

Submission to the Productivity Commission in response to its draft report, *A path to universal early childhood education and care*

Introduction

This submission responds to the Productivity Commission's (the Commission's) Draft Report, *A path to universal early childhood education and care* (the Draft Report). Due to the interdependencies between the reports, it also discusses the ACCC's three reports on childcare markets (the ACCC Reports).

This submission focusses on ECEC for children before they reach school. Some brief comments about OSHC are made in section 8.

The Draft Report contains many sensible findings and recommendations that will incrementally improve the ECEC system. However, if adopted as drafted, it will not fully succeed – it will not deliver a system that meets the Commission's objective for up to 30 hours or three days per week to be available to every child, and it will not meet the Commonwealth Government's objective for a universal system that provides "affordable, accessible, equitable and high-quality ECEC that reduces barriers to workforce participation and supports children's learning and development".¹

This is because there are a number of issues in the ECEC system to which the Draft Report does not give sufficient consideration and weight; in which it is mistaken or incomplete in its analysis; or where systemic problems are identified but left unchanged by any Draft Recommendation. The Draft Report does not paint a complete picture of what Australia's ECEC system should be or achieve, and does not sufficiently consider alternatives to current approaches or policy settings.

In particular, the Draft Report:

1. does not fully consider what is involved in moving ECEC in Australia to a system that seeks to fully meet two objectives – supporting both children's development and parents' workforce participation;
2. does not fully consider how effective the current system is, including in terms of how it supports equity and quality, or the extent to which demand is not met by supply;
3. does not fully consider what is involved in moving to a stewarded system;
4. misunderstands the cause, and underestimates the impact, of the cross-subsidisation between older and younger children in centre based ECEC;
5. does not adequately address the complexity of the current system, the costs of this complexity, and who is bearing this cost;
6. does not address future affordability for the vast majority of families; and
7. disregards supply-side funding reform options for reasons that are tenuous or inconsistent with other aspects of the Commission's proposed approach.

Each of these issues, and their potential implications for the Final Report, is outlined in this submission (sections 1-7), as well other observations relevant to the Commission's Final Report (section 8).

¹ This is from the Inquiry Terms of Reference, but the Commonwealth Government has made similar statements about its ambition in other places, including in the [Employment Whitepaper](#), stating the "Government is committed to charting the course for universal access to ECEC in Australia that is high-quality, equitable, affordable and accessible" (page 211).

Properly weighting, considering and dealing with these issues would lead to a different set of recommendations, broader in scope and greater in aspiration and imagination. Many of the issues with the current system cannot be fixed by simply adjusting existing settings, even if this involves turning the dial up to eleven – some require reconsideration of fundamental aspects of the system to address systemic problems.

A significant focus of this submission is on an accurate understanding of the challenges in the current system, and their causes. Problem definition is the most important part of any policy process. Once there is a clear and comprehensive understanding of the problem, effective solutions should become clearer. In the case of this Inquiry, this should lead to the Commission recommending more significant changes to the system than those contemplated in the Draft Report, including broader funding model reform and greater consideration of the appropriate role of government.²

Thank you for the opportunity to contribute to this Inquiry, and for your consideration of this submission. I would be happy to discuss any aspect of this submission with the Commission.

About the Author

My name is Gabi Burman. I am a policy, strategy and communications consultant, with nearly a decade of experience in early childhood policy and reform in Australia. My previous work includes as an executive in the Victorian Department of Education focussing on early childhood reform; as a strategic adviser to the Centre for Policy Development's Early Childhood Development program and the New South Wales Department of Education; and leading the secretariat of the Review to Achieve Educational Excellence in Australian Schools through Early Childhood Interventions. This is a personal submission; all views are my own.

² In this submission, unless otherwise indicated, reference to 'government' includes both Commonwealth and State and Territory governments. This reflects that both currently play a role in ECEC, and, as acknowledged in the Draft Report (page 510), both will likely have a future stewardship role in the system. The question of which level of government undertakes a function or role in the system is a secondary (albeit important) consideration at this stage – the focus should initially be on *what* government should be doing in the system to make it work better; once this is settled consideration can be given to *which* government is best placed to undertake which function.

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Acronyms used

ACCC	Australian Competition and Consumer Commission
ACCS	Additional Child Care Subsidy
CCS	Child Care Subsidy
ECEC	Early childhood education and care
ISP	Inclusion Support Program
NQF	National Quality Framework
NQS	National Quality Standard
OSHC	Outside school hours care
VET	Vocational education and training

1. Implications of moving to a system with two objectives

Implicit in the Draft Report (and much of government's comments and actions) is that the Commonwealth Government-funded ECEC system in Australia is broadly moving from being primarily focussed on supporting workforce participation, to supporting both children's development and workforce participation.^{3,4}

This change in the overall purpose of the system needs to cascade through the entire system, and be reflected in policy and funding settings. The Commission should carefully and explicitly consider what it means to move from a single-objective system (workforce participation) to a dual-objective system (child development and workforce participation).

Currently, most of the system is set up to support workforce participation, not children's development. Funding and government effort is overwhelming focussed on access for families meeting the Activity Test, rather than providing for quality or meeting educational need. Supply is driven to areas with greatest ability to pay, rather than in a way that meets demand or ensures disadvantaged children have access to a quality service. The form of ECEC with the highest educational value – preschool – is often considered to be separate to the rest of the system, and was not considered in detail in the Draft Report.

A shift to a dual-objective system requires a significant change to policy settings and system and funding design. This not just about the Activity Test – the adequacy of the funding system and the incentives contained in it should be reconsidered against these two objectives. Keeping the basic architecture of the system as it currently is, despite the recognition of the changing purpose of the system, is not likely to meet the system's two objectives.

The Commission should also ensure that, in its Final Report, reform options are considered in terms of their impact on both workforce participation and children's development. While workforce participation benefits may be more straightforward to model, the impact on children is still very much extant,⁵ and should be considered more

³ Both 'workforce participation' and 'child development' are shorthand terms that describe broader objectives (for example, parents working more days or engaging in study, or children's wellbeing and learning) but are adopted as they are useful shorthand and generally well-understood representations of different objectives, and this submission is long enough already.

⁴ This describes, in substance, the Commonwealth Government's changing policy objectives for ECEC. It is not a simple, binary transition – for example, the Commonwealth has generally said it aims to support both objectives, has provided some support for preschool education (most notably since the 2008 National Partnership Agreement on Universal Access to Early Childhood Education), and has contributed to the National Quality Framework. But it has, through its ECEC funding and program design, and through both what it has and has not done and incentivised, given far greater emphasis to encouraging ECEC use as a driver of workforce participation than as a contributor to child development. The Activity Test is the most obvious example of this – it significantly restricts access if parents are not participating in the workforce. Other examples include a lack of investment or other effort in quality improvement, minimum standards regulation or access for low-income families. Conversely, states and territories have historically given greater emphasis to child development in preschool delivery, often funding or operating programs that are not optimal for parents' workforce participation due to short and/or inconvenient operating hours. This would appear to be changing. At a Commonwealth level, the Terms of Reference for this inquiry, for example, indicate greater recognition of child development benefits. Similarly, states and territories are increasingly recognising the parental workforce participation objective (often through a lens of gender equity) through their reforms.

⁵ In addition to qualitatively considering these benefits, it is also possible to model at least many of the benefits from children's improved development from increased ECEC participation. See, for example, PwC for The Front Project, [A Smart Investment for a Smarter Australia: Economic](#)

and more explicitly. For example, in considering and recommending different CCS-reform options in Supplementary Paper 6 of the Draft Report, considerable emphasis is placed on the workforce participation benefits of options, but scant attention is paid to the potential benefits for children's development.

1.1 The differential benefits for different children and of different forms of ECEC

If the objective of ECEC is only to support workforce participation, then its quality or benefit to children is of lesser importance – if ECEC supports workforce participation without causing harm to children it could, in this construct, be considered a success, and any benefit to children is an incidental bonus. In this sense, ECEC could be considered to have a binary outcome – it either supports workforce participation or it doesn't, and this outcome occurs essentially irrespective of the age of the child, or the type or quality of the ECEC.⁶

However, as Australia moves to a system that has dual objectives, in order to meet the child development objective, it becomes necessary to consider the degree to which different children benefit from different types of ECEC, as the most efficient and effective way to achieve this objective should inform policy settings and funding design. The Draft Report does not do this in detail, and instead generally treats all children and all forms of ECEC as equivalent to each other.

Without undertaking an exhaustive literature review, it seems generally accepted that the benefit of ECEC to children is considered to differ according to a few key factors:

- The **age of the child**. At a universal/population average level, older children (especially three- and four-year-olds) are likely to benefit more from attending ECEC than younger children.
- The child's family circumstances are the main exception to this. Younger children who are **vulnerable or disadvantaged** benefit more from attending ECEC for a variety of reasons – because ECEC provides opportunities the home environment does not for stimulation, engagement, socialisation, and healthy, supportive interactions and relationships with other adults. It also creates an opportunity for identification of health, development or other issues, supporting earlier intervention. In some cases, simply taking the child out of a toxic home environment each day helps the child's development.
- The **quality** of the ECEC. This does not just mean a service's NQS rating (although this is a useful if imperfect proxy), but more specifically about the quality of the interaction between the child and the educator. This can be complex to measure at scale, but it has consistently been shown that **higher-qualified educators** (especially bachelor qualified or higher) generally provide higher quality ECEC and are more impactful than lower-qualified educators. This is, fundamentally, the rationale behind preschool as a specific program, being led by a bachelor-qualified teacher.

In an Australian context, this means that a preschool program is likely of highest value to children, followed by a long day care service (which under the NQS has a

[analysis of universal early childhood education in the year before school in Australia](#) (2019); and Deloitte for the South Australian Royal Commission into ECEC, [Three-year-old Preschool Return on Investment Analysis](#), (2023) which are two Australian examples; there is also much international literature.

⁶ This is a slight over-simplification – a form of ECEC that is unsuitable for very young children, or whose quality is so low that parents are not willing or confident to leave their children there, would prevent it from supporting workforce participation because it would not be used.

mix of educator qualifications), with Family Day Care having lower expected child development value as it has lower qualification requirements for educators.

In large part, these factors can explain (and are demonstrated by) Australia's historic and current approach to preschool, with access prioritised to older children, and where universal approaches are not taken, targeted access provided to some children. For example, many jurisdictions prioritised three-year-old preschool for vulnerable, disadvantaged or First Nations children when not offering it universally, and the South Australian Royal Commission recommended additional hours of preschool for three- and four-year-old children identified as being at greatest risk of developmental vulnerability, above the universal offer.⁷

Of course, such an approach is predicated solely on the benefit to the child - as noted, ECEC aims to achieve two objectives, and ECEC can also provide a safe, supportive and stimulating environment for children while their parents undertake work or other activities. This could justify, for example, not distinguishing a child's entitlement to ECEC according to their age. But in considering the design of a future system - including the design of the entitlement and how funding is prioritised and allocated - it should be explicitly acknowledged and considered.

