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Doubtful debt

The rising cost of student loans

Andrew Norton



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Andrew Norton's higher education reports are notified via Twitter, @andrewjnorton, and through the Grattan Institute mailing list. Please go to: www.grattan.edu.au

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Overview

Student loans have helped millions of Australians finance their higher education since the Government introduced the Higher Education Contribution Scheme, HECS, in 1989. The successor to HECS — the Higher Education Loan Program, HELP — lends more than \$6 billion a year. It has been a very effective policy. But it has become expensive. By 2017 the Commonwealth will have \$13 billion of loans on its books that it does not expect to collect.

Students and former students repay their education debt only if they earn more than a threshold amount — currently \$51,309 a year. Income contingent loans cleverly help cash-poor students pay for their education when they can afford to do so. Some of them never earn enough in Australia to repay what they borrowed.

About 17 per cent of new lending is now classified as doubtful, meaning it is not expected to be repaid. This expense, which appears each year in the Department of Education's Budget Statements, is projected to be \$1.1 billion this financial year. With student numbers rapidly increasing, and new uses being found for income contingent loans, doubtful debt costs will continue to rise.

This report investigates several ways of reducing doubtful debt while still protecting against financial hardship.

One reason for doubtful debt is that HELP debtors leave Australia. Because HELP is repaid through the Australian income tax system it is not collected from people living elsewhere. England and New Zealand have similar student loan schemes and both require debtors in other countries to pay. This report recommends

the New Zealand policy of requiring a flat annual repayment from student loan debtors living overseas.

For debtors staying in Australia, some never earn more than the income threshold or do so for too few years to repay all their debt. Because the threshold is linked to average weekly earnings, it is increasing in real terms. Over time, this means that fewer debtors are obliged to repay. Linking the threshold to inflation would maintain its real value while increasing future repayment levels.

Although these reforms would reduce HELP's costs, on their own their effect on doubtful debt is modest. Its main cause is that HELP debt in deceased estates is written off. This is not a good use of scarce higher education funding.

Most beneficiaries of the HELP write-off will not be financially dependent on the HELP debtor. Partnered HELP debtors earning less than the threshold are not usually the household's main income earner. Their children will be adults by the time the estate is distributed. Introducing asset contingent HELP repayment for estates over \$100,000 would radically improve HELP's finances.

If all these reforms were implemented now, they would save \$860 million a year by 2016–17, and remove the need for planned cuts to teaching and research expenditure.

HELP's repayment system was never designed for lending on the scale we see today. With the reforms in this report, we can achieve the goals of HELP at a much lower cost

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1. Introduction

This report examines student loan doubtful debt. It focuses on higher education students who have borrowed under the Higher Education Loan Program, HELP, which finances courses and course-related costs, but the report's findings have broader implications.

In recent years HELP has been extended to some vocational education courses. There are also active proposals to advance similar loans for student income support.

In principle, greater use of income contingent loans is a good idea. These loans help students shift their education expenses to a later, more affluent, time in their lives. The risk of default and a tarnished credit record is largely removed by income contingent repayment.

But in practice, income contingent loans are expanding with little public discussion of the money that will not be paid back. Although some unrepaid debt is an intended feature of income contingent loans, current levels are higher than necessary. HELP's policy goals can be achieved at lower cost to taxpayers.

Chapter 2 explains the policy thinking behind HELP, and the trends in doubtful debt. It shows how doubtful debt makes the proposed new uses for income contingent loans less financially viable.

Chapter 3 contains new research into which groups of graduates are at most risk of not fully repaying their HELP loans. Graduates

of some disciplines have high expected doubtful debt levels. HELP doubtful debt is linked to broader issues of full-time workforce participation.

Chapter 4 looks at one policy response to doubtful debt: changing the income threshold at which HELP debtors start repaying their debt.

Chapter 5 considers ways of recovering money from HELP debtors who are living overseas. The most feasible method requires some departure from income contingent repayment.

A lower real threshold and overseas repayment would increase government revenue by several hundred million dollars in the next few years. Most of this would be faster repayment of HELP debt that would eventually be repaid anyway, but there would be some reduction in doubtful debt.

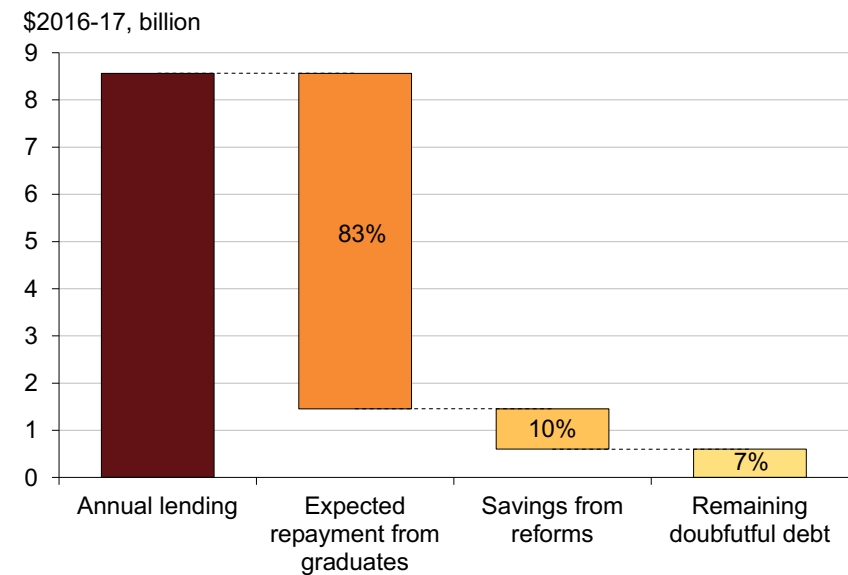
Chapter 6 re-evaluates the current practice of not collecting outstanding HELP debt from deceased estates. It argues that this is poorly targeted spending, and that vulnerable estate beneficiaries could be protected at much lower cost by requiring repayment from estates of \$100,000 or more.

As most HELP debtors are still young, this policy change would not raise significant revenues for many years. Yet it would have a long-term benefit to HELP's Budget costs.

Chapter 7 summarises the savings to be made from the proposed policy changes. Put together, the three reforms could reduce

doubtful debt from 17 per cent of new lending in 2013–14 to 7 per cent of new lending in 2016-17.

Figure 1: Reduction in doubtful debt from HELP reform 2016-17



2. Doubtful debt under HELP

The Higher Education Loan Program, HELP, was never designed to recover all the money it lends to students. Loan eligibility is determined by course admissions, not by credit checks. Debtors do not repay if their income is below \$51,309 or if they are overseas. And unlike almost all other debts, a HELP debt dies with the debtor.

HELP started out as the Higher Education Contribution Scheme, HECS, in 1989. Given the typical ages at which people attend university, most HELP debtors are less than 45 years old. With this relatively young population, final debt write-offs are not yet large. But a significant minority of students and former students are expected to never fully repay the money they borrowed. We call the money they owe 'doubtful debt', and the Department of Education's Portfolio Budget Statements include the cost estimate. The amount exceeds a billion dollars a year, and is expected to grow significantly in coming years.

Doubtful debt is an expected feature of HELP. This was partly a political concession: it helped the government reduce per-student public subsidies. Even with doubtful debt, the government was financially better off lending money rather than giving it away. It was also partly deliberate policy design. To support enrolment in higher education, the government was and is willing to take some of the risk that further study will not bring financial benefits.

The policy question now is whether government is taking too much of this risk. HELP lending is vastly greater than was anticipated when its repayment system was designed in the late

1980s. If Budget projections are correct, there will be nearly twice as many students eligible for a HECS-equivalent loan this year as there were in 1989. On average, these students borrow a lot more now than then. In today's money, students in 1989 paid about \$3,500 a year for their higher education. Now they pay between \$6,000 and \$10,000 a year, depending on the subjects they take.

As well as these increases, HELP is being used for new purposes. The descendant of the original HECS scheme, HECS-HELP for government-supported university students, has been joined by FEE-HELP for full-fee students, SA-HELP for the student amenities fee, OS-HELP for overseas study, and VET FEE-HELP for vocational education students. Soon there may also be HELP-like schemes for student income support.

Including all these new schemes, the government now lends as much through HELP — \$6.3 billion in 2013-14 — as it spends on direct higher education tuition subsidies. In 2014-15, HELP lending will significantly exceed tuition subsidy expenditure. With so much lending, HELP repayment policies need re-examination.

2.1 The purpose of HELP loans

Around the world, government programs help students avoid paying up-front fees for higher education. These policies aim to help prospective higher education students overcome financial obstacles to study. The goals in Australia are similar to those in other countries: to provide a skilled workforce, to promote social mobility, to support personal development, and to pursue

knowledge for its own sake.¹ In Australia, public opinion overwhelmingly supports the proposition that cost should not prevent qualified students from attending university.²

The two main types of government financial assistance for tuition costs are subsidies and loans. Although in the long run subsidised higher education can pay for itself through taxation on the higher incomes of graduates, at least in English-speaking countries the trend has been away from direct subsidies and towards loans. HECS was an early part of this trend, ending a period of free higher education that began in 1974.³

HECS was introduced in part because the then government did not believe it could finance expanded higher education from its own resources alone.⁴ While in theory increased taxation could fund more higher education, in practice governments often find it politically difficult to increase tax rates or impose new taxes. Key ministers also believed that free higher education was regressive.⁵ Higher education subsidies largely went to people from affluent families, and to people who would enjoy significantly above average incomes over their careers.⁶

HECS partially reconceptualised the role of government in higher education. It assumed that students do not need a full subsidy,

but that they do need to postpone payment. HECS shifted the cost of their education away from a cash-constrained time to a later period of relative affluence. It did so by not requiring repayment below a threshold income, and by charging lower rates of repayment for people earning slightly over the threshold compared to those on higher incomes.⁷

Compared to up-front fees, HECS both gives more people an opportunity to study and spreads purchasing power more evenly over a person's life. Typically, it means that they can buy more when they are young but less at a later age when they are repaying their debt. The British economist Nicholas Barr describes these income smoothing activities as the welfare state acting as a 'piggy bank' to be drawn on and repaid over a life, rather than the welfare state working as a 'Robin Hood', distributing income from the rich to the poor.⁸

Although the 'piggy bank' activities of government are mostly about income smoothing, they also manage risk. This is one key difference between a private loan to finance higher education and a government-supported loan. Normal loan schedules require minimum repayments regardless of income. Graduates sometimes take time to find appropriate work, and so this type of debt creates a risk of default. In the United States, student debt defaults affect the creditworthiness of large numbers of people.⁹ In Australia, this problem is rare.¹⁰ For most student debtors, low

¹ DEEWR (2009), p. 7

² McAllister (2008)

³ Chapman and Nicholls (2013). There had been a small 'Higher Education Administration Charge' from 1986.

⁴ Dawkins (1987), esp. chapter 11, and Wran (1988)

⁵ Chapman and Nicholls (2013), p. 112

⁶ See Norton (2012a) on the private benefits of higher education and Norton (2013b) p. 29-30 on the social background of higher education students.

⁷ See ATO (2013e) for the repayment requirements at different levels of income.

⁸ Barr (2001)

⁹ Historically, at least 5 per cent of US student debtors default within 5 years. Recently the default rate has been 10 per cent; Turner (2013)

¹⁰ Some people are unable to pay their tax liabilities, a problem to which HELP debt may contribute.

income relative to their education debt means repayment delay rather than default.

One issue this report raises is whether making loans contingent on income is the principle behind HELP, or whether it is a mechanism used to implement HELP's income smoothing and risk management policy goals.¹¹ As this report will show, strict application of income contingency as a principle undermines the original objective of HECS and HELP: to require those who can contribute to the cost of their education to do so. It substantially increases the public cost of higher education, but with few compensating public benefits. The lost money transfers wealth to people who would not, under normal social policy criteria, be eligible to receive it. In specific circumstances, income contingency can be supplemented with other repayment mechanisms to ensure that more people repay their student loans.

2.2 Trends in HELP doubtful debt

The level of HELP debt not expected to be repaid — what this report calls doubtful debt — is calculated each year by the Australian Government Actuary (AGA). Its work is based on data supplied by the Australian Taxation Office (ATO).

Predicting what will happen over a long time period is inherently difficult. Eventual HELP repayment rates will depend on the repayment rules and how personal circumstances mix with broader social and economic trends. Complicating matters further,

¹¹ See also Chapman (2006), especially chapter 3, on income smoothing and risk management.

the ATO can only give the AGA a limited amount of information. Historical incomes, age and gender are used to predict likely repayments. Chapter 3, drawing on a wider range of data sources than the AGA's HELP analysis, unpacks some of the causes of doubtful debt.

Using its model, the AGA predicts that \$7.1 billion of the \$30.1 billion outstanding HELP debt at 30 June 2013 will not be repaid.¹² Accounting conventions require doubtful debt to be expensed annually: in other words, as an honest account of the true expenses incurred each year. In 2013–14, 17 per cent of new lending — or about \$1.1 billion — is not expected to be repaid.¹³

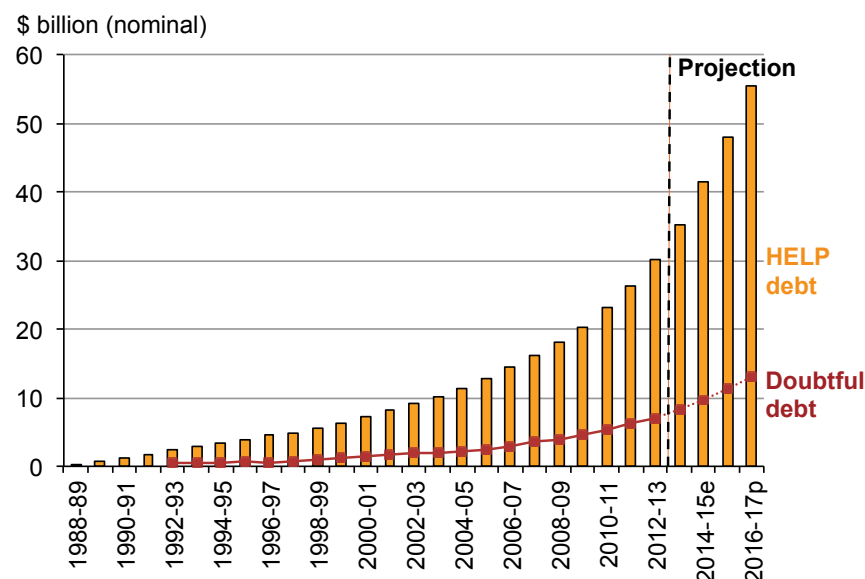
The amount of doubtful debt goes up every year, reflecting accumulating doubtful debt from earlier years and new lending (Figure 2). Assuming 17 per cent of new debt will not be repaid, in 2017 doubtful debt will reach \$13 billion, out of an estimated total \$55 billion HELP debt.¹⁴

¹² DIICSRTE (2013b), p. 245

¹³ Communication from the Department of Education. For 2011–12, 8 per cent of borrowers were expected to make no repayment, and another 10 per cent to partially repay their debt.

¹⁴ It is also possible for the stock of doubtful debt to be re-valued up or down, which will affect the level of doubtful debt on top of the influence of new lending.

Figure 2: HELP debt and debt not expected to be repaid, 1988–89 to 2016–17



Notes: Forecast of HELP debt is based on combining the CPI-indexed stock of HELP debt from last year with new lending and subtracting estimated annual repayments. Doubtful debt estimates are only available from 1992-93 onwards.

Sources: DIICCS RTE (2013a); c); DIISRTE (various years); Communication from the Department of Education

Although the total amount not expected to be repaid goes up every year, its percentage of the outstanding total varies. Over time, it has fluctuated between 14 and 23 per cent, its level in 2012-13.¹⁵ This is higher than the 17 per cent of new debt that is

¹⁵ DIISRTE (2012b), p. 39

doubtful. This is because ‘old’ doubtful debt builds up over time. For example, in 2010 the ATO reported that nearly \$500 million was still owed by 56,000 people who incurred a HECS debt in 1989, long after everyone else at university that year had repaid.¹⁶

Estimates from 2012 are that more than a quarter of all remaining HELP debtors will not fully repay what they owe. This is made up of 16.5 per cent who are not expected to repay anything, and another 11 per cent who are expected to repay only part of their debt.¹⁷ The remaining debtors are expected to repay in full.

2.3 Budget pressures

HELP doubtful debt is increasing at a time when the Commonwealth Budget is under significant pressure.¹⁸ As a result, higher education is targeted frequently for cuts, with new expenditure reductions announced in April 2013.¹⁹ In the latest Budget savings, the Commonwealth plans to reduce previously legislated increases in funding for teaching and research. These cuts affect the core activities of universities.

Minor savings from the HELP scheme have been included in these cutbacks.²⁰ Little has been done about doubtful debt, the

¹⁶ ATO (2012), table 19

¹⁷ For the year ending 30 June 2011, Communication from the Department of Education.

