

## Senate Education and Employment Legislation Committee

### Inquiry into the provisions of the Higher Education and Research Reform Bill 2014

From:

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## Summary

- Extension of the demand driven system to sub-bachelor qualifications would help students take the courses that best meet their academic needs
- Extension of the demand driven system to private universities and non-university higher education providers would make Australia's higher education system fairer
- Extending the demand driven system to sub-bachelor qualifications but not non-university higher education providers would compromise the sub-bachelor reform
- Reductions in Commonwealth contribution rates would not have a major impact on the financial attractiveness of higher education
- By the end of Year 12 low and high SES students make the same judgments about the value of higher education, with ATAR primarily explaining differences in participation rates
- Rejecting savings measures in higher education risks alternative cost cutting that would have worse long-term outcomes
- The financial costs of HELP to government are significant and need attention
- HELP doubtful debt could be reduced by recovering HELP debt from deceased estates
- A reformed loan fee on HELP borrowing and real interest only for repaying HELP debtors should be considered as an alternative to real interest on all HELP debt
- The lower initial threshold for HELP repayment should be introduced

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

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

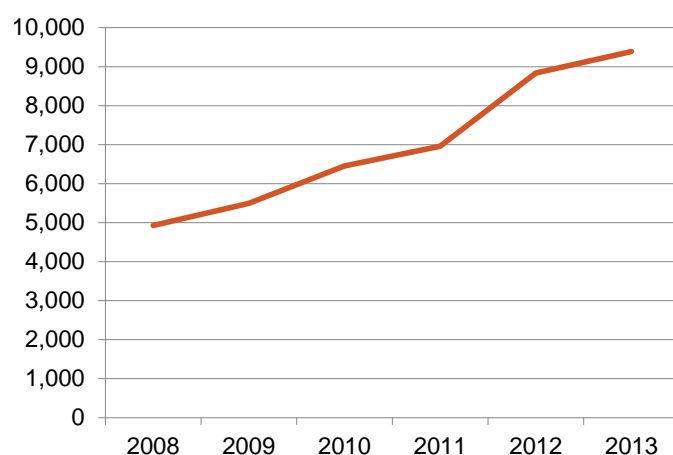
### 1.1 Limits on demand driven funding

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

Despite the designation of sub-bachelor courses their numbers grew rapidly from a low base, as seen in Figure 1. However, this growth is not meeting demand. In a Senate Estimates hearing, the Department said that it had declined applications for nearly 4,000 more sub-bachelor places for 2014.<sup>2</sup>

The *Higher Education Research and Reform Amendment Bill 2014* seeks to repeal the November 2011 determination (item 205).

**Figure 1: Commonwealth-supported sub-bachelor places, 2008-2013**



Source: Department of Education (2014d)

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

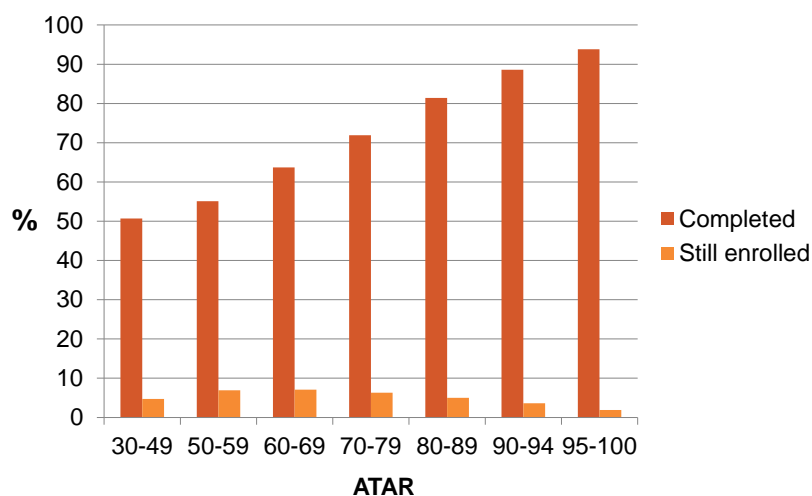
<sup>1</sup> These are described in Norton (2013), chapter 7

<sup>2</sup> Senate (2014), p. 48

## 1.2 Providing the right courses for lower-ATAR students

While an open access demand driven system is a positive development for higher education opportunities, it creates new issues for both policymakers and higher education providers. One of these is that people who would previously have gone into vocational education or directly into the workforce are now considering, and in some cases choosing, higher education. In the school leaver population, this means more lower-ATAR students. Applications data released in May 2014 confirms the trend reported in the *Review of the Demand Driven Funding System: Final Report*: an increasing proportion of applicants with ATARs below 60 are receiving offers.<sup>3</sup> The elevated risk of dropping out these students face can be seen in the strong relationship between ATAR and eventual completion of a bachelor degree (Figure 2).

