

Victorian Government submission in response

Productivity Commission's draft report, *A path to universal early childhood education and care*

Executive Summary

The Productivity Commission's (the Commission) inquiry comes at a time of significant reform, ambition and opportunity for early childhood education and care (ECEC) in Australia.

The Victorian Government, in its initial submission to the Commission¹, outlined its significant reform ambition and investment in early childhood. All Australian Governments are working, through National Cabinet, to outline their vision for the ECEC system in Australia through the *National Vision Early Childhood Education and Care* (the National Vision). A draft has been released, and the final National Vision is expected to be finalised shortly. The National Vision will provide over-arching direction, including to this Inquiry.

The draft National Vision recognises that ECEC both has enormous benefits to children's learning and development, and is a key enabler of workforce participation.

The Victorian Government supports many of the draft recommendations in the Draft Report, a number of which should begin to be implemented as soon as possible, as 'no regrets' investment to commence to transform the system.

The current system is not working well enough to achieve the governments' objectives and ambition for the system. Many children are missing out on the experience of high quality ECEC, and many families are not able to make the choices about work and family that they would prefer to.

Incremental changes to current settings and programs will not sustainably fix the underlying challenges with the current system and will not realise governments' ambition for ECEC in Australia.

The Victorian Government encourages the Commission, in its Final Report, to:

- provide a holistic blueprint for the future of the ECEC system, aligned with the National Vision in scope and ambition, including considering the role of preschool and the opportunity for an increased minimum national preschool entitlement for all children
- expand on the proposed approach to stewardship, being an explicitly more active and interventionist role for governments in pursuing the principles underpinning the draft National Vision (access, equity, quality, and affordability), and in supporting the workforce
- outline necessary changes to national arrangements to give effect to this approach to stewardship, where roles and responsibilities are more coherently allocated between levels of government, rather than a new ECEC Commission with broad functions which may complicate, rather than streamline, already overlapping roles and responsibilities
- advise on options for more significant funding model reform, including a sector-neutral model as well as other alternatives put forward by Inquiry participants. Funding should account for the full cost of provision including workforce, infrastructure, quality and equity.
- provide a roadmap of how reforms could be phased or staged, with high priority and foundational reforms (for example, supply-side funding to address immediate workforce challenges, and relaxation of the Activity Test) introduced as soon as possible, and other reforms brought in over time.

In developing its Final Report, the Commission should take a holistic and ambitious view consistent with the National Vision, including considering the systemic causes of – and solutions to – the challenges facing the ECEC system in Australia today; and how the system can be best set up to transform into a single, truly universal system, which promotes equity, affordability, quality and accessibility.

¹ This submission builds on the Victorian Government's [initial submission](https://www.pc.gov.au/_data/assets/pdf_file/0005/361184/sub146-childhood.pdf) (https://www.pc.gov.au/_data/assets/pdf_file/0005/361184/sub146-childhood.pdf) in June 2023. The Initial Submission included background information about ECEC in Victoria and Victoria Government programs and reforms. The government subsequently released its [Best Start, Best Life Workforce Strategy](https://content.vic.gov.au/sites/default/files/2023-12/Best-Start-Best-Life-Workforce-Strategy.pdf), (https://content.vic.gov.au/sites/default/files/2023-12/Best-Start-Best-Life-Workforce-Strategy.pdf) which contains significant further detail and may be of benefit to the Commission.

1 A broad and ambitious view of the whole system, including preschool

1.1 Supported recommendations of the Draft Report

The Victorian Government supports many of the draft recommendations in the Draft Report, a number of which should begin to be implemented ahead of the Commission's Final Report, as 'no regrets' investment to begin to transform the system.

- The Activity Test adds complexity to the system and acts as a barrier to access for many vulnerable and disadvantaged children, and any steps to relax it are supported. The Final Report should recommend its full removal.
- Allowing preschools to access the Child Care Subsidy (CCS) to offer additional 'out of preschool' hours could help preschool services to offer more family- and work-friendly programming options, and increase overall system capacity. However, further detail is required to understand its intended operation, for example who would be eligible to access the CCS and when subsidised sessions would be available.
- Increased Commonwealth Government investment in inclusion support, and streamlining of administrative processes, are important steps to improve the inclusiveness, accessibility and equity of the ECEC system.
- Access and availability are key barriers to achieving a universal system. Investment by the Commonwealth Government to establish new services in areas of inadequate provision, and to adopt a different funding approach where the general funding model is not viable due to low population levels, are supported.
- The co-design of funding arrangements with Aboriginal Community Controlled Organisations is supported, and the Victorian Government is working to progress this through the Early Childhood Care and Development Policy Partnership.
- The recognition of the need for greater Commonwealth Government effort and investment in the ECEC workforce, including to support attraction and retention, is welcomed. The Victorian Government notes the Draft Finding that pay and conditions are at the heart of recruitment and retention challenges. Without funding from Commonwealth Government, any pay increase would impact the cost to families.
- The recognition that the Commonwealth Government should resume providing funding to support regulatory activity is important to reflect the resourcing needs of the regulatory authorities who have a significant role in ensuring the safety and quality of the sector.

