on the type of service provided.
- ABF is often used as a component of kindergarten funding models, where services are funded in accordance with the number of enrolments they receive.

Conditions for success:

- ABF relies on the effective measurement and collection of activity-based data and costs. Where this cannot be collected with confidence, there is scope for misspecification of the funding model in ways detrimental to the achievement of policy objectives – for example, the funding provided can be inadequate to ensure delivery of the service.
  - The cost may be calculated and applied independently of Government to promote fairness and transparency of the process. Alternatively, the cost may be calculated internally by Government and applied.
- There must be a clear understanding of what ABF covers and what it does not, to the extent that alternative funding types must be aligned to complement it.
  - For example, the ABF may reflect a base cost of delivery, the cost associated with a given level of quality or the willingness to pay by consumers.
- Variation in the cost of activity must be incorporated to ensure that providers are encouraged to support access and participation of cohorts, and not be disincentivised to be selective about those with fewer support requirements.
  - Without appropriate specification, there is a risk that ABF can incentivise providers to place precedence on volume of services over quality of services. To mitigate this, estimation of levels of funding should be robustly estimated and implementation should be paired with alternative mechanisms to support quality (such as the National Quality Framework).

Advantages:

- Offers targeted supported funding to services proportional to the level of activity that is generated.
- Provides government with the flexibility to incentivise the participation of cohorts or demographics, through the adjustment of funding rates (where cost information is available).
- Opportunity to reflect real wages / labour costs.

Disadvantages:

- Relies on the accurate estimation of a 'unit cost' which is challenging given the variability in utilisation (occupancy and attendance patterns).
- Relies on economies of scale, without which some services would not be financially viable under ABF, meaning it must be complemented with other funding types if universal access is required.
- As funding is dependent on activity levels, there is a degree of funding uncertainty for services, influencing the ability to plan effectively for the future.
- Detailed reporting of activity has the potential to increase administrative burden for services.

Individualised funding

Overview: This model is characterised by consumer choice, where consumers of services receive funding and have the autonomy to select their own service providers. It is financed through demand driven approach where all eligible individuals receive access.

In respect to the ECEC policy principles, individualised funding can support increased quality and affordability through encouraging increased competition between providers. However, this is dependent on the market functioning effectively including with good information for consumers, market choice and low transaction costs. Individualised funding can risk accessibility if there are not safeguards in place to ensure provision in thin markets.

How is it estimated: Funding is typically estimated based on analysis of what is reasonable and necessary to support the consumer's needs. It requires an understanding of the cost of delivery of services, as well as the cost of participation in services (or fees charged for services) (ie. accounting for margins that may be charged by service providers).

How it is distributed: Funding can be allocated to the providers of the service (to be redeemed by individuals) or allocated directly to individuals wishing to access relevant services.

Current use:

The funding model is notably applied in the ECEC and disability sectors.

- The Child Care Subsidy (CCS) is used to subsidise early childhood education and care for families. The level of funding received is subject to both a means and activity test. Individuals can choose which 'approved' childcare provider to use. The CCS is paid directly to the childcare provider and is used to offset the fee paid by families with families required to pay a 'gap fee'.
- The National Disability Insurance Scheme (NDIS) is an insurance-based entitlement model developed as a scheme of the Australian Government that distributes individualised funds to eligible participants. The scheme provides individuals with the flexibility to distribute their funding how they deem best to support their disability needs and pursue their goals. It is motivated by the large diversity of support needs of individuals with a disability (Buckmaster & Clark, 2019).

Conditions for success:

- An individualised funding model requires a level of alignment in the market, where the supply of services is sufficient to meet the level of demand in the market. This should be underpinned by transparent sharing of information to ensure individuals can make informed choices, which should also encourage appropriate levels of competition in the market. An alternative to this is stronger regulation of prices and possible uncompetitive behaviour by providers in the sector.
- An individualised funding model may need to be complemented by other funding models to ensure service delivery can be maintained, notably in thin markets or for particular cohorts from whom additional support may be required to achieve desired outcomes (e.g. children with additional needs in ECEC). However, by doing this, there is also a risk that it adds complexity, particularly where funding is distributed to both providers and consumers.
  - While complexity in and of itself is not necessarily a disadvantage, complexity for families can act as a disincentive to participation, particularly where the service is not compulsory. In ECEC, those families most likely to be eligible for multiple funding streams are those experiencing vulnerability and where the benefits of participation are highest. Any added barriers to accessing affordable services should ideally be minimised.
- Regulation and ongoing market monitoring is important to ensuring that the sector is comprised of suitably high quality, efficient providers (Foleya et al., 2021).
- An individualised funding model is most effective where there are a diverse range of needs as it has the flexibility to accommodate these, at the cost of increased complexity for consumers. Where near universal participation is a goal or the service provided is relatively comparable, the advantages associated with individualised funding are unlikely to outweigh the additional complexity and the impact on accessibility.

