Senate Education and Employment Legislation Committee

Second inquiry into the provisions of the Higher Education and Research Reform Bill 2014

From:

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Summary

- Fee deregulation and large per student funding cuts mean that the *Higher Education and Research Reform Bill 2014* is unlikely to pass the Senate as introduced, but this should not mean abandoning all elements of the package

- Extension of the demand driven system should proceed
    - including sub-bachelor qualifications in the demand driven system would help students take the courses that best meet their academic needs
    - including private universities and non-university higher education providers in the demand driven system would make Australia's higher education system fairer

- With the proposed 30 per cent cut to Commonwealth contributions for non-university higher education providers (NUHEPs), in the absence of fee deregulation maximum student contribution rates should be increased to match total funding rates available to universities

- Extending the demand driven system can be done without increasing total higher education expenditure
    - Without fee deregulation, fewer higher education providers will enter the demand driven system, so additional spending will be lower than in Budget forward estimates
    - Encouraging enrolment growth in NUHEPs would reduce the cost to the Commonwealth of higher education expansion
    - More broadly applied loan fees would reduce the cost of HELP
    - The caps on FEE-HELP borrowing should not be removed
    - The HECS-HELP benefit is unnecessary and should be abolished
    - A lower threshold for HELP repayments, and indexation based on CPI rather than growth in average weekly earnings would reduce HELP interest and doubtful debt costs

1 Introduction

This submission largely re-submits material from my submission to the first inquiry into the *Higher Education and Research Reform Bill 2014.* However, it has a narrower focus on proceeding with the demand driven system in isolation from fee deregulation and significant Budget savings from the Commonwealth Grant Scheme. The submission assumes from the public statements of Labor, Green and crossbench Senators that these measures do not have majority support.

I have also made a submission to the parallel references committee inquiry that addresses some broader issues around higher education reform and funding.

2 Extension of the demand driven system to diploma, advanced diploma and associate degree places

Demand driven funding replaced a system in which the numbers of Commonwealth supported places were regulated both in total and for each public university. Originally, the demand driven system was intended to include all domestic undergraduate students, except in medicine. This covered sub-bachelor degrees – diplomas, advanced diplomas and associate degrees – as well as bachelor degrees. However, in November 2011 the then minister removed sub-bachelor places from the demand driven system.

2.1 Limits on demand driven funding

In removing sub-bachelor places from the demand driven system, the minister used one of the significant reserve powers to control student numbers and public spending.[1] One of these is the power, under section 30-12 of the *Higher Education Support Act 2003*, to 'designate' a course of study. If a course is designated it is removed from the demand driven system and distributed in numbers and by criteria determined by the government. Funding agreements between the government and higher education providers receiving Commonwealth supported places are used to allocate designated places.

Although the Commonwealth has increased the number of sub-bachelor places, they are not meeting demand. In a Senate Estimates hearing, the Department said that it had declined applications for nearly 4,000 more sub-bachelor places for 2014.[2]

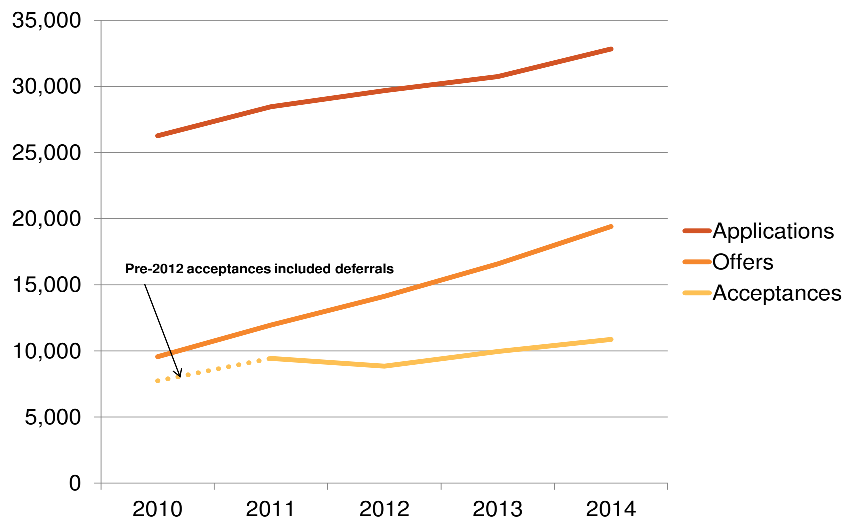
The funding status of sub-bachelor places was a key issue in the review of the demand driven funding system I conducted with David Kemp.[3] We recommended that they be put into the demand driven system.

