the Front Project

Centre for Policy Development

CREATE. CONNECT. CONVINCE

Funding Models Paper - working paper for consultation

Purpose of this working paper

This discussion paper is an invitation to early childhood stakeholders to engage in the next steps of the Productivity Commission's inquiry into early childhood education and care (ECEC), seeking to influence the Productivity Commission and the Commonwealth Government to develop and implement a funding model that can support a high-quality, truly universal ECEC system and better serve children, families and the sector. In its draft report, the Productivity Commission has invited people to consider and comment on the design and features of any future funding model.

An important opportunity presents itself for the sector to consider different funding types, to deepen understanding of the different types of funding models, their strengths and weaknesses and if possible coalesce on a set of underpinning funding design principles.

Discussions from the consultation process on this paper have been synthesised and summarised at pages 17-21. We encourage stakeholders to reflect on the critique of each funding model and to use this work as a resource in their own considerations and responses to the Productivity Commission inquiry.

Acknowledgement of Country

We respectfully acknowledges the Traditional Owners of the land on which we work and learn, and pay respect to Elders, past and present. Sovereignty has never been **ceded**. It always **was** and always will be, Aboriginal **land**.

ABOUT THE FRONT PROJECT

The Front Project is an independent, national enterprise working to improve quality and create positive change in Australia's ECEC system. We work with government, business and the early education sector to address disadvantage, improve outcomes for children and increase the short and long-term gains for Australia. We find innovative solutions that create impact in all parts of the system so that all children can thrive, regardless of the different challenges they experience.

We know high quality early education lays foundations for children that can last a lifetime, and at the same time provides significant benefits to our society and the future prosperity of Australia. Our society will see the full benefits of investment in the early years when the system is geared toward ensuring all children can access high quality education and take advantage of the opportunities this presents.

To realise our vision of addressing disadvantage by improving quality and access in Australia's early childhood education system, the Front Project applies a systems approach to our work. We carefully navigate the varied levels of the rich and complex ECEC system to positively impact the experiences and improve the outcomes of children. With many organisations and individuals holding diverse perspectives and 'moving parts' of the system, we work with the whole ECEC system – both people inside the sector and those who intersect with it – to influence change across all levels.

What makes our approach unique compared to pure advocacy, research or policy work is how we: consider the entire early education system to understand how it intersects with our broader society; learn where the best opportunities are to optimise outcomes; and find appropriate, feasible solutions that deliver the most benefits to children, families, employers and our economy. We view the current unacceptable levels of developmental vulnerability experienced by children in Australia as a complex social problem. This is because there is no simple solution to the issue, and it is possible to approach the issue from multiple, sometimes competing, perspectives, which may have multiple possible solutions.

ABOUT THE CENTRE FOR POLICY DEVELOPMENT

The Centre for Policy Development (CPD) is an independent, values-driven, and evidence-based policy institute. Our motivation is an Australia that embraces the long term now. CPD exists to solve the biggest policy challenges facing Australia and the region, and to take people on the journey solving them. Our policy development seeks to advance the wellbeing of current and future generations. CPD's core model is three-fold: we create viable ideas from rigorous, cross-disciplinary research at home and abroad. We connect experts and stakeholders to develop these ideas into practical policy proposals. We then work to convince governments, businesses, and communities to implement these proposals. CPD has offices in Sydney and Melbourne and a network of experts across Australia. We are not-for-profit: donations to our Research Fund are tax deductible. More information about CPD is available at cpd.org.au.

Background

There is strong evidence that high quality, affordable ECEC has significant benefits for children, parents, society and the Government - now and in the future.

The momentum and support for investment in the early years, and specifically in the creation of a universal ECEC system, continues to grow. The Prime Minister's commitment to universal ECEC provides a strong starting point for the Productivity Commission to examine what a universal system can look like in Australia. Consistent with the government's objectives, a high-quality universal system is both desirable and possible.

The Productivity Commission inquiry has been welcomed in the context of significant focus on early childhood wellbeing, education and development in States and Territories and at the Commonwealth level. Initiatives being led by the Australian Government include the development of a national vision for the early years, a whole-of-government Early Years Strategy, and the ACCC Child Care Price Inquiry.

The Productivity Commission has been tasked to consider options that improve or support:

- affordability of, and access to, quality ECEC services that meet the needs of families and children;
- developmental and educational outcomes for Australian children, including preparation for school;
- economic growth, including through enabling workforce participation, particularly for women, and contributing to productivity;
- outcomes for children and families experiencing vulnerability and/or disadvantage, First Nations children and families, and children and families experiencing disability;
- the efficiency and effectiveness of government investment in the sector.

Timelines

23 November 2023	Draft report released
14 February	Responses to draft report due
Late February	Public hearings start
30 June	Final Report to Government
TBA	Final report released

* This paper focuses on funding models for long day care and excludes funding for Family Daycare.

Challenges with the current funding system

There are a range of challenges with the existing funding model that impact the affordability, accessibility and quality of ECEC. These include, but are not limited to:

1. **Affordability challenges** for many families. Data indicates that childcare in Australia is more expensive for households than in most other OECD countries, with a couple on average wages having net childcare costs of 16% of net household income [2]. Research conducted with families by the Front Project confirms the pressure of affordability with 61% of families having to make significant financial sacrifices to afford ECEC, an increase from 47% of families in 2021 [3].

