Universal ECEC system – wages funding stream

This paper provides further clarification on wages reform following discussions with the Commission at Public Hearings. It addresses how the wages funding stream would work and proposals for the most efficient and effective model to deliver on the universal entitlement in the immediate and longer term.

Goodstart and many other sector leaders have proposed that the new universal ECEC system should include a stand-alone wage subsidy 'top-up' funding stream, that would complement the CCS. In our final submission to the PC (p 82), Goodstart recommended that:

1. Draft Finding 3.1 be expanded to reflect the importance of addressing wages to rollout of a universal ECEC system;
2. That Government funding of wages increases in the ECEC sector be identified as a priority investment to support universal access to quality, inclusive ECEC; and:
3. That the Final Report include an additional specific recommendation relating to Government funding of a wage increase for the ECEC sector via a wages subsidy and a new supply-side funding mechanism to deliver it. For the PC's consideration, suggested wording could be:

Recommendation 3.8: Funding stream to support a wage increase for the ECEC workforce
To address low wages and conditions offered to the ECEC workforce, and noting that a wage increase funded by a fee increase would make ECEC less affordable for many families, the Australian Government should:

- *Agree to fund a wage increase for the ECEC workforce that properly values the work of early childhood educators and starts to close the gap with wages in the rest of the education sector*
- *Utilise the expanded range of processes available under the Fair Work Act to ensure any wage increase flows through to educators*
- Develop a funding mechanism to deliver the wages subsidy directly without providers needing to *increase fees to cover the additional cost. In the short term, this may need to be grant based. But, in the longer term, it could be paid electronically based on payroll data reported by providers' third-party payroll software providers (similar to CCS payment arrangements).*

The Child Care Subsidy is neither an efficient nor effective mechanism to deliver government funding for a wage increase

Goodstart would strongly caution the Commission from recommending that a wage rise be funded through an increase to the Child Care Subsidy (CCS) hourly rate cap. Such funding would be inefficient and inequitable with several undesirable impacts as outlined below.

The CCS is an efficient and effective financing instrument to cover the main drivers of cost when delivering ECEC, namely labour and land (property) costs. The policy challenge is how to deliver an increase in wages while ensuring:

- the pay increase is fully passed onto educators,
- increased costs are not passed onto families as higher fees, and
- Government investment is not simply absorbed by providers in higher profits.

For this reason, supply-side (top-up) funding is the most appropriate mechanism to complement the CCS when Government needs to deliver deliberate, targeted policy outcomes, such as a wage increase. It would mean the full current wage costs (approx. 70% of all costs) would continue to be covered by the CCS as the primary funding instrument. Only the relatively small proportion of labour costs that constitute the 'increase' would be covered by the targeted, supply-side wage subsidy. This approach gives Government significant control and flexibility to determine the level of that wage increase and any commensurate conditions, such as reporting requirements and ensuring that the subsidy is fully passed on to educators. It also allows Government to remain at arms-length of the core labour costs for the sector.

CCS is paid as a percentage of fee but wages – as a share of fees – vary significantly between providers.

This would mean that different providers would need to increase fees by different percentages to fund a wage rise. The ACCC found that wages are a much higher proportion of costs for NFP providers (77% of costs) than FP providers (63% of costs). Further, wages are an even higher proportion of fee for NFP providers than FP providers after accounting for margins. This is particularly the case for small and medium providers. See Table 1 (below).

Table 1: Wages shares of costs and fees (hourly)

Provider size	**Wages % Total costs**		**Margin % Fee**		**Wages % Fee**	
	NFP	**FP**	**NFP**	**FP**	**NFP**	**FP**
Large	76.6	63.6	6.0	9.0	72.1	57.8
Small & Medium	77.8	68.0	-1.3	20.0	78.8	54.4

(ACCC Interim report Sep. pp. 54-57, 130)

On this analysis, to fund a 20% wage rise would require a 15.8% fee increase for a small NFP provider but a 10.9% fee increase for a small for-profit provider. To meet a policy objective of a wage increase not leaving families worse off, a CCS offset would need to vary by income, fee and by type of provider, making it highly complex and not feasible to administer via the CCS.