2.2 Providing the right courses for lower-ATAR students

While an open access demand driven system is a positive development for higher education opportunities, it creates new issues for both policymakers and higher education providers. One of these is that there are more students without strong academic backgrounds. In the school leaver population, this means more lower-ATAR students. As Figure 1 shows, there is larger growth in applications and offers than in acceptances. However, these have risen over time.

[1] These are described in Norton (2013), chapter 7
[2] Senate (2014), p. 48
[3] Kemp and Norton (2014)

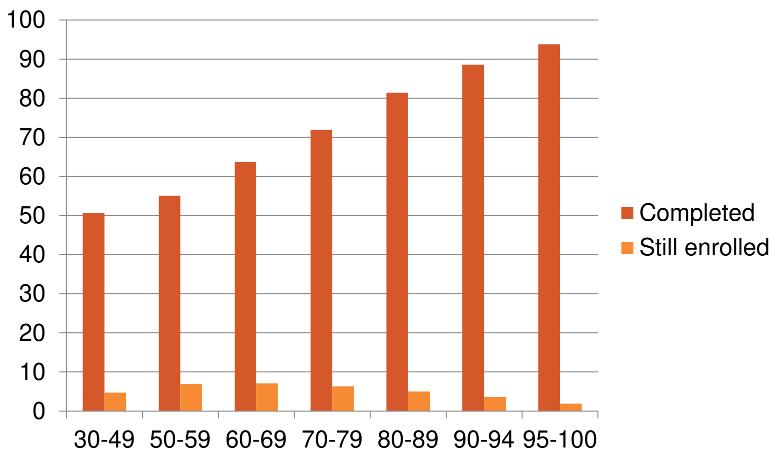
Figure 1: ATAR 60 and below applications, offers and acceptances, 2010-2014



Source: Department of Education and Training (2015)

The elevated risk of dropping out these students face can be seen in the strong relationship between ATAR and eventual completion of a bachelor degree (Figure 2).

Figure 2: Bachelor degree completion rates, 2005 cohort by 2012 (public universities)



Source: Department of Education (2014a)

Evidence submitted to the demand driven review supported the idea that for many lower-ATAR students it is better to commence their higher education studies in a 'pathway' diploma program. Pathway programs typically teach the same curriculum material as a target bachelor degree course, but do so in ways that help build study skills. Students who successfully complete pathway programs do better in their bachelor degree than would otherwise have been expected.[4] For students who don't want to continue with higher education, diploma programs offer an exit qualification after one year.

[4] Ibid., p. 17-19

2.3 Fairness for lower ATAR students

The exclusion of sub-bachelor places from the demand driven system creates unfairness for students, and particularly lower SES students. They are over-represented among the lower ATAR school leavers who are the target market for pathway programs. For example, in 2013 31 per cent of low SES applicants had an ATAR of 60 or below, compared to 11 per cent of high SES applicants.[5]

Lower-ATAR students who cannot get into the limited number of Commonwealth supported place (CSP) pathway programs can attend a full-fee pathway college. There were a little under 7,000 full-time equivalent full-fee sub-bachelor students in 2013. A Grattan Institute analysis of published fees for pathway programs indicates that their average cost is around $17,000 a year. With the 25 per cent FEE-HELP loan fee, students who borrow all to pay for all their pathway college fees would incur a debt of more than $21,000 a year.[6] This is double or more what they would pay on current student contribution levels if more CSP sub-bachelor places were available.

The cost of full-fee pathway programs may encourage some lower-ATAR students to enrol directly into a bachelor degree program, for which public universities have unlimited numbers of CSP places. However, as Figure 2 shows there are substantial risks for the students associated with this option. In the long run, it may be a false economy for the student to take the cheaper bachelor degree course. Denying sub-bachelor degree places to students may also be a false economy for taxpayers, who will fund increasing numbers of students who do not complete their courses.

As the current exclusion of the sub-bachelor courses from the demand driven system promotes neither educational nor equity goals, it should end, subject to considerations in section 4 below.

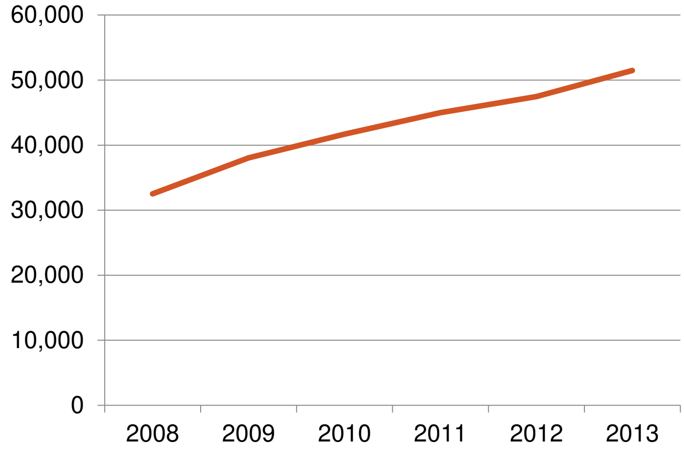
[5] Department of Education (2013), appendix table A9.2

[6] 85 per cent of sub-bachelor degree domestic students borrow at least some of their tuition costs through FEE-HELP.

3 Expansion of the demand driven system to private universities and non-university higher education providers

An increasing number of undergraduate students are choosing to study in private universities and non-university higher education providers (Figure 3). Under current policies, only higher education providers listed in Table A of the *Higher Education Support Act 2003* participate in the demand driven system. A limited number of other higher education providers have Commonwealth supported places allocated through funding agreements. The *Higher Education and Research Reform Bill 2014* would open up demand driven funding to all higher education providers.

Figure 3: Number of undergraduate students in private universities and non-university higher education providers, 2008-2013



Source: Department of Education (2014c)
Note: Only higher education providers eligible for FEE-HELP are included in these statistics. Some growth is due to more providers becoming eligible for FEE-HELP.

The current system is not based on any clear public policy objective. It is an artefact of history. Institutions or descendants of institutions that were in the equivalent of Table A in the late 1980s are part of the demand driven system. Institutions that were not in the equivalent of Table A in the late 1980s, or were founded since the 1980s, are not in the demand driven system.

Over time, policy has edged towards a more consistent approach. Students in non-university higher education providers (NUHEPs) and private universities have long been entitled to student income support. Since 2005, they have been entitled to income contingent loans (albeit on less favourable terms than other students). Since 2012, all higher education providers have been part of the same standards-based regulatory system. Eligibility for Commonwealth supported places is the major exception to this general pattern.

Like the Bradley report before it, the *Review of the Demand Driven System: Final Report* recommended a consistent and coherent system of higher education funding. The main reasons are summarised below.

Fairness to students As with the sub-bachelor places, there are issues of fairness in excluding private university and non-university higher education providers from CSP places. Under the current system, students in Table A institutions are in places that receive subsidies of up to $21,707 a year and have access to the generously subsidised HECS-HELP scheme. Other students are in places that receive no subsidies and are charged a 25 per cent loan fee on any undergraduate tuition fees that they borrow through FEE-HELP. Fairness does not require that every student is treated in the same way. But it does require that differences in treatment have rational explanations linked to public policy objectives. The current system fails this test.

These radical funding differences are not based on any assessment of students' financial needs. The current system means that low SES students end up paying full fees. Enrolment data provided for the demand driven review found that 14 per cent of undergraduate students paying full fees had low SES backgrounds. Opposition to extending the demand driven system equates to support for low SES students paying full fees. Senators concerned about increasing costs for students in public universities should be as concerned about students in other higher education providers.

Supporting extension of pathway programs Pathway colleges were pioneered by the private higher education sector. Originally they were aimed at international students, but now serve both international and domestic markets. The universities consulted during the demand driven review were very satisfied with the pathway system, usually involving arrangements between their institutions and specific pathway colleges. Some universities already have their own pathway colleges, and more are likely to create them if the demand driven system is extended to sub-bachelor courses. But it will inevitably take time for these colleges to be created and for universities to work out how to run them effectively. It makes sense to use organisations that already do it well.