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



Source: Department of Education (2014a)

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

## 1.3 Fairness for lower ATAR students

Although the number of sub-bachelor places has expanded, their exclusion from the demand driven system has unfair consequences for students. Lower-ATAR students who are not admitted to the limited number of CSP pathway programs can attend a full-fee pathway college. There were a little under 7,000 full-time equivalent full-fee sub-bachelor students in 2013. A Grattan Institute analysis of published fees for pathway programs indicates that their average cost is around \$17,000 a year. With the 25 per cent FEE-HELP loan fee, students who borrow \$17,000 would incur a debt of more than \$21,000.<sup>5</sup> This is double or more what they would pay on current student contribution levels if more CSP sub-bachelor places were available.

<sup>3</sup> Department of Education (2014e); Kemp and Norton (2014), p. 13-14

<sup>4</sup> Kemp and Norton (2014), p. 17-19

<sup>5</sup> 85 per cent of sub-bachelor degree domestic students borrow at least some of their tuition costs through FEE-HELP.

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

The exclusion of sub-bachelor courses from the demand driven system particularly affects low SES students. They are over-represented among the lower ATAR school leavers who are the target market for pathway programs. For example, in 2013 31 per cent of low SES applicants had an ATAR of 60 or below, compared to 11 per cent of high SES applicants.<sup>6</sup>

As the current exclusion of the sub-bachelor courses from the demand driven system promotes neither equity nor efficiency goals, it should end, subject to considerations in section 3 below.

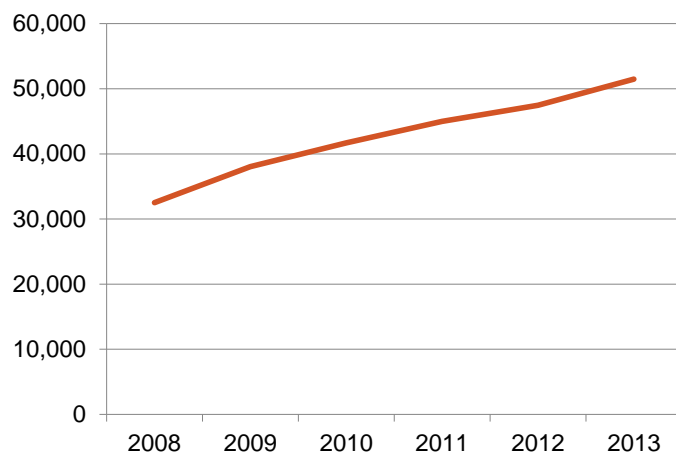
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<sup>6</sup> Department of Education (2013), appendix table A9.2

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

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

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



Source: Department of Education (2014d)

Note: Only higher education providers eligible for FEE-HELP are included in these statistics. Some growth is due to more providers becoming eligible for FEE-HELP.

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

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

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

**Fairness to students** As with the sub-bachelor places, there are fairness issue in excluding private university and non-university higher education providers from Commonwealth supported places. Under the current system, students in Table A institutions are in places that receive subsidies of up to \$21,707 a year and have access to the generously subsidised HECS-HELP scheme. Other students are in places that receive no subsidies and are charged a 25 per cent loan fee on any undergraduate tuition fees that they borrow through FEE-HELP. Fairness does not require that every student is

treated in the same way. But it does require that differences in treatment have rational explanations linked to public policy objectives. The current system fails this test.

These radical funding differences are not based on any assessment of students' educational or financial needs. Pathway colleges are mostly in the full-fee NUHEP sector and specialise in assisting students with educational disadvantage, which is in turn correlated with financial disadvantage. The TAFEs offering higher education also have a strong focus on educational and socioeconomic disadvantage.