These are welcome steps to improve the system, however they do not address the systemic issues in the current system in a comprehensive or sustainable way. The Commission should consider further and broader reforms that are needed to realise the National Vision.

1.2 A broad and long-term approach to achieve the National Vision for ECEC

In the National Vision, Australian governments will outline at a high level what the ECEC system should deliver, and the opportunity for the Commission's Final Report is to consider and provide further advice on how this can be best achieved.

The Final Report should provide a blueprint for a future universal system, outlining what the system should look like – to children and their families, to the workforce, to providers, and to government. The design of a future universal system should begin with the recognition in the draft National Vision that the ECEC system supports both children's learning and development, and workforce participation.

There would be significant benefit in the Commission's Final Report providing more detailed consideration of what a well-functioning, high-quality ECEC system should look like, in support of realising the National Vision. This should include issues such as:

- What levers do different levels of government have in the system, and how can they best be used to achieve governments' objectives? Which level of government is best placed to perform which function?
- What kind of a funding system and workforce and other supports from government will most effectively, efficiently and equitably deliver the desired end state?
- How can the system be markedly simpler and easier for parents to understand and navigate?
- How can the system ensure that children and families who need extra help or early intervention get it?
- What are ambitious but reasonable objectives and measures that governments should be aiming for in terms of equity, affordability, quality, and accessibility?

1.3 A national entitlement for ECEC, including preschool

The Commission's Final Report should include the important role of three- and four-year-old preschool programs and preschool services in the national ECEC system. Preschool programs form an important part of children's educational journey, and nearly every child in Australia attends a preschool program before they start school. The role of preschool in a national ECEC system is of significant importance and is a key part of Australia's education system.

The Preschool Reform Agreement provides all children an effective entitlement to 15 hours per week of a preschool program in the year before fulltime school. This recognises the strong evidence of the benefits of preschool to children's education and development.

The Commission should give further regard to the benefits of an increased minimum national entitlement to preschool for children in the two years before they start school. This has been considered and recommended in many previous reports and studies,² and many states and territories have begun to deliver this. Doing so at a national level would have significant additional benefits. It would provide an important signal to families and the community about the importance of preschool education, encouraging participation. In the absence of a national approach, there is a risk that smaller, less-resourced jurisdictions – often home to a more disadvantaged cohort of children – would receive a lower level of preschool than children in larger jurisdictions.

A national approach could also allow for an expanded preschool entitlement to be more effectively and efficiently delivered. As jurisdictions seek to increase their preschool entitlement, many are increasingly utilising long day care services to achieve their reform ambition. This can be of benefit to parents and children, but two levels of government providing different funding streams and policy settings into the same long day care service, supporting the same children, risks inefficiency and results in a confusing and difficult system for families to navigate.

Recognising the extensive evidence of the benefits of preschool programs, the entitlement should eventually include 15 hours per week of preschool for three-year-olds, and 30 hours per week for four-year-olds. It will take some time for capacity to expand to deliver this entitlement, but this process is already underway in several jurisdictions, and establishing it nationally will increase the incentive for services to expand their capacity to meet the need.

This higher preschool entitlement should be a part of a simpler national minimum entitlement for ECEC for every child, combining both preschool and what is currently child care.

² See, for example, [South Australian Royal Commission Final Report](https://www.royalcommissionecec.sa.gov.au/__data/assets/pdf_file/0009/937332/RCECEC-Final-Report.pdf) (https://www.royalcommissionecec.sa.gov.au/__data/assets/pdf_file/0009/937332/RCECEC-Final-Report.pdf); Pascoe, S., and Brennan, D. (2017). [Lifting Our Game: Report of the Review to Achieve Education Excellence in Australian Schools through Early Childhood Interventions](https://www.education.vic.gov.au/Documents/about/research/LiftingOurGame.PDF) (<https://www.education.vic.gov.au/Documents/about/research/LiftingOurGame.PDF>); Fox, S and Geddes, M. (2016). [Preschool - Two Years are Better Than One: Developing a Preschool Program for Australian 3 Year Olds – Evidence, Policy, and Implementation](https://content.vu.edu.au/sites/default/files/media/two-years-are-better-than-one-mitchell-institute.pdf?_gl=1*1h33gl8*_ga*MTQxNDUzMjk1OC4xNzA0ODU5NmM4*_ga_Q1LS42WZC4*MTcwNDg1OTczOC4xLjAuMTcwNDg1OTczOC42M2C4wLjA) (https://content.vu.edu.au/sites/default/files/media/two-years-are-better-than-one-mitchell-institute.pdf?_gl=1*1h33gl8*_ga*MTQxNDUzMjk1OC4xNzA0ODU5NmM4*_ga_Q1LS42WZC4*MTcwNDg1OTczOC4xLjAuMTcwNDg1OTczOC42M2C4wLjA) Mitchell Institute Policy Paper No. 03/2016.