In particular, the Commission should consider distinguish between types of ECEC when considering access and equity - this includes expanding the universal entitlement to a preschool program, and considering how access to high-quality ECEC (both in terms of NQS ratings and the underlying expected benefit of the program) to priority cohorts of children should be improved. Treating all forms of ECEC as interchangeable risks a system that consigns some of the neediest children to forms of ECEC that are of the lowest expected benefit. In particular, Family Day Care should not be seen as a solution to supply gaps without carefully considering the likely lower developmental benefit to children compared to other forms of ECEC.

The Commission should also consider differentiating between children in setting an entitlement, providing a greater entitlement to some children, similar to the South Australian Royal Commission's recommended additional hours of preschool for children identified as being at greatest risk of developmental vulnerability. Another approach would be providing higher intensity, high-quality ECEC to particularly vulnerable children - Kids First's Early Years Education Program is one example of the potential impact of high intensity, early intervention programs.⁸

The ability of services to meet children's developmental needs

Equity in the ECEC system is not just about access. Access is a necessary but insufficient precondition for the system to support children's development. What happens when a child is in a service is an essential part of the system's effectiveness.

As the system moves away from being primarily about enabling workforce participation to being one that gives greater weight to supporting children's development, greater consideration needs to be given to how services are able to fulfill this child development objective. In particular, further consideration should be given to how the level of resourcing available to each service or provider is determined, and how quality is incentivised.

In the context of a system that seeks only to support workforce participation, a 'market failure' could be considered to be a situation where a family does not have access to

⁷ Recommendations 25 and 26 of the [Report of the Royal Commission into Early Childhood Education and Care](#).

⁸ See [Early Years Education Program - Kindergarten Model evaluation](#).

place in a service. In a dual-objective system, however, a 'market failure' needs to be more broadly conceived, including considering quality and other circumstances where the operation of a service is not supportive of children's development.

Services' resourcing is determined by parents' ability and willingness to pay

Currently, the level of resourcing available to a service is generally determined by the ability and willingness of its parents to pay fees (after the application of the CCS). This is, notably, not necessarily linked to (or associated with) the cost of delivery of quality ECEC, or the level of educational or other need of the children attending.⁹ This leads to a system where, essentially, services supporting higher socioeconomic families are better resourced (due to higher fees), and are higher quality, than services supporting lower socioeconomic families. This is the inverse of how a system that aims to support child development and address disadvantage should operate, but is the logical and predictable result of a system that is designed the way it is.

A 100% CCS for some families may ameliorate this to a degree, but parents' income is an imperfect proxy for children's need,¹⁰ it does not address quality or how additional revenue from a 100% CCS would be used in a service, and it only applies to a minority of the population. A 100% CCS may also give rise to other unintended consequences (discussed in section 3.2) that would further limit its effectiveness in addressing children's developmental needs.

This is a fundamental challenge in the current funding system, where the vast majority of Commonwealth Government funding and effort is directed to supporting access and affordability, but not the ability of services to meet the needs of the children once they are in the room. For the system to effectively support children's development, the Commission should further consider changes to the current funding system, or alternative funding approaches, that better allocate funding to support children's needs.

The funding system does not incentivise good quality or deter low quality

There is nothing in the current funding system that incentivises good quality or creates consequences for low quality. Government has specified minimum quality levels for ECEC in the NQS. However, services can fail to meet these standards, in perpetuity, and still receive the same government funding on the same terms as services that meet or exceed the NQS. Viewed as a procurement, this would be an abject failure – the government has pre-specified minimum quality standards, the provider has not met them, the government is paying for the service anyway and will continue to do so irrespective of future quality. This is a failure of stewardship.

In addition to government providing direct support for quality improvement (Information Request 8.3), the Commission should consider how government's funding lever can be used to improve quality in the system. There are trade-offs (most notably between supply and quality) in using funding (or access to funding) as a lever to improve quality, but in a system where there is limited demand-side pressure for quality, 70% of services are operated for profit, and the majority of the funding is provided by government, the failure to even try to use the funding lever to improve quality is a significant missed opportunity. Markets of any type cannot work effectively if there are no consequences for poor performance. Low quality services that cannot or will not improve should, as a general principle, not continue to receive government funding. Genuinely requiring

⁹ The ISP, as currently operating or as envisaged by the Commission in the Draft Report, is a much narrower than educational need, and while its existence (in some form) is important, it does not fully address the issues discussed.

¹⁰ For example, AEDC data shows that more than one in seven children in the *highest* income quintile are developmentally vulnerable on one or more domain at school entry ([AEDC National Report](#) 2021, page 34).

minimum quality standards is an important part of the continuing professionalisation of the sector. Additional government investment in regulatory effort and greater support for quality improvement may also be needed, but services that repeatedly fail to meet the NQS, given the reasonable chance to improve and failing to do so, should not continue to receive government funding. Services can be transferred to higher-quality providers to maintain access for the community. Such an approach would likely deal with the challenge of services repeatedly failing to meet the NQS efficiently and effectively.

The Commission could also consider how government can incentivise higher quality in the system. Currently there is no incentive from government for higher quality. Higher quality services may be able to charge higher fees, but this raises equity issues about access to high-quality services.

Funding-related incentives for quality need to be carefully designed to avoid inequitable outcomes or unintended consequences. And some may find the use of such incentives to be distasteful in an education system. But in a system that is already 70% for-profit, such an approach may be a powerful and efficient way for government to achieve its objectives, and is worth considering.

1.2 The complex and counter-productive Activity Test

The Activity Test may make sense in a system that seeks only to support workforce participation. However, in a system that also seeks to support children's development, it does not. The Activity Test, both how it currently operates and how it is proposed to operate in the Draft Report, essentially serves to exclude three types of children from full participation in ECEC:

- Children whose parents are, due to various circumstances or other challenges in life, unable to satisfy the Activity Test. These children are almost always axiomatically vulnerable or disadvantaged in some sense.
- Children whose parents who are choosing not to work or undertake other activities that would satisfy the activity test – perhaps because another parent is a high-income earner, or because of personal preferences about child-rearing.
- People who do not use ECEC, or use less ECEC than they otherwise would, because they are confused or otherwise unable to navigate the complexity of the system, or are worried about owing money because they have not fully understood and/or complied with requirements.

In considering the future of the Activity Test, it is helpful to consider how its abolition would impact each of these groups.

- Vulnerable and disadvantaged children would be more likely to attend ECEC. This is a positive outcome, as these are among the children who benefit most from attending and therefore represent a higher return on investment for government. Some may still be prevented by other barriers, including cost and logistical challenges, but these can be often addressed through other means (e.g. by increasing the CCS to 100% or providing funding to support transport to services).¹¹
- Families who are choosing not to work or undertake other activities would continue to do so. Where a second parent was not working because the other family member had a high income, they may choose to send their child to ECEC anyway. This would likely be of at least some benefit to the child, and given the family is likely a high-income family, the cost to the taxpayer in a means-tested system would be relatively low.

¹¹ This is not to diminish the importance of solving these barriers – abolishing the Activity Test is necessary but insufficient; it needs to be accompanied by supporting reforms that promote access, equity, quality, etc.

Where non-attendance reflected the parents' preference about child-rearing, their decision would not be impacted and there would be no change for the child or taxpayer.

- Families who were not using ECEC due to the complexity of the system would be more likely to, as the complexity would be reduced. (There may still be other complexity, but this could be reduced in other ways.) This would result in these children attending ECEC, and may increase workforce participation too.

The Activity Test may have made conceptual sense if the only goal of ECEC was to support workforce participation. But if that were ever the case, it is not now. Government is clear (as is the Commission) that the system has two objectives. In this context, the Activity Test is a flawed way to ration access and funding, with the perverse impact of keeping some of the neediest children out of ECEC. It should be abolished. There are more effective and efficient ways to ration access and resources, if needed.¹²

1.3 The diminishing distinction between 'preschool' and 'child care' systems

The distinction between historically separate preschool and child care/long day care service systems are increasingly blurring for families and providers, but the Draft Report's recommendations effectively maintain these separate funding, entitlement, policy and governance approaches, rather than consider and manage their integration.

Historically, as the Draft Report observes,¹³ there have effectively been two ECEC systems in Australia – an education or child development-focussed preschool system, primarily the responsibility of the states and territories; and a workforce participation-enabling 'care' system, primarily the responsibility of the Commonwealth Government. There may have been a time when these systems operated separately – when preschool was only offered in a dedicated preschool service, and when families thought of them as distinct service offerings. However, that is certainly not the case today, and the interaction between what is, in many ways, different parts of the same system, will only increase. This is the case for many services, which provide both preschool programs and CCS-subsidised ECEC, therefore often dealing with two governments and two funding systems for the same child. It is also the case for many children and families, who need to understand and navigate entitlements from two levels of government, and often end up moving between two different services each week.

This increasing blurring of the distinction between preschool and long day care services is being driven by a few factors. First, the general increase in women's workforce participation over time has meant that parents are increasingly thinking not just about their child's education but also the availability and convenience of a service's operations, including span of hours and days. Secondly, there is increasing recognition that early childhood education, especially teacher-led programs, are of significant benefit to children and that expanding access is therefore a significant public policy goal. However, as individual states and territories have sought to expand their preschool offer, they have found that their previous approach to preschool delivery is often unable to be significantly expanded because of cost, logistical or other practical barriers. This includes the availability of land and buildings, and the suitability of an operating model that does

¹² For example, many Victorian local councils offer a Central Registration and Enrolment Scheme for preschool, which allows parents to nominate preferences across multiple services and applies the state's Priority of Access rules to ensure equitable access. See [Kindergarten Central Registration and Enrolment](#). Even if workforce participation was one factor in determining priority of access, adopting such a system more broadly would allow other factors to be considered, and mean any rationing occurs at a local level, rather than nationally based on broad entitlement rules. This would likely lead to a more efficient allocation of access.

¹³ Page 500-501, "Historic arrangements remain a feature in today's ECEC system".

not support parents' workforce participation.¹⁴ There have also been concerns about the impact of any preschool expansion on the viability of long day care services (and therefore broader ECEC capacity and system viability) due to the way older children cross-subsidise younger children.¹⁵ Preschool expansion is particularly challenging in jurisdictions with school-based preschool systems, but there are significant challenges in expanding in any jurisdiction. This can be seen in how jurisdictions that have opted to expand their preschool offer have relied heavily on long day care services to provide preschool programs, and will not be expanding their existing four-year-old preschool delivery approaches proportionately with their expanded entitlement.

This means that the 'two systems' – with different funding models, separate entitlements, and in many cases different workforce pay and conditions – will become increasingly interconnected and interdependent. This will need to be dealt with through changing policy, funding and other settings; if not now, then in the coming years. The Commission should have further regard to this, particularly as it considers the efficiency and effectiveness of government investment in the sector, and the complexity created for families experiencing the system.

