

## **Sydney – The demand driven higher education system: frozen or finished?**

**13 February 2018**

In late December 2017, the government suddenly froze public funding for bachelor degree places in Australian universities. In doing so it ended six years of ‘demand driven’ funding that let public universities enrol unlimited numbers of bachelor degree students.

Should the demand driven system be restored? Its supporters argue that it increased access to higher education, fixed skills shortages caused by too few graduates, and encouraged innovation in teaching. Its detractors argue that admission standards fell, that we now have too many graduates, and that it cost taxpayers far too much.

**Moderator:** Libby Hackett, Partner, Perrett Laver

**Speakers:** Craig Emerson, Managing Director, Craig Emerson Economics  
Judith Sloan, Contributing Economics Editor, The Australian  
Andrew Norton, Higher Education Program Director, Grattan Institute

MEGAN FRENCH: Hi there, it's Megan from the Grattan Institute. You're about to hear a recording of our *Forward Thinking* event held on 13<sup>th</sup> February 2018 on the demand driven higher education system. Please note, we unfortunately had Andrew Norton Skyping in and had some audio issues. As such, some of our audio recording has been re-recorded by Andrew so that you can hear his answers. Other parts have been left as is, so bear with it and hopefully you enjoy. Thanks.

LIBBY HACKETT: Good evening everybody and welcome to this Grattan Institute debate this evening on the demand driven higher education funding system and whether it's frozen or finished. Now talking of frozen, what we hope is not to have a technology freeze tonight because one of our panel members is joining us by Skype. I'll introduce your panel members soon, but hopefully Andrew will stay with us from Melbourne throughout the whole evening. My name's Libby Hackett and I'm delighted to see you all here this evening. I'd like to start by acknowledging the Gadigal people, the traditional custodians of this land. We pay respect to the elders both past and present of the Eora nation and extend that respect to any Indigenous visitors here with us this evening. The subject this evening is the demand driven higher education system and for those of you that are not dye in the wool higher education policy experts - and I'm sure you all are - in late December 2017, at the end of last year, the government froze public funding for Bachelor degree places in Australian universities. In doing so, it ended six years of demand driven funding that had let public universities enrol unlimited numbers of Bachelor degree students on a fully funded basis.

The question we're asking this evening is should the demand driven system be restored? Its supporters would argue that it increases access to higher education, contributing to social mobility; that it fixed the skills shortages caused by too few graduates; and it encouraged innovation in teaching. Its detractors, however, argue that admission standards have fallen; that we now have too many graduates in Australia; and that it costs taxpayers far too much money. So this evening we have three speakers with us and I would like to introduce our excellent speakers to you. Firstly, Judith Sloan. Judith is Contributing

Economics Editor at *The Australian*. She's also been an academic and a Commissioner at the Productivity Commission and the Australian Fair Pay Commission, as well as a company director. Craig Emerson many of you will recognise as Managing Director of Craig Emerson Economics and a consultant at KPMG. He was a member of the House of Representatives, of course, from 1998 to 2013 and a Minister in the Rudd and Gillard governments, including the Minister for Tertiary Education in 2013. Andrew Norton is with us on the screen behind you. Andrew is the Higher Education Program Director at the Grattan Institute and has helped put so much of this evening together for us. In 2014 he was the co-author of the government commissioned review on demand driven funding systems, so we all know Andrew's views on this subject, unless of course they've changed.

So, I'm delighted to get started this evening. In terms of the format, we're going to run until about 7pm with more structured questions agreed in advance with the panel that I'll be working through with them and keeping them to their time and their moderated approach, then from 7pm 'til 7.30pm we'll open it up to question and answer, and we would like to invite any question at all, we'd be delighted to receive them. I will get started with our first question. The first question is to Andrew and it's really just a bit of background to help all of us this evening. So Andrew, in about two to three minutes could you please sum up what demand driven funding is and what has happened to it?

ANDREW NORTON: Demand driven funding has to be contrasted with supply driven funding, which is what we've had historically in Australia and we're back to now, where effectively that means that the government decides how much it'll fund universities and then allocates that funding to universities. So what that has created over time is a system where supply is always well below demand. That has meant historic high unmet demand from people wanting to go to university and around the time of the Bradley Report in 2008, which is what led to the demand driven system, there were a wide range of skill shortages, about 40 regular occupations in skills shortage. I think at the time the government decided that they didn't know how to second-guess this market, so they created the demand driven system. What we've got now is, this year and next year, the universities will receive a maximum of the money they received in 2017 and then after that, in 2020, funding will be increased in line with national population growth, provided universities meet various performance indicators around low SES (socioeconomic status) participation, attrition, and graduate outcomes.

LIBBY HACKETT: Excellent, thank you, that's a great summary. So our first set of questions is around participation and equity. Craig, starting with you if I may, one of the goals of the demand driven funding was to increase higher education participation in general and, particularly, participation from low SES background individuals. We've reached a point where 40% of 20 to 25 year olds will hold a Bachelor degree by 2025. This may sound quite high, but it actually doesn't put Australia anywhere near the highest amongst OECD countries. It is, nevertheless, an achievement. In terms of low SES students participating, if we look at the bottom quartile they're projected to be 20% of enrolments by 2020 and the actual individual numbers have doubled from 20,000 to 40,000 students participating over ten years from low SES backgrounds. So do you think it's achieved what it was hoping to do and how threatened do you think this progress is by the funding freeze? If I could ask you to speak for three or four minutes and then we'll ask Judith and Andrew to respond for one minute each.

CRAIG EMERSON: Sure, okay. By way of background, I became a voter in 1972 when Gough Whitlam became Prime Minister and there was this great vision of free university education, which of course was



never free, it just meant that taxpayers paid for it, but for the user it was to be free. There was a pretty strong message in that: this was to open the gates to kids from more disadvantaged backgrounds. So it was a big social reform, but it didn't actually open the gates to kids from low SES backgrounds and I think an analysis of the period then right through each five years would show that there was no real change. I did have the pleasure of introducing Senator Chris Evans to Bob Hawke one day at a function at The Lodge and I said, "Bob, this is Chris Evans - and it was he who was Higher Education Minister and implementing the Bradley recommendations - and under him, at last that vision, if you like, is starting to become a reality". So those low SES numbers are moving and that's frankly why I'm so attracted to it. There are other arguments that we'll get into as to why it is or isn't a good idea, but my key criterion in this, the test that I apply is has it changed the socioeconomic composition of kids going to uni and the answer is yes. And it's the first - there are lots of programs that have been attempted over the years and none of them worked. That's why I was so encouraged about the demand driven system and that's why I think it's a dreadful mistake to re-cap university places.