1.4 Complexity of the current system for families

The Draft Report and the Australian Competition and Consumer Commission (ACCC) note that the subsidy system is itself a barrier to accessing ECEC, and many families struggle to understand their entitlements and actual out of pocket costs.³ The approach proposed in the Draft Report maintains most of the current complexity of the system. This includes maintaining the Activity Test for families wanting to access more than 3 days of ECEC in a week; maintaining separate national and state-based entitlements for preschool and non-preschool ECEC; maintaining a subsidy system that varies according to parents' income; and maintaining the hourly rate cap.

The Commission should consider whether the expected benefits of the complexity outweigh the costs of the complexity, and who bears the burden of complexity. Even with a relaxed Activity Test and 100% CCS, families will still need to understand and monitor the hourly rate cap and their billed hours. Families that want more than 3 days of ECEC or have income approaching the \$80,000 threshold will also need to monitor their activity and income levels as they do now. Even families who fully satisfy the Activity Test need to consider the impact of the 100-hour limit, which may limit one parent to part-time work – as 100 hours can be insufficient to support full-time ECEC where billed sessions are often more than ten hours per day.

Although it is unclear exactly how the Draft Report's proposed entitlement would operate, it may also add to complexity in the system. The Final Report should provide further detail on how the proposed 3 day/30 hour entitlement would operate in practice. For example, a family may prefer to spread 30 hours of ECEC across more than 3 days, or 30 hours may be less than 3 full days of ECEC, but it is unclear how the proposed entitlement would work in these circumstances, and what a family would be entitled to. It is also unclear to what extent the proposed entitlement includes preschool programs, which could create further confusion for families.

The Commission should consider both simplification of the subsidy system and removal of the Activity Test, and moving to a national minimum entitlement for ECEC, including preschool. A national entitlement would be significantly simpler for families to understand, and would reduce or remove the need or incentive for children to move between multiple services each week, disrupting their connections with educators and peers. It also removes the historic split of 'education' and 'care' between levels of government and service type, allowing for holistic stewardship of a single ECEC system.

2 The approach to stewardship, and governments' roles in improving the ECEC system

2.1 The proposed ECEC Commission

While governments may have different roles in the system, the draft National Vision acknowledges governments need to take shared responsibility for the system, and work together to realise shared goals.

The Draft Report's proposal for an ECEC Commission identifies important functions that need to be performed to improve the functioning of the system. It also identifies the current allocation of roles and responsibilities can be unclear or inconsistent. However, it is unclear whether the proposed ECEC Commission would clarify roles and responsibilities or confuse them further.

Adding a new governmental actor with broad functions to the system will increase the overlap and risks greater confusion of roles and responsibilities that currently exists between Commonwealth and state and territory governments. It may also increase the complexity of policy, funding and governance arrangements.

³ See, for example PC Draft Finding 6.2 ("Complex ECEC subsidy arrangements can be a barrier to access for some families") and ACCC Final Report Finding 27 ("The Child Care Subsidy is complex for parents and guardians to understand and it is difficult to estimate out-of-pocket expenses) and September Interim Report page 165, citing parent research from the ACCC and NSW PC.

As the Draft Report identifies, a key aspect of effective stewardship is the use of available levers to steer system actors.⁴ Creating a ECEC Commission with broad responsibilities but limited levers or powers to fulfil them is unlikely to support the successful stewardship of the system, and risks undermining or confusing the responsibilities and accountability of governments as stewards of the system. Governments should be responsible and accountable for their stewardship of ECEC as an essential, universal system.

Many of the functions proposed or considered to be performed by a national ECEC Commission require connection with, and deep local knowledge of, individual communities' preferences, needs and circumstances. Having a national body undertake these functions is inconsistent with the principle of subsidiarity and will not be effective. In addition, many of these are longstanding functions performed, at least in part of the ECEC system, by state and territory governments as preschool system managers.

Combining oversight functions with other functions is problematic, and risks confusing the role of any ECEC Commission. An ECEC Commission assuming regulatory functions⁵ could also be incompatible with other functions, and the case for a national regulatory function is not made and is of unclear benefit.

