POLICY NOTE

GOVERNMENT FUNDING OF SKILLS

Introduction

This note aims to set out the main high-level issues which need to be considered when designing systems for government funding of skills. It attempts to outline the options available to policy-makers and to discuss their various advantages and disadvantages.

There are distinct stages in designing funding systems. They can be summarized as follows:

- objectives; what is the aim in providing public funding. Is funding actually necessary?
- beneficiary group; who is it intended should benefit from the public funding?
- management of programme; which government departments, agencies or local units should be responsible for the good management of the programme?
- source of funds; should monies come from general taxation, local revenues or levies on industry?
- budgeting; how will we estimate how much money is adequate, and that unnecessary expenditure is avoided?
- allocations; funds usually need to be allocated geographically, and/or by sector;
- funding scheme; how will funds be allocated to beneficiaries?
- controls and monitoring; how will it be established that the funds have been used as intended?

As we shall see, these issues interact with each other. At the end of the day a whole system needs to be made operational, which may mean compromising on one aspect in order to achieve the best solution on the other (for example, the need for financial controls may mean that a non-bureaucratic system for passing funds straight to enterprises or individuals is unworkable).

A basic point – who benefits from skills training?

Before considering these individual issues we need to bear in mind a matter which underlies a lot of policy on skills. Three different parties may benefit from training:

- individuals, who can obtain better, higher-paid jobs;
- employers, who can achieve better productivity and higher-priced products;
- governments, who have richer firms and individuals paying more taxes, enabling more services to be provided for society in general.

However, this three-way pattern of benefits does raise questions about who should pay for training. If individuals benefit, then they should pay. The same applies to firms. It might be argued that government need not pay for training at all, since this could be left to the 'free market'. If firms or individuals do not think a certain type of training is worth the costs, then it may well be that it is not. Indeed many areas of skills training in many countries are not supported with public funds at all.

However in many cases governments have decided to fund training. This can be for a number of reasons, for example:

- certain individuals may not have the resources to pay for training, and are not credit-worthy to enable them to borrow;

- firms prefer to attract workers who are already skilled rather than undertake training themselves. This also acts as a disincentive for firms who might consider training, as they risk losing the workers they have trained in new skills;
- the government wishes to accelerate industrial change (replacing unproductive older industries with new ones) and to lessen the effects of change on individuals;
- there is evidence of systemic under-training which the government wishes to correct.

But even where the government does choose to help funding, the fact that firms and individuals will benefit may mean that they can also participate in the funding, for example through firms meeting a share of the costs, individuals accepting lower pay during training, or repayment of loans after more productive work has been secured. As well as reducing the costs to the government, involvement of firms and individuals means that training is more likely to be relevant and efficiently provided.

Training which is broader, and applies to a number of jobs, is more likely to benefit individuals than job-specific training which applies only to a single employer. For that reason governments tend to avoid meeting the whole of the costs of job-specific training for which employers will enjoy most of the benefits.

Objectives

There are many different objectives that governments may have in providing public funding to support training. Typical aims are:

a) to introduce or extend the vocational preparation of young people to ease their passage into work;
b) to help unemployed people find work;
c) to assist industrial restructuring (replacing old industries with new ones), or to help the development of depressed regions;
d) to encourage desired industries (for example as part of a national economic plan);
e) to raise the general level of productivity within the economy.

Though it is perfectly reasonable to have more than one objective for a funding programme, it can be confusing to do so. Usually it will be better to pursue these objectives with different programmes, designing funding rules, beneficiaries and agencies involved in the light of the particular objective for each one. For example, schools and colleges are likely to involved in (a) and may be the recipients of funds, while sectoral bodies may have a role to play in (d); schemes to assist industrial restructuring or regions (c) are likely to be limited to specific times and specific locations, while more general encouragement of modernization (e) will have a longer-term time frame and may be applied nationally.

Beneficiary Group

The objectives for a skills programme will usually indicate the beneficiary group. The aim will be to increase the skills of individuals, but the type of individual will be important in designing funding rules and in considering which agencies or organizations are most likely to have access to that beneficiary group and so be able to channel funds for their training. Typically there are three potential beneficiary groups for government-funded training:

- young people in transition to the labour market. Funding programmes for these will typically be fairly generous (because young people have little ability to raise or borrow money), focus on broader skills (because it will not be known which firms a young person will work with in their future careers), and may combine skills with continuing education. Education providers are likely to be involved and may be funded on behalf of their students;
- unemployed people seeking work. Training for the unemployed will often be an option in a range of 'active labour market policies' which include coaching in job-search, periods of work experience etc. Funding will be likely to meet the full costs of training since the unemployed will have little ability to fund training themselves. Funding is likely to be targeted at particular people and particular skills which have the most likelihood of resulting in work in the short-term;
- employed adults. Few governments provide funding for up-skilling of the general employed population. This is left to employers and individuals to arrange and fund for themselves. However, it may be that particular sectors or regions are selected for special treatment. Even in such cases public funding (or tax incentives) is likely to be available for only a small proportion of the costs, and decisions about particular training courses are left to firms or individuals (who are likely to be careful in their choices as they will bear most of the costs).

Programme management

Once we are clear about the objectives and beneficiaries of a funding programme, it is time to consider which governmental unit will manage it. Programme management is essential: some organization needs to design the rules and modify them over time, to estimate and hold the allocated budgets, to set targets and monitor delivery so that funds are properly and efficiently used, to take account of representations that will always be made from many stakeholders when public money is on offer, and to arrange evaluations of the programme to see whether they are meeting their objectives in the most effective way. If funds are allocated centrally, the programme manager will have regular dialogues with the Finance Ministry about future budgets, numbers of beneficiaries, results and changes in funding rules.

A government department may be the programme manager. For programmes for the unemployed this will typically be the Department of Labour or Social Security. A Department of Labour may be responsible for programmes for young people, though another obvious possibility is the Department of Education. In the case of programmes for selected industries it may be that the Ministry for Industry will be most appropriate choice, particularly if training is a component of a more general package of assistance for chosen sectors (for example loans for new machinery).

In some cases a government agency will be the right choice (for example, an Employment Service Agency), though such agencies will normally be accountable to a ministry.

It might be appropriate to place some or most programme management responsibilities to regional or local bodies (eg. local governments). In such cases it needs to be clear whether they are accountable to a central government department for the use of funds, or whether they have a licence to disburse money on their own account (eg. from revenue they have raised themselves and/or under their own legislative competence).

It may make sense to group different skills programmes together under a single organizations (a Skills Agency). This will allow better co-ordination and a strategic view over the whole governmental effort on skills, balancing one programme with another as circumstances change. However it can give rise to remoteness and lack of balancing with other policies; for example, if skills funding for firms is located within a Ministry for Industry, decisions can be taken about the relative priority to be given to training compared with programmes for investment in equipment; moreover paperwork and promotional materials for each programme can be combined.

Decisions on responsibilities for programme management will be greatly influenced by the respective strengths of various organizations; some will be better established, with sounder administrative capacity than others.

Sources of funds

General national tax revenues are the most obvious source of finance, and are frequently used. However they are not the only possible source of funds.

Co-funding arrangements are often possible, for example:

- combining funds from central government with those from local government. Where education is the responsibility of local government, it will often make sense to expect a local contribution to efforts to improve vocational training for young people, who would otherwise attend regular schools.
- in emerging economies donor funds can often be employed to supplement monies from government. In these cases care needs to be taken to ensure there is a common understanding about aims and the way in which expenditure is to be controlled.
- as has already been mentioned, it will often be helpful to build a requirement for contributions from employers, and sometimes from individuals, into the design of a funding scheme. This can be done either by asking for a monetary commitment, limiting government funds to specific items and leaving others (eg. wage costs or subsistence allowances) to firms, or simply ensuring that the government contribution is less than the costs of training so that others must make up the difference.

A number of countries have 'levy-grant' schemes. Under these arrangements employers are obliged to pay a payroll tax into a dedicated industry-wide fund, from which they can draw funds for approved training. The idea underpinning these schemes is that those employers who train will gain revenue at the expense of those who do not (and who otherwise benefit from attracting skilled workers from the employers who train). As well as providing a source of funding, these schemes are intended to encourage firms to train as they gain if they do, and lose if they do not.

Levy-grant schemes are usually based on industry sectors (because costs of training vary greatly between industries). Their main disadvantage is bureaucracy; administering the sectoral funds fairly gives rise to costs, and employers need to complete paperwork on the training they do in order to reclaim costs – the average employer who trains adequately for their own needs will need to pay the payroll tax and then complete forms to claim the same money back, with no obvious gain either to the firm or to the economy generally. Governments may need to contribute funds either to help meet the administrative costs or to supplement the funds when there is a general economic downturn.

Budgeting

Estimates need to be made of the amount of funds which are needed to achieve the objectives. Of course it is normal for funds to be limited, in which case decisions will be needed to modify the objects and associated targets. Typically this involves negotiation with the Ministry of Finance and with politicians. Trouble can be caused when political leaders promise more than the funds are able to support.

Essentially budgeting involves two elements:

- unit costs: how much does the average training cost? This can be estimated through examination of existing costs (for example, of vocational schools or charges by private training providers), and – where subsistence allowances are made to individuals – of wage levels or social security rates. The duration of training is a key element as costs will be closely related to this; estimates should take account of some rate of early leaving. If contributions are expected from employers or individuals, these will offset the overall unit cost;
- volumes: how many people are to be trained? This will depend on the client group and some proportion of the people who are eligible for training will be assumed. Where that proportion is low, then consideration will need to be given about either restricting eligibility (for example, by placing limits on age, a minimum period of unemployment or size of firm) or giving guidance as to how local decision-takers are to select amongst the eligible clients.

Volume assumptions should be used as targets for monitoring once the programme is operational. If the budget is fully used but volumes are less than projected, then this means that unit costs are exceeding the estimates with implications for expenditure in future years.

Other elements may need to be added. It may be necessary to fund or support capital costs for new buildings and equipment, and for the training of trainers. These should be treated as separate items as they will not usually need to be repeated for each year.

When a training programme is new or expanding it will be necessary to take account of delays between training activity and the claims for funds, as in most cases providers will claim after training has taken place.

As funding programmes roll forward year by year adjustments will need to be made to budgets and associated targets. Periodic reviews of unit costs will be needed – there will always be representations by firms and providers that they are too low! It will be reasonable to expect regular 'efficiency gains' with a gradual reduction in unit costs each year as providers become more effective. On the other hand, inflation in costs will also need to be reflected.

Volumes should be monitored regularly, and the budgets for future years will need to reflect lack of take-up or variations from the assumptions of early leaving.[1]

1 When a programme starts it very often 'underperforms' with less take-up and expenditure than anticipated. This is because policy-makers very frequently over-estimate the speed at which firms and individuals respond to new opportunities and the fact that administrative systems take time to put in place.

Allocations

Once we have secured an overall budget, we need a way of distributing it to potential beneficiaries. In cases where the budget is national, and where local areas (eg. local governments or employment offices) will be responsible for selecting beneficiaries, the budget will need to be divided amongst them in order to ensure a fair distribution of funds. There will certainly be representations if some areas get much less than others for no good reason.

There will be many ways to divide the budget. The most obvious way is to use a relevant statistical indicator, preferably one which is publicly available so as to make allocations transparent. In choosing an indicator it is best to select one which is relevant to the target client group, for example:

- for vocational training for young people, the numbers aged 14-21 in each area, perhaps subtracting those that undertake academic higher secondary and university courses.
- for training for the unemployed, the numbers claiming unemployment benefits or perhaps those who have been unemployed for more than a given period (eg. six months).
- for schemes for employed workers, the numbers in employment, or those in certain sectors if the fund is designed to be concentrated in particular industries.

Indicators can be combined into a formula. For example a multi-objective fund might be allocated to each area 50 per cent on the basis of unemployment and 50 per cent on the basis of eligible young people. Where statistics do not exist for the precise client group some relevant available indicator can be used.

As a programme continues into subsequent years adjustments can be made in the light of:

- increases or decreases in the overall national budget;
- changes in the distribution of the client group (for example if unemployment in an area falls significantly).

The combination of these factors can give rise to undesirable short-term volatility in certain areas (eg. when there is a decrease in the national budget and a reduction in the client group). In such cases it may be necessary to build in methods for dampening large changes, for example a rule that no area will gain or suffer more than a 10 per cent change in funding in a given year.

It may be sensible to hold back a proportion of the national budget for distribution in the middle of a year, to cater for unexpected demands (eg. sudden closures of large factories).

Funding scheme

How will funds actually be distributed to beneficiaries? There are two basic models:

a. a discretionary scheme, where a local decision-taker will decide which firm or individual is to be selected for help, agree a training plan with them (and with a provider of training), agree the costs involved and make payments when those costs have been incurred;

b. a formula-based scheme, where rules are published in advance about eligibility of firms and individuals, types of training which will be funded and rates of funding.

The advantages of a formula-based scheme are that firms and individuals are clear about what is, and what is not, eligible for funding and will self-select, thus reducing administration. It will also reduce suspicion of favouritism by officials and can be seen to be fair to all. The problem with such a system, though, is that funding commitments can be open-ended, so that expenditure can over-run when the eligible client group is large. To avoid this, sudden cut-offs can be put in place (when funds are exhausted), but this is disruptive and gives rise to considerable frustration on the part of those affected.

In practice a pure formula-based scheme is probably only worth considering when either a discretionary scheme has been used for a number of years and there is good knowledge about take-up, or where the aim is cater for the whole of a new client-group (eg. vocational schools being able to mount six-month courses for any unemployed 15-18 year old).

In the case of a discretionary scheme, guidance will be needed for those making decisions about who is to benefit and what kind of training is eligible for funding. Such guidelines may be more or less detailed, and will probably be elaborated as experience is gained within the administrative machinery. They will probably include:

- firms or individuals who are eligible, together with indications of the priority to be given within the eligible group;
- maximum duration of training;
- maximum rates payable to training providers or employers (per week or per month);
- types of training which are not eligible (eg. driving lessons);
- restrictions on the type of training provider (eg. those accredited to deliver formal qualifications, publicly recognized training centres etc.)

It will help if such guidelines are published. This lowers the risk of accusations of favouritism, and (like formula based schemes) leads potential beneficiaries to self-select, thus reducing administrative costs and frustration about fruitless applications.

It can be seen that a discretionary scheme with published guidelines can develop over time into a formula-based arrangement.

Decisions also need to be made about what elements of training will be funded. The simplest scheme in principle will be to refund costs. Eligible costs might include training fees to providers, subsistence allowances, travel costs, the costs of necessary tools and safety clothing. However a cost basis for funding has limitations:

- it does not encourage efficiency – beneficiaries have no incentive to find the most cost-effective solution, and providers have obvious incentives to raise fees;
- it is difficult to apply to in-company training, since no fees to training providers are paid and items such as equipment, supervision etc. are used for production purposes as well. In-company training, however, might well be the most efficient method, since only marginal costs are incurred and training is likely to be up to date and relevant.

While a simple cost re-imbursement basis might be suitable for small-scale one-off training interventions, it is unlikely to be the best solution for a large, on-going training scheme. Instead a set-rate scheme is likely to be more suitable. Here standard rates are set for each week or month of training. These rates may be different for different types of training (engineering training is more expensive to deliver than training for office-workers, as involves more equipment and materials) and for different types of worker (younger, long-term unemployed or disabled people might attract higher rates).

Sometimes duration-based funding schemes have an element for completion of training, to discourage early leaving or an element for the attainment of a formal qualification to act as a mark of quality assurance. Training schemes for the unemployed often contain an element which is paid when an individual is placed in regular work (sometimes after a given period of successful employment). These payments for outputs are intended to act as incentives for quality and effectiveness, but they do involve the need for additional checks and if they are set too high can distort behaviour on the part of training providers – for example selecting only those candidates most likely to succeed, the creation of 'artificial' temporary jobs, or making short-cuts in the procedures for the award of qualifications.

It is of course possible to combine a set-rate scheme with provision for special exceptional payments made on a cost basis, for example for unusually high travel costs, special tools or clothing, or adaptations needed for disabled people.

Controls

Once it has been decided to fund a firm, individual or training provider, we need to ensure that the monies are properly spent. Unlike the provision of goods, training is typically carried out in a way which is not easily visible to the funder, so procedures need to introduced which give confidence that what is expected to happen has actually happened.

The first step is to ensure that there is a common understanding between the funder and the beneficiary (or training provider) about what activities will be supported, what evidence will need to be given, what monies will be paid and when. This will normally take the form of a written agreement or contract (though it can take the form of government regulations).

The controls will reflect the funding scheme, and both should be designed together. If a cost-basis scheme is used, then invoices for costs incurred will be expected and should be presented before re-imbursement. For a standard-rate scheme, evidence of trainee attendance will be needed (eg. a signed register). If an element of funding is for outputs, evidence of certification and/or job attainment will be necessary.

It may not be necessary for comprehensive documentation to be sent to the funder with each claim, but rather a declaration that the claimant holds the relevant documentary evidence and that it is available for inspection. Periodic 'spot-check' inspections should be carried out, preferably at short notice. These should not only involve examination of the documentation, but also include some 'proof of life' checks that the trainees signed in for that day are actually present.

As well as spot-check financial inspections there may be a case in long-standing funding schemes for quality assurance visits by experienced training inspectors. Such arrangements are common in state education and can be used to identify and spread good practice as well as to eliminate inadequate training providers.

A higher level of control involves monitoring. This involves collecting and reviewing administrative statistics on the progress of the programmes. Figures for starts training months claimed, should be easily available. It is important to collect these promptly and to compare them with the budgetary estimates as they will give early indications as to whether expenditure is likely to conform with the budget.[2] They will also indicate whether the targets originally assumed are being met. Data on course completions, and results for trainees (qualifications gained, outcomes in terms of jobs or progress to higher-level training) are rather more difficult to obtain reliably and promptly. If there are problems

2 average length of training can be computed from data on training months and trainee starts.

in getting these from administrative sources, then sample surveys of trainees after the end of their courses may prove a valuable source of regular evaluative information.

Data from monitoring can be used at all levels of the programme. At provider level it will indicate whether the volumes anticipated in contracts are being fulfilled or whether that provider will 'undershoot' (in which case funds can be switched to another provider). Similarly national authorities will be able to determine the relative performance of regions and localities. And early monitoring data from the current year (as well as those from past years) will help contribute to the framing of budgets for future years.

Other ways of promoting training

This note has been concerned with programmes which directly fund training activity by individuals or within firms. There are many other methods by which governments can support vocational training in an indirect way and at comparatively little cost, for example:

- giving specific grants for modern equipment in schools (in many countries vocational school equipment is badly outdated);
- supporting the training of trainers within industry;
- running skills competitions and making awards to give public recognition to firms which undertake good training;
- supporting interchanges between instructors in vocational schools and supervisors in industry;
- funding staff time for vocational schools to arrange placements for students within industry and commerce;
- tax incentives for firms which train;
- loan guarantees for individuals who want to borrow to fund their own training.

Many countries have developed schemes of this type to supplement their main training programmes.

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Employment and Skills cluster works with the government of the Republic of Indonesia and social partners with the aim of improving skills development systems and promoting Decent Work for all. In particular, the team promotes: industry-TVET collaboration; e-/distance-learning; revitalization of national skills development systems; and women's access to TVET and employment.

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