2. The unique characteristics of childcare markets mean that **the CCS and the hourly rate cap are having limited effectiveness as a price signal and constraint on prices** [4], and if CCS settings are increased, this will be even less effective [5]. Further, the "inherent complexity" [6] of the CCS "can make it very difficult for parents to understand what they are entitled to and their choices".

3. Market dynamics mean that **those with the highest willingness to pay are being provided with higher quality services** [7]**.** Providers' supply decisions are highly influenced by expectations of profitability within a particular area or markets, which is driven by expectations of demand and willingness or ability to pay. This is resulting in inequitable educational and/or developmental outcomes across all children and households and reduced workforce participation in some areas. [8]

4. The current system, with undifferentiated subsidy levels and an undifferentiated hourly rate cap, **does not recognise this cost difference between younger and older children** [9].

5. The system is **based on a one-size-fits-all approach** that assumes that all children have the same needs and require the same support.

6. The funding approach **does not adequately support disadvantaged children or First Nations children** as the system does not recognise the higher costs of delivery in these communities.

7. **The Inclusion Support Program (ISP) does not fully cover costs of inclusion and has narrow eligibility.**

8. **The activity test significantly restricts some children's access to ECEC.** It has been estimated that the activity test is contributing to at least 126,000 children missing out on ECEC [10]. This means that families miss out on the full range of benefits of participating in ECEC, including not only educational and developmental benefits but also a protective space for children who may be exposed to safety risks at home. ECEC services are also a place to provide families with the information and connections that they need to support their own health and wellbeing.

9. A lack of pricing transparency makes it **very difficult for families to compare quality, price and out-of-pocket costs across services.**

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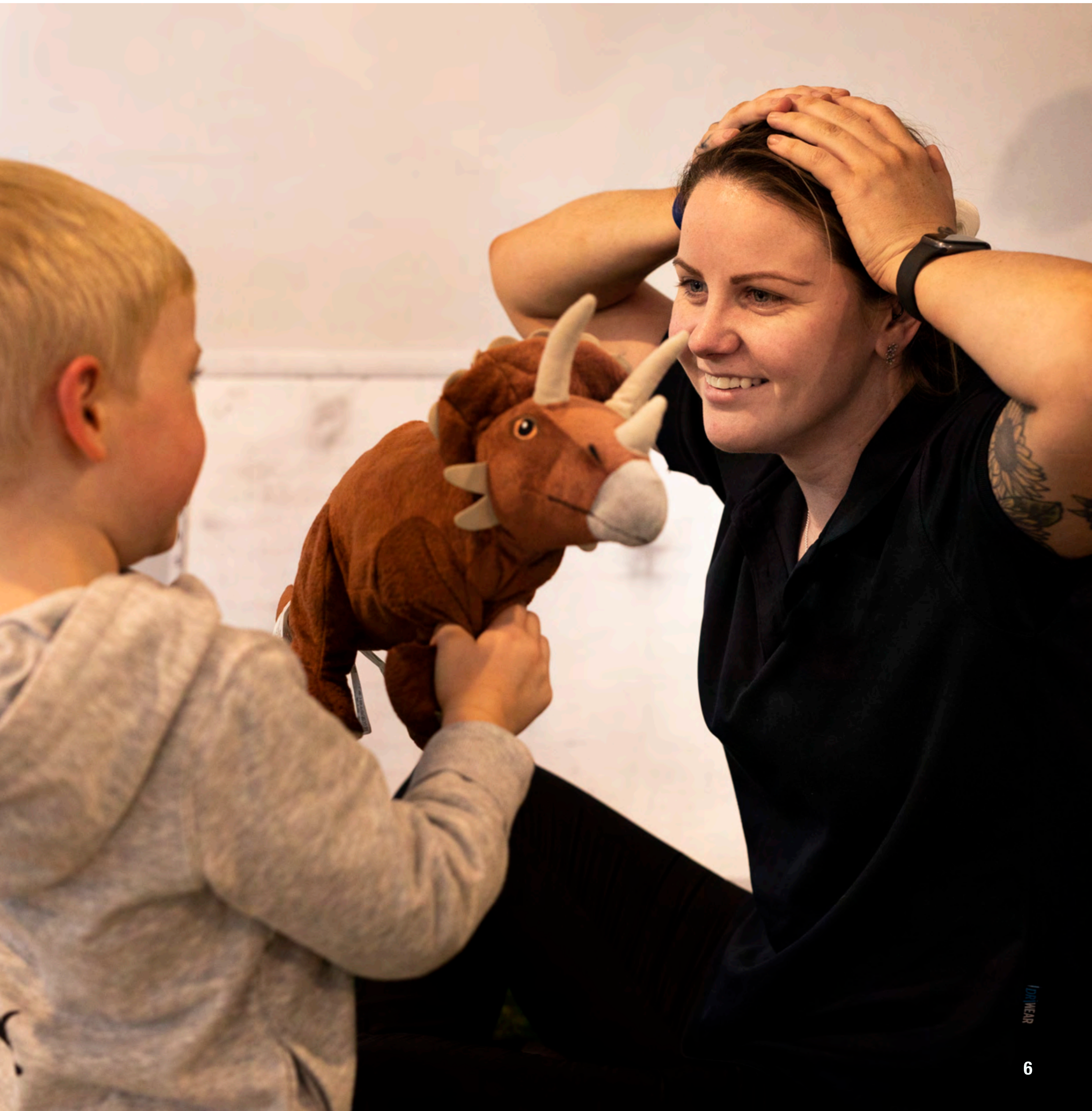
2. ACCC Childcare Inquiry - September Interim Report 2023, p 187 and p 188
3. https://www.thefrontproject.org.au/media/attachments/2021/11/24/work-and-play-report-final.pdf
4. ACCC, Childcare Inquiry - September Interim Report 2023, p 22
5. ACCC, Childcare Inquiry - September Interim Report 2023, p 199
6. ACCC, Childcare Inquiry - September Interim Report 2023,p 23.
7. ACCC, Childcare Inquiry - September Interim Report 2023,p 17
8. ACCC, Childcare Inquiry - September Interim Report 2023, p 17
9. ACCC, Childcare Inquiry - September Interim Report 2023, p 85
10. Impact Economics and Policy (2022) Child Care Subsidy Activity Test: Undermining Child Development And Parental Participation. Since this report was prepared, the Commonwealth has modified the activity test for Aboriginal and Torres Strait Islander children and families so they can access at least 36 hours of subsidised care per fortnight (from July 2023). See Australian Department Education (2022) Changes to the activity test for families with Aboriginal and Torres Strait children attending child care.