In its Final Report, the Commission should begin with a clear explanation of what would be involved in a more active stewardship approach (discussed below), and then consider who (including different levels of government) is best placed to perform which function. If the Commission considers a function is best performed by a new ECEC Commission, the Final Report should include a clear explanation as to why other options are not preferred.

2.2 Stewardship

The Victorian Government welcomes the Draft Report's support for a stewardship model, and its conclusion that both the Commonwealth and state and territory governments are 'the most practical stewards for the ECEC system,'⁶ rather than other system actors or a new ECEC Commission. The Victorian Government encourages the Commission to consider in further detail what stewardship entails.

The Victorian Government considers more active system stewardship important to fully realising the benefits of the ECEC system. This should explicitly include a more directive approach by government – being clear about what is wanted from the system and actively utilising available levers to achieve it. This means moving away from a passive approach that provides subsidies and runs grant programs but largely 'lets the market run', to one where governments take responsibility for the effective and efficient operation of the system, and intervene where needed to achieve objectives. This includes governments working collaboratively, coordinating their efforts in the ECEC system to maximise their effectiveness.

An example of this is in the approach to challenges in establishing new services in thin markets.

The Commission's modelling of access/supply of services found that only 8% of children live in an area where the threshold of 0.6 places per child is met by Centre Based Day Care (CBDC) alone, and only 21% of children live in an area where this threshold is met by a mix of CBDC, Family Day Care (FDC) and preschool services. This means that, even including FDC and preschools, 79% of children live in an area where current supply is not sufficient to meet the Commission's proposed entitlement of 3 days per week.

If 4 out of 5 markets are considered 'thin markets', this is suggestive of a broader and deeper problem within the system. The Draft Report identifies this as a significant challenge, and makes some recommendations to address this through grant funding, competitive tendering processes, and advice on these funding process to be provided by the Commonwealth Department of

⁴ See, for example, Draft Report Figure 23, page 54.

⁵ Draft Report, page 510.

⁶ Draft Report, page 510.

Education. However, the scale of the access challenge is significant, and the proposed solutions are unlikely to prove effective at sufficient scale.

The Inquiry should consider how the Commonwealth Government can work more closely with states and territories as it delivers the Draft Report's recommended increased funding for infrastructure to provide better access to high quality services, including increasing strategic planning to meet forecast demand and population growth.

The Commission should, in its Final Report, consider further how system stewards can better cultivate supply in the system – understanding and planning for gaps, supporting existing high-quality providers to expand, and encouraging new providers to enter the sector. For example, most of the sector is relatively small operators, which can limit a provider's capacity or capability to do the work needed to expand. Some organisations – particularly not-for-profit providers – may have difficulty accessing capital, have a lower risk appetite, or not have an entrepreneurial culture or skill set that is inclined to expansion. Providers, especially small not-for-profit services or others dependent on philanthropic support, may also be reluctant to take the financial and reputational risk of establishing new services where they may not succeed. Many providers also find the process of seeking government funding complex and time consuming. However, a healthy system requires a sufficient quantum and mix of high-quality providers, and it is in governments' interest to support high-quality providers to expand.

In addition to the recommended grants funding, additional options for the Commonwealth Government could include capital co-contributions (where government would retain a share of ownership of the land/building), underwriting the operation of new services in priority areas (reducing the risk for providers), and closer and more deliberate working with high quality providers on expansion plans and access to government supports.

Stewardship could also entail undertaking planning for future provision, understanding current and future need. As part of this, a steward should have regard not just to the availability of places, but the mix and quality of places available, endeavouring that every local market has high-quality options for families. A steward should gather and seek out local system intelligence, to understand local conditions and local community needs, to inform local and system-wide policy and investment decisions. The Commission could also give further consideration to the role of steward(s) in provision, particularly where other providers are not operating.

This kind of market stewardship – not just making funding streams available but thinking deeply about what is needed to make them effective, and taking those additional steps to fill gaps and facilitate other system actors – is an important example of how a new approach to stewardship is needed.

The approach to the ECEC workforce would similarly benefit from a stewardship approach. As the Draft Report identifies, the workforce is a critical enabler for the ECEC system, and a more proactive approach to monitoring the system and responding to emerging issues may have prevented, or at least reduced the scale of, the current workforce challenges being faced by the sector. Expanding the system as envisaged by the Draft Report will require more work from governments.

The Victorian Government has recently released its *Best Start, Best Life Workforce Strategy*, which builds on the 2021 kindergarten workforce strategy and includes significant investment in the workforce for preschool services and long day care services with a funded kindergarten program. However, significant responsibility and levers sit at a national level. The Commonwealth Government needs to take greater responsibility for addressing workforce issues, and its efforts must be commensurate with both the scale of the challenges currently facing the ECEC system, and the need to ensure sufficient, high-quality supply in the future to meet its ambitions for a universal ECEC system.