I'm more from the philosophy of markets and I am able to re-tell the description of Professor Max Corden, who helped me with my PhD thesis along with Ross Garnaut. Max famously wrote about the pre-existing system before the demand system and he described it as "Moscow on the Molonglo". That is that public servants would sit around and, amazingly, not only would come up with a total, but every university and every course in every university would be given a number by the commissars in Canberra. I thought it's a pretty crazy system where we've turned our backs rightly on communism a long time ago, and yet that was the system of allocating places and that was no longer the case. The last thing I'll say on the demand driven system - and I'm sure we'll get further into this - is it is true that it allows young people who did not do so well at school to get into university. It's a fair question to ask why we should allow kids who didn't do so well to get into university and I typify it by the electorate that I represented. Logan City had a lot of disadvantaged people, it had a lot of disadvantaged Pacific Islander kids, and it wasn't unusual for a young person at school to be in a home, very often a Housing Commission home, with five, six, seven, eight brothers and sisters, a lot of noise, and they might only start studying at nine o'clock at night and finish at ten-thirty. It's very hard to do really well at school to go into university, but isn't that a wonderful thing that they have a chance under a demand driven system? Those who just by their home circumstances would like to do better but can't do better under the old system didn't really have a chance of getting into university; under the demand driven system yes, they did.

LIBBY HACKETT: Judith, on equity in access, how would you respond?

JUDITH SLOAN: Well, I have a completely different perspective on this, actually. Let us assume for a minute that that is the objective of policy, to increase the participation of those from low SES backgrounds. Just opening the floodgates is not a good answer; you really have to dig deep and think about what are the barriers to those young people participating? Indeed, we're kind of selling them a pup because we're opening the floodgates and what has happened is that those with low ATAR scores don't complete or they complete to a much lower extent than other people. The returns to university education have gone down significantly, both in terms of the rate of employment, particularly the rate of full-time employment, and the salary premium attached to being a graduate has been quite significantly eroded in quite a short time. It's really what economists would say is a very poor linking of objective with the policy measure. Let's think about the barriers to the participation of those from low

SES backgrounds, and you're right to make that illustrative point but we, of course, have a system where probably the brightest from those low SES backgrounds have actually participated for quite some time, because the HECS scheme was deliberately designed so upfront costs would not deter those people and, of course, there is quite significant youth allowance support and the like.

So I just worry that these kids have been sold a pup. They haven't done well at school. They possibly have had inferior schooling. They have lived in environments which are probably not conducive to excelling in higher education for a whole lot of reasons, including the fact that probably there wasn't a culture within the family that was conducive for that. I guess the final point I would make is that the flipside of this opening the floodgates through demand driven enrolment has been basically killing off the VET (Vocational Education Training) sector. If you actually were interested in a more holistic way of how to help these kids navigate through the labour market and you look at where the jobs are - and Andrew has accepted that those skill shortages have faded - you should start to think of aged care, disability services, childcare and the like. Now, how do you get into those industries? You basically need to go through VET, but that system has been put under incredible financial and, indeed, number pressures as the parallel to the floodgates being opened to university education.

LIBBY HACKETT: Thanks Judith, those are really helpful points. Andrew, your perspective on the access equity issue?

ANDREW NORTON: I think Judith has got a powerful point about this vocational education alternative. I think this is particularly the case for young men where there are still pretty good financial benefits from vocational education, but I think the story is different for young women. Most of the data we've been able to look at is that young women with a vocational Diploma or Certificate III or IV there's very little, if any, financial gain from doing the vocational education path, while there is still a substantial gain from doing higher education. So I guess I am certainly against arbitrary caps on students numbers, but certainly we need to give people good advice about what's in their own interests, given both their academic aptitude and the jobs that are going to be available over the next five to ten years.

LIBBY HACKETT: Thank you Andrew. That leads us nicely onto the next area of conversation for the panel and, Judith, I'll start with you if that's okay. We're talking about academic suitability and definitions of this. One of the main criticisms of the demand driven funding was that it lets in too many students who are not academically suited to higher education. Do you agree? What do we mean and how do we measure "not academically suited"? Would tougher academic standards on entry set by universities resolve the problems of a demand driven system in your view?

JUDITH SLOAN: I think it's a complicated issue. Actually, I worked for 18 years at Flinders University and you never asked a student there why they were there because they'd say, "Because I didn't get into Adelaide" and this was well before the days of demand driven enrolments. The truth of that matter is there really were quite a lot of people there who were very unsuited particularly to a course like economics, which is both conceptual and a wee bit mathematical. I used to eventually say to some of them, "I don't know why you're here" which was probably working against my interests. I think this is really an important issue. See, I don't trust the universities. I think that they are prepared to allow the standards to slip in order to put bums on seats and I think that's partly how I interpret what's happened. Andrew has presented some really interesting figures and I understand, Libby, they're going to go up

on the web after this presentation we're making, which I'd encourage you to look at because some of the universities have increased to the most remarkable extent, like by 16,000, 17,000 additional students to their student body. It's absolutely extraordinary numbers. Now, you can't tell me that a university can increase their enrolments, which I'm thinking are probably a 50% to 60% increase, without allowing the standards to slip.

The final point I would make, and maybe this will make me seem nicer, is that I think a lot of these kids probably need some sort of pathway, some transition, some Associate Diploma, some means. Instead of enrolling first up in an undergraduate Bachelor degree program, what they really need is a stepping stone. As I understand it - and Andrew is an absolute whizz at keeping up-to-date with the funding requirements - at least for quite a lot of this period of time the funding was very hostile to those stepping stone programs. I think they were kept, Andrew? So let me think of Melbourne, where Victoria University is probably the most marginal university. It seemed to me their most sensible strategy was to get kids into some sort of pathway program getting them ready for higher education, but sadly the funding has not always been conducive to that. So I would see that as an appropriate way for policy to shift.

