The benefits of and issues associated with output-related funding (ORF) were assessed by examining the use of ORF in vocational education and training (VET) in the European Union and the United States. Data were gathered in the following ways: several online bibliographic searches; consultation with 54 experts, including VET researchers, national policymakers, and lobbyists; CEDEFOP requests for information from organizations and individuals; and traditional library searches. ORF was defined as basing funding on outputs produced, which are generally measured in terms of the achievement of qualifications for school-based training and/or job attainment. The emphasis given to ORF in the VET programs examined ranged from 75% (the United Kingdom's Training for Work program) to 5% (Job Training Partnership Act programs). ORF was determined to offer the following benefits: gives training providers more flexibility in the type of provision offered; enhances improvements in performance; increases value for money by providing incentive to fulfill certain achievements and discouraging "time-serving" in training, which does not lead to outcomes; and simplifies administration and clarifies audit requirements. ORF's success in achieving efficiency, reducing administrative costs, and enhancing accountability could not be determined unequivocally because it was rarely used as the sole instrument of performance management. (57 references) (MN)
Output-related funding in vocational education and training

A discussion paper and case studies

A report prepared by
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on behalf of CEDEFOP
Output-related funding in vocational education and training
A discussion paper and case studies

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A great deal of additional information on the European Union is available on the Internet. It can be accessed through the Europa server (http://europa.eu.int).

Cataloguing data can be found at the end of this publication.

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This Report builds on internal CEDEFOP research carried out by Ms Sarah Elson-Rogers before this project was commissioned in November 1997. I am most grateful to Ms Elson-Rogers and CEDEFOP for allowing me to draw so readily on this work. I am particularly grateful to Ms Elson-Rogers for the guidance given at every stage of the project, including suggesting experts to contact, pointing out written material of relevance and commenting on various drafts of the Report.

The Report forms part of a much larger CEDEFOP programme of research on the Financing of Vocational Education and Training. This includes a series of portraits describing the way in which vocational education and training is financed within individual Member States of the European Union, as well as a number of discussion dossiers on certain aspects and mechanisms of financing, of which this Report is one. For further information on this programme contact:

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<tr>
<td>CCTE</td>
<td>Chambers of Commerce, Training and Enterprise</td>
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<tr>
<td>CEDEFOP</td>
<td>European Centre for the Development of Vocational Training</td>
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<td>CETA</td>
<td>Comprehensive Employment Training Act</td>
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<td>DfEE</td>
<td>Department for Education and Employment</td>
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<td>DoL</td>
<td>Department of Labor</td>
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<td>EOC</td>
<td>Equal Opportunities Commission</td>
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<td>EU</td>
<td>European Union</td>
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<td>GAO</td>
<td>General Accounting Office</td>
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<td>ILO</td>
<td>International Labour Organisation</td>
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<td>JTPA</td>
<td>Job Training Partnership Act</td>
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<td>LEC</td>
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<td>MA</td>
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<td>ORF</td>
<td>Output-Related Funding</td>
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<tr>
<td>PIC</td>
<td>Private Industry Council</td>
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<tr>
<td>RSA</td>
<td>Royal Society for the Encouragement of Arts, Manufactures and Commerce</td>
</tr>
<tr>
<td>SDA</td>
<td>Service Delivery Area</td>
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<tr>
<td>STN</td>
<td>Special Training Needs</td>
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<tr>
<td>TEC</td>
<td>Training and Enterprise Council</td>
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<td>TfW</td>
<td>Training for Work</td>
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<td>UK</td>
<td>United Kingdom</td>
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<td>US</td>
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<tr>
<td>VET’</td>
<td>Vocational Education and Training</td>
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<tr>
<td>YC</td>
<td>Youth Credit</td>
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<td>YT</td>
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This Report aims to inform policy-makers about the issues arising from and practice of funding Vocational Education and Training (VET) on the basis of programme outcomes rather than enrolment/attendance (i.e. switching the emphasis of funding from inputs to outputs). It gathers together in a single dossier an outline of the policy issues output-related funding (ORF) generates as well as a number of real-world examples of its use in countries within and beyond the European Union. The objective of the Report, therefore, is to provide a useful summary document of evidence on ORF and its practice, which policy-makers and others may wish to consult.

ORF offers several benefits to policy-makers. These include:

- giving training providers more flexibility in the type of provision offered
- enhancing improvements in performance
- increasing value for money by providing an incentive to fulfil certain achievements and by discouraging ‘time-serving’ in training which does not lead to outcomes
- simplifying administration and clarifying audit requirements

Set against these benefits are a number of operational issues which need to be tackled before ORF can be introduced, as well as a number of consequences and implications which can arise from its implementation and use. These can be summarised in a series of policy questions:

- What level of ORF is required to reap the optimum benefits of tying funding to output?
- Is ORF passed on to all those in the contracting chain?
- How is output defined?
- How is output measured?
- How are funding uncertainties minimised?
- Do the measures of performance used to financially reward and penalise training providers act as good proxies for the long-term labour market prospects of trainees?
- Are only the best candidates ‘creamed off’ onto output-related funded programmes?
- To what extent are eligibility criteria used to counter the danger of ‘creaming’ by requiring training providers to ‘dredge’?
- How is participation of disadvantaged members of the labour market protected?
What consequences does ORF have for the content and occupational spread of training provision?

Does ORF lead to cash flow problems among training providers?

Are particular types of training provider more at risk than others from the operation of ORF?

Does ORF raise barriers to entry for new training providers?

Are the administrative rules and regulations that accompany ORF simpler or more complicated than other systems?

Does ORF reward the value added by training intervention?

Does ORF reward all or only some of the value added by training providers?

What checks and balances are in place to ensure probity and reliability?

What mechanisms are used to counter these problems?

How successful is ORF in achieving its aims?

The Report outlines the operation of ORF in countries within and beyond the EU with the above policy questions in mind. In particular, attention is focused on the British system of funding government training schemes, the US system of training the disadvantaged and poor through a federally funded programme, and Dutch proposals to use some form of ORF in the near future to finance adult and vocational training. As such the Report provides a wealth of material for policy-makers and other interested parties to reflect on a funding arrangement from which other EU Member States may wish to borrow or learn.
1.1 Aims and Objectives

This Report aims to inform policy-makers about the issues arising from and practice of funding VET on the basis of programme outcomes rather than enrolment/attendance (i.e. switching the emphasis from inputs to outputs). It outlines in a single dossier the policy issues output-related funding (ORF) generates as well as a number of real-world examples of its use in countries within and beyond the European Union (EU). The objective of the Report, therefore, is to provide a useful summary document of evidence on ORF and its practice, which policy-makers and others may wish to consult.

It should be noted at the outset that ORF in the Report is discussed in the context of public sector provision of initial vocational training and training for the unemployed - although the discussion could also apply to the public provision of continuing vocational training. The terms ‘output’ and ‘outcome’ are used interchangeably throughout the Report.

1.2 Methods

Material for the Report was gathered in a number of ways; four avenues in particular were pursued. First, several on-line bibliographic searches were launched using different search engines and a range of keywords. The latter included ‘output-related funding’, ‘performance-related funding’, ‘financing training’, ‘funding training’ and ‘creaming’ as well as titles of specific training programmes. Through these means, the contents pages of recent (post-1990) social science journals were searched. If the title and abstract seemed relevant to the focus of the project, the articles were consulted.

Secondly, in order to ensure that the material available for inclusion in the Report was as up-to-date and comprehensive as possible, international Vocational and Education
Training (VET) experts were contacted by letter, fax or email. They were asked to supply information or contacts relevant to the Report's focus. A total of 54 experts, including VET researchers, national policy-makers, lobbyists and representatives of international organisations, were contacted in this way during the life of the project. Most of these were based in the EU, and nearly all of them responded with information of one sort or another.

Thirdly, CEDEFOP carried out a number of searches of its own and lodged requests for information with organisations and individuals with whom it is in regular contact, making additional documents available to the project.

The fourth material-gathering device was the traditional library search. Two libraries in particular were the focus of attention: the University of Leicester library and the Department for Education and Employment (DfEE) library in Sheffield. Keyword searches were made at both.

1.3 Outline of the Report

The Report consists of two parts:

- an outline of some of the economic and social issues arising from ORF regimes
- three examples of ORF usage from both within and outside the European Union

The Report is structured accordingly. Section Two discusses the policy issues which may arise, Section Three provides information on how ORF has so far been used to fund VET in several countries and Section Four concludes the Report with a short summary which brings the two major parts of the Report together.
This section of the Report discusses what output-related funding (ORF) is, the rationale and principles behind its introduction, a series of operational issues, and a number of consequences and implications which can arise from its implementation and use. Within these sub-sections a number of issues associated with output-related funding will be discussed. At the end of the section, the discussion will be summarised by posing a series of policy questions to be considered when evaluating and assessing ORF regimes.

In this section, the discussion takes place in the abstract and makes no judgements about the very different VET funding systems across the EU. The points made below are general issues associated with output-related funding, which could vary according to individual VET systems and the policies and programmes which govern them.

### 2.1 What is Output-Related Funding?

There are three main activities or events to which the funding of vocational education and training (VET) can be related:

- enrolment (sometimes called 'starts' or 'entries')
- the duration and nature of programmes (i.e. course length, attendance requirements and infrastructure needs)
- the outputs produced (usually measured in terms of qualifications achievement for school-based training and/or job attainment with regard to labour market training)

Output-related funding (ORF) refers to the last of these mechanisms. It can be used singularly or in combination with the other two.

All three mechanisms are related in some way to the performance of training institutions, measured in terms of enrolment, attendance or attainment. Hence, the use of the term performance-related funding can sometimes lead to confusion. Indeed,
several experts consulted for this project conceived performance-related funding in such an all-encompassing way. This Report, therefore, avoids using this term wherever possible. Having said this, it is important to note that the term is commonly used in the US literature (see Section Three below) to refer to what this report calls ORF.

For this Report, output-related funding is defined as funding which is linked in some way to a pre-defined 'successful' and 'measurable' output of the VET system. What might constitute a 'successful' and 'measurable' output to the training system is discussed in more detail below.

It is important to point out that an ORF mechanism is unlikely to be introduced as a single measure; rather, it will be the result of other reforms and changes to the VET structure and funding regime. As it operates on the supply side, it will usually be introduced as part of a package of measures aimed at improving the delivery of training by decentralising the management of programmes and resources to those nearer the point of delivery. As a result, ORF is often used as a means of ensuring that those charged with administering government programmes (whether private or public sector organisations) are financially accountable for the success, or otherwise, of the outcomes delivered. In other words, ORF is often used as a means of monitoring performance and ensuring accountability.

2.2 What is its Rationale?

In general terms, the rationale behind introducing output-related funding is to create an incentive-based funding mechanism which aims to improve (or discourage) certain pre-defined outputs as a means to reward, or penalise, training institutions. Within this general principle there are more specific ones which depend on individual VET systems and the relationships between the various stakeholders.