Similar to provisioning, stewardship in a workforce context means taking an active approach to workforce supply in partnership with the sector, and using all the levers available, not just relying on programmatic approaches. This includes long-term workforce planning that identifies opportunities for system level improvements to support attraction and retention of quality workforce

at the local level, and is cognisant of other workforces and reforms. This could include developing a more effective approach to monitoring supply and quality – without a clear view of supply (including Vocational Education and Training [VET], Initial teacher education [ITE] and migration), system reform and expansion is unlikely to succeed, and more and better data needs to be collected and shared to support this. The data should then inform government action, for example by increasing the number of Commonwealth Supported Places for early childhood teaching degrees. The Commonwealth Government has a greater role to play in funding and coordinating a coherent, national approach to building supply and quality, including through the *National Children’s Education and Care Workforce Strategy (2022–2031)*.

2.3 Roles and responsibilities of governments

The ongoing split of roles and responsibilities creates gaps and inefficiencies, resulting in a fragmented model of ECEC provision that is difficult for families to navigate. Genuine reform to roles and responsibilities, which extends beyond the clarification of roles, could lead to significant benefit.

The transition to any new arrangement of roles and responsibilities would take some time, and the fiscal and other implications would need to be negotiated as part of a new intergovernmental agreement. Where there are changes to responsibilities, suitable funding arrangements will need to be made, noting that most of the fiscal benefits of ECEC participation flow to the Commonwealth Government. However, there would be benefit in the Commission further considering options to improve arrangements in the long term.

In its Draft Report, the Commission notes there are areas where the roles, responsibilities and priorities of governments have not been clear, based on a historical split in responsibilities for education (states and territories) and care to support workforce participation (Commonwealth). Examples of this include different funding systems, different entitlements, and different approaches to the ECEC workforce. Functions that are performed for part of the sector do not exist in other parts. For example, state governments often undertake service planning for preschools and invest in new services, but the Commonwealth undertakes no planning for long day care services and investment is market-driven.

It is in parents’ interest to be able to easily understand their entitlements under each level of government, and how they interact and apply in different service types.

The Inquiry provides an opportunity to consider how stewardship over the ECEC system may be better exercised, and to set up the ECEC system in a more efficient and effective way. The Final Report could include further recommendations to progress this. The Victorian Government suggests that further consideration be given to a stewardship model for ECEC, including preschool. One example that would involve greater change but could be considered is an approach where:

- The Commonwealth Government could take broad responsibility for access and affordability, workforce attraction and supply (given its levers in pay, VET and ITE), and investment to address supply issues.
- States and territories could continue to lead local system management and maintain responsibility for implementation of the nationally-agreed regulatory system, and could continue to have a role in preschool provision and funding.
- Some responsibilities could be shared. For example, collection and sharing of data, and overall system quality (where the Commonwealth could use its levers in ITE and VET, and the funding system, and states and territories could provide programmatic and other supports to services and the existing workforce). Key overall system decisions, including agreeing on the objectives of the system, provision approach and funding system design, could be made jointly.

This approach could apply to the whole of the ECEC system, and work with a single national entitlement and new funding system.

Such an approach could allow state and territory governments to draw on existing relationships, networks and knowledge of local communities developed through their current role as system manager for preschool. It could also improve coordination and integration with other state-based service systems, including child and family services, maternal and child health, allied and other health, and schools. This could be particularly beneficial to families experiencing vulnerability and disadvantage.

Any future approach to roles and responsibilities should respect the principle of subsidiarity and recognise the existing roles of states and territories in preschool, child and family services, maternal and child health, allied health and the school system, all of which have sustained service connections with long day care services. Any approach should also utilise each government's levers and strengths, and create a clearer set of responsibilities than current arrangements. This may include a further stage of more detailed options design.

A new approach may, in effect, allocate many of the functions the Commission proposed to be performed by the ECEC Commission to states and territories. Any approach to stewardship would require increased information sharing, collaboration and partnership between the Commonwealth and state and territory governments. Appropriate coordination, governance, funding and other arrangements could be established between governments (at both Ministerial and official levels) as part of agreeing changes, and would not require a new ECEC Commission.

3 Alternative funding models

Victoria supports the Commission's commitment to further explore the relative merits of different funding approaches in the Final Report. As part of this, it is important that the Final Report comprehensively consider the alternatives to a predominantly demand-side approach. As raised by inquiry participants, this should include a hybrid approach, a predominantly supply-side funding model, and direct service provision.