LIBBY HACKETT: Thank you. The document that Judith is referencing is *Demand Driven Facts & Figures*, a report that Andrew wrote and was published by the Grattan Institute in February 2018, but we'll make sure the link is up in relation to this event as well. Craig, any comments on this particular issue?

CRAIG EMERSON: Yes, sure. I'll disagree and agree on two different points that Judith made. I don't think there's any basis to say the brightest kids from poor backgrounds get into uni anyway. Maybe there were some circumstances that allowed them to express their talents, often, by the way, a mother. The statistical evidence suggests - and this is where you do actually get this kind of entrenched privilege and entrenched disadvantage - if mum's been to university, the chances of their child going to university are very high; if mum hasn't been to university you can still get there, but the probabilities are much lower. So I don't have that confidence that somehow the brightest will come through. I think there are a lot of people who are bright - or even if they're not bright, I don't care if they're not bright, just so long as they can do it. Why do we have to say only bright people can go to university anyway?

JUDITH SLOAN: Because they're universities and they strive for excellence. That's what a university does, but there we go.

CRAIG EMERSON: Well, that's just elitism, that's just straight elitism and I don't think that -

JUDITH SLOAN: Right.

CRAIG EMERSON: Yes, exactly. I admire you because you actually say, "I'm an elitist" and that's fine. I'm not. I'm for egalitarianism, but I do respect that that's what you say, you're an elitist. And I don't mean in a derogatory way, I'm just saying you've got a different philosophy.

JUDITH SLOAN: No, but I'm making a more nuanced point, which is that I think high quality higher education is not suitable for everyone and we're just kidding ourselves if we think it is. The only way that you can broaden out a student body in the way they have - and let's forget about the socioeconomic

background, let's talk about their school performance - is by basically dumbing down the courses. Now, I've seen it, it does happen.

CRAIG EMERSON: Well, okay, let me continue on. In terms of access and the bridging courses, they are very important. When I was the Minister for Tertiary Education for just that one year, when the Gillard government was cutting back on funding everywhere to help finance the so-called GONSKI changes, I was instructed to find savings in that area, which I did but I said as part of this overall arrangement I'm asking for increased funding for the bridging courses. Again, it's probably because I'm a politician, but I'd like to tell a quick story about it. At Logan Institute, a TAFE, that was a very, very popular course for exactly the circumstances of people, their basic English expression mightn't be good enough, basic mathematics mightn't be good enough, but they do that course for one year and then they get into university. I think they're magical. I think they're really, really important.

LIBBY HACKETT: Thank you Craig. Andrew, before we ask for your comment, two things I would note. When we discussed this, as we have done for 20 years or so, in the UK, two things always come up in this debate. First is whether we have a broad enough definition of higher education and whether we want to merge our further education, our TAFE, and our higher education systems and have a tertiary sector at some point, but that gets very controversial very quickly. The second angle that is always brought up is the Robbin's Principle. In the UK in 1963 the Robbin's Review established a principle that university places should be available to all who are qualified by their ability and attainment to pursue them and who wish to do so. I think my question to you, Andrew, on this section of academic suitability is are we all in agreement with this principle? Is the debate about how to identify who is academically qualified or is this debate really coming back to this first principle itself? Is that principle too simplistic in a mass higher education system 55 years later?

ANDREW NORTON: One of the big issues in higher education is working out who's got potential to succeed. You can use measures like ATAR, but the lower it gets, the less reliable it is in predicting who will succeed and who won't succeed.

One of the ways around that is to send students via a Diploma Pathway Program. What those do is they typically teach the first year of a target Bachelor degree course, but they do it with more remedial assistance to fill whatever academic gaps you've got. What we've found in various studies is that the students who go via the Pathway program outperform students who actually got higher ATARs than they did and went straight into the Bachelor degree. So that's one way of doing it. The other thing we've been doing at Grattan recently is that we have been looking at this whole process of selection into uni and subsequent attrition. What we've come to believe is this is actually quite an experimental process and that we've got students who aren't necessarily sure about whether higher education is for them, but they have a go. Some of them succeed and stay, others leave. The key thing here is not necessarily to be very, very strict with this uncertain group at the start, but if things are going wrong after they do start studying, to exit them fairly quickly at minimal cost to themselves and minimal cost to taxpayers.

LIBBY HACKETT: Thank you. Andrew, we're going to stay with you for the next section of conversation, which is around employment outcomes. The demand driven system has contributed to some of the worst ever employment outcomes for graduates, certainly six months after graduation. Wouldn't some capping ease this problem? Could you also talk about whether our employability measures are the right

measures? Are we trying to look at the future based on categories from the past? How are we working and how are we tracking in terms of employment outcomes? Are we looking at that in an appropriate way?

ANDREW NORTON: I think with the demand driven system there was a bit of historical bad luck in that as it was being introduced the GFC (Global Financial Crisis) was hitting and this had some particularly significant effects on the labour market in coming years. What we saw was that even though the number of full-time jobs for graduates went down, although only slightly, the number of graduates went up a lot, and the combination of those two factors was that graduate un- or underemployment, this is people looking for full-time work after finishing their degrees, went up significantly to its worst ever levels - it was over 30% in 2014, so it was a very negative outcome. We've also seen some decline in the quality of jobs as measured by what percentage of graduates are getting professional or managerial jobs, that's also been negative. On the other hand, we do see that even though people are getting a difficult start to their careers, in a three year out survey, which tracks the same people we looked at four months out, full-time employment rates have generally been reasonably good, including for those who graduated in the worst possible year, which was 2014.

I think this is going to be an area of ongoing difficulty, but the key question for me is always not is this group of students doing well compared to cohorts in the past, because the answer to that is probably going to be no. The key question is for young people considering their options, which of these are going to maximise their opportunities and minimise their risks for the future? I think there probably is a group of students for whom vocational education would be better, but I think for the vast majority of people who chose higher education over the last decade or so, that probably was the best choice they could've made at the time, even though the results for some of them have been disappointing.