Advantages:

- Leverages market principles and competition to increase quality and maintain downward pressure on prices for consumers (in areas where there is a sufficient supply and conditions for the market to operate effectively).
- Service providers must respond directly to the needs and wants of the consumer to remain competitive in the market and to gain and maintain market share.
- Services expand to meet demand as the market responds. This has been observed in the ECEC market over the past decade (PC Inquiry 2015).

Disadvantages:

- Consumers who do not know how to navigate a system and allocate their funding will be at risk of selecting an inappropriate provider.
- The model is unlikely to be able to support service delivery or constrain growth in prices in thin markets, without additional support.
- Without strong policy and regulatory settings, a for-profit motive can allow providers to reduce quality or inflate prices to retain more government funding as profit.
- Some markets could be oversupplied resulting in an inefficient use of government resources.

Needs-based funding

Overview: Needs-based funding is recurrent resourcing targeted towards service providers based on characteristics of demonstrated need as defined by the consumer and provision context (NSW Government, 2021). It is often financed through demand driven instruments but can also be delivered via capped funding instruments where loadings are adjusted to meet a fixed funding envelope.

In respect to the ECEC policy principles, needs-based funding can support higher quality service provision through the provision of additional funding to those with greater needs. It can also increase accessibility by removing any financial disincentives for services to take on children and families with higher needs.

How is it estimated: Needs-based funding is determined by estimating the level of resourcing required to meet the service-delivery need of different cohorts in different contexts. It is typically delivered as a base and loadings formula, with loadings typically provided for priority cohorts such as individuals with a disability or low levels of English proficiency, Aboriginal and Torres Strait Islander status and/or low socio-educational disadvantage. In some cases, loadings may be provided at the service level, recognising potential need associated with scale or location.

How it is distributed: While needs-based funding is determined by individual characteristics of consumers using a service, funding is distributed to the overall service provider.

Current use:

Needs-based funding is commonly used in both primary and secondary schooling, although is also applied in ECEC.

- The Schooling Resource Standard (SRS) includes six needs-based loadings for student priority cohorts and disadvantaged schools. These loadings were developed through analysis of how much funding would be required to 'help students achieve their full potential' (DESE, 2022a).
- In Victoria, School Readiness Funding is distributed to early childhood services to support children's learning and development. The amount of School Readiness Funding each ECEC service receives is based on the level of need of the children enrolled at their service. This is informed by parental occupation and education data (also known as Student Family Occupation and Education data) as this is considered an accurate predictor of educational disadvantage. Similarly, Student Family Occupation and Education data is used in schools to allocate 'needs-based' funding (Victorian DET, 2021).

Conditions for success:

- Needs-based funding arrangements require an understanding of disadvantage and the level of funding to ensure children have an opportunity to achieve comparable outcomes. This requires a detailed evidence base and collection of comprehensive outcomes data to translate potential differences in outcomes to estimates of loading amounts. In the absence of this, an understanding of the drivers of disadvantage (e.g. parent occupation, parent education, socioeconomic status) and how these are likely to translate to support requirements and loadings support is required.
  - Services need to understand the data and the needs of relevant cohorts to ensure the funding is optimised.
- It is important that providers have sufficient incentives to facilitate quality service delivery for children with additional support needs and to ensure funding is adequate over time to provide sustainable services.

Advantages:

- Needs-based funding recognises the individual needs of consumers (e.g. children) and aims to provide the level of funding required to cover any additional support requirements.
- This provides funding assurance to develop both long-term and short-term goals of the service provider. For example, staff training can be incorporated to better meet the needs of their service users, translating to better outcomes and improved service quality.
- Minimises the financial disincentive to take on specific types of service users, ensuring accessibility for consumers of all backgrounds and quality of delivery.
- Opportunity to reflect real wages / labour costs, including higher costs for cohorts with higher needs.