Enrolment data provided for the demand driven review found that 14 per cent of undergraduate students paying full fees had low SES backgrounds, compared to 17 per cent of students in Commonwealth supported places. Opposition to extending the demand driven system equates to support for low SES students paying full fees. Senators concerned about increasing costs for students in public universities should be as concerned about students in other higher education providers.

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

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

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

With a funding system less biased against NUHEPs and private universities, the industry structure may change in ways that lead to more direct competition with public universities. The TAFEs are in the best current position to do this. Their fees suggest low cost structures, they have existing campus networks, they have established brands and recruitment channels, and they have a mission commitment to affordable education. However, direct competition on price between public

universities, private universities and NUHEPs is likely to take time. It will require new courses, and possibly new higher education providers, to make it work.



### 3 Interaction of sub-bachelor reforms and NUHEP reforms

It is clear from the public statements of Senators, and the Government's willingness to negotiate the details of its package, that there may be a different combination of reforms than the one set out in the *Higher Education and Research Reform Amendment Bill 2014*. One purpose of this submission is to highlight potential consequences of different mixes of policy changes.

In itself, the reform facing least opposition is the extension of the demand driven system to sub-bachelor places. However, implementing this without extending the system to NUHEPs is likely to have negative consequences.

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

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

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<sup>7</sup> Department of Education (2014c), full year student summary tables

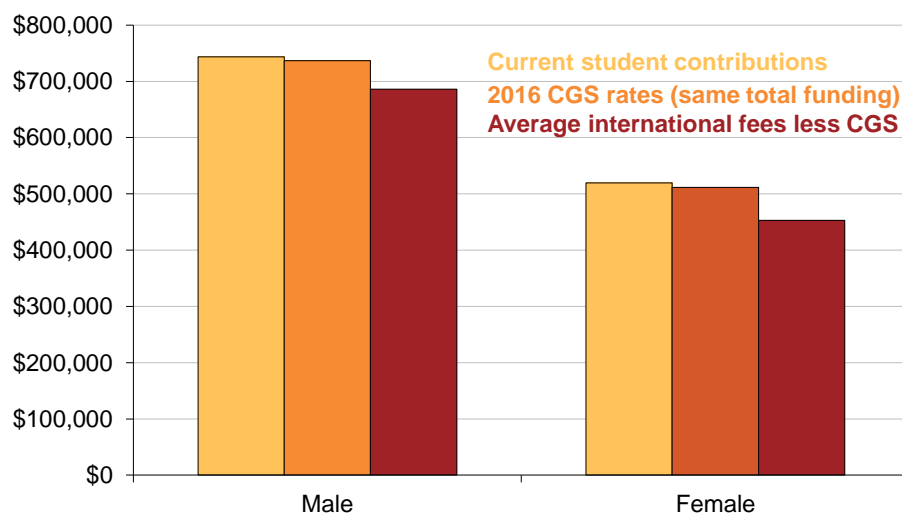
## 4 Cuts to Commonwealth contributions

In the Budget, the government announced reductions in Commonwealth contributions. These would hold total Commonwealth Grant Scheme spending at slightly above current levels, despite a forecast increase of nearly 100,000 student places. This growth is due to expected increases in public university enrolment and bringing NUHEP and private university students into the CSP system. Compared to the counter-factual of adding 100,000 places at current Commonwealth contribution levels, the new rates would save approximately \$1.1 billion in 2016-17.

### 4.1 Impact of cuts on graduates and prospective students

I am on the public record, in the *Graduate Winners* report, in arguing that current tuition subsidy levels are not required to produce the public benefits associated with higher education.<sup>8</sup> In theory, subsidies attract people to higher education by decreasing its cost and therefore increasing the net private benefit of higher education. However, private benefits are already sufficiently high in most cases that the subsidy is unlikely to make a difference to the basic yes/no decision to undertake university study. Figure 4 updates *Graduate Winners* research to include Census 2011 income data, the planned cuts to the Commonwealth Grant Scheme, and the most recent data on international student fees. The left-side bars are current Commonwealth contributions, the middle bars are the proposed 2016 cuts with compensating student contribution increases but no fee deregulation, and the right-side bars are average international student fees less the proposed 2016 Commonwealth contribution rates. In all cases there are still very significant financial rewards, but clearly these reduce as educational costs increase.