¹⁸ Daley, *et al.* (2013)

¹⁹ Emerson (2013)

²⁰ These include reductions in the discount for up-front payment of student contributions from 20 per cent in 2011 to 10 per cent in 2012. In the April 2013 package an abolition of the discount was announced, but it has not yet been legislated. The savings from this change will be reduced by increased doubtful debt through more lending. A ‘bonus’ for repaying early was reduced from 10 per

biggest current HELP cost. Leaving doubtful debt out of higher education expenditure control shows questionable priorities. Lower debt costs could free up money for teaching and research.

Not tackling doubtful debt also creates additional fiscal concern about expanding HELP. Its use for additional student income support has been proposed many times.²¹ Two specific schemes have realistic prospects of becoming law. The previous government announced, but did not legislate, conversion of the current Student Start-Up Scholarship to a loan.²² The new Coalition government is attempting to proceed with this change. However, this scheme does not provide students with any more money than they would otherwise receive under Youth Allowance. During the 2013 election campaign, the Coalition promised a HELP-like 'Trade Support Loan' of up to \$20,000 to finance "everyday costs" for apprentices in vocational education Certificate III and IV courses.²³ This would be a new entitlement.

An income support loan could allow students to improve their living standards and/or to work less while studying. Both England and New Zealand include income support in their student loan schemes. About half of full-time Australian undergraduates say their work commitments adversely affect their performance at

university.²⁴ A majority say they would be likely to use a loan for living costs.²⁵ In the case of apprentices, the Coalition's policy aims to reduce the number of people leaving for higher-paying jobs before finishing their apprenticeship.

Despite the policy attractions of loans for student income support, previous experience suggests that people who borrow for income support are higher risk than people who borrow to pay tuition fees. Doubtful debts were estimated at 50 per cent for the Student Financial Supplement Scheme, a loan scheme for people on student income support that ran for a decade from 1993.²⁶

The debt write-off also raises questions about proposals that the Commonwealth increase the maximum contributions paid by Commonwealth-supported students (those receiving tuition subsidies and HECS-HELP loans). Some universities argue that such a change would ease their financial problems and finance improvements in teaching. While these are worthwhile goals, the existing maximum student contributions limit potential HELP doubtful debt. Unless HELP's costs are controlled, any increase in student contributions will be partly funded by taxpayers.

The Coalition's proposed Trade Support Loan scheme for apprentices is the latest extension of income contingent loans into vocational education. Since 2009, some students in diploma-level vocational education courses have had access to VET FEE-HELP

cent in 2011 to 5 per cent in 2012, with its completion abolition announced but not legislated.

²¹ Higgins (2011)

²² Emerson (2013)

²³ Liberal/National (2013), p. 4-7

²⁴ Bexley, *et al.* (2013), p. 51. However, research into whether or not paid work negatively affects academic performance is more sceptical: e.g. Coates and Edwards (2009), p. 99.

²⁵ Bexley, *et al.* (2013), p. 42

²⁶ Higgins (2011), p. 471. Of the remaining SFSS debt, 63 per cent is classed as doubtful: DIICSRTE (2013b), p. 245.

loans. A VET FEE-HELP trial is underway for select certificate IV courses.²⁷ In principle the arguments for income contingent loans are the same in vocational or higher education. However, the repayment system was designed for university graduates. The lower typical incomes of people with vocational qualifications may exacerbate doubtful debt issues, as section 3.5 discusses.

²⁷ Department of Education (2014)

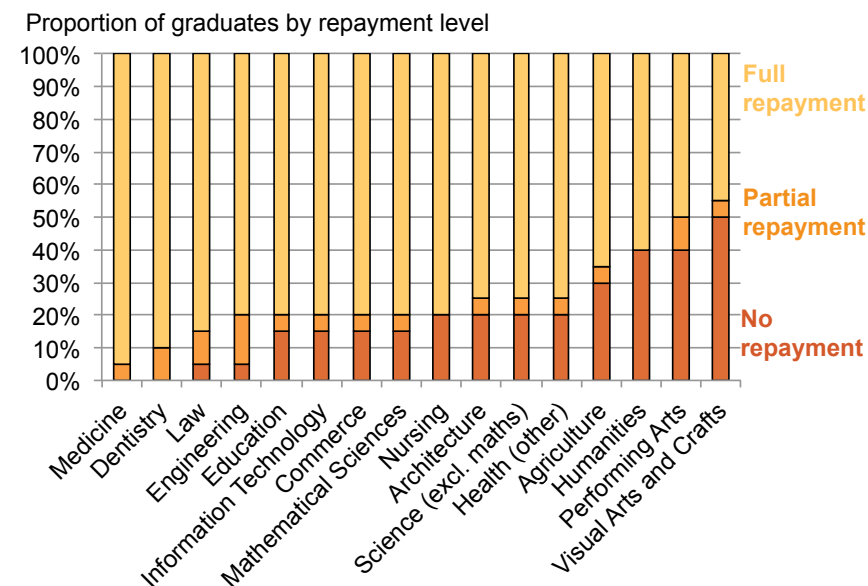
3. Why is so much HELP debt doubtful?

There are no official accounts that explain why so much HELP debt is doubtful. Given the limited information the ATO collects, tax statistics alone paint only part of the picture. In this chapter, we use other data sources to help explain why some people persistently earn less than the HELP repayment threshold.

3.1 Differences in income between disciplines

Graduate earnings differ by discipline.²⁸ Since HELP debtors only repay if their income reaches the threshold, graduates of some disciplines are more likely than others to repay their debt. Figure 3 is based on earnings patterns evident in the 2011 Census. It shows what proportion of bachelor degree graduates with no further higher education are likely to repay their debt and at what level.²⁹ The proportion of these graduates who are not expected to fully repay ranges from 5 per cent in medicine to 55 per cent in visual arts and crafts.

Figure 3: Proportion of bachelor degree graduates by their expected repayment level, 2011



Notes: Based on the analysis of Weidmann and Norton (2012a) updated with Census 2011 data. The student contribution for science (excl. maths) and mathematical sciences courses reflects the current contribution level, not the lower level for 2011. Health (other) includes health fields other than medicine, dentistry and nursing. Graduates aged 18-65 who are also Australian citizens are included. People who did not specify their income are excluded. The 2010-11 threshold was used.

Source: ABS, Census 2011

²⁸ Daly, *et al.* (2012); Weidmann and Norton (2012a)

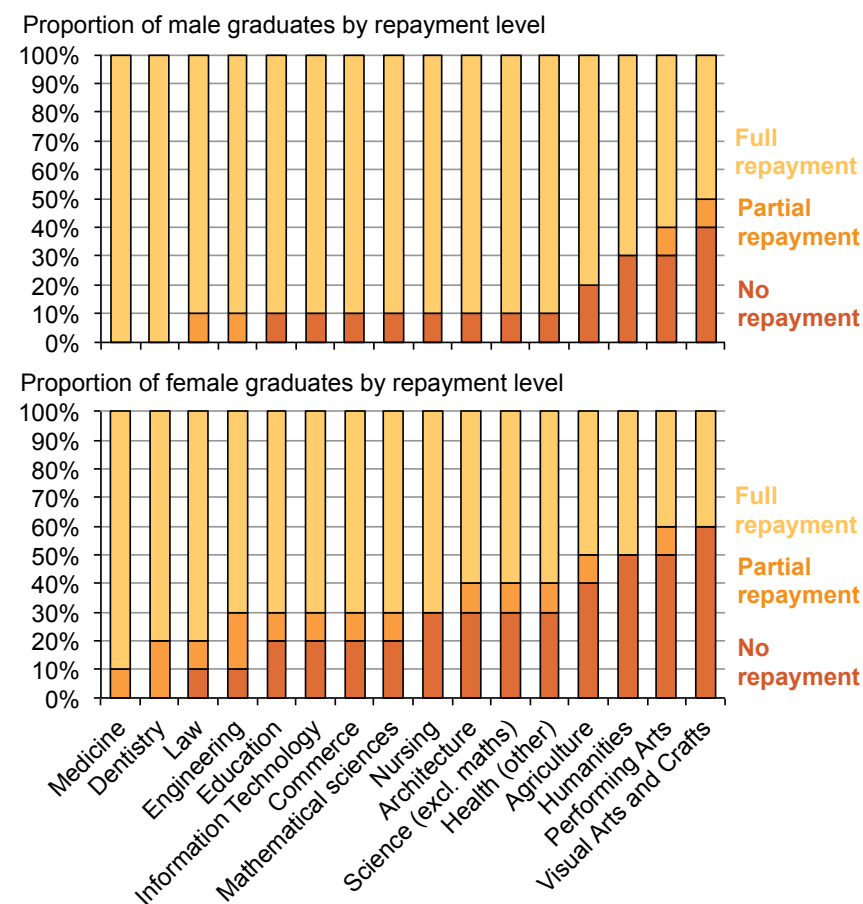
²⁹ Due to a data restriction, we are unable to exclude graduates who do not have outstanding HELP debt from the sample. Upfront payments differ by discipline, usually but not always reinforcing the Census patterns of predicted payment: Wiblin (2011), p. 35.

Figure 4, by contrast, shows what proportion of male and female bachelor-degree only graduates are expected to repay their debt. The effect of course studied on repayment remains roughly the same for men and women, but overall women are less likely to repay.

Large disciplines with lower repayment prospects are the main contributors to doubtful debt. Although performing arts and visual arts and crafts have a higher proportion of non-repaying graduates, commerce, education, nursing, science and humanities are the main contributors to doubtful debt once their larger number of graduates is accounted for. Figure 5 shows the number of graduates by their predicted level of repayment for each discipline.

Women tend to be over-represented in disciplines with low repayment prospects. The proportion of female graduates ranges from 61 per cent of graduates in humanities to 92 per cent in nursing.³⁰ There are equal numbers of men and women in commerce. Some of the reasons for women's lower repayment prospects are discussed in the next section.

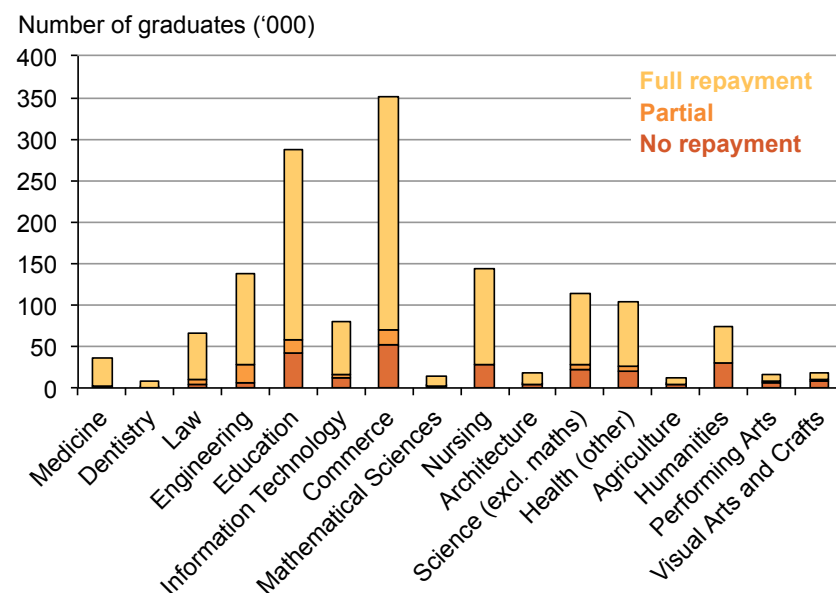
Figure 4: Proportion of bachelor degree graduates by repayment level, 2011



Note: See notes for Figure 3.
Source: ABS, Census 2011

³⁰ ABS (2011)

Figure 5: Number of bachelor degree graduates by their expected repayment level, 2011



Note: The number of graduates shown is an approximation of the actual number since not all graduates respond to the Census question on education. See also the notes for Figure 3.

Source: ABS, Census 2011

3.2 Women's labour force participation

Since 1987 women have made up the majority of higher education students.³¹ Women's earnings therefore significantly affect HELP's finances. At a given point in time, women are more than twice as likely as men to earn income below the HELP repayment threshold, as Figure 6 shows. At the minimum, this affects the speed at which women repay compared to men.³²

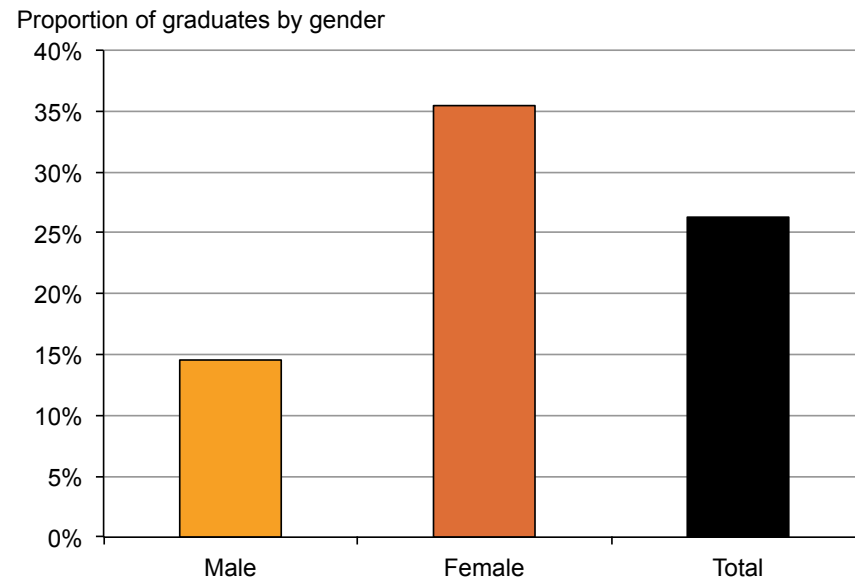
For the purpose of estimating doubtful debt, what matters most is for how long women's incomes are above or below the threshold for repayment. If their income exceeds the threshold for a sufficient number of years — 10 to 15 years for a median graduate — they will repay their loan in full. If their income is below the threshold in all or most years of their working lives, their HELP debt will eventually be written off.

However, the snapshot in time shown in Figure 6 can over-emphasise temporary factors affecting graduates. A longitudinal survey that records income data from the same individual over time provides a more realistic picture of long-term prospects. The Household, Income and Labour Dynamics in Australia survey (HILDA) shows that women are much more likely than men to persistently earn incomes that are below the HELP threshold.

³¹ Norton (2013b), p. 28

³² See also Higgins and Sinning (2013) on gender differences in repayment times and prospects.

Figure 6: Proportion of higher education graduates with earnings below the threshold, 2011

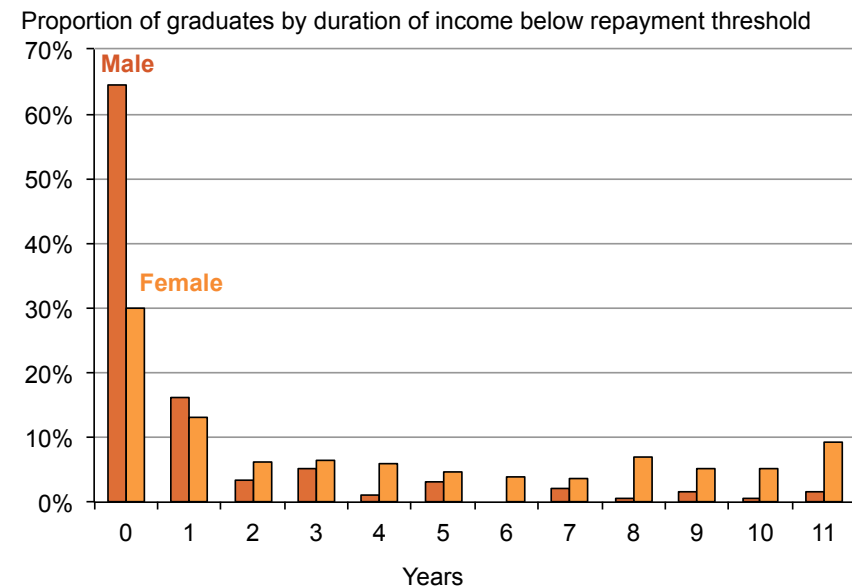


Notes: The Census income data is presented in ranges. Uniform distribution is assumed within each income range to determine the number of people with income above the threshold within the range \$41,600–51,999. The data includes postgraduate, bachelor, graduate diploma and diploma certificate graduates who were Australian citizens in 2011, not just those with HELP debt. It excludes graduates below 24 or above 54 years old and people are still studying. The 2010-11 threshold is used.

Source: ABS, Census 2011

Figure 7 shows that over the 11 years covered by the survey, 34 per cent of women but only 7 per cent of men spent six or more years earning less than the threshold income. In addition, the majority of men earned income above the threshold for the entire 11 years, but only 30 per cent of women did so.

Figure 7: Proportion of higher education graduates by number of years of below the repayment threshold income, 2001–2011



Notes: The data includes postgraduate, bachelor, graduate diploma and graduate certificate graduates who were Australian citizens in 2011. It excludes graduates below 24 or above 54 years old and people who are still studying.

Source: HILDA (2011)

Graduates in full-time work are likely to make repayments. About 75 per cent of full-time jobs pay more than the threshold.³³ Graduates are less likely than non-graduates to be in the lower-skill jobs that pay below the threshold, so the proportion of full-time jobs that pay more than the threshold would be higher for graduates.³⁴

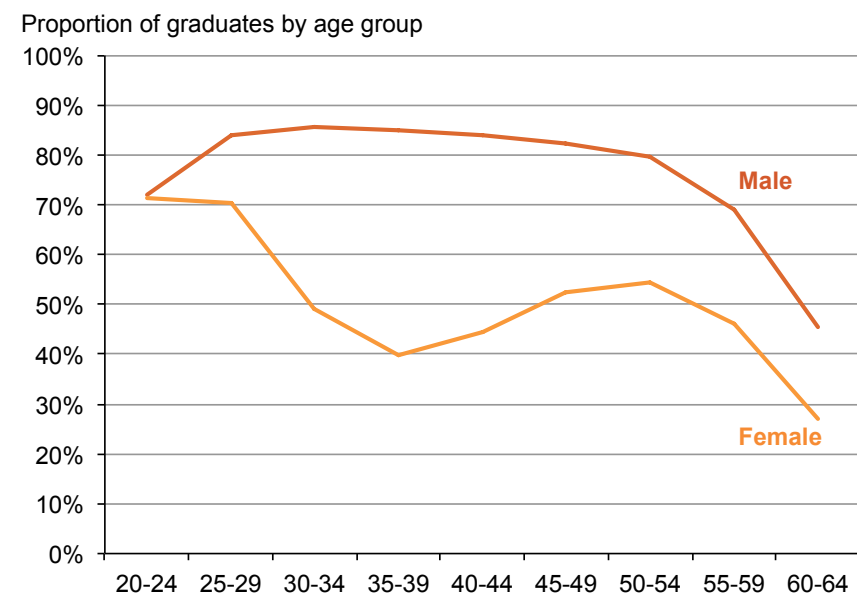
The main reason female debtors do not repay their HELP debt is that they are less likely than male graduates to work full time, as Figure 8 shows. Female graduate full-time work rates peak at 72 per cent in the 20 to 24-year old age group. They then decline to 40 per cent in the 35 to 39-year old age group, before recovering for 15 years. After age 54 a phase-down to retirement occurs. By contrast, the majority of male graduates work full-time, except in the 60 to 64-year old age group.

Women with child-raising responsibilities are much less likely to work full-time. Figure 9 shows the full-time workforce rates of female higher education graduates in different household situations. For women with children, full-time work rates peak in their early 50s, when their children are adult or no longer need supervision. Single women with children consistently have higher full-time participation rates than married women with children.

³³ Adult full time jobs, ABS (2013d)

³⁴ ABS (2013c)

Figure 8: Full-time labour force participation, male and female higher education degree holders, 2011



Notes: The data includes postgraduate, bachelor, graduate diploma and graduate certificate graduates who were Australian citizens in 2011. It excludes graduates below 20 or above 65 years old and people who are still studying.

Source: ABS, Census 2011

Three-quarters of female graduates have children by their late 30s, so child-raising responsibilities are a major influence on their full-time workforce participation. However children are not the only cause, since female graduates without children also start leaving the full-time labour force in their late 20s. Married women do this

at a higher rate than do single women, possibly because they can maintain their living standards by sharing their partners' income. Perhaps consistent with a pattern of partners sharing finances, married male graduates have higher rates of full-time work than do their single peers.³⁵

Long-term projections of HELP doubtful debt are sensitive to female employment patterns. An increase in female full-time workforce participation would reduce doubtful debt. Conversely, since less than 20 per cent of part-time jobs pay above the threshold, a decrease in female full-time workforce participation would increase doubtful debt. A comparison of the 2006 and 2011 census indicates that female graduates aged 20 to 64 have reduced their full-time participation rate from 52 to 50 per cent.³⁶ As the trend is likely to continue, doubtful debt will increase in the future.³⁷ Workforce participation is outside the scope of this report, but policies that affect it could have significant effects on the long-term cost of HELP.³⁸

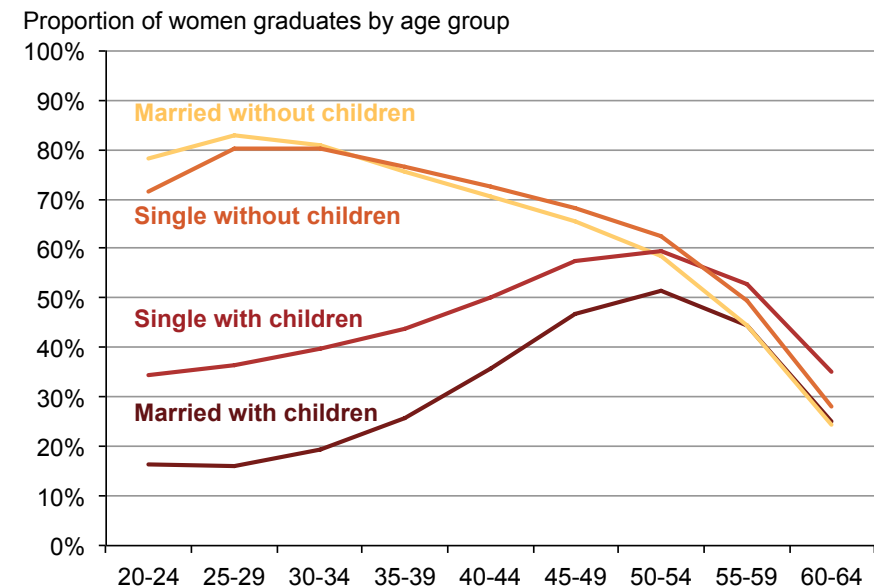
³⁵ ABS (2011)

³⁶ Male graduate full-time workforce participation also declined by a percentage point. The patterns show that young graduates are finding it harder to find full-time work, but women are more affected than men. Women returning to the workforce in their thirties and forties are less likely to work full-time in 2011 compared to 2006. Men never exited and are maintaining full-time work rates. Full-time workforce participation is increasing for men and women aged over 50 years: ABS (2006); ABS (2011).

³⁷ Borland (2013)

³⁸ See Daley (2012), chapter 4

Figure 9: Full-time labour force participation, female higher education graduates, household circumstances 2011



Notes: The data includes postgraduate, bachelor, graduate diploma and graduate certificate graduates who were Australian citizens in 2011, not just those with HELP debt. Social marital status is used which includes married in a registered marriage and married in a de facto marriage. It excludes people who are studying.

Source: ABS, Census 2011

3.3 Incomplete higher education

Not everyone who starts a higher education course finishes it. Completion rates are not routinely published, but the available information suggests that 20 to 25 per cent of people who started an undergraduate course in 2005 never received a qualification.³⁹ This means that significant numbers of people acquire HELP debt without getting a degree.

Data limitations make it difficult to work out how much doubtful debt is due to people with incomplete qualifications. People with incomplete courses will leave higher education with lower average debt than people who finish their studies. Some people will have borrowed for only one semester, but others may have years of accumulated HELP debt.

Our ability to predict repayment rates for university dropouts is restricted by limited research into their long-term financial outcomes.⁴⁰ If dropouts earn as much as people with Year 12 education only, Census 2011 data shows that about half of men but only 30 per cent of women aged 25 to 45 had incomes above the HELP repayment threshold. However, this is likely to understate dropouts' income prospects. People who do not complete are disproportionately from those with weaker school results, but their results still suggest higher academic ability than

school leavers who never went to university.⁴¹ This prior ability may be reflected in subsequent earnings. It is possible that people who leave university before finishing their course nevertheless acquire skills that are valuable in the labour market. They may also have or acquire other qualifications that improve their earnings prospects. Some higher education applicants already have a vocational education qualification.⁴² An old research paper reported that about one-third of young people who left higher education went to vocational education.⁴³

No precision is possible, but university dropouts probably earn more than people with no post-school study, but significantly less than people who complete their qualifications. Due to their lower average original debt, dropouts need fewer years of above-threshold income to completely repay their HELP debts. However, they are likely to be over-represented in HELP debtors who are not expected to repay.

3.4 Moving overseas

People who leave Australia for an extended period are generally not required to pay tax in Australia.⁴⁴ HELP debt is recovered by the ATO through the Australian tax system. As the ATO has no international jurisdiction, repayments from overseas debtors are not collected and their outstanding debt will not be recovered unless they return to Australia.

³⁹ Lomax-Smith, *et al.* (2011), p. 79

⁴⁰ Compared to people who finished school but had no further qualifications Marks (2007) found no financial benefit from incomplete higher education using a small Australian sample of people who were still young. An English study found no benefit: Walker and Zhu (2013). However, an American study found some benefit from incomplete college education: Greenstone and Looney (2013).

⁴¹ On the link between Australian Tertiary Admission Rank and attrition see Norton (2013a), p. 7

⁴² Department of Education (2013c)

⁴³ McMillan (2005), p. 14

⁴⁴ ATO (2011)

Unfortunately there are no reliable statistics on HELP debtors living overseas. In 2010–11 the ATO reported 32,365 HELP debtors with unknown or overseas addresses, or two per cent of the total outstanding HELP debtors.⁴⁵ However, that understates the true number. HELP debtors are not obliged to report foreign addresses, and other sources suggest that the number is higher.

Australian National University economists Bruce Chapman and Tim Higgins used the Beyond Graduation Survey to determine the proportion of graduates working overseas. They estimated that 10 per cent of graduates work overseas for at least one year in the first 3.5 years after graduation. Of these, they estimated that 76 per cent spend fewer than five years abroad before returning to Australia.⁴⁶ With domestic student course completions approaching 200,000 a year and a growing proportion of students taking out a HELP loan, there is the potential for significant numbers of recent graduate HELP debtors to be overseas for an extended period.⁴⁷

The Beyond Graduation Survey cannot tell us about the longer-term locations of graduates who are still overseas after three years. Chapman and Higgins used migration data to better understand long-term movements. The data do not show education levels but they can identify the general demographic group most likely to include HELP debtors. The researchers found

that a third of Australian citizens aged between 20 and 30 (the main HELP repayment years) who left Australia long-term in 2004 were still away after six years.⁴⁸ While some will return, the longer they remain away the more their careers and personal lives will keep them overseas, making it less likely that they will ever repay.

The international nature of Australia's domestic students may contribute to this emigration. In 2012, 22 per cent of domestic students were born overseas.⁴⁹ Migration data shows that overseas-born Australians make up 27 per cent of the population but 35 per cent of all long-term departures of Australian citizens.⁵⁰ Migration not working out, family pressures to return to the country of birth, increased opportunities from being multilingual and work rights in home countries may all contribute to this phenomenon. Since 2002, Australia has allowed dual citizenship, which means more migrants retain full legal rights in their country of birth.

3.5 VET-FEE HELP

The Vocational Education and Training (VET) FEE-HELP scheme was established in 2009, as an extension to the FEE-HELP scheme. It provides income contingent loans to students undertaking diploma, advanced diploma, graduate certificate and graduate diploma courses with an approved VET provider.⁵¹

⁴⁵ ATO (2013j), p. 23

⁴⁶ Chapman and Higgins (2013), table 3, scenario 2 is used. They used the Department of Immigration's Travellers' Characteristics Database to make this estimate.

⁴⁷ Department of Education (2013b) and preceding years, table 5.1 and award course completions. The proportion of people paying up-front has declined from 22.5 per cent in 2005 to 16.4 per cent in 2012.

⁴⁸ Chapman and Higgins (2013), p. 289

⁴⁹ Department of Education (2013b), table 9.1

⁵⁰ DIAC (2013), p. 103

⁵¹ Department of Innovation (2009–2011). Vocational education graduate certificate and graduate diploma courses were removed from the Australian Qualifications Framework in 2013: AQF (2013)

Since the introduction of VET FEE-HELP, the number of eligible students has grown more than threefold, from 19,273 students in 2009 to almost 70,000 in 2011. The take-up rate on loans has increased from 27 to 56 per cent over the same period. Consequently, the number of students with a loan has increased more than sevenfold.⁵²

Doubtful debt is the amount of debt not expected to be repaid from all HELP schemes, including HECS-HELP, FEE-HELP, VET FEE-HELP, OS-HELP, and SA-HELP. As VET FEE-HELP is recent it does not yet account for a large portion of existing doubtful debt. But VET FEE-HELP assisted students are expected to triple by 2016–17.⁵³

People with vocational education diploma or advanced diploma qualifications are less likely to repay HELP debt than are higher education graduates.⁵⁴ Using Census 2011 data, Figure 10 shows that the income distribution of people with diplomas is skewed towards the lower income range, compared with bachelor graduates. More than half of people with diplomas aged 20 to 39 earn less the repayment threshold. They are 50 per cent less likely than higher education graduates to make a repayment.⁵⁵

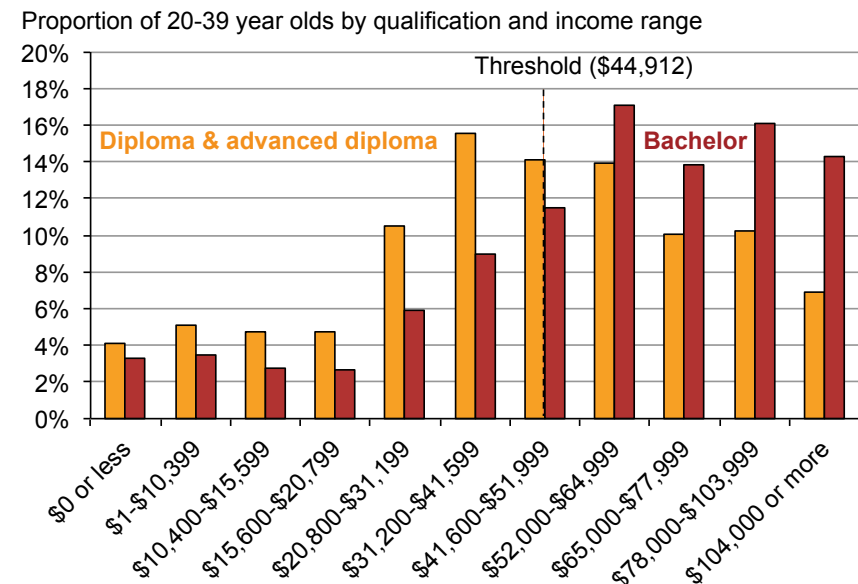
⁵² Department of Innovation (2009–2011)

⁵³ DIICCS RTE (2013c)

⁵⁴ Although there are also higher education diplomas, they are only a small percentage of all diploma students: NCVER (2013), table 4. In higher education, students often take diploma courses as a pathway to a bachelor degree course, or in combination with a bachelor degree. They will therefore not show in the Census, which asks only about a person's highest qualification.

⁵⁵ Assuming a uniform distribution of population within each census income range and most repayment occurring between the ages of 20 and 39.

Figure 10: Income distribution of 20–39 years olds with diploma or bachelor qualifications, 2001–2011

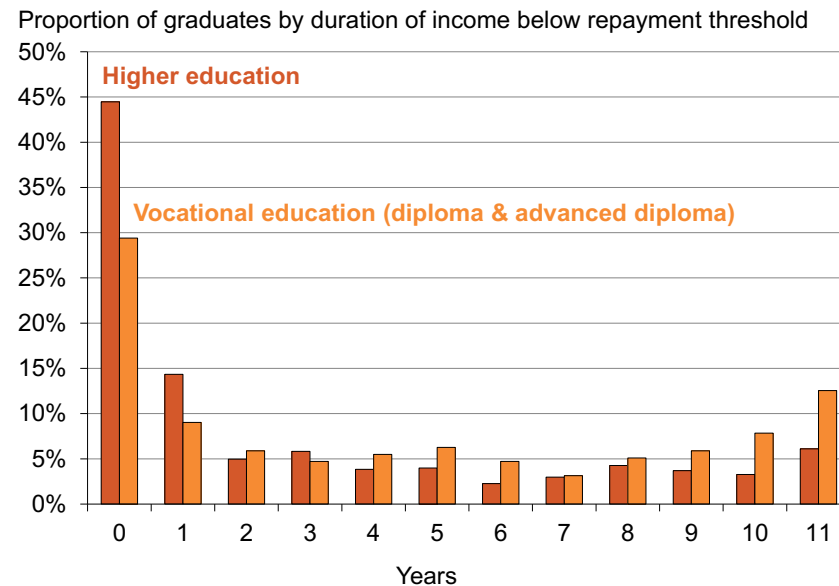


Note: Income represents annual income derived from weekly earnings.

Source: Census 2011

Since a snapshot of income at a particular time can over-represent temporary factors, HILDA, a longitudinal survey spanning more than 11 years, is also used to check the results. HILDA data show that 13 per cent of vocational education diploma holders earn less than the repayment threshold for 11 years, which is twice the level of higher education graduates, as Figure 11 shows.

