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The Structure and Funding of the School System

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1. Introduction

Caldwell (2004) argues that the state school system in Australia is in danger of becoming 'residualised'. Growing enrolments in private schools and evidence that (controlling for other relevant variables, for example, socio-economic status) students in private schools on average outperform students in state schools (Marks 2004) mean that there is a significant danger that the state system may become an inadequate 'safety net' system. As a result, government schools may be unable to provide the kind of high quality education that students need to achieve their potential.

This concern is raising pressure to reform the government school system. One option, which would be considered to be quite radical in Australia but is common overseas, is to move to an integrated public–private system. That is, bring private schools into the public system, in order to raise the overall quality of the whole system. The success of such an integrated system depends on a variety of factors, including the model for school funding.

Funding is a key issue for an integrated school system. How can primary and secondary schools be given at least limited autonomy over funding while retaining equity of access and education quality? In this article we analyse potential solutions for integrated school funding. Our aim is not to endorse a single 'preferred' alternative but to present a range of approaches that would improve the flexibility

and incentives embedded in education funding, while maintaining equity and excellence within the education system.

This article is based upon a longer paper (King and Anderson with Caldwell and Dawkins 2004), which was presented at the Making Schools Better Conference. That paper reviews international practice for school ownership, management and funding. In summary:

- (i) There is a wide variety of education funding models operating in different countries. Funding is often either explicitly or implicitly associated with students and student numbers.
- (ii) Government funding is not tied with government school ownership in a significant number of countries.
- (iii) There is an international trend to devolution of control and management of schools to school communities.
- (iv) There is a movement in some countries to increase the choices available to families when selecting schools, moving away from 'zoning' type systems.
- (v) While funding formulae differ between countries, a common approach to funding private schools is that they are integrated with the public system and funded on the same basis (or a similar basis) to public

schools. Private schools may choose to not be integrated and to either receive no government funding or reduced funding.

- (vi) Where private schools are funded on a similar basis to public schools, there is often a requirement that they charge no additional compulsory fees or are limited in their ability to charge such fees.

King et al. (2004) go on to discuss the broad principles that economic analysis suggests should underpin the ownership, management and funding of schools. Suffice it to say that in the longer paper we conclude that there is no fundamental reason why privately owned schools should not operate within the public system and that devolution of management responsibility and specialisation and diversity of schools should be encouraged.

In this short paper we focus on alternative models for an integrated public–private system, should such an approach be adopted.

2. Towards a Funding Model for an Integrated Public–Private System

We begin with some basic propositions that underpin the ideas incorporated in the alternative funding models that we present:

- (i) Equity of access and efficient educational service delivery are key factors that drive educational funding.
- (ii) The diversity of demands for educational services in the community means that government policy should allow for a broad choice of school by families and allow for an increased ability for schools to specialise in service delivery (including curriculum) subject to relevant minimum standards. This means that government-owned schools should have more control over their own curriculum and should be allowed to specialise.
- (iii) Funding for government-owned and privately owned schools needs to be integrated to maximise family choice and to

increase system equity. This can be achieved through a student-focused funding method, such as a universal per student allowance. Government funding will be associated with the student regardless of the school that they choose to attend.

3. Funding Options

3.1 Universal Allowance

An initial approach to education funding would be a universal per student allowance. The school attended by any child would receive the allowance associated with that child. The payment of the allowance would not be based on either the ownership or the management of the school, subject to the school satisfying the relevant minimum requirements set down by the government. Schools would need to be registered to receive the allowance and would be monitored to guarantee that minimum requirements were being met. Beyond these requirements, diversity among schools could be encouraged particularly in urban areas and at the high school level where each child potentially has a number of accessible schools.

3.2 Income-Based Allowance Funding

A universal per student allowance would be similar to the system that currently exists in some state schools in Australia. One limitation with a simple universal allowance scheme is that it need not provide the best targeting of limited government resources. For example, why should a high-income family with significant ability to pay for their children's education receive the same level of allowance as a low-income family? It is costly for the government to raise the taxation revenue required to fund a universal allowance. An alternative approach to a universal allowance might involve an allowance based on family income. Thus, a family whose income is say \$20000 per year would receive a higher allowance than a family whose income was say \$100000 per year. The allowance may also differ depending on the number of children in a family. For example,

the allowance might be lower for the first child and higher for later children.

An income-based allowance system would need to be carefully designed to avoid creating additional poverty traps for low-income families. It might be based on income over a period of time, for example the previous three years. This would reduce the shock associated with a loss of allowance as income rose.¹

3.3 Fees and Funding

What happens if a relevant school wishes to either charge fees directly to students in addition to the educational allowance or wishes to raise those fees? If schools are allowed to charge top-up fees in addition to receiving the allowance, does this mean that poorer families are relegated to allowance-only schools? Further, how does the government ensure that allowance-only schools exist?