**Figure 4: Lifetime private financial value of a degree compared to Year 12 only, three tuition cost scenarios for a bachelor degree graduate with median earnings**



Source: Income data derived from ABS (2012)

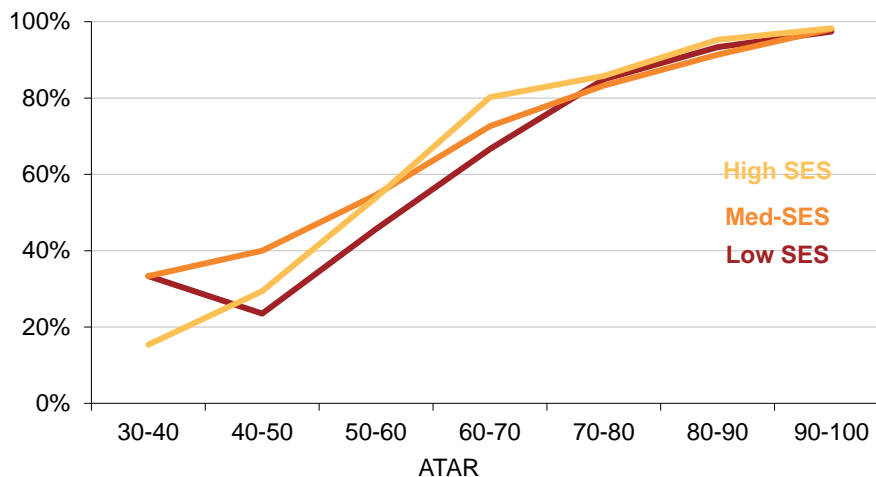
Note: These scenarios assume a 2 per cent real interest rate.

<sup>8</sup> Norton (2012a)

We have also updated research cited in *Graduate Winners* on higher education participation by ATAR and SES (Figure 5). It is based on the Longitudinal Survey of Australian Youth 2006 cohort. It tracks the progress of a sample of students who were in Year 9 in 2006, in this case up to 2012. Unlike previously published LSAY research, it incorporates any possible effects of the 25 per cent increase in student contributions in 2005. It confirms that ATAR rather than SES is the main driver of university participation, with no significant differences by SES in the 70-plus ATAR group, which was the main category of school leavers going on to university (79 per cent of those admitted based on ATAR in 2012).<sup>9</sup> The LSAY results are consistent with offer acceptance rates recorded in the annual applications data, except that these show low-ATAR low-SES applicants are more likely to accept an offer than low-ATAR high-SES applicants.<sup>10</sup>

We should question the assumption that low-SES Year 12 school leavers are especially prone to making poor judgments about their education options, based on either their own social backgrounds or student contribution levels. For students with high ATARs, going on to higher education is almost certainly the best option for the vast majority of young people, and that is what happens across the SES spectrum. As ATAR declines the risks of higher education increase (see Figure 2 on completions) and university application and attendance rates sensibly decline.

Figure 5: Participation in higher education by SES and ATAR, 2012



Note: 1) Data includes respondents who attended universities but did not complete their degrees. 2) Father occupation score based on the Australian Socioeconomic Index 2006 (AUSEI06) is used to determine respondents' SES levels. Low SES represents the score of 25 or below. High SES represents the score of 75 or above.

Any participation rate risks of higher fees through reduced Commonwealth contributions need to be assessed against the risks of reduced participation through other means of controlling higher education expenditure. This is discussed in the next section.

## 4.2 Cuts not going ahead

There has been some speculation about cuts to research funding if the Senate rejects reductions in Commonwealth contribution rates. This is because the government is looking for savings that do not require Senate approval if the savings provisions of the *Higher Education and Research Reform Amendment Bill 2014* are rejected.

An alternative way of controlling higher education spending is to put caps on Commonwealth Grant Scheme funding per university. This can be done without Senate approval through funding

<sup>9</sup> Kemp and Norton (2014), p. 15

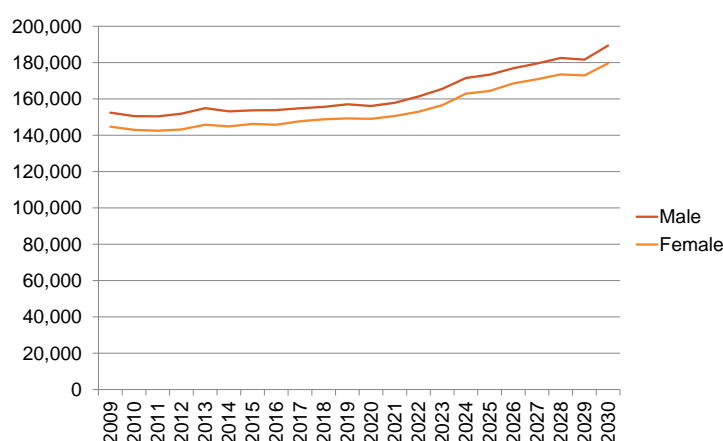
<sup>10</sup> Ibid., p. 39

agreements under section 30-27 of the *Higher Education Support Act 2003* (the provision of the amending bill is the same in its substantive content, but widens the scope of higher education providers). Although under section 30-27 the capped amount cannot be less than the total of the previous year, maintaining the funding status quo would have much the same effect of the current Budget proposal: to hold total Commonwealth Grant Scheme spending at around existing levels.

This change could not be implemented until 2017, due to existing funding agreements being in place until the end of 2016. However, if the government gave notice that it was going to pursue this option universities would immediately start controlling their numbers, to ensure that they were not left in 2017 with large numbers of students with no Commonwealth funding. The announcement would also deter private universities and NUHEPs from entering the system at all, generating further savings.

In the short to medium term, capping funding is likely to stall rather than reverse the trend towards increased higher education participation rates. The short-term forecast is for fairly stable population levels of the main higher education demographic (Figure 6). In the last years of this decade, however, and especially in the 2020s we start to see a major increase in population as the mid-2000s baby boom children reach their higher education years.

Figure 6: National population and population projections, 18 year olds



Sources: ABS (2013); (2014), series B for projections

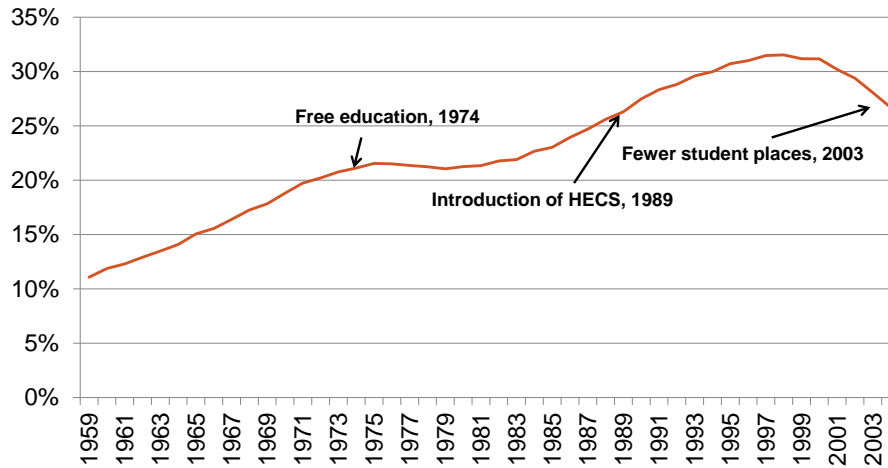
One major advantage of the demand driven system is that it can automatically adjust to population changes. In the *Review of the Demand Driven Funding System: Final Report*, David Kemp and I noted that if student places had remained at 2007 levels through to 2012 higher education participation rates for 17-24 year olds would have been 17.5 per cent, instead of the 21.4 per cent actually achieved.<sup>11</sup>

This is a key lesson of Australian higher education policy: supply needs more attention than demand. The free higher education era from 1974 is often hailed as a great period of access. In reality, Figure 7 suggests higher education attainment stalled in this period after a long period of growth. It shows lifetime higher education attainment of Australian citizens as of the 2011 census, but with the values shown against the year they turned 18. Despite the opportunities for mature age study since the 1970s, the people who reached early adulthood in that decade have much lower attainment than subsequent generations. The number of higher education places did increase in this period, but 1950s baby boom population growth meant that new places had limited impact on overall attainment rates. In the early 2000s the proportion of the population attending university declined

<sup>11</sup> Ibid., p. 33-35

as the then government moved to penalise ‘over-enrolled’ universities (universities exceeding the targets set out in the equivalent of today’s funding agreements). Attainment levels for this cohort will improve due to mature age study, but are likely to remain below what they would have been if there had been more opportunities in their immediate post-school years.

Figure 7: Lifetime higher education attainment in 2011, by the year when turned 18



Source: Data from ABS (2012)

Reductions in student places would inevitably hit low SES applicants hardest. This is because they are over-represented in applicants with weaker school results, and most universities ration scarce places according to prior academic performance. The early 2000s decline in commencing places saw low SES enrolments decline in absolute and relative terms. Correspondingly, enrolment growth since the demand driven system was introduced has disproportionately benefited low SES students.<sup>12</sup>

A freezing of the system via the funding agreements would, on the analysis in the *Review of the Demand Driven System: Final Report*, also have other negative consequences. These include less responsiveness to student demand and less scope for new courses.

In deciding whether or not to reduce Commonwealth contribution rates, Senators need to consider the government’s likely reaction. Rejection of lower rates will not end the government’s overall Budget strategy. Instead, it will just reduce the number of options they have for achieving their Budget targets. The risk is that Commonwealth Grant Scheme funding will be capped in another way, so that some students receive current subsidy levels while others pay full fees or are excluded from higher education entirely.

It is possible to separate cuts to Commonwealth contributions from fee deregulation. Maximum student contribution amounts can be increased to cover any reduction in public funding.

<sup>12</sup> Ibid., p. 37

## 5 The university/NUHEP funding rates

The *Higher Education Research Reform Amendment Bill 2014* proposes funding non-university higher education providers (NUHEPs) at 70 per cent of the university Commonwealth contribution rate (revised section 33-10). The stated rationale is that NUHEPs do not have the same research and community engagement obligations as universities.<sup>13</sup> This provision is an important policy shift, as it brings back research funding on a basis that is not performance driven, and expressly funds community engagement for the first time. However, this submission focuses on what a lower funding rate could mean for the policy goal of expanding the demand driven system to NUHEPs.

### 5.1 Effects on NUHEP entry into the market

The 70 per cent Commonwealth contribution rate is another area in which the nature of the *Higher Education and Research Reform Bill 2014* as a package is important. If the lower funding rate is introduced in conjunction with fee deregulation it is unlikely to have any major implications, although it would further tip business-focused colleges against entering the system (they would face the bureaucratic hassles and business risks of CSPs for only \$1,263 per EFTSL). If it is introduced without fee deregulation it would affect the attractiveness of the demand driven system to NUHEPs.

Grattan has collected domestic full-fee data on 267 NUHEP bachelor degree courses. We then estimated likely CSP revenues for those courses on varying assumptions, and added it to current student contributions. All figures were inflated to approximate their likely 2016 levels. The results are in Table 1. On current Commonwealth and student contributions, most NUHEP courses (167/267) would generate enough revenue to match existing full fee revenues. Many courses could be offered at lower student contribution than those in equivalent fields of education at public universities. This would support the policy goal of bringing price competition to the system (section 2).

Reducing the current Commonwealth contributions by 30 per cent would, however, nearly halve the number of courses that would generate enough revenue to match current tuition fee income. Lower base Commonwealth contribution rates would further reduce the number of courses that were at least revenue neutral. Table 1 also notes the number of courses where Commonwealth and student contribution revenue would come close to tuition fee income. The viability of a number of CSP courses currently taught in NUHEPs may also be threatened.

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

<b>Current Commonwealth contributions</b>	<b>Current Commonwealth contributions less 30%</b>	<b>NUHEP Commonwealth contribution rates in legislation</b>
167/267 courses match current fee revenues. A further 7 within \$1,000 of doing so.	87/267 courses match current fee revenue. A further 14 within \$1,000 of doing so.	76/167 courses match current fee revenue. A further 3 within \$1,000 of doing so.

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

<sup>13</sup> The obligations are derived from the Higher Education Standards Framework: DIICCS RTE (2013). The explanatory memorandum for the *Higher Education and Research Reform Bill 2014* states that the lower rates are because NUHEPs 'are not required to sustain the same kind of research or meet the same community service obligations as universities' (p. 5).

