

Review of Higher Education  
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Submission from

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## Introduction

This submission focuses on issues of higher education market design. In the terms of reference for the review, it therefore is concerned mostly with creating a globally focused and competitive sector, responsiveness to student and labour market demand, and effective and efficient investment in teaching.

In all these areas, with the sole exception of a global focus through international students, the current system performs very poorly. It wasn't designed to be responsive or to efficiently target student investment, and it doesn't. It therefore needs to be redesigned, building responsiveness and efficiency mechanisms into its policy architecture. What policymakers need to do can be summarised in four points:

1. Treat all institutions and students consistently.
2. Abolish central distribution of student places, with public funding for tuition (where available) following the student.
3. Abolish controls on student fees.
4. Create a new student loan system.

### **One: Treat all institutions and students consistently**

Greater responsiveness and efficiency will be driven by competitive markets. But in order for these markets to operate effectively, participants in them need to be treated consistently. Otherwise, regulatory and funding quirks, rather than educational factors, will steer market outcomes. Currently, these quirks exist in both how tuition subsidies are distributed and in eligibility for the HELP loan scheme, Australia's system of income-contingent student loans.

#### *The subsidy system*

For tuition subsidy, there are three categories of higher education institution: table A institutions, national priority place institutions, and those that receive no tuition subsidy.

Table A of the *Higher Education Support Act 2003 (HESA)* lists the public universities plus the Batchelor Institute of Indigenous Education. These institutions are allocated 'Commonwealth-supported places', places with a Commonwealth subsidy, across all disciplines (not all institutions offer all disciplines, but there are no legal obstacles to them doing so). There are price-controlled student charges on these places. Students can borrow money to pay these charges under the HECS-HELP loan scheme. From 1998 to 2008, table A institutions could also enrol full-fee domestic undergraduates when they had filled all their Commonwealth-supported places in a course. These places are being phased out from 2009. However, table A institutions can enrol full-fee postgraduates, who can borrow money under the FEE-HELP loan scheme. Access to table A is based on funding system history, and there is no set procedure for gaining access to it.

The second tuition subsidy category is a group of private institutions that have so-called 'national priority' places, mainly in teaching and nursing, but at the University of Notre Dame including medicine, information and communications technology, and Indigenous students. They receive the same tuition subsidy per student as table A institutions. Institutions with 'national priority' places are still allowed to enrol full-fee domestic students. Effectively, this group of private institutions now has the most favourable regulatory treatment by government. They can target price-sensitive students with Commonwealth-supported places, while still being free to charge higher prices to other domestic students. There is no consistent basis for declaring a field of study a 'national priority', or determining which institutions should get such places. Access to 'national priority' status is by lobbying.

Students at most other accredited higher education institutions have no access to tuition subsidies. Though one of the major reasons for tuition subsidies is to target equity students, 12% of students in the full-fee sector in 2006 were classified as being of low socioeconomic status, a higher rate than that achieved by several Group of Eight universities.

These distinctions lack a stated public policy rationale. They distort and narrow student choices by creating large price differences unrelated to underlying cost or value, require some low SES students to pay full fees, and create obstacles to new providers entering the industry.

The distinctions should be scrapped, and tuition subsidy made available on a consistent basis. This does not mean that all students in private higher education institutions should receive tuition subsidies. Subsidies should not be paid unless there is some public benefit. What it does mean is that if subsidies are paid, they are paid without discriminating between students or institutions.

#### *The loan system*

Unlike the subsidy system, for Australian higher education providers access to the FEE-HELP loan scheme, which lends money to pay tuition costs for full-fee students, is based on non-arbitrary criteria. As of June 2008, sixty-six institutions had become eligible for FEE-HELP, in addition to those whose eligibility is based on a specific statutory mention.

However, the existing legislation discriminates against foreign higher education providers. Eligibility depends on an institution having its 'central management and control in Australia'. While having management in Australia is reasonable to ensure accreditation and other requirements are met, there is no need for the provider's 'central' management to be located here for this to occur. Effectively, this provision makes it hard for foreign higher education institutions to establish operations in Australia, as their central management is likely to be in their home country. This provision is an obstacle to the diversity the review's terms of reference assume is desirable.

The previous government impliedly admitted that this provision was flawed when it allowed students enrolled at the Adelaide campus of the US-based Carnegie Mellon University access to the FEE-HELP scheme. It did this by a special amendment to *HESA*. As with the national priority places, this means access is gained by lobbying and backroom deals, rather than by meeting set criteria.

The terms of reference to this review call for a 'globally focused' higher education sector. This suggests that institutions from other parts of the globe should be admitted to the Australian higher education market.

To support this goal, the word 'central' should be deleted from the current section 16-25(a)(iii) of *HESA*.

Reforming access provisions to the subsidy and loan system will create competitive neutrality in higher education, and bring the principles of the rule of law to the legislation.

#### *The student income support system*

Student income support is already provided without discrimination on the basis of institution attended. No change is required to this aspect of the student income support system.