3.4 Opt Out

One way to deal with the issue is to require that any schools that wish to charge top-up fees must opt out of the government funding system. A school may choose to simply accept the per student educational allowance and compete with other schools for students and their associated allowances. Such schools would not be allowed to charge any additional compulsory fees and there would be strict guidelines governing any so-called voluntary fees. Alternatively, a school may choose to charge fees directly to students and their families. Such schools would no longer be eligible for the educational allowance associated with each of their students. Such a scheme is similar to that operating in the United Kingdom.

3.5 A 'Fee Tax'

The problem with the opt-out approach is that it effectively involves a very high tax rate on schools for the first dollar of compulsory fees that any school wishes to levy. For example, if the government funding associated with a student is set at \$5000 per student then any school wishing to charge any compulsory fees would

lose the entire \$5000 for each of its students. Thus, if a school decided to impose a compulsory fee of \$100 per student per year then this fee would cost the school \$4900 per student. School communities that wish to access additional resources to increase the quality of education provided by their school are unable to do so unless they give up all of the relevant government funding. This is likely to have undesirable educational consequences.

The adverse effects of the opt-out arrangement could be modified by introducing a progressive tax on top-up fees. A school that chooses to charge students and their families fees in addition to the government allowance would lose a certain proportion of the per student allowance for each dollar of fees raised. For example, the tax rate could be set at 30 per cent, in which case a school would lose 30 cents in every dollar for additional top-up fees. In this case, if the basic per student allowance was \$5000 per student per year and the school chose to levy an additional \$1000 per student fee, then this would lead to a \$300 reduction in per student government funding for that school. Thus, the additional fee would raise \$700 overall, resulting in a total payment of \$5700 per student per year to the school.

3.6 A 'Fee Tax' with a Differential Government Allowance

This would allow school communities significantly more freedom to increase educational resources for their community. However, as with all top-up fee proposals, it raises the problems of free-riding and access. To see this, consider a school that does charge an additional \$1000 top-up fee. Some members of the school community may be unable to pay the relevant fee for legitimate personal reasons. To maintain equality of access the school would need to have appropriate mechanisms in place to ensure, for example, that low-income families were not disadvantaged due to their inability to pay the fee. But those mechanisms must also be able to prevent families from free riding. Some members of the school community who are able to pay the top-up fee and who would be willing to pay this fee were education

a standard private good may choose not to pay the fee claiming personal circumstances. Mechanisms that allow the school community to differentiate between legitimate cases of hardship and simple cases of free riding may be intrusive and difficult to administer.

The problem of access and free riding partially can be overcome by incorporating a top-up fee tax with a differential allowance. As noted above, the government per student allowance need not be uniform across all students. It can be based on ability to pay and may be differentiated according to family circumstances or the number of children of school age in the family. The base level of allowance might be \$5000 per student per year but this might rise to \$7500 for lower income students or for later children in households of moderate means. Schools might be allowed to charge top-up fees so long as the total per student contribution does not exceed the maximum per student government allowance.

To see an example of this type of scheme, suppose that the government sets the tax associated with school top-up fees at zero per cent subject to total payments by any household not exceeding the maximum per student government allowance. Again assume that the basic allowance is \$5000 per student per year and the maximum allowance is \$7500 per student per year. A school would then be allowed to charge a top-up fee that brought the total payments to no more than \$7500 per student per year. A school community could for example agree to a top-up fee of \$1000 per year. All students associated with a government allowance of less than \$6000 per year would be required to pay a top-up fee to raise their total payment to \$6000 per year. Thus, a student who receives a basic allowance would pay the full \$1000 per year. A student who received an allowance of \$5500 per year would only pay \$500 of the top-up fee. And any student who received a government allowance of more than \$6000 per year would not pay any top-up fee at all.

Alternatively, suppose the government imposes a 30 per cent tax on top-up fees. In that situation, if the school community decided to charge a top-up fee of \$1000 per year, all payments would be as above from the perspective

of individual families, but the school would lose the equivalent of 30 per cent of any top-up fee raised. Thus, a student who is only eligible to receive the basic allowance of \$5000 per year would still be required to pay a top-up fee of \$1000, but the school would lose \$300 of that student's basic allowance meaning that the school would receive \$5700 for that student. For a student eligible to receive an allowance of \$5500 per year, the top-up fee would remain at \$500, but this additional fee would lead to a reduction in the allowance received by the school in relation to that student of \$150. Thus, the top-up fee would leave the school with \$5850 from that student. Again, any student whose basic allowance is more than \$6000 per year would not pay any top-up fee and the school would just receive the allowance associated with that student.