Figure 11: Proportion of higher education graduates and diploma & advanced diploma holders by number of years of below the repayment threshold income, 2011



Notes: Higher education degree includes postgraduate, bachelor, graduate diploma and graduate certificate. The data includes people who were Australian citizens in 2011 and obtained qualification prior to 2001. It excludes people below 24 or above 54 years old and people who are still studying.

Source: HILDA (2011)

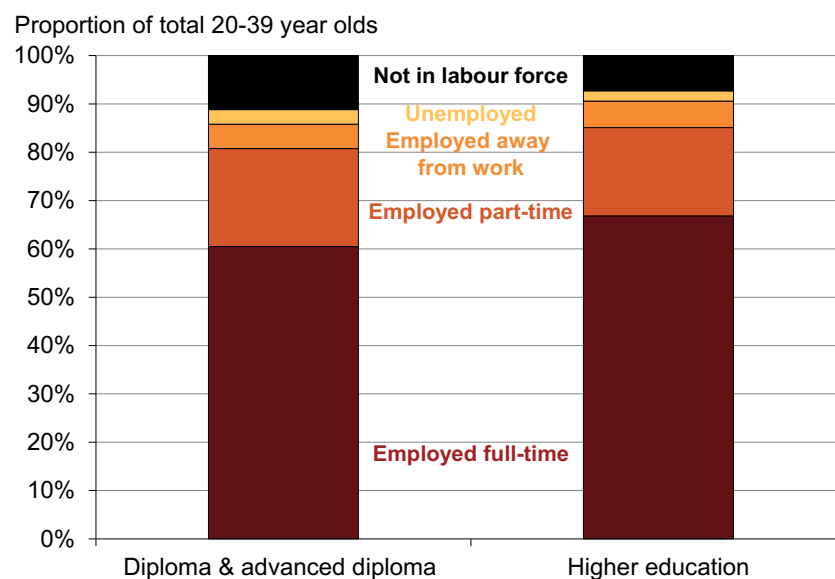
As in higher education, women with diplomas or advanced diplomas have worse repayment prospects than their male counterparts. This is particularly important for VET FEE-HELP

since more than 69 per cent of students who borrowed in 2012 were women.⁵⁶

The fact that people with diploma qualifications are less likely to work full-time than are higher education graduates reduces their repayment prospects. While most full-time jobs pay more than the repayment threshold, less than 20 per cent of part-time jobs do, as section 3.2 discusses. Of 20 to 39-year olds with diplomas or advanced diplomas, 40 per cent were not working full-time in 2011, as Figure 12 shows. They are 11 per cent less likely to be in full-time work than are their higher education counterparts.

⁵⁶ Department of Education (2013d)

Figure 12: Labour force participation status of higher education and diploma & advanced diploma holders, aged 20–39, 2011



Notes: Higher education degree includes postgraduate and bachelor. The data includes graduates who were Australian citizens in 2011. It excludes people who are still studying.

Source: ABS, Census 2011

4. Changing the repayment threshold

The current initial HELP repayment threshold is \$51,309. Everyone earning less repays nothing; everyone earning more pays at least 4 per cent of their annual income, or \$2,050 a year or more.⁵⁷ Anyone persistently earning slightly above the threshold will repay over 10 to 15 years, on average. Anyone persistently earning less than the initial threshold never repays his or her HELP debt.

This chapter outlines the rationale behind the original repayment threshold and its indexing method, and issues involved in changing them. It also investigates the possible savings from changing the threshold and the indexation system.

4.1 Basis of the initial threshold

The current initial threshold incorporates two concepts that originate in the report of the Wran Committee, which in 1988 recommended introduction of the Higher Education Contribution Scheme, HECS. The committee thought that people with “little or no capacity to pay” should not do so. That included people who were unemployed, in low-paid employment, on welfare or out of the workforce for child rearing.⁵⁸

The \$51,309 threshold is set more than high enough to meet this condition. Raised in 2004–05 to improve the financial position of graduates on lower incomes, the threshold exceeds other

government indicators of financial need.⁵⁹ For example, a part aged pension is paid to people with incomes below \$48,000.⁶⁰ The annual minimum wage is \$32,354.⁶¹ A threshold based on that figure is the lowest possible amount consistent with a “little or no capacity to pay” principle. On that basis, the threshold would be \$33,700 once a 4 per cent repayment was factored in.

Despite suggesting a “capacity to pay” principle, the Wran Committee proposed basing the threshold on average weekly earnings (AWE) for all full- and part-time employees, which would put it well above low-paid employment. AWE is influenced by the wages of highly-paid managers and professionals, who are a growing proportion of all wage earners.⁶² The Wran report itself noted that AWE positioned graduates favourably in the overall income distribution.⁶³

In practice AWE is only partly used to set the threshold for repayment. The current threshold is \$3,600 less than AWE, but

⁵⁹ On why the threshold was increased: Nelson (2003), p. 21.

⁶⁰ DHS (2014), p. 35. Calculated by multiplying the fortnightly maximum income by 26.

⁶¹ Fair Work Commission (2013). Calculated by multiplying the weekly minimum wage for a 38 hour week by 52. The Commission is required to take the needs of the low paid into account in setting the minimum wage.

⁶² For example, the proportion of all employed persons who are professionals has increased from 17 per cent in 1996 to 22 per cent in 2013: ABS (2013f). However this compositional shift has been offset by an increase in part-time work from 25 per cent to 30 per cent of employees: ABS (2013e).

⁶³ Wran (1988), p. 57

⁵⁷ HELP debtors can pay up to 8 per cent of their total income: see ATO (2013e).

⁵⁸ Wran (1988), p. 57

indexed according to an AWE-based formula.⁶⁴ As AWE typically grows by more than inflation, the threshold is rising in real terms.

AWE indexation means that the threshold incorporates a relative measure to preserve graduates' financial position compared to other people. It is more generous than most other programs offering government financial assistance. The benefits of most people receiving government support start reducing at lower amounts than \$51,309. Major benefits such as the Newstart Allowance and the Family Tax Benefit are indexed to the Consumer Price Index (CPI).⁶⁵

The AWE influence is consistent with the role of income contingent loans in smoothing income over a graduate's lifetime. It puts more repayments into later periods of relative affluence. If there were no cost to government in lending to HELP debtors, this income smoothing would be unproblematic. It would make graduates in their early adult years better off without making anyone else worse off. However, a high HELP threshold brings costs. It increases the risk that debt will not be repaid.

4.2 Other considerations in changing the threshold

Ideally, HELP repayment rules should be consistent over time. Stable rules allow debtors to plan their finances. With large cuts to the threshold, some students working while studying may unexpectedly have to start repaying before completing their

⁶⁴ The series is called 'total earnings' which includes all workers, both part-time and full-time: ABS (2013a). The threshold would have been \$54,917 in 2013-14 if based entirely on AWE.

⁶⁵ Department of Social Services (2012); Department of Human Services (2013c); Department of Human Services (2013b)

qualification. People with HELP debt may have made financial commitments based on the higher threshold.

Prospective students may decide against further education if a lower threshold exposes them to additional costs or risks. This would undermine one goal of HELP, which is to encourage people to undertake further study.

In the history of HECS and HELP, we have one major experiment in decreasing the threshold. From the 1997–98 financial year the initial threshold was cut from \$28,495 to \$20,701, with AWE indexation. This lasted until 2004–05, when an increased base threshold was introduced. After the change was announced in 1996, there did appear to be an 'announcement effect' with school students' stated intentions to pursue higher education temporarily declining.⁶⁶ Actual school leaver demand for higher education as measured in applications through tertiary admissions centres is harder to interpret. The historical data is consistent with a small decline in applications as a share of the relevant age cohort from 1997.⁶⁷ Because the threshold change coincided with a large increase in HECS charges, it is impossible to say whether the reduced threshold or the total price caused the fall in demand.

⁶⁶ Chapman and Ryan (2005); the study followed the same group of students at age 14 and 15 in 1995 through to 1998. At the end of each year, the students were asked about their intention to attend university. After the 1996 announcement of higher HECS charges and a lower threshold, university intentions temporarily dropped across students from all wealth levels. The effect was largest in the higher wealth groups.

⁶⁷ Using data from AVCC (2003) and ABS (2008b). However, applications were not recorded precisely by age.

Mature age students are more vulnerable to threshold changes than school leavers. Older students are more likely to already have incomes in the range of potential lower thresholds.⁶⁸ Many of them would have pre-existing financial commitments that constrain their capacity to take on new expenses. Consistent with these observations, after the 1997–98 threshold cut was announced applications from people aged 21 or over declined and took years to recover.⁶⁹ Higher HECS rates and fewer people in their early 20s may also have contributed to reduced demand, so it is not clear what effect the lower threshold had.⁷⁰

Another factor to consider is the interaction between the threshold and other government programs. Many graduates receive government benefits, especially relating to family support. The income tests applying to these benefits are arguably analogous to the hardship indicators identified by the Wran Committee. For example, full Family Tax Benefit Part A is available if household income does not exceed \$48,837.⁷¹ The government may not want HELP repayments to reduce the income of parents it otherwise deems deserving of full family benefits.

4.3 Savings from changing the threshold

The considerations count against large cuts to the initial repayment threshold. However ATO data suggests that these would be needed to make a significant short-term difference to

repayments.⁷² The most recent available data is for the 2010–11 financial year, in which 1.57 million people had an outstanding HELP debt.⁷³

The incomes of HELP debtors are spread over a wide range, as Figure 13 shows. The number of people earning slightly less than the threshold in 2010–11 is perhaps surprisingly small. A \$1,000 reduction in the threshold would have increased the number of repaying debtors by only 15,000 people, or one per cent of total debtors.⁷⁴ It would only have raised \$26 million, as seen in Figure 14. Reducing the threshold to the 2010–11 minimum wage of \$30,644 would have raised about \$300 million in additional repayments.⁷⁵ It would have added 19 per cent to the \$1.57 billion the Government collected in that year.⁷⁶ However, it would also have undermined some of HELP's policy objectives.

⁶⁸ For example, at the time of the 2011 Census 17 per cent of 25 to 39 year old students had annual incomes between \$31,200 and \$51,999, compared to 8 per cent of 20 to 24 year olds, and 2 per cent of those aged less than 20.

⁶⁹ Norton (2012a), p. 75

⁷⁰ ABS (2008a), table 4.1

⁷¹ Department of Human Services (2013a).

⁷² One per cent sample file from the ATO.

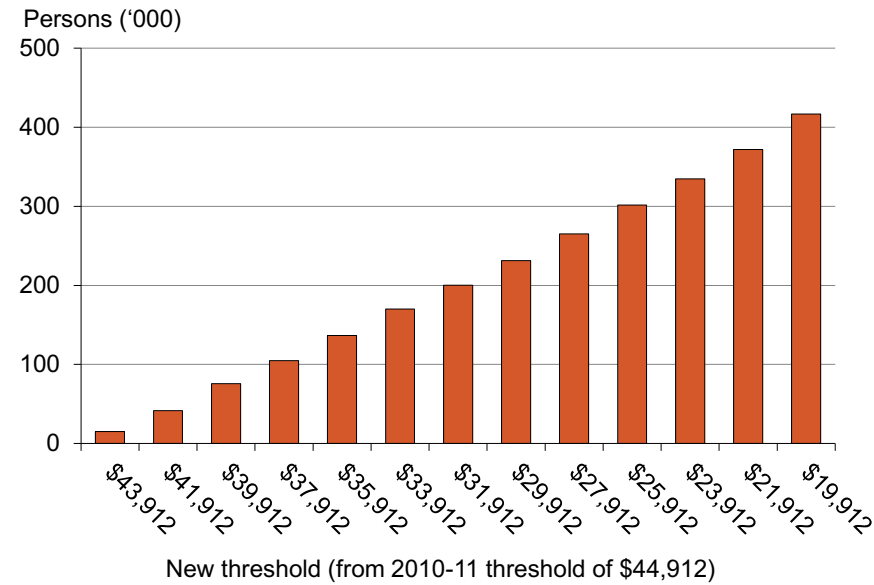
⁷³ ATO (2013i)

⁷⁴ There are very high repayment changes when crossing a threshold, as HELP debtors must pay 4 per cent of all their income, not the income above the threshold. This creates an incentive to keep income below the threshold. However, there is little evidence that this is occurring: Chapman and Leigh (2009)

⁷⁵ Fair Work Ombudsman (2011)

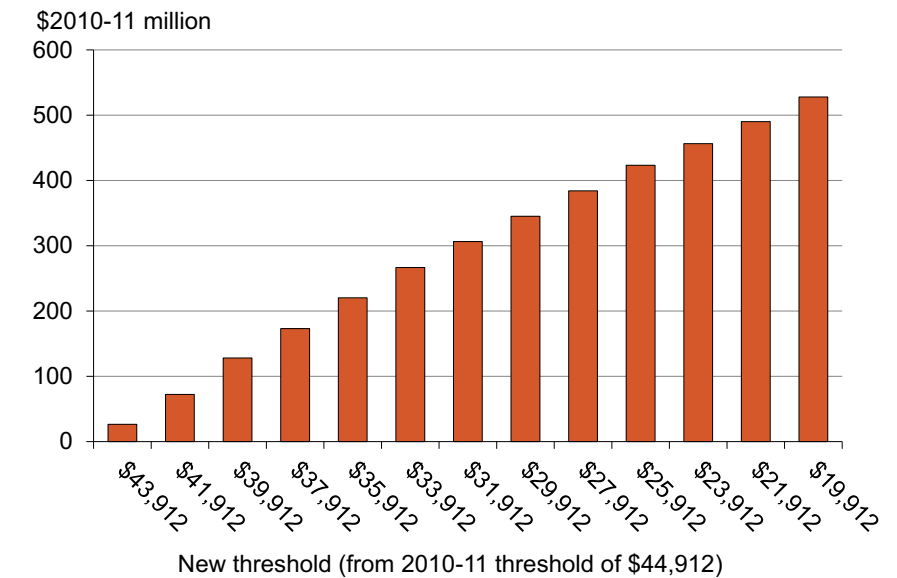
⁷⁶ Amount received including compulsory and voluntary repayments in 2010–11: ATO (2011), p. 66

Figure 13: Additional annual repaying HELP debtors, 2010-11



Source: ATO (2013a)

Figure 14: Additional annual repayments from lower thresholds, 2010-11



Note: A 4 per cent marginal rate is used to calculate the extra repayments. We assumed that additional repaying debtors have at least 4 per cent of their income in outstanding HELP debt.

Source: ATO (2013a)

4.4 The effects of indexation

In the original framework of HECS, HELP's predecessor, the repayment threshold was indexed to CPI movement. Since 1994, the indexation system has followed the movement in average weekly earnings of all employees.⁷⁷

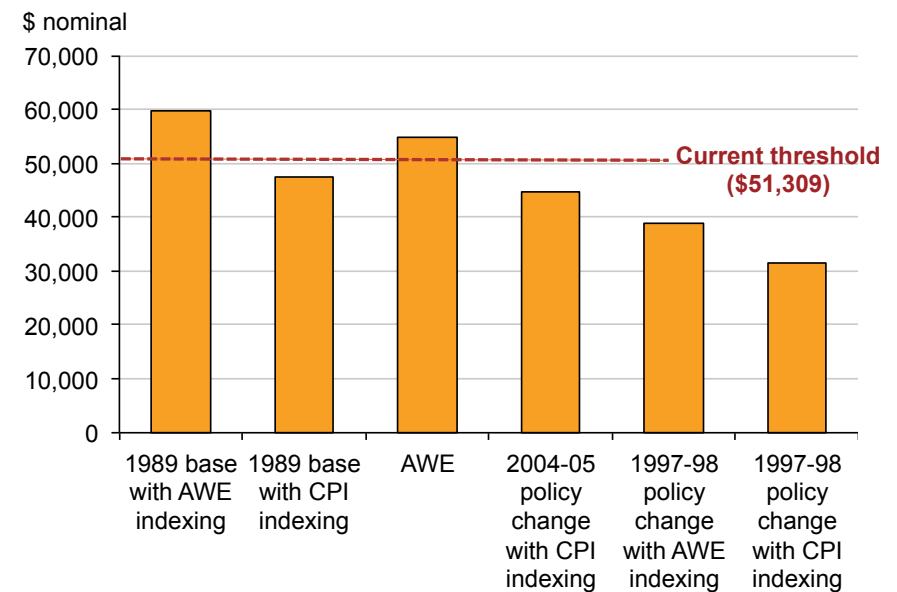
Over the long run, indexation systems can have a significant impact on the threshold. Figure 15 shows other potential repayment thresholds, depending on how they are calculated. If AWE had been used to index the 1989 threshold and kept until today, the 2013–14 threshold would be \$59,772 — more than \$8,000 above the current figure. By contrast, if the CPI were used, the threshold would be \$47,379, \$3,930 below the current figure. Finally, if the 1997–98 change to the threshold had been kept and indexation had followed the movement of the CPI, the threshold would be \$31,440, almost \$20,000 below the current threshold.

Because the HELP threshold is indexed to AWE rather than to the CPI, it is increasing in real terms. On average since 1996 AWE have grown at 4.1 per cent a year. The CPI has grown at 2.6 per cent a year.⁷⁸ If the threshold had been indexed to CPI after it was increased in 2004–05, the current level would be \$44,836 rather than \$51,309.

⁷⁷ Australian Government (1988–2013); Australian Government (1993); Australian Government (2003); as part of the Higher Education Funding Legislation Amendment Act 1993.

⁷⁸ ABS (2013a); ABS (2013b)

Figure 15: Potential threshold using different historical bases and indexation systems, 2013–14



Note: The threshold shown represents the initial threshold where the marginal rate is 4 per cent.

Sources: ABS (1994–2013); ABS (2013b); Higher Education Funding Act 1988 from multiple compilations, and Higher Education Support Act 2003

4.5 Using CPI indexation

This report does not recommend major cuts to the initial HELP income threshold. There are advantages in stable and predictable repayment rules. A large reduction in the threshold could adversely affect demand, at least from mature age students. As many HELP debtors are also likely to be eligible for family-related

benefits, ideally the threshold should be coordinated with these entitlements.

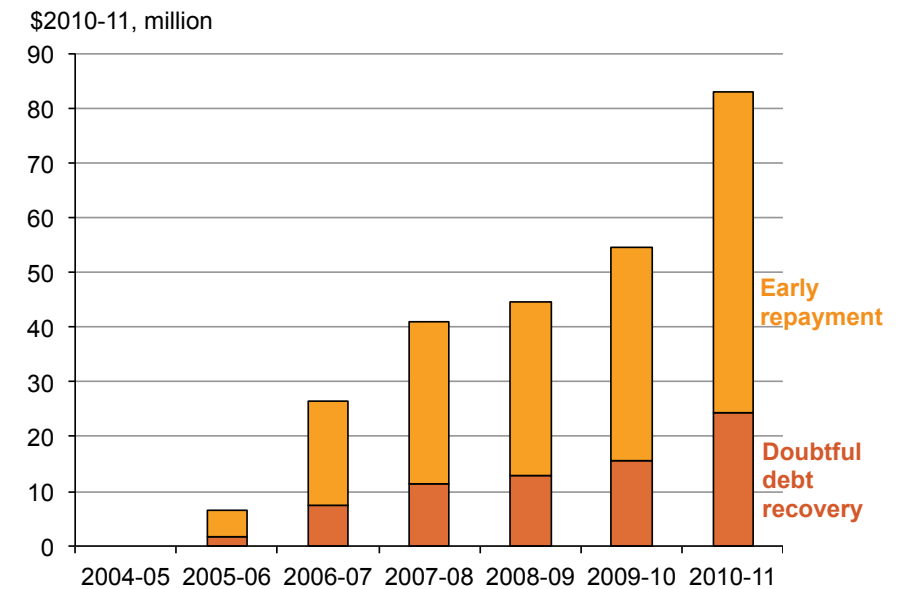
None of these concerns stand in the way of CPI indexation. This would maintain the real value of the threshold while, over time, increasing HELP repayment revenues. If CPI indexation had been used since 2004–05 it would have increased repayment revenues by 5 per cent or \$83 million in 2010–11, on top of the \$1.57 billion actually received (Figure 16).⁷⁹ Using analysis based on the Household, Income and Labour Dynamics Australia (HILDA) survey, we estimate that 29 per cent of the \$83 million would have been reduced doubtful debt, while 71 per cent would have brought forward repayments that would eventually have occurred anyway.

If indexation to CPI had been adopted in 2004–05, the accumulated extra repayment would have been \$257 million over the seven years to 2010–11. Using the HILDA survey, we estimate that \$73.4 million of this amount would have been reduced doubtful debt, and \$183.3 million early repayment.

These estimates are conservative, as they only include money from people who would not otherwise make an annual repayment. In practice, indexation affects 10 different income thresholds from the initial \$51,309 through to \$95,288. At each threshold, the debtors have to repay an extra half percentage point of their total income, up to eight per cent. With CPI indexation, graduates on higher incomes will repay more quickly than they do now. Speed matters, because faster repayments increase the chance of all debt being cleared before HELP debtors leave the full-time workforce (section 3.2).

⁷⁹ 2010–11 is the latest year for which we have ATO unit record data.

Figure 16: Additional repayment if the repayment threshold is set at 2004–05 policy change with CPI indexing



Notes: A 4 per cent marginal rate is used to calculate the extra repayments. Due to data limitations, we assumed that additional repaying debtors have at least 4 per cent of their income in outstanding HELP debt. More repayment could be expected if higher repayment thresholds were also indexed to CPI.

Source: ATO (2013a)

As the amount of HELP debt is expected to grow substantially, so is the doubtful debt. If indexation to CPI were to be adopted in 2014–15, we estimate that the Government could receive \$230

million in extra repayments by 30 June 2017. Of this, \$64 million would otherwise be doubtful debt.⁸⁰

For these reasons, the threshold should be indexed to CPI. The change can be readily defended as consistent with the original goals of HELP. It will preserve current levels of income smoothing and risk management, and hence is unlikely to affect demand for higher education. At the same time, it will reduce doubtful debt and speed up the repayment of other HELP debtors.

⁸⁰ In \$2016-17; HILDA (2011); ABS (2013b); Treasury (2013c); Treasury (2013a); DIISRTE (various years); Communication with the Department of Education

5. Collection of HELP from overseas debtors

HELP debtors working overseas are not obliged to repay their HELP debts. There is no reason for this in principle. The challenge is to design a cost-effective repayment system.

This chapter investigates existing measures to avoid losses from overseas HELP debtors and other countries' experience. It evaluates different ways of reducing doubtful debt caused by overseas debtors.

5.1 Existing measures to protect against loss of HELP overseas

Higher education funding legislation does not specifically exempt HELP debtors working overseas from repaying. Overseas debtors not repaying is a by-product of the chosen repayment mechanism — the Australian tax system. Anyone not paying income tax in Australia does not incur a HELP repayment obligation.

Although existing legislation does not require repayment from people overseas, it recognises the problem. New Zealanders and Australian permanent residents are entitled to a Commonwealth-supported place in an Australian university, but not a HELP loan.⁸¹ Since their foreign citizenship means that they can easily move back home and avoid repaying their HELP debt, their exclusion from HELP represents a measure to minimise the overseas debtors problem.

⁸¹ *Higher Education Support Act 2003*, sections 36-10(2), 90-5 and 104-5. HELP eligibility for New Zealand-born long-term residents of Australia has been announced but not legislated.

For similar reasons, Australian citizens cannot get HELP loans for courses taken primarily at the overseas campuses of Australian universities.⁸² As of 2011, Australian universities had 12 overseas branch campuses offering full-degree programs.⁸³ Australian citizens are also ineligible for HELP loans if their higher education provider believes they will not undertake any subjects in Australia.⁸⁴ This provision prevents Australians living overseas from borrowing under HELP to take online courses. Studying overseas indicates a capacity and perhaps an intention to stay away from Australia, and reduces the likelihood that these students will repay their HELP debt.

However, nothing stops HELP debtors studying in Australia and then moving overseas.

5.2 The overseas experience

England and New Zealand both have income contingent loan schemes modelled on HELP. Each has measures to collect from overseas debtors, recognising the problem that permanent and long-term migration pose for tax-based repayment systems.

In England, people from other European Union countries can take out student loans, and British citizens have work rights in other EU countries. Despite the potential for large-scale emigration after

⁸² *HESA 2003*, sections 90-10 and 104-1(2)

⁸³ Lawton and Katsomitros (2012), p. 37

⁸⁴ *HESA 2003*, sections 90-5(3) and 104-5(3)

study, only three per cent of student debtors with known addresses reside overseas, according to official statistics.⁸⁵

England maintains the income contingent repayment system for overseas student debtors.⁸⁶ Thresholds for repayment vary according to country, allowing graduates to match the living standard of debtors in England. Debtors to the English Student Loan Company (SLC) living in Australia have a threshold for repayment equivalent to A\$41,000, and have to pay 9 per cent of their income above the threshold.⁸⁷

This income contingent method of overseas debtor repayment involves significant paperwork. Overseas debtors need to send the SLC documentary evidence — such as photocopies of payslips and bank statements — of how much they earn. Debtors who are not working need to show, through a letter from a parent or another third party, for example, how they support themselves. A default monthly repayment amount applies to debtors who do not submit income evidence. It is equivalent to \$615 for debtors in Australia.

The SLC can apply penalty charges to debtors who do not meet their obligations, require repayment of the loan in full, and charge for the cost of collecting the debt.⁸⁸ Despite these enforcement measures a quarter of overseas resident debtors were in default

as of April 2013. A third were repaying, with the rest earning less than the income threshold.⁸⁹

Overseas student debtors are a major issue in New Zealand. Twenty-seven per cent of the people who graduated in 2004 had spent six months or more overseas by 2010.⁹⁰ In 2013, 15 per cent of all student loan debtors were overseas.⁹¹ For New Zealanders, easy access to the Australian labour market means that many graduates spend time working overseas. Finding an effective way of collecting from overseas student loan debtors has been a significant policy challenge.

Compared to the complex English system, New Zealand minimises management costs by charging overseas graduates flat annual amounts based on outstanding debt levels.⁹² The repayment amount ranges from A\$900 for small loan balances to a maximum of A\$4,600 a year on balances exceeding \$A55,000.⁹³

Flat amounts make the repayment system simpler, but sacrifice income contingency. New Zealand student debtors pay 12 per cent of their income above \$A18,000, so some overseas graduates could pay more in a flat amount than they would at home under income contingency. However, many others would

⁸⁵ Two per cent of debtors have unknown status; Student Loan Company (2013a), calculated from table 1A(i) for 2012 cohort.

⁸⁶ Graduates are deemed to be overseas for repayment purposes if they are away for three months or more.

⁸⁷ Student Loan Company (2013b). Currency conversion 1 December 2013. A higher threshold will apply for loans taken out from late 2012.

⁸⁸ Student Finance England (2013), p. 19

⁸⁹ Student Loan Company (2013a), table 1

⁹⁰ Smyth and Spackman (2012), p. 30

⁹¹ Ministry of Education (NZ) (2013), data appendix, table 28. After a period of residency in New Zealand, recently increased to three years, Australian citizens can also take out New Zealand loans: Doyle (2013). This further increases the risk of graduates leaving the country.

⁹² Graduates are deemed to be overseas for repayment purposes if they are away for more than six months, although they can apply for a one-year 'repayment holiday'.

⁹³ Inland Revenue (2014), Currency conversion 4 April 2014.

pay less with the flat amount than under the income contingent system.

Although New Zealand has always required overseas student debtors to repay, policies have changed over the years. A now-abolished three-year repayment holiday for overseas debtors exacerbated repayment problems. New Zealand is finding that it is difficult to get debtors into repayments after such a long break.⁹⁴

New Zealand uses advertising to alert overseas student debtors to their obligations and debt collectors to improve repayment levels.⁹⁵ They data-match passports and tax records to increase compliance from debtors returning to New Zealand. Yet despite increasing amounts of repayment from overseas student debtors, 60 per cent of them still have overdue payments.⁹⁶

In the latest move to increase repayment rates, the New Zealand Parliament has passed a law allowing authorities to arrest defaulting student loan debtors at airports.⁹⁷ This will catch people living permanently outside New Zealand who return temporarily on business or to see friends and family.

5.3 Recovering HELP from overseas

In principle, overseas HELP debtors should repay. The original idea behind HECS was that students contribute to the cost of their education when their income reaches a threshold. HELP debtors who leave Australia permanently are not doing so. Requiring repayment from overseas HELP debtors would treat all debtors fairly, rather than allowing some to escape their obligations.

⁹⁴ Ministry of Education (NZ) (2013), p. 35

⁹⁵ Ibid., p. 36

⁹⁶ Ibid., comparing data appendix tables 28 and 34.

⁹⁷ New Zealand Parliament (2013)

However, getting HELP debtors overseas to repay would not be straightforward. The English and New Zealand experience suggests that the degree of non-compliance would be significant. This is despite those two countries making it clear to loan applicants that they must repay regardless of location, and taking extensive steps to keep track of debtors' locations overseas.

Australia would start well behind England and New Zealand in implementing an international repayment policy. We do not know how many HELP debtors are overseas, or possess their contact information. The mere task of informing HELP debtors of their obligations would create major difficulties for the ATO.

Income contingent HELP collection overseas would also require setting thresholds in foreign currencies. Debtors would have to prove how much they earned and the government would need new bureaucratic systems to verify foreign income and calculate repayments. The question then is whether there are simpler and more cost-effective ways to collect HELP debt from overseas.

5.4 International agreements for overseas HELP collection

Tax treaties have occasionally been suggested as a way of getting HELP debtors overseas to repay their debt. Although HELP repayments are not taxes, tax systems allow efficient collection of income contingent loans. Treaties allow countries to exchange tax and income information, and in certain cases assist tax collection for another country. Australia currently has income tax treaties with 46 countries. It also has tax information exchange agreements with 36 other countries.⁹⁸ It has mutual obligations to assist in tax collection with New Zealand, Norway, and South Africa.⁹⁹ Under a tax treaty, countries could also collect each

⁹⁸ Treasury (2013b)

⁹⁹ Treasury (2008), no. 17; ATO (2013b); ATO (2013c)

other's student debt repayments. As with using local tax agencies, this would make use of existing income information, collection systems and enforcement mechanisms.

Australia recently took the first steps towards an international agreement on student debt collection. When New Zealand Prime Minister John Key visited Australia in February, a joint statement announced that Australia would provide information to New Zealand to help them recoup unpaid student loans. It also stated that New Zealand would reciprocate if Australia decided to require its overseas HELP debtors to repay.¹⁰⁰

Yet while these bilateral agreements may be useful, they are unlikely to do more than complement other repayment systems. Agreements would be needed with the countries where overseas HELP debtors are living. Figure 17 shows the top seven overseas destinations for recent graduates of Australian universities. Of the seven, the UK and New Zealand would have the most interest in reciprocal arrangements with Australia. They have income contingent loans and problems with overseas repayments.

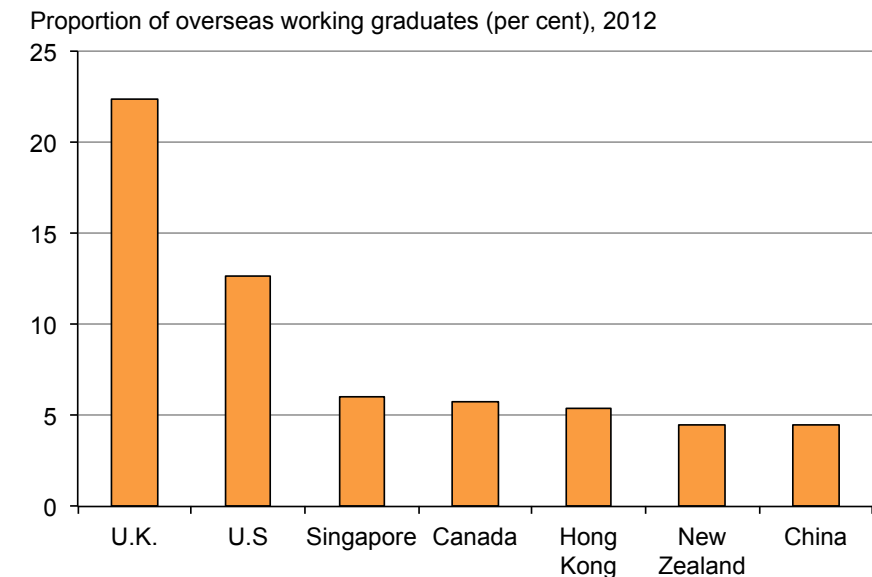
It is much less clear what benefit the other five major destination countries would see in a student debt collection treaty with Australia. They have other ways of financing higher education students and recovering student debt. Agreements covering the destination countries of less than 30 per cent of recent overseas HELP debtors would still leave a significant repayment problem.

Even for Australia, a tax treaty to collect repayment for other countries could create high costs relative to revenues. There would be significant work in identifying foreign student debtors, applying different repayment rules to Australia's, and making sure no more money was collected than owed. Given the lopsided

patterns of Australia–New Zealand migration, a cross-Tasman tax treaty could mean significant bureaucratic effort in Australia to collect debts owed to New Zealand with only limited additional HELP revenue in return.

We need a repayment system that can collect from debtors in many different countries at a low administrative cost.

Figure 17: Top destinations for working Australian graduates, 2012



Notes: The data contains a sample of 466 graduates from the end of 2008. It only includes Australian citizens and permanent residents who were working overseas (part and full time) in 2012. The results for 2011 do not differ significantly. Japan was part of the top 7 in 2011 rather than Singapore.

Source: GCA (2012)

¹⁰⁰ Abbott (2014)

5.5 Overseas debtors collection method for new debt

The most feasible method of collecting overseas HELP debt is to require a minimum annual repayment, as New Zealand does. Chapman and Higgins suggest requiring HELP debtors planning to leave Australia for 6 months or more to repay a flat annual amount.¹⁰¹ The sum could be linked to the minimum amount required of debtors earning at the threshold for repayment, rounded up to the nearest \$100 for simplicity. For 2013–14, this would be \$2,100.

Where debtors comply there would be relatively little extra work for them or the ATO. The ATO would not need to record or monitor foreign income. Overseas debtors would not be required to document their income or calculate how much they owe. Debtors could pay from overseas using existing provisions for online payment. The amount would be deducted from their outstanding HELP balance as if they were in Australia.

Only limited exemptions should be made to this repayment requirement. These should be provable with simple evidence, and with a good reason provided for being overseas. Full-time postgraduate study at an overseas university would qualify. Prolonged international travel would not. HELP repayment would have to be taken into account in budgeting for travel. Debtors can return to Australia if their income is low and they do not want to pay the \$2,100 charge. The ATO would retain its discretion to delay repayment when enforcing the obligation would cause extreme hardship.¹⁰²

The ATO's main bureaucratic difficulties would be monitoring who is overseas and enforcing repayments. HELP debtors would have

to notify the ATO of their overseas contact details if they plan to leave Australia for six months or more. Penalty fees could be imposed on debtors who fail to do so. As in New Zealand, data matching could be used to check on the movements of people the ATO suspects are overseas. Penalty interest could be imposed on the debt of people who default.

If overseas HELP debtors do not meet their repayment obligations, the standard tax compliance model could be adopted. In the first instance debt collectors could be used to chase repayment. Travel restrictions on Australian passports could be imposed. Court action could be used against long-term defaulters.¹⁰³ Some countries recognise Australian court judgments against debtors in default.¹⁰⁴ However, separate legal proceedings would be required in other countries. Court costs make it uneconomical to take legal action to recover small debts. This problem could be overcome by requiring payment of the whole debt in some circumstances, as can happen in England.

5.6 Prospective or retrospective recovery?

Requiring HELP repayments from overseas debtors does not in itself raise any major issues of principle. Students have never been promised that leaving Australia exempts them from repayment. Not collecting HELP repayments from overseas has nothing to do with the income smoothing or risk management objectives of HELP. It was a “design fault” of the original scheme.¹⁰⁵ Repayment from overseas debtors is fair to HELP

¹⁰³ ATO (2013f); ATO (2013h)

¹⁰⁴ *Foreign Judgments (Reciprocal Enforcement) Act 1933* (UK) sections 2, 12 and 13; *The Reciprocal Enforcement of Foreign Judgments (Australia) Order 1994* (UK) section 4; *Reciprocal Enforcement of Judgments Act 1934* (NZ), section 4

¹⁰⁵ Summers (2012)

¹⁰¹ Chapman and Higgins (2013), p. 295

¹⁰² ATO (2013d)

debtors remaining in Australia and will improve HELP's long-term finances.

However, removing income contingency for overseas repayments would partially depart from HELP's original design. Although low-income HELP debtors could return to Australia to avoid repaying, some overseas HELP debtors on below-threshold incomes would have to repay the flat amount. A judgment is needed as to whether this approach or a high administrative burden for both debtors and debt collectors is preferable. On balance, this report favours the New Zealand approach with its lower complexity and compliance costs.

When should the repayment obligation start? The HELP booklet that people applying for a loan must read specifically states that if their income is below the threshold they are not required to repay. HELP debtors living overseas on incomes below the threshold could reasonably claim they were misled. While the rules for government programs do change, this is undesirable when people may have made major decisions based on what they were told at the time.

For the ATO, implementing new overseas collection of existing HELP debt would be difficult. Many overseas HELP debtors do not have any interaction with the ATO. It would be costly, and in some cases impossible, to inform them of their obligations. The English and New Zealand experience is that overseas debtors are not always aware of their obligations. This problem would be worse for Australia, given the long period in which overseas debtors correctly believed they were not obliged to repay. The belief that repayment is not necessary could take years to overturn.

These considerations count against making former students liable for overseas HELP repayment. Instead, the scheme should be

prospective, applying to anyone taking out a HELP debt in future. As in England and New Zealand, the HELP loan application process could clearly inform debtors of the need to notify the ATO if they travel overseas for more than six months, and their obligation to repay while they are overseas.

5.7 Additional repayment revenues from overseas HELP repayment

Estimating additional repayments from a flat annual charge for overseas HELP debtors is difficult. Until the scheme is implemented, we are unlikely to have an accurate count of how many HELP debtors are overseas. As section 3.3 explains, the two per cent of HELP debtors with unknown or overseas addresses is probably an under-count. We also need to make assumptions about how long HELP debtors stay overseas, what proportion never return, and the level of compliance. Appendix B discusses in more detail how our estimates were calculated.

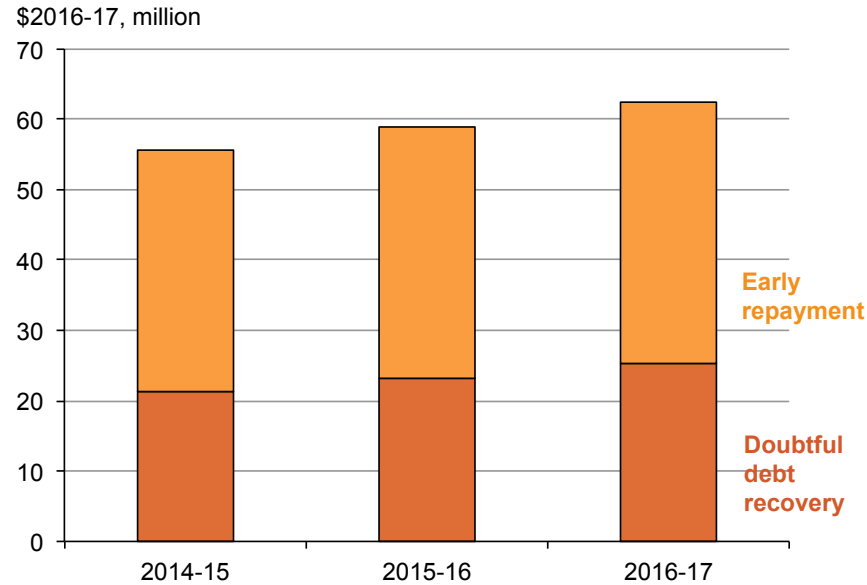
On the available information and the assumptions used, a flat repayment amount could provide \$177 million in extra revenue if implemented for the period 2014-15 to 2016-17.¹⁰⁶ In light of the English and New Zealand experience, this assumes 50 per cent compliance.¹⁰⁷ Of this, we expect \$70 million to be doubtful debt recovery, as Figure 18 shows.¹⁰⁸ The rest of the money is the bringing forward of repayments that would have occurred anyway, after the person's return to Australia.

¹⁰⁶ In \$2016-17

¹⁰⁷ For overseas graduates who permanently reside overseas.

¹⁰⁸ If CPI were also adopted to index the income threshold from 2014-15, the doubtful debt recovery from imposing a flat amount system on overseas debtors would be between \$51million and \$86 million.

Figure 18: Potential savings from flat annual repayments from future overseas debtors



Notes: The average estimates are shown. See Appendix B: Recovery from overseas debtors through a flat amount system for details.

Sources: Grattan Analysis of ABS (1994-2013); GCA (2011); (2012); Chapman and Higgins (2013); Treasury (2013a), table 2; Department of Education (2013a), table 2; DIICCSRTE (2013a), p.70; DIICCSRTE (2013c)

The estimate is conservative since the data does not include VET FEE-HELP debtors or people who leave Australia more than three years after graduation.

6. Ending the deceased estate debt write-off

The main cause of high doubtful HELP debt is that it is not fully collected from deceased estates. Requiring HELP to be repaid from deceased estates would substantially reduce total doubtful debt.

This chapter proposes a system of asset-contingent repayment. In other words, estates of HELP debtors would have to repay if their estates are worth equal to or greater than a threshold. The reform can ensure the eventual recovery of most outstanding debt, while protecting the estates of HELP debtors with little wealth.

6.1 HELP's deceased estate debt write-off

Writing off student debt in deceased estates was in the original legislation establishing HECS, but it is an unusual provision.¹⁰⁹ Debts are rarely discharged on death. Bank loans, credit cards, utility bills and other personal liabilities must be repaid from an estate, as must money owed to a government. Any remaining income tax liability has to be paid out of the deceased's estate, including any HELP repayments required that year if his or her earnings were above the threshold. The repayment is only on that year's earnings: all other HELP debt is written-off. This write-off rule is anomalous in the ordinary management of deceased estates.

Every year, a small number of students and young graduates die from accidents and illnesses. Perhaps policymakers had these

cases in mind when they decided to discharge HECS debt on death. Fortunately, such situations are rare. As of mid-2011 fewer than 10,000 of the 2.7 million people who had taken out a HELP debt had died without repaying all their debt.¹¹⁰

Figure 19 shows death rates by age and gender between 2009 and 2011. Men are more likely to die earlier in their lives than women, but people of normal working age have very low death rates. Ninety-five per cent of women and 91 per cent of men die at the age of 60 or above. People with post-secondary education are even less likely to die early than the general population.¹¹¹ HELP doubtful debt is principally driven by people expected to die at the age of 60 and above.

Apart from repayments on any income in the last year of a person's life, recovering HELP debt from estates is not income contingent. This raises the issue of whether income contingency is an implementation mechanism of, or the principle behind, HELP. Chapter 2 argues that income contingency supports the policy goal of smoothing income and consumption over a person's life. Once their life is over that policy goal is no longer relevant.

¹⁰⁹ *Higher Education Support Act 1988*, section 77. The current provisions are in the *Higher Education Support Act 2003*, sections 137-20 and 140-40.

¹¹⁰ ATO (2013j), p. 24

¹¹¹ Clarke and Leigh (2011)

Figure 19: Cumulative probability of people dying by age group and gender, 2009-2011



Source: ABS (2012), table 1.9

HELP also manages debtor risk. Some students may see the debt write-off as protecting their partners and children from hardship should they die first. However, this insurance will rarely be needed. As Figure 19 shows, few people die young or during the main child-rearing years. Partnered people earning less than the threshold also tend not to be their household's main source of income. By the ages of 35 to 50, three-quarters of these lower-income partnered graduates are living with someone who earns more than the threshold. For partnered female graduates earning

less than the threshold, 38 per cent have partners who earn more than \$100,000 a year.¹¹²

While the main beneficiaries of HELP debt write-offs will be the debtor's surviving partner and children, usually they will not be financial dependants. The partner will be or have been the higher-income earner and the children will be adults. Their additional inheritance through the HELP write-off will be a windfall gain. There is no obvious public policy purpose in granting this windfall. It is hard to see why the government recovers overpaid social security benefits from deceased estates yet writes off HELP debts.¹¹³ Although HELP was not designed to recover all that it lent, it does not need a general debt write-off.

A more focused policy is needed for when recovering HELP debt from estates could cause hardship. Asset-contingent repayment would serve this purpose. Deceased estates worth below the \$100,000 threshold would not be subject to repayment. But estates valued at or above the threshold would need to repay the outstanding HELP debt. If an outstanding debt is greater than the value of the estate above the \$100,000 threshold, the remaining unpaid debt would be written off. The threshold should be indexed to CPI to maintain its real value.

In circumstances where the asset-contingent recovery of HELP debt could still cause financial hardship to estate beneficiaries, the ATO has discretion to deal with the problem. Where repayment would leave dependants of the estate unable to afford food, accommodation, clothing, medical treatment, education and other

¹¹² HILDA (2011), wave 10

¹¹³ *Social Security Act 1991*, part 5.4. There are some exceptions.

necessities, the ATO can release estates from their debt, as they can with other taxation debt they collect.¹¹⁴

Asset contingent repayment would preserve the risk management aspect of HELP. It would avoid the political problem of the ATO recovering student debt from the small estates of deceased students or young graduates. Other minor estates would also be left untouched, protecting creditors and leaving an inheritance for beneficiaries.

Asset-contingent repayment is unlikely to reduce demand for higher education in the main student demographic groups. The death write-off has never been a major selling point for HECS or HELP. If school leavers are aware of it, they are likely to see it as dealing with a small risk in the very distant future. Most will expect to repay during their lives, and enrol on that basis.

Recovery from deceased estates may, however, more plausibly influence the decisions of older prospective students. In 2012, about 6,000 people aged 60 years or more were enrolled in HELP-eligible courses.¹¹⁵ This age group have poor repayment prospects (see, for example, the full-time work statistics in Figure 8). Some of these people may enrol because they believe they will never pay. Given the relatively low public benefits from subsidising the education of retired compared to young people, making education free for them should not be a public spending priority. Asset-contingent repayment will help avoid the need to

put age restrictions on HELP loans, as New Zealand has done for some aspects of its student loan scheme.¹¹⁶

6.2 Savings from ending the debt write-off for existing HELP debtors

An asset-contingent threshold set at \$100,000 would meet the policy objectives of managing risk for HELP debtors, while also substantially reducing HELP doubtful debt. A large proportion of Australians aged 60 or above have wealth exceeding \$100,000, as Figure 20 shows.¹¹⁷ In 2010, 31 per cent of older Australians had personal wealth, such as money in bank accounts, of \$100,000 or more. The HILDA survey does report personal ownership of household assets such as homes, vehicles and businesses. In this report we spread the value of these assets across household members to get pro-rata wealth, which is added onto personal wealth to arrive at the total wealth of a person. Under this approach, 81 per cent of people 60 years old or above had wealth of \$100,000 or more, with median wealth of \$367,000.¹¹⁸

¹¹⁴ ATO (2013g); ATO (2013d)

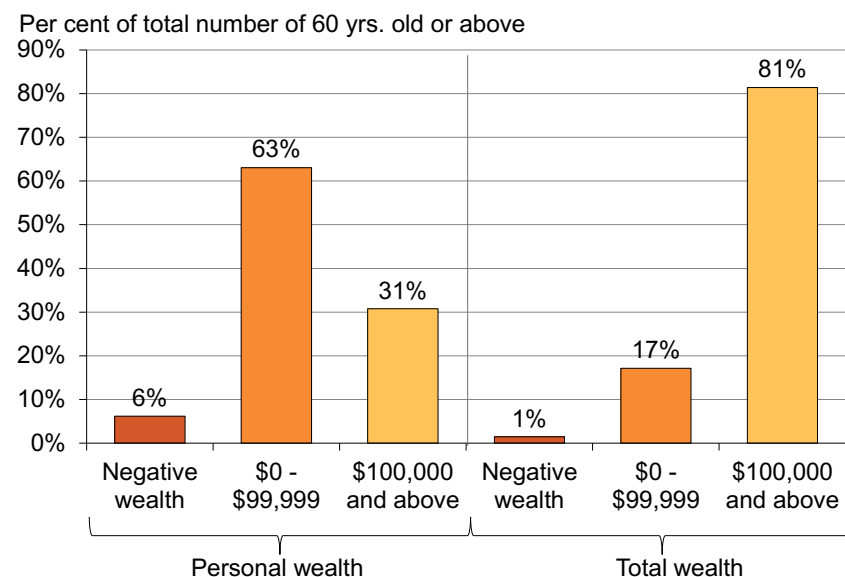
¹¹⁵ Department of Education (2013b), calculated from table 2.2

¹¹⁶ Ministry of Education (NZ) (2013), p. 67

¹¹⁷ HILDA (2011) wave 10

¹¹⁸ This number excludes superannuation wealth. The distribution is consistent with the distribution of wealth in 2006 (ibid.).

Figure 20: Wealth distribution of people 60 yrs. old and above, 2010



Notes: The data contains 3,138 people. Personal wealth includes bank account balance. Total wealth includes personal wealth and pro-rata household wealth, where household wealth includes business assets, investment (cash and equity), collectibles, home assets, trust funds, and vehicles.