Nevertheless, the arguments in favour of ORF have widespread applicability, which may appeal to those concerned with 'training' issues as well as to those concerned with
funding'. It is worth rehearsing these in some detail at this point, so that policy-makers can balance the potential benefits against the possible costs ORF may bring.

2.2.1 ORF as an incentive to improve efficiency

By making a proportion of a training institution’s budget dependent on the achievement of a particular output(s), an incentive is immediately created for institutions to improve or change certain aspects of their training policies in order to increase their chance of generating the desired output(s). Depending on the definition of output, this could include focusing on the quality of the training delivered and/or the assessment and guidance offered to trainees prior to, or after, training. By re-focusing and re-assessing certain aspects of the training process, the efficiency of the whole training system may be enhanced. For example, more emphasis could be placed on placing trainees in appropriate courses where they will have a reasonable chance of success, closely monitoring their progress, and taking quick corrective action when a trainee is underachieving or exhibits an inclination to drop out. Furthermore, provided the output-related funding regime is correctly weighted to maximise achievement and support training for those with special needs, ORF can offer training providers financial inducements to take on trainees with special needs and provide an incentive to stretch all trainees to their fullest potential.

In addition, funding on the basis of training weeks can encourage stakeholders to think in terms of time-serving, and can be an incentive to training providers to retain trainees for an unnecessarily long time. Paying for outcomes, on the other hand, gives an incentive to reduce training time to the point necessary for trainees to achieve the 'output', whether this is concerned with gaining a qualification and/or obtaining employment. It also means that training provider income is geared to success. If a trainee leaves earlier than expected, but gains an outcome, the training provider's income is not affected. Conversely, lengthy training times are not rewarded.
2.2.2 ORF as a means of enhancing flexibility

Linking funding to outcomes could provide an incentive for training providers to offer a broader and more flexible range of training options. Providers could opt for a long, low-cost-per-week solution, or a short, high-cost-per-week arrangement, with the same overall financial effects; the ability to do this will depend on existing regulations regarding the time spent in training. Nevertheless, the flexibility inherent in an ORF model might be of benefit to all concerned: to trainees whose training can be more closely tailored to their needs; to training providers designing programmes; and to programme administrators, who can better match training and labour market needs and trainees' aspirations.

2.2.3 ORF as a means of reducing administrative costs and bureaucracy

Detailed attendance records on all participants are required if funding is tied to the time spent in training. This means that considerable resources are devoted to the collection, monitoring, and auditing of attendance records; such resources might be better spent on delivering the training itself. A process-based funding system, therefore, might be costly to maintain, complex, and open to abuse. One of the potential benefits of ORF is that it can be used to simplify administrative systems, help to develop clearer audit paths, and hence enhance provider accountability. The volume of data to be checked under an outcomes regime is potentially more manageable and the documentary evidence required is for discernible one-off events. This can release resources to be used for training delivery.

2.2.4 ORF as a means of improving transparency and accountability

Last but not least, ORF provides a financial incentive to fulfil certain achievements and therefore provides a mechanism for policy-makers to emphasise the delivery of the outputs they consider essential. This could mean adding to the overall stock of qualifications held by the workforce or getting people into jobs. Tying funding directly
to these policy goals can make these training objectives and their achievement more transparent, and therefore makes the parties involved more accountable.

2.3 Operational Issues

The introduction of ORF requires that a number of operational issues be dealt with before the potential benefits outlined above can be realised. Again, these issues will largely depend on the way in which individual funding and training systems are structured. However, some general points can be made.

2.3.1 ORF mechanisms

Although the principle of ORF is straightforward, it is rarely used in its purest form, i.e. funding for outputs only, for a number of reasons outlined further below. Instead, ORF is used in combination with enrolment- and attendance-based funding; these are often referred to as ‘starts and outcomes’ and ‘weeks and outcomes’ regimes. In both cases funding is split into two parts. Under the ‘starts and outcomes’ regime, one part of the payment is triggered by each trainee who enrols in the programme, while the other is due for each trainee who exits the programme with a particular outcome. The ‘weeks and outcomes’ regime maintains a stronger link with the process of training, where payment is based on trainee attendance as well as trainee performance on completion.

Under either regime the emphasis given to ORF can vary. Indeed, as Section Three shows, the UK gives significantly more emphasis to ORF than the US. Moreover, the tendency in the UK has been to tilt the balance even further in the direction of ORF in order to maximise the potential benefits it brings. This raises the question of the optimal balance between input-related and output-related funding that maximises the potential benefits of ORF (some of these have been outlined above), while minimising its associated costs (these are outlined further below).
2.3.2 Institutional structure

It should be noted that the funding chain between government and training provider is often mediated by other organisations. This means that ORF contracts between government and training intermediaries need not be passed on in full, or even in part, to training providers. ORF, therefore, needs to be studied at various points along the contractual chain, as it cannot be assumed that agreements reached at one level are automatically passed on unchanged or unmodified to those further down. This point is made in more detail in the case studies contained in Section Three.

2.3.3 Defining a successful output

A key operational issue is: What is defined as a 'successful' output? While this might be politically determined, one can single out two major outputs commonly sought from government-funded VET. First, the acquisition of skills as shown by qualification attainment; this can refer to the grade/level achieved, the number of certificates awarded and/or the area of study. Second, output may be defined, in both initial training and training for the unemployed, simply as getting trainees into jobs.

2.3.4 Measuring a successful output

Associated with this operational issue is how outputs, once defined, are measured. In principle, there are three ways of doing so: 'absolute', 'relative' and 'value-added' measures. The 'absolute' measure takes no account whatsoever of the quality of intake; that is to say, institutions are measured according to the outputs they achieve, regardless of the quality of the recruits they are able to attract. The second, 'relative' measure is designed to reward enhanced provider performance by linking funding to improvements training providers are able to make to their past performance. However, neither an absolute nor a relative measure links inputs to outputs. The third measure - 'value-added' - attempts to achieve this feat, thereby isolating the contribution training providers alone make to output. This can be achieved by comparing 'the characteristics and attainment of learners at entry (the input data) and their achievements at exit (the
output data)' (Further Education Unit, 1993, quoted in Further Education Development Agency, 1995: 1). In practice, this means finding an indicator which acts as an approximation for every training participant's 'input' value into the training process and establishing whether the process of training leads to higher 'output' value, i.e. the value added to the stock of human capital. Such a measure, therefore, aims to identify the expected output of the training process, given that there are differences in input levels. This ensures that the achievement of a 'successful' output is within the ability of every training institution, since success is measured by the difference between inputs and outputs.

2.3.5 Funding an ORF regime

Another key operational issue is how the regime is to be funded. One of the central advantages of the system of ORF is that it encourages training providers to achieve increasingly better outputs. However, this raises difficulties from a funding perspective, since public expenditure commitments will also rise (fall) in line with increased (decreased) training provider performance. One way of countering funding uncertainty is to place a ceiling on the payments that can be made to training providers, thereby capping funding at a certain level. However, there is a trade-off between giving training providers greater financial incentives to do well and knowing with some certainty what is likely to be spent. Inevitably, a compromise between these two positions has to be reached before ORF can become operational.

2.4 Some Consequences and Implications of ORF

Like other funding mechanisms, ORF can have a number of consequences when put into practice. Many of these are revealed by the evaluations reviewed in Section Three - some have led to modifications of the ORF regime, others have even prompted institutional reform. It is, therefore, worth considering, albeit briefly, the possible consequences and implications of ORF in relation to its potential benefits in the abstract before considering them in real-world situations in Section Three. Again, these
consequences and implications will depend on the existing policies and regulations concerning individual training and funding structures.

2.4.1 ORF: efficiency and equity?

- Measuring short-term performance

The system of ORF usually rests on observed outcomes shortly after the completion of a training programme. This is partly due to the nature of recurrent funding and the need to minimise the time-lag between training delivery and the receipt of payment (i.e. cash flow). Definitions of successful outputs include participants in work at a designated week after graduation, their weekly earnings that week or the number of hours worked during that week. However, these are short-term indicators of performance and may be poor proxies for the evaluation of the long-term benefits of investment in human resources. In other words, training programmes may temporarily raise the labour market prospects of those who participate, but the advantage they gain may quickly disappear. Rewarding training providers for longer-term effects, however, is likely to lead to measurement and cash flow difficulties. Measuring output on the basis of short-term indicators might affect the long-term efficiency of the funding and training system.

- ‘Creaming’ and ‘dredging’

Operators may react to ORF by enrolling only those most likely to meet the output criteria, i.e. they will ‘cream’. This is more probable in cases where the applicant pool is much larger than the available places and hence the scope for selection is enhanced. Similarly, under conditions of limited resources, the tendency is to ‘cream’. On the other hand, this issue is less of a problem where the applicant pool is small and resources are more readily available. This means that when there is a large and diverse pool of eligible participants, screening by training providers can be undertaken to identify promising candidates, while weeding out those who might be more troublesome. Those with special needs are the most likely to be excluded.

In economic literature this is referred to as the problem of ‘moral hazard’ or ‘the folly of rewarding A, while hoping for B’. Moral hazard occurs when A and B diverge. This is
a common problem in subcontracting arrangements which require the subcontractor to provide a service rather than a tangible product to another group of individuals. The provision of government-funded training is one such example. If the goal is to enhance someone’s employment chances, then the output indicator needs to be able to measure this effect of the training, rather than encouraging training providers to screen for those with better prospects which would exist regardless of the training. A value-added measure of output, as well as other institutional reforms, may be used to counter creaming.

On the other hand, programme objectives may be set to extend rather than limit training opportunities to the most disadvantaged in society. In these circumstances, there is no ‘floor’ to the selection criteria; however, there is a ‘ceiling’ beyond which participation is not permitted. The ‘ceiling’ could be defined by education levels, income or previous employment. As a result, only the most disadvantaged form the available pool from which selection takes place. This practice is termed ‘dredging’ and is usually justified for reasons of equity. In so far as government training schemes have eligibility criteria, dredging, by definition, can be said to operate. However, the narrower the eligibility criteria, the greater the extent of dredging required by policy-makers. Moreover, the criteria can be changed to refocus training activity on those most in need, thereby minimising the extent of creaming.

- Altering patterns of participation

As a result of creaming, it is often alleged that ORF alters the pattern of participation and shifts provision away from the most disadvantaged groups in society. Notable among the ‘losers’ are women, ethnic minorities, the poorly educated and those with special needs. However, ORF mechanisms themselves may be designed to counter this tendency by, for example, attaching more funds to outputs attained by disadvantaged groups, i.e. dredging, as discussed above.
2.4.2 ORF: enhancing flexibility?