### **Two: Abolish central distribution of Commonwealth-supported places**

The higher education system operates under a highly prescriptive allocation of student places. Commonwealth-supported places are allocated to public universities and a few other higher education providers (as described above) through 'funding agreements'. These set out the number of places the provider has been allocated, and which 'funding cluster' they fall into. There are eleven funding clusters corresponding to groups of fields of study, including seven different Commonwealth subsidy amounts. The amount of the subsidy multiplied by the number of places in each cluster gives the Commonwealth funding for that year. New places are allocated to universities with even more detailed control, down to particular courses at

particular campuses. (A copy of a funding agreement is at appendix A; note also allocations down to four decimal places).

In a reform starting this year, table A institutions and the University of Notre Dame can now be funded at up to 5% more than their funding agreement target, if their actual enrolments exceed their target enrolments. However, the declining offers and acceptances for commencing student places observed for 2008 suggests that it is unlikely that this reform has triggered much if any behavioural change among institutions.

Funding agreements should be abolished. Instead, any higher education institution eligible for students with Commonwealth-supported places would be paid according to its enrolments.

This change would give students more options, give them a better chance at receiving an offer for their first-preference course, and create a more competitive system.

#### *Give students more options*

The table A institutions are, with the sole exception of the Batchelor Institute of Indigenous Education, a homogenous group. All offer degrees from bachelor through to PhD; none specialise in education at a particular level. All cover a wide number of disciplines; none specialise in one or a small number of areas. Almost all have large student enrolments; only two have fewer than 10,000 students, and 15 have more than 30,000 students. All claim to have a research mission, though with varying evidence for it. At the undergraduate level, all operate a traditional academic calendar, with long breaks from teaching (though Summer and Winter schools have become increasingly available). Outside Victoria, few are well-integrated with vocational education. All have high student:staff ratios. Between them, in 2007 it is likely that they had around 95% student enrolment market share.<sup>1</sup>

It is very unlikely that this represents the enrolment distribution between institutions that would have occurred in a more competitive environment. In the United States, this type of institution has only around a 25% market share. When non-table A institutions are placed on a more competitive basis, through Commonwealth-supported places or access to FEE-HELP, they enjoy strong enrolment growth. Table 1 provides data on the three institutions for which we have before and after data on the 2005 reforms to higher education, which extended FEE-HELP to undergraduates at private higher education providers. Avondale and Notre Dame also have some 'national priority' Commonwealth-supported places. It is notable that Bond, which offers shorter course completion times through teaching all-year round and smaller class sizes, nearly doubled its numbers in two years despite fees that are triple or more the student contribution amounts paid at table A institutions.

**Table 1: Commencing domestic bachelor-degree students**

	<b>2004</b>	<b>2006</b>	<b>Increase</b>
<b>Avondale College</b>	194	281	44.85%
<b>Bond University</b>	319	636	99.37%
<b>The University of Notre Dame Australia</b>	1048	1625	55.06%
<b>Total</b>	<b>1561</b>	<b>2542</b>	<b>62.84%</b>

Source: DEEWR, *Students: Selected Higher Education Statistics*

Strong demand for FEE-HELP loans from students in the private higher education sector suggests that, before FEE-HELP's introduction, student preferences were being frustrated by up-front charges. This frustrated demand was mostly in niche markets that have not been attractive to public universities, and have consequently been under-serviced. Though the 2006 enrolment data only reliably capture Commonwealth-supported and FEE-HELP students

<sup>1</sup> DEEWR, *Students: Selected Higher Education Statistics*. First half-year. This is an estimate only, as private higher education providers that do not have access to FEE-HELP do not report their student numbers.

(because the non-table A institutions were not required to report students paying up-front fees), the non-table A institutions had more than a 20% market share of reported below-bachelor level undergraduate education. The Navitas Ltd-owned institutes of business and technology, for example, offer advanced diploma courses that articulate into second-year courses at public universities. For the domestic student market, they are aimed at students whose Year 12 results are not strong enough to go straight into university. On full-fees, the Navitas institutes can offer the smaller classes and additional help needed by these students, which public universities cannot.

*Give students a better chance at a first-preference course*

Total unmet demand for higher education, for 2008 estimated at 5.8% of all eligible applicants, is now quite low.<sup>2</sup> However, many applicants do not receive an offer for the first-preference course. In recent years (table 2), about four in ten applicants have missed out on their first preference.

In some disciplines, non-responsiveness to demand has imposed very high costs on both the unsuccessful applicants and the broader Australian community. Throughout the 1990s, there was very high unmet demand for places in medical courses, though in the early to mid-1990s the government actively cut back on commencing student numbers. The shortages of medical professionals that cause delayed medical treatment for many Australians are a direct consequence of too few students being able to take their preferred course.

