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Two Steps Forward, One Step Back

Dr Nelson Mixes Price Flexibility and Rigid Quotas

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EXECUTIVE SUMMARY

Commonwealth Education Minister Brendan Nelson's higher education reform package is a radical evolution in policy, preserving and even tightening many elements of the old centrally controlled system, but also creating new price signals and giving students enrolled at private higher education institutions access to a loans scheme.

- Under Dr Nelson's package, student charges in government-subsidised places would be set by the university, within limits imposed by the Commonwealth, and these would go to the university.

  This is a very important change to the current system of all HECS payments going to the Commonwealth, because it means universities will respond to price signals.

  Universities will have a financial incentive to focus on student concerns, evening up a funding system currently rigged in favour of research.

  The scope for fee increases on subsidised students will bring the total investment in higher education closer to optimal levels, though still artificially constrained by a price cap.

- Loans will be made available for full-fee paying students in public universities, meaning more students will be able to enrol in their first preference course.

  Loans will be made available for students in private universities and colleges, which should eventually create competition with the public system.

  The evidence suggests that the higher fees are affordable and will not affect access by low-income groups.

- The quota system of allocating subsidised student places will be tightened by adding discipline targets and by penalising universities enrolling more than 2% above their quota of non-full fee paying students.

  Rigid quotas are undesirable because they reduce competition and responsiveness to student demand.

  The 2% limit is impractical, because universities cannot target numbers that accurately.

Despite its flaws, the Nelson package is better than what we have now, and with some modifications it could work more smoothly than if implemented in its current form.

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The current funding system

For universities: There are 38 universities entitled to receive Commonwealth subsidies for undergraduate students, plus four other higher education providers that receive financial assistance. Entitlement is a political decision, and not based on objective criteria. Institutions within the subsidy system receive funding from the Commonwealth for set numbers of Australian HECS-liable (Higher Education Contribution Scheme) undergraduate students. Though historically this funding was based on nominal costs per student in each discipline, it is now effectively an average subsidy with no relationship to actual costs. Universities cannot receive any money from HECS-liable students for tuition, but they can charge for non-academic services, commonly known as the union or amenities fee. If universities enrol less than their quota number of HECS-liable students they can be penalised; if they enrol more they receive about $2,700 each. This is less than 25% of average funding. The total number of places funded is less than total demand from eligible applicants, creating 'unmet demand'. Since 1998, universities have been able to offer full-fee paying places to Australian undergraduates when they have filled all their HECS-liable places. Such students may not exceed 25% of domestic enrolments in any course. However, there are no limits on the number of overseas students.

For students: Since 1989 Australian undergraduates have had to pay part of their education costs under HECS, and most have always paid a union or amenities fee. Current HECS charges range from $3,680 to $6,136 a year, depending on degree, and amenities fees range from $100 to $559, depending on university and enrolment status. HECS charges are set by the government and go to the government. Students can pay up-front and get a 25% discount; about one in five take this option. All the others defer payment, and their debt is indexed to inflation. They must begin repaying when their earnings reach $24,635 per annum, paying at that point 3% of their total income. Repayment rates reach 6% of income for those earning $43,859 or more. Undergraduates taking full-fee positions receive no loans from the Commonwealth. However, postgraduates taking full-fee positions can get a loan under the Postgraduate Education Loans Scheme, known as PELS. PELS debts are merged into HECS debts, and indexed to inflation.

Dr Nelson's proposed funding system

For universities: The number of public universities would remain a matter for government, but other accredited higher education institutions could access a student loan scheme. All institutions must comply with quality tests. The number of students in non full-fee places (HECS-HELP students) is more strictly controlled than before. The government will 'negotiate' a discipline mix with each public university, and set a target total number of students. For HECS-HELP students, the government will pay universities a subsidy per student based on discipline. Regional campuses will receive additional subsidies, as will universities which meet governance, productivity, and teaching quality criteria. The university can then charge a fee in excess of whatever subsidies they receive, ranging from $0 to 30% above existing HECS levels. The university will receive this money, either directly from the student or via the government, which will pay on behalf of the student, with the money to be recovered through the tax system. However, universities will no longer be able to charge compulsory fees for costs 'not directly related to course provision'.

If universities exceed their quota number of students by more than 2% they will be penalised instead of receiving $2,700 each. However, once universities meet their target number of HECS-HELP students, they can enrol full-fee paying (FEES-HELP) Australian undergraduates. The numerical limit on these students will be extended from 25% of all domestic enrolments to 50%. Fees for these students will be set by the market, but a $50,000 loan ceiling may serve as a de facto price cap. As before, there will be no upper limit on numbers or fees for overseas universities.

For students: Students will pay a fee set by the university. In the case of students within the university's HECS-HELP quota, they will benefit financially from a subsidy of between $1,509 and $16,934, based on discipline. However, most students can benefit from subsidies for only five academic years in a new 'learning entitlement' restriction. HECS-HELP places also have a price cap of 30% higher then existing HECS levels. In courses with high subsidies, prices may go down at some universities. Given cost pressures on universities, average fees will almost certainly be higher. The new restriction on non-course related charges could reduce costs, but also services. Students who pay tuition fees up-front will get a discount of 20%. Students who defer and take out a loan from the Commonwealth will effectively pay a surcharge of 25%, plus their debt will be indexed to inflation, as happens now.

The strict quotas mean that the number of HECS-HELP places may be lower than the number of HECS places currently available. However, the number of full-fee places available under FEES-HELP will increase to a maximum of 50% of domestic students in the course. The PELS scheme will be abolished, and all Australian full-fee students will be able to borrow up to $50,000 through FEES-HELP. At least for courses with total fees below $50,000, this should mean that more students are able to enrol in their first preference course. Students or graduates with FEES-HELP debts will have their debts indexed to inflation, and will be charged 3.5% interest for ten years. The income threshold at which both HECS-HELP and FