

# The Treasury

## Budget 2011 Information Release

### Release Document

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## **Vote Education (Tertiary Education)**

# Four-year Budget Plan

Version 2

10 February 2011

Submitted by:

**Ministry of Education**

## Section 1: New baseline and summary of changes

### Direction of Change

1. We intend Budget 2011 to continue in the direction established in Budget 2010 – making the tertiary education funding system more responsive to changes in demand and improving the value of the Government’s investment in student support.
2. The Minister for Tertiary Education has indicated that new funding is not anticipated for tertiary education in Budget 2011, [2]

This might influence the timeframe over which we can make progress on some tertiary education priorities, depending on the phasing of reprioritisation. Funding will need to be shifted between years and/or subsectors (along the lines of the recent reallocation of funding from industry training to universities) in order to achieve the Government’s tertiary education priorities and to respond to changes in demand.

3. The Government wants to see more people, and particularly young people, Pasifika and Māori, achieving qualifications at higher levels. Foundation education needs to give people skills that lead to employment or higher education, and vocational education has to provide high quality qualifications that are relevant to the skills that employers want.
4. The major pressures on tertiary education funding are demand for places (particularly during the next two years), providers’ cost pressures, and the relatively high cost to the Government of lending through the Student Loan Scheme.
5. In the recent past, the Government has responded to cost and demand pressures by purchasing more student places and providing across-the-board increases in subsidy rates. [2]  
the Government will need to be more selective in how it responds to cost and demand pressures. For example, the Government will need to focus on meeting demand for higher-value study by reallocating funding away from low-demand and low-value programmes.
6. [2]

## Overall Impact

Operating	Impact (\$000s)				
	2010/11	2011/12	2012/13	2013/14	2014/15
Current Baseline	2,768,224	2,744,940	2,740,938	2,736,738	2,739,270
Cost of new/increased activities	TBC	TBC	TBC	TBC	TBC
Amount reprioritised	TBC	TBC	TBC	TBC	TBC
New baseline	2,768,224	2,744,940	2,740,938	2,736,738	2,739,270

Capital	Impact (\$000s)				
	2010/11	2011/12	2012/13	2013/14	2014/15
Capital proposals seeking new funding in Budget 2011.	-	-	-	-	-
Capital proposals seeking decisions in Budget 2011 funded within baselines.	-	-	-	-	-
Total capital intentions	-	-	-	-	-

## Section 2: Vote Priorities and Pressures

### Tertiary education priorities

7. Education and skills are two of the drivers that will improve New Zealand's economic performance and support stronger, real growth in the future. People with higher-level qualifications are more likely to be employed and earn higher salaries than those people with low or no qualifications.
8. Tertiary education needs to respond flexibly to long-term industry and professional skills requirements. The tertiary education system also has an important role in encouraging the evolution and growth of industries by supporting innovation.
9. To this end, these are the Minister for Tertiary Education's priorities for 2011 and beyond:

- *Tertiary funding systems that more effectively promote government priorities*

Given the current fiscal constraints, the Minister for Tertiary Education will be focusing on getting better value from current levels of expenditure. A key part of this will be ensuring funding settings are aligned to achieve government priorities.

- *Improving information systems for better tertiary decisions by funders and students*

Work is underway to make the Government's tertiary education information more accurate and timely. The Minister for Tertiary Education also wants to continue to make more tertiary education information publicly available, to better inform students' study decisions.

- *Vocational education that provides relevant skills for employment*

Vocational education needs to be responsive to employers' demand for skills, and deliver relevant, high quality qualifications. The Minister for Tertiary Education has reviewed the ITF baseline as part of Budget 2011 and, in the medium term, will be considering the underlying policy settings for Industry Training and Modern Apprenticeships.

- *Foundation education that provides essential skills for participation in the economy*

Progression rates from formal and lower-level certificate study need to improve, because the more substantial benefits come from tertiary study at levels four and above rather than from foundation-level study. [2]

- *Improving the management of the Student Loan Scheme*

Given the importance of the Scheme to the Government's fiscal position, the Minister for Tertiary Education wants to see the Scheme better managed and its value increased by ensuring study funded by loans will contribute to tertiary education priorities, and by improving borrowers' repayment rates.

- *Improving student welfare*

The Government has set an expectation that tertiary providers will focus on improving pastoral and academic support to ensure that students have the maximum opportunity to succeed.

- *Supporting quality research that helps to drive innovation*

The higher education sector is a major source of research in New Zealand that helps to raise firm productivity by developing and adapting innovative ideas and processes. The sector also expands the research and development workforce through research-based qualifications, and increasingly these are providing innovators as well as researchers. [2]

- *Stronger growth in international education*

International education contributes at least \$2.2 billion to the economy each year. With demand for international education growing, and students being increasingly mobile, the Government has a good opportunity to expand the international education sector. The establishment of a new international education Crown Agent will support and contribute to a marked expansion in the value to the economy of international students and other aspects of export education.

### **Lowest value programmes, relative to government priorities**

10. The more straightforward reprioritisation decisions, such as simplifying the funding system by disestablishing small funds and reducing capability funding, were pursued in the previous two Budgets (summarised in the tables below). Thus the lowest value areas of tertiary education expenditure are now, for the most part, programmes which have desirable policy intent, but which are not cost effective, or providing adequate value for money.

#### **Tertiary education Savings – Budget 2009**

<b>Savings initiative</b>	<b>Four-year total savings</b>
Scholarships	\$98.089m
Disestablish small funds	\$37.375m
Phase out CPI adjustments for tertiary education funding	\$172.800m
Reducing tertiary education capability funds	\$117.093m
Reducing low priority tertiary provision	\$87.434m
Removing growth in literacy, language and numeracy	\$94.300m
Streamlining the Tertiary Education Commission	\$31.425m
International education (education counsellor network; export education innovation programme; scholarships; domestic status for German and French Masters students)	\$29.100m

## Tertiary education Savings – Budget 2010

Savings initiative	Four-year total savings
Aligning Student Achievement Component rates for Other Tertiary Education Providers with Private Training Establishments	\$2.433m
Reprioritisation of tertiary education organisation component	\$221.934m
Two year stand-down for student loans for permanent residents and Australians	\$79.284m (operating) \$181.746m (debt impact)
7 EFTS student loan life-time limit	\$0.408m (debt impact)
Changes to the Student Loan Scheme administration fee	\$65.065 (operating) \$7.575 (debt impact)
Student loan performance element	\$137.836m (operating) \$271.449m (debt impact)

11. The focus is now on ensuring large areas of expenditure are configured and targeted to maximise their cost-effectiveness. Four examples are outlined below.
12. The performance of the Industry Training Fund (\$135.7 million in 2010/11) is being improved, with new funding and operational rules coming into effect in 2011, funding no longer available for short duration health and safety and regulatory compliance programmes from 2012, a minimum industry cash contribution to each Industry Training Organisation (ITO) from 2013 onward, and tighter constraints on the programmes that will be funded at levels 1-2. The Minister for Tertiary Education has also asked officials to undertake a fundamental review of Industry Training and Modern Apprenticeships during 2011.
13. The Student Loan Scheme is relatively costly. New lending costs the Government 45 cents in the dollar, although this has reduced from 49 cents in the dollar following changes in Budget 2010. The Scheme needs to be managed better, given the size of the asset and its impact on the Government's books. The changes made in Budget 2010 tightened eligibility for the Scheme, including the introduction of a performance element, which will improve the return on government expenditure on the Scheme. As part of Budget 2011, the Minister for Tertiary Education will be considering changes to improve borrowers' repayment rates and deter low-value borrowing, which will improve the value of the Student Loan Scheme.
14. Tertiary education provision at levels 1 and 2 – foundation education – is most valuable when it includes literacy and numeracy learning and leads on to study at levels 4 and above. Although the quality of foundation education has improved in recent years, it is not providing an adequate return on the Government's investment. The Minister for Tertiary Education has agreed to policy settings which, from 2013, will clarify the purpose and improve the cost effectiveness of provision at levels 1 and 2. [2]

### **Tertiary education expenditure: major pressures and cost drivers**

16. The major pressures on tertiary education expenditure over the next four years are:
  - overall demand for tertiary education
  - providers' cost pressures, from inflation and wage costs
  - the relatively high cost to the Government of lending through the Student Loan Scheme.
17. Demand for tertiary education is a significant pressure over the next few years because demand is forecast to be above the funded baseline until 2013. However, in a capped funding system, excess demand does not automatically translate into increased expenditure; the Government chooses if and how to respond to demand.
18. The key variables that drive demand for tertiary education are population projections of 18-22 year olds, senior secondary school retention and achievement rates, and unemployment rates by age group. In the past couple of years, demand for Student Achievement Component-funded tertiary education has been high, as a peak in the 18-22 year old population has coincided with high rates of unemployment, especially for young people.
19. It is not just overall demand, but demand for different types of tertiary education, which drives tertiary education expenditure. Study at higher levels (post-graduate and some degree-level study) is more expensive than certificate-level study. Demand for degree-level study has been increasing in recent years – for example, funded EFTS at universities increased by 7.4% between 2005 and 2009.
20. The Government wants to see more young people studying at higher levels, but achieving this within existing baselines will require reprioritisation away from provision of lower value or with lower demand. It will mean the Government pays more per qualification, since degrees typically take longer to complete than lower-level study (although the earnings premium, and thus the human capital development, is greater for higher-level study). It may also result in the Government purchasing fewer EFTS overall, as more study at higher levels will increase the average price per EFTS that the Government pays.
21. Based on our most recent forecast, demand for tertiary education is expected to decline from 2011 onwards, as youth unemployment reduces and the 18-22 year old population group declines. However, as mentioned previously, it is still forecast to remain above the Student Achievement Component baseline for

tertiary education until 2013. Having said this, the unemployment rate, which is currently quite volatile, can have a significant impact on demand for tertiary education. If employment rates increase at a slower than expected rate over the next couple of years, we would expect to see demand for tertiary education to decline more slowly.

22. The Government subsidises the cost of tertiary education with providers charging fees to cover their remaining costs. When providers' costs, such as staff salaries, increase, this places pressure on the Government to increase the size of tuition subsidies. The removal of tripartite adjustment funding from 2011, which allowed universities to receive additional funding for staff salaries, will put greater pressure on university wages for academic staff.
23. The Government has discretion in responding to providers' cost increases, both in terms of if and when it chooses to, and by how much. Subsidy rates have typically been increased to reflect cost increases; in Budget 2010 the Minister for Tertiary Education increased Student Achievement Component subsidy rates by 2.2 per cent from 2011.
24. The initial write-down on lending under the Student Loan Scheme is a major cost to the Government. As previously discussed, new lending costs the Government 45 cents for every dollar lent. Given the size of the Scheme, relatively small changes in economic settings can have quite a large impact on the Crown's accounts. Reducing the cost of lending through the Scheme is important in its own right, but also in the context of other tertiary education policy settings. If the cost of new lending reduces, [2]

### **Management of cost pressures and associated risks**

25. In the medium term, we expect that demand and providers' cost pressures can be managed through increasing the value of current expenditure and shifting funding between subsectors, rather than through fundamental changes in system settings.
26. As noted above, managing demand within existing baselines will require more active management of provision, with funding reallocated from areas of lower value or low demand to higher value and in-demand provision. The Minister for Tertiary Education's recent decision to shift some funding from industry training to university places illustrates the approach we expect to take to manage demand in coming years.

[2]

28. The Minister has also indicated an interest in options for improving the value for money of areas of high-cost provision. For example, aviation pilot training has a high cost for the Government as students use their student loans to cover the costs of the flight hours that make up the practical component of training. Historically it has also been characterised by low qualification completion rates and unclear employment and training pathways. A new aviation qualification, in place from 2012, is expected to improve the industry relevance of aviation training and result in higher completion rates. [2]

29. In terms of responding to providers' cost pressures, we expect the Government to move away from across-the-board price increases to using price to incentivise study by particular groups or at particular levels. At this stage, the Minister for Tertiary Education is not considering an across-the-board increase in subsidy rates in Budget 2011.

[2]

33. Seeking efficiency gains from providers instead of increasing prices across-the-board in response to cost pressures will need to be balanced with ensuring that the financial health of the sector is not put at risk, and that the quality of provision is not affected. The introduction of performance-linked funding will provide an incentive for providers to focus on the quality of provision whilst managing their costs.

### **Section 3: Proposed Changes for Budget 2011 (Reprioritisation)**

#### **Potential savings**

##### *Student support*

34. Budget 2010 introduced a package of changes tightening eligibility for student loans. In the lead-up to Budget 2011, the Minister for Tertiary Education is considering options for improving collection of student loan repayments. This is consistent with Cabinet's decision in June 2010 that Inland Revenue adopt a more proactive, commercial approach to recovering overdue student loan repayments from overseas-based borrowers, initially in Australia. Potential changes in Budget 2011 are one aspect of a longer-term work programme to improve the management of the Student Loan Scheme and to reduce the cost to the Government of new lending through the Scheme.
35. Listed below are changes to the Scheme under consideration for Budget 2011. These changes aim to contain the Government's tertiary education expenditure and improve the quality of spend, in order to assist the Government to meet its student support objectives of objectives of enabling access to study while providing financial sustainability, good asset management, and equity.
36. The Minister for Tertiary Education will receive advice on the design parameters and financial implications of these options shortly. He intends to present a Student Loan Scheme package for Budget 2011 to Cabinet Strategy Committee in March.

##### *Introducing an upper age limit for student loan eligibility*

37. Officials are investigating options to restrict student loan eligibility to people over a certain age threshold. There are higher costs and a higher risk of non-repayment associated with older borrowers. **[2]**

**[2]**

[2]

Restricting student loan eligibility where repayments from previous loans are overdue

41. The Minister for Tertiary Education has agreed to not to lend for further study until the borrower has fully met overdue loan repayments, where those overdue repayments exceed a threshold, possibly \$500 or \$2500.

[2]

Amending the repayment regime for New Zealand-based borrowers

43. Changing the repayment regime for New Zealand-based borrowers could assist to meet the Government's student support objectives of financial sustainability/good asset management, and equity.
44. The student loan repayment threshold has generally been adjusted annually for CPI, but it was not adjusted for the 2010/11 tax year, in order to reduce student loan costs and increase repayments [CAB Min (09) 44/5 refers]. Cabinet has agreed to maintain the current repayment threshold for the 2011/12 tax year, and has agreed to the associated appropriation changes [SOC Min (10) 30/12 refers]. This decision will result in \$3 million per annum of savings, reflecting the expected decrease in the cost of new lending through the scheme. Officials are investigating the possibility of maintaining the repayment threshold at its current level until the fiscal environment improves, in addition to options to broaden the definition of income for repayments from New Zealand-based borrowers.

Reducing the repayment holiday for overseas-based borrowers

45. Overseas-based borrowers who are overseas for 6 months or more can take a repayment holiday for up to 3 years. Officials are investigating options to amend the repayment holiday, including looking at reducing the repayment holiday to two years or adding an application option.

*Industry Training Fund*

46. The Industry Training Fund (ITF) supports structured employment-based training arranged by ITOs. Training results in credits and qualifications linked to the New

Zealand Qualifications Framework, and should attract a cash contribution by employers and/or trainees.

47. Cabinet reduced the ITF baseline for 2010/11 from \$179.9m to \$135.7m after the ITF was under-allocated by the Tertiary Education Commission (TEC) by \$38 million for 2011 [CAB Min (10) 36/5 refers]. The under-allocation was due to falling demand for industry training in the current economic climate and an operational review of industry training in 2010 which found significant issues with the quality and performance of some industry training arrangements.
48. Cabinet noted in 2010 that the Minister for Tertiary Education would review the ITF baseline as part of Budget 2011 [CAB Min (10) 36/5 refers]. The Minister has considered advice on the appropriate size of the ITF beyond 2011, and has agreed to the following baseline for the ITF in 2011/12 and beyond:

	2010/11 (\$m)	2011/12 (\$m)	2012/13 (\$m)	2013/14 and outyears (\$m)
Current baseline (following September 2010 Cabinet decisions to remove \$38 million in 2011) <sup>1</sup>	135.7	152.2	171.6	171.6
New baseline	135.7	147.8	150.6	139.0
Total savings	0.0	4.4	21.0	32.6

49. The savings reflect a reduction in the ITF baseline of about \$9.5 million from the 2012 calendar year to remove funding for short regulatory compliance and health and safety training. The baseline for the 2013 calendar year onwards reflects the current best estimate of demand for substantive, well-performing and valued industry training from 2013.
50. Recent changes to industry training, such as the operational review, the introduction of performance-linked funding, and some tightening of key policy parameters, will focus funding allocations on well-performing training. These changes should ensure that the number of good quality outputs of the industry training system should increase over time for lower overall cost to the Government. Furthermore, the Minister for Tertiary Education has indicated to officials that he is interested in a wider, fundamental review of Industry Training and Modern Apprenticeships. Any such review would occur during 2011, and will have no implications for Budget 2011.

*Reprioritisation of tertiary education departmental expenditure*

51. In August Cabinet agreed that the Ministry of Education be designated the principal advisor to the Government on tertiary education policy [CAB Min (10) 30/4A refers]. Cabinet also agreed that there should be an “at most” fiscally-

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<sup>1</sup> Note the total Industry Training Fund appropriation also includes funding of approximately \$8m per annum for ITOs delivering literacy, language and numeracy training embedded within their training at NQF levels 1 to 3.

neutral baseline transfer of operating funding to the Ministry of Education from the TEC. \$0.803m of funding – \$0.303m in 2010/11 and \$0.500m in 2011/12 – was returned to the Crown for use in non-departmental tertiary education funding. The Minister for Tertiary Education intends to put this funding towards the Budget 2011 pressures outlined below.

### *Performance-Linked Funding*

52. From the 2012 academic year, five per cent of providers' Student Achievement Component (SAC) and Industry Training funding will be based on their performance in the previous year. Performance-Linked Funding will provide financial incentives for providers to improve the educational performance of their students. However, Performance-Linked Funding will not be used to reward high performing providers. As a result, there will be residual SAC and Industry Training funding each calendar year from 2012.
53. In theory, the residual funding could be up to five per cent of the total SAC and Industry Training Fund (ITF) appropriations. However, the system has been designed to target particularly poor performance and so in practice the residual funding will be much less than this. [2]
54. Until an event-driven tertiary education data collection system is in place, the actual amount of residual funding is unlikely to be known until June of the relevant calendar year at the earliest. So the residual funding for the 2012 calendar year will be known at the start of the 2012/13 year.
55. As part of Budget 2011, the Minister for Tertiary Education intends to seek Cabinet agreement that the residual funding that will result from Performance-Linked Funding be reinvested in the SAC and Industry Training Fund.