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

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

<b>Current Commonwealth contributions</b>	<b>Current Commonwealth contributions less 30%</b>	<b>NUHEP Commonwealth contribution rates in legislation</b>
30/46 courses match current fee revenues. A further 2 within \$1,000 of doing so.	21/46 courses match current fee revenues. A further 1 within \$1,000 of doing so.	17/46 courses match current fee revenue. None within \$1,000 of doing so.

Another complication is that section 36-30 of the *Higher Education and Research Reform Amendment Bill 2014* is an 'all in or all out' provision: as a condition of receiving Commonwealth Grant Scheme revenue all undergraduates need to be enrolled on a Commonwealth-supported basis. This was a recommendation of the *Review of the Demand Driven System: Final Report* to ensure that public universities and NUHEPs have consistent rules. However, it means that NUHEPs with some courses that are viable on current CSP rates and some that are not may stay out entirely.

If the Senate approves admission of NUHEPs to the demand driven system, the number that actually enter will depend on what other parts of the *Higher Education and Research Reform Amendment Bill 2014* package are passed. If fee deregulation is enacted, many providers are likely to enter. If current Commonwealth and student contributions are maintained, Tables 1 and 2 suggest that many NUHEPs will enter (the assumption of the demand driven review). However, Tables 1 and 2 suggest that a package that cuts Commonwealth contributions without increasing student contributions would substantially reduce NUHEP entry.

It follows from this that if the Senate rejects fee deregulation but endorses some or all cuts to Commonwealth contributions, it should provide compensating increases in maximum student contributions.

## 6 The student loan scheme

The Higher Education Loan Program is an increasing part of Commonwealth higher education expenditure. Even assuming that the change to real interest rates is approved by the Senate, the cost of HELP as forecast in the forward estimates will increase from 17 per cent of teaching and learning expenditure in 2013-14 to nearly 24 per cent in 2017-18. This is driven by predictions that doubtful debt will increase.<sup>14</sup>

Regardless of what Senators think about the specific HELP proposals in the *Higher Education and Research Reform Amendment Bill 2004* the cost of HELP needs attention. Some money that will be spent on HELP could be used more effectively for other aspects of higher education or used for broader savings in the Budget.

### 6.1 Doubtful debt

The Grattan Institute report *Doubtful debt: The rising cost of student loans* argues that the current practice of writing off HELP debt on death is a poor use of public funds.<sup>15</sup> This is because much of the doubtful debt is held by people who are not in financially-deprived households. Rather, the reason they earn less than the threshold for repayment is that they live with someone who is the main household income earner. For example, among partnered female graduates earning less than the threshold, 38 per cent have partners who earn more than \$100,000 a year (HILDA data). Many of the ultimate beneficiaries of the HELP write-off will be adult children of affluent households. The HELP write-off adds to their windfall gain when they inherit their parents' estate.

Doubtful debt is one reason why fee deregulation is not a costless policy for taxpayers. As average student debt increases, more former students will spend too little time earning above the threshold for repayment to pay off all their HELP debt. The cost of their study will then be incurred by taxpayers. Ending the deceased estate write-off would eventually recover some of this money.

The Grattan Institute higher education program plans further work on the relationship between HELP and deregulated fees. We want to explore carefully the various ideas that have been floated for limits on lending. It is too early to form a strong view on the specific proposals that have been made. However, as a general principle lending rules can help protect both borrowers and lenders from imprudent decisions. For this reason, the limits on HELP borrowing in the current *Higher Education Support Act 2003* should not be removed without careful consideration.

### 6.2 Real interest rates and loan fees

The real interest rate proposal has been made because there are potential large costs in carrying HELP debt. Low 10-year bond rates have kept these costs down in recent years. However, a combination of increasing student debt and higher 10-year bond rates could make annual HELP interest subsidies a significant proportion of all higher education spending. Real interest rates would cover all or most of these costs, and provide an incentive for early repayment.

However, as many people have pointed out, real interest rates substantially increase the total cost of borrowing for slower HELP repayers.<sup>16</sup> This means that it is unlikely that there will be political support for a real interest rate system for debtors who are not currently making repayments. This has turned attention back to loan fees, which in various forms have been used for many years.