**Table 2: First preference offers, 2001-2008**

	2001	2002	2003	2004	2005	2006	2007	2008
% Eligible Applicants Receiving 1st Preference Offer	56.0%	49.2%	45.1%	45.6%	56.1%	58.7%	59.9%	61.0%

Source: DEEWR, *Undergraduate Applications, Offers and Acceptances 2008*

Other costs are also incurred as a result of this mismatch between supply and demand. About a quarter of students who do receive an offer of a university place reject it. This is an understudied group, but presumably disappointment at the offer actually received is a factor. The academic and career potential of these applicants is lost or delayed. Other disappointed applicants accept their offer and hope to transfer to their preferred course based on their university results. About a quarter of students commencing undergraduate courses are admitted based on previous higher education. To the extent that they do not receive credit for their previous higher education work, this adds to the time and expense of acquiring a higher education qualification (including taxpayer expense, because most of these students will have occupied Commonwealth-supported places).

Universities have finite capacity and minimum academic standards, so not all applicants could or should receive a first-preference offer. However, the centralised system works against universities increasing or re-organising their supply of Commonwealth-supported places to meet demand.

Table A institutions are largely shielded from the market pressures that might otherwise steer the supply of Commonwealth-supported places towards meeting student demand. The federal government has always kept the number of Commonwealth-supported places below the number of university applicants. This produces a sellers market: anyone who wants to go to university will eventually have to take what is offered. To further protect table A institutions, the government ensures that competitors either have to charge more (non table A providers), are excluded from the loan scheme (foreign-controlled providers) or are constrained by their funding agreements from expanding significantly to take market share (other table A providers).

<sup>2</sup> 'Unmet demand' is an estimate of the number of the academically eligible applicants not receiving any offer of a university place. For school leaver applicants, an ENTER of 56.2 is regarded as 'eligible'. See DEEWR, *Undergraduate Applications, Offers and Acceptances 2008*

The external environment provides no need to change. The internal university incentives are to stay with the status quo. Because faculty budgets are linked to student numbers, moving student places from a faculty would cost it money and jobs. In the 'collegiate' decision-making environment of a university that is a last-resort option. Also, because there are very few officially teaching-only permanent academic positions, removing teaching and research staff because of a decline in student numbers may not make strategic sense in the context of the university's overall mission.

Even if a table A university did nevertheless want to meet student demand, the funding agreement system makes it difficult. Under this system, universities have minimum student enrolment targets and maximum spending limits. The interaction of these two requirements creates a powerful force for inertia. Take the following hypothetical example of an institution with an enrolment target of 150 students and grant of just under \$1.4 million, using the 2008 actual Commonwealth funding rates of \$1,674 for a commerce student and \$18,227 for a student of dentistry, medicine or veterinary science. Adding 5 more students in the more expensive category would cost 44 commerce students, and cause the institution's enrolments to fall well below its target. Under this system, it is difficult to move places between disciplines that do not have the same Commonwealth funding rate without upsetting one of the funding agreement targets.

**Table 3: Hypothetical course reallocation**

	Student numbers	Total funding
Commerce	100	167,400
Dentistry, medicine, veterinary science	50	911,350
<b>Total</b>	<b>150</b>	<b>1,078,750</b>
Commerce	46	76,265
Dentistry, medicine, veterinary science	55	1,002,485
<b>Total</b>	<b>101</b>	<b>1,078,750</b>

Unsurprisingly, in practice, funding agreements vary little from year to year except when the Commonwealth offers new places. This is done only on an ad hoc basis. No system for monitoring the appropriate distribution of places within the federal education department has ever been publicly disclosed. Apart from some 2007 ALP election promises, there are no new places funded in the Budget or scheduled for 2009. Some universities have already signed 3-year funding agreements that would protect them from student places being redistributed. Every aspect of the system of allocating Commonwealth-supported places, with the sole exception of occasional new places, is geared to entrenching the status quo.

Yet with better regulation and incentives, universities will proactively respond to student demand. By 2006, about 2.5% of all Australian undergraduate students were enrolled in the domestic full-fee places the new government is abolishing from 2009. These places could only be occupied if universities had first filled all their Commonwealth-supported places. As universities had a financial incentive (usually, these places provided significantly more revenue per student than a Commonwealth-supported place), and no artificial constraints on numbers, more demand was met than would have been possible within the centrally-controlled system.

On a much larger scale, the massive growth in international student numbers shows that universities had the capacity to enrol many more Australian students than in fact they did. While the government's claim that international students do not take places away from Australian students is technically true, that is only because Australian government policy prevents those places being created in the first place.

The compacts system of distributing university places proposed by Labor in their 2006 white paper, *Australia's Universities: Building our Future in the World*, would reproduce the discrimination against Australian applicants of the current system. Though the current status of this white paper is unclear, compacts in some form are assumed by this review's terms of reference. Labor's white paper compacts were a modified version of the Coalition's funding agreements, instruments of central place allocation that would limit the total number of places available to Australian students and at particular institutions. The choices of Australian students would be restricted to options set for them in Canberra. By contrast, universities would remain free to respond to demand from international students.

The problem here is not the international students. Instead, they set the model the Australian government should follow in its treatment of domestic students.

### *Create more competition between institutions*

The lack of competition between institutions is one reason so many students do not receive a first-preference offer. But it also has consequences for the students who do receive first-preference offers, in unbalancing the incentive system within universities against teaching. If universities are effectively guaranteed student numbers, and can receive no financial reward or penalty for teaching quality, then the incentive to focus on teaching standards is weak. With the Commonwealth-supported student system, universities receive the same amount of Commonwealth-supported student revenue whether they do a good job, an indifferent job, or a bad job.<sup>3</sup>

By contrast, the rewards for research excellence are strong. The main driver of research funding is research project grants, which are highly competitive based on quality. Only about one in five applications to the Australian Research Council is funded. Success in these competitive grants, along with other performance measures such as numbers of publications, determine block research funding grants. In addition to this, academics themselves are highly oriented towards research over teaching. In the 2007 Changing Nature of the Academic Profession Survey, only 7% of respondents indicated a preference for teaching over research. Of the 69% who prefer teaching and research, 40% lean towards research and 29% have a strong preference for research.<sup>4</sup>

The consequences of this imbalance have been very evident in institutional practices. While increasingly a PhD, which takes at least three years to complete, has become the minimum qualification for a permanent academic job, a 1999 survey of academics found that only 44% had received teacher training at the start of their careers, with the figure even lower—around 30%—for mid and later career academics.<sup>5</sup> Much of this training has been short and informal without learning being assessed or any credential being awarded. While there have always been some brilliant teachers in Australian universities, this has been a matter of individual talent or conscientiousness, not systems put in place to ensure good outcomes. With so little riding on teaching performance, a proper professional teaching ethos with accepted minimum standards has been slow to emerge.

The results of this were put on dismal display when the results of the first Course Experience Questionnaire (CEQ), sent to all completing students, were published in the early 1990s. Though the CEQ has obvious limitations, especially in requiring respondents to average their reactions to many different teachers and subjects over several years, it showed low levels of satisfaction on all the items in its 'good teaching scale' (GTS), covering the amount of time

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<sup>3</sup> The Learning and Teaching Performance Fund was an attempt to provide bureaucratic rewards for student outcomes and satisfaction. However, it did not operate as an incentive scheme, because it rewarded past performance on criteria that changed from year to year. Its latest iteration, for 2009, will provide payments for improvement. However, at \$74 million for the entire sector the sums involved are very small and unlikely to have a major impact.

<sup>4</sup> Leo Goedegebuure and Jeannet van der Lee, 'Changing Nature of the Academic Profession: preliminary findings from a national survey', Centre for Higher Education Policy and Management, University of New England.

<sup>5</sup> For this and related findings, see Andrew Norton, *The Unchained University*, (Sydney: The Centre for Independent Studies, 2002), pp. 50-54.

staff put into commenting on work, feedback on performance, motivation of students, skill at explanation, effort at making subjects interesting and understanding student difficulties. On none of these did clear satisfaction (the top two points on a five point scale) reach 40%.

All of these results have improved significantly since then, with a consistent upward trend in the GTS since 1996.<sup>6</sup> Only the question on understanding difficulties is now below 50%, though the highest (feedback) is only 55%. This is despite trends like increased student:staff ratios that might have been expected to cause greater dissatisfaction among students. The main reason for this surprising upward trend is likely to be fee-paying international students. With universities now dependent on tuition fee income, their internal cultures have started to re-orient towards teaching. Graduate Certificates in Tertiary Education have become more common as universities start to professionalise university teaching, and teaching performance is now a routine part of staff promotion criteria.

Extending competition to the entire student body would reinforce these positive pressures, and lifting controls on student charges (section 3, below) would give universities greater capacity to invest in their teaching workforce's skills development and in technologies that can assist learning.

While the government should no longer allocate student places to universities, it has a potential useful role in making information about satisfaction with courses and universities more accessible. Apart from the institution-level starring system in the *Good Universities Guide*, would-be students lack easy access to satisfaction data. While information on satisfaction can be found by diligently searching university websites, it is usually located on the website of the university statistics or planning office, not the website for future students, and is presented as a report to the bureaucracy, rather than as a user-friendly source for potential students.

### Three: Abolish controls on student fees

For Commonwealth-supported places, the current pricing system is set out in table 4. The student contribution amount is a maximum, with universities permitted to charge less, though in practice this happens very rarely. These prices are the cumulative effect of an expenditure analysis twenty years ago, a below-inflation indexation system adopted in 1995, a 7.5% Commonwealth contribution increment paid in exchange for workplace and governance reforms, the HECS rates of 1997 inflated by 25% in 2005, and some funding cluster increases that took effect in 2008. No government has ever looked at what it would cost to deliver a course to a reasonable standard, only at what universities are currently spending. Even within the inherent constraints of a price control system, the quality of price control regulation in higher education has been very low.

**Table 4: Prices for Commonwealth-supported places, 2008**

Funding cluster	Commonwealth contribution	Student contribution	University income
	\$	\$	\$
Law, accounting, administration, commerce, economics	1,674	8,499	10,173
Humanities	4,647	5,095	9,742
Maths, statistics, computing, built environment, health	8,217	7,260	15,477
Social studies, behavioural science	8,217	5,095	13,312
Education	8,217	4,077	12,294
Allied health	10,106	7,260	17,366
Visual and performing arts, foreign languages, clinical psychology	10,106	5,095	15,201
Nursing	11,280	4,077	15,357
Engineering, science, surveying	14,363	7,260	21,623
Dentistry, medicine, veterinary science	18,227	8,499	26,726
Agriculture	18,227	7,260	25,487

Source: Department of Education, Employment and Workplace Relations

<sup>6</sup> See Graduate Careers Australia, *Graduate Course Experience 2007*, (Melbourne: GCA/ACER, 2008), esp. 20-34.

### *The role of prices*

In a market, prices are signals to producers and consumers. The producers are motivated by the prospect of profits (or the avoidance of losses) to supply goods and services at prices consumers are willing to pay. Higher education is an unusual market, in that most producers are not-for-profit organisations. Their business decisions are not principally based on money-making for the sake of it. However, they do respond to financial incentives.

Table 5 shows that for the disciplines mentioned average international fees were at least 20%, and up to nearly 75%, higher than the amount the university would have received for a fully-funded Commonwealth-supported place. Prior to 2008, universities would receive only the student contribution (see table 4) for Australian Commonwealth-supported places enrolments up to 5% more than their funding agreement number of students, and nothing after that. So for the marginal student, the premium for an international student was even larger than the levels reported in table 5—over 300% more in the case of dentistry and veterinary science. We cannot be surprised that between 1996 and 2006, international student enrolments nearly tripled, while the number of students in Commonwealth-supported places increased by only 5%.

In preferring international students to local students, universities were acting according to the incentives of the system. Fee control on Commonwealth-supported places has priced Australian students out of the market—not in the way claimed by student organisations, of fees being too high, but through fees being too low.

**Table 5: 2008 international fees compared to Commonwealth-supported place income**

	Arts	Commerce	Business	Computing	Dentistry	Law	Veterinary science
CSP	9,742	10,173	10,173	15,477	26,726	10,173	26,726
International full-fee	15,430	17,658	14,455	18,570	37,992	18,276	34,928
International price premium	58.38%	73.58%	42.09%	19.98%	42.15%	79.65%	30.69%

Source: For average international fees, *Good Universities Guide*.

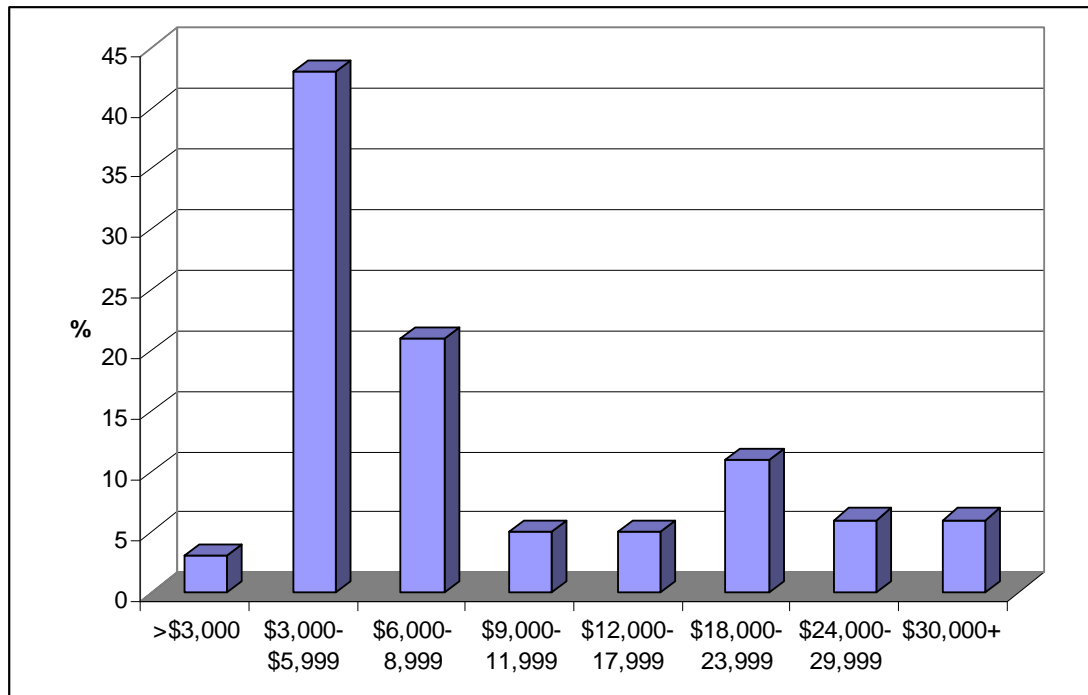
Note: Though commerce and business are the same field of study, the 'commerce' terminology tends to be used in the older universities with higher fees.