Much of the national reforms in the early 2000s emphasised that ECEC encompasses both preschools and long day care services. The NQF brought in a single regulatory framework and an overarching learning framework for ECEC. This has just not been fully followed through by bringing together a single approach to entitlement, funding or governance/stewardship.

The question of the interaction of preschool and broader ECEC system – and the limited attention paid to it by the Draft Report – is illustrated by the interaction between the Commission's proposed entitlement for three days or 30 hours for all children, and the commitments of New South Wales and Victorian governments for 30 hours of preschool in the year before school for all children. How would the entitlements and systems interact or inter-relate? Is the Commission's entitlement in addition to the states' entitlement? (So children get 60 hours a week?) Does the Commission's entitlement include the states' entitlement, so children do not get any additional access and the Commonwealth is effectively cost-shifting ECEC to the states? It is unclear. The Draft Report does not note that the two things may overlap, nor address how it would be treated. The Draft Report has not fully considered how the system is currently operating or how proposed changes will play out in the system and how, in practice, families and services will respond. The same gap in consideration exists in terms of the interaction with three-year-old preschool.

The Final Report should further consider the interaction between preschool and other ECEC types, and consider ways to manage this and simplify this for services and families.

¹⁴ They have also found that the Commonwealth is unwilling to expand its contribution to preschool beyond the existing four-year-old entitlement for 15 hours a week, but this is a separate issue, albeit also one that deserves further consideration by the Commission.

¹⁵ This is discussed in section 4, but the experience of the Tasmanian Government is instructive – it initially proposed to expand the school-based delivery of preschool to three-year-olds, but had to stop this approach and start again due to, in large part, concerns from the long day care sector about the impact on their long-term viability. See Department of Education (2017), [Social and Economic Impacts of Implementing the Voluntary Earlier School Starting Age, Report from the Secretary of the Department Of Education](#)

2. The effectiveness of the current system

The Draft Report and the ACCC's Reports do not fully consider the extent to which the current system is performing effectively. In particular, the Reports do not consider:

- the impact of the current system on child outcomes, particularly in terms of quality and equity; or
- the degree to which the system is currently meeting actual demand.

Both issues are vital to the effectiveness of the system, and their more considered analysis would likely lead to further and different recommendations.

2.1 Equity and quality in the current system

Quality and equity are key measures of the health and effectiveness of the ECEC system. As the Draft Report outlines, the benefit to children's development from ECEC comes from the ECEC system being of a high quality, and the higher the quality, the greater potential benefit. The level of quality in the system, and how this quality is distributed, is therefore vital to considering the effectiveness of the system.

Equity is important not just in a distributional sense (e.g. how are supply and quality distributed through the system and communities) but in terms of the ability of a service to meet children's different developmental needs. This is not just through the narrow lens of the ISP, which deals primarily with disability, but, concomitant with the move to an ECEC system that seeks to improve children's developmental outcomes, needs to be viewed more holistically as how a service is able to support each child's development.¹⁶

However, the Draft Report contains little on these issues or how they can and should be improved. What focus there is in the draft recommendations is on a level of equity of access (in terms of increasing supply and a higher CCS for some lower income families), rather than improving the quality of ECEC delivered by the system.¹⁷ Despite the extensive discussion of, and support for, the role of the system in supporting children's development and government's stewardship of the system, the focus is primarily on inputs rather than children's outcomes and how they can be improved.¹⁸

Many of the causes of these challenges are discussed elsewhere in this submission – the lack of incentive or support for quality, services' resourcing (and therefore ability to meet

¹⁶ The Draft Report states that "[s]ervices that meet the NQF should be sufficient to meet the needs of most children" (section 2.2), but there is no evidence or argument provided to support this, other than the existence of previous NQF reviews. (It is also unclear what constitutes "most"; there would be a material difference between if this were true for 51% of children or if it were true for 95% of children.) Perhaps the authoritative modern study of quality in Australian ECEC (the E4Kids study) suggests otherwise, stating that "even programs rated as meeting or exceeding the NQS may provide very low levels of Instructional Support, well below the threshold levels needed to shift children's outcomes", and "[i]t seems possible for ECEC programs to have, for example, an 'exceeding the standard' and a CLASS rating below the level where it is likely to have an impact on children's learning outcomes." Tayler C, [The E4Kids study: Assessing the effectiveness of Australian early childhood education and care programs](#) (2016), page 11.

¹⁷ Draft Recommendation 8.4 is titled "incentivise quality provision in new ECEC services" but is substantively about priority in administrative processes for new services. It is difficult to see how it could have a material impact on the existing system (especially given so many providers are single-service operators).

¹⁸ For example, the best available broad measure of children's outcomes is the Australian Early Development Census (AEDC). The Draft Report contains as many references to the AEDC in a single paragraph about playgroups (page 426) as it does in the entire paper about how services support children (Supplementary Paper 2). Supplementary Paper 1 is titled "Children's Outcomes" but only mentions the existence of the AEDC, and does not discuss its results or provide other discussion that considers children's development outcomes in Australia today. (Supplementary Paper 1 is perhaps mistitled, but the analysis needed – how the system is performing in terms of supporting children's development in Australia – is not found elsewhere in the Draft Report either.)

children's needs) being determined by their parents willingness and ability to pay rather than any consideration of developmental need, etc – and the Final Report should holistically consider how quality and equity could be better supported, including through the funding system and other aspects of stewardship. Quality and equity are essential to an effective system, and greater attention should be paid to their improvement.

2.2 The extent to which the system is currently meeting demand

Neither the Draft Report nor the ACCC's three Reports on the state of the childcare market consider one of the most fundamental questions of market analysis – to what extent is supply meeting demand?¹⁹ There is commentary about relative supply, and the Commission has modelled supply against hypothetical demand. But neither has empirically considered the degree to which current supply is meeting current, actual demand. This is both an important measure through which to understand the performance and adequacy of the current system, and a necessary basis from which to consider whether the system will meet future demand, and if not, what may be required in order for it to do so.

The Draft Report and the ACCC's Reports look at *gross* supply (how many places/services are there?), *relative* supply (where are there more or fewer places/services?) or trends in supply (where has supply changed?), but neither considers whether this supply meets demand either in individual local markets, or more broadly across the system.

There are several reasons to think that, even in areas where there is lots of supply (relative or absolute), there may still not be adequate supply. These include:

- The likelihood that demand is not uniform and will vary across communities (so relative supply, or supply against a national benchmark, will not adequately indicate whether supply is meeting demand). Demand will vary for many reasons, including differences in demographic patterns (families with young children are not evenly distributed around Australia); parents' preferences for work/family balance; parents' attitudes to work/career development; economic conditions; parents' cultural or other attitudes towards ECEC and what they consider to be best for their children; the cost of available ECEC; and the quality of available ECEC.
- Widespread reports of difficulty finding places or parents having to make compromises/choices about workforce participation or other activities due to a lack of available appropriate ECEC (e.g. working fewer days because additional days of ECEC are not available).
- The absence of excess capacity in the system would be consistent with the limited demand response to the recent CCS changes.²⁰

There is no comprehensive data on demand or unmet demand – however it would seem to be within the scope of the Commission's work to endeavour to obtain this, and to suggest an approach to regularly collecting it in the future. (Ensuring that supply meets demand would seem to be a crucial stewardship activity that should be carried out by government.) At the very least, the Final Report should acknowledge that it is at least unknown whether supply meets demand, and that this has significant implications for the effectiveness of the system.

The Draft Report gets close to acknowledging the general deficit of supply in the sector when it calculates existing capacity relative to a 0.6 place per child benchmark, finding

¹⁹ The ACCC looked at waitlist and offered place data from large providers at a single point in time (section 5.3, ACCC Final Report) but noting the many limitations of these data, did not make any conclusions.

²⁰ See, for example, Roberts, J, The Sector, [Cheaper Child Care changes to CCS yielded only modest LDC attendance increases says DoE data](#) 8 Jan 2024.

that the vast majority of Australian children live in areas where this benchmark is not met. But the Draft Report does not properly address the scale of this shortfall, suggesting only minor and incremental responses to a widespread problem.

Implications of demand exceeding supply

If supply does not meet demand in the system, it is important to consider how this impacts the effective and efficient operation of the market. Conventional economic analysis is that where demand exceeds supply, the price rises as a rationing mechanism to reduce demand until the market clears. The higher price can act as a signal to increase supply, in the longer term reducing the price (and meeting a higher level of demand), although this is not always the case – there can be barriers to entry, or a lack of key inputs or resources, that prevent a supply response.

Considering this in the context of ECEC, there would seem to be some supply response in the system – the strong growth in for-profit services over the past decade being the most obvious indication. However there also appears to be areas where demand still exceeds supply, which may allow providers to exercise a level of pricing power and increase prices. It also effects provider decision making in terms of establishing new services (or expanding or allocating capacity) – if a provider can set up one new service and is choosing between two areas that it thinks are under-supplied, the rational response is to establish the new service in the area with the highest willingness and ability to pay (at least relative to local costs).

This would mean that price is rationing access both within a market (the service can set rates at a higher level because of a supply shortage) and between markets (in terms of determining resource allocation and where supply is established).²¹

There may be a logic to using price to manage access this way if the only purpose of the ECEC system is to support workforce participation. If supply is limited, using price to ration access will, *ceteris paribus*, mean that the supply is allocated to enable the highest value employment as people employed in the highest paying jobs will have the greatest ability to pay higher ECEC fees.²²

There are, however, several obvious problems with this.

- It is not a universal system that ensures an appropriate minimum level of provision of access to all families and children – it is a market that allocates resources to those most willing and able to pay.
- It is not in government or the community's interest to allocate resources in this way. A person's income is not a reliable indicator of the value of their work to the community; allocating resources in this way risks inadequate supply for lower paid workers, many of whom may be considered 'essential workers'.
- It risks compounding disadvantage because lower income families have less access to ECEC to support their workforce participation.
- Providers having pricing power may allow for abnormally high returns to be earned in a sector that is in many ways low risk, with reliable demand underwritten by a high level of government subsidy. Such economic rents would be extracted from both government (as majority funder) and families (paying the remainder of the cost).
- And perhaps most importantly, this has assumed that the only objective of the ECEC system is to support workforce participation. But the system should also be about

²¹ This is obviously a slightly simplified analysis; there are a range of other factors, considerations and barriers. But it has been broadly borne out in the system over many years, and is a powerful underlying explanation for much of what is seen in the system today.

²² The progressive nature of the CCS may dampen this to some degree, but it is also clear from where new services are being established that this is not fully so.

supporting children's development. A system that seeks to support children's development but, in practice, prioritises access for children in higher socioeconomic families over lower socioeconomic families, is perverse and flawed.

The Commission, in its Final Report, should consider whether supply is currently meeting demand, and consequentially consider the implications of this for the system, including with respect to how government supports or creates supply in the system. The Commission should also consider the need for, and possible approaches to, price regulation, and alternatives to rationing access through price. These considerations will be particularly important while the system's capacity is built to address current shortfalls, and to meet the increased demand that would be expected to flow from the Draft Report's proposed changes to access and affordability (including the relaxation of the Activity Test and introduction of a 100% CCS).