Diversity in the higher education system Institutional diversity matters where it can help students find courses and institutions which are a better match with what they are seeking. Diversity can be found in particular types of students, qualification levels, curriculum content, pedagogical methods and non-academic features such as institutional size, location, or campus environment. The growth over time of private university and NUHEP enrolments shows demand for different types of higher education than is offered by the public universities.

Fee affordability and competition in the higher education system At the moment, few people would choose a private university or NUHEP because it is cheaper than the alternatives. The average annual fee for a bachelor degree in a NUHEP is just under $15,000, nearly 50 per higher than the maximum student contribution amount. So far as Grattan research can find, only a handful of NUHEP courses, all at TAFEs, are priced below the maximum student contribution rates for their field of education (although once the 25 per loan fee was taken into account the cost to students is more than the student contribution). Given a funding system that is heavily biased against NUHEPs and private universities, direct competition with public universities is not a common business strategy for them. They are more likely to be in complementary relationships with the public sector (eg pathway courses), in niche discipline areas that public universities have been reluctant to enter (eg theology, alternative medicine) or offer similar courses in a very different way (eg the small classes of Bond University). They have all needed something that will make them attractive to students *despite* higher student charges.

With a funding system less biased against NUHEPs and private universities, the industry structure may change in ways that lead to more direct competition with public universities. The TAFEs are in the best current position to do this. Their fees suggest low cost structures, they have existing campus networks, they have established brands and recruitment channels, and they have a mission commitment to affordable education. However, direct competition on price between public universities, private universities and NUHEPs is likely to take time. It will require new courses, and possibly new higher education providers, to make it work.

4 Interaction of sub-bachelor reforms and NUHEP reforms

In itself, extension of the demand driven system to sub-bachelor places is one of the least controversial measures in the overall reform package. They could be included by regulation, by repealing the November 2011 designation. However, implementing this reform without extending the system to NUHEPs is likely to have negative consequences.

As already noted above, excluding NUHEPs could delay expansion of quality pathway programs if universities have to establish their own new courses and colleges (some universities already have separate colleges registered through TEQSA, to create distinct brands and not lower their published ATAR requirements). Another option universities may pursue is franchise arrangements with their existing NUHEP pathway providers, so that the student is technically enrolled with the university but actually taught by the NUHEP. Given the proposal for a lower funding rate for students directly involved with a NUHEP (section 5 below), this would be more expensive for government than giving NUHEPs access to the funding system for sub-bachelor courses.

Giving public universities exclusive access to demand-driven sub-bachelor places could undermine the business models of NUHEPs. They are more reliant on the sub-bachelor market than universities. Around 20 per cent of private university and NUHEP places are in sub-bachelor courses, compared to less than 1 per cent of public university places.[7] While competition between public universities and NUHEPs is desirable, this should not be based on one sector being subsidised and the other not. Making business conditions more difficult for NUHEPs would be a setback for the long-term diversity and competitiveness of the higher education system.

[7] Department of Education (2014b), full year student summary tables

5 The university/NUHEP funding rates

The *Higher Education and Research Reform Bill 2014* proposes funding non-university higher education providers at 70 per cent of the university Commonwealth contribution rate (revised section 33-10). The stated rationale is that NUHEPs do not have the same research and community engagement obligations as universities.[8] This provision is an important policy shift, as it brings back research funding on a basis that is not performance driven, and expressly funds community engagement for the first time. However, this submission focuses on what a lower funding rate could mean for the policy goal of expanding the demand driven system to NUHEPs.

5.1 Effects on NUHEP entry into the market

If the lower NUHEP funding rate was introduced in conjunction with fee deregulation it would not have any major implications for extending the demand driven system. As now seems near certain, there will not be fee deregulation. However, extending the demand driven system with only the existing student contribution rates would cause difficulties.

Grattan has collected domestic full-fee data on 267 NUHEP bachelor degree courses. We then estimated likely CSP revenues for those courses on varying assumptions, and added it to current student contributions. All figures were inflated to approximate their likely 2016 levels. The results are in Table 1. On current Commonwealth and student contributions, more than 60 per cent of NUHEP courses (167/267) would generate enough revenue to match existing full fee revenues. Many courses could be offered at a lower student contribution than those in equivalent fields of education at public universities. This would support the policy goal of bringing price competition to the system (section 3).