- **Encouraging/discouraging certain types of training**

In funding systems which take no account of the variable costs of training for different occupations, training provision may shift towards 'low cost' forms of training such as business administration and away from 'high cost' areas such as engineering. Participants may also be steered away from more difficult programmes and placed in courses for which it is easier to demonstrate 'success' according to the output criteria. This shift may occur regardless of the skills and training demands of employers, and therefore the qualifications gained may be inappropriate. ORF regimes, however, may be weighted to counter this tendency, with more costly or more 'necessary' training carrying higher output funding.

- **Changing the content of training**

The content of training may change as a result of ORF depending on the way in which 'output' is defined. For example, where ORF is linked to job placement, then on-the-job training and job search assistance may be more effective and quicker in placing people into jobs than, for example, classroom-based training. Shifts in the content of training are therefore likely. Training times, too, may change. If funding is no longer attached to the process of training, then there are economic incentives to reduce the length of courses, prompting accusations of quality dilution. However, it could be argued that the ability to alter both the length and content of courses may lead to a more efficient use of scarce resources.

- **Creating cash flow problems**

ORF may lead to cash flow problems among training providers whose costs are incurred on an on-going basis but whose income is uncertain and 'lumpy'; expenditure and income may not be well aligned over time. Estimating when trainees will achieve outcomes may not be easy, and the assessment and verification of outcomes may increase the uncertainty of funding triggers being reached. This problem will be even
greater for occupations commonly regarded as requiring 'high cost' training, such as engineering. The higher the level of ORF, the greater these problems may become.

- Threatening/protecting some types of training provider

Certain types of training provider may respond more quickly to the ORF regime than others. Providers whose main activity is the provision of training on a commercial basis may be quicker and less reluctant to rid themselves of occupational areas and types of trainees in which, and for whom, it is difficult and costly to trigger ORF payments. Other providers (such as employers and industry associations) may continue to provide such training, but only by cross-subsidisation from their other activities. Specialist providers, on the other hand, may suffer greater financial pressure and may, therefore, be forced to exit the market altogether.

In addition, an increased emphasis on funding outputs may act as a barrier to entry for new providers. Unlike existing ones, they will not have a stream of outputs arising from trainees who have started earlier, so the cash flow problem for them is likely to be even more acute. This will raise barriers to entry and reduce levels of competition faced by existing training providers. Flexibility in the short-term might, therefore, reduce the breadth of provision in the long-term.

2.4.3 ORF: reducing administrative costs and bureaucracy?

It is often claimed that ORF can reduce administrative costs and bureaucracy. However, this is by no means certain, due to the implications of addressing some of the negative consequences of ORF through the ORF mechanism itself. For example, the ORF mechanism adopted may be complicated by the desire to make the system more equitable by recognising, for example, that not all trainees start with the same human capital endowments. As a result, the same output may trigger different payments depending on the background of trainees. This may require pre-training verification and therefore add to the administration and bureaucracy of the system. Similarly, rewarding part outputs or a ‘basket’ of outputs will add to the number of outputs that need to be monitored and rewarded.
2.4.4 ORF: enhancing transparency and accountability?

- ** Appearing to add value 

A training programme creates value when, as a result of training, a participant’s prospects in the labour market exceed what they would have been in the absence of such an intervention, i.e., when the programme adds to the stock of human capital, as discussed above. However, observing a trainee’s prospects ‘before’ training and his/her prospects ‘after’ training does not necessarily indicate value-added. Other confounding variables (not always observable to the evaluator) also determine labour market (and qualification) prospects. These can range from situational factors such as access to transportation to attitudinal factors such as motivation and attitudes to training and/or work as well as the labour market context. Furthermore, the mix of participants in the training programme can influence how training programmes appear to fare. For example, a programme consisting of large numbers of high-potential participants will fare much better than one consisting largely of participants with low potential, irrespective of the quality of the training intervention. In other words, ORF contracts may encourage contractors to create the appearance of valuable training without actually producing real changes in the clients they serve, even when value-added measures of output are used, thereby distorting the transparency of the input/output relationship.

- ** Failing to reward all aspects of value added 

On the other hand, output-related funding may not reward all the additions training makes to a person’s stock of human capital. This is especially the case where some progress has been made towards a particular performance goal, but the candidate has just fallen short of it. A good example here are systems which fund training providers on the basis of candidates who achieve a qualification. There may be cases where candidates are not able to complete the entire qualification for one reason or another, but who nonetheless attain part of the qualification. In addition, the value added through training may be multi-dimensional, which may not be captured in the definition of output. As a result, the ORF regime may not recognise all of the ways in which the stock of human capital can increase.
Financial probity and reliability can be compromised by ORF unless certain checks and balances are instituted. A training organisation whose aim is the promotion of learning, and which searches out income for that purpose, or which has strong links with an industry and its traditions, may value its reputation sufficiently to overcome any temptation to ‘bend’ in order to secure output-related funds. However, other organisations might be more vulnerable to these pressures. For example, linking funding to qualification attainment where training providers are involved in the assessment process may lead to a conflict of interest where the training provider could lower the assessment criteria in order to secure output-related funds. Linking funding to job placements can also be open to abuse, with training providers providing trainees with fictitious employment in order to trigger payment. This danger is further enhanced in situations where providers have responsibility for all three parts of the process - that is, recruitment of participants, the training programme and job placements. In addition, incentives to bend the rules may be stronger where the proportion of funding dependent on reaching output triggers is high. If such potential exists then the principles of transparency and accountability may become blurred.

2.5 Summary

This section has highlighted the benefits of ORF. These can be summarised as providing an incentive to encourage:

- more flexibility in the type of training provision offered
- improvements in performance
- increasing value for money by providing an incentive to fulfil certain achievements and discouraging ‘time-serving’ in training which do not lead to outcomes
- simplifying administration and clarifying audit requirements

Set against these benefits are a number of operational issues which need to be tackled before ORF can be introduced, as well as a number of consequences and implications which can arise from its implementation and use. These can be summarised in a series of policy questions:
• What level of ORF is required to reap the optimum benefits of tying funding to output?
• Is ORF passed on to all those in the contracting chain?
• How is output defined?
• How is output measured?
• How are funding uncertainties minimised?
• Do the measures of performance used to financially reward and penalise training providers act as good proxies for the long-term labour market prospects of trainees?
• Are only the best candidates ‘creamed off’ to output-related-funded programmes?
• To what extent are eligibility criteria used to counter the danger of ‘creaming’ by requiring training providers to ‘dredge’?
• How is the participation of disadvantaged members of the labour market protected?
• What consequences does ORF have for the content and occupational spread of training provision?
• Does ORF lead to cash flow problems among training providers?
• Are particular types of training provider more at risk than others from the operation of ORF?
• Does ORF raise barriers to entry for new training providers?
• Are the administrative rules and regulations that accompany ORF simpler or more complicated than other systems?
• Does ORF reward the value added by training intervention?
• Does ORF reward all or only some of the value added by training providers?
• What checks and balances are in place to ensure probity and reliability?
• What mechanisms are used to counter these problems?
• How successful is ORF in achieving its aims?

Equipped with this broad overview, we now turn to a number of real world examples of the use of ORF within and beyond the EU.
SECTION THREE:
CASE STUDIES OF OUTPUT - RELATED FUNDING

During the course of this project, considerable effort was devoted to the identification of countries both within and outside of the EU which are using, or have had experience of, ORF for VET programmes. The result of these searches and enquiries confirmed our original suspicions that the US and the UK offered the best examples of its usage, with only piecemeal usage elsewhere in the EU. Indeed, the UK government, wishing to learn from international experience of ORF, commissioned a study in 1993 to review ORF in six countries - France, Germany, Sweden, Australia, Canada and the US (Green et al., 1993: 3). Tellingly, only the US was able to offer any pointers for the development of ORF. Our own enquiries for this study revealed much the same.

In the case of the US, ORF has been in use since the Job Training Partnership Act (JTPA) of 1982. This was designed to create an outcomes-driven training programme for the disadvantaged, which would demonstrate measurable results and do so without excessive costs. The UK's use of ORF can be dated from the early 1990s and the establishment of Training and Enterprise Councils (TECs) to administer government-funded training programmes. The UK and the US, therefore, provide the two most obvious examples of ORF in practice, not least because there is a considerable descriptive and evaluative literature on its operation in both countries. This section of the Report will summarise this material in the light of the policy issues raised earlier. The striking feature of the review is the finding that the British emphasis on ORF as a tool of performance management is much stronger than that of the country in which the concept originated. In addition, this section will provide information on the issues facing those Member States - such as the Netherlands - which plan to introduce ORF in the near future; this section is divided accordingly.
3.1 ORF in the United Kingdom

3.1.1 Rationale and Operation

A network of 82 Training and Enterprise Councils (TECs) covering England and Wales was established in 1991.1 They were set up as locally-based and employer-led institutions charged with contracting with government 'to plan and deliver training and to promote and support the development of small business and self-employment within their area' (Department of Employment, 1988: para 5.7). In 1998, the number of TECs had fallen to 78 due to two mergers, one declared bankruptcy, and one closure (Cobbold and Martin, 1997; Times Higher Educational Supplement, 21 November 1997).

The majority of TECs' funding comes from training programmes; around 5% comes from employers and individuals, about 1.5% from the EU, with the rest coming from central government (House of Commons, 1996: xxxvi). Three-quarters of this goes to fund training for young people entering the labour market for the first time (initial training) and for those seeking to re-enter the labour market after a period of unemployment (the dislocated).

These schemes are Youth Training (YT), which caters for 16-17 year olds who have left school, and Training for Work (TfW) which caters for workers aged 18-63 years old who have been unemployed for six months or more. YT is aimed at providing young people with vocational qualifications at or above National Vocational Qualification (NVQ) level 2, whereas TfW is designed to get the unemployed back into work and/or improve their vocational skills. Young people gain access to YT through the Youth Credit (YC) system, in which public funding is routed through the individual young person rather than the training provider in an attempt to empower the learner (see Felstead, 1993; Youthaid, 1997). However, the YT programme itself and the contractual relationships which surround it are the same. As a further complication,

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1 At the same time, 22 Local Enterprise Companies (LECs) covering Scotland were established. Since LECs have a much wider remit covering environmental, community and local economic development issues in addition to TEC-like responsibilities for the local implementation of national training and enterprise programmes, the discussion will focus on TECs.

2 NVQs are awarded at five levels. These range from NVQ level 1 at the bottom to NVQ level 5 at the top. Government-funded training schemes, in the main, focus on providing training at NVQ level 2 and...
young people can also enrol in a Modern Apprenticeship (MA) which takes as its basic aim the achievement of NVQ level 3.

The function and institutional set up of TECs makes them hybrid organisations. While they are private organisations which deliver public services paid for by the taxpayer, they are different from a private commercial company working under contract to government - in this case the Department for Education and Employment (DfEE). While their formal responsibilities are the same as those of any other private company, they operate on a not-for-profit basis which prevents any surpluses generated from being dispersed to shareholders. Instead, surpluses can only be spent on activities considered important for the area, or else carried over into the next financial year (Jones, 1995).