Evidence that suggests demand is not exceeding supply

There are three possible counterpoints that it is worth considering which could be used to support the proposition that demand is (generally) being met by supply, and explaining why they are not persuasive.

- There are claims (including in other submissions to the Inquiry) of areas of over-supply. These claims – especially when made by providers without supporting evidence – should be treated with some caution, as they often serve as the basis for seeking government intervention, in some form, to minimise competition. This can include through increased controls on the location of new services, restrictions on entry to market, etc. Such self-interest is to be expected in a market, but should be received with appropriate scepticism by analysts and policy-makers.²³
- Services generally report operating below licensed capacity. While this would be the case where demand is fully met and supply exceeds demand, there are other possible causes that are more likely. One obvious (and hopefully transient) cause is that workforce shortages lead to enrolments being capped below physical capacity. But the most enduring is that ECEC markets are small, places are not always interchangeable, and significant matching challenges exist. While in some ways a 'licensed place' represents capacity, in practice this is not always the case – parents want or need places on different days (a place on a Friday is not helpful to a parent who needs ECEC on a Tuesday because that's when their shift or class is), and a place in a four-year-old room generally cannot be taken by an 18 month old.²⁴ Parents may prefer late starts or early finishes, meaning a service may have some capacity at the beginning or end of the day, but this is practically unusable for other families due to its short duration or time of day.²⁵

So, it is possible (indeed likely) that a service is operating under licensed capacity and there will be unmet demand in the same community at the same time. Services almost never run at full, licensed capacity – there almost has to always be a gap between theoretical maximum (licensed) capacity and the practical capacity that a

²³ This is not to say that there is no market in Australia experiencing over-supply – with such small catchment areas, there are hundreds of local ECEC markets in Australia, so it would be surprising if literally not a single market was over-supplied at some point in time. But it is unlikely to be a widespread or systemic occurrence.

²⁴ This can be for several reasons, including staffing requirements (ratios), practical considerations about mixed age groups, and the financial implications for the service (the cross-subsidy, discussed in section 4).

²⁵ These factors, plus those in the footnote immediately below and the incentives created for both parents and providers by the hourly rate cap to spread the costs over more hours, help explain the 'air pockets' the Commission observed in the system.

service can hope to achieve.²⁶ This needs to be considered when analysing system capacity.

- The ACCC did not find that excessive profits were being widely made, as could be expected if providers have significant pricing power as a result of demand exceeding supply. There are several possible explanations for this that could still be consistent with supply not meeting demand. Excessive profits could be being extracted through rent or other occupancy costs,²⁷ or surplus funds could be being used to fund other service costs (including wages or quality), or invested in growth or expansion initiatives across a provider network.

The ACCC considered only one measure of profitability – profit as a percentage of revenue – and not other measures, such as return on equity, or consider the level of financial risk being taken, which may provide a better indication of risk-adjusted investor returns. It was also not clear what the ACCC would have considered 'excessive profits'.

The ACCC only had access to some providers' data, and it is unclear how representative these are of the broader sector. It is not stated how many large providers were included in the analysis, but there would appear to be only eight centre-based providers (three not-for-profit and five for-profit) that met the ACCC's definition of a large provider, collectively representing less than 20% of centre-based services in Australia. The ACCC only had access to small and medium providers' data when they provided it voluntarily, and it seems unlikely that providers making excessive profits would volunteer evidence of this to the ACCC.

The period examined by the ACCC (2018-22) was mostly unusual, impacted by the COVID period and recent acute ECEC workforce shortages.

The age of the services does not appear to have been considered in the ACCC's analysis. It seems likely that newer services would be less profitable as it may take time to establish a service in a community and bring in enough families to reach profitable levels of occupancy. In the short term, this would reduce the profitability of single-service providers. In the larger provider networks, providers could strategically roll-out new services at a pace that allows existing, profitable services to effectively underwrite loss-making new services for several years, maintaining overall provider viability in the short term and supporting higher profits or further expansion in the medium and long term.

²⁶ Additional factors contributing to this, depending on what measure of utilisation is being used, include children being temporarily absent (for example due to illness – a common occurrence for young children), and a level of annual cyclicity in demand. For example, older children typically leave a service at the end of the year as they begin school in January, but new children join throughout the year (for example, as parental leave entitlements are exhausted and parents return to work).

²⁷ The ACCC's failure to fully investigate the role of land and occupancy costs in ECEC was a missed opportunity to shed light on a key cost driver in ECEC and inform future reform. It may not be possible in the time available for the Commission to conduct this analysis in detail, but it could recommend further work. This could include understanding how ECEC occupancy costs (and changes over time) differ or are the same as other sectors' occupancy costs (i.e. is there something particular to ECEC happening, or is it typical of property in Australia?) The ACCC looked only briefly at this issue, and considered only relative changes during the period 2018-22, which did not consider absolute differences in occupancy costs or longer-term trends, and was likely distorted by the impact of COVID on office and retail properties (see ACCC Final Report, pages 122-123).

Consideration should also be given to the level of private investment in the sector in recent years, in both service operations and associated real estate, as a form of revealed preference. A lot of things can and have been said about private equity and other sophisticated and institutional investors, but they are not generally regarded as incompetent or 'dumb money' – if they are investing significantly in the sector, it is because they have a rational basis for expecting at least a reasonable risk-adjusted return on their investment in the future.

3. Moving to system stewardship

3.1 System stewardship

The Draft Report talks about moving to a stewardship approach, but stops short of fully describing what this would entail. The Final Report should contain further detail on this.

In order to address existing issues in the system, and achieve government's objectives for the system, it is clear that government needs to be more involved in the system – the more *laissez faire* approach of providing a subsidy (the CCS) and some small safety nets (such as the Community Child Care Fund, ACCS and ISP), and otherwise leaving things to the market, is not working. Government needs to be more active in the system – gathering and sharing information, solving problems, coordinating action and holding themselves and others accountable. Government should be clear about what it wants from the system, and then it should use all its levers to get it.

Fundamentally, this is a move to a system where government takes responsibility for the system – understanding how the system works and acting to support it so that it delivers the outcomes government wants (and is paying for). It avoids a situation like that which the system is currently facing with respect to the workforce, where nobody was ready for the workforce crisis which everyone expected.²⁸

The approach to stewardship should consider the scale and composition of the sector, and be tailored to its specific needs. A large proportion of the sector are single service providers or small providers (rather than large networks of many services), and most services are relatively small operations (most long day care services have 70 or fewer licensed places), so the lack of economic and operational scale can be a challenge in the system. This could require a steward to play additional roles, helping to create or realise some benefits of scale that otherwise may not occur.²⁹

The move to a universal ECEC system, as envisaged by the government or the Commission, is a significant reform program that will take some time. In considering how government could approach this, it could be instructive for the Commission to consider how some states are undertaking ECEC reforms. In particular, the Commission could consider the level of effort and investment that has been required to *enable* expansion –

²⁸ Cf. Tolstoy, *War and Peace* - "Nothing was ready for the war which everyone expected."

²⁹ The impacts of this lack of scale warrant further and explicit consideration as part of an assessment of the operation of the ECEC market and considering how it will meet future needs. While regulations (including staffing ratios) rightly limit the ability to realise some economies of scale, and to a degree limit the operational flexibility of a service (for example, to release an educator to undertake professional development), it is likely that scale challenges lead to other inefficiencies and missed opportunities in the system at a provider level. These could include, for example, inefficiencies in back office and support functions such as HR, payroll, administrative support, legal and compliance; limited ability to aggregate and dedicate resources to quality support and improvement; limited career paths for staff reducing the attractiveness of the sector; and limited opportunities for in-service peer support and informal mentoring. In addition to considering ways to directly mitigate this, if it were of sufficient significance, government could also consider encouraging or facilitating greater scale and provider aggregation in as part of its stewardship of the system.

separate to the additional funding for core service delivery (equivalent to the CCS), jurisdictions have invested significantly in workforce attraction, support and development; new and expanded services; sector communications; quality improvement and support; and the establishment of local staffing teams to support reform.³⁰ The contrast with the Commonwealth's historical focus on service delivery (the CCS system) and limited investment in other aspects of the system indicates the scale of change that is required in a move to stewardship and a more effective system. The Commission's Draft Recommendations start to get to this, but the breadth and depth of the change required to move to a genuine stewardship approach is not explicit.

3.2 Taking a system view

ECEC is, as outlined in the Draft Report, a complex system. It has multiple objectives and there are complexities in measuring them and determining how they are best achieved. But the Draft Report does not properly step back and think about what it is trying to achieve and how it is best achieved, instead focussing on some specific challenges and possible incremental changes to the current system that it considers may address them.

The Final Report should paint a broader picture of what the ECEC system in Australia should look like – not just a minimum level of access, but what constitutes affordable ECEC, what a reasonable level of quality should be, what would constitute an equitable system, etc. The Commission could also provide advice on what may constitute an ideal market mix or composition, including having regard to provider scale and quality.

In painting a broad picture, the Commission would inform its own recommendations (what steps are necessary to achieve this?), government's future actions (how will it know when it needs to increase effort or change settings?) and government's accountability (is it achieving what it should?).

This should include consideration of the underlying dynamics in the system and consider broad policy solutions. For example, if it is considered that demand often exceeds supply (see section 2.2), and that the children and parents who use the service are often not in a position to exercise choice, assess and select for quality, and/or be price sensitive, but the government pays most of the cost and the majority of the provision is by for-profit providers, you might be of the view that the system requires effective price regulation to manage prices, effective regulation to ensure quality, and for the funding system to align funding with desired outcomes. Only the regulation for quality would appear to be in place at the moment, and the Draft Report suggests that greater investment is needed for it to be effective.

In taking this broad perspective of the ECEC system, the Commission should consider adopting National Cabinet's four key principles for the ECEC system (equity, affordability, quality and accessibility)³¹ rather than the framework in the Draft Report (availability, affordability, inclusivity and flexibility). In addition to the benefits of aligning Commission's work with the Commonwealth, state and territory governments' vision for ECEC, it provides more prominent emphasis to equity and quality, two vital aspects of an effective ECEC system. Flexibility could be considered as part of accessibility, and inclusivity as part of the equity of the system.

The Final Report should take a broad approach to the system in its analysis of reform options. In considering the costs and benefits of possible reforms to the system, it is important to recognise that the system contains many actors (including governments,

³⁰ See, for example, the South Australian Royal Commission, which considered this in some detail.

³¹ See [Draft National Vision for Early Childhood Education and Care](#).

parents, children, services, providers and educators), and that each actor may respond to the actions (or inactions) of other actors, creating second-order effects that can complicate analysis. Even within a class of actors (e.g. services) different parties may react differently (e.g. for-profit and not-for-profit services, or large and single-service providers).