It is possible that with new economies of scale courses would be viable on lower average revenue per place than currently received through fees. Table 1 also shows the number of courses charging fees within a $1,000 range of the total funding rate for a CSP place. These courses are likely to have potential to enter the system, if we assume they would have more students with lower average fees.

Table 1: Estimated viability of NUHEP bachelor courses with current student contributions under different Commonwealth contribution assumptions

Current Commonwealth contributions	Current Commonwealth contributions less 30%	NUHEP Commonwealth contribution rates in legislation (with 20% average cut)
167/267 courses match current fee revenues. A further 7 within $1,000 of doing so (65% potential).	87/267 courses match current fee revenue. A further 14 within $1,000 of doing so (38% potential).	76/267 courses match current fee revenue. A further 3 within $1,000 of doing so (30% potential).

Note: In courses which would involve subjects with different funding levels, the proportion of each was estimated.

Reducing the current Commonwealth contributions by 30 per cent would, however, nearly halve the number of courses that would generate enough revenue to match current tuition fee income. Lower base Commonwealth contribution rates would further reduce the number of courses that were at

[8] The obligations are derived from the Higher Education Standards Framework: DIICCSRTE (2013). The explanatory memorandum for the *Higher Education and Research Reform Bill 2014* states that the lower rates are because NUHEPs 'are not required to sustain the same kind of research or meet the same community service obligations as universities' (p. 5).

least revenue neutral. The viability of a number of CSP courses currently taught in NUHEPs may also be threatened.

Grattan has also collected domestic full-fee data on 46 NUHEP diploma pathway courses. The same caveats as with bachelor degree courses apply. Of these courses, 30 are likely to be able to match their full fee revenue if current Commonwealth and student contributions were carried through to 2016. However, this number would drop to 17 with the planned funding cuts and 70 per cent NUHEP rate.

Table 2: Estimated viability of NUHEP pathway diploma courses with current student contributions under different Commonwealth contribution assumptions

Current Commonwealth contributions	**Current Commonwealth contributions less 30%**	**NUHEP Commonwealth contribution rates in legislation (with 20% average cut)**
30/46 courses match current fee revenues. A further 2 within $1,000 of doing so (70 % potential).	21/46 courses match current fee revenues. A further 1 within $1,000 of doing so (48% potential).	17/46 courses match current fee revenue. None within $1,000 of doing so (37% potential).

If the Senate rejects fee deregulation but endorses some or all cuts to Commonwealth contributions, it should provide compensating increases in maximum student contributions.

6 Savings measures

This section examines how demand driven funding could proceed at no or limited cost to the Budget.

6.1 Lower implementation costs

Extending the demand driven system without fee deregulation would result in expansion costs that are lower than forecast in the Budget. Based on the analysis in Table 1 and Table 2 (first column of each, if student contributions are allowed to compensate for lower Commonwealth contributions) about a third of courses may not be viable on Commonwealth funding rates. With fewer higher education providers entering the demand driven system, it is likely that the increase in Commonwealth Grant Scheme spending will be lower than original predictions.