In addition to the principle that TECs must be locally-based and employer-led, there was a third condition - they must stand or fall on their own performance. This principle is the one most relevant for this Report. In the then government's words, this meant 'attaining better value for money, greater efficiency and a higher return on investment' (Training Agency, 1989b: 4). There are several inter-related ways in which the TEC system is designed to achieve this aim; the most visible is the annual publication of TEC performance league tables. The institutional and ORF framework within which TECs operate is set out at Figure 1 below:

**Figure 1: Institutional Framework of TEC Network**

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Department for Education and Employment (DfEE)

Contractual arrangements, training programmes agreed, output targets set and ORF regime.

Training and Enterprise Councils (TECs)

As above, although output targets may differ.

Training Providers (Youth Training, Training for Work)
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NVQ level 3. Level 2 refers to basic entry qualifications for employment, while level 3 is pitched at craft/intermediate employment (see Felstead, 1997).
The delivery of government-funded training by TECs is measured according to six criteria (Performance Indicators and Analysis Unit, 1997).

For Youth Training (YT) the criteria are:
- cost per output point (each NVQ achieved carries output points)
- number of output points per 100 leavers
- number of qualifications gained per 100 leavers

For Training for Work (TfW) the criteria are:
- cost per output point (points here are awarded according to NVQ level and jobs or places on full-time education courses)
- number of jobs acquired per 100 leavers
- number of qualifications gained per 100 leavers

Thus the output criteria for YT and TfW include the number of qualifications, the level of qualifications and job placement rates. They are compiled in the Inter-TEC Comparison Tables and are published every September. This allows the government to identify high- and low-achieving TECs.

Increasing competition among training providers is designed to enhance efficiency gains - ORF being one of the means of doing so. Other means are also deployed. Every year TECs bid for funding based on the volume of training (measured by training weeks, on-programme payments or starts/enrolments), the number of qualifications and jobs (outputs) they expect to deliver, and the total cost of doing so. Separate bids are made for YT and TfW (as well as for enterprise programmes not discussed here) and are outlined in an annual Business Plan (Training Agency, 1989a: 25-26). The Business Plan quantifies the plan for both training programmes including: the number and type of trainees catered for; estimated costs; broad plans for the distribution of training by occupation; and the performance level the TEC expects to reach for each programme. The DfEE then negotiates with each TEC on the volumes, outputs and prices contained in the bid. Following this process, agreed volumes, outputs and a total contract price are written into the TEC’s Business Plan for the forthcoming year.
The total contract price is divided into two parts: payment for specified volumes of training and payment for specified outputs. The total contract price has a ceiling, as do volume and output payments. In other words, those who exceed their contractual requirements do not receive extra funding; however, those who fall short of their contractual obligations suffer financially.

The TEC receives payment upon production of the relevant documentation. This can take a number of forms: attendance records are needed if funding is tied to the number of training weeks; a signed declaration confirming that an Individual Training Plan has been agreed is required if volume payments are made according to the number of programme starts; and written confirmation of trainee participation is needed if volume is measured according to the number of trainees on-programme on specified dates each month. Output payments, too, can only be triggered by the relevant documentary evidence. This includes written notification from the Awarding Body that a qualification has been awarded, an employer's letter confirming that a former trainee has been in full-time work for at least 7 days within 13 weeks of leaving the programme or documentary evidence of enrolment on a full-time education course within 52 weeks of exit (DfEE, 1997c: 12-15 and 23).

Payments for volumes are relatively simple - TECs supply DfEE with the relevant documentation and are paid the agreed rate. However, paying for outputs is more complicated as not all outputs are treated in the same way; certain outputs take longer and are more difficult to achieve than others. For example, under the 1997-1998 arrangements, a YT trainee achieving an NVQ level 3 triggers two-and-a-half times the payment triggered by someone achieving level 2. Similarly, TfW trainees who get a job within 13 weeks of leaving the programme trigger output payments double those triggered by trainees who go onto full-time education or those who get NVQ level 2 (DfEE, 1997d: 32 and 51).

The funding arrangements also incorporate some allowances for those with Special Training Needs (STNs) who, by definition, require longer to achieve the same results as those in the 'mainstream'. On YT those endorsed as having no realistic prospect of achieving NVQ level 2 are allowed to follow a programme leading towards level 1 which, once awarded, carries a payment one-and-a-half times the payment a
'mainstream' trainee triggers on achieving NVQ level 2. Those with literacy and numeracy difficulties can follow specific non-NVQ courses designed to improve their basic skills in these areas. Once achieved, these trigger the same payments as triggered by YT 'mainstreamers' on the level 2 route. However, level 2 and above qualifications carry the same payments irrespective of trainee background (DfEE, 1997d: 32). Similarly, concessions are made for trainees with literacy and numeracy difficulties who enrol on TfW. However, no other allowances are made for those TfW trainees with STNs - an NVQ or a job carries the same payment (and number of points) whatever the trainee's background (DfEE, 1997d: 51).

As outlined above, the ORF funding system for TECs in the UK is a complicated one, so as to recognise that trainees may not all start with the same skills, and that achievement of a particular output for some represents more of an achievement than for others, i.e., it attempts to reward value-added. However, whether this is sufficient to take all the major aspects of value-added into account is another issue. This reveals that there is policy dilemma between a complex measure of output which is equitable, and one which is simple and less equitable but easier to administer.

Detail apart, the balance between paying for training volume and paying for outputs has been shifting ever since the TECs were first set up. More and more emphasis has been given to payment by results. Initially, output-related funding contributed to approximately 10% of TEC budgets, but has since crept up to around 25% in 1992-1993 and reached between 25-40% in 1993-1994 (Ball, 1993: 10). The shift in emphasis has continued. Today, ORF accounts for 25-35% of TECs’ YT budget and at least 75% of TfW funding (DfEE, 1997d: 22 and 49). The continued and increased emphasis on ORF of government-funded training has occasioned much debate and many evaluations of its consequences. It is to these that we now turn.

3.1.2 Evaluation

It is widely acknowledged that ORF can be a useful means of focusing TECs and their training providers on securing effective outcomes from taxpayers’ money. However, a number of studies have raised serious concerns about how the system has developed in practice (some of these are summarised in House of Commons, 1996: Part IV).
One such study was undertaken by Coopers and Lybrand (1995) who carried out an evaluation of a pilot funding scheme for Training for Work (TfW). This exercise involved an assessment of the consequences of changing the way in which TECs received their funding through, in particular, giving even more emphasis to ORF. The evaluation centred on seven TECs which agreed to pilot a new funding formula, whereby 25% of their training fees were paid per TfW trainee starter with the remaining 75% paid according to each ‘successful’ completion of the programme (i.e. on trainees getting a job, becoming self-employed, entering full-time education or attaining a recognised qualification). This funding arrangement was almost a complete reversal of the mechanism in place at that time, where it was customary to pay 75% of the training fee for the number of training weeks completed with only 25% held back to reward ‘successful’ completion (Employment Department, 1993).

The evaluation was designed to assess the effect that these new arrangements had on the efficiency of the TfW programme. Two methods were used: an analysis of the statistical data relating to the seven pilot TECs and their comparators (selected on the basis of broad equivalence in terms of their economies, labour markets, size and performance); and a series of interviews with TEC officials, four or five training providers and up to two Employment Service offices in each area.

According to the government’s interpretation of the evaluation, the results of the pilot funding scheme were very good, producing significant increases in both the number of jobs and qualifications achieved by trainees. The Employment Department said that ‘positive outcomes per 100 leavers in the pilot TECs improved from 15 in 1992/93 to 40 in 1994/95. Comparable figures for non-pilot TECs were 16 and 27. So from similar bases, pilots have improved by 25 percentage points compared to the 11 percentage points of the non-pilots’ (Employment Department, 1995b: 4). The evaluation report itself, however, was less sanguine about the success of this shift in funding emphasis. It suggested that most of the improvements were the result of factors, at best, only partially related or, at worst, wholly unrelated to the funding regime (Coopers and Lybrand, 1995: 37-39). For example, pilot TECs were allowed to record ‘positive outcomes’ - that is, those getting jobs or going onto full-time education - and claim ORF payments at
any time during the 13 week period rather than on a particular spot date in week 13. As a consequence, the report concluded that:

> 'the improvement in recorded performance ... is primarily due to the *earlier* and more *accurate* reporting of the performance that is actually being achieved, whereas at non-pilots much of the performance goes unreported and unrecorded' (ibid: 18; my emphasis).

In other words, by placing a greater emphasis on the proportion of funding allocated according to output levels, there was a greater financial incentive to monitor outcomes more effectively.

Coopers and Lybrand (1995) also found that placing more emphasis on ORF further shifts the focus of training activity toward meeting short-term labour market needs rather than equipping trainees with the skills necessary for long-term employability. This was revealed in a number of ways. The study found that in the pilot areas, increased attention was focused on the highest-performing courses - leading some to reduce or even close down training provision which did not quickly lead to jobs. In addition, a shift away from 'high cost' and/or long duration courses towards 'low cost' and/or short courses was detected. The evaluation also pointed out that the enhanced ORF regime made it more difficult for new providers to enter the market, especially in occupations commonly regarded as 'high cost' training areas. Signs were already evident that the provider network was shrinking, thereby reducing the range and choice of provision as well as the intensity of competition between providers. Finally, the study revealed that the pilot areas were more selective in their recruitment - for example, there was tendency for pilot TECs to recruit trainees from the more job-ready section of those eligible for the programme at the expense of those needing additional help, i.e. to 'cream'. (Coopers and Lybrand, 1995: 34, 52).

Specific research into the consequences which ORF has for the training of those with Special Training Needs (STNs) has also been carried out (Meager, 1995). The data for this particular study come from two postal surveys. One focused on the entire TEC network and the other focused on a sample of 200 training providers, many of whom specialised in catering for the disadvantaged. Both had a response rate of around 65%, yielding information on 53 TECs and 126 training providers. The study was conducted
on behalf of a consortium of TECs and training providers with a particular interest in STNs.

Several points of relevance to this Report emerge from the study. First, although a flat rate fee is paid to each TEC irrespective of the type of YT trainee or the training occupation (see above), TECs themselves can and do offer differential pricing to their YT providers (also see Felstead, 1994; Felstead et al., 1994). In 1995-1996, for example, two-thirds of TECs surveyed paid different volume prices to providers according to type of trainee and/or training programme. A third of these paid higher prices to training providers who took on trainees with STNs than to those catering for 'mainstreamers' (Meager, 1995: 48; see also Employment Department, 1995a and DfEE, 1996). These types of volume contracts appear to be on the decline—they were offered by 73% of TECs in 1994-1995 compared to 67% a year later. A continuation of this trend is likely to make it increasingly difficult to offer YT to those with STNs since they are, by definition, a client group who are more difficult to train. The same principle applies to particular occupations—such as engineering—where it is more expensive to deliver training because of the cost of equipment, materials and trainers' time.