The Draft Report does this to some degree – for example, it considers the response of providers to a 100% CCS rate for lower income families, predicting it will encourage some new services to be established in lower socioeconomic areas. But in other ways, it does not consider how many providers may respond to a 100% CCS in terms of their pricing behaviour (immediately raising fees to, at least, the hourly rate cap and treating the increase as a windfall gain as they face no increase in costs), or how parents may respond (eligible families over-enrolling their children as there is no financial disincentive for unused days or hours; ineligible families decreasing their use of ECEC due to a mix of higher fees, reduced capacity due to increased enrolments from eligible families, and services' potential preference for families from whom they do not need to collect fees and may be less likely to attend).

One can also imagine (as has occurred in other sectors) new providers entering the system purely to take advantage of a 100% government subsidy that also offers the opportunity for mispricing, and the introduction of undesirable practices to induce enrolments. Given many families eligible for a 100% CCS would also be otherwise vulnerable or disadvantaged, they would seem to be particularly susceptible to unscrupulous behaviour. There is a not insubstantial history in Australia of opportunistic individuals and organisations being able to move faster than policy-makers and regulators to take advantage of well-intentioned but mis-set funding settings, and they can gain significant benefit before government responds and the opportunity is closed off.³²

If the objective is to provide a level of free ECEC to low income families, it may be that the current funding system is not the best way to deliver this (as it was designed to include, inter alia, a compulsory parent contribution), and therefore different ways to achieve the objective should be considered, including different funding systems and/or approaches to price regulation. These sorts of issues are important considerations in whether and how a 100% CCS should be implemented, and the Final Report should explore them further. This is an issue raised by the ACCC, which "emphasises that shifts in policy settings that result in a significant disconnect between the price of using a childcare service and the financial consequences for the person deciding to use it, are likely to require a different regulatory approach in the longer-term."³³

3.3 The proposed ECEC Commission

The proposed ECEC Commission could represent a significant change to the ECEC system in Australia. However, to the extent that it is described in the Draft Report, it is problematic and should be reconsidered. In particular, it:

- risks undermining, rather than supporting, a stewardship approach to the system by diluting government's responsibility for the system; and

³² Everyone will have their favourite examples, but those that come to mind include VET, water and energy efficiency programs, the NDIS, and family day care. Some practices in ECEC – such as offering iPads or cash as inducements for enrolments – have already had to be [banned](#). The situation seems little changed from a quarter of a century ago, when Clarke and Stevenson observed that "[i]f you put \$5 million on the table in this town, the room fills with the same flies every time, doesn't it?" (Clarke, J, and Stevenson, R, (2000) *The Games*, s02e05, *Inquiry*).

³³ ACCC Final Report, page 205.

- is a collection of functions and responsibilities that lack coherence or the resources and powers to discharge them effectively.

The proposed ECEC Commission will undermine, rather than support, government's stewardship of the system

A fundamental aspect of moving to a stewardship approach in ECEC is that government recognises that it has overall responsibility for the health, performance and operation of the system, and is accountable for the system. Government is not merely another actor in the system, undertaking discrete tasks (such as providing a subsidy), but must consider the functioning of the system as a whole, and be responsible and accountable for making sure that the system works as desired.

Putting aside its effectiveness (discussed below), providing a separate, independent ECEC Commission with a variety of functions could undermine this stewardship approach and confuse accountability for the system. Simply put, it would give government someone else to blame for the failings of the system. Government should feel *more* on the hook for the ECEC system as a result of a move to stewardship, not less.

The rationale for creating a new, independent ECEC Commission is not clear from the Draft Report. There is no lack of actors involved in the ECEC system currently. Adding a new actor risks increasing complexity and confusion for all other parties. Certainly, many of the functions identified in the Draft Report for the ECEC Commission should be performed in the system. But it is unclear why a separate, independent ECEC Commission is needed or beneficial. The ECEC system is complex and policy decisions can be contentious, but it is not monetary policy – it does not need to be taken out of the hands of elected representatives and presided over by an independent, expert board.³⁴ It is not exercising judicial functions that need to be independent of Executive Government. Indeed, stewardship of the ECEC system will require inherently political decisions to be made – about the best split between government and parent contributions, about trade-offs between quality, access and equity, about prioritising investment and reform for different places and cohorts of children and families. These are decisions that should ultimately be made by government, not an independent ECEC Commission.³⁵

The functions and responsibilities of the proposed ECEC Commission

The Draft Report provides a short description of the possible functions of the ECEC Commission, being to:

- support the Australian, state and territory governments to better coordinate and deliver ECEC policies, by providing information and advice
- provide a mechanism to hold the system stewards publicly accountable for achieving the objectives of ECEC policy.³⁶

However, throughout the Draft Report, a broader list of possible functions and activities for the ECEC Commission is provided. This includes having the ECEC Commission:

- Oversee implementation of a new National Partnership Agreement for ECEC.

³⁴ At the very least, it is no more complex or contentious than school education, public hospitals, VET, emergency services, etc – services that are seen as core responsibilities of government, for which responsibility ultimately rests with the relevant Ministers and Departments.

³⁵ Government should receive advice on these issues – this Inquiry is an example of this – but this does not require an ECEC Commission. This is core business for a government department, and whatever capability or knowledge a government department would need to build in order to give this advice would apply to any new ECEC Commission to the same extent (if not more so).

³⁶ Draft Recommendation 9.2

- Publish regular reports on performance against the commitments made under the National Partnership Agreement, as well as on the performance of the sector more broadly.
 - Provide advice to governments and monitor progress towards universal access.
 - Monitor and evaluate the costs and benefits of reforms implemented.
 - Track and report on progress against key milestones, such as the preschool outcomes measure and the National Children's Education and Care Workforce Strategy.
 - Provide advice to the stewards as to where gaps may be emerging and priorities may need to be adjusted.
- Start planning the transition towards universal access to ECEC, including considering changes to the CCCF, such as the quantum of funding, the areas where funding is required and the types of services that will address community needs.
 - Coordinate investments and provide advice on the type of assistance necessary.
 - Play a pivotal role in developing priorities for investment and planning so that expanded ECEC focuses on areas of greatest need and is achieved at a sustainable pace.
 - Monitor trends in the availability of ECEC and advise governments on their investment priorities and the outcomes that the CCCF funding is achieving for children and families.
 - Monitor the ECEC market to identify availability gaps and highlight where investment is required. This could extend to advising on what service delivery models may be most appropriate in different communities by consulting with local governments and other organisations, and identifying where there is a need for more tailored solutions, such as integrated services. This may be particularly relevant for remote areas where the number of potential ECEC users is small, the infrastructure and workforce needed to deliver a service do not exist, and incentives from the current funding model are inadequate to encourage the establishment of a service.
 - Identify communities where services will require block (or flexible grant) funding to enable the establishment of an integrated service or a service dedicated to Aboriginal and Torres Strait Islander children.
 - Provide advice as to where grant funding could be best spent [to improve availability]. It could also identify where there is a need for more intensive interventions, such as integrated services hubs – including those delivered by ACCOs.
 - Advise governments on the need for integrated early years services involving ECEC and the communities in which they are needed.
 - Examine connections between ECEC and other child and family services and identify the most suitable way to address any gaps.
 - Consider less common models of service provision, such as occasional care.
 - Advise on the need for additional investments in occasional care and the communities in which these services are needed.
 - Consider a community's preference for a playgroup when assessing ECEC availability.
- Be responsible for a coordinated approach to workforce planning, including clear objectives and monitoring.
 - Provide advice on where [policy/government] priorities may need to be adjusted.
 - Have the authority to collect data from the Australian, state and territory governments, as well as mechanisms to safely store and share data between jurisdictions.
 - Support the development of a knowledge base to guide ECEC policy and practice, working with researchers and policymakers to identify priorities, address gaps in the availability (and existence) of data and coordinate and fund research.
 - Monitor the substantial future risks for the availability of places offered at CBDCs due to the cross-subsidisation of younger children by older children becoming less viable as government preschool provision expands.
 - Be responsible for system-level quality.
 - Play a strong role in disseminating clear information to families, services and communities on their local markets.
 - Undertake roles currently undertaken by ACECQA, leaving ACECQA to deliver a fit-for-purpose regulatory system that works to continuously lift quality and inclusion across all services.
 - Undertake regulatory functions which could involve staff from state and territory regulatory agencies – who may ultimately become employees of the ECEC Commission.

- Oversee a research agenda.
- Report on where state-based approaches diverge or where there are overlaps between national and state level approaches that may be causing fragmentation and complexity for families and providers. The Commission could identify whether these inconsistencies could or should be improved by introducing nationally consistent arrangements. This could cover a range of domains, such as:
 - **inclusion support** programs offered by states and territories, and their interactions with the Australian Government's Inclusion Support Program
 - **workforce policies**, such as educator and teacher qualification requirements, career development pathways and professional development policies
 - **regulatory approaches**, such as ensuring sufficient resources for state regulators and considering broader policy responses to regulatory issues (for example, support for services that are working towards the NQF)
 - **OSHC contracting** approaches, developing a consistent approach to OSHC provision in schools.
- Review regulatory arrangements for out-of-scope services receiving direct Australian Government ECEC funding to ensure they meet the needs of children. As part of this work, the ECEC Commission, with Australian, state and territory governments should undertake a process of joint decision-making with Aboriginal and Torres Strait Islander services, communities and peaks to determine the appropriate way to regulate the quality of Aboriginal and Torres Strait Islander services out-of-scope of the National Quality Framework.

Without belabouring the point, the ECEC Commission's possible functions are found in Draft Recommendations 2.1, 7.1, 7.2, 7.5 and 9.2; Draft Findings 1.2 and 7.2; and in commentary on pages 5, 33, 36, 47, 49, 54-55, 121-122, 143, 197, 344, 348, 351, 424, 447, 463 and 515-516.

Which is to say that the actual functioning of the ECEC Commission – a central aspect of the Draft Report's proposed ECEC system – is not cohesively considered in any single part of the Draft Report, nor is there a clear vision for how the independent ECEC Commission would practically operate or fit within the Australian ECEC system.

The breadth of functions is significant, including reporting on governments' commitments and advising government about a range of access and other issues.

The Draft Report also contemplates significant, additional functions beyond the core scope of oversight and advice, including being "explicitly" responsible for "system-level quality" (page 463), being responsible for "a coordinated approach to workforce planning" (page 36), playing "a strong role in disseminating clear information to families, services and communities" (page 516), undertaking "regulatory functions" including those currently undertaken by State and Territory staff (page 516), and to "implement a comprehensive research agenda" (page 3). How these direct responsibilities would fit within a body whose primary purpose is provide advice to government and be an accountability mechanism is not explained, but there would seem to be significant tension between these fundamentally different functions.

It is unclear why these functions have been proposed for an independent ECEC Commission, but others, such as monitoring fees and out-of-pocket costs (Draft Recommendation 6.1) or reviewing and regularly adjusting the hourly rate cap (Draft Recommendation 6.2), are not.