Disadvantages:

- Accurate calibration of funding rates can be onerous.
- Need to have a 'critical mass' of need for additional funding to be meaningfully applied to improve services if applied on a per-capita basis (e.g. as opposed to locational).
- The detailed evidence base and collection of comprehensive outcomes data required to support this approach may be more burdensome, relative to other funding types.

Outcomes-based funding

Overview: Outcomes (or performance) based funding models distribute funding attached to required levels of provider performance across set performance metrics. This is typically used to incentivise higher performance across the sector within specific areas and may only represent a portion the overall funding flowing to providers. Outcomes-based funding can also be used to encourage innovative service delivery models, as funding is not tied to specific activities or delivery methods.

In regard to the ECEC policy principles, outcomes-based funding is most closely aligned to quality – providing a mechanism for innovative or more efficient service responses to be trialled, in line with desired outcomes.

How is it estimated: A series of outcome measures can be developed with reference to expected or desired outcome performance and how this may vary across particular circumstances, adjusting for impacts that are outside of a provider's control. One approach to doing this is the development of a counterfactual model that simulates the baseline performance of a provider, for their unique combination of characteristics. The difference between this model and the provider's actual outcomes is considered reflective of their performance.

How it is distributed: Funding is delivered directly to service providers or their controlling organisation.

Current use:

Outcome-based funding models have been used in the health and education sectors (Cutler et al., 2019).

- In hospitals, pay-for-performance (P4P) is used to incentivise providers for achieving specific targets typically negotiated between the provider and payer. It is used alongside activity-based funding (ABF) to improve health care quality and efficiency.
- For health care services, bundled payments are used to reward providers through shared savings and penalise them for poor quality care through shared excess costs. Bundled payments primarily improve efficiency by incentivising a reduction in unnecessary hospital services.
- In ECEC (alongside other sectors), social impact bonds are used (most commonly on a small scale) to encourage innovative models to improve educational opportunities (predominately for disadvantaged communities). Notably, this approach was used in Utah where a majority of children start early childhood education without basic literacy skills (Centre for Public Impact, 2016). Social impact bonds have also been used in Australia to improve school attendance (Berry Street, 2021).

Conditions for success:

- Detailed collection of outcomes-based data is necessary to accurately determine outcome funding amounts and clearly communicate this with providers. A key risk is that without transparent methods of outcomes-based funding, providers may be unclear exactly what they are doing poorly and therefore must improve.
  - It should be considered whether existing measures of outcomes/performance (e.g. meeting or exceeding the National Quality Standards) are sufficient to link outcomes to funding.
- Incentives and unintended consequences must be well thought through and feed into the specification of the model. For example, if high attendance is decided to be a criterion for additional funding, this might create an incentive to exclude children from enrolling with a high likelihood of low attendance.
- The funding model must account for service sustainability in the absence of payments, or if payments are delivered post outcomes realisation. In the absence of this, outcomes-based funding models can favour larger organisations who are less dependent on cashflow – creating an uncompetitive environment.

Advantages:

- Outcomes-based funding model scheme used in conjunction with ABF arrangements may improve outcomes. Given that ABF does not provide an explicit incentive to improve service quality, and focus solely on greater volumes, the two funding models are complementary.
- Outcomes-based funding allows for innovation to better meet community need. As such, the model may be useful in lifting outcomes in communities and cohorts not well serviced by current delivery models.
- Provides the opportunity to focus on outcomes at the service level, such as National Quality Standards quality ratings, alongside aggregated outcomes of children.

Disadvantages:

- High risk of perverse incentives if not carefully designed.
- It is challenging to accurately define and measure outcomes for some cohorts, such as young children.
- Requires detailed collection and analysis of outcomes data, including the ability to adjust for external factors outside a services' control that impact their performance.

Programmatic-based funding

Overview: Programmatic funding refers to bespoke funding made available for targeted investment for specific purposes and needs. Programmatic funding is typically an additional funding stream alongside recurrent funding streams, existing for a set period of time.

In respect to the ECEC policy principles, programmatic funding is most closely linked to quality – providing a mechanism to support the delivery of activities or interventions not captured within the recurrent funding model.

How is it estimated: Programmatic funding is estimated based on the cost of delivery for specific programs or interventions.

How it is distributed: Funding is typically invested into institutes or broader governing bodies responsible for the specific provider, to whom the funding is allocated for. Programmatic funding covers funding for programs designed to support access to and participation in programs. It does not necessarily need to flow directly to services.