3.1 Challenges not sufficiently addressed in the Draft Report

3.1.1 Equity

Much of the current funding system is designed to improve equity in the *affordability* of ECEC. However, with limited exceptions, there is little in the funding system to ensure that services are inclusive of all children or equipped to meet the needs of all children. While a dedicated inclusion funding stream is available in the current system, the Draft Report notes its many limitations and challenges, and it is not intended to address the many different forms of additional need children may have.

One solution that was proposed by inquiry participants was moving to a predominantly supply-side model, which includes needs-based funding. There would be value in the Final Report considering funding on the basis of need (needs-based funding), which could improve access by removing any financial disincentives for services to take on children and families with higher needs.

Consideration as to the appropriateness of a needs-based funding model is relevant, given it is also a fundamental part of the school education system but does not exist in the national ECEC system. In many ways the ECEC system results in the opposite of needs-based funding – services supporting better-off communities can often charge higher fees and provide higher quality ECEC, while services supporting lower socio-economic communities often have less ability to raise funds from families.

To properly support children's learning and development, the system needs to systematically resource services to meet the different needs of children and their families.

3.1.2 Affordability

It is vital that services are resourced adequately to sustainably provide the high quality ECEC that is of benefit to children. A system where parents carry too much of the resourcing burden will have perverse effects – lower income families, whose children would be among those that benefit the most from high quality ECEC, would be less willing or able to pay the required fees.

As both the Commission and ACCC note,⁷ recently fees have risen significantly and above inflation, but out of pocket costs have not risen as much due to CCS rate increases. Without these changes, out of pocket costs for families would have risen significantly more.

Further consideration is required on how affordability will be maintained or improved for the 70% of families who the Draft Report does not recommend receive an increase in the CCS, and whose out-of-pocket expenses have only been contained in recent years due to subsidy changes.

Both the Commission and the ACCC have found⁸ that the hourly rate cap is not effective at containing prices, at least in part due to its complexity and opacity. Yet the Commission proposes that it be retained, and to be relied on as a key mechanism to manage affordability in the future.

A 100% CCS should improve affordability for eligible families. However, the absence of a parent contribution, given the current CCS system's design, will likely remove an aspect of demand-side pressure to keep prices lower, and an integrity measure to ensure families are provided a valued service. No specific new measures, designed to address this, were proposed in the Draft Report. This is of particular importance in a sector where the majority of provision is for-profit. If the current funding system is retained, the Commission should further consider what other changes are required to give practical effect to a 100% CCS rate, while protecting both families and the taxpayer.

The Draft Report recommends the Commonwealth Government monitor changes in fees and out of pocket expenses. If the current subsidy-based funding approach is continued, further consideration should be given to the design and likely effectiveness of an ongoing price monitoring function. For example, a system reliant on families to raise concerns about fee increases is likely to be significantly less effective than one where government monitors fees and intervenes proactively. Government could also give guidance about what is a reasonable fee increase.

The Commission should give further consideration to the legislative treatment of third-party payment of gap fees. Currently, any third party contribution (including by state and territory governments) to a family's fees so they can access a CCS-funded service is treated as making a pre-subsidy contribution, so the benefit to the family is significantly reduced.⁹ States and territories have received a temporary exemption under *Child Care Subsidy Minister's Rules 2017* (Cth) in order to support Free Kinder in long day care services, but this is time limited. If the current system is broadly retained, the overall operation of the legislation should be reviewed to remove this rule for payments from other governments, as this currently operates as a barrier to achieving legitimate policy objectives.

3.1.3 Quality

The Draft Report correctly identifies quality as an essential element of a universal ECEC system in order to achieve child development outcomes, to provide safe care of children, and to provide parents with the confidence to leave their young children in someone else's care.

The Draft Report suggests that Regulatory Authorities should have a greater role in providing programmatic support for quality improvement.¹⁰ The Victorian Government supports greater support for services to improve their quality. However, allocating such responsibility to Regulatory Authorities risks confusing their role with the sector, and raises potential conflicts of interest (in being responsible for both helping services improve and then assessing the degree to which they have improved and holding them accountable for it). In Victoria, the Kindergarten Quality Improvement Program is carried out by a separate part of the Department of Education. This

⁷ See, for example, Draft Report page 361, and ACCC June Interim Report Chapter 5 and Final Report page 44 ("Affordability benefits are also unlikely to endure").

⁸ See, for example, Draft Report page 368, and ACCC Finding 25 ("[the cap] has had a limited effect in placing downward pressure on prices and constraining the burden on taxpayers").

⁹ For example, if the fee is \$100 and an 80% CCS rate would provide a subsidy of \$80 with a \$20 gap fee, a \$20 contribution from a third party reduces the effective fee to \$80, making the subsidy \$64 and the gap fee \$16 rather than just paying the gap fee and reducing it to zero.