JUDITH SLOAN: Actually, I agree with Andrew, but I think that the two key issues are this. I'm of the view that a fair element of higher education completion is just a screening device. So it's not actually improving productivity, it's just a signal to employers that these people have stuck with it, they're reasonably compliant and maybe their grades indicate that they're reasonably smart. Do they actually have any real absorption of course content that would be useful in most jobs? Probably not and I'd like a lot of research done on that. So what's happened is that the decline in the employment rates and the salary premium attached to graduates is completely consistent with that screening hypothesis, in my opinion. Andrew might say, and it's an interesting point, that if you look at higher education participation in other developed economies, including ones where actually students bear probably a much higher financial burden of undertaking it, they look fairly similar. Is he nodding?

ANDREW NORTON: Yes.

JUDITH SLOAN: Good. I guess one response to that is that, in other words, the demand driven enrolment system doesn't really make that much difference because we have similar participation rates to other countries. I actually think this might be very confirmatory of this screening hypothesis, that basically around the world young people know that the only way they're going to get a leg into the sort of better jobs is by completing a degree. So that force is so strong that, irrespective of the funding arrangements, that's what happens and I refer you, in particular, to Brian Caplin's work on this, which I think is most entertaining. Why this is important is that in the Australian case we're spending a lot of

taxpayers' money on this screening and a lot of taxpayers' money has very high opportunity costs. We could be doing other stuff with this money. If you look at Andrew's figures, we basically went from spending \$4 billion on student tuition to \$7 billion, so a 75% increase in a really short space of time. We're talking serious money, even in Warren Buffet terms, so I think we have to ask the question and we always, as economists, have to ask the question, we need to identify these opportunity costs - which at a minimum might be actually returning it to the taxpayer, I might add - but I think there are a lot of people even in this audience who could dream up activities to fund other than the marginal higher education student body.

LIBBY HACKETT: Thanks Judith. There is quite a lot of academic evidence around what you're discussing. Professor Alison Wolf at Kings College, London is another advocate of this "tyranny of numbers" theory she's written about, that once you get over 40% or 45% participation in higher education, employers, students and parents think about it differently and it becomes a necessary minimum. Craig, what are your views on the employment consequences for graduates of the demand driven system?

CRAIG EMERSON: Judith said earlier, and I agree with her, that university isn't for everyone, but no-one is suggesting that university is for everyone. 40% is not everyone; it's not even half of everyone. I think in the digital age we're going to need to have - I won't even call them skillsets, because as soon as we think skill we think mechanistically and I'm thinking more about an ability to learn through your life that you acquire through university. I'm going to say something fairly radical here. I think that, maybe with the exception of the group that Andrew's talking about who quit really early, that might only be there for three or four months then say, "It's not for me", is it a disaster if someone goes to university and doesn't complete the degree? Is this a shocking thing? Yes, it does involve taxpayers' money, but you'll be aware of Professor Andrew Lee, now a Member of Parliament. He did pretty rigorous statistical analysis on kids staying on at school from Year 11 to Year 12. Just staying on, not successfully graduating with all the stars and whistles and everything else, and there were very tangible benefits from them just being at school for that extra year, even if they didn't do well and maybe didn't even pass at the end of the year.

I think that university education is a very civilising experience and I think that's important for the quality of our society and important in terms of the skills that we're going to need in the digital age, because repetitive skills, whether they are done by people on low incomes or even middle and high incomes, are going to go, so we need these other attributes that I think are provided by university education.

JUDITH SLOAN: Andrew might be able to tell me the answer, but in terms of the return to dropouts, as I understand it, it's very, very poor. So if you go to university and you don't complete, a very poor return. I'm not sure I'm really keen on the taxpayers giving people a shot, shopping around. I go back to the point, let us think seriously about the opportunity costs of this. If someone's so uncertain they'll just sort of give it a go then they might be much better advised to give vocational education a go where, in many instances, you can get a Certificate in six to 12 months and a Diploma in two years, so.

CRAIG EMERSON: I think Andrew hit on an important point in that may actually be truer for blokes. You know, women can be electricians and no problem, but I'm just saying it's more likely to be blokes who are electricians or tradies and so on and the returns from that - everyone here has asked a tradie



to come and quote on a job and will say they're pretty good. I noticed that in the big increase in enrolments from the demand driven system one of the biggest increases was in nursing. Well, I'm really happy to have lots more nurses. We've got an ageing population, we've got much more sophisticated health technologies, and in a rich country we actually like quality health services, so I think that's a really good thing.

LIBBY HACKETT: Yes, nursing and science were the biggest growth areas and I think that's a fantastic accolade to the ambition of young people. I do think we need to be a little bit careful of mindsets. As whole nations, as whole societies, we can come up with quite fixed mindsets. If you go to the US and ask them about retention or dropout, they are so much more relaxed about it over there. Now, again, is this a structural tertiary education issue? Because they would be very hung-up about it in the more elite universities, but in the community colleges it is absolutely about recognising that they do it in units, there are huge levels of what some might describe as dropout, but those individuals that have had that chance, that have had that life-changing experience, see the value in that, even if there isn't anything like the same financial return to those going for the full five years to the elite institutions.

Let's move on to the financial side and the financial elements, which we've been covering, of course, because it weaves into all of this. Craig, I'm going to ask you to start. Demand driven funding contributed to a very large increase in spending - was it \$4 to \$7 billion, is that right - and the main tuition subsidy program, the Commonwealth Grant Scheme, increased by nearly 60% in real terms from 2007 to 2017. This is billions of dollars of additional, ongoing federal funding. Craig, in 2013 you became the first of several Higher Education Ministers to propose reduced demand driven funding with an efficiency dividend on the Commonwealth Grant Scheme for 2014/15. Do you believe that it's better for higher education overall for universities to have a bit less per student, rather than cap the whole system entirely?

CRAIG EMERSON: Just to correct you, I did not propose reduced funding.

LIBBY HACKETT: I like corrections, thank you.

CRAIG EMERSON: The Department of Finance proposed reduced funding which was supported by the Prime Minister and the Finance Minister. I'd just come back from a trip to China to be told that there needed to be some curbing of funding. It might be worth explaining exactly what happened. This is what the curb looked like in terms of actual spending on the demand driven system. What we were trying to do in the Education Department and through me was to say don't just keep drawing a straight line here, because there is such a thing as a backlog. So you introduce a demand driven system where there has not been one before and, again, I'll typify it. It was very common for women in their thirties to say, "I want to do that" - and I'm assuming nursing, but I could be wrong - and a backlog is a fixed amount that gets soaked up over time. So I tried to argue with the Department of Finance that this would level off and, looking at the charts, I think it actually has.

LIBBY HACKETT: It has started to level off.

CRAIG EMERSON: But they've got a job to do, they're bean counters and they go, "Well, we don't know if it's going to level off or not, so we're recommending to the ERC that some changes be made". I was actually in negotiation with the universities about the idea of voluntarily saying let's just take the foot off

the accelerator a bit here so that we keep the system. Finance then said, “We’re not going to recognise any voluntary agreements” and that’s what happened when I was in China because - and it should be this way - they are the ones who put the numbers in the Budget - politicians don’t get to do that - and they said, “Even if you come to these agreements with the universities - who were very interested in principal in doing this - we won’t count it”. That’s when it came to this efficiency dividend which was not to cut the funding, because it was still rising, but to pull it back by 2% in the first year and 1.5% in the second year, or vice versa. That kind of led to a very, very active political campaign by the 31 universities. One university, the University of Canberra, did not join in that campaign. Then, sadly, with the change of government, it led to an agreement amongst some of the group of eight, which had been cooked up before the Budget announcement that they were going to completely deregulate university fees. I thought that would be a very, very bad outcome and it never came to pass because the Senate wouldn’t allow it.

LIBBY HACKETT: Thank you, Craig. Judith, your view on the cost of demand driven higher education?

JUDITH SLOAN: Look, I think I’ve made my point that I find it hard to justify. Okay, I may as well make myself really unpopular. You’ve got to understand the universities’ objectives are actually also to maximise research grants and if you look at the figures, there’s been quite a variation in terms of maximising student numbers. If I think of my university, the University of Melbourne, they deliberately chose not to increase their undergraduate intake much. Possibly a strategy that might ultimately fail, their game was to actually get more Commonwealth funded postgraduate students, in keeping with the Melbourne model.

But if you go to most universities in Melbourne, and my guess is it is true in Sydney, you can see how lavishly funded they are. There are Taj Mahals everywhere. When I went to the University of Melbourne as an undergraduate, it stopped at Grattan Street. It now basically occupies most of Southern Carlton. There are new buildings being built all the time. It is lavish. Can I also point out that Vice-Chancellors, most of them earn close to a million. Do you honestly think that would’ve happened under the previous arrangement? Well, it didn’t. There are Deputy Vice-Chancellors and Pro-Vice-Chancellors. I mean, I look at those titles and I wonder what they do, these people. I’m actually wondering whether I should apply. There are economic theories for it. It’s the theory of bureaucracy, so basically a lot of these gains are snaffled by the managerial class and, indeed, I think the hardworking academic back at the coalface feels reasonably bitter about what’s happened. Now, of course, in amongst this mix has been basically the salad days of full fee paying overseas students and that has helped pretty much every university, but some more than others. Take the Faculty of Business & Economics at the University of Melbourne, they could fill the entire first year undergraduate quota, which is huge, I might add, with overseas full fee paying students.

So I think it’s worth us not thinking just about demand driven enrolment in isolation from other things that have happened, frankly. When the universities talk about unmet demand I think, “Oh, give it up”. What does that even mean in the context of variable entry standards? It was always absolute bollocks, in my opinion, that one. Secondly, these are institutions which are extraordinarily well-funded and, going back to my opportunity cost thing, I’m quite happy to see real funding taken away from them – and it may not just be in respect of student enrolments - and reallocated to worthier causes.

LIBBY HACKETT: Thanks Judith. Andrew, you get the last word from the panel, for the time being at least, and then we'll enter into Q&A. On this financial side, can I particularly ask you, do you think it's possible to have demand driven higher education system without the burden of cost falling on the Federal Government and should domestic full fee places be reintroduced for over-enrolments, as was the case pre-2009?

ANDREW NORTON: On the question of whether full fee undergraduates places should be reintroduced now that we've got some caps on numbers, I think the answer to that is no. I think we should be pushing for restoration of the demand driven system. Full fee places are only really needed when there are hard caps and people simply can't get into university. When we tried this last time, from the mid-'90s to the mid-2000s effectively, there was huge controversy over a relatively small number of students and I really think we shouldn't be re-opening that particular wound; we should be trying to fix the capping that was put in place last December.

LIBBY HACKETT: Thank you. We'll move on to Q&A with the audience.

AUDIENCE: I just wanted to point out, firstly, that when you said there's an average of 40% participation at university, it's actually about half that in the regions. My question is should there be more of a place-based focus in terms of funding policy for universities? An example perhaps would be the involvement of universities in things like city deals. The University of Tasmania is at the crux of a Launceston city deal and there's funding for places and infrastructure as part of that. Is that a good model to go ahead with, do you think?

AUDIENCE: Craig, you make a very good point that only 40% of people go to university, 60% don't and, on the whole, people who graduate, notwithstanding all of the nuances that have been discussed, tend to be better off if not before, then after. The 60% who are subsidising the 40% are actually people, on the whole, with lower incomes. I want to combine that with a point, Judith, that you made, that universities tend to capture a lot of benefits from taxpayer subsidies. So my question is, if the taxpayers who are funding these Taj Mahals and so forth are the lower income people that, Craig, you care about from an egalitarian point of view, should perhaps the universities themselves have some skin in the game? For example, if the university gets a benefit even if it enrolls someone just because they've got a pulse rather than because they will be able to repay the loan from the taxpayer, should the university have to wear the cost if that loan is never repaid? Would that create an incentive for universities to look at enrolling people who will be able to complete the course and will be able to repay the money?

