

Unit cost calculation methodology and implementation

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Executive summary

The Budapest Institute developed a methodology for the application of a simplified cost option, in particular, unit costs for EU-funded labour market training for jobseekers. The project was commissioned by the Prime Minister's Office – Secretary Office for Monitoring and Evaluation. Besides wage subsidies, subsidised training is the most frequent type of active labour market programmes financed by EU funds in Hungary. Tailor-made complex programmes financed by SROP-1 absorbed about 70% of all SROP-1 funds and more than half of the participants received training subsidies. In each year, several thousands of jobseekers participate in subsidised training in Hungary.

The main goal of introducing unit costs as a simplified cost option is to reduce the complexity of the funding process and to ease the administrative burden placed on the institutional system and on the beneficiaries, while curbing the possibility for mistakes that may arise in a complex regulatory and implementation framework. With the help of the Standard Cost Model methodology (which is also endorsed by the European Union), the reduction in the level of administrative burden can be estimated as well. Another advantage of simplified cost options is that they enable cohesion policy to become more result oriented, as the funding is based on outputs (results) rather than on inputs (costs), which generates a change of approach during planning and implementation as well.

We propose to develop a unit cost-based financing system in three steps. As the first step, incentives in the quasi-market of subsidised training have to be reconsidered and an efficient institutional framework has to be developed. Second, for each project, the optimal methodology for defining and calculating unit costs has to be defined, and lastly, the system has to be evaluated and updated regularly.



In order to prevent a drop in the quality of training and to increase the efficiency of government interventions, the following institutional requirements have to be fulfilled:

- Detailed information on all completed and available training courses should be recorded in a central database, and this **training database** should be made available to all jobseekers. The reimbursement of costs for the beneficiary (the National Labour Office [NLO]) should be partially conditional on the fulfilment of this reporting obligation.
- For each course of each training provider, the training database should contain the **share of successful examinations** and **the share of those entering employment** within 6 months after the end of the training. The reimbursement of the costs of the training providers should be partly conditional on the fulfilment of this reporting obligation and the quality of the data provided, and the authenticity of the data should be verified.
- The rate of reemployment after training should be measured by using **administrative data** (NLO datasets linked on individual level with National Tax and Customs Administration data) instead of self-reported data. For the sake of comparability, the employment indicator should be adjusted for local labour market characteristics. Profiling and clustering should be used as the basis for the adjustment.
- This training database should be made available and easily searchable for all jobseekers and the general public.
- **The head of the examination board should be appointed centrally.** The regulation in force prescribes that the examination board is to be appointed by the minister responsible for vocational training and adult education through the NLO, but in practice, training providers can ask for specific persons to be appointed. The examination certificate has to include both the names and signatures of the examination board members. This requirement is especially important in the case of outcome-based unit costs, when the outcome is the exam certificate.
- The training database should contain **the results of the surveys measuring the satisfaction ratings** of the participants as well. The satisfaction surveys should be filled in right after the exam, and the surveys should be collected by the head of the examination board.



- It should be ensured that **jobseekers are able to make informed decisions when choosing among providers**, and they have to be aware of the fact that they have the **possibility to choose training courses from other counties** as well.
- **Training providers should be chosen by the county PES offices in a standardised, fair, objective and transparent manner**. This is especially important since, when using unit costs the price offers of the providers will be the same and only the quality of the training will differ.
- Introducing **training vouchers** can ensure jobseekers' freedom of choice and high quality of the training. Vouchers are one of the most frequent forms of demand-side subsidies: using a voucher system, the state supports training indirectly through demand. Jobseekers receive a voucher and they choose (with the help of the PES) the provider best suited for their needs themselves. The training provider receives the reimbursement according to the contract concluded.
- **Monitoring** duties should be delegated to an **independent institution** which is interested in maintaining the quality of the training. **Monitoring of the quality of the training** should be added to current monitoring practice, which should include supervising the quality of the curricula and the teaching methods used.
- It might be worthwhile to expand the Project Progress Reports (PEJs) by collecting further indicators to provide better quality information for the monitoring of labour market programmes. For the list of potentially useful indicators, see the evaluation study on the SROP I programmes written by Budapest Institute (Adamecz et al., 2013b).
- The training providers and the training courses must be recorded electronically in the files of unemployed participants in the PES client database in a clear and unequivocal way.
- Yardstick competition among county PES offices (adjusted with clustering and profiling) can induce improvements in efficiency (e.g. better choice of training courses) and provide possibilities for less-efficient county PES offices to learn from other offices which operate more efficiently. **Yardstick competition among providers** can also enhance efficiency.