Table 2: CCS Rate Increase needed for families to not be worse off – small & medium providers

	Fee increase	**90% CCS**	**80% CCS**	**70% CCS**	**50% CCS**
NFP	15.8%	1.6%	3.2%	4.8%	7.9%
FP average fee	10.9%	1.1%	2.2%	3.3%	5.5%

For a family on 90% CCS, a 1.1% CCS rate increase would be needed to cover the additional out of pocket cost of a wage increase in a private small or medium sized provider, but a 1.6% increase would be needed in a NFP provider. This would double for a family on 80% CCS, treble for a family on 70% CCS, and so forth. Whatever new CCS rate was set, there would be families over compensated and under compensated.

The impact of very large fee increases to fund wage increases could also impact on service viability, particularly as fee increases would be largest for smaller NFP providers.

Services with the highest fees and lowest wage expenditure would have the smallest fee increases to cover costs, while services with the lowest fees and highest wages shares would have the biggest increases. Community-managed ECEC services in disadvantaged communities would be most adversely impacted.

The impact also varies by fee. Wages are a lower percentage of costs for a high fee service than a low fee service. The fee increase required would thus vary dramatically across the fee range.

Under Family Assistance Law the CCS rates apply to all providers, regardless of if they have agreed to an enterprise agreement incorporating a wage increase or not.

This is a key difference between the approach to increases wages in the aged care sector (where the award rates are being increased for all employees) and ECEC (where the mechanism is enterprise bargaining and does not apply to all employees). Current scope for a wage increase only includes centre-based day care but Family Day Care (FDC) and Outside School Hours Care (OSHC) are both also subject to the CCS.

This analysis assumes that full compensation of a wage increase is applied through the CCS, that is, that the fee is below an (adjusted) hourly rate cap. But some fees are more likely to be above the hourly rate cap – nursery rooms are more expensive to run than preschool rooms, shorter sessions (9 and 10 hour) and inner metro services are more likely to exceed the hourly cap. Families with a fee above the hourly rate cap may not be fully compensated for the increase in wage costs.

For these reasons, Goodstart and other ECEC providers continue to advocate that funding of a wage increase should not be through the CCS and instead be funded directly from Government to providers.

A summary of the advantages and disadvantages of funding a wages subsidy through the CCS is below.

Table 3: Advantages and disadvantages of funding a wage increase through the CCS

Advantages	Disadvantages
Easiest to implement – utilises an existing funding mechanism, IT infrastructure and systems	**Implementation risk:** Would require separate CCS rates and caps for employers who are eligible for the wage subsidy. Employers not eligible, FDC & OSHC would continue on the current scale – challenging as CCS rates attach to the family not the provider. Complex changes to CCS can have a long lead time. If a flat rate CCS change was adopted, it would require acceptance by Commonwealth of risk of free riders, i.e. those benefiting from increased rate caps (fee revenue) without passing on wage rises, OR making the wage rise a requirement of CCS via an additional condition on Approved Provider status. **Family experience risk**: Fees would need to increase substantially, resulting in families bearing some of the cost of wage increases. If CCS% were altered to absorb the knock-on cost to families of the fee increases, families would need to understand complex CCS changes to ensure they were not worse off. As the CCS rise would be a flat rate, undercompensated providers (including many NFP providers) would have to raise fees above the 'average'. Birth to 3 rooms may face higher fee increases as wage costs are twice as high as 3-5 rooms due to NQS ratio requirements. If there was to be a two-track CCS system for those passing on/not passing on wage rises, a family may receive different % levels of support if they have children attending two different long day care centres, or a long day care and an OSHC. **Perverse incentives:** In a two-track system with providers applying the wage rise accessing the higher rate caps, they would also be advertising fees 10-20% higher than those that didn't, creating perverse market incentives for families to choose services where workers receive lower wages.