LIBBY HACKETT: Those are both great questions, so first on the importance of place and, secondly -

CRAIG EMERSON: Yes, on place, it turns out that I think it's fair to say - and Andrew or Judith might be able to correct me and I invite them to if I'm wrong - that regional universities especially access the demand driven system. I think that is a good thing. I wrote a book called *Vital Signs, Vibrant Society* in 2005 where I identified a few policy levers that could create more interesting places in our regions as part of an overpopulation strategy. So my answer to you is yes, but as part of a broader regional strategy, increasing the social capital, making sure there are really good hospitals, a university and so on so that people will say, "There are actually advantages of getting out of this crazy city" and move into the regional area. So I think as part of that, yes. On who pays for those who do go through university, I hear from people who make this same argument the following statement: have a look at the income

tax statistics and you'll find that high income people pay most of the income tax. Well, people can't have it both ways. Either high income people do pay most of the income tax and therefore it's not poor people who are paying, or they don't. I often hear the same people making two completely contradictory arguments.

In terms of economic theory, I think there are spill over benefits for society of people going to university. I think it's great for them and I think it's great for society. As I said earlier, I think university education is very civilising. I wouldn't be at all surprised if you looked at the incidence of domestic violence, of general violence and so on, you would find that amongst university graduates it's lower. So I just have this view that if we can get people into that richer experience, then society becomes more civilised, more decent. In terms of opportunity cost, everyone's got their own view about priorities. For me, personally, that's a high priority. If you're saying there should be scrutiny of budgets, people up until a few years ago on \$120,000 a year were getting family payments, cheques sent to them every fortnight from the government. It was the Howard government that dramatically increased middle class and upper class welfare, often for university graduates. If I were looking for savings, I'd be looking in those areas rather than in universities.

LIBBY HACKETT: Thank you. Judith?

JUDITH SLOAN: If you want to feel scared though you should go and have a look at the Parliamentary Budget Office's estimates of what will ultimately be the unpaid debt on the HECS student loans. It's really scary and, in fact, that's not actually brought to book in the Budget. We're talking billions of dollars. The point I would make is that the way HECS is designed it probably doesn't impose sufficient contribution on the student, including we've got this weird system with the small number of private universities who have to pay a service fee and the others don't. I'd like to see that extended to everyone, frankly. If students are bearing more of the real cost then I guess I don't really care if they go and play around, but I'm worried that because they're charged too little that creates bad incentives.

On the regional issue I would make the point that if you look at regional employment it's not nearly as higher education-intensive as the cities and, of course, the Grattan Institute is doing a lot of research which shows that all the future is in big cities, not in regions, but there we go. If you look at the universities that have expanded the most, they're not actually the regional ones. So Swinburne, that's one that's gone up by about 17,000 between 2008 and 2016. Australian Catholic University, I don't think that's particularly regional, I think that's all city. Deakin, okay, it's Geelong, but would you call that regional?

CRAIG EMERSON: I call that regional.

JUDITH SLOAN: Well, if you go to Geelong I'm telling you, you probably wouldn't and, of course, it's got a huge campus in Melbourne, in Burwood. Macquarie University, not regional. Curtin University, not regional. University of Tasmania, I guess that does have a more regional flavour. Western Sydney, do we call that regional? Do we? Okay. RMIT, Griffith. So it's kind of interesting isn't it that the regional universities are not the ones with the highest increases. I mean, these are in absolute terms, so I guess some of the regional universities were quite small and so proportionally they have expanded quite a lot, but being a dry economist's equivalent to the Sahara Desert, I wouldn't like to see any particular favours given to regional universities.

LIBBY HACKETT: Andrew, your comments on the importance of place in demand driven system and also this interesting idea that if universities were asked to share the burden of cost of attrition, would that have any institutional incentive on them?

ANDREW NORTON: On the issue of regional students, I think we have to be very careful to distinguish between regional students and regional campuses, because what we've seen during the demand driven system and even, to some extent, before is there's been an increasing number of regional students that have actually decided to go to city universities for their education. Really, the demand driven system was a break with the idea that the funding system was all about the interests of universities. Instead, it's about the interests of students and if they actually prefer a city university to a regional university, that's a positive outcome from the demand driven system.

A number of economists have called for universities to have what they call "skin in the game" and by that they mean that universities should take some of the financial risk of things not going well for the student. For example, if a student doesn't get a job and doesn't repay their HELP debt, the university should incur some of the cost of that rather than taxpayers. While I understand the logic behind this, I think this has got the same problem as saying that the admissions process can work out who is going to succeed and who isn't going to succeed. There's actually too much uncertainty here for universities to be able to make correct judgements and if they want to be really, really safe the reality is that the only genuinely low-risk students are young men with high ATARs enrolling in professional degrees. To have that as a university system would take us back many, many decades and unwind many of the things that we've been trying to do effectively since the post-World War II era. So I think whilst universities should not be reckless in the way they enrol students, we don't have any effective way of getting them to manage these risks and, for that reason, the taxpayer is the best placed to absorb them.

AUDIENCE: Extracting away from socioeconomic status differences from a moment, so if you were to assume that all students came from the same background, what do you think is the optimal share of the population that should go to university? Is the 40% number too low or too high? Because you have to think that it is a very significant investment, it's three to five years of your life, and there are significant costs for the taxpayer and for yourself, so what number should we be thinking of?

AUDIENCE: Could you say which country you think could serve as a model for Australia in terms of higher education? I'm sure you probably have different answers, but if you could each say what you think would be your preferred model.

LIBBY HACKETT: Great questions, thank you. Judith, would you like to start with those?

JUDITH SLOAN: As is my requirement, I have to read all these tortuous, long-winded government reports, and the Bradley Report was no different. Don't you love it, this idea that the student should be choosing for themselves and that not 25% or 35% or 55%, but 40% of 25 to 34 year olds should hold a Bachelor degree? That was just made up. That was just a made up figure. I mean, they had a little look overseas and the like, but the idea that that should be the proportion was just silly. The idea that that should've driven government policy always struck me as absolutely silly and it goes back to this argument about is university education mainly signalling or is it productivity enhancing? It's a really, really important issue to sort out. I accept that if you do engineering or you do medicine or dentistry or pharmacy or stuff, one would hope that is actually knowledge-enhancing and people have a really

serious set of skills when they graduate, which of course has to be developed on the job, but I'm less convinced of a lot of other courses, so we've got to sort that out. I don't think there is an answer and I do go back to the point that we've expanded one system at the dramatic expense, and I'm talking dramatic expense, of the VET. It's been stuffed up for a variety of reasons, including a very ill-advised form of allowing in private providers and extending the student loan scheme to it but, leaving that aside, we should've always run with a much more balanced landscape for people to choose appropriately post-secondary educational outcomes.