Secondly, TECs and providers were asked about the degree to which ORF is included in YT contracts, and the extent to which it varied between different types of provision. Here, there was much less variation. Around four out of five TECs offered no variation whatsoever in the payments they made to training providers for the outputs delivered whatever the type of trainee or occupational area. However, 15% of TECs reported varying payments according to trainee type, with another 6% varying payments according to occupational area (Meager, 1995: 51). These variations take the form of higher payments for some outcomes if trainees are designated as having STNs. Also, some TECs do pay more for qualifications in certain 'high cost' occupational areas—such as engineering (see Felstead, 1994). It is evident from this that TECs are under no obligation to pass on the ORF regime set by government to training providers.

Respondents to the STN survey (Meager, 1995) were asked to identify factors which had an effect on the quality of training provision for those with STNs. Interestingly for
the purposes of this Report, ORF was frequently mentioned. Providers tended to see both ORF per se and the degree of ORF as having a negative impact on STN provision. For TECs it was not ORF per se that was problematic, but rather the degree of ORF (too high) which they felt - as did training providers - was having a negative impact on provision. However, not all providers were opposed to the principle of ORF, but some were concerned about the standardised nature of the outputs recognised for payment purposes. One voluntary sector training provider summarised these concerns as follows:

'We do not disagree in principle with ORF, and we do not disagree in principle with TEC quality assurance systems. The former can be used to focus objectives and the latter to measure them ... On TfW, however, we are unhappy that we only get paid for whole NVQs and not for units towards NVQs ... We would like to see other forms of measures introduced under TfW ... the main goal, as we see it, is that someone moves forward, makes progress. It is not always possible to get someone from unemployment into a state of employability through one TfW course, and the ORF regime tends to regard as failures, what may in reality represent considerable progress for the individual' (quoted in Meager, 1995: 103, my emphasis).

This reveals the potential inadequacies of an output measure which fails to record incremental achievements. However, as mentioned earlier, this has to be balanced against the disadvantages of using a more complex measure (such as reducing transparency and increasing bureaucracy).

Other studies suggest that ORF may act to the detriment of other groups in society. For example, the present means of measuring TEC performance makes the launch of 'positive discrimination' programmes financially unattractive to TECs (i.e. the provision of women-only training for occupations in which women are significantly under-represented). By their very nature non-traditional training courses are likely to yield fewer 'positive outcomes' per 100 leavers than sex-stereotyped courses, since sexual stereotyping continues to influence the job recruitment process (Curran, 1988; Collinson et al., 1990). In addition, it has been argued that the cost of single-sex training courses leading to employment in non-traditional occupations is likely to be high, as they are more likely to be classroom- rather than workplace-based (see Felstead 1995).

Given these factors, only a few TECs (17%) in 1992 had set up courses for women in non-traditional areas (EOC, 1993: 31). As output performance indicators have assumed
a greater importance since that time, it is unlikely that the situation has improved. After all, positive action programmes carry the risk of putting downward pressure on a TEC's performance rating, which may ultimately threaten its very survival (for a more detailed discussion see Felstead, 1995).

The high level of ORF in the UK also heightens the likelihood that government funds may be misappropriated. With so much at stake, in terms of showing that training has produced outputs, there is a greater pressure on training providers to cut corners and even manufacture outcomes (qualifications or jobs). For example, in some occupational areas - such as business administration - NVQs can be awarded by several different bodies, some of which are considered less stringent than others when it comes to certification. Furthermore, as Stanton (1996) has pointed out, ORF places severe strain on the impartiality of the NVQ assessment process which sets out to attest to the ability of an individual to perform to workplace standards. This process relies heavily on the ability and willingness of those in a position to observe an individual's workplace performance and make an impartial assessment of it. Often these assessors are the individual's supervisor and/or trainer. If these assessors are in circumstances where their incomes (or the resources of the organisation for which they work) are affected by whether or not they judge a candidate to be competent, then their impartiality may be compromised. Some commentators have suggested that fraudulent claims may result:

'Output-related funding encourages people to look for loopholes but it wouldn't be such a massive problem if you couldn't fiddle the results. The only answer is wholly independent assessors who have no interest whatsoever in whether a candidate passes or fails' (Charles Bell, spokesperson for Article 26, education human rights charity, quoted in Times Higher Educational Supplement, 14 March 1997).

This suggestion has also been corroborated by a recent survey of 1,057 assessors which found that 38% felt that 'many candidates pass who shouldn't' (Eraut et al., 1996: 65; Financial Times, 5 December 1996; Times Higher Educational Supplement, 29 November 1996).

Other fraudulent behaviour has also been identified. For example, a training provider with contracts with 13 TECs allegedly claimed training funds aimed at the long-term unemployed despite the fact that those on the course already had jobs. The scale of the
alleged fraud was so serious that it led to the closing down of one of the TECs concerned (Financial Times, 25/26 October 1997 and 18 November 1997). Misappropriation of funds has also been uncovered with regard to qualifications attainment. Recently, a total of 25 TECs have been ordered to repay funds paid to them by DfEE for the qualifications generated by a Telford-based motor industry training provider (Financial Times, 11 November 1997). There have been other cases of training providers registering non-existent trainees, double-counting candidates, inventing courses and placing trainees with 'friendly' employers for a short time in order to trigger output payments related to job placement (People Management, 3 April 1997).

The extent of these irregularities has been the subject of a recent investigation by the Committee of Public Accounts which estimated that £8.6 million in 1995-1996 was incorrectly paid by the government to training providers via the TECs (House, of Commons, 1997: vi). In response, the government has launched a fraud hotline as part of a package designed to clamp down on fictitious or inappropriate claims for funding from training providers (People Management, 19 March 1998).

The Committee of Public Accounts also used the opportunity to highlight one of the other dangers of ORF:

'We are concerned that output-related funding may encourage some providers of offer training which they find easiest and cheapest to deliver' (House of Commons, 1997: xiv).

For example, some occupational areas suffer from high staff turnover, and hence it is easier to trigger employment-based output payments by placing former trainees in jobs in these areas. A training provider for TECs made this point in evidence to the House of Commons Employment Committee during its investigations into the work of the TECs (House of Commons, 1996: xlii). She suggested that placing trainees in companies with a high turnover of trainees could make it easier for her company to meet its output requirements, rather than securing long-term employment for the trainees. Furthermore, the quality of the job - as measured by its content, pay and the nature of the employment contract - made no difference whatsoever to her 'positive outcome' payments. Where the emphasis is on getting trainees into jobs where the quality of that job is irrelevant (as
on the TfW programme), an economic incentive exists for training providers to seek the quickest, cheapest and easiest routes sufficient to trigger ORF payments.

Both TECs and training providers are subject to the same pressures. TECs get paid the same amount, whether the output achieved is in a ‘low cost’ training area such as retail or a ‘high cost’ training area such as engineering and whether it is a relatively high-paying or low-paying job. In addition, the performance ratings reflect none of these differences. Furthermore, TECs are free to allocate any surpluses they generate (efficiency savings) to activities they wish to promote. There is, therefore, a financial incentive, a performance rating incentive and a surplus generation incentive to achieve outputs in sectors where qualifications or job placements are relatively easy to secure (e.g. clerical, hairdressing).

An Employment Department study (1994) based on eight sample TECs in three regions provides evidence to this effect. For example, in one TEC area the majority of its outputs were generated from a national private sector organisation specialising in clerical/business administration training. At another two TECs, major contributions to output achievement came from national providers which specialised in clerical and hairdressing training. As a result, the training profiles of these TEC areas consisted of predominantly clerical and hairdressing provision (Employment Department, 1994: para 19). Skewing provision towards these occupational areas, where training costs are lower, can enhance the TEC’s financial performance, its value-for-money rating, and its operating surplus (Jones, 1995 and 1996b) without regard to the long-term needs of the trainees or the labour market.

3.1.3 Recent and Future Developments

The principles of ORF can also be seen in other government-funded VET programmes in the UK. For example, there is an ORF component in the government’s New Deal (launched nationally in April 1998) for 18-24 year olds who have been unemployed for six months or more.\(^3\)

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\(^3\) As a result, the eligibility criteria for TfW (now Work-Based Training for Adults) has been changed to cover the 25-63 age group, since 18-24 year olds will be covered by the New Deal.
Those eligible for the New Deal are offered four options: jobs for up to six months with one day a week off-the-job training leading to a recognised qualification; full-time education and training for up to 12 months, but only for those not qualified to NVQ level 2; placements lasting up to six months with the Environment Task Force comprising a minimum of one day a week (or equivalent) training; or work placements with the voluntary sector on the same terms as for those on the Environment Task Force (DfEE, 1997a).

Interestingly, the provider payment process under each option contains an element of ORF. For example, full-time education and training providers receive 20% of their funding on 'starts', 50% on attendance, 20% on achievement of qualifications and 10% when trainees get a job expected to last more than three months (DfEE, 1997b: 7). At least 10% of provider funding under the other non-employer options (Environment Task Force and other voluntary sector organisations) is also tied to getting trainees into jobs. In addition, the funds paid to employers for the training component under the subsidised employment option are tied to outputs. A third of the £750 government subsidy available to employers is paid upon the production of an agreed training plan, another third is paid after the participant has attended for 13 weeks and the remaining third is paid at the end of the placement, provided the objectives initially identified are met.

A key element, then, of the new government's welfare-to-work programme - the New Deal - is funding tied to outputs. The principle of ORF is, therefore, firmly rooted in the UK. However, the government has recently announced its intention to review the role of TECs and the contracting and funding arrangements under which they operate (People Management, 28 May 1998).
3.2 ORF in the United States

3.2.1 Rationale and Operation

There are many similarities between the British TEC system and the US system of funding federal government training schemes (see Bailey, 1993; Bennett, 1994). However, the similarity of greatest significance for this Report is the emphasis the Job Training Partnership Act (JTPA) places on outputs as the means of securing accountability for the dispersal of public funds. Under the JTPA’s predecessor - Comprehensive Employment Training Act (CETA) - the US Department of Labor (DoL) exercised tight control over federally funded employment and training efforts. The DoL contracted with hundreds of non-profit or local government agencies charged with administering programmes at local level. They, in turn, subcontracted programme delivery to a network of training providers. Administrative control was exercised by regional DoL offices over all those involved in programme delivery. The funding emphasis, at this time, was on the numbers enrolled, the number of days trainees spent in class, certifications granted, and other input and process measures, since these were all assumed to lead to greater trainee competence, higher rates of employment and lower welfare demands. The central assumption governing the 1982 JTPA reforms was that bureaucratic, process-orientated training policy had failed, and that an outcome-orientated system of accountability would lead to better results and greater efficiency. As one of its architects remarked: ‘the new system will be based on performance, not process’ (Senator Orrin Hatch, quoted in Donahue, 1989: 6).