Supply-side top-up: Grant-based funding – best option short-medium term

In the short term, funding for a wage increase would need to be supply-side grants based, either based on a report of wage costs or a reasonable averaging approach based on attendances. This could be delivered through the Business Grants Hub[1] or one of the Federal Department of Education's established wage subsidy schemes, such as Workforce Australia[2] or ADMS.[3]

A flat rate per attendance would be similar to the Early Childhood Teacher Supplement paid by the Victorian Government.[4] Attendances are already reported to the Department through the CCMS. Funding would then be through a grants mechanism to the provider on a monthly or fortnightly basis. The funding rate could draw from the ACCC reports on wage costs, expressed as a percentage of average hourly fees, with higher rates for NFP providers than for-profit providers, given the different wages as a share of costs identified by the ACCC. Consideration could be given to higher rates for birth to three attendances than three to five attendances, given the higher labour costs for these rooms due to higher ratio requirements.

Inevitably, there will be 'unders' and 'overs' for an attendance-based payment. The Government may need to allow providers to manage the risk of this at the margins through their fee decisions. However, fees should be monitored to ensure that providers do not use the opportunity of increased wages costs to also increase margins. Some of this could be ameliorated by negotiating adjusted rates for particular providers who can demonstrate disadvantage (e.g. maintaining higher qualification mix due to quality and workforce supply reasons).

[1] https://www.industry.gov.au/government-government/grant-design-and-delivery-services
[2] https://www.dewr.gov.au/wage-subsidies see also ANAO report on wage subsidy schemes https://www.anao.gov.au/work/performance-audit/use-and-administration-wage-subsidies
[3] https://www.australianapprenticeships.gov.au/about-adms
[4] https://www.vic.gov.au/kindergarten-funding-guide

Table 4: Advantages and disadvantages of funding a wage subsidy through a grants mechanism

Advantages	Disadvantages
Would not require a fee rise by providers – so increased cost not borne by families Could be built on attendance data already provided to the Department. Could reflect differential rates for 0-3 and 3-5 rooms reflecting the higher wage costs. Could allow for differential rates to be negotiated at a provider level (by exception), where justified. Employers already paying above award could choose to meet the % increase (i.e. absorb part of the wage increase while passing on the extra funding in full to employees) or apply the % increase to current above award rate Similar to Vic Govt ECT Supplement	A flat rate only provides full compensation where all providers are rostered exactly to NQF ratios at the same wage rate – which is not usual practice in LDC. It would not account for higher wage costs when rooms are not full, (i.e. any utilisation not fully aligned with ratios) or for loadings for overtime, casual or shift work. It would not account for providers that staff above NQS qualification ratios or adult:child ratios (unless such providers were allowed to apply for a differentiated rate on quality/inclusion grounds) Providers may still need to adjust fees at the margin to account for 'unders' and 'overs'. Would require new funding mechanism built on reported attendances with payment in arrears fortnightly. Accounting for child absences could be complex as the staffing cost impact for an absence varies depending on rostering alternatives available.

Funding should be passed on in full to employees

A condition of funding should be that the employer agrees to an industrial instrument, which guarantees the funding is passed onto their employees within a set timeframe (or that the agreed wage increase has already been paid to employees, for payments in arrears). In the short term, that is likely to be through an enterprise agreement:

- A single enterprise agreement covering one employer (e.g. Goodstart, C&K, Uniting NSW, Lady Gowrie Tasmania, and SDN are employers that currently have single enterprise agreements);
- A multi-employer single interest agreement (e.g. the Professional Community Standard Agreement covering 60 community ECEC services in Victoria);
- A multi-employer supported bargaining agreement (i.e. an agreement is currently being negotiated across 60 providers with potential to include more providers later).