10. **Funding arrangements do not efficiently or effectively support increases in wages and conditions for the workforce.**

11. **There are minimal conditions placed by government on services to receive the CCS,** with services receiving funding even if they fail to meet the NQS.

12. The **complex interaction between long daycare funding and preschool funding,** with shared responsibility between the Commonwealth, States and Territories and differences in the commonwealth's contribution to different states and territories for 15 hours of universal access. This is further complicated by each State and Territory having their own system of preschool funding and some states now delivering, implementing or considering provision of three-year-old preschool, currently without any contribution from the Commonwealth. This interplay can also create complexity and confusion for families and service providers.



Principles and objectives for a future funding system

Developing a new funding model is complex and technical, and aspects will depend on other choices the Commission (and governments) make about a future system and the ongoing work of the ACCC in its ECEC inquiry.

In considering the design of a future funding system, it is important to be clear not just about the objectives of the overall ECEC system but also what the funding system itself is intending to achieve. There are several core principles and objectives that should underpin any new funding approach.

Below are five proposed guiding principles that a future funding system should aim to achieve. These have been developed based on principles suggested to the Productivity Commission through the submission process and have been considered recently by the Early Childhood Development Council.

1. Accessibility

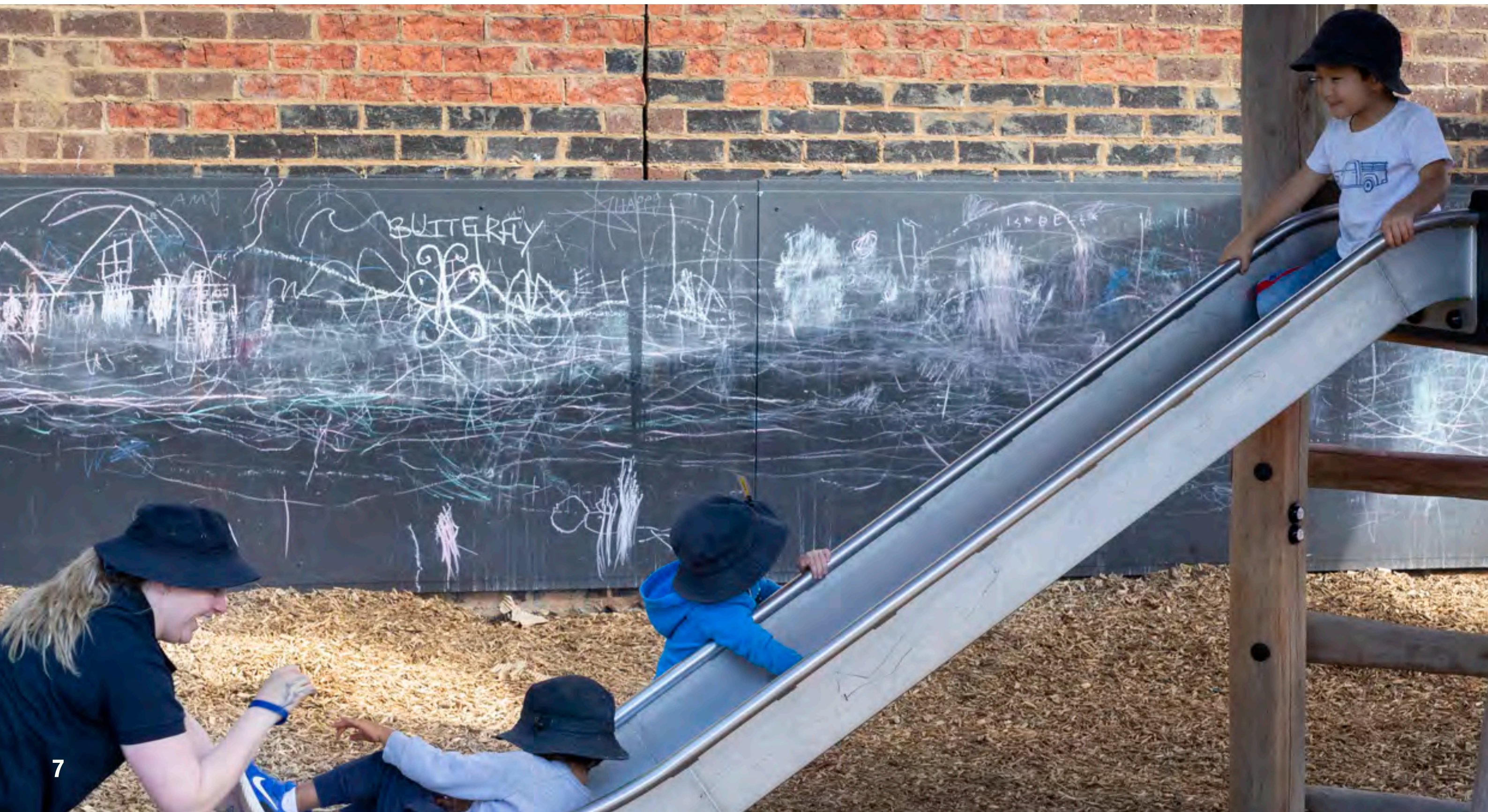
A future funding system should be grounded in equity and address disadvantage[11] for children and families. A well-designed and well-functioning universal system should provide services to all children, delivered with an intensity and a scale that is proportionate to their level of need and using a delivery model that works for their circumstances. A funding model must support appropriate access to early education and care, including for children likely to be experiencing vulnerability, and supporting workforce participation for parents.