It is generally unstated why the functions nominated are best performed by a body independent of government. The logic is clear where the ECEC Commission is proposed to oversee government, for example by publishing reports against agreed objectives (this is a fairly traditional and well-understood form of independent commission), but the functions mentioned in the Draft Report go well beyond this.

The success of the proposed ECEC Commission will be made more challenging as the ECEC Commission is not proposed to have funding or other levers to discharge its responsibilities, notionally only serving in an advisory or oversight capacity. It seems unlikely to succeed. It is difficult to recall a similarly conceived body that has been successful in modern Australian public administration.

Traditionally in public sector governance, the principle is that 'form follows function' – first settle what functions should be performed, then consider what the best body or bodies to perform the functions are.³⁷ Instead, the Draft Report appears to have started with the idea of an ECEC Commission, and then assigned it a disparate range of functions (and problems to solve) without outlining why these would be best performed by an independent ECEC Commission, or considering how effective such an ECEC Commission would be in practice.

The practical operation of the proposed advisory functions requires careful consideration. The Draft Report envisages an ECEC Commission with significant knowledge of individual communities across the country including, for example, their preference for playgroups when assessing ECEC availability (Draft Finding 7.2), unmet need for occasional care (Draft Recommendation 7.5), and identifying and addressing gaps between ECEC and other services (Draft Recommendation 7.2). Developing this knowledge would presumably require, inter alia, an extensive staff network that worked with and understood communities across Australia, as this would be needed to inform the ECEC Commission's advice to government on individual communities and projects. Is it the Commission's intention that government would then simply accept the ECEC Commission's advice? If this is the case, the ECEC Commission is, in practice, making significant decisions about the allocation of public funds, but operating independent of government and presumably not subject to the same accountability to Parliament. It also leaves government's role as steward unclear, as the ECEC Commission would be responsible for significant aspects of the system. If the Commission expects government to consider the ECEC Commission's advice as an input, and reach its own view, government would need to establish its own systems, processes and staffing to gather similar information to inform itself about the suitability of the ECEC Commission's advice. This would seem to be duplicative.

If the Commission wishes to proceed with an ECEC Commission, it should carefully consider its functions, powers and accountability. It could identify similar bodies that have proven successful, and carefully consider why these bodies have been successful and whether such success would likely be replicated in the ECEC system in Australia today. In practice, it seems likely that following such consideration, any ECEC Commission with broad functions may look a lot like a government department. The question then becomes why such a body should operate independently of government – what functions that it performs would benefit from independence from government, as opposed to being part of government and subject to traditional democratic and accountability processes.

4. The cause and implications of cross-subsidisation in the system

The Draft Report correctly identifies that in most long day care services, older children cross-subsidise younger children. Younger children are more expensive to provide ECEC for because staffing requirements (the majority of ECEC costs) are significantly higher

³⁷ This is also Commonwealth Policy, see Department of Finance [Commonwealth Governance Structures Policy \(Governance Policy\)](#) ("A clear and unambiguous purpose is fundamental to designing an effective governance structure. ... Form follows function.")

than for older children.³⁸ However, the Draft Report is mistaken to attribute this cross-subsidisation to parent and provider preferences for simpler pricing structures.³⁹ The cross-subsidy is imposed on families and providers by the funding system, as neither the CCS nor the hourly rate cap vary according to the age of the child – services *cannot* charge the actual costs of provision because it would be unaffordable for parents of younger children as fees would significantly exceed the hourly rate cap and therefore a large proportion of the fee would be unsubsidised.

This is a significant issue with the current funding system that means the funding associated with an individual child is not aligned with costs incurred by the service in providing ECEC to that child, and has profound implications for:

- the number of available places for younger children (as it means the availability of places for younger children is, essentially, restricted to being a proportion of the number of older children in a service);
- the price parents pay for ECEC (as ECEC for older children is more expensive than it would otherwise be, without the cross-subsidy);
- the vulnerability of the long day care sector to reforms that draw older children out of long day care services and into preschools (as with fewer older children to provide the cross-subsidy, they are unable to provide ECEC to as many younger children); and
- the incentives for providers.⁴⁰

Failing to recognise the cause of the cross-subsidisation, and effectively address it, means that the Commission's proposed reforms will not succeed – there is simply no way for the system to provide enough places for all 0–2-year-olds to access three days per week of ECEC if these places need to be cross-subsidised by 3–4-year-old children as they are now. This is evidenced in the current system already, with poorer availability for children aged 0-2 than older children.⁴¹

There are, broadly, three possible approaches to the cross-subsidy that the Commission could consider.

The first is to leave it in place. This has the benefit of being least disruptive, but it will leave in place systemic issues that will prevent the system from reaching the Commission and government's objectives – it will constrain capacity and therefore access for younger children; it will keep or increase upwards pressure on prices for older

³⁸ It is difficult to precisely quantify the level of the cross-subsidy as there is limited publicly available data, but given the staff level required by ratios is at least double that for younger children than older children (1:4 or 1:5 compared to 1:10 or 1:11), and labour is approx. 69% of the cost of ECEC delivery (ACCC Finding 8), it is highly significant. The ACCC, which otherwise showed a notable lack of curiosity on the implications of this for the operation of the market, said that it "could expect that labour costs to care for children under 3 years old would be close to double the cost of children over 3 years old" (September Report, page 85). Goodstart has reported that "the cost of running a birth to three room is around twice that of a 3-5 room" (page 18, [Goodstart submission to IPART](#)).

³⁹ Page 351.

⁴⁰ It is somewhat curious that many services do not operate only for older children, avoiding the need for cross-subsidisation. Given the scale of the cross-subsidy this could, in theory, allow them to both charge lower fees and make higher profits than services that offer a birth to five service. The reason for this would appear to be a combination of factors – families with both older and younger children value being able to use a single service for both children; providing ECEC to younger children is a form of 'customer acquisition' as they stay in the service when the child is older; services need a 'social licence' to operate and excluding young children may breach this; some services being purpose rather than profit driven; and the power of existing norms in the system.

⁴¹ Page 338.

children; and it will keep the long day care business model – and therefore the future viability of the whole system – highly susceptible to any reform or behaviour change that encourages children to attend standalone preschools. This seems an unsustainable approach to take.⁴²

The second option is to try and address it through the existing system. Using the existing architecture of the CCS system, as the Draft Report seems to want to keep in place, this could involve setting a different hourly rate cap depending on the age of the child, and setting different CCS rates depending on the age of the child (as well as the existing differences due to the income of the parents and number of children in ECEC). This would allow services to vary their fees according to the age of the child (and therefore the cost of delivery), but would introduce significant further complexity into the system, likely befuddling parents. This would be especially confusing for parents with children of different ages in ECEC, as they would be dealing with different fees, different CCS rates and different hourly rate caps for different children. This would send potentially confusing price signals to families, as the hourly rate cap and CCS rates would fall as the child ages, but so would the 'per day' price. Parents already struggle to understand the operation of the system; adding complexity seems at best undesirable and possibly unworkable.

The third option would be to adopt a new funding approach. This could be an entirely new system, replacing the current CCS, or it could be a supplement to the existing system. An entirely new funding system would allow many of the issues identified in the Draft Report and elsewhere to be better addressed, including by better aligning funding with need and costs, and embedding better incentives into the system. A supplement to the existing system (such as a supplementary payment from government for hours of ECEC to children under three) could be complex to design and implement (including ensuring that fees for older children reduced appropriately), and would not address other issues identified with the system. It could also risk over-correcting the current system, leading to a displacement of older children with younger children.

The Commission should give further consideration to the cause and impact of the cross-subsidy in the current system, and its implications for the system's ability to meet the objectives of the system. If the funding system is not able to deliver the desired objectives, then either the objectives need to be changed, or the funding system needs to be changed.

5. The cost and incidence of complexity in the system

Any system of any scale will have complexity. This complexity can be powerful and advantageous, increasing the effectiveness and efficiency of the system. But complexity also comes with costs, and the question of who bears these costs requires careful consideration, as the wrong complexity, or complexity being borne by the wrong actors in the system, can create inefficiency or reduce the effectiveness of the system.

⁴² The only reason to take this approach would be if it were desirable to limit the number of younger children in ECEC. This is not an unreasonable approach – younger children from advantaged backgrounds benefit less from attending ECEC, and could often happily be at home with a parent. However, this does not appear to be consistent with the Commission or government's objectives for the ECEC system, and would presumably need to be accompanied by other reforms reflecting less emphasis on workforce participation, such as significantly expanded paid parental leave or other family support payments. It seems far more likely that the cross-subsidy exists as an unintended consequence, rather than a deliberate policy choice.

Complexity in ECEC comes in many guises – leading an educational program for four-year-olds, or managing a room full of toddlers, is a difficult and complex exercise. In the ECEC system, it is the responsibility of trained educators. This makes sense – they are specifically trained for the job, and they are remunerated for their time and effort. This complexity is also unavoidable – it is inherently required for the system to operate.

In other regards, the complexity in the system is not well considered or allocated.

Both the Draft Report and the ACCC have noted the complexity of the current system – the Activity Test, the tapering subsidy rates, the hourly rate cap (both by itself and in contrast to the daily fees usually charged by services), the interaction with the rest of the tax and transfer system, the operation of withholding and end of financial year balancing, etc. Both the Draft Report and the ACCC have noted that parents find this difficult to understand and navigate, have difficulty understanding what they are entitled to and how to access it, and that this complexity can, in some cases, be itself a barrier to access. In addition, there is the complex administrative burden to participate in and comply with this system – updating work and income details with Services Australia, etc. And there are other aspects of complexity that are not directly related to the funding system, such as finding an available place on the desired days.

Some complexity and administrative burden on families is unavoidable. And much of the current complexity has an at least ostensibly rational purpose – targeting and means testing support, incentivising workforce participation, etc. Irrespective of considering how the system should change given the changed objectives of the ECEC system, further consideration should be given to the costs and implications of the complexity of the system. A system may be designed with conceptually perfect incentives, but if the people who need to respond to the incentives cannot understand them, or find the system so confusing they give up trying, it is not going to be effective. It may also be that the cost of the complexity is greater than any benefits. It is not enough for the system to work in theory, it also needs to work in practice. As the modern philosopher Homer said, "I agree with you in theory. In theory, communism works - *in theory*."⁴³ The current system places too much of the burden of complexity on families, undermining the practical effectiveness of the system.

This is particularly relevant in a universal system, where it is intended that all families are able to access ECEC, so the system needs to be navigable and comprehensible to them. Both the Draft Report and the ACCC say, in effect, that this is not the case in ECEC – that the hourly rate cap is too hard to understand (so does not act as an effective price constraint), that families struggle to understand their entitlement, that complexity is a barrier to access, etc. But the Draft Report maintains most of this complexity in the system. In this respect, it is difficult to follow how some of the Draft Report's analysis leads to some of its recommendations, and does not lead to other recommendations.⁴⁴

Consideration is also required of how the burden of complexity is distributed - a system where the costs of complexity are disproportionately borne by lower socioeconomic families, less educated families, or families with lower English proficiency or numeracy, is a particularly perverse outcome. The current system, with its complexity of entitlements and administration, likely creates particular difficulties for many of these families. It is also worth considering how this needs to be navigated by *any* family wanting to access

⁴³ Simpson, H, 'Bart gets an elephant' (The Simpsons s05e17, 1994). In practice, Communism does not work.