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<sup>14</sup> Department of Education (2014b), p. 76

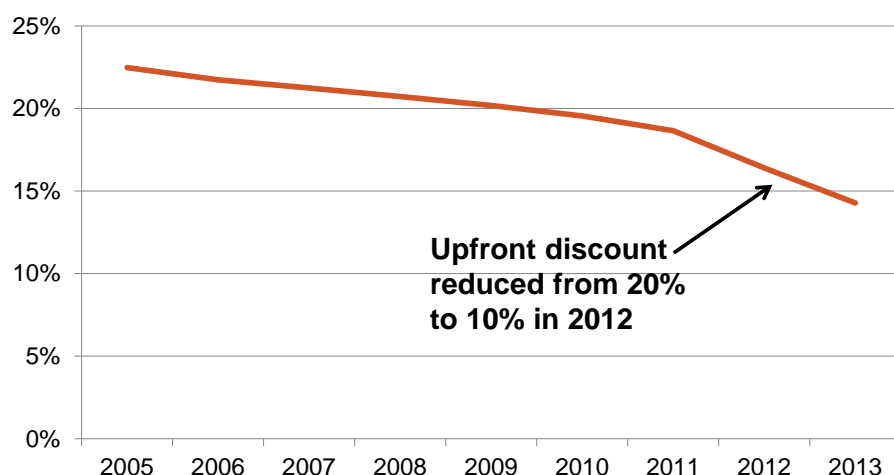
<sup>15</sup> Norton and Cherastidtham (2014)

<sup>16</sup> Chapman and Higgins (2014)



The current HELP system has untidy loan fee arrangements. For HECS-HELP borrowers, there is a loan fee of 11 per cent (expressed as a 10 per cent discount for paying upfront). This does not add to government revenue as it is paid to universities. However, it provides an incentive for students to pay upfront, removing the risk of bad debt on the loans that would otherwise be taken out. There have been declining rates of up-front payment over time, as seen in Figure 8. In 2013, 14 per cent of students paid their student contributions upfront. The increasing rate of borrowing adds to the cash outlays required to fund higher education.

Figure 8: Rate of up-front student contribution payments, 2005-2013



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

For undergraduate FEE-HELP borrowers there is a 25 per cent loan fee, which would be abolished by the *Higher Education and Research Reform Bill 2014*. This loan fee is additional revenue for government. 20 per cent of undergraduate domestic full-fee students paid up-front in 2013. This is six percentage points higher than the up-front payments of student contribution liable students. Possibly the higher FEE-HELP loan fee encourages more students to pay up-front. For postgraduate and Open Universities Australia FEE-HELP borrowers there is no loan fee. HELP provides further examples of how students are treated very differently for reasons that are unclear.

Loan fees mean that, in real terms, everyone who pays the fee incurs the same real charge in dollar terms. People who repay quickly incur higher effective interest rates than slow repayers, to the point that with some loan fees they receive no subsidies and may pay more than they would under a real interest system.<sup>17</sup> Everyone who completes their loan repayments, however, makes some contribution towards the cost of HELP lending.

Given the lack of political support for real interest rates, but the need for the total costs of HELP to be reduced, a reformed system of loan fees should be considered. All students, and not just undergraduate full-fee students, should make a contribution to the cost of their HELP loan. This would improve HELP's long-term finances and encourage up-front payment of student charges.

This would be consistent with a 'hybrid' scheme, in which HELP debtors earning more than the repayment threshold also incur real interest. This is one of the possibilities modelled by Bruce Chapman and Tim Higgins.<sup>18</sup> It would raise additional revenue and encourage early repayment from those who can afford to do so. This is the most promising option overall that preserves the original risk management and income smoothing aspects of HELP, but reduces its cost.

<sup>17</sup> Ibid., p. 7-11

<sup>18</sup> Ibid.

### 6.3 Threshold for repayment

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

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

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

Importantly, it would have increased the speed of HELP repayments across all the HELP thresholds. Especially if the real interest rate reforms are not passed, speeding up repayment is one way that interest subsidies can be reduced. It would also slightly reduce the level of HELP doubtful debt.<sup>19</sup>

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

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<sup>19</sup> Norton and Cherastidtham (2014), chapter 4

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