ECEC must be available to everyone, but where children have higher needs, they should receive more support. This 'progressive universalism', whereby services are available to everyone, but delivered with an intensity and scale proportionate to the level of need, combines the benefits of a universal system with the benefits of targeted systems.

The funding model should deliver simplicity for families so they understand their entitlement and can plan their lives. It also needs to be simple and easy to understand for providers, many of whom are small and may not be able to manage a complex funding approach.

The funding model should support flexibility and choice for parents. Families have different needs and preferences, for example for different lengths of ECEC sessions and access to different types of services.

[11] https://www.researchgate.net/figure/The-five-Domains-of-Disadvantage-defining-inclusion-criteria-for-this-review_fig1_357033032



2. Affordability

The funding system should deliver funding at an adequate level to support the reasonable cost of high-quality provision and support service viability in thin markets, noting different services may have different cost drivers. It is notable that while the school funding system is built around a strong understanding of the cost of quality delivery (i.e., the School Resourcing Standard), there is limited understanding of the actual cost of ECEC delivery. Better understanding the cost of delivery should include better understanding the impact of occupancy costs (e.g., rent), given different arrangements (ranging from peppercorn rents to commercial rents with large real estate trusts) could be a source of significant cost variation. The ACCC's current work is assisting with this.

A funding model should also deliver simplicity and affordability for families. Financial barriers to accessing services should be minimised to ensure the participation of children and families from all socioeconomic backgrounds. While the primary purpose of the CCS is to make ECEC affordable, it remains expensive for many families. Whilst changes to the childcare subsidy are only recent, many families are reporting that ECEC remains unaffordable with some services lifting their fees in response to the change [12].

3. Quality

The provision of high-quality early education and care ensures that children receive the full benefit from attending ECEC and that parents feel confident in leaving their children at a centre. The system must not only ensure that every child receives ECEC that meets minimum safety and quality standards, but it must actively work to promote and improve quality over time. Quality is underpinned by a well-designed, sustainable funding system and supported by a sufficiently sized, stable and capable workforce. Any future funding system must invest in the workforce, aligning with the objectives and initiatives of the National Children's Education and Care Workforce Strategy.

Lifting the quality of the ECEC system requires a funding model that responds to the needs of diverse communities, acknowledging that there are disparate outcomes for children depending on socioeconomic status, geographic location and various categories of vulnerability.

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.

[12] https://www.thefrontproject.org.au/images/downloads/Final%20Families%20Report%20-%20Work%20and%20Play%20.pdf

4. Adequacy

Total funding (from governments, and any parent or other revenue) must be adequate to meet the cost of sustainable delivery of high quality ECEC. This includes the costs incurred by a service to operate within and connect to a broader ECD/service system. It is noted that this cost can vary from child to child and service to service. Cost variations at a service level can include occupancy costs (eg. rent, land) and workforce costs (including different pay and conditions and industrial arrangements and the need to attract qualified staff in 'hard to staff' areas). Cost variations at a child level are considered in 'equity and inclusion' (principle 2).

5. Equity and inclusion

The funding system should recognise that children will have different needs, and this affects the cost of providing them a high-quality service (separate to how these elements affect children's ability to access a service due to cost to the family). This includes disability, developmental delay, educational or socioeconomic disadvantage, cultural or language diversity, Indigeneity, and geography. (There will be some children who meet more than one of these factors).