Current use:

Programmatic funding can be used to fund programs designed to boost participation and engagement in kindergarten or directly support service delivery.

- In Queensland, programmatic funding is used to support alternative kindergarten delivery models (eKindy) to children who cannot easily access a centre-based kindergarten program due to distance, a medical condition or itinerant family lifestyle (Queensland Government, 2022).
- In Victoria, the Early childhood language program supports kindergartens to employ an additional teacher to deliver part of their four-year-old kindergarten program in another language.

Conditions for success:

Programmatic funding is best used to complement existing recurrent funding when a new program, initiative or policy goal has been introduced.

Clear goals, guidelines on use and reporting are essential to ensuring funds are used effectively and efficiently.

It is necessary to have a clear understanding of how programmatic funding aligns with recurrent funding to ensure they are complementary in their pursuit of the system objectives.

While it is important that the funding be tied to a specific issue or objective, the ability to pilot programmatic funding means that there is opportunity to continue to evaluate and refine this.

Advantages:

- Programmatic funding is beneficial in circumstances where recurrent funding is not sufficiently targeted to reach all children, services, families or communities that require additional resources, or in meeting short term funding needs.
- Short term programmatic funding can be an effective way to pilot and trial new initiatives.

Disadvantages:

- Under programmatic funding, there is high uncertainty around whether funding will continue.
- Where programmatic funding represents a large portion of the overall funding, it may add unnecessary complexity to the funding system and be perceived as of secondary importance, relative to recurrent funding streams.

2. Inputs to funding models

For a funding model to be most effective, it must be appropriately parameterised to reflect the cost of delivery. Where a funding allocation or funding model underestimate the cost of delivery, it may not be feasible for services to operate sustainably. Where this is overestimated, it is inefficient for government.

The sustainability of services and affordability to consumers is also going to depend on how much funding is provided, independent of the estimated cost of delivery. There is still a level of choice by government in order to determine the extent to which the cost of delivery is shared between government and consumers.

The **National Efficient Cost (NEC)** or **Nationally Efficient Price (NEP)** represent the level of funding determined to best reflect the 'efficient cost' of service delivery. Determination of the NEC or NEP is typically used to underpin activity-based funding although can also be applied to the other funding types outlined (with the exception of outcomes-based funding). NEC is associated is supply-based (ie. reflective of the cost observed by provider), whereas NEP incorporates a margin and is demand-based (ie. reflective of the cost or 'price' observed by consumers).

Determination of the NEC must be underpinned by a strong understanding of the cost of delivery and how this is linked to outcomes, recognising the diversity of costs within the sector relating to service and child-based characteristics. In the ECEC sector, the estimation of an efficient cost of delivery is likely to require new and extensive cost data collection exercises. An example of this is the annual data collection that supports the development of a NEC and NEP for public hospital services by the Independent Hospital Pricing Authority in Australia.

Development of a National Efficient Cost would be very complex in ECEC because of the high reliance on commercial property in the provision of long day care centres. Property costs vary dramatically between geographic areas, and also between management types (ie. some not for profits in publicly owned property have low rents compared to privately owned centres subject to commercial leases). These complex issues of property costs often do not emerge in other sectors where national efficient costs can be applied (e.g. schools and hospitals).

Another complexity with achieving a National Efficient Cost is that high variability in occupancy or utilisation dramatically impacts the calculation of average costs as fixed costs are divided by attendances. Higher occupancy centres tend to have lower per unit costs than low occupancy centres. This is of particular note in ECEC in Australia, where the majority of users attend part-time, unlike schools or aged care where the assets and labour costs can be allocated across full time attendance or permanent beds.

An alternative approach is the estimation of a **reasonable cost**, which differs to efficient cost as it is intended to reflect a cost that is adequate or sufficient to achieve a purpose (ie., the delivery of ECEC). A 'reasonable cost' may include the essential costs involved in an acceptable level of delivery quality (e.g. meeting the National Quality Framework standards), including staffing, rent and administrative costs. It should also include a reasonable surplus for NFP providers and a reasonable profit for for-profit providers.

Both an efficient and reasonable cost estimation should be appropriately parameterised to not penalise services for employing staff with higher than required qualifications and/or paying above award. This is often complex to include in practice however, suitable adjustments may be included to manage this.

Box 1: Workforce considerations

A sufficiently sized and quality workforce is necessary to the operation and sustainability of the ECEC sector. The nature of the workforce is intrinsically related to the way ECEC is funded.