Under JTPA Private Industry Councils (PICs)\(^4\) run local organisations - Service Delivery Areas (SDAs) - which administer training programmes in the area. There are around 650 SDAs, one-third of which cover a population of close to 200,000 - the minimum threshold announced when SDAs were first set up. Many SDAs are contained within larger state agencies, which allows them to combine their relatively small resources with larger local and state organisations. SDAs, then, are local administrative units over which PICs have strategic control. PICs are, therefore, ultimately responsible for SDA performance. The institutional framework under which ORF operates within JTPA is set out in Figure 2 below.

\(^4\) A PIC comprises a majority of private sector members, a private sector chair, and a minority of representatives from education, labour, community groups and government agencies. Each PIC has responsibility for a particular SDA.
The US experience of performance standards, performance evaluation and ORF has lessons for European policy-makers who are considering introducing such a market-orientated or bottom-line approach to their VET delivery, or those who simply wish to learn more about ORF in practice. ORF has been used in the US for sixteen years, occasioning much debate and many evaluations of its consequences along the way. However, before considering these in detail, the Report will outline how the JTPA system operates.

Various training initiatives (or Titles) are run under JTPA. These include: Title II-A programmes offering training to disadvantaged youth and adults; Title II-B schemes generally consisting of summer vacation training courses for disadvantaged young people (aged 14 or over); Title III programmes aimed at displaced workers; and Title IV schemes providing specific training for Native Americans and migrant and seasonal workers, and intensive residential programmes mainly for high school dropouts (known as Job Corps).
About a third of the total JTPA budget is spent on Title II-A and around a fifth is spent on each of the following: Title II-B, Title III and Job Corps (Jones, 1996a).

Elements of performance management can be found in all of these programmes, but it is within Title II-A that systems of performance management have been developed furthest. It is also where most of the prominent evaluations in the field have been carried out (see below). Nevertheless, performance management is at the heart of the entire JTPA project and its associated institutions. It involves setting performance standards, evaluating programmes against these measures, and drawing up a series of rewards and sanctions to be triggered by various parties on the basis of their performance in relation to the measures. The emphasis on performance is the centrepiece of the JTPA legislation:

"The legislation must insist on performance. The current CETA system does not have any effective means of measuring program results or penalizing non-performance. The new legislation will provide standards for judging the programs for what they accomplish - by whether those trained are hired and earn more as a result of training. It will end federal involvement with the process of how people are trained. It will provide for measurement of the outcomes and remove the Federal government from involvement in the details of program operations" (Senate Committee on Labor and Human Resources, 1992, quoted in Bailey, 1993: 10).

The legislation characterises job training as 'an investment in human capital', and it directs the Secretary of Labor to develop 'criteria for measuring the return on this investment' and to translate these criteria into operational standards which SDAs must meet. Specific performance criteria for each type of programme are outlined in the legislation.

Originally, performance criteria for adults under Title II-A were:
- placement and retention in unsubsidised employment
- increases in participant earnings
- reduction in the numbers receiving welfare payments and the amounts paid out

For youth they included:
- attainment of 'employment competitiveness' as defined locally
- completion of elementary, secondary or post-secondary education
- enrolment in other training programmes, apprenticeships or the armed forces
Additional cost criteria were added to each of these targets. The legislation vested the Department of Labor (DoL) with powers to attach standards/targets to each of these aims and to provide optional models for the adjustment of national standards to take account of local SDA conditions. These are issued each year by the DoL. The standards themselves are set at levels intended to be reached by at least 75% of SDAs. Hence, some have claimed that the 'performance standards are ridiculously easy to meet' (Walker et al., 1986: 26). In each SDA, state governors are responsible for which standards to adopt - those set nationally or those modified to take into account local conditions. In the early years, most state governors adopted the national standards; today, however, most evaluate SDA performance against locally modified yardsticks (Green et al., 1993).

The distinctive feature of the US system is that, unlike the British system, performance management appears to be more unevenly adopted at different levels and entails the use of various kinds of rewards and sanctions (see Figure 2). Performance management at the state level is noticeably absent, with emphasis instead on procedural and regulatory requirements. JTPA funding allocations from the federal government are based on the criterion of need as measured by levels of unemployment and the numbers of disadvantaged individuals living in the state. Once states receive their funds, they must use the same funding allocation formula to disburse JTPA funds to SDAs (Svorny, 1996: 230). There are, however, additional regulations governing how the states spend their JTPA allocations. For example, under the original legislation 78% of the JTPA II-A allocation had to be spent directly on training provision, 40% had to go on youth provision, a maximum of 15% could be spent on administration and a further 6% could be used for technical assistance to SDAs or for incentive payments.

Further down the chain the rewards and sanctions become less procedural and more financial in character. At the SDA level, both are at work. Here, the state monitors the performance of each of its SDAs against the performance criteria it has set for them (from a selection set by the DoL). If an SDA fails to meet these standards, the state is required to offer technical assistance to the troubled locality. If it misses the mark for two years running, the state governor and the DoL must impose a reorganisation plan. This could involve restructuring the SDA, 'blacklisting' offending contractors or assigning authority for the programme to a completely new entity. However, the imposition of reorganisation
plans is rare (Green et al., 1993). In addition to wielding such procedural sanctions over poor performers, states have the option of rewarding the better performing SDAs with bonus payments. The JTPA regulations allow 6% (now 5%) of a state’s allocation to be spent on special incentive payments of this kind. However, it is unclear how widespread this practice is.

Nevertheless, the evaluations of JTPA (see below) suggest that SDAs are influenced by the performance targets which they are set and that they do respond to the rewards and sanctions to which they are subject. However, it is far from clear whether the procedural sanctions or the financial rewards are the more dominant force. Having said this, there are several factors which cast doubt on the strength of the financial incentive. Incentive payments make up only a small percentage of the state funds available for distribution, SDA funding levels remain protected irrespective of programme performance, and some states also use the incentive payment fund to provide extra help to those SDAs falling short of their performance targets. This is in marked contrast to the British system: local organisations - TECs - compete against one another for funds, their performance is monitored nationally with no allowance made for local economic variation, league tables against national standards are published annually and funding is tied to performance (under TfW at least three-quarters of funding is dependent on generating outputs).

However, the nearer one gets to the delivery of the training, the greater the emphasis on ORF becomes. Yet, the JTPA itself does not stipulate how SDAs should deliver training, nor does it mention how outside training providers should be funded. These decisions are taken by each PIC for the local organisation - the SDA - under its control. Given the diversity among the 650 or so SDAs across the US and the considerable leeway they are permitted to exercise in this area, one might expect to observe a wide range of contrasting funding arrangements for training providers. The evidence, however, shows the contrary; they exhibit a marked preference for ORF-style contracts - tying part, or in some cases all, of their funding to the achievement of outputs. At the end of the nine-month launch period for JTPA (October 1983 to June 1984), 46% of all provider contracts were based on ORF principles, by the first full year of operation the proportion had risen to two-thirds, and by the end of the 1980s, 80% were using ORF-style contracts (Donahue, 1989; Hoachlander, 1989).
Three reasons can be identified for such a preference. First, it is a means of ensuring provider accountability. Secondly, it ensures that training providers are working towards the same goals against which SDAs are themselves judged. Thirdly, it allows SDAs to disguise some of the administrative costs of running the programmes. JTPA legislation puts a limit on the proportion spent on administration (originally this was set at 15%, although since 1992 this has been raised to 20%). However, if an SDA concludes an ORF contract with training providers, all payments made under this arrangement count as training costs and none are counted as administration. This heightens the incentive to offer training providers ORF contracts, since many SDAs find it difficult to meet the administrative cost constraint. In addition, it encourages SDAs to transfer administrative functions - including important ones such as trainee recruitment and placement - on training providers.

There is, however, little information on the specifics of the ORF contracts used by SDAs - indeed it is difficult to determine which types are the most common. Nevertheless, it has been suggested that a typical ORF contract is one in which some 10-20% of funding is contingent on certain outputs being achieved. Other, more stringent ORF contracts have been identified. For example, in Baltimore some of the early contracts paid 20% on enrolment, 40% on mid-point proficiency tests, 20% on end-of-programme tests and 20% on job placement at or above the minimum wage. More recently, the focus has shifted (in line with the changes in the DoL’s standards) towards end of programme and post-programme triggers. It now pays nothing on enrolment, 40% at the mid-point, 30% on completion and 30% on placement achieved within 30 days of completion (Green et al., 1993: 21). Despite these examples, the evidence suggests that the US system of linking provider funds to performance is less extensive than currently practised in Britain. Indeed, at all levels in the US system the emphasis on ORF appears weaker. Nevertheless, evaluations of JTPA have paid particular attention to the practical consequences ORF has for training delivery in the US.

3.2.2 Evaluation

The eligibility criteria for participation in JTPA programmes have a major bearing on how ORF works in practice. Title II-A programmes are restricted to those with family income below a level denoting ‘relative poverty’ or those who receive some form of
public assistance (Devine and Heckman, 1996). Hence, there is no requirement that participants need be unemployed and there is no restriction on the degree or duration of economic disadvantage. According to some estimates (e.g. US General Accounting Office, 1989) there are between 10 and 39 million Americans eligible for JTPA, yet only about one million of these participate each year. How, then, are these people selected from the many who are eligible?

In principle, procedural penalties for falling short of performance standards and financial incentives for exceeding them (as discussed above) discourage SDAs from serving the more difficult-to-train social groups, since a focus on them raises costs and makes it more difficult to meet performance standards. Awarding training providers with ORF contracts further encourages ‘creaming’ - that is, the non-random selection of participants. Both suggest that creaming is likely under JTPA and that ‘service providers choose program participants very carefully’ with job-readiness a key consideration (Walker, et al., 1986: 24). However, the form creaming takes and its significance is an empirical question which many JTPA evaluations seek to address.

At a crude level, patterns of JTPA participation show that some groups are over-represented in the programme compared to their share among those eligible, while others are under-represented. For example, Donahue (1989: 15) found that women were under-represented by 7%, Hispanics by 9%, welfare recipients by 5% and high school dropouts by 35%. The over-represented groups included men (9%), whites (7%), blacks (30%) and high school graduates (16%). The evidence also suggests that the shift from a process-based system of funding under CETA to a performance-based system under JTPA has tilted the balance against the disadvantaged in favour of the more employable fraction of those eligible for JTPA entry. The groups under-represented in JTPA are the same groups which suffered a drop in representation following the switch from CETA to JTPA. The unemployed, women, minorities and high school dropouts all fell as a proportion of enrolled trainees; whites, the employed or recently employed, men and high school graduates saw their share rise (US General Accounting Office, 1985). Furthermore, screening may also take place within these groups. Training providers will often be able to observe - via interviews, application forms and references - characteristics which government training programmes may have difficulty altering, but
which are likely to affect labour market success. These include age, intelligence, family attitudes towards work and so on.