### **Pressures**

#### *Responding to enrolment pressures*

56. As noted previously, demand for tertiary education is currently greater than can be met through the baseline, but demand is expected to decline to baseline levels in 2013. Within this overall trend, demand for university and Private Training Establishment places is expected to decline, but still be above the funded baseline in 2012 and 2013, whilst demand at polytechnics and wānanga is forecast to be below the funded baseline from 2011 onwards.
57. The Minister for Tertiary Education recently decided to purchase 2,900 additional EFTS at undergraduate level at universities, spread over 2011 and 2012. This will go some way to meeting demand for university places above and beyond the funded baseline for 2011 and 2012. University allocations will be reviewed as part of Budget 2011 and 2012 in light of updated demand forecasts. Depending on how forecast demand is tracking compared to the number of funded places, places could be reallocated from subsectors with falling demand – polytechnics and wānanga – to meet the high demand for places at universities. While there is the option of purchasing additional places to meet demand, the Minister for Tertiary Education has indicated a preference for reallocating places between subsectors if and as forecast demand allows.

58. We will advise the Minister for Tertiary Education on SAC-funded places for the 2012 year by 1 March, once data on the actual number of EFTS for the 2010 year is available from the February Single Data Return.

[2]

#### Additional medical places

62. The Government has a manifesto commitment to fund 200 additional medical places over five years. Eighty places have been funded so far – 60 in Budget 2009 and 20 in Budget 2010. The additional places in Budget 2010 were funded through Vote Health, and our understanding is that the Minister of Health is considering funding further places in his package for Budget 2011.

#### *Annual Maximum Fee Movement*

63. Tertiary education fees are regulated to ensure that government subsidies are reflected in lower fees for students. However, allowing providers to increase their fees is one way of alleviating providers' cost pressures. It is more cost-effective for the Government to let providers increase their fees than it is to increase subsidy rates, however, this still has a cost to the Government in terms of increased borrowing through the Student Loan Scheme.

64. As part of Budget 2010, Cabinet agreed to allow for a four percent increase in fees and course costs for 2011. There is funding in place for this until 2013/14. It will cost approximately \$10m (operating) and \$20m (capital) each year to maintain the four percent increase beyond 2013. [2]

65. Changes to voluntary student membership (subject to the enactment of the Education (Freedom of Association) Bill 2009) will have an impact on student loan borrowing. Students will no longer be able to borrow through the compulsory fees component of the student loans scheme for students' association membership fees. [2]

but the overall impact is expected to be a saving in the cost of new borrowing through the Student Loan Scheme of approximately \$8.5m per annum.

#### *Tertiary funding for refugees*

66. Each year New Zealand accepts about 600 people who are refugees or members of refugees' families. Due to the time it takes to learn English, about 2400 refugees require places in ESOL programmes each year. There were 1700 places available in intensive ESOL programmes in 2010, but this reduced to between approximately 1000 and 1350 places this year as changes made in Budget 2009, Budget 2010 and other policy settings start to take effect.

67. The Minister is currently considering advice on how current ESOL provision can better serve refugees and how best to meet refugees' tertiary education needs. We expect additional funding of approximately \$5m will be required for this in Budget 2011.

#### *International education*

68. International education is already a substantial and expanding contributor to the national economy. The enrolment of nearly 100,000 international fee-paying students is worth at least \$2.2 billion to the economy annually and supports around 32,000 jobs. The Government wants to see this sector expand still further and provide greater value to the economy.

69. To this end, Cabinet has agreed to the implementation of a rationalised structure for government support of international education through the creation of a new Crown Agent. The new Crown Agent will be fiscally neutral: the Minister for Tertiary Education intends to reallocate \$11.5 million of existing Crown and departmental baselines for international education, within Vote Education and Vote Economic Development, to form the baseline of the new Crown Agent for International Education from 2011/12 onwards.

70. In addition, the Minister for Tertiary Education is increasing the budget for international education promotions by \$10m per annum, from \$3.45 million in 2010/11 to \$13.45 million in 2011/12 and outyears. This increase will be funded through the Prime Minister's Emerging Priorities Fund.

[2]

## **Section 4: Summary of Financial Movements**

TBC