Higher wages in the sector are likely to be beneficial in the retention of teachers and educators and attracting new staff into the sector. However, higher staff wages also translate to increased cost of delivery for services, which within the current system, is likely to be passed through to families.

For government, adjusting wages within the ECEC sector (e.g. through award levels) may be a consideration in supporting system sustainability. Other approaches that have on occasion been adopted, and that have less direct impacts on costs for families, include:

- **Adjustments to the Fringe Benefit Tax** – for example, including an additional exemption to include not-for-profit (NFP) providers would increase the level of after-tax income for relevant staff. This would only be relevant for NFP service types, and the redistributive effects would need to be considered and estimated (e.g. flow of staff from for-profit to NFP services).
- **Payroll tax exemptions** – for example, an exemption from jurisdictional payroll taxes in for-profit services would increase the level of after-tax income for relevant staff. The cost of this change and redistributive effects would need to be estimated.

Alongside any change to income for those working in the sector, the funding model must also support investments in workforce capability and professional development, both of which are other levers available to government and complementary to the outcomes of the sector.

Advantages

These approaches offer a relatively quick change which increase the after-tax income of those in the sector, which is likely to benefit retainment and attraction to the sector.

Relevant staff will get automatic access, without additional barriers to participation.

Disadvantages

Adjustments to tax rates and exceptions are not necessarily the most direct and transparent approaches to increasing income for those in the sector.

3. Developing a funding model

The funding types outlined in this document are most commonly applied in combination with each other to form an overarching funding model. In this manner, different components of the overarching funding model are calibrated to meet the different needs of the sector.

For example, supporting appropriate access to ECEC can be achieved through:

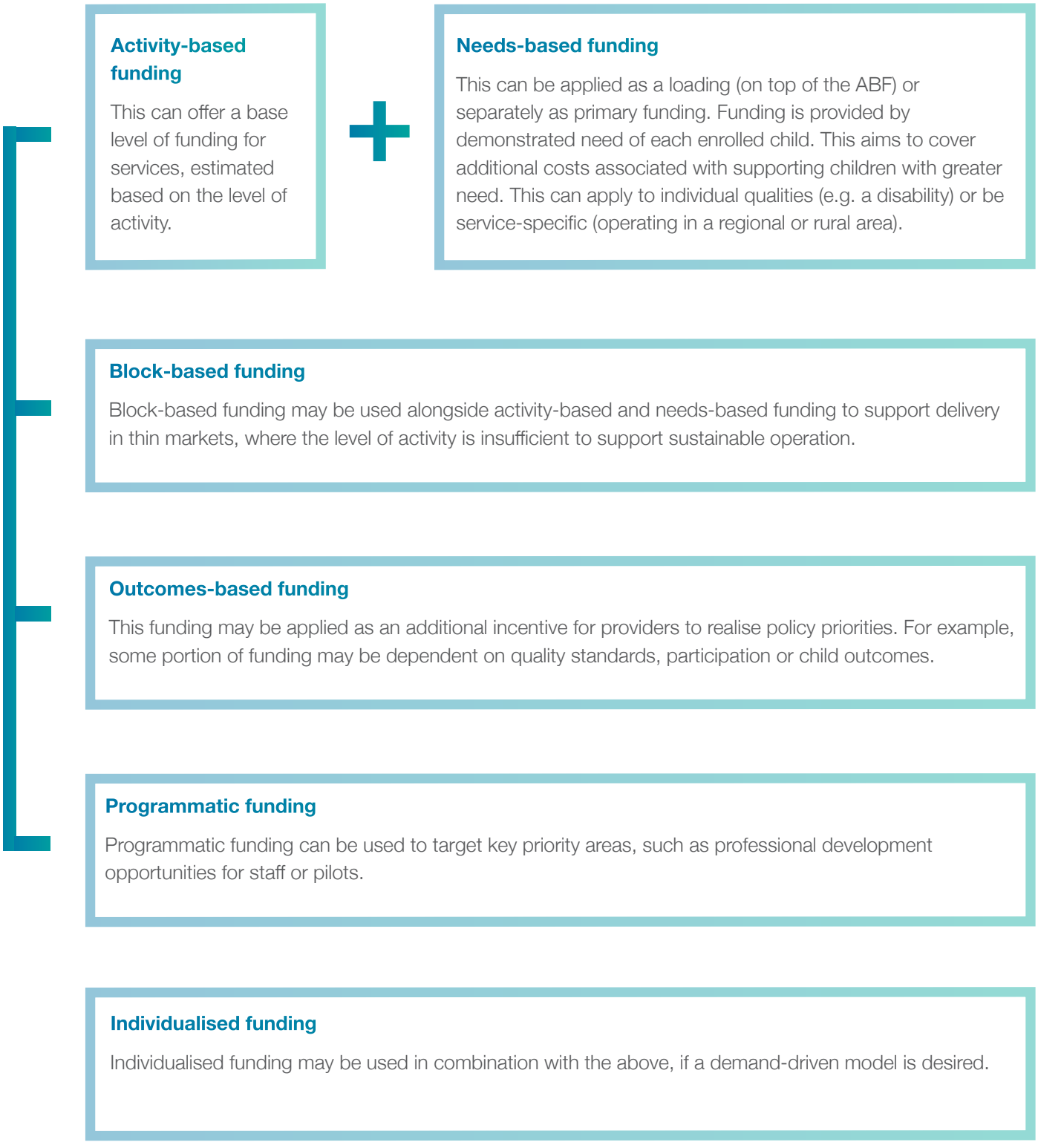
- needs-based funding: through incentivising services to enrol students with additional support needs
- block-based funding: through ensuring services are able to operate sustainably in thin markets
- outcomes-based funding: by linking funding to the participation of key cohorts
- programmatic funding: by targeting programs at initiatives directly linked to access and participation.