The basic allowance should be sufficient to guarantee that all schools who rely only on this allowance are able to offer a good quality of education for their students. However, if the school community decides that it wishes to provide a higher level of educational services for its students then the top-up fee system allows the school to do this. If a family does not believe that the additional services offered by the school are 'worth their money' then the family can leave the school community and choose a more appropriate school for their children.

3.7 Voluntary Fees and Subsidised Out-of-Hours Programs

In educational services, many families 'get around' the government-imposed constraints by either moving their children to schools that do not face these constraints (for example, the existing private school system) or by purchasing ad hoc external educational services, ranging from 'extra curricular activities' such as music education to subject-specific tutoring.

The use of external ad hoc services to increase educational consumption is likely to continue regardless of the form of educational funding. But, to the degree that equity is a major consideration for educational services, such external provision of services clearly

undermines the equitable nature of educational opportunities. While the ad hoc services allow families who wish to consume extra educational options to pursue such options, this is purely on an ability-to-pay basis outside the formal schooling system.

To overcome these types of problems, one option could be to combine top-up fees, set subject to the maximum constraints noted above, together with tax deductible voluntary fees or service-specific fees. Voluntary fees could be set at a level above the standard school fees. Students would not be allowed to be excluded from any school activities if their families did not pay these fees, but the fees themselves would be tax deductible. This would provide an extra incentive for families who were able to contribute more funds to do so.

Such fees will always be subject to free-rider problems. Some families who could pay and whose children will consume the relevant services will try to avoid paying the voluntary fees. Such free riding may be avoided by having service-specific fees. For example, schools could offer additional 'out of hours' services such as music education or tutoring. While these services are currently available on the private market, by bringing the activities inside the school the government can use differential funding to help maintain equity and equality of access to educational services while reducing free-rider problems.

By recognising that there already exists differential educational consumption, and by bringing such consumption within the purview of the broader school community, the government will be able to extend the objectives of equity and efficient educational production to out-of-hours services. This will allow the school community to increase consumption while minimising free-rider effects without creating a segregated system based on ability to pay.

4. Compulsory Fees

4.1 Charging Compulsory Fees

Bringing out-of-hours programs within the basic educational framework allows school

communities and individual families to raise their level of educational consumption if they so desire while maintaining equity of access. However, this type of scheme still only involves a relatively low level of freedom to raise educational consumption. An alternative approach would be to allow schools to levy compulsory fees that could be used to fund a higher level of educational services, with the relevant level of fees set by the school community without a government upper bound. Thus, a school community that wanted a significantly higher level of educational services than the basic level supported by government funding would be able to charge additional fees in order to provide those services. Such fees might be tax deductible.

Many private schools currently operate on this system. In some situations the school communities are happy to charge and pay relatively high fees, in excess of \$10000 per student per year, without tax deductibility. However, the vast majority of private schools do not set such high fees and the school community determines fees at a lower level that is appropriate for their desired educational services.

The establishment of compulsory fees clearly eliminates any free-rider problem as students who do not pay the fees are excluded from the school. At present, however, the ability to charge such fees only resides with the minority of private schools while government-owned schools are prevented from charging any compulsory fees.

Any requirement to pay compulsory fees creates issues of equity and access. A student from a low-income family might be unable to afford to pay such fees. If fees were charged by all schools then a student might effectively be excluded from attending all relevant schools due to an inability to pay the fees.

There is a variety of ways to address the problems of access and equity with compulsory fees and we discuss these below.

4.2 Compulsory Fees Subject to Minimum Admissions

One way to overcome the issues of access and equity would be to require that any school that

charged such fees and that wished to remain eligible for basic government funding must admit a minimum number of students on an allowance-only basis.

To see how such a scheme would work, consider the opt-out system discussed above. Under this system a school that charged any compulsory fees was required to opt out of government funding altogether. Suppose instead that the school could charge additional compulsory fees to, say, 75 per cent of its students so long as it reserved 25 per cent of places in the school for allowance-only students.

The objective of such a scheme would be to maintain access and equity while providing the school community with flexibility to fund additional educational services if that school so desires. The process of choosing those students eligible for 'fee free' places would have to involve a transparent arms-length process based on ability to pay or some equivalent measure. As already noted, schools may not be well placed to make judgements about individual families. Thus, the government might have a role in determining which students would be eligible for fee-free places at various schools.