6.2 Growth in lower-cost providers

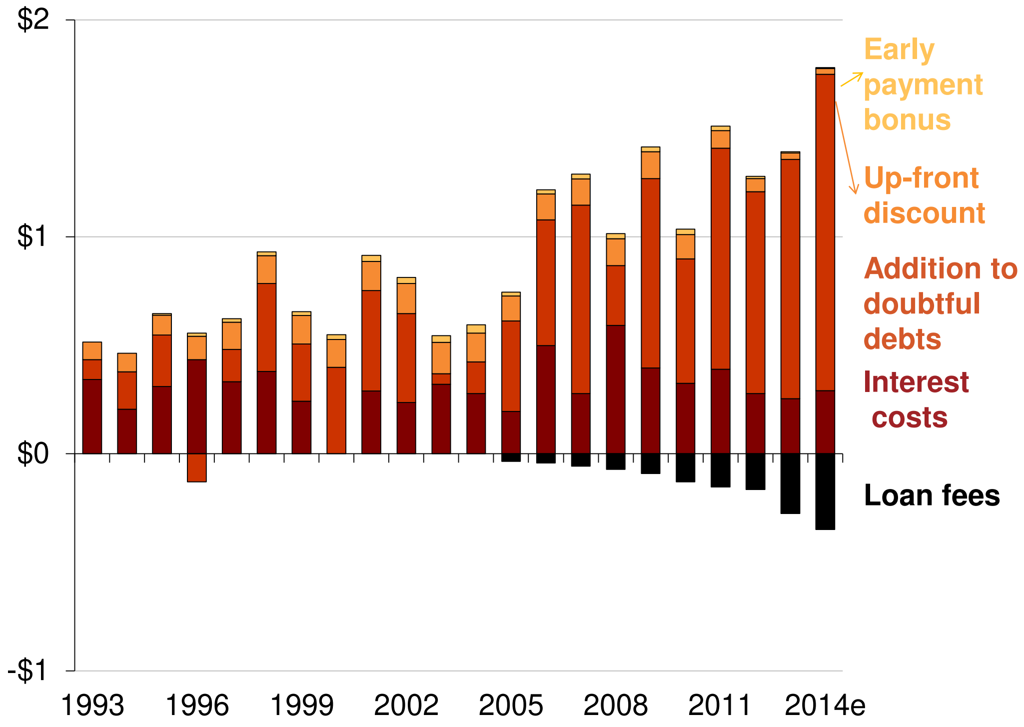
Although NUHEPs are typically not aimed at direct competition with public universities (section 3), with a more competitive funding system they are likely to gain market share over time. This would reduce the longer-term cost of the demand driven system. As universities receive higher per student subsidies than NUHEPs, it will be cheaper for government if NUHEPs take more of the anticipated growth in student numbers.

6.3 Retain and expand loan fees

The second version of the *Higher Education and Research Amendment Bill 2014* abandons the previous proposal to charge real and variable interest on student debt. While there were reasonable policy and political grounds for dropping this element of the package, the bill retains abolition of loan fees for VET FEE-HELP (20 per cent of the loan amount) and undergraduate FEE-HELP (25 per cent of the loan amount). This means that the interest cost of HELP debt will be increased by the revised package compared to the status quo, rather than decreased, as in the bill's original version. Given the growing cost of HELP, this is not desirable. As Figure 4 shows, in recent years loan fees have made a significant contribution to offsetting HELP's costs.

Loan fee arrangements as they stand are anomaly-ridden and need reform. Undergraduate but not postgraduate FEE-HELP borrowers have to pay the loan fee. So a low SES school leaver taking a pathway college diploma course pays the loan fee, but not a corporate executive taking a MBA. For HECS-HELP borrowers, there is a loan fee of 11 per cent on their student contribution (expressed as a 10 per cent discount for paying upfront). This does not add to government revenue as it is paid to universities. But if the same student borrows to pay their student amenities fee (SA-HELP) or to study overseas (OS-HELP) there is no loan fee (or discount for paying upfront). There are also no loan fees for Open Universities Australia FEE-HELP borrowers.

Figure 4: Loan fee contribution to offsetting HELP costs ($2014, billion)



Notes: Addition to doubtful debt calculations is the increase in doubtful debt since the previous year. Interest cost is calculated as the difference between ten-year Commonwealth bond rate and the indexation rate, multiplied by the level of outstanding debt. Loan fees include both FEE-HELP and VET-FEE-HELP, based on estimates of loan fee-liable lending. Deflated using CPI.
Sources: Based on DEEWR (2012), annual reports for portfolios responsible for higher education, information supplied by the Department of Education.