Funding types

There are a variety of options available to the government (and the Productivity Commission in its recommendations) for funding the ECEC system based on funding types and how different types can be combined.

The Front Project's "Funding Models and Levers" paper from October 2022 details different types of funding and how they work, and is a useful guide to be read in conjunction with this paper.

1. Block-based funding:

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.

2. Activity-based:

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 whereby all eligible activity is funded.

In respect to the ECEC policy principles, ABF holds some risks to accessibility if safeguards 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.

3. Individualised:

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 a 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.

4.Needs-based:

Needs-based funding is recurrent resourcing targeted towards service providers based on characteristics of demonstrated need as defined by the consumer and provision context [13]. 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 support 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.

5.Outcome-based:

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 of 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 can support quality - providing a mechanism for innovative or more efficient service responses to be trialled, in line with desired outcomes.

6.Programmatic:

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 provides a mechanism to support the delivery of activities or interventions not captured within the recurrent funding. model.

7.Hybrid model:

Elements of the above funding models can be combined.

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.

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, especially in thin markets.
- outcomes-based funding: by linking funding to the participation and/or outcomes of key cohorts.
- programmatic funding: by targeting programs at initiatives directly linked to access and participation.

13. NSW Government, 2001

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.

Activity-based funding

This can offer a base level of funding for services, estimated based on the level of activity.

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Needs-based funding

This can be applied as a loading (on top of the ABF) or separately as primary funding. Funding is provided by demonstrated need of each enrolled child. This aims to cover additional costs associated with supporting children with greater need. This can apply to individual qualities (e.g. a disability) or be service-specific (operating in a regional or rural area).

Block-based funding

Block-based funding may be used alongside activity-based and needs-based funding to support delivery in thin markets, where the level of activity is insufficient to support sustainable operation.

Outcomes-based funding

This funding may be applied as an additional incentive for providers to realise policy priorities. For example, some portion of funding may be dependent on quality standards, participation or child outcomes.

Programmatic funding

Programmatic funding can be used to target key priority areas, such as professional development opportunities for staff or pilots.

Individualised funding

Individualised funding may be used in combination with the above, if a demand-driven model is desired.

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 funding 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.

A combination of these funding types is likely to best support the ECEC system. Given the ECEC sector is made up of hyper-localised and interconnected markets, flexibility is required to make sure services can operate under different conditions. For example, whether a centre is rural or urban, what the local demographics are, and the availability of resources will all contribute to the supply costs for providers and will influence what funding is required.

ECEC funding model options

Four funding model options are presented below for consideration. These options are most commonly discussed in the Australian context as ways that ECEC could be funded:

1. Subsidy based model
2. Reasonable cost of provision model
3. Block funding
4. Outcomes based model

For ease of the discussion, this paper only considers models for ECEC services, and not models for funding standalone pre-school services. However, the provision of ECEC and pre-school services are becoming more integrated and a funding model that also integrates the funding avenues for ECEC and pre-school is worthy of consideration.

1. Subsidy based model

The current funding model is a subsidy-based model. The government provides families with a subsidy through an hourly rate cap to reduce the out-of-pocket cost of ECEC. This is a fixed amount based on a family's income, activity level, the type of care and number of children in ECEC. It does not account for the age of the child or any additional needs that the child or family has.

The current subsidy is 90% for families earning less than $80,000. It reduces by 1% with each $5,000 earned and families earning over $530,000 are not eligible for a subsidy. Within the existing system, there is an hourly rate cap which sets a limit on Government subsidy contribution.

For children experiencing vulnerability there is also the Additional Childcare Subsidy. Consistent with the PCs Terms of Reference, the subsidy amount could be increased for all families to 90%.

Under a subsidy model, providers set their own fees. The subsidy covers a percentage of the fee (in the current system, this is based on the hourly rate cap), and the family pays the remainder.

This model can be used in conjunction with other funding models listed below, such as block based funding or funding for additional needs.

2. A reasonable cost of provision model

An alternative approach to funding can be to provide for the reasonable cost of provision for all children.
This can look like:

1. **Base funding** to cover the core costs of providing ECEC, based on the age of children and the number of days of ECEC provided. The base cost should reflect all the ordinary, reasonable costs of ECEC delivery, including staff costs, occupancy, consumables, administration, regulatory compliance, building maintenance, etc. It should function as an average over the year. It should also include funding for the costs incurred by a service as being an active part of a service system, for example in supporting families to access allied health or other services, and outreach and engagement to local families.

2. **Additional funding** that accounts for:

Child driven differences

- The educational need or disadvantage experienced by the children enrolled in a service. This can be done relatively simply by collecting information about parents' occupation and educational attainment as part of the enrolment process, with higher per-child additional funding for a higher level of disadvantage. This is already used as the basis for calculating the School Resourcing Standard.
- Whether a child is Aboriginal or Torres Strait Islander. This reflects the multiple and concurrent challenges faced by many Aboriginal and Torres Strait Islander children (including socioeconomic disadvantage, geographic challenges and the current poor outcomes), and the need to dedicate additional resources and efforts to 'close the gap'.
- Whether a child has a disability or significant developmental delay. Subject to the findings of the ongoing reviews of the inclusion support program and the NDIS, the additional funding needed to support the child should be built into the overall funding model. Different funding levels (tiers) could be established based on the level of need. Government could also help support services' access to dedicated supports, as discussed further below in 'sector support'.