¹⁰ Draft Report, pages 478-9.

professional development program provides intensive, targeted support to early childhood services with identified quality improvement needs.

In addition to programmatic responses, the Commission could further consider how government could use its lever(s) to incentivise quality and quality improvement, especially among services persistently failing to meet standards. This is particularly important given the challenges noted in the Draft Report of parents exercising demand-side pressure to improve quality.

When considering access challenges, the Commission should maintain focus on the supply of services of the highest possible quality to those who need it and would benefit from it most. The Draft Report observes that services in lower socioeconomic areas are less likely to meet the National Quality Standard, and the Final Report could better consider how government can use its levers (including how new and existing services are supported) to address this. There is a place for different models of care, including FDC, in a national ECEC system. But careful consideration needs to be given about their different roles in the system and the families and children they support. There are many challenges in providing ECEC across Australia, including in diverse, smaller, rural and remote communities, but families in these communities should not be restricted in care options, or to options of lower quality.

The Draft Report recognises that the workforce is essential to ensuring access for children and families, but greater emphasis could be given on the centrality of the workforce in service quality. The interactions between the child and the educator/teacher are critical for realising the benefit of ECEC on children's outcomes, and support for the workforce is a critical part of supporting quality in the system.

It is important that services are culturally safe and inclusive for children and families, and cultural competency and trauma-informed care training can be undertaken by all staff working in early childhood services. Cultural safety and inclusivity are not just important for children, but for the workforce as well, including for their development and retention.

3.2 A new funding model, aligned with costs and policy

The Commission has been instructed by the Commonwealth Government to consider a universal 90% CCS rate; however, the Draft Report notes that the main beneficiaries from a universal 90% CCS rate would be higher income families. The Final Report should consider how an equivalent Commonwealth Government investment in the ECEC sector, combined with existing state and territory investments, could be leveraged to improve equity, access, affordability, and quality for all children and families that use ECEC.

Many of the challenges in the current system are driven by what the current funding system does and does not do. However, the Draft Report is primarily focused on variations to the current funding system. The Final Report should also advise on options for more significant reform such as sector-neutral funding system for long day care and preschools that could be overseen jointly by the Commonwealth and states and territories.

In a sector-neutral model, funding could be provided on the same basis to long day care and preschool services, removing the historic split between systems, creating a truly integrated ECEC system and ensuring ECEC is equitably and adequately funded irrespective of setting. It could also help support supply in thin rural markets that often have preschools but no other ECEC service, allowing current providers to build on existing services with access to CCS for all children.

As noted in the Draft Report, a predominately supply-side funding model could involve directly funding services. Such a model could also involve the quantum of funding being based on the reasonable cost of quality delivery (including the cost of a sufficient, skilled and appropriately paid workforce), the nature of the service being provided, the number and characteristics of children attending, and governments' policy objectives.

The needs-based aspect of this alternative could include additional funding (in the form of supplements, streams or loadings) for additional supply-side costs faced by a service (for example, operating in a remote area or providing a preschool program), and based on the needs of the

children attending the service (for example, supporting children with a disability or from a disadvantaged background, or First Nations children).

The Commission could draw from the experience of other funding allocation methods currently used in Australia. For example, although there are differences between the sectors, the funding approach for schools in Australia (the Schooling Resourcing Standard) provides an example of how a needs-based funding model can be designed to cover reasonable costs of provision, and recognise that these costs can vary, including due to the location of the service and the characteristics of the children attending.

Similar approaches are already used in ECEC in Australia in preschool systems in many states and territories. In Victoria, the kindergarten funding system includes a core per child rate that is higher in rural areas or where services employ staff under specified terms and conditions. It also includes an additional funding stream targeting the level and concentration of educational disadvantage (School Readiness Funding), an additional funding stream conditional on services offering a Free Kinder program (rather than charging parent fees), and a dedicated stream for children with a disability or complex medical needs.

The Commission could also consider an approach where the Commonwealth Government provides jurisdictions with CCS equivalent funding for preschool regardless of the setting it is delivered in. A sector-neutral funding model would remove the financial imbalance and level the playing field for long day care and sessional settings. States would then be able to design a delivery model that worked best for families and supported parent choice. The CCS (or other funding approach) could be administered through the Preschool Reform Agreement, with a clear delineation of funding that was for core service provision versus additional funding that may be for reform.

3.3 Needs-based funding

The Commission notes that it will further explore the merits of reforming the funding model, including the merits of moving to a predominately supply-side funding model (incorporating needs-based funding).

Needs-based funding is a foundational characteristic of the current school funding system in Australia, and its introduction into university funding was raised by the Universities Accord Interim Report. Given this context, it would be appropriate for the Commission to consider whether an early childhood education funding system with needs-based funding (beyond a means-tested subsidy) is an opportunity to enable the ECEC system to help counteract disadvantage early in life.