To the second question, I don't know whether anyone's got it right, but I go back to the point about what are the features of a student loan scheme which are wrong here? I think probably the rate is too low and I like this idea of including a service fee which applies to private universities for everyone. I would impose a real interest rate - and I don't know whether they got the change in the income threshold through, did they, in the end?

LIBBY HACKETT: They did. I believe they did.

JUDITH SLOAN: But only a wee bit wasn't it?

ANDREW NORTON: Down to \$52,000.

JUDITH SLOAN: Indeed, Andrew has done some interesting work on this which had shown that the threshold below which you didn't pay anything was incredibly low in Australia compared with, I think, the UK and New Zealand, for example. Does any country have it exactly right? Probably not, but you've just got to work through what you regard as the desirable design features, bearing in mind I accept what you're saying that they're mainly private benefits of higher education kids completing, but there probably are some public spill-over benefits, although I'm not quite sure what they are. Because if it's right we should be all completely civilised and holding hands and singing Kumbaya with the big increase in higher education participation.

CRAIG EMERSON: I don't think that follows. If it's 40%, again, that is well short of 100%.

JUDITH SLOAN: 100%?

CRAIG EMERSON: I said 40% is well short of 100%. I'm surprised we're debating that.

JUDITH SLOAN: But it's a lot higher than it used to be.

LIBBY HACKETT: Craig, your comments to the two questions?

CRAIG EMERSON: I wasn't around in the cabinet when the Bradley Report was commissioned, but I speculate that the reason the 40% number appeared was because someone would've said to Denise Bradley, "You're going to get asked for a number" so maybe she provided a number. I don't think it would have a lot of science behind it, maybe it does and maybe I'm completely wrong about that, but when you do a big shift like this people are going to say surely, "Well, what do you think? What does a good ratio look like?" I suspect it doesn't have a lot more to it than that, but that doesn't mean you don't answer the question if you're writing a report like that or don't try to. It's a bit strange because

Judith and I both have a kind of market background and, given my approach to “Moscow on the Molonglo” and the old system, if I’m of that view that it shouldn’t be so prescriptive and set by public servants then I would not mind a particular number to be optimal, I would just say, “Let’s see how it falls out”.

One quick thing about the lavishness of universities, I’ve noticed it too, but they do make a hell of a lot of money out of full fee paying foreign students and that changed. Through the mining boom the Australian dollar was buying US\$1.10, now it’s buying 80c or less, there’s been a really big further increase. I suspect that actually explains a lot of it, but I did find it frustrating when a Vice-Chancellor said, “We really don’t have two bob to scratch together, it’s just shocking. This 2% efficiency dividend is just going to devastate us and we’re going to do a really big advertising campaign against it” which they did. In terms of the question about optimal models, I don’t think we’d be too far away from it here in Australia and the reason I say that is, notwithstanding the arguments that Judith is putting about the risk to standards and so on, whenever I see these publications, as flawed as they are, about our universities compared with the standards of universities in other countries, how many we’ve got in the top hundred and how it’s changed, it all seems to have actually changed for the better. The demand driven system isn’t a global phenomenon, it’s an Australian phenomenon and, notwithstanding the demand driven system which is supposed to have dumbed down the whole university system, how come our universities are doing pretty well in international ratings?

JUDITH SLOAN: Because they’re all based on research rankings and by Nobel Prize winners and the like. Those rankings have absolutely nothing to do with the student experience.

CRAIG EMERSON: Well, you say signalling is important?

JUDITH SLOAN: I think that is an interesting point in the sense that the rankings, I think, are very important in terms of attracting overseas students. I think a lot less so for domestic students, they choose different universities for more practical reasons. It’s very much driven and gamed and which ranking do you want, but I would accept the fact that Australian universities, certainly in terms of their research output and world rankings, have done pretty bloody well.

LIBBY HACKETT: Thank you. Andrew, I think we’re struggling with the audio again, I’m really sorry. In the meantime, I’ll take Chair’s privilege and make a couple of comments to those excellent questions, because I think it’s quite fun.

I think what’s splitting our panel at the moment in terms of the proportion of students in higher education is really a view on whether they agree or not with new economic growth theory with regard to higher education. New economic growth theory would state that as you put graduates into the economy, they necessarily grow the economy by virtue of the fact that they’re graduates. You put them in any company, any place, any position and they will over perform to the point that they are performing at graduate level. That is a particular theory. Those that expand that theory will be the sorts of people that will put aspirational figures on what percentage of people in the economy should go to university, because the theory is if you can get to 40%, 45%, 50%, you’ll grow your economy by growing your proportion of graduates in the economy. This was Tony Blair’s passionate theory and is why he set a 50% participation rate and then, of course, was I think behind a lot of the 40% target as well. It doesn’t matter

that it's slightly arbitrary or ambitious figure, because the belief is that those graduates will grow an innovation knowledge-based economy.

The other side of the coin are those people that believe that new economic theory is hugely flawed - and there is a lot of academic evidence to show that it is quite flawed - and would be able to demonstrate that it is limited by the utilisation of graduates in our economy. So our employers' ability to utilise graduates in our economy is a sticking point for new economic growth and this is where we come into all these fun conversations about what proportion of students should be going to university, what kind of economy do we want and how are we able to stimulate the economy to absorb the graduates or to grow graduates that actually would be entrepreneurs, starting new businesses and employing people themselves? We don't even know how to measure that in terms of graduate employment, so it's a whole new world. Andrew, have we got you on volume at this point?

ANDREW NORTON: The original question, I'm agreed that the 40% had no science behind it. I think it's a really great point that this is about adapting to needs as they emerge, not actually meeting any target. Australia is doing reasonably well and it's very difficult to compare, particularly on the funding side because every funding system is deeply enmeshed with the broader tax and welfare systems of different countries. But I think we have been an innovative country in income-contingent loans and we have managed to greatly increase our research output through effective incentives and the rankings. Probably the one area where we're still behind at least England and the US is our students are not as satisfied with teaching as they are in other countries, and that's probably a weakness in Australia.