Cost driven differences

- Whether a service is rated excellent or exceeding the National Quality Standard. A small amount of additional funding should be provided to a high-quality service. This both recognises the additional costs likely incurred in operating at a higher level, and more importantly, provides an incentive for services to improve and a signal from government that it wants and is willing to incentivise this.
- An additional loading based on certain service-specific costs. This would apply to higher costs than those factored into the base funding that are both material and generally outside the service's control, such as rent or, more broadly, the higher cost of operating in some geographies.

Funding would be paid directly to the provider, but would remain generally demand–driven in that funding would be based on occupancy in the service.

3. Block funding:

Another approach to funding model design that has been proposed is a hybrid system that includes some base or block funding from government, with the remainder of funding being met by a combination of parent contribution and a percentage-based government subsidy. This is similar to early approaches to ECEC funding, for example where the Commonwealth set funding levels based on wage costs, with fee relief provided to families in addition. [13]

One model could be a wages subsidy model where a 'wages subsidy' would be paid directly to providers to fully cover, or cover a large percentage of wages costs and on-costs based on NQS ratios and government agreed rates. These rates could be set to pay higher minimum levels of pay and conditions . The workforce is the most significant supply-side challenge in the current system, and pay and conditions are the most significant contributor to workforce challenges.

The remainder of the fee would be covered by a fee to families and could be subsidised by a CCS style payment.

4. Outcomes based funding:

In many sectors and approaches to commissioning of services, the funding model is based on 'payment for outcomes'.

In the ECEC context the funding system could be used to incentivise and reward things that are known to improve outcomes (eg. quality) and use other system management approaches to improve them. For example, services would only be eligible for funding if they:

- met minimum quality standards; and/or
- paid their staff a specified and fair wage (where this has not been resolved through other industrial or legal processes, government should use its funding lever to support and require improved pay and conditions across the system); and/or
- did not charge parents more than the parent contribution set by government; fees would be capped at a certain rate; fee increases were limited to a certain rate.

Parent contribution

Coupled with the funding models above, there can also be a parent contribution. There are different options for how the parent contribution is determined:

1. **No parent contribution**
   The government covers the full cost of the provision of ECEC. It is a free service provided to children. This could be a 5 day a week free entitlement, or it could be limited to a certain number of days eg two days of free ECEC per child.

2. **Fixed fee**
   Another option is to set a fee that parents pay. The fixed parent contribution can be set in different ways:

   a. An agreed financial amount per child per day eg $10 per day. This is similar to the model trialled in Quebec and being rolled out across Canada. Providers are not able to charge families more than this fixed fee. The remainder of their provision costs are paid by government.

   b. A tapered fixed fee based on parental income. Government would set parental income bands, and for each band there would be a fixed fee. The fee could be minimal for parents on a low income, and increase as parental income increased up to a maximum fee.

   c. A fee band. Providers could be provided with a fee band that they could charge families eg between $10 and $40 per day. It would be at the providers discretion as to what fee they charge within the band.

3. **Flexible fee** - (current model)
   Service can charge any fee that they determine.