Alternatively, the fee-free places could be left to the school's arms-length choice but the government could provide differential per student allowances so that fee-charging schools would have a monetary incentive to admit students from lower income families to their fee-free places.

This is not the only type of scheme that could be used. An alternative would involve a 'tax' on any compulsory fees that the school would have to redistribute to fee-free places. For example, suppose that a school faced a 25 per cent tax on additional fees that had to be allocated to fee-free places if the school wished to retain government funding. Thus, if the school charged a fee of \$10000 it would effectively receive \$7500 from each full-fee student, with the additional \$2500 being allocated to a fee-free student. Clearly, to gain the \$7500 (after tax) amount required for a fee-free place, the school would need three full-fee students. Thus, the 'tax' would be equivalent to requir-

ing the school to provide 25 per cent fee-free places.

While a tax-based scheme and a simple fee-free requirement would be similar, the tax-based proposal allows more flexibility. For example, the government could increase the 'tax' as the fee level rises. For example, a school that only requires a \$1000 fee might face a tax of only 10 per cent so that there would be 10 per cent fee-free places. But as the compulsory fee rises, the tax could also rise so that a school charging higher fees must also have a higher number of fee-free places if it wishes to maintain its government funding.

4.3 Location-Based Admissions

An alternative approach could be to require that schools take fee-free students from within their geographic zone, but are able to charge fees to students outside the zone. For example, an urban high school in Melbourne might be required to take all students within a relevant geographic area without charging fees, but would be able to charge compulsory fees for any students who are 'out of area'.

Such a scheme guarantees that all students have access to at least one fee-free schooling option. It would be a relatively modest amendment to the operation of existing government-owned schools, for example, in Victoria. In this sense, it may allow government-owned schools additional flexibility with relatively little additional administrative burden.

The limitations of such a scheme are, however, exemplified by the existing zoning system for high schools in Victoria. Schools with better reputations are in high demand and families are willing to pay a premium on housing to be in a relevant 'school zone'. The introduction of out-of-zone fees would exacerbate this effect. Families would be willing to pay more for a house close to a high-fee school in order to be able to avoid paying the relevant fees. Thus, there would be a transfer to current home owners in desirable zones rather than to the relevant schools. In effect, families who could pay the fees would be able to avoid the fees by buying a relatively expensive house in a desirable school zone. Poorer families would not have

this option and would either be excluded from the school as they live outside the zone or would have to pay the fees.

5. Summary and Conclusions

Given a number of basic propositions outlined at the beginning of this article, we have put forward the following suggestions should an integrated public-private system be pursued.

- (i) Privately owned schools that choose to gain access to government funds must be subject to similar restrictions regarding compulsory fees as government-owned schools.
- (ii) Scarce educational funds must be better targeted and school communities should have flexibility to top up government funding subject to the maintenance of equity of access.
- (iii) To improve targeting and school flexibility, per student funding could be means-tested or based on 'area income'. Schools would be allowed to charge top-up fees to families where the government deems that those families are able to contribute more to educational funding. Low-income families would be protected through the differential government payment.
- (iv) The government could impose a tax on any top-up fees if it was deemed desirable.
- (v) To allow schools to offer improved programs while maintaining equity of access and avoiding free-riding problems, schools could be allowed to charge voluntary fees above the government cap, where these fees are tax deductible.
- (vi) If the government allowed some or all schools to charge additional compulsory fees above the government cap, then these fees should only be allowed if the school makes fee-free places available to students. The number of these places (as

a percentage of the total student enrolment) could vary with the size of additional compulsory fees.

- (vii) Regional schools face specific funding issues. In particular, families may face limited school choice. Higher per student funding to ensure equitable access while maintaining the highest quality service may be desirable for regional schools.

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Endnote

1. One idea that could be adapted to help avoid poverty traps and deal with equity issues is the use of income contingent loans. For example, the higher education contribution scheme (HECS) involves assistance based on future lifetime earnings and so reduces any poverty trap effects. In the case of primary and secondary education some use of a HECS-type system could be possible. Such a scheme could be targeted at either the parents or the child, although a scheme targeted at the child would need to be relatively moderate and would probably only apply to the later years of high school.

Another way to avoid creating a poverty trap for parents is to base the allowance on local area income. This type of scheme is used by the federal government when funding private schools. Parents who live in relatively poorer areas would receive a higher educational allowance. For example, a family living in a relatively poor rural area of Queensland would receive a significantly higher educational allowance than a family living in a middle-class Brisbane suburb.

Such an area-based system raises the prospect that richer families might choose to move to poorer areas in order to gain a higher educational subsidy. However, to the extent that such a movement occurred this may have good social spillovers.

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