LIBBY HACKETT: Yes, that's very fair. Thank you, Andrew.

AUDIENCE: If you agree with Craig's point that the universities are pretty lavish and generally you might say universities are a bit lazy in their use of revenue and capital, if we're not sure whether changing the demand driven system will really do anything about increasing productivity in the universities, how do we go about raising productivity and getting better value for the money that is spent?

AUDIENCE: I'm curious about the discussion around economic performance. First of all, a point about the extra \$3 billion that you've been talking about coming into the system, at the same time we've had a huge increase in international student numbers and I would've thought that the growth in the domestic system has also contributed to that growth in international student numbers, so we should offset some of those numbers there. More importantly, in the discussion around academic performance we haven't touched on the performance of the school system preparing people for university and I wonder if the panel would like to comment on is there an opportunity here to think about the school system and how we can prepare people better for university and then enable that larger cohort to go through? Also, a further point if I may, is there an opportunity here to move some of the risk from government or students onto the universities themselves about employment outcomes?

LIBBY HACKETT: Thank you. Craig, would you like to start?

CRAIG EMERSON: It is a quandary isn't it? Because I used to be the Minister for competition policy, my argument is competition is good and more competition is better, but I have noticed that when a lot of money comes in it gets spent in different ways and you'll find that a lot more in administration and buildings and so on. I wouldn't argue that buildings are a waste of space or a waste of time, but I don't





really know how to make them more efficient with the money. Again, I suspect - and Andrew may have a sense of this - that a lot of the extra money is actually overseas students, but I'd love to be able to say this is what needs to happen. The instinct of policymakers would be to say we'll draw up all these accountabilities and KPIs, all that sort of stuff, and then some more staff will be engaged to work on the KPIs. I used to work at the UN, a little bit later I'll tell you about the program co-ordination and monitoring office which was supposed to make the UN delivery system more efficient and all it did was we spent all our time talking to the PCMO about how we could make ourselves look more efficient. I'm just saying I don't think that's the solution, so I'd be trying to think in terms of competition policy, but honestly I can't immediately think of a way.

Efficiency dividends can actually help there I think because you've got to do the basic stuff and then, if you get some more money, you do slightly less basic stuff and so on. Don't get me wrong and don't say "former Tertiary Education Minister argues for a new round of efficiency dividends", but I don't like overly prescriptive stuff coming out of Canberra because they'll just create an army of people to meet those requirements.

JUDITH SLOAN: That really, of course, is the model going forward which I don't like, so I think 2020 there are all these silly accountability measures and I don't like that at all. It's a really interesting conundrum. I think there is some element of competition, but there's a very lazy use of capital at universities. I think Bond University, they run through the year don't they so they have three semesters. I'm surprised that hasn't come about more. I was reading an article, and you probably read it too, by an American academic, like take first year economics. Basically, first year economics is a standard course and what they're suggesting is that you could develop a series, in a competitive element, of five or six of the top economists really classify videoed and that would form the basis of the first year economics course right through the country. Then you'd spend your resources on small class stuff, seminars and tutorials, which is I think picking up your point. Because we also have to remember that student experience these days is very different from when I went to university. Pretty much everyone has a part-time job, so it's a combined activity these days; it's both education and employment. That might be also partly the solution to your issue, get away from the big classes and have that.

The other thing, and I'd be interested whether there is some regional experience of this, when I was at Flinders University we had what you'd call outreach programs. I never was very good at it because there were a whole load of high schools that were quite closely located and I'd often go to the wrong one, but we as academics would actually participate in Year 11 and Year 12 economics and try and be part of the bridging program almost at that point. We were trying to encourage them to come to our university, which was possibly fairly obvious, but I'm really interested in those perhaps more decentralised experiments as a way of dealing with some of the problems. My wonder is whether probably the regional universities may well participate in that sort of thing too. I really think it is an issue about how we can improve the productivity. Indeed, it's not just higher education; it's schools and hospitals and everything. It's a really huge chunk of the economy and that, I think, is where a lot of the discussion will go.

CRAIG EMERSON: Bit of an old-fashioned view on preparing kids for university. Two thoughts, one is what's wrong with grammar and spelling so on? I think if, say in our profession, you're an economist and you say, "I'm putting forward this policy prescription" and it's full of spelling errors, you know what

people are going to do? They're going to say if they can't spell, I'm not very confident. Or grammar and the dropping of apostrophes like confetti onto a page, I just find that astonishing and the deterioration there is just amazing. You're talking about signalling. That sends really bad signals as far as I'm concerned. Beyond that though I don't think it's the role of schools necessarily to prepare kids for university; it's to give them the best education that they can. The economics lecturer at ANU when I was doing my PhD and I was tutoring, his name was Ted Seper and they used to ask Ted what the school prerequisites for Economics 1 are. He said, "Economics 1. Come along, do economics one, fail". The pass rate amongst those who repeated Economics 1 was about 90%. The pass rate in the first year was one-third. So he just said, "Well, come and learn economics and that's the best prerequisite for economics".

LIBBY HACKETT: Thank you, Craig. I'm conscious we're out of time, so if I could ask Andrew to make his closing remarks on these questions, particularly whether you could address the question about moving the risk of the employment outcomes and whether there's a way to move that risk back to the universities at all?

ANDREW NORTON: I think the way that the demand driven system should work is to reward the universities who are actually delivering good employment outcomes, and we're already seeing that in university advertising. The unis that are doing well are telling students about that and so they should be rewarded with more students, rather than bureaucrats in Canberra trying to decide what outcomes students should have that I think the central planning mentality of the demand driven system was supposed to take us away from. Ultimately, universities are aware of this and are doing a whole lot of work around employability, not just having the right skills but the other interpersonal skills. I think this is a sign the demand driven system is working and responding to the negative outcomes we had a few years ago.

LIBBY HACKETT: Thank you so much. It comes to me to close this evening's discussion and thank each of our speakers, Judith, Craig and Andrew, each of you for your participation and your patience with our technical faults, and particularly to the Grattan Institute for hosting and inspiring this evening and, of course, to the New South Wales' State Library for this wonderful environment as well. Thank you so much for attending and please do look for the podcast and further material that will be available on the Grattan Institute website. Thank you.

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