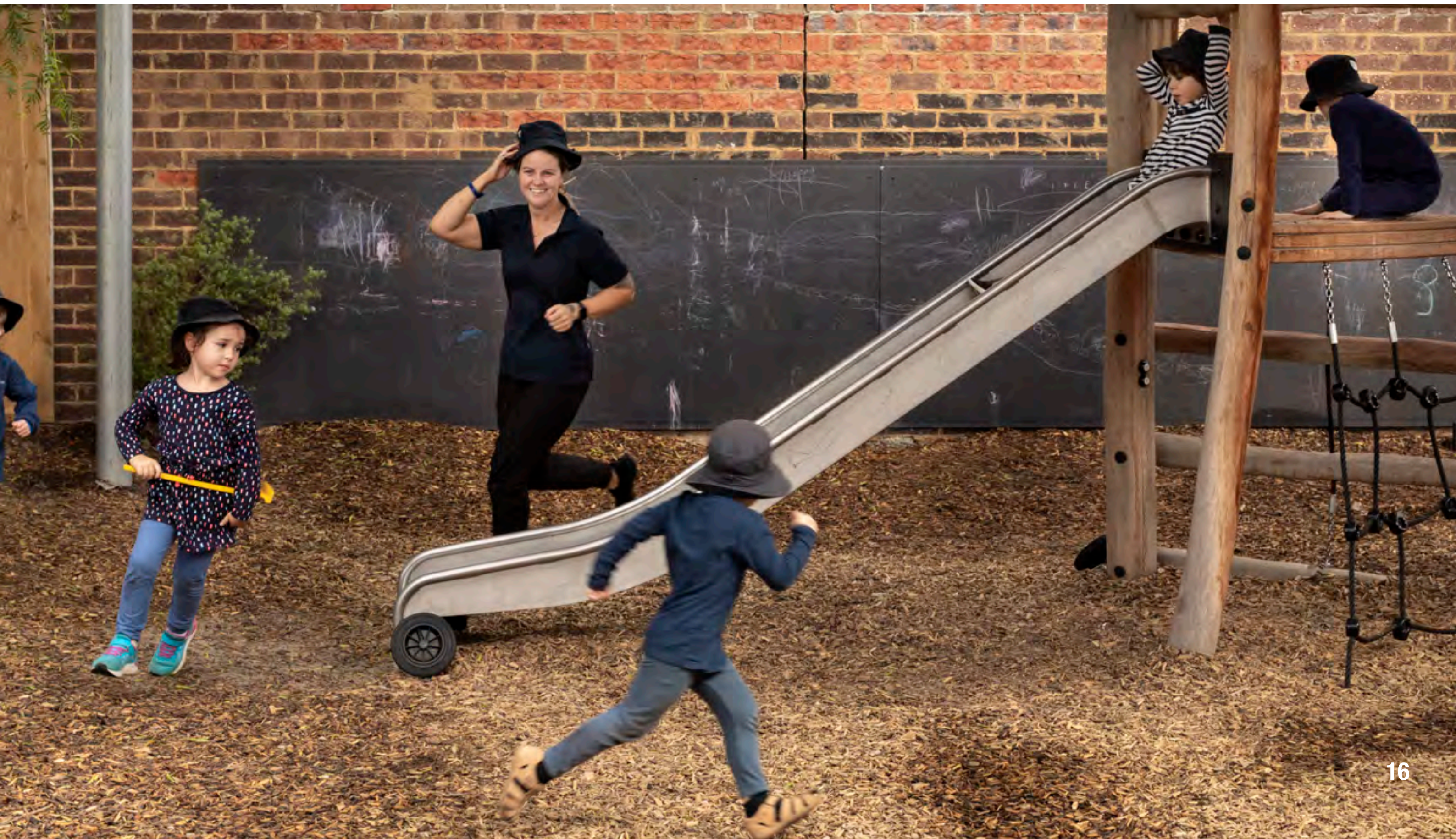
13 See, for example, Centre for Policy Development, A Brief History of Commonwealth Government involvement in Early Childhood Education and Care in Australia. (August 2023, report for the South Australian Royal Commission into ECEC)

Addressing thin markets

A broad funding system may not be able to account for all the different circumstances in a system. Separate funding approaches could be taken for 'thin markets' to support ongoing service sustainability, and the establishment of new services where the market doesn't meet need.

Funding options that can be considered are:

- Services serving small communities, where there are no alternative services reasonably available, could be funded at a guaranteed minimum level to ensure viability so they are able to provide ECEC to the local community. Depending on the funding model adopted, the higher costs of provision, including higher labour costs in some areas may need to be accounted for to ensure services are adequately funded to provide a high quality service.
- Provide support for capital such as direct government investment in building new services, offering financial incentives for non-government investment, facilitating debt markets or brokering arrangements for trusted providers, targeted underwriting of provider borrowings (secured against services), or cooperative co-investment arrangements (for example, to construct and operate multiple new services). Efforts could be made to co-locate ECEC services with other community facilities, such as schools. Some of these supports may be more appropriate for not for profit services, which face particular barriers to expansion.
- State and Territory governments operating as a service provider, if no other provider can be found to operate a service.



Feedback and reflections from the sector on the four funding models

In December 2023, the Front Project and the Centre for Policy Development ran two sessions with sector stakeholders to deepen understanding of the four funding models. The sector stakeholders were members of the Early Childhood Development Council and Apiary Fellows, providing a good representation of the sector. In the two sessions, participants were asked to consider the opportunities and risks for each model, and any necessary conditions that might better enable the model to be implemented. A summary of the session discussions is below and provides a high-level outline of the strengths and risks of the different approaches. These tables are not an exhaustive analysis of the funding models, however, provide a good overview of sector responses to each.

Subsidy based model (Note this model is the closest to the current Child Care Subsidy model. As such, participants had this model in mind when providing feedback)	
Opportunities of the model	• Is demand driven and can maintain supply /viability for the majority of services in markets with adequate demand. • Unlocks private capital and enables sector investment in infrastructure • Can deliver free provision for children at risk. For example, in the current system through the Additional Child Care Subsidy (though complex). • Can allow service level agreements in a crisis (i.e.: emergency/disaster/welfare payments)
Risks of the model	• The subsidy may not cover the true cost of delivery as it may not account for child and service cost differences. • The subsidy may not incentivise investment in thin markets. • The subsidy may not incentivise government objectives or critical elements of the system - for example, quality or pay and conditions for the workforce. • Without price regulation, a subsidy model can be open to provider misuse or drive unwanted behaviours. • Can be complex for families to navigate depending on its design. • If additional measures are included to improve equity, such as the Additional Child Care subsidy in the current CCS model, this can be stigmatising, preventing families applying. • Subsidises parents rather than paying services directly.
Necessary conditions, possible improvements + ideas to maximise	• A necessary condition for this model to work well is system stewardship. A more active approach from governments can enable better transparency and affordability for parents,

opportunities and/or mitigate risks	monitor quality and have more oversight over the use of the subsidy. • The costs of delivering a quality service need to be included in the subsidy. The subsidy should be adjustable based on cost differences. This includes educators' receiving suitable pay, and age and geographic cost differences. • There is an opportunity to complement a subsidy model with other funding models to address equity issues. This includes supply-side funding for children with additional needs, those experiencing disadvantage and First Nations children and thin markets. A place-based approach may also complement this model. • There is the opportunity to leverage existing ICT infrastructure as this is the current funding model. • This model could be enhanced by more transparency around fees, more information for parents on quality and more funding for inclusion.