### *The distorting effects of low and flat prices*

The low and flat pricing structure has also meant that some types of education are very difficult to purchase. Students are not able to use the price system to buy better-quality services, as they can in almost every other market. For example, driven by common funding rates, there was a trend across the table A institutions towards higher student:staff ratios in the 1990s and early 2000s. Without price control, it is likely that we would have seen far more variability in these trends: some institutions may have still have increased student:staff ratios to reduce costs and attract students looking for low prices, while others may have kept the status quo or reduced student:staff ratios. Instead, small classes became a niche market for the private higher education providers.

Figure 1 shows that in the far more diverse American higher education market, there are a wide range of fees charged. More than 40% of students pay between \$3,000 and \$5,999 year, similar to the fees paid by Australians in Commonwealth-supported places, but many other options, and their associated fee levels, find a market.

**Figure 1: Annual fees paid by American undergraduates, 2005-06**



Source: Annual Survey of Colleges, The College Board

Australian undergraduates in Commonwealth-supported places pay the same student contribution amounts wherever they go, but the value of what they get in return differs. While measuring quality of teaching is difficult, we know the academic quality of the students varies substantially. This is evident from differing entry requirements. American research indicates that 'peer effects', the contribution of other students to learning and social development, can be substantial.<sup>7</sup> Whatever the quality of teaching, it is likely that the overall educational experience is better at institutions with higher entry requirements. The brand names of these institutions probably also contribute to the long-term career success and earnings of their graduates, though no Australian research establishes this as fact.<sup>8</sup>

Because the value of a degree from a more selective institution is higher, but the cost the same, the less-selective institutions are put at a disadvantage. They cannot offer lower fees to attract students. This is one reason that lifting quantity constraints, as proposed in the previous section, is problematic without also lifting price constraints. Where both quantity and price constraints are lifted, as in the international student market, the institutions with weaker brands are able to find markets by offering competitive prices. Table 6 provides some examples.

**Table 6: Comparative annual international student course fees , 2008**

<b>Bachelor of Commerce</b>	<b>\$</b>	<b>Bachelor of Business</b>	<b>\$</b>
University of Melbourne	24,610	Victoria University	16,000
University of Sydney	22,800	Southern Cross University	13,900
University of Queensland	20,500	Central Queensland University	14,880

Source: University websites.

<sup>7</sup> Ernest T. Pascarella & Patrick T. Terenzini, *How College Affects Students: A Third Decade of Research*, (San Francisco: Jossey-Bass, 2005), pp.121-22; 187-89.

<sup>8</sup> It is true of the high-prestige institutions in the United States: see William G. Bowen & Derek Bok, *The Shape of the River: The Long-Term Consequences of Considering Race in College and University Admissions* (Princeton, NJ: Princeton University Press, 1998), esp. chapter 5.

### *What purpose does price control have?*

In a Group of Eight (a lobby group for the research universities) proposal to partially deregulate fees, the only rationale given for partial rather than full deregulation was to 'avoid exploitative pricing'.<sup>9</sup> Perhaps they had something like the fees in table 6 in mind? The fees charged by Group of Eight universities are almost certainly well above the average cost of delivering those places. From the public statements of universities, at least some of this money is diverted to fund research. Is this 'exploiting' students paying high fees? Students pay these fees at least in part to buy a share of the university's prestige. As research is a major driver of that prestige, in funding research students are arguably getting what they pay for. While some policy analysts may think that these prices are too high, given that a globally competitive market exists for international students, no Australian institution has the market power to price in an 'exploitative' way. There are too many alternatives, in Australia and abroad.

In the domestic market, students unwilling to move have fewer options. However, in the major cities it is unusual for there not to be any local alternatives for their preferred course. This is one reason why take-up of domestic undergraduate students at public universities has been modest. In most cases, there were cheaper substitute courses that offered better value for money. The potential for overpricing in uncompetitive markets is a reason why deregulation of places and prices should occur simultaneously. Where this has occurred, in the international student and postgraduate coursework markets, we see a wide range of differently priced courses, as seen in the United States in figure 1.

A less emotive reason for price control is to keep university fees 'affordable', to use Kevin Rudd's term.<sup>10</sup> Obviously, 'affordability' is in everyone's interests—those of the students who want a university education, and of the universities who want to provide them with it. The question is what process should be used to find the 'affordable' price. The process to date, to set the one price that applies to everyone, assumes that students are a homogenous group with a common threshold of 'affordability'.