Providing a relatively flexible stream of additional funding allows services to allocate resources to the specific needs of the community they serve. It allows the provision of complementary and integrated support to vulnerable and disadvantaged families. For example, in some communities transport may be a barrier to access, but in others a bicultural worker may be needed, or additional outreach to parents and families. Services could also bring in specialist help, such as speech pathologists or audiologists, or use funding to support integration with other services or programs.

Children arrive at early childhood services from a wide range of backgrounds and circumstances, reflecting the breadth of the community – different socioeconomic, cultural and linguistic backgrounds, different family circumstances, and different home environments. While an ECEC service should be able to accommodate and respond to many of these needs, some children will need additional support, and the service will need additional resourcing or assistance to provide this.

A needs-based funding system that scales with the level and concentration of disadvantage targets funding to where it is needed most, and allows services to allocate funds to the additional services and supports that meet the needs of their local community. This contrasts with the current system, where a service's resources are significantly influenced by the ability and willingness of parents to pay, rather than the children's level of need.

To ensure the additional, needs-based funding is used to provide the additional support intended (and not, for example, lead to a windfall gain to providers), restrictions would need to be placed on

its use. For example, in Victoria, School Readiness Funding is allocated to services delivering a preschool program; it is primarily required to be spent on a 'menu' of evidence-based interventions maintained by the Department of Education. Services go through a planning process each year to outline how they intend to spend their School Readiness Funding, with plans approved by the Department and then acquitted at the end of the year. A similar system could be adopted nationally, with states and territories, as local system managers, working with services to plan and acquit spending.¹¹

3.4 Implications of an alternative funding model

A supply-side, sector neutral funding model as discussed above could have a number of implications that should be considered in the Final Report, including:

- Under any activity-based model, services would only receive funding for children who are enrolled and attending, maintaining the incentive for services to open and operate in areas of demand, and to operate services in a way that encourages attendance and participation (for example meeting families' needs and preferences, or being inclusive).
- A sector-neutral funding model would level the playing field for long day care and sessional preschool settings. This would remove fragmentation in the ECEC sector and make it easier for parents and providers to navigate the system. A streamlined ECEC system would enable families to use ECEC in a way that best suits their needs and would maximise the combined benefits of education and care.
- A supply-side funding model would make it easier for governments to impose funding conditions on services, supporting a stewardship approach where governments more actively use their levers to drive outcomes from the system. This could include giving governments greater influence over families' fees (including where it is intended to be free to access), including through a combination of funding being better targeted to costs and need (reducing the need for prices charged by services [or the quality of service provided] to be adjusted to reflect these cost differences) or imposing other conditions to restrict any provider pricing power.
- A needs-based approach allows the funding system to recognise the significantly different per child cost involved in providing ECEC, without this flowing through to parent fees.
- The impact on the system from any funding model changes being considered needs to be examined and outlined in the Final Report. This includes any possible increase in demand for ECEC which could place significant strain on existing services and workforce.

4 Staged implementation of reforms

The reforms outlined in this submission would represent a significant change to the current system and would take many years to fully deliver. It would take time to agree any new roles, responsibilities and fiscal arrangements between levels of government, and to hire and train staff to undertake these roles. It would also take several years to develop, test and refine the funding model and give time for services, governments and families to adequately understand and prepare for the change. The detail of staging implementation of these reforms will also need to be cognisant of future reforms undertaken in response to the National Disability Insurance Scheme Review, including consideration of implications for children, families, services and relevant workforces.

The Final Report should consider whether targeted supply-side funding streams could be introduced to the CCS system, as part of a longer-term transition to any new funding model. Initial streams that provide funding for improved workforce pay and conditions (for example, funding pay changes flowing from current Fair Work processes) and the introduction of a needs-based funding stream could operate in parallel with the existing subsidy system and be introduced more quickly

¹¹ Planning and acquittal arrangements could also be risk-based, with greater requirements for services or providers in receipt of higher levels of additional funding, or that are otherwise considered higher risk.

than an entirely new funding system. In addition to helping government and services become more familiar with a supply-side funding stream, this would also see the benefits of the funding streams begin to flow sooner.

Other reforms, including changes to the CCS and Activity Test, and allowing preschools to access the CCS, could also be delivered as immediate, interim steps towards any new model. Investment in workforce supply and development, and to establish new services in underserved markets, should also commence immediately, and would be necessary to build the capacity of the system in any scenario. An increase in the minimum national preschool entitlement could be phased in, with jurisdictions with more advanced expansion programs able to provide an expanded entitlement sooner.