The need for further institutional requirements depends on the unit cost calculations of each project. If unit



costs are outcome-based, calculated on the basis of successful exam certificates or other outcomes, it is crucial to **prevent potential cream-skimming**¹. With **outcome-based** unit costs, both the beneficiary and the training provider have the incentives to involve jobseekers in the training who are most likely to achieve the defined outcome. This could lead to a situation where jobseekers that are the most vulnerable are left out of the programmes. It can lower the risk of cream-skimming if the provider does not have the opportunity to reject any jobseekers, although that is difficult to accomplish. First, some of the training courses have applications over quota, and some of them require an aptitude test. A potential solution is to delegate the organising of the aptitude test to another agent, or to link it with vocational guidance. Another option for preventing cream-skimming is **to differentiate the payment of grants by target group with the help of statistical profiling**. For example, based on precisely defined criteria, more generous grants are paid to providers who take on more disadvantaged (e.g. less educated) jobseekers. During the yearly supervision and re-evaluation of the system, we suggest examining the extent of potential cream-skimming as well, and adjust incentives as necessary.

In the 2014-2020 programming period, the Common Provision Regulation (CPR, Regulation [EU] No. 1303/2013) and fund specific regulations (e.g. ESF Regulation: 1301/2013/EU) define the possibilities for simplified cost options. Methods based on standard scales of unit costs for subsidised training can be developed either outcome-based or process-based, or mixed, and to specific cost elements, different unit cost measures can be applied as well.

The choice of outcome measure defines the amount of actual ex post grant payment and the administrative requirements of the project. If unit costs are defined by HUF/person/training hour, the number of participants in each training class has to be administered, and only the costs of training those who actually participated can be reimbursed. If unit costs are outcome-based, then the realisation of the outcome has to be verified for audit, and grants can only be paid in case of fulfilment. For example, if unit costs are based on successful exam certificates (HUF/certificate), then only the costs of training those who received a certificate can be reimbursed. In this case, the calculation of unit costs should contain the ex ante expected realisation of the outcome, or the managing authority has to define who should bear the risk of unpaid grants due to unsuccessful participants. When using outcome-based unit costs, the chosen outcome should be a result of

¹ Cream-skimming or creaming occurs when outcome-oriented providers or the PES select the most gifted jobseekers for the training (or for other programmes) to ensure their success.



the training process (for example, showing up at the examination is not an outcome but a successful exam is).

Unit costs can be calculated several ways: based on the sum of specific cost elements (supply-side calculation), based on historical data on subsidised training, or based on market prices (demand-side calculation). The problem of supply-side calculation is that the differences between the direct costs of different types of training can be large due to the different needs for technology and material. The biggest problem of demand-side calculation is that historical data on training costs (and data on past prices) has a large dispersion. We propose that the beneficiary should first define direct and indirect costs based on the beneficiary's own historical data, and then calculate the unit costs for each project separately.

The EMIR database (in its present form) does not contain sufficient information on the project costs for the calculation of unit costs. The EMIR database contains data on costs in the level of projects and/or accounts, but the costs of specific measures (e.g. training, mentoring, counselling etc.) cannot be identified. The beneficiary should use other sources of own or external data for the calculation of unit costs.

The use of unit cost options has to be reviewed annually, and the re-evaluation of the system should cover the following verifications:

1. Was the level of the unit cost in each project **set correctly**? This question has to be answered by comparing the calculated unit costs to eligible costs actually incurred. Two aims have to be established:
 - a. the planned progress of the project should not be hindered by the use of unit costs;
 - b. the beneficiary or other agents of the system should have neither deficit nor excess compared to real costs incurred.
2. Did the use of unit costs **cause any market distortions**? If a specific training required by county PES offices are not offered by any providers, that can imply that the unit cost prices for these types of training are too low and the PES office might consider to raise them.
3. However, if the number of offers for a specific type of training rises unexpectedly after the introduction of unit costs, that might imply that the calculated unit cost price is too high.



4. It is recommended to examine whether the introduction of unit costs **favoured one-sidedly some types of providers** or whether it **excluded some others** from the market. This might be the case if some providers' revenues from subsidised training rise unexpectedly or some other providers disappear from the market. Firm-level datasets, openly available firm-level registers containing accounting data, and the training database suggested by us can help the managing authority to check this assumption.
5. It has to be verified whether the parameters used in the calculation of the unit costs (e.g. in the case of unit costs based on the number of certificates, the rate of successful participants) are calculated correctly, and the **parameters should be adjusted based on new information**. For example, if the ex ante assumption was that 80 percent of participants would pass the examination, but the actual rate is significantly higher or lower, during the planning of similar future projects these new rates should be used.
6. The **market prices of non-subsidised training courses compared to the direct costs of subsidised ones** should be monitored. Large differences can imply that the unit cost prices were miscalculated.
7. The **extent of cream-skimming** should also be monitored: it has to be checked whether the most disadvantaged groups of jobseekers are left out of training in the new system. If jobseekers participating in training have much better observable characteristics than those who are left out (e.g., more educated, mostly aged 25-50, do not belong to disadvantageous target groups etc.), it may imply cream-skimming. Most of these characteristics can be checked by using NLO administrative data. However, it is also possible that selection is based on unobservable characteristics (e.g. motivation, soft skills). Information should be collected by conducting surveys with random sampling.

