



The Early Years Single Funding Formula: National policy and local implementation

**Clare Market Paper 22
September 2016**

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Research Brief

Introduction

Given the complexity of early years provision, creating an effective and efficient funding system for publicly funded early education is challenging and important. The funding arrangements affect the sustainability, quality and flexibility of provision. The funding mechanism interacts not only with the schools funding system, but also with market-based private provision.

In some areas almost all early education provision for 3 and 4 year olds is provided by nursery classes. In other areas there are no nursery classes and all provision is within private, voluntary or independent (PVI) settings.

In 2011, following concerns about the inadequacy and inequity of prior funding arrangements, the Government introduced a locally determined Early Years Single Funding Formula (EYSFF) as the mechanism for funding the free early entitlement across the diverse range of providers.

The full report (Noden and West, 2016) describes in detail how that policy was implemented at the local level. It draws on budget data for 2014-15 from 150 local authorities in England and case study evidence relating to nine of those areas. It provides a detailed picture of how the local formulae have been variously constructed, how funds have been distributed to different types of providers, and how formulae have addressed different policy priorities.

The 'core principles' for the EYSFF stated it should:

- Support effective and efficient distribution of resources at the local level;
- Facilitate greater flexibility of provision so that parents have greater choice in how they use the free entitlement;
- Preserve diversity and choice in the market;

- Incentivise improvements in the quality of provision and recognise the ongoing costs associated with quality;
- Support the narrowing of achievement gaps and recognise the additional costs associated with children from deprived backgrounds;
- Be clear and transparent.

In designing formulae, local authorities had to strike a balance between the various policy goals and in response to changing guidance from central government.

Formulae had to include a 'base rate', which could vary according to the type of provider, and a deprivation supplement. They could also include various supplementary payments, in particular relating to the quality, flexibility and sustainability of provision.

Main findings

Local authorities vary substantially in the design of their funding formulae. In 43 local authorities a single base rate was used across all types of provision. 55 authorities used one base rate for each of the main types of provision (PVI provision, nursery classes and, where applicable, nursery schools) and those rates were not equal. Fifty-two local authorities used different base rates for 'sub-types' of provision within at least one of the main types. Among these authorities there was no uniformity in the 'sub-types' of provision identified to receive different base rates, rather they were chosen to reflect variations in the cost of different sub-types of provision. Such 'sub-types' could, for example, identify a different base rate for childminders rather than all other PVI provision, or a different rate for small schools compared with larger schools.

Overall 90% of funding was distributed via base rates, 4% through the deprivation supplement, 2% through quality supplements, 1% through flexibility supplements and the rest through other supplements.

Fifteen of the sixteen possible combinations of the different types of supplement were represented among formulae. This again reflects the immense variety in formula design.

Across England, the average payment per hour across the three main types of provision was £3.96 in PVI settings, £4.08 for nursery class provision and for nursery school provision it was £7.13.

The case for providing a higher level of funding for nursery schools rests on their very strong reputation for quality. Ofsted's annual report for 2015 reported that 58% of nursery schools were graded outstanding (compared with 13% of all early years providers).

Where childminders were paid a different rate than other PVI providers (that is, when they were identified as a separate 'sub-type' of provision) this rate showed

marked variation, sometimes being substantially less than the rate paid for nursery class provision and sometimes substantially more.

Most early education provision for 3 and 4 year olds is provided by PVI providers or nursery classes rather than nursery schools which account for less than 4% of provision. We compared the average level of funding per hour received by PVI providers with the average level of funding received for nursery class provision. In 81 local authorities the average payment for nursery class provision exceeded the average payment per hour for PVI provision. Payments for PVI provision were higher, on average, than payments for nursery class provision in 61 authorities.

Across the local authorities, the average payment per hour for PVI provision ranged from £3.24 to £5.23. For nursery class provision, average payments ranged from £2.64 to £5.62 per hour.

We compared levels of expenditure across the 150 local authorities. Higher levels of overall expenditure on early years provision, higher average payments to PVI settings, and higher average payments for nursery class provision were all associated with local area characteristics. In particular, higher levels of spending were associated with higher proportions of children living in low income households and spending levels also showed regional variation (and in particular, higher payments within inner London). Controlling for these variables, the political control of local authorities (Labour, Conservative or 'other') was not associated with the level of expenditure either overall or within sectors.

We also examined the size of the *nursery class premium*. (The nursery class premium for each local authority was calculated as the average payment made for nursery class provision minus the average payment made for PVI provision. In 81 authorities the class premium was positive while in 61 it was a negative figure – indicating that the average rate paid for PVI provision exceeded the average rate paid for nursery class provision.)

In keeping with our findings relating to the *level* of spending across local authorities, we found that the size of the *nursery class premium* was associated with the proportion of hours provided by the PVI sector. That is, a higher proportion of provision within PVI settings was associated with a larger nursery class premium.

The average size of the nursery class premium was larger in Conservative controlled authorities than in Labour controlled authorities (15p compared with 4p). However, when we controlled for the proportion of provision within PVI settings, Labour controlled authorities were associated with a larger nursery class premium than Conservative authorities. At the average level of PVI provision (56%) the nursery class premium in Labour authorities was estimated to be 22p larger for Labour authorities than Conservative authorities. However, more than 80% of Conservative authorities have higher levels of PVI provision than the average (associated with a larger premium) and more than 80% of

Labour authorities have less than the average level of PVI provision (associated with a smaller premium).