In ECEC, there are many localised interconnected markets that operate under different conditions. Flexibility in how these funding types are implemented and combined is most likely to ensure that can be aligned to the needs of services operating under various conditions.

There can also be limitations of funding types which can be mitigated through pairing them with complementary alternatives. For example, programmatic funding may be effective in targeting key initiatives, such as accessibility or quality, but is not well suited to the flexibility required for funding to be responsive to market context and how factors (such as region, demographic, and available resources) are likely to impact the cost for providers.

In some cases, funding will be better suited to particular markets over others. For example, a notable feature of individualised funding is that it prioritises individual choice and is likely to drive competition (having implications for affordability and quality). An individualised funding model, however, is less well suited for sectors with relatively comparable service offerings, difficulties in switching services or where participation is a policy priority.

Figure 1.1: provides an illustrative example of how a combination of funding types may be applied to develop a funding model. It includes examples of how this may flow through to an illustrative regional and metropolitan provider. This example assumes that the determination of funding amounts has been appropriately estimated to ensure the funding model is both sustainable and operating as intended.



Source: Deloitte Access Economics (2022).

Illustrative provider examples

Regional provider

A regional provider operates in a thin market (with low population, low enrolments, low participation rates). The level of enrolments is not sufficient to fund the operation of the service through activity-based funding alone. In addition, a number of children have additional support needs, which activity-based funding does not recognise.

Alongside activity-based funding, the following funding types may support quality and sustainable service delivery:

- **Needs-based funding** – This funding mechanism will target the specific needs of each child attending ECEC services.
- **Block-based funding** – This will support service viability and ensure access.
- **Programmatic funding** – This will contribute towards workforce training to enhance the skills of existing staff and initiatives to increase participation.

Metropolitan provider

This metropolitan provider is operating in a highly competitive market, where there is an equally high level of demand and number of ECEC providers. While the economies of scale is present to ensure activity-based funding will meet baseline operating costs, the challenge for metropolitan providers is ensuring the needs of each child are met.

In addition to activity-based funding, the following funding mechanisms may support quality service delivery:

- **Needs-based funding** – This funding mechanism will target the specific needs of each child attending ECEC services.
- **Programmatic funding** – This can contribute towards workforce training and quality improvement of staff.
- **Outcomes-based funding** – In high enrolment care settings, this can motivate providers to maintain high quality service provision for improved child outcomes.

4. Conclusion

This paper synthesises funding instruments, models and levers that are available to the Australian early childhood education and care system. It is hoped that a broader understanding of each funding type will enable stakeholders across the system to engage in constructive and collaborative discussions around the best type, or combination of types, to support an ECEC system that is accessible and affordable for all children, has high-quality service provision, and is supported by a sufficiently sized and capable workforce.

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For further information, please contact:
Jane Hunt
Chief Executive Officer
The Front Project
✉ jhunt@thefrontproject.org.au