These findings raise a major policy issue: is the pool of eligible participants so large that it allows providers to systematically identify the most promising candidates for training while weeding out those least likely to get jobs and/or stay the course (i.e. to make it look as though they are adding more value than they really are)? To make this particular point Donahue uses an analogy worth quoting at length:

‘Harvard Business School graduates tend to earn more, over the course of their careers, than the average for the population as a whole. If the Harvard Business School selected its students randomly, this would be clear evidence that sitting through two years of case studies increased business acumen and earning power. But students are not selected randomly. The screening process is sufficiently rigorous that the people selected for admission would still tend to earn somewhat more than the population average if they spent two years in the Peace Corps, or learning to play the harp, instead of studying cases. It is impossible to distinguish conclusively between the value added by the professors and the value identified by the admissions office. A similar uncertainly complicates JTPA’s contractual system of accountability’ (1989: 17; his emphasis).

This view also indicates the interconnected issues of screening (or creaming), value added and accountability.

More sophisticated analyses of the extent of creaming have also been carried out. Like the studies reviewed above, these start out by comparing the social characteristics of JTPA participants with those eligible for, but not included in, the programme; their findings are similar. Anderson et al.’s (1993) examination of the Title II-A programme in the State of Tennessee, for example, found that women, the less educated (high school dropouts in particular), benefit recipients and older workers are significantly under-represented in JTPA programmes. However, bivariate comparisons may capture other confounding factors: for instance, dropouts are almost five times more likely to be benefit recipients with a physical or mental disability as well as being educationally disadvantaged. This shows the importance of undertaking multivariate analyses of the chances of being selected for inclusion in the JTPA programme. Using this approach, the better educated are significantly more likely to be selected to participate, but there is no additional dropout effect on the chances of selection. Similarly, gender and ethnicity
have no significant effect on the probability of selection, despite bivariate suggestions to the contrary. In other words, Anderson et al.'s (1993) analysis suggests that the only real selection criteria is better education; women, ethnic minorities and dropouts tend to be less educated rather than being directly discriminated against.

For creaming to take place, one also needs to show that a biased selection of participants leads to higher placement rates than would occur had the trainee population exactly mirrored those eligible to take part. Adopting such an approach, Anderson et al. (1993) show that creaming does take place. Simulations suggest that placement rates in Tennessee would fall from 71% to 62% under these counterfactual circumstances. Although modest, placement rates would fall by nearly one-quarter if JTPA were focused exclusively on high school dropouts - a group which faces high and multiple barriers to employment. However, the multiplicity of barriers they face would - unless factored into the evaluation system - prompt creaming within the dropout population.

Other studies have sought to examine the effect that different performance regimes have on the nature of the training delivered under JTPA and the extent of creaming. Most notably, Cragg (1997) assesses inter alia whether states which offer SDAs with relatively high rewards for exceeding performance targets and harsh sanctions for falling short have a greater tendency to cream off the more able individuals. The analysis is based on a nationally representative survey which allows one to pick out a sample of individuals eligible for JTPA (and its predecessor, CETA) as well as a sample of individuals enrolled on the programme.

Using this approach Cragg examines the consequences of inter-state variations in performance regimes. These variations are captured in four ways: first, up to 6% (now 5%) of a State's JTPA budget may be used for incentive payments to SDAs - the higher the percentage set aside for this purpose, the greater the financial incentives for meeting performance standards set. Second, states may choose to pass on to SDAs all or some of the performance standards they are themselves set by the DoL - as more standards are required, higher incentives are generated. Third, the likelihood that SDAs will be punished for poor performance can be proxied by the number of standards which need to be met in order to avoid punishment. Fourth, states may be lenient towards SDAs in implementing the rewards and sanctions regime; this can be detected by whether or not
states permit SDAs to make special appeals for unexpected difficulties encountered - 29% of States allow special appeals of this type.

Multivariate analysis can then be used to compare the enrolment probabilities of individuals. In addition to variations in performance regimes, other variables - such as gender, age, education, ethnicity, labour market experience and local unemployment - are also entered. The results of these analyses indicate that high incentive regimes encourage enrolment of the more able individuals from the eligible pool. They also show that creaming has become more prevalent after the switch to JTPA with its emphasis on performance incentives.

The types of training offered under JTPA reflect the emphasis placed on job placement rates. Four types of training are offered: classroom instruction; on-the-job training; help with job search; and work experience. In general, the lengthier the training the lower the job placement rate. So, for example, work experience and classroom-based training take, on average, longer to complete, yet they have the poorest placement records. On the other hand, the least intensive JTPA type of training - job search - posts almost the highest placement rate. The emphasis JTPA places on getting trainees into jobs and the use of ORF provider contracts has seen a pronounced shift towards types of training best placed to boost placement rates. As a result, the change-over from CETA to JTPA saw job search enrolments rise by 535% and on-the-job training grow by 80%, while work experience fell by 84% and classroom instruction declined by 19% (Donahue, 1989). The implication is clear: the quicker and more reliably a type of training leads to placement, the greater the emphasis on that type of training. Such a shift in training provision may indicate that the system of performance management is creating more efficient types of training. However, what may be efficient in the short-term may be detrimental in the long-run. Furthermore, groups with the greatest chance of re-employment (e.g. whites, high school graduates) have seen their representation rise among the more successful types of JTPA delivery such as on-the-job training, while those with the poorest chances have seen their share fall.

5 SDAs have considerable latitude in the kind of training provided in their areas. For example, Tennessee has 14 SDAs with a wide range of training approaches. In Nashville, on-the-job training is rarely offered to participants, but classroom training, work experience and job search assistance are quite common. In contrast, in the Memphis area, which has traditionally had a much higher unemployment rate, on-the-job training is the more common type of JTPA training offered (Anderson et al., 1993).
Some researchers have cast doubt on the relevance of the performance standards themselves, especially in the light of JTPA's specified aim of delivering a measurable return on investment in terms of 'the increased employment and earnings of participants and the reduction in welfare dependency' (JTPA, section 106(a), quoted in Orr et al., 1995: 5). Subsequent evaluations of the JTPA programme have suggested that the short-term performance measures used to reward or penalise SDAs and training providers have little association with participants' longer-term employment, earnings and benefit dependency prospects. For example, Doolittle et al. (1993) calibrate these short-term performance measures against a longer-term evaluation of the performance of JTPA participants. The evidence for this study comes from the National JTPA Study which tracked the labour market performance of Title II-A applicants in 16 SDAs. Applicants were randomly assigned to two groups: two-thirds were allowed to enrol, while the remaining third were prevented from enrolling for 18 months (for a summary, see Bloom et al., 1997; for overview of evaluation techniques, see Fay, 1996). Doolittle et al. (1993) found that SDAs with strong performance according to the DoL's short-term measures - such as the percentage entering employment on exit and average wage rates on placement - appeared to add little value to a participant's prospects over a 30 month post-training period. This has led some to argue that:

'performance measures are virtually useless in making rational decisions about effectiveness, even though they provide political protection because they make JTPA seem like a performance-driven program' (Grubb, 1996: 26).

However, it must be borne in mind that the US performance management system relies more on procedural 'sticks' than ORF 'carrots'.

3.2.3 Recent and Future Developments

In recognition of some of these problems, the JTPA has been modified on several occasions. The 1988-1990 reforms, for example, were designed to shift the programme's emphasis towards the provision of skills for sustained employment as opposed to job search activities whose effect might be more short-term. These reforms involved a staged transition from end-of-programme to post-programme performance measures. The new measures were devised to evaluate JTPA participant performance
13 weeks after programme completion. These measures included employment rates, average weekly earnings, proportion of welfare recipients in work and average number of weeks worked.

However, the most extensive changes to JTPA were the 1992 amendments to the legislation. The amendments had two aims. First, additional eligibility criteria were introduced in order to target the programme more directly towards those most in need. In addition to being economically disadvantaged, at least 65% of participants must have at least one 'barrier to employment', such as having a disability, being a school dropout, lacking basic skills or having childcare responsibilities. In order to target youth, and especially those at greatest risk of economic exclusion, a separate Title (II-C) was created for youth programmes under JTPA. The 1992 amendments specified that a minimum of half of those recruited to this part of JTPA must be high school dropouts. In this way the legislators have attempted to counter the effects of creaming by imposing a ceiling beyond which participation would not be permitted. In other words, this is an example of 'dredging' on the basis of targeting policy to those most in need. Secondly, the 1992 amendments were a further attempt to shift the emphasis away from job search and short-term placement towards training and long-term employment. In order to encourage intensive training programmes, 'stand alone' job search activities were outlawed and instead greater emphasis was placed on skill acquisition, training and qualification attainment (Green et al., 1993).
Beyond the UK, it is difficult to find other EU examples of the use of ORF in the delivery of government-funded VET. However, experiments with ORF in higher education can be found in several Member States of the EU. In Sweden, for example, resources in higher education have since 1993 been allocated, in part, according to the outputs individual institutions generate; 60% of Swedish university funding is dependent on student grades, while the remaining 40% is allocated according to the number of full-time equivalent students taught at each institution. In other Member States the principle of ORF is also used to allocate higher education funds. In Finland, 5% of university funding is tied to results, while in Denmark a proportion of funds is allocated according to the number of students who successfully complete their course. In Germany, some Länder have begun to experiment with the allocation of funds according to performance criteria. For example, in 1993 North-Rhine Westphalia decided to allocate 10% of institutions' budgets according to the number of graduates over the previous three years, thereby giving institutions economic incentives to ensure that students do not drop out and that they graduate within the appropriate timescale. This represents a significant move away from the traditional German approach of funding entirely according to inputs (European Commission, 1996: 41-45).

However, cases of ORF being used in VET delivery are rare. For some Member States, shifting the emphasis away from allocating block grants to institutions towards capitation funding represents a major move; yet this falls well short of ORF - although perhaps this represents an intermediate step towards considering the relationship between inputs and outputs. Since 1990, for example, vocational education in Denmark has been funded according to the so-called 'taximeter' system. The main principle here is that programmes are placed in certain price categories, and institutions delivering these programmes receive funding directly related to the number of full-time equivalent students enrolled at four points in the year (Hansen and Rasmussen, 1996). Funds to cover administration and other operating costs are also related to the number of students enrolled. In addition, institutions receive a basic grant dependent on the nature of the institution, its size and the number of courses offered (Gasskov, 1997). This still leaves
a large part of funding linked to the numbers enrolled, albeit counted four times rather than once a year.