Reasonable cost of provision model	
Opportunities of the model	• Provides for the cost of delivering a service that accounts for different child and service costs. It can include additional funding for children with additional needs, and fund improved pay and conditions. • Allows governments to have a better understanding of costs of delivery, aiding their stewardship of the system • Would highlight 'hidden' costs e.g. collaboration with allied health • Funding provided directly to the service lessens the administrative burden for families and is a more efficient allocation of funding. • Could encourage some providers to specialise in complex cohorts. • If coupled with a fixed parent contribution, can be simple for families to use and can limit fee increases for parents. Can help to minimise extreme profit-making and price gouging in the current market system.
Risks of the model	• Defining and calculating the reasonable cost for services is challenging. o Cost information can be difficult to determine and there are variations in the cost of provision. • If cost is not correctly determined, children and services may face a funding shortfall e.g. services

	that currently use cross age subsidisation to maintain viability
	• The reasonable cost may not meet the cost of quality provision, which includes service integration
	  o There may be reduced capacity for providers to innovate to meet community need for the things not included in the reasonable costs.
	  o Costs may not adjust upwards on an ongoing basis resulting in insufficient funding being provided and an unsustainable system over time.
	• Subject to the design of the model, there could be an administrative burden applying for additional funding.
	• If there are quality payments in the model, these could advantage those who are already providing a high-quality service and not adequately assist those needing to improve
	• This model would take time to develop and transition to at scale.

Necessary conditions, possible improvements + ideas to maximise opportunities and/or mitigate risks	There are some necessary conditions to ensure funding is reasonable:
	  • A pricing authority or other independent body would be required to ensure that government is properly directed, and that it has sufficient powers.
	  • Clear definition of what is included in the reasonable cost of delivery. The Pricing Authority would need to work with providers to determine reasonable cost, noting the administrative burden on providers of doing so.
	  • Model needs to account for unique differences in cost in the sector, and that ECEC costs do not align with CPI.
	  • Ensure the implementation is not rushed and take the time to determine the reasonable cost.
	Given the long implementation time for such a model, ensure that support is provided to parents in the interim and that there is a transition plan.

Block funding model	
Opportunities of the model	• Less administrative burden as it is not attendance based. • Can be used to address remote and regional service gaps, such as thin markets and used to address the additional costs of inclusion.

	• Can be a faster funding response as it is not reliant on the market to respond. • Provides services with certainty and consistency, allowing services to plan more easily and secure a more permanent workforce. • Can be used to incentivise system objectives - e.g. if wages are funded through block funding, this can support workforce attraction, quality improvement.
Risks of the model	• Expensive and inefficient for governments. The high cost of block funding makes it difficult to scale. • May not fully cover costs of delivery or account for different delivery costs or child-based costs e.g. increased costs in rural and remote services. • May not incentivise participation as it is not based on enrolment or attendance. • Risk to quality if not underpinned by a strong performance framework (i.e.: a guaranteed amount of funding may not incentivise quality improvement, or support increased access or attendance)
Necessary conditions, possible improvements + ideas to maximise opportunities and/or mitigate risks	Needs to properly account for the adequate cost of delivery, and any additional service and child-based cost differences. It also needs to include indexation to ensure costs are met overtime. More appropriate as a targeted funding measure in particular circumstances, e.g. in thin markets and complex communities. To ensure it is effectively implemented, consideration should be given to how government objectives could be incentivised.

Outcomes based model	
Opportunities of the model	• Performance measures, if defined well, can create positive outcomes and impact on quality. E.g. Staff retention could be higher due to higher wages, leading to improved workforce performance and value. • By taking a “flexible commissioning approach”, and addressing outcomes of a defined population, this model is able to manage variability in

	outcomes depending on the community in which the service is located.
Risks of the model	• The outcome being measured may not account for service or child-based differences or challenges for specific cohorts, resulting in these children and services not receiving the funding they need. This approach is also reliant on good data collection. • The outcomes being measured could be changed with new governments. • If attendance is used as a measure, there could be risks and consequences for funding certainty for services. • If the outcome is based on service quality outcomes, this may penalise services that are working to improve their quality. • The outcomes being rewarded may impact the behaviour of providers and the supply or undersupply of services, e.g. improved child outcomes may require smaller group sizes or higher qualified staff. Unwanted provider behaviour could unintentionally be incentivised
Necessary conditions, possible improvements + ideas to maximise opportunities and/or mitigate risks	An equity-based funding approach in addition to outcomes-based funding could be a more beneficial mix of funding approaches. Could be a suitable funding model following significant investment in quality uplift. Place-based solutions and communities in need would need to be accounted for.