⁴⁴ Making the website better (Draft Recommendation 6.4), creating system navigator roles (Information Request 7.2), and similar steps are a small way of acknowledging and trying to manage the complexity, not removing it.

ECEC, who are likely to be already dealing with the interrupted sleep and general life chaos that comes with having young children.

In addition to other opportunities to simplify the operation of the system, the Commission could consider alternative ways for parents to contribute to the cost of ECEC. Under a different funding model (e.g. where the government directly funds services), a parent contribution could occur directly through the tax and transfer system (e.g. similar to how FEE HELP repayments are taken out of an employees pay, or through a levy such as the Medicare Levy) or otherwise be paid directly to government, rather than to a service. This could still allow for means testing and tapering, but would remove some of the complexity and administrative burden from families, and break the current link between parent fees and a service's level of resourcing. Rather than continuing the hourly rate cap, alternative approaches to price regulation (including restrictions on fees services are able to charge as a condition of government funding) could also significantly simplify the system for parents.⁴⁵

6. Ongoing affordability challenges

A significant focus of the Draft Report, and more broadly public discussion and government action in ECEC, is on the cost of access. The cost of access can be considered in three different ways:

- **Prices**, being the fees charged by services.
- **Out-of-pocket costs**, being the costs actually incurred by families (effectively, prices after the application of the subsidy).
- **Affordability**, being the measure of out-of-pocket costs relative to some other measure – for example, out-of-pocket costs as a percentage of household income. More broadly (or in addition), it could be considered the degree to which the out-of-pocket costs serve as a barrier to reasonable access.

In terms of **prices**, it is difficult to conclude that the system is constraining prices. Prices have consistently risen over time. The central element of the current funding system – the CCS – is a percentage subsidy that reduces the price sensitivity of consumers, while leaving government as majority funder of the system. The system relies on two things to keep prices down – the hourly rate cap, which both the Commission and the ACCC have not found to be effective at keeping prices down (but is proposed to be kept), and local competition on price. Local competition on price is, at best, limited and constrained by overall supply shortages and because the demand side is not very price sensitive, and the service is often non-discretionary (as parents need to use ECEC to continue to work or study). To the extent that the subsidy is increased in the future, the efficacy of relying on local competition to restrain prices will be further reduced.

⁴⁵ There are pros and cons of different approaches to price regulation, but various options should be considered in the Final Report, including relative to the pros and cons of the current approach and its likely suitability and effectiveness in the future. Some have pointed to the experience of Quebec as a cautionary tale against greater price regulation, but consideration of any system should be holistic, examining the full context and all policy settings, and not seek to attribute every aspect of a system's performance to its pricing approach. This would include, in the context of Quebec's reforms and outcomes, consideration of the adequacy of its quality standards and regulation, the adequacy of its supporting investment in workforce and service supply to meet increased demand, the design and adequacy of its funding approach, and the decision to operate two different funding systems alongside each other for different service types and the incentives this created for parents and providers. Any approach to price regulation is only one of many aspects of system design.

In terms of **out-of-pocket costs**, the Draft Report and ACCC note that these have fallen in real terms in recent years, but that this is only because of increases to the CCS rates. Without changes to the CCS rates, out-of-pocket costs would have increased in real terms. This is as a result of prices increasing above the rate of inflation,⁴⁶ and the design of the subsidy, which shares any increase in price between government and families. (This would be the case even if the hourly rate cap did not exist, or was regularly adjusted.) This implies that in order to keep out-of-pocket costs constant (in real terms), the CCS rates will need to be regularly adjusted to accommodate above-inflation price increases. The Draft Report has not proposed (or considered) this.

In the absence of changes to CCS rates (proposed only for 30% of families), and given price increases are all but certain for the foreseeable future, out-of-pocket costs will rise in real and nominal terms. This will inhibit access to ECEC and exacerbate existing cost concerns. While the Draft Report flags possible changes to the CCS taper rates as a result of the introduction of a 100% CCS for some families (Information Request 6.2), it does not propose anything beyond the reset and indexation of the hourly rate cap to improve current affordability, or to ensure future affordability, for the vast majority of families. The introduction of a 100% CCS could see out-of-pocket costs increase for some families – it will reduce price sensitivity for eligible families, and providers supporting eligible families would be able to increase their prices to the hourly rate cap, forcing non-100% CCS families to pay the higher price if they want to continue using ECEC at the service. There are no other changes to the CCS, and there is nothing that will improve the effectiveness of the hourly rate cap as a price restraint or otherwise constrain prices or pricing power. The Final Report should further consider how families' out-of-pocket costs are likely to increase in coming years, and what (if anything) should be done to address this.

The question of **affordability** is more complex, and also requires policy decisions – what does the Commission (or government) consider to be a reasonable level of out-of-pocket costs to families for accessing ECEC? This could be in absolute dollar terms (e.g. \$X per day), relative to household income (e.g. X% of annual household income for Y days per week), or descriptive (set at a level that means cost is not a barrier to access so every child can attend Y days per week, or every Z year old child can attend Y days per week). There are different approaches with different pros and cons, and a final position would ultimately reflect the policy view of the government of the day. But it would be helpful for the Final Report to describe how affordability should be considered in a universal system, and provide guidance to government to inform policy settings. The funding and other system settings could then be designed in a way that seeks to achieve a specific level or conception of affordability. Such a definition could constitute a benchmark against which future changes to funding and pricing approaches could be assessed.

6.1 Consideration of a universal 90% subsidy

The Inquiry's terms of reference specifically direct the Commission to consider a universal 90% CCS rate, in the context of "identifying solutions that will chart the course for universal, affordable, ECEC – in the great tradition of universal Medicare and superannuation". This is of particular note as it was a central part of the now-Commonwealth Government's election commitment with respect to ECEC.⁴⁷

⁴⁶ It's a separate discussion, but in short it seems unlikely that this will change in the short- or medium-term – ECEC is a labour and land-intensive service to provide, and absent other reforms, these inputs seem inherently likely to increase above average inflation for the foreseeable future.

⁴⁷ See, for example, the 31 March 2022 press release [Labor's Plan for Cheaper Childcare](#), which included "the Productivity Commission will conduct a comprehensive review of the sector with the aim of implementing a universal 90 per cent subsidy for all families."

The Draft Report considers a universal 90% CCS relatively briefly, essentially concluding that it would cost a lot of money, and the incremental cost savings from the change would flow disproportionately to higher income families. These points are accurate, but also self-evident. The Commonwealth Government would have been aware of both when it made its commitment, and when it commissioned this Inquiry. It is unlikely that the Draft Report has significantly added to government's understanding or consideration of the option.

It is not clear or unarguable that a universal 90% subsidy is the best approach. But the Draft Report's discussion of what constitutes reasonable affordability, or being clear about what would be involved in moving the system to a universal 90% CCS (or similar), is inadequate to reach a considered conclusion about it. The intent of a 90% CCS could also be effectively achieved (in terms of having a universally low cost for parents) by other means, for example through adopting of a different funding model that provided for lower and/or specific fees.

A 90% CCS in a universal system is not just an affordability reform, but would necessitate significant changes to many aspects of the system, including price controls, the role of government in supply, community attitudes and behaviours, and the operation of providers. The Commission could also give specific consideration to the benefits to children (in addition to workforce participation) that would be expected to flow from a 90% CCS (or similar). These benefits are likely to arise not just from increased attendance due to lower costs, but also from how a universal 90% CCS (or similar) would change the system (for example, greater operating scale and better-resourced services able to offer higher quality), and changed parent attitudes to ECEC (itself improving attendance) from the signal that such an approach would give about ECEC's importance. These benefits would be increased if other, complementary reforms were introduced alongside the subsidy change. A 90% CCS (or similar) could be transformative to the ECEC system; it warrants further consideration given the Commonwealth Government's specific interest in it.

The Final Report should further consider the different possible conceptions of a universal system, including with regard to access and affordability. This should include consideration from first principles of how the system should operate, not just in terms of the cost of any changes from the status quo. For example, public schooling and public hospitals are considered universal services in Australia, and are available, on essentially the same terms and costs, to whoever walks through the door. Public schools do not charge higher income families higher fees. This is generally considered to be because they are essential services offered to all Australians as part of a broader social compact. There are good reasons to consider ECEC similarly.

7. The Draft Report's consideration of supply-side funding

In the Draft Report, the Commission provides a brief outline of what it sees as the challenges in moving to a broad supply-side funding instrument.⁴⁸ This reasoning appears to form part of the basis for the Commission not recommending more substantial changes to the funding system in its Draft Report. It is worth considering each of the Commission's concerns in turn, as their strength suggests that more significant funding reform is worth further consideration.

⁴⁸ Page 490.

Implementing a broad supply-side funding instrument within established ECEC markets could dampen incentives for ECEC providers to tailor services to what works best for families, or weaken price signals that providers reference when making decisions about when to enter, expand or exit an ECEC market.

This may be true to an extent, but the materiality of it depends on the design on the funding system. For example, a supply-side funding system where most funding is based on available capacity could significantly dampen these incentives, but a supply-side funding system where most funding is activity based (for example, based on the number of days attended by the number of children) should still provide significant incentives both for the establishment of new services, and for services to operate in a way that meets families' needs and preferences (comparable to the current system).

Other supply-side funding approaches, for example different funding levels (or separate funding streams) would also increase the incentives for providers to act in accordance with government priorities in many cases – for example, operating in otherwise underserved areas (as contemplated by Draft Recommendation 5.1) or for particular cohorts of children and families (as could be provided by funding targeted to need, or other dedicated funding streams such as that proposed for Aboriginal Community Controlled Organisations in Draft Recommendation 5.1).

To the extent that a supply-side funding approach is more closely aligned to the cost of delivery, it would be removing incentives for services to over-service, and/or reducing the ability of services to achieve excessive profits in provision – this could be considered a strength of such a system, and lead to a more efficient and effective allocation of funds.

Some broad supply-side instruments also require governments to: develop an accurate understanding of the efficient cost of service delivery

This is accurate, but could be considered a feature rather than a bug of such funding instruments. That this is raised as a concern suggests that the opposite (and current system) may be true - that is desirable for government to spend billions of dollars a year subsidising a service from businesses without any understanding of what the efficient cost of quality provision is, and with limited other effective measures in place to exert downward pressure on prices. Better aligning government funding with the true costs of efficient, high-quality provision is likely to lead to a more efficient and effective use of government funds than government simply making funding available and hoping that is achieving value. It could also allow for funding to be better targeted to children's need, and could provide a mechanism to address the significant difference in the cost of providing ECEC to older and younger children (discussed in section 4) or where the cost of delivery varies significantly (such as remote areas) without impacting parent costs.