At least one EU country - the Netherlands - is contemplating introducing an ORF formula for its adult and vocational training centres. The new funding formula is expected to take effect from the year 2000. The policy debate this has prompted revolves mainly around the mechanisms needed to ensure that institutional funding rewards value added. The method proposed differs significantly from the US tactic of tightening up on eligibility rules to minimise creaming and the British approach of the same outputs triggering differential returns in certain circumstances.

The Dutch proposals attempt to tie institutional funding more directly to the difference between students' educational level on entry and their level on exit. Ideally, this requires that all students be subject to a detailed test of their knowledge and skills upon entry and then again on exit. However, this would be cumbersome and costly to carry out. Instead, the proposals suggest that previous education at the time of entry be taken as the initial benchmark from which students start. This would, then, be used to determine an institution's input-funding; that is, students starting from a low base would be funded for longer periods to follow courses of a prescribed length, while those with higher-level entry qualifications would be funded for shorter periods. Years which are repeated, or spent on a course which is later abandoned in favour of something else, add little to the student's knowledge, and hence no additional funding would be allowed under these circumstances.

The proposals also suggest an element of ORF, although the balance between this and input-funding is yet to be fully spelt out. What is clear, however, is that the award of an educational qualification is the output measure since:

'A diploma is the only type of educational qualification which is formally acknowledged by society at large, and people with diplomas have better employment prospects. It is therefore intended that output should in the future account for a greater proportion of total funding than it does at present' (Ministry of Education, Culture and Science, 1997: 13).

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6 Much of the subsequent discussion is taken from a document kindly provided by Peter Vrancken (Ministry of Education, Culture and Science, 1997).
The question of whether qualification outputs should be conceived more broadly to include modular certificates as well as completed diplomas has also been debated in Dutch policy circles. The proposals recommend a narrow focus on the latter since a broader focus - including modular certification - would bring many disadvantages. These include: an administrative burden as hundreds of thousands of modules are completed each year; the heightened risk of fraud; the cost of monitoring and maintaining effective supervision of the system; and increased likelihood that institutions would respond by awarding large numbers of low-level modular certificates rather than full diplomas in order to trigger ORF payments.

Recently, agreement on these proposals has been reached. The proportion of funding comprising ORF has been set at 20% with 80% dependent on the number of students enrolled; bonus payments will be given for students with low entry levels; and courses will carry one of a small number of different prices. Interestingly, two elements of the proposed value-added arrangement will be excluded when the new funding regime is due to become operational in the year 2000. Students who enrol more than once for a course will still be counted for enrolment-based funding and the period of their enrolment will not be dependent on their entry level. These elements have been temporarily excluded from the system of value-added since the necessary data for their inclusion are not yet available. However, it has been agreed that these data will be collected and that these two elements will be subsequently included in the funding formula in (probably) 2004.
3.4 Summary

From this review of case studies, several general points readily emerge:

- First, beyond the UK it is difficult to find other EU examples of ORF in the delivery of government-funded VET. However, experiments with ORF in the educational system can be detected - in Sweden, Finland, Denmark and Germany. Nevertheless, some Member States - such as the Netherlands - are planning to introduce ORF into parts of their VET system in the near future. The longest standing use of ORF in the delivery of government-funded VET is to be found in the US.

- Second, despite appearances to the contrary, the use of ORF in the UK and the US differs markedly. These differences include the emphasis it is given, its use along the contracting chain and the nature of the institutional environment in which it is embedded.

- Third, ORF is not a simple and straightforward mechanism, easily understood in practice. On the contrary, it is often complex and varied.

- Fourth, even within the UK and the US systems there are large gaps in our knowledge. For example, for neither country do we have sufficient information about the nature of training provider contracts and their consequences.

However, the literature reviewed in the course of this section does provide us with concrete examples, evidence and well-grounded research material from which to reflect on the policy questions posed earlier. This opportunity is taken up in the concluding section which follows.
The principle of providing a financial incentive to reward a predetermined level of performance in VET delivery coupled with a financial penalty for those failing to achieve this level is deceptively straightforward. However, the use of ORF in VET delivery raises many policy issues worthy of note. Section Two has highlighted several of the more important to bear in mind when evaluating and assessing ORF regimes, while Section Three has provided us with the details necessary to answer these questions from a real-world perspective. In this concluding section of the Report we bring both of these sections together - reflecting on the policy questions posed by summarising some of the case study evidence presented.

- **What level of ORF is required to reap the optimum benefits of tying funding to output?**
  The case studies indicate the range of emphasis that can be given to ORF - from 75% in the case of TfW in the UK to around 5% in the case of JTPA in the US. Both claim to be set at the optimum level.

- **Is ORF passed on to all those in the contracting chain?**
  This need not be the case. Indeed, while we know much about the contractual relationship between central government and its first-tier suppliers (TECs in the case of the UK and states in the case of the US), less is known about the contractual relationships further down the chain - especially those which govern the operations of training providers.

- **How is output defined?**
  Typically, definitions include qualifications, jobs subsequently obtained, earning levels, enrolment on other programmes and reduction in welfare dependency.

- **How is output measured?**
  On the whole, absolute measures of output are used more often. In other words, outputs are measured with little reference to the individual’s/institution’s starting position. Experiments with value-added measures are more exceptional.
• How are funding uncertainties minimised?
In the US, the Federal government is insulated from funding uncertainty by basing state JTPA budgets on the basis of need - only 5% of their budget can be used for ORF. In the UK, TECs budgets are subject to a funding ceiling, with ORF operable only up to that point.

• Do the measures of performance used to financially reward and penalise training providers act as good proxies for the long-term labour market prospects of trainees?
Research evidence suggests that the proxies are not that good. However, it is not obvious what other proxies could be used, without putting training providers’ cash flow under even more pressure.

• Are only the best candidates ‘creamed off’ onto output-related funded programmes?
‘Creaming’ is an inherent problem to ORF. While its extent remains an empirical research question, its minimisation is a key policy challenge faced by all ORF systems.

• To what extent are eligibility criteria used to counter the danger of ‘creaming’ by requiring training providers to ‘dredge’?
Eligibility criteria have been used as a means to target programmes towards those most in need. This provides an important means of minimising ‘creaming’.

• How is participation of disadvantaged members of the labour market protected?
In some cases, a certain proportion of those enrolled must be from certain groups such as high school dropouts in the US. However, not all disadvantaged groups are protected in this way, and they may therefore lose out.

• What consequences does ORF have for the content and occupational spread of training provision?
In the absence of corrective measures, there tends to be a shift away from ‘high cost’ and/or long duration courses towards ‘low cost’ and/or short courses when increased
emphasis is given to ORF. Particular types of training delivery also suffer - such as classroom-based training - and training times are reduced.

- **Does ORF lead to cash flow problems for training providers?**
  Reliance on funding triggered by outputs inevitably adds to training providers’ cash flow difficulties. As above, this may affect some training providers more than others.

- **Are particular types of training provider more at risk than others from the operation of ORF?**
  UK evidence suggests that some training providers may have difficulty in remaining economically viable. While employers and industry associations may continue to provide ‘high cost’ training via cross-subsidisation from other areas, specialist stand-alone providers may suffer greater financial pressure and exit the market altogether.

- **Does ORF raise barriers to entry for new training providers?**
  There is evidence that ORF has raised entry barriers to new training providers, especially those in ‘high cost’ training areas. This reduces the range and choice of provision as well as the intensity of competition between providers.

- **Are the administrative rules and regulations that accompany ORF simpler or more complicated than other systems?**
  There is a policy dilemma between a complex measure of output which is equitable, and one which is simple and less equitable, but easier to administer. The ORF mechanism in the UK is complicated and fairly sophisticated, while both the US approach and the Dutch proposals are simpler and easier to administer.

- **Does ORF reward the value added by training intervention?**
  In the UK, the same output carries a different level of reward depending on the type of trainee. However, differentiated payment regimes are complex and cumbersome, and they are not always passed on to all those in the contracting chain.
Does ORF reward all or only some of the value added by training providers?
Most ORF systems recognise only a handful of outputs. As a result, training providers are not always rewarded for the value they add to the stock of human capital. Recognition of part-outputs, however, makes the system more bureaucratic, as recently acknowledged by the Dutch proposals for ORF.

What checks and balances are in place to ensure probity and reliability?
An effective ORF system requires that the output indicators not be fraudulently achieved by placing trainees with ‘friendly’ employers or by bending the rules in other ways. Systems which define output in terms of qualifications and rely on provider involvement in the certification process (such as those in the UK) are most at risk.

What mechanisms are used to counter these problems?
US policy-makers have tended to counter many of these problems by revising primary legislation which governs the JTPA and, in particular, the eligibility criteria. UK policy-makers, on the other hand, have relied more on variations in the contract which governs its relationship with the TECs.

How successful is ORF in achieving its aims?
Despite the evidence reviewed in this Report, it is difficult to be unequivocal on how successful ORF has been in achieving efficiency, reducing administrative costs, increasing flexibility, and enhancing transparency and accountability. Often ORF is but one element, albeit a significant one, in a host of institutional and funding reforms. In addition, ORF is rarely used as the sole instrument of performance management, rather it is one element within a package of measures. It is, therefore, difficult to isolate with certainty its effects. For example, both the UK and US case studies indicate that a number of reforms have been made partly as a result of introducing an ORF mechanism, e.g. narrowing the eligibility criteria for JTPA in the US. Whether these reforms were necessitated by the introduction of ORF and its associated imperfections or whether ORF has made the funding and training system more transparent (and therefore made existing problems more visible) is just one issue which is difficult to assess.
Introducing an element of ORF within the public sector funding of training requires careful thought in terms of both principle and practice. In principle, ORF may present many benefits to existing funding and training regimes. In practice, however, it does not operate in a vacuum. Hence, it may distort or enhance a number of other aims and policies. This Report has presented many of these abstract principles. It has then used the British system of funding government training schemes through TECs, the US system of JTPA delivery via the states and SDAs, and Dutch proposals to use some form of ORF to finance adult and vocational training to show how these principles relate to practical implementation and policy development. Many of these issues have wide applicability. Therefore, the discussion and cases presented provide material from which policy-makers and other interested parties may wish to borrow or learn.


Employment Department (1994) TEED/TEC Funding Arrangements, Sheffield.


Training Agency (1989b) Training and Enterprise Councils: A Prospectus for the 1990s, Sheffield.


Output-related funding in vocational education and training
A discussion paper and case studies

This report aims to provide information on the issues arising from and the practice of funding vocational education and training (VET) on the basis of programme outcomes rather than enrolment/attendance (i.e. switching the emphasis of funding from inputs to outputs). It outlines the policy issues which output-related funding (ORF) generates as well as a number of real-world examples of its use within and beyond the European Union (the Netherlands, the United Kingdom and the United States of America). The objective of the report, therefore, is to combine, within one document, discussion and evidence concerning ORF.

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