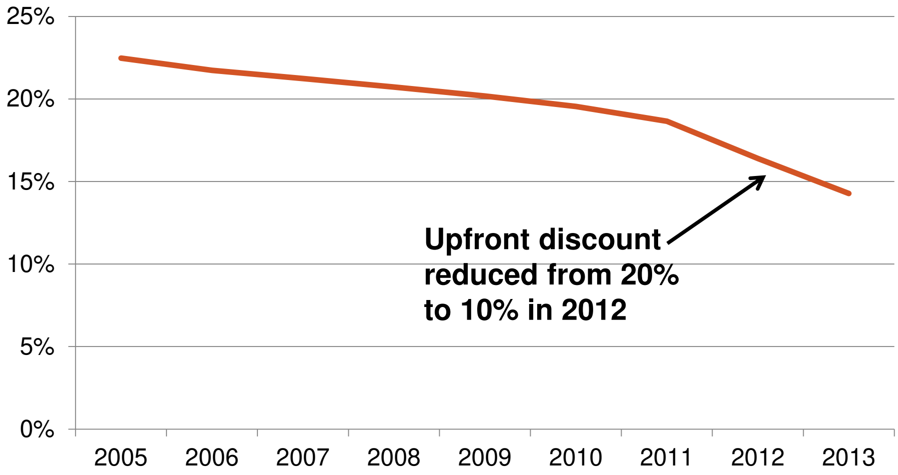
Just because loan fee arrangements are a mess does not mean that consistency should be achieved by abolishing them. Loan fees are a way of borrowers making a contribution to interest costs and possibly to doubtful debt costs, while not exposing slow repayers to high interest costs, as would have been the case in the original bill. The cost is capped at the original loan fee. Under a loan fee, people who repay quickly incur higher effective interest rates than slow repayers, to the point that with some loan fees they receive no subsidies and may pay more than they would under a real interest system.[9] Everyone who completes their loan repayments, however, makes some contribution towards the cost of HELP lending.

Loan fees would also help counter the declining rates of up-front payment over time, as seen in Figure 5. The increasing rate of borrowing adds to the cash outlays required to fund higher education. In 2013, 14 per cent of students paid their student contributions upfront instead of borrowing under HECS-HELP. For students facing the 25 per cent FEE-HELP loan fee, 20 per cent paid upfront in 2013. Loan fees encourage those who have the cash to pay upfront to do so. It is likely that the most significant savings are in the postgraduate market, where high rates of employment mean that there is likely to be the greatest capacity to pay upfront.

The appropriate level of the loan fee would need Department modelling of the likely impact on revenue and lending.

[9] Chapman and Higgins (2014), p. 7-11

Figure 5: Rate of up-front student contribution payments, 2005-2013



Source: Department of Education (2014b) and predecessor publications, status liability tables

6.4 Keep and extend lifetime loan limits

The *Higher Education and Research Reform Bill 2014* removes lifetime limits on HELP borrowing, which currently only apply to FEE-HELP borrowing. Pending a more sophisticated review of HELP and its finances, these limits should be preserved and extended to all HELP borrowing. The current limit of nearly $100,000 for most categories of student is already at a level that many borrowers are unlikely to repay. Retaining and extending the limit would help control doubtful HELP debt.

6.5 Abolish the HECS-HELP benefit

The *Higher Education and Research Reform Bill 2014* would abolish the HECS-HELP benefit. This benefit reduces HECS-HELP repayments by about $1,700 a year for graduates who go into particular occupations. Analysis for the demand driven review showed no significant change in rates of graduates with relevant qualifications entering the target occupations.[10] Furthermore, many of the occupations on the list were in skills shortage when the program was introduced, but are not now.[11] Given that graduates have deteriorating employment prospects, they do not need an additional incentive to take a job that matches their qualifications.

6.6 Lower the threshold for HELP repayment and change the indexation system

The *Higher Education and Research Reform Bill 2014* proposes a new initial threshold for repayment of HELP debts of $50,637, at which HELP debtors repay 2 per cent of their income.

The issue here is that because the HELP repayment thresholds are indexed to average weekly earnings the real value of the threshold has been going up over time. For example, in 2013-14 the initial threshold was $51,309 (with 4 per cent of income repayment). If it had been indexed since 2004-05 to inflation the 2013-14 initial threshold would have been $44,836.

It is surprising that the government did not seek to replace the average weekly earnings indexation system with a consumer price inflation based index. This would have been consistent with its general approach to indexation. It would have maintained the real value of the HELP thresholds. Importantly, it would have increased the speed of HELP repayments across all the HELP thresholds.

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[10] Kemp and Norton (2014), p. 31
[11] Department of Employment (2014)

Especially if the real interest rate reforms are not passed, speeding up repayment is one way that interest subsidies can be reduced. It would also slightly reduce the level of HELP doubtful debt.[12]

Although a once-off change to the initial repayment threshold would not be as effective as a change to indexation, it should be supported as part of package of reforms to improve HELP's finances.

[12] Norton and Cherastidtham (2014), chapter 4

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