This assumption is clearly mistaken. With an income-contingent loans scheme, 'affordability' is relative to a person's future income stream. We know that, on average, people with undergraduate qualifications earn a lot more than those with Year 12 only education (table 7). For male bachelor-degree holders in full-time work, the average annual earnings premium over someone with a Year 12 education is, pre-tax, enough to pay for three years of the highest student contribution amount. We also know that the income of graduates varies a lot—that these averages include some very high and some quite low income earners. The threshold of affordability for higher education costs will differ enormously depending on the age, ability and career plans of potential students. A highly intelligent, ambitious and hardworking 18-year old has the potential for very high returns on his or her human capital investment. A working life of forty years of significantly above-average earnings would pay even for the \$30,000 a year fees in figure 1 many times over. But those who start later, or have less ability, or less desire to focus on a lucrative career, would have lower levels of 'affordability'.

**Table 7: Average weekly bachelor-degree earnings and earnings premium, 2005**

	<b>Male full-time</b>	<b>Female full-time</b>	<b>Persons full-time</b>
<b>Bachelor</b>	1413	1041	1236
<b>Year 12</b>	910	735	840
<b>Bachelor premium</b>	503	306	396

Source: ABS, Education and Training Experience, Australia, Cat. 6278.0

<sup>9</sup> Group of Eight, *Seizing the Opportunities: Designing new policy architecture for higher education and university research*, Group of Eight, June 2007.

<sup>10</sup> Samantha Maiden & Jo Pritchard, 'Uni fees must fall: Rudd', *The Australian*, 18 December 2006.

A policy aimed at lowest-common-denominator 'affordability', at not deterring the marginal would-be university student unsure whether or not further education is worthwhile, discriminates against the most able and ambitious students by preventing them from investing more in their education. For most people, their single most important asset is their human capital. Yet Australian government policy has long been to artificially hold down investment in undergraduate education.

*Is competent price control possible?*

Even if price control was a good idea in principle to promote affordability, its advocates need to explain how it will be implemented in a competent manner. The record is hardly encouraging. Though policymakers in the late 1980s set out to create a uniform system, making it possible (in theory, at least) to set course standards, cost them, and fund accordingly, this was *never* done. The people who say the government should control student contributions admit this failure. They say that the government has 'under-funded' higher education—in other words, that it has failed to price university places correctly. What they don't say is why we should believe that things will be any different in the future.

The election of the Labor Party does not provide a reason for believing things will consistently change for the better. The policy that drove the real cuts per student place during the Coalition years was a below-inflation indexation policy introduced by the Keating government and retained by the Rudd government in its first budget. Higher education is, in practice, a low budget and policy priority for both parties. It has a relatively small political constituency, and has never succeeded in putting itself near the top of the political agenda. This is not a conducive political environment in which to set the price paid for a university place, something in need of continual fine-tuning.

In the higher education sector, only the Group of Eight has to date published a proposal for how price setting might be done more competently in the future. They want the Productivity Commission to set an 'indicative' cost for various fields of study, thus partly removing student place price setting from the political process. Their partial price deregulation would be an up to 25% premium on top of that indicative cost. Other industries have professional price controllers along the lines proposed by the Group of Eight. For example, Victoria's Essential Services Commission (ESC) regulates prices for electricity, gas and water. While seeking to protect consumers' interests in reliable services at reasonable prices, it also takes account of the financial viability of the regulated industries. In principle, a higher education equivalent would be a major improvement on the status quo.

There are, however, important differences between higher education and the commodities regulated by the ESC. Compared to higher education, electricity, gas and water are homogenous products. Though production and delivery costs may vary between suppliers and according to the consumers' location, in most cases the end product is identical. Whether electricity is generated from a coal, gas, hydro or wind source it has exactly the same uses. Though price setting that takes into account the ESC's competing considerations is still complex, the nature of energy and water as commodities makes the price controller's task viable.

Higher education lacks this uniformity. Disciplines differ in their underlying cost structures. Some require expensive equipment while others do not; some require small-group teaching while others can be taught in large classes. Another significant problem is that higher education is difficult to cost because it is co-produced with other services. Most full-time staff are teachers and researchers, and are often expected to perform community service as well. Much, though not all, of the infrastructure at universities is used for two or more functions. Even within a higher education system like Australia's, with policy encouraging convergence on similar courses around the country, working out what price would cover teaching costs is conceptually and practically difficult.

These difficulties would increase over time, as the system became more diverse. The current table A institutions may provide a base for an initial 'indicative' cost calculation, but as institutions emerged based on quite different teaching methods or philosophies of education

this base would make less and less sense. It is very hard to set a common indicative cost in a system that may include global online higher education providers and local liberal arts colleges with low student:staff ratios. The policy goal of greater diversity greatly complicates the policy mechanism of price control. Effectively, the Group of Eight proposal would take us from 1 size fits all to 1.25 sizes fits all.

The political and practical difficulties inherent in price control of university fees make it an unattractive option. The pricing problems of the current system—undersupply of places, lack of diversity, and sup-optimal human capital investment—would replicate themselves in the new system. The policy strength of the market alternative is that the pricing decisions would be decentralised to those who have the greatest knowledge and the greatest incentive to get them right: higher education providers and students. The political strength of the market alternative is that the higher education industry only has to get lucky once. After the system is deregulated, the industry will continually adjust itself in response to changing market conditions. It will not be reliant on regular and competent policy review by bureaucrats and politicians, events our history suggests are much rarer than gamblers beating the odds.