In addition, controlling for the proportion of PVI provision, authorities using formulae with multiple base rates for different subtypes of provision had smaller nursery class premiums than those using formulae with a single base rate.¹

Nine local authority areas were selected as case studies to gain a more contextualised understanding of the design of funding formulae. The areas varied in a number of characteristics including political control, area deprivation, region, formula design and the size of the class premium. They illustrated well that formulae need to be understood as individual entities and in relation to local circumstances.

The case studies again illustrated the immense variation in formula design. They also suggested that different approaches to design were taken in response to local circumstances including, for example, a need to improve the quality of provision or a shortage of flexible provision. It was also clear that the approach taken in relation to base rates and supplements did not provide a shortcut to gaining an understanding of an explicit or implicit rationale for the formula.

The case studies also drew attention the wide range of operating models of early education providers and to their differing prospects, and vulnerabilities, in relation to changes in funding rates or to an increase in the entitlement from 15 hours to 30 hours.

Policy implications

Central government plans to introduce a national funding formula for distributing funds from central government to local government (DfE, 2016). The proposals, their origins and, in the light of our research, their likely consequences, are described in the full report (Noden and West, 2016, Annex 4).²

The proposed national funding formula will replace the current allocation system using the Dedicated Schools Grant (DSG). The DSG is distributed to local authorities on the basis of their level of expenditure in 2005-06. These allocations may not be closely related either to the needs of local populations or to the cost of provision. The proposals would also modify how local authorities can distribute resources locally. Importantly, the proposals would require all local funding formulae to use a single base rate by 2019-20 and also state that the government is 'minded' to disallow supplementary payments based on quality.

¹ When variables for both political control and formula design were included in the model, along with the proportion of provision in PVI settings, neither reached the level of statistical significance.

² Some of the conclusions presented below arise from the analysis are presented in Annex 4.

Alongside the consultation document, the DfE has calculated, for each local authority, the hourly rate of funding each authority would receive in 2017-18 and also (on the basis of some strong assumptions about the distribution of resources within local authorities) an illustrative average hourly rate that a provider might expect to receive in 2017-18. The proposed reforms will generate substantial turbulence in funding levels – across local authorities, across phases within local authorities, across sectors and between providers.

The proposals represent a shift in resources across local authorities. The consultation document reports that while 112 local authorities will see an increase in their funding rate, in 38 there would be a reduction in funding (these are described as ‘overfunded’ authorities). However, because it is proposed that 95% of funds are passed on to providers (93% in the first year of operation), in most of these areas *providers* would receive a higher rate per hour, on average, than was received in 2015-16. In such areas a key question will be whether the reduction in central expenditure can be achieved without either increasing costs for providers or reducing the quality of provision.

In some areas the changes to the DSG also represent a shift of resources across educational phases *within* local authorities. That is, 20 of the 38 ‘overfunded’ authorities received *additional* funds for schools in 2015-16 as they belonged to the ‘least fairly funded’ local authorities for school provision. In short, in relation to the balance of funding between early years provision and the years of compulsory education, the proposals place much greater control in the hands of central government. Notably however, the balance struck across these educational phases has not been based on an analysis of the efficiency of investing in different phases of education.

On the basis of the proposals, and making strong assumptions about the distribution of resources within local authorities, the DfE has calculated an illustrative average hourly rate that a provider might expect to receive in 2017-18.

In some authorities the illustrative hourly rate for 2017-18 is lower than the average funding rate received in 2015-16. For nursery class provision, the illustrative rate is lower than the average funding level in 2015-16 in 23 local authorities, for PVI provision the rate is lower than that previously received in five areas and in a further 13 areas the illustrative rate is lower than the average payment to both provider types in 2015-16. In the case of nursery schools, additional funds have been provided to support funding rates although this is only guaranteed for two years, thus putting at risk their long-term viability and so reducing the availability of high quality early years education.

The early years national funding formula consultation document describes the impact of the proposals by analysing the local authority budget data used in this study. Our findings suggest that, on the basis of that data, central government cannot be confident as to the consequences of the planned reforms, either in relation to the sustainability of providers or for protecting improvements in the quality of provision.

This is for two reasons. First, the Section 251 proforma data does not provide information as to the funding rates received either by individual providers or by groups of providers. Second, it does not provide any insight into the vulnerability of providers of different types and in different areas to the introduction to the 30 hour entitlement.

With the prospect of substantial turbulence in funding levels, with increases and decreases in funding seen across local authorities, across sectors of provision within local authorities, and across different providers, some local authorities will inevitably need to give a high priority to ensuring providers remain sustainable.

Yet with the proposals that local authorities use a single base rate for all provision, and that 90% of funding flows through that base rate, they will have fewer tools at their disposal. In particular, the consultation states the government is also minded to disallow the inclusion of quality supplements in local formulae. Thus to the extent that formulae have successfully created incentives to improve the quality of provision, those benefits will be removed.

The proposals for changes to the funding arrangements for the free early education entitlement are intended to support the delivery of the 30 hour entitlement for working parents of 3 and 4 year olds. That entitlement will see a welcome and substantial reduction in the childcare costs of the families concerned. However, it is also important that reforms are implemented without placing at risk either the sustainability of early education providers or the quality of provision available.

References

Noden, P. and West, A. (2016) The early years single funding formula: National policy and local implementation, Clare Market Papers 22, London: LSE.

Acknowledgements

The research was funded by the Nuffield Foundation. The Nuffield Foundation is an endowed charitable trust that aims to improve social well-being in the widest sense. It funds research and innovation in education and social policy and also works to build capacity in education, science and social science research. The Nuffield Foundation has funded this project, but the views expressed are those of the authors and not necessarily those of the Foundation. More information is available at www.nuffieldfoundation.org