Implicit in this is the idea that government would have greater responsibility for ensuring that services are provided sufficient funding to deliver its intended purpose. This could be regarded as a strength of a supply-side instrument and consistent with move to a stewardship approach, with less reliance on the market to achieve desired outcomes.

Government developing an accurate understanding of the efficient costs of service delivery would also be required to implement Draft Recommendation 5.1 (block funding in some communities to cover capital and operating costs), Draft Recommendation 6.2 (set a new hourly rate cap based on average efficient cost, and review it every three years to ensure it continued to reflect costs), and Draft Recommendation 7.3 (set a different hourly rate cap for non-standard hours, based on the cost of provision), and it is effectively proposed by Draft Recommendation 6.1 (commission a detailed investigation of costs and profits across the sector every three years).

Some broad supply-side instruments also require governments to: develop a mechanism to adjust this over time to mitigate the risk of a mismatch in funding

This is accurate, but is in large part already recommended by the Commission in Draft Recommendations 6.1 and 6.2. It is also likely to lead to a more efficient and effective allocation of funding than is currently the case, as discussed in the above paragraphs.

Some broad supply-side instruments also require governments to: play a much stronger role in planning and coordination of service provision to address availability gaps

This could also be considered to be a feature of a new funding system, rather than a deficiency of it. A greater role for government in planning and coordination of service provision is required in the current system given well-documented issues with supply, and is also entirely consistent with other recommendations of the Draft Report (in particular, Draft Recommendation 5.1) and a stewardship role for government.

A stronger role for government in planning and coordinating supply does not have to be total control – government could focus on incentivising and supporting growth where needed, rather than on restricting entry to market.

It should be acknowledged that, depending on the degree to which incentives for the establishment of new services are dampened, there may be a need for additional government investment in new services, filling a gap created by the changed behaviour of the private sector in response to changed incentives. This may be an additional cost, but is one already contemplated by the Commission (see Draft Recommendation 5.1) and should be considered as part of a broader consideration of the costs and benefits of reform options – it is unlikely that any individual reform will be only of benefit, without any cost and risk.

Some broad supply-side instruments also require governments to: move away from individualised means testing.

This depends on the design of the system. Assuming a level of individualised means testing is retained (noting the earlier discussion in section 5 about the costs and incidence of complexity), there are a number of options available to government, including using the tax system to obtain a means-tested parent contribution (or otherwise having government, rather than the service, collect the fee), altering the level of funding provided to the service depending on the parents' income (and therefore, effectively, requiring higher fees for higher income families), or regulating fee levels with reference to parent income. Each of these has strengths and weaknesses, but they are plausible options that maintain a form of individualised means testing, and should be considered as part of a comprehensive consideration of reforms.

Other considerations

The main challenges of moving substantially or entirely to a supply-side funding approach are likely to be different to those identified above, in particular the ability of a supply-side funding system to adequately recognise reasonable variation in the costs of quality delivery across Australia,⁴⁹ and the likely inherent requirement for stronger price regulation restricting or removing the ability of services to use fee levels as a way to manage this risk.⁵⁰

⁴⁹ Although the ACCC found "the costs to supply different areas of remoteness and socio-economic advantage do not differ greatly, except for the areas of most remoteness or most advantage" (ACCC Final Report, page 111), which suggests this may not be as significant a challenge.

⁵⁰ The detail would depend on the specific approach to supply-side funding taken, but essentially if government provides funding directly to services in exchange for specified levels of provision or availability, but did not in some way restrict the ability of services to charge additional fees from

These are complex issues worthy of detailed analysis and consideration in the Commission’s Final Report to inform how supply-side funding might be implemented (including possible approaches to mitigate risks), what its strengths and weaknesses could be, and how this compares to the strengths and weaknesses of other approaches including the changes proposed by the Draft Report and the performance of the current system. This is work that the Commission could undertake that would meaningfully inform government about reform options in ECEC.

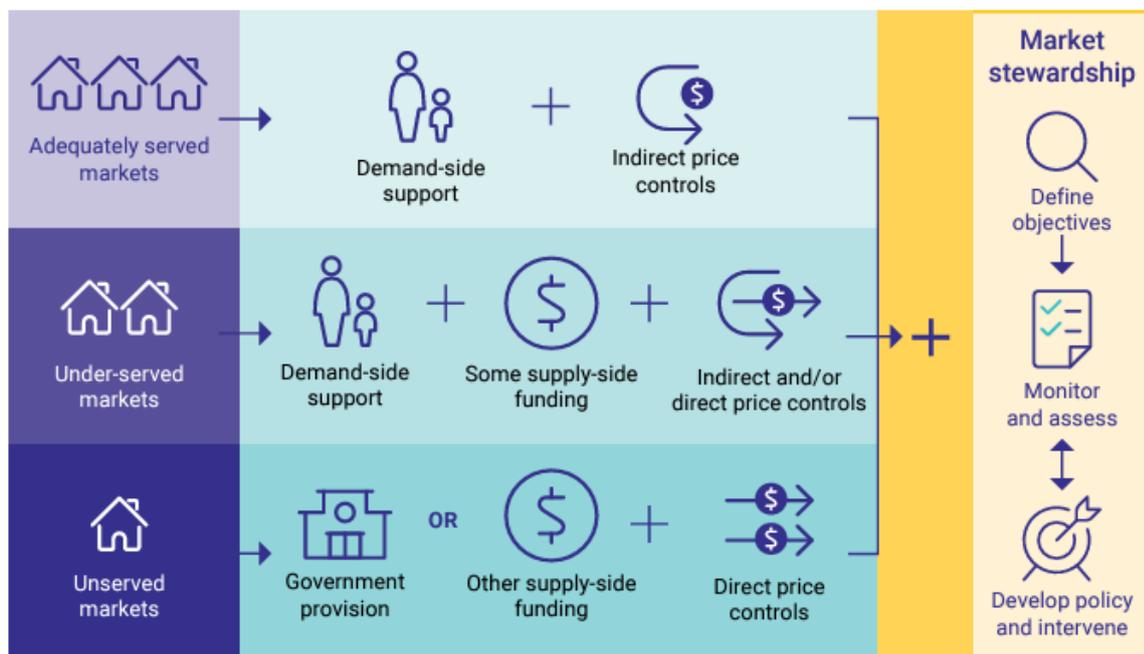
8. Additional comments

This section contains additional comments that do not fit within the earlier themes, but may still be of value to the Commission.

8.1 The ACCC’s conceptual model

The ACCC considered a variety of issues and, in its Final Report, provided a conceptual model for a future ECEC system (below). Given the ACCC’s Final Report is likely to be an important input into the Commission’s Final Report, it is useful to make some brief observations about this model.

Figure 1: Types of Australian childcare markets and recommended regulatory arrangements



Source: ACCC Final Report, page 4.

The ACCC’s broad proposed model – which essentially provides different levels of change from the current funding and price regulation approach and level of government intervention depending on the degree to which the market is considered to be failing – is conceptually logical and theoretically attractive. But it is difficult to understand how this would work in practice. The groups and characteristics that the ACCC suggests are examples of a market being under-served include children aged 0-2, culturally and linguistically diverse families, shift workers, areas of relative socioeconomic

parents, there would be significant access, affordability and equity issues, and many services would have the opportunity to extract windfall and/or excessive profits. So some form of price regulation would be needed (noting that price regulation approaches exist in the current system, but the same ones may not be suitable in a supply-side funding system).

disadvantage, and children with a disability. This would seem to include almost every community – and almost every *service* – in Australia. Such broad incidence of ‘market failure’ suggests that the issue is not isolated but systemic – there are not isolated areas of market failure, there is a broad failure of the current system.

In a practical sense, without going too far into the details (which is difficult because the ACCC does not provide them), it is unclear how the three different approaches to funding, provision and price controls would work in practice. Would it be determined at a community/geographic level? Would it be determined on the child or family’s characteristics? In many cases, individual families would be in multiple categories (e.g. with two children of different age), or services across the road from each other could be subject to different price control regimes. Consideration needs to be given to the complexity this would create, and price signals it may send, to families and services. There would also be complex family and provider incentives and market border/leakage issues to consider, as well as the challenges of government operating three quite different systems in parallel. Some of the challenges of reforms in Quebec would seem to flow from trying to have two different approaches to funding and pricing operating alongside each other in the same communities. The concept of more thoughtful and deliberate targeting government funding and action is sound, but its practical application requires careful consideration.

8.2 The place of OSHC in the ECEC system

The better question for OSHC may not be whether it should be included in the NQF (Information Request 2.1; it presumably needs some kind of minimum standards/regulatory framework, being generally the for-profit provision of care to children), but why it is part of an ECEC system at all. Granted, it is a support for workforce participation and child development, but so is schooling. Compared to other forms of ECEC, it generally uses different providers and different educators to provide a different service to a different age cohort of children in a different location. Its inclusion in the national ECEC system is likely a historical artifact of the Commonwealth Government’s focus on supporting workforce participation. (The almost complete separateness of it is illustrated well in the Draft Report and the ACCC’s Reports, which generally separates OSHC from other forms of ECEC when providing analysis, as considering OSHC as part of the same system as long day care is essentially pointless.) It is difficult to come up with a reason for keeping it in the same system, other than the doctrine of continuing error.

OSHC could instead be treated as part of the school system, with schools or school systems responsible for its provision and, potentially, its funding. The fiscal implications of such a change could be considered as part of a broader national discussion that addresses ECEC funding and governmental responsibility issues.

Conclusion

The Draft Report contains much important analysis and some useful recommendations. However, the analysis is, in some places, incomplete or incorrect, or its implications are not followed through with relevant recommendations. The Draft Report proposes primarily incremental changes to existing settings that will not solve systemic issues in the current system, nor achieve governments’ core objectives for the system.

This is not the first time the Commission has considered the ECEC system in Australia. It conducted a similarly broad inquiry in 2013-14, and its predecessor body, the Economic Planning and Advisory Commission, undertook a similar review in the mid-1990s.

In order to prevent another, similar inquiry in the 2030s, the Commission should return to first principles. The Draft Report is relatively clear about what ECEC should be

achieving at one level, but does not explicitly set out what this means in detail, what kind of a system is required to deliver it, or how to fix current systemic issues.

In order to effectively address the Commission's Terms of Reference, the Commission's Final Report should go further in its recommendations, being more holistic, more comprehensive, more ambitious and more imaginative in its advice for what a future ECEC system in Australia should look like, and how it can be realised. This should include greater focus on how the system supports children's development (including its equity and quality); consideration of broader funding reform (including how funding relates to need and cost); how barriers to and gaps in access can be addressed, including how the system can be significantly simplified for families; how affordability can be improved and maintained over time; and the appropriate governance and stewardship of the system.

This Inquiry represents a significant opportunity to improve the effectiveness and efficiency of the ECEC system in Australia, delivering significant benefits for children and families, government and the broader community. The opportunity should not be missed.