Source: HILDA (2011)

Our analysis uses the HILDA survey to estimate how much the government can expect to recover if asset-contingent recovery were adopted. Because HELP and its predecessor, HECS, have been around for only 25 years, most borrowers are below 45 years old. The analysis is therefore not based on actual HELP debtors at old age. It is based on the wealth at old age of people

with characteristics of existing HELP debtors who are not expected to repay.¹¹⁹

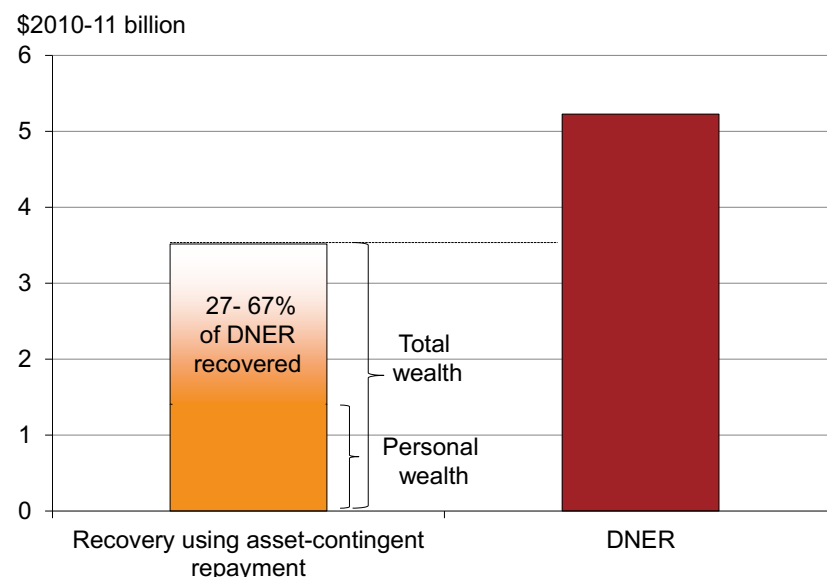
As Figure 21 shows, removing the deceased estate write-off could reduce doubtful debt by between 27 and 67 per cent, if household wealth was equally distributed. Doubtful debt was \$5.2 billion in June 2011. If asset contingent repayment at death were imposed, doubtful debt could be reduced by \$1.4 billion if only personal wealth was in the estate, or \$3.5 billion if an assumed share of household assets was also in the estate.¹²⁰

The 27 per cent recovery of HELP debt solely through personal wealth is a very conservative estimate. It would be true only if HELP debtors have no ownership of assets such as the family home. In practice, many couples share ownership of their home. As women typically live longer than men (Figure 19), they are likely to eventually inherit the home and other household assets. The evidence collected in this report suggests that women in couples make up a large share of those unlikely to persistently earn more than the threshold. Realistically, we would expect savings from removing the deceased estate write-off to be at the high end of our estimates.

¹¹⁹ See Appendix A.

¹²⁰ If the repayment threshold is indexed by CPI rather than AWE, the saving figures are likely to be slightly smaller than shown. But we do not expect this to be significant since most people who did not repay have had income far below the proposed threshold: HILDA (2011).

Figure 21: Doubtful debt recovery from retrospectively imposing asset contingent repayment at death as of 30 June 2011



Note: See notes for Figure 20
Sources: HILDA (2011); ABS (2012); DIISRTE (2012a)

6.3 Prospective or retrospective recovery?

Recovering HELP debt from the estates of current HELP debtors would require retrospective amendment to the rules under which they took out their loans. Students who want to take out a HELP loan are required to read a HELP information booklet and sign a form agreeing to repayment in accordance with the relevant legislation. Until recently the booklet mentioned the death write-off

clause.¹²¹ By contrast, there is no explicit commitment to index the threshold to average weekly earnings or exempt overseas HELP debtors from repayment.

Under one possible interpretation of the law, students who take out HELP loans enter into a contract with the Commonwealth. The HELP booklet and form set out its terms. Under consumer law, if the Commonwealth is carrying on a business in lending money under HELP, it cannot unilaterally vary the terms of contract.¹²² Ending the death write-off would do so.

An alternative view is that there is no contract. The form students sign when taking out a HELP loan informs them of their statutory rights and obligations, not the terms of a contract. Like other statutory rights and obligations, these are subject to change. Although rule-of-law principles conflict with retrospective legislation, the Constitution does not prohibit it. In practice, HELP repayment rules have changed many times, without legal challenge.¹²³

Whatever the legal situation, retrospectively imposing HELP recovery would be controversial. Existing debtors may expect the debt write-off and complain they were misled. Some people may claim, albeit inaccurately, that recovery of HELP debts from deceased estates would be a 'death duty' (Box 1). The political costs would need to be measured against the gains from recovering additional HELP debt.

¹²¹ The 2012 version of the booklet explicitly includes the death write-off condition, whereas the 2013 and 2014 do not.

¹²² Australian Government (2011); section 25(1)(d)

¹²³ See Jackson (2003) for changes up to 2003.

Box 1 – Is HELP debt recovery from deceased estates a ‘death duty’?

Australia has no taxes on deceased estates. Recovering HELP from deceased estates would not change that.

The Australian Constitution distinguishes between taxes and fees for service.¹²⁴ A High Court case concluded that a tax is “... a compulsory payment of moneys raised for government purposes, where the exactions do not constitute payment for services rendered....”¹²⁵

Before 2005, HECS had some tax characteristics. It was set by government to offset the cost of expanding the higher education system. In 2005 HECS was replaced with a ‘student contribution’ set and received by the student’s university.¹²⁶

A HELP loan that finances student contributions and other fees is now a separate service provided by the Commonwealth to students. A HELP loan is not compulsory, as students can pay up-front or take out loans from other sources.

The tax system is used to collect HELP, but it is paying off a debt voluntarily incurred to pay for a specific service.

A retrospective change to the HELP rules may prove difficult. But ending the automatic deceased estate write-off benefit for future debtors would not raise retrospectivity issues. HELP would be like any other kind of debt a person takes out. The value of the education it finances would have to be assessed against its costs, including a reduced estate.

6.4 How much would removing the death write-off raise for new HELP lending?

Annual HELP lending is expected to increase by 56 per cent, from \$5.5 billion in 2012–13 to \$8.6 billion in 2016–17, as Figure 22 shows. As more is lent, the amount of doubtful debt goes up. Additional doubtful debt is expected to increase to \$1.5 billion for 2016–17 lending.¹²⁷

Ending the deceased estate write-off would not produce a large cash saving or fiscal balance impact in the short term. The Department of Education’s Portfolio Budget Statements include an honest estimate of this cost but any impact on the Commonwealth Budget only occurs when debtors die. Since debtors are generally younger than the age range when death is likely, the policy impact on the Budget’s fiscal balance is long term (Figure 19). The savings would appear immediately on the Department of Education’s Portfolio Budget Statements and would increase the size of the Commonwealth balance sheet.

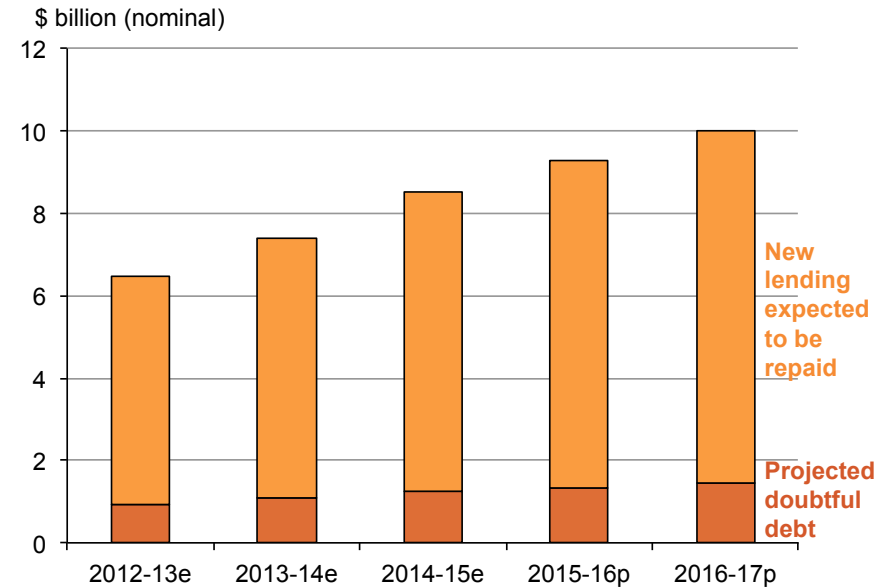
¹²⁴ Section 53

¹²⁵ LexisNexis, *Halsbury’s Laws of Australia* (at 1 July 2008) 405 Taxation and Revenue, ‘1 Introduction’; *MacCormick v Commissioner of Taxation (Cth)* (1984) 158 CLR 622 at 638–641 per Gibbs CJ, Wilson, Deane and Dawson JJ.

¹²⁶ The maximum student contribution is set by the Commonwealth Government.

¹²⁷ Communication from the Department of Education; DIICSRTE (2013a), p.70. The estimate for VET FEE-HELP lending reflects preliminary data.

Figure 22: HELP lending and estimates of doubtful debt



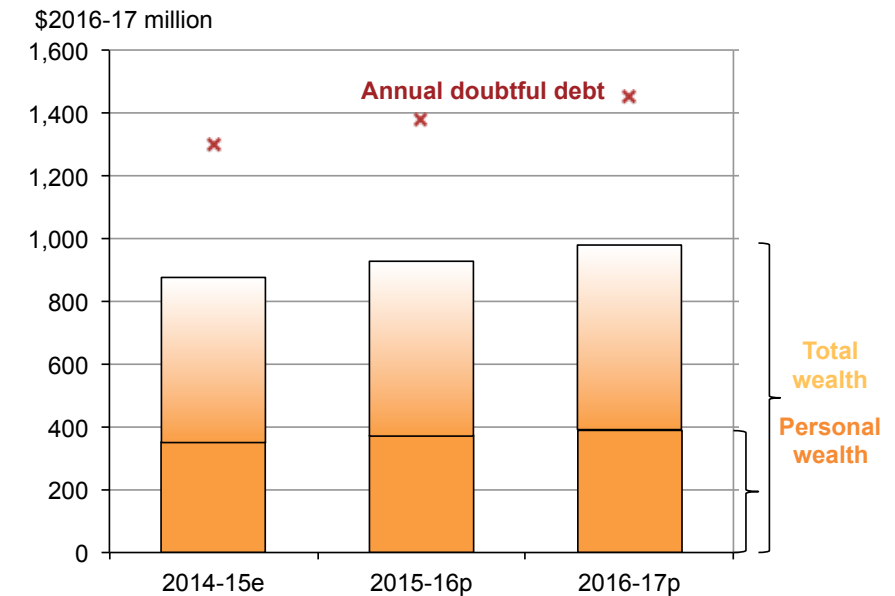
Notes: 'e' represents estimates. 'p' represents projections.

Sources: Communication from the Department of Education; Treasury (2013a); DIICSRTE (2013c), p. 93

The scale of savings depends on the size of future deceased estates. The analysis presented in section 6.2 suggests that most deceased estates of HELP debtors will have wealth exceeding \$100,000.¹²⁸ Based on projections of new HELP debts, the accumulated savings from removing the deceased estate write-off over the 2014–15 to 2016–17 period would be between \$1.1

billion and \$2.8 billion (Figure 23). Due to partners sharing ownership of their home and inheriting much of each other's wealth, the final number is likely to be towards the top of that range.

Figure 23: Potential savings from removing HELP debt death write-off for new HELP lending, 2014-15 to 2016-17



Notes: 'e' represents estimates. 'p' represents projections.

Sources: Communication from the Department of Education; HILDA (2011); Treasury (2013a)

¹²⁸ Based on 2010-11 estimates

The HELP debt deceased estate write-off has very high financial costs relative to its benefits. Its limited social policy objectives can be achieved with an asset-contingent repayment system that would concentrate expenditure on low-asset families. The savings could be re-directed to other higher education purposes, or returned to the Budget.

7. Conclusion

Australia was the first country to use income-contingent loans to help students finance their higher education, with the introduction of the Higher Education Contribution Scheme in 1989. Since then the lending policies of HECS and its successor, HELP, have been progressively updated to meet new needs, including assisting full-fee paying higher education students and some vocational education students. But HELP's repayment mechanisms were not designed for our current circumstances.

The scale of borrowing under HELP is much greater than could have been envisaged in the late 1980s. Since then, the number of Australian higher education students has more than doubled. On average, students borrow much more now than they did then. When HECS was first introduced, full-time students paid \$3,500 a year in today's money. Now annual student contributions are at least \$6,000 a year, and up to \$10,000. Full-fee students pay much higher fees on average, which many of them finance with FEE-HELP.

On the original student numbers and borrowing levels, the Commonwealth could perhaps afford generous repayment mechanisms. Those days are gone. With other higher education spending being cut to reduce a Budget deficit, spending more than a billion dollars a year on HELP doubtful debt is not the best use of scarce public funds. Without any policy change, total doubtful debt will reach \$13 billion by 2017.

This report proposes ways of reducing HELP's costs while preserving most of its income-smoothing and risk management attributes.

Consistent with the original principles of HECS and HELP, indexing the threshold for repayment to the CPI would make the system less costly while ensuring that graduates are not worse off in real terms. The savings would be small at first but would grow over time. If the new index were adopted this year on all existing HELP debtors, the government could reduce doubtful debt by \$64 million by 2016–17.

Once they graduate, many HELP debtors leave Australia to live overseas. Since the ATO has no international jurisdiction, these debtors are not obliged to repay their HELP debt. Income-contingent repayment for overseas debtors would be very complex. This report proposes a simpler system of charging overseas debtors a flat amount equal to the minimum repayment for Australian debtors who reach the threshold: \$2,100 a year in 2013–14. If the government were to adopt the flat amount system in 2014–15 year, it could provide \$177 million of extra repayments by 2016–17, of which \$70 million would not otherwise be repaid.

Many debtors are not expected to repay their HELP debt and it is cancelled upon death. Since most people die of old age, the debt write-off is a windfall for their estate's beneficiaries, often their adult children. Ending the debt write-off upon death on new HELP debt and replacing it with asset contingent repayment on estates of \$100,000 or more could reduce doubtful debt significantly. The

accumulated savings could be up to \$2.8 billion between 2014–15 and 2016–17.

On an annual basis, together the proposals would reduce doubtful debt by between \$440 million and \$1 billion in 2016–17. There is a wide range because the HELP debtor's share of household assets is uncertain. But as we believe that HELP debtors are likely to share in ownership of the family home and other valuable household assets, savings are likely to be at least \$860 million in that year. This would reduce the anticipated 17 per cent of new HELP lending that is doubtful to 7 per cent.

HELP is an important Australian policy innovation. But after a quarter of a century it needs some policy renovation. Changing the indexation of thresholds, imposing a flat amount repayment system on overseas debtors, and ending the automatic debt write-off upon death are feasible and cost-effective measures. HELP would continue to meet its original objectives. But it would do so at a much lower cost to taxpayers.

Appendix A: Return on collecting HELP from deceased estates

Since most HELP (and HECS) debtors are below 45 years old, the calculation of likely assets on death cannot be based on the actual wealth of HELP debtors in old age. An alternative approach was used to estimate their wealth at death using income characteristics of HELP debtors, age-adjusted wealth distribution and the ABS's Life Tables.

The analysis primarily uses the Household Income and Labour Dynamics (HILDA) survey as it contains both the wealth and outstanding HELP debt of individuals. To calculate the return for asset contingent debt recovery at death, the process is as follows:

1. OLS regression is used to estimate the marginal effect of age on wealth adjusting for heterogeneity and a minor lack of normality. The estimate for age is also controlled for individual-specific and family-specific characteristics.¹²⁹ The marginal effect of age is applied to the wealth of all respondents according to their age to get their age-adjusted wealth.
2. For each income percentile, the corresponding age-adjusted wealth distribution is calculated based on the age-adjusted wealth, creating an income to wealth map.
3. To obtain the income characteristics of non-repaying debtors, we use all HELP debtors aged above the expected age when

an average debtor makes their last repayment.¹³⁰ Using the current income distribution for these individuals and the estimated income to wealth map, we establish the likely wealth profile and HELP debt for each individual.

4. The debtors who contribute to doubtful debt are categorised into two groups: people who are not expected to repay their debt fully and people who are not expected to make any repayments over their lifetime.¹³¹ Due to a data availability issue, the percentage increase in HELP loan accounts was used to back-cast the number of debtors in 2010–11 from 2011–12 data. Our analysis uses the 2011 Census to calculate the equivalent number of people who are not expected to repay at all from the number of people who are not expected to repay fully.¹³²
5. The ABS's Life Tables are used to estimate the proportion of people dying between 50 and 59 years old and 60 years old and above given they have lived beyond the expected

¹²⁹ The explanatory variables are age, age-squared, gender, education, marital status, health and number of children.

¹³⁰ Based on individual specific qualification and average repayment period analysis (Census 2011). Due to data availability, the sample may include debtors who have partially paid for their HELP debt.

¹³¹ Data obtained from the Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education

¹³² We have also calculated the proportion of partial repayment using HILDA and the results are consistent between the two datasets. For personal wealth, the expected repayment is \$1,405,977,330.925 using HILDA and \$1,406,098,485.116 using the Census 2011. For total wealth, the expected repayment is \$3,516,873,001.988 using HILDA and \$3,517,176,053.746 using the Census 2011.

graduate age of 22 years old.¹³³ Using the total number of debtors contributing to doubtful debt, we can calculate the number of debtors who are expected to die with outstanding HELP debt aged between 50 to 59 years old and at the age of 60 years old and above.

6. A wealth profile is created for each group: people of age 50 to 59 and people of age 60 and over, age adjusted for their corresponding life expectancy. Based on these wealth profiles, the wealth distribution found in step 3 is used to determine the proportion of people whose income is above the income threshold in each group.
7. Based on the total number of debtors who are expected to die in each group (50-59 years old and 60 years old and above) found in 5, we can find the number of people with assets above \$100,000 in 2010–11.