#### **Four: Create a new student loan system**

The current HELP loans system—HECS-HELP, FEE-HELP and OS-HELP—puts lifetime limits on how much students can borrow to fund their education. This may keep human capital investment below optimal levels for some individuals. For example, it is not possible to complete a medical degree on a full-fee basis within the FEE-HELP cap, though medical students are typically low credit risks. They have high labour force participation and well-above-average earnings. It would be possible to complete a medical degree under all a student's theoretical HELP entitlement, adding HECS-HELP, FEE-HELP, and OS-HELP together. However, the system is not flexible enough to allow all these entitlements to be used in this way.

Lending caps have a policy rationale in limiting the cost to taxpayers of debts that incur implicit interest subsidies and a high risk of turning bad. There is an implicit interest subsidy because though some HELP loans have a debt surcharge of 20% (ie, the student must repay 20% more than he or she borrowed), after that the debt is indexed to inflation only. The simplest way to explain what happens is that when the federal budget is in deficit, the federal government borrows money in the financial markets at real rates of interest, but lends to students at a zero real rate of interest. That interest cost is a subsidy to the student. There is a risk of bad debt because HELP debtors may never earn more than threshold at which they have to start repaying (about \$40,000 a year), they may live overseas where the Australian Taxation Office cannot collect repayments, or they may die with debt, at which point it is written off. These factors are far from trivial in their consequences for taxpayers. Their cumulative effect, according to the 2006-07 Department of Education, Science and Training (DEST) annual report, is that a HELP debt with a face value of \$14 billion is worth only \$9.1 billion.

Some of these losses are a deliberate part of policy design. The \$40,000 repayment threshold is intended to transfer the risk of low financial returns from students and graduates to the Commonwealth. This is to encourage more people to undertake higher education, and to protect those who need to leave the workforce—such as parents with young children—from compounding interest on their student debt. However, there are measures that could be taken to reduce the costs of HELP without compromising these objectives.

Not all HELP debtors have to pay the 20% debt surcharge. Most absurdly, postgraduate full-fee students don't have to pay it, but undergraduate full-fee students do have to pay it. Postgraduates can even engineer themselves a subsidy, by borrowing money and then repaying, getting a 10% bonus for 'early' repayment. For example, suppose a course cost \$10,000. A postgraduate could borrow this money under FEE-HELP, and then repay \$9,091, with the 10% bonus clearing the remaining debt, leaving for the student a profit of \$909 courtesy of Australian taxpayers. This loophole should be closed immediately.

Action should also be taken so that Australians with HELP debts repay while overseas. The DEST 2005 *Higher Education Report* reported that the Australian Taxation Office did not have valid or complete postcodes for 14% of all HELP debtors. Presumably a significant number of them are living overseas. In the *University and Beyond 2007* survey, of current university students, 43% of respondents gave 'work overseas' as a change expected within 5 years of graduation. Clearly, the potential for delayed or lost HELP repayments is very significant. New Zealand and England, which also have income-contingent student loans system, attempt to collect from their overseas debtors. International cooperation between the three countries could increase the repayment compliance rates for them all.

To preserve the original open access policy intent of HELP a loan without credit checks should be retained, but capped to limit taxpayer losses. The cap should be the same for all students, merging all existing HELP schemes into one. It should at least be enough to complete a mid-range priced undergraduate course. Rather than it being a lifetime limit, the cap should apply at any one time up to a student age of 50 years. This assumes that those who have repaid student debt in the past are relatively low credit risks. The age limit is to leave time for remaining debt to be repaid before retirement.

For students wishing to borrow more than the HELP limit, they should be able to do so on a commercial basis. Indeed, it has been suggested that it would be possible to do this through private firms.<sup>11</sup> Within an extended HELP system, it would mean that though the income-contingent aspect could be retained, creditworthiness checks could be done and real interest charged. This would encourage early repayment. An extended HELP system would strike a balance between ensuring that students could make appropriately high levels of investment in their education, while protecting taxpayers from the costs of large student debts.

## **Conclusion**

Though the Australian higher education system is very poorly designed, its issues are, compared to other issues on the government's agenda, superficial. There are no complex technological, economic and collective action problems like those that afflict climate change policy. Apart from enrolment rates among some 'equity' groups, higher education's weaknesses are not due to deep-seated social problems. Most of higher education's shortcomings are the result of policy mistakes only. Things will improve quickly when those mistakes are corrected. This is another way of saying that the most difficult task is a political one: convincing the higher education sector and its constituencies that government regulation and control hasn't, won't and can't fix their problems.

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<sup>11</sup> Joseph Clark, 'Shares in People', *Policy*, vol. 21, no.1, Autumn 2006.