Employers should not be forced to move from their current agreement to a single, multi-employer agreement. This would be contrary to the objectives of the Fair Work Act and could also unravel employment conditions favouring either employees or the employer built up over many years. Goodstart is currently negotiating our fourth EA since 2012, building on the base of above award wages and conditions and operating arrangements in our previous EAs. We would not want to reduce or lose any of the agreed conditions.

In the longer term, it may be that award rates are raised to a level that properly reflects the value of the work performed by educators, having particular regard to the gender equity objectives of the Fair Work Act. This would require a work value/pay equity case to be pursued in the Fair Work Commission, either at the application of a union or the Commission itself. Such a case is likely to be long and complicated and would be unlikely to be successful without a commitment from the Federal Government to fund the outcome.

The aged care work value case, for example, was originally filed in November 2021, and has been running for more than three years already, with final wage determinations yet to be paid.[5] Given the most recent decision in that case, the sector could be cautiously optimistic that the application of the Commission's revised approach to gender undervaluation in the award system may lead to a substantial increase in wage

[5] https://www.fwc.gov.au/hearings-decisions/major-cases/work-value-case-aged-care-industry

rates in ECEC. However, any such outcome may be years away and, in the short to medium term, wage increases are more likely to be determined through the enterprise bargaining route.

Direct funding of wage supplement: best option longer term

In the longer term, funding for the 'top-up' wage increase could be calculated based on actual payroll reporting and automated through third party software providers through the Child Care Management System (CCMS) or a similar system. This could be implemented in time for the next iteration of the multi-employer EA, and when the appropriate IT systems have been developed.

Rather than an attendance-based methodology, direct funding of the top-up wage increase would be paid to employers as a wage supplement based on actual payroll reporting. This could be gross eligible payroll (with funding then in accordance with an agreed percentage supplement) or reporting of actual hours worked at each wage level. The wage supplement could be paid fortnightly or monthly in arrears and should include an allowance for on-costs.

Either option could be supported by automated, auditable reporting through an online payroll system, such as SAP (Goodstart) or Xero (small providers), direct to the Government in a similar way to how providers currently report fees and attendances through third party software providers. Payroll programs like SAP can provide any report on hours and salary levels required by Government for payment. Longer term, the funding system may even be brought into scope for the Single Touch Payroll system managed by the ATO. However, this would be a longer-term ambition and it is unlikely it would be able to be included in the current, medium-term scope for the STP program.

Importantly, the vast bulk of wage costs would still be met by the employer (i.e. current wage costs), encouraging employees to be efficient with labour rostering within their fee revenue. Providers would also be able to offer employees higher wages, however, any additional amount would need to be funded by the provider (i.e. from fee revenue). Longer term, the system should be flexible enough to manage the funding stream not just from future enterprise bargaining rounds (beyond the current agreements being negotiated)[6] or a revision of award rates following a work value/equal pay case in the Commission, but also could potentially cover future annual increases in award wages. By directly funding annual national wage case award increases, the wage supplement could reduce annual fee increases by 60-70%.

Table 5: Advantages and disadvantages of funding a direct, automated wage subsidy through CCMS

Advantages	Disadvantages
Would tie funding direct to increases in wages paid. Would not require any fee increases, with wage cost increases fully offset. Could build on existing third party payroll systems. Would provide a strong audit and reporting trail. Would be flexible dependent on risk appetite of funder, i.e. based on an agreed % of eligible payroll, or on reporting of actual hours at actual wage levels. Reward actual pay rises and staffing choices – the right incentives.	Would require Government to build a new funding mechanism, which could delay a wage rise. Would need to be supported by effective online wage calculators to ensure compliance. Could place pressure on third party software providers and on providers with manual payrolls. IT systems risks are hard to quantify - could be a significant administrative burden for providers and the Department

[6] It should be noted that the wage rates in an enterprise agreement continue to be payable beyond the nominal expiry date of an agreement until a new agreement is struck.