The analysis was performed on both personal wealth and total wealth, where personal wealth contains the net of bank account balances and total wealth includes the net of personal wealth and pro-rata household wealth, where household wealth includes business assets, investment (cash and equity), collectibles, home assets, trust funds, and vehicles.

¹³³ ABS (2012)

Appendix B: Recovery from overseas debtors through a flat amount system

Our goal is to project the amount of recovery from imposing flat repayment on overseas debtors during 2013–14 and 2016–17. For reasons discussed in chapter 5, the new repayment system should only be applied to new HELP debt. Since the focus of this report is on doubtful debt, the estimates are also found for savings that are related to doubtful debt (would not otherwise be recovered) and savings that are simply early repayments.

The flat amounts charged to overseas debtors represent the minimum repayment a debtor who repays would repay. That is, 4 per cent of the minimum threshold rounded up to the nearest \$100. The CPI forecast and projections are used to index repayment threshold between 2014–15 and 2016–17.¹³⁴

First, the number of graduates with HELP debt who spend at least a year overseas after graduation is estimated. Using the Beyond Graduation Survey from 2012 (latest), the proportion of graduates who have HECS-HELP debt working overseas approximately one year after graduation was found. The average growth rate of student completions from 2009–2012 was used to project the level of student completions during 2013–2017.¹³⁵ Combining the

proportion and projected completions, the number of overseas debtors was estimated.

Since the flat amount would be charged each year, the number of years graduates who remain overseas needs to be estimated. Bruce Chapman and Tim Higgins analysed the Beyond Graduation Survey data from 2010 and the Travellers' Characteristics Database of the Department of Immigration to predict three plausible scenarios of how long people work overseas. Scenario 2, which represents an average of the other two scenarios, was used.¹³⁶

Combining the estimates for flat amounts charged and the time graduates spend overseas, the amount of savings from each graduate cohort was found. As discussed in section 5.5, it would be difficult to enforce repayments for Australian graduates who leave Australia permanently. Our analysis assumes only half of the graduates who leave permanently repay.

To determine the proportion of debt not expected to be repaid (DNER) of these savings, the proportion of overseas graduates who would not otherwise repay was estimated. Chapman and Higgins estimate that of the graduates who spend at least one year overseas, 20 per cent of them stay permanently.¹³⁷

¹³⁴ Treasury (2013a), p.1-8

¹³⁵ Since the student completion data are reported for a calendar year, rather than a financial year, the average of the two calendar years is used to approximate the number of completions for a financial year. For example, completions for 2013 and 2014 are combined to approximate the number of completions for 2013–14.

¹³⁶ Scenario 1 is based on the Beyond Graduation Survey and scenario 3 is based on the Travellers' Characteristics Database.

¹³⁷ Chapman and Higgins (2013), scenario 2

The upper bound of repayment takes into account graduates overseas who return to repay their HELP debt. For graduates that earn above the threshold while overseas, it is assumed that they would also earn above the threshold locally when they return. To determine the proportion of graduates who earn enough to repay while overseas, the three years out income data of graduates based on the Beyond Graduation Survey 2012 was analysed.¹³⁸ For graduates who do not earn above the threshold while overseas, the proportion of them who return to earn below the threshold is estimated based on the 2010 and 2011 data from the Beyond Graduation Survey 2011.¹³⁹ For these debtors, the flat repayment represents a decrease in DNER.

¹³⁸ Based on BGS 2012

¹³⁹ Data of graduates who finished their degree/s at the end of 2007

Appendix C: Securitisation and sale of HELP

So far as we are aware, there are no specific offers to the government to buy HELP debt. However, following media reports the idea of securitising and selling HELP debt was put to the Commission of Audit.¹⁴⁰ The value of the HELP debt is affected by the level of doubtful debt. This appendix explains why selling the HELP debt will not improve the government's financial position.

7.1 Can securitisation improve the government's budget?

The securitisation and sale of HELP debt would give the government access to cash now by moving expected future revenues into the current period. In return, private investors would receive some or all future repayments of HELP debt.¹⁴¹

The sale of HELP debt would improve the underlying cash balance at the expense of the future. Unless the debt can be sold for more than its book value it cannot improve the accrual budget balance sheet.

The HELP debt's face value is already written down from \$30 billion to \$22 billion to account for debts not expected to be repaid and the interest subsidy as of 30 June 2013.¹⁴² To improve the government's balance sheet, it would need to receive more than \$22 billion for the HELP debt.

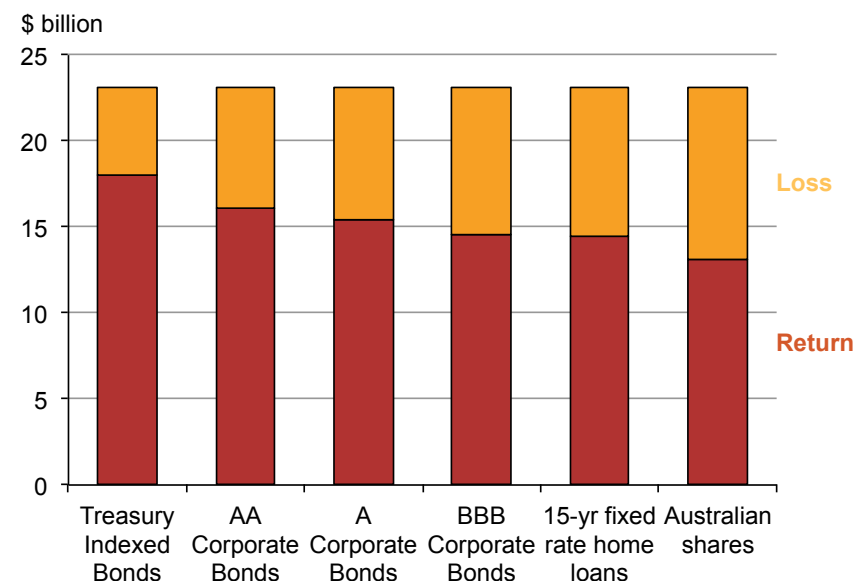
¹⁴⁰ Ross (2013a)

¹⁴¹ Securitisation is a financial practice which involves converting a pool of assets into tradeable securities. The term does not formally imply that the securities would be traded (RBA (2004)). However, it is generally assumed that securitisation would involve the assets being sold in the near future.

¹⁴² DIICCS RTE (2013b), p. 245

Realistically, however, investors would pay much less than \$22 billion for the HELP debt. Their cost of capital is higher than the government's risk-free cost. The government also uses an optimistic payment timeline for graduates.

Figure 24: Realistic valuations of HELP debt as of 30 June 2013



Notes: 22-yr TIBs are used (GSI035). Return on Australian shares is based on 20-yr average to 2011. Inflation expectation is calculated from the TIBs and TBs.

Sources: ASX (2012); DIICSRTE (2012a); ASX (2013); CBA (2013); DIICCS RTE (2013b); GCA (2013); RBA (2013a)

As shown in figure 24, the government could expect to receive \$14.6–15.4 billion for the HELP debt, depending on the capital costs of the private investors.¹⁴³ It would lose between 33 and 37 per cent of HELP's book value. This valuation takes into account recent and expected labour market conditions for graduates, the composition of courses undertaken and the gender of HELP debtors (see Appendix D). This estimate is consistent with valuations by Professor Bruce Chapman, the architect of HECS, Professor Scott Bowman, the Vice-Chancellor of Central Queensland University, and ACIL Allen Consulting on behalf of Universities Australia.¹⁴⁴

Since the offer price is expected to be below the government's book value, selling the HELP debt would weaken the government's long-term accrual budget balance.

7.2 Can the government make better use of HELP proceeds now?

Rodney Maddock, now a Vice-Chancellor's Fellow at Victoria University, suggests that securitisation is attractive as the government can make better use of the money now.¹⁴⁵ Professor Glenn Withers agrees and suggests investment in education.¹⁴⁶

¹⁴³ Based on A and BBB corporate bond rates

¹⁴⁴ Professor Chapman, Professor Bowman and a report to Universities Australia by ACIL Allen Consulting suggest that the government could lose 35, 30-52, and 36 per cent of its fair value from selling HELP debt; Ross (2013a); Bowman (2013); ACIL Allen Consulting (2013) table A3

¹⁴⁵ Maddock (2013)

¹⁴⁶ Ross (2013b)

The Treasurer argues that infrastructure investment is necessary to boost the economy's productivity.¹⁴⁷

Although in theory these proposals may have merit, history suggests that governments tend to consume windfalls. The mining boom contributed about \$190 billion to accumulated budgets, most of which has been given away or consumed.¹⁴⁸ Selling HELP debt would also provide the government with a windfall (albeit of a smaller scale). There is little reason to believe this will be spent more wisely than previously.

If the government has worthwhile investment proposals selling HELP debt is not the only way to fund them. It can already efficiently raise capital through issuing bonds. Unlike a new market for HELP debt, the markets for Australian Treasury Bonds (ATB) are established, reputable, deep and efficient. The government has complete information about the amount of money it can raise and at what cost. The ATB markets do not suffer from liquidity premiums and have low transaction costs. For these reasons, ATBs are a better source of revenue for government investment projects.

7.3 Can securitisation help reveal the true cost of HELP?

One difficulty in pricing HELP debt is a lack of information about the repayment profiles of graduates. This is partially due to limited information being published by the government, but more broadly due to the debt not being traded in the market.

¹⁴⁷ Allard (2013)

¹⁴⁸ Minifie, *et al.* (2013)

Having access to accurate price information on HELP debt would help with decision-making. Figure 24 shows that the government overstates the value of HELP, but if HELP debt were traded on a market, the government would be required to use the market's cost of HELP as its book value.¹⁴⁹

This could help create pressures to reform HELP, and identify the features of HELP that are creating significant losses for taxpayers. The same information could inform prospective students of the risks associated with different types of courses and careers.

7.4 Does securitising HELP introduce new political and social problems?

Students owing sold HELP debt are not likely to be exposed to changing repayment conditions after the sale. Indeed, sale of the HELP debt would reduce this risk as private sector lenders cannot unilaterally change repayment conditions, while the government can change the law relating to repayment.

However the government may change the rules prior to sale to increase the amount of money that it would receive. In this respect, securitisation complicates the politics of HELP reform. If securitisation is kept on the political agenda, we risk a perception that reforms are aimed at improving returns for private investors.

History tells us that it is hard enough to reform higher education finances when the beneficiaries are other students or other government priorities. Reforms perceived to benefit private investors are much less likely to prove acceptable to the public.

¹⁴⁹ Bowman (2013)

Appendix D: Valuation of HELP debt

There are two reasons to believe that the government's valuation of HELP is an overestimate of its market value. Private investors have higher cost of capital than the government. The government also uses an optimistic payment timeline for graduates.

Since the government does not explicitly describe its calculation of interest subsidy (known as 'unexpired discount'), we cannot describe the issues with the calculation in detail. However, from the available data, the interest subsidies represent 3.5 per cent of non-doubtful debt loans.¹⁵⁰ Using the 1 per cent real discount rate, the equivalent number of years for an average debtor to repay is around 4, which is significantly below our analysis based on the Census 2011.

The analysis evaluates the price in which the government may expect to receive for selling the HELP debt as of 30 June 2013. It contains two parts: finding the appropriate cost of capital for HELP loans and predicting a credible repayment profile for the cohort of debtors.

The cost of capital for HELP debt reflects its risk profile and therefore the risk profile of HELP debtors. Since the government publishes limited information about HELP debtors, multiple real rates are used based on various types of assets, from Treasury Indexed Bonds (TIB) to equity.

Australian Treasury Bonds (ATB) are used to represent risk-free assets by Australian regulators. HELP loans have volatile repayments so investors will require a higher yield on HELP debt than they do on TIBs to compensate for the increased risk of investing. However, HELP loan repayments will be less volatile than returns on equity, as the incomes of graduates are less variable than corporate earnings or profits.

Grattan Institute analysis used corporate bond rates as a guide for the risk profiles of HELP debt and adds a liquidity premium since HELP debt is a new type of asset with no established market. Ultimately the appropriate discount rate will be affected by the tranches of debt the government sells.

In calculating the coupon amount (annual repayment to private investors), a credible earning profile of all HELP debtors is required. The repayment profile of an average debtor is based on the analysis of HELP repayment profiles in *Graduate Winners*, a 2012 Grattan Institute report.¹⁵¹ The analysis has been updated to use earnings of bachelor degree graduates from the Census 2011.

The analysis follows the process below.

1. An individual repayment profile is calculated using the total estimates for all graduates weighted by gender.

¹⁵⁰ Communication from the Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education

¹⁵¹ Norton (2012a)

2. For each cohort of graduates, individual repayment profiles are aggregated to estimate the total per-cohort repayment profiles. Repayments are assumed to end at the retirement age (65).
3. To create the total repayment profile for all cohorts, repayment profiles are time-shifted according to the number of years since graduation. The repayment profiles are then added together weighted by the corresponding share of university enrolment.
4. Since HELP loan is a new type of asset with a thin market, a liquidity premium of 0.20 per cent has been added to the discount rate.
5. The repayment profile is based on 2011 Census data as most debtors graduated prior to the global financial crisis. Due to the softer labour market since the crisis, and expectations that it will deteriorate further in the coming years, an impairment is applied.¹⁵² The impairment is approximately \$1 billion, which is

equivalent to pushing back all repayment by 1.5 years, on average.

The net present value of the repayment stream is calculated using different discount rates inclusive of the liquidity premium.

¹⁵² Graduates of bachelor degrees entering their first full time employment between 2009 and 2012 experienced a weak labour market. Graduates who found full time work within 4 months of graduation as a proportion of graduates available for full time work fell from 85.2 per cent in 2008 to 76.1 per cent in 2012 (GCA (2013)). They also received lower starting wages relative to movement in average weekly earnings (AWE) and wage price index (WPI), falling by 3.2 per cent for AWE and 1.7 per cent for WPI between 2001 and 2008 compared to 2009 to 2012 (ABS (1994-2013); ABS (2013g); GCA (various years)). Due to the progressive repayment structure of HELP loans, a 1 per cent fall in average graduate wages will cause a larger than 1 per cent fall in HELP repayments. In addition, unemployment is expected to gradually rise for a year until 2015 where it will begin to decline (RBA (2013b), *ibid.*). The deterioration in labour market conditions is likely to suppress graduate employment and starting wages until at

least 2015. Outstanding HELP debt includes debt for students graduating in 2013 and partial allotments of debt for students expected to graduate in 2014, 2015 and 2016. For these reasons, the average repayment of debtors graduating in 2009–2016 has been scaled to 95 per cent of the original repayment schedule and the repayment schedule is delayed by 6 months to capture the increase in non-full-time work and further study. Our analysis shows the soft labour market and lower expected repayments reduce the price that government can expect to receive by approximately \$1 billion.

Glossary

ABS	Australian Bureau of Statistics	GCA	Graduate Careers Australia
Asset contingent repayment	Conditional repayment based on level of assets	Health (other)	A subset of the ABS 2-digit field 'Health' that includes 'Pharmacy', 'Optical Science', 'Veterinary Studies', 'Public Health', 'Rehabilitation Therapy', 'Radiography' and 'Complementary Therapy'
ATO	Australian Taxation Office		
AWE	Average weekly earnings		
Commonwealth supported place	Australian Government subsidised enrolment at approved universities. Students enrolled in Commonwealth supported places are referred to as Commonwealth supported students	HECS	Higher Education Contribution Scheme
		HECS-HELP	HELP for Commonwealth supported students
CPI	Consumer Price Index	HELP	Higher Education Loan Program
HELP debt death write-off	Cancellation of HELP on death	HILDA	Household Income and Labour Dynamics in Australia survey
DNER	HELP debt not expected to be repaid		
Doubtful debt	HELP debt not expected to be repaid	Humanities	A subset of the ABS 2-digit field 'Society and Culture' that includes 'Political Science and Policy Studies', 'Studies in Human Society', 'Language and Literature', and 'Philosophy and Religious Studies'
Face value of HELP debt	Outstanding amount of HELP (and HECS) debt owed to the Commonwealth Government		
Fair value of HELP debt	The government's valuation of the outstanding HELP debt accounting for debt not expected to be repaid and interest costs	OS-HELP	HELP for CSP students undertaking part of their study overseas to pay for a range of expenses
FEE-HELP	HELP for full-fee students	SA-HELP	HELP for the student amenities fee

Student contribution	The charge paid by Commonwealth supported students
SFSS	Student Financial Supplement Scheme
Student Start-Up Scholarships	Lump-sum payment from Commonwealth to students already receiving income support
Student Start-Up Loans	A proposed scheme to provide loans from Commonwealth to scholarship-receivers in lieu of SSUS
Tax treaties	Bilateral and multilateral agreements between countries to avoid double taxation and tax evasion
TB	Treasury bond
TIB	Treasury indexed bond
VET FEE-HELP	HELP for students studying vocational education and training qualifications, diploma level and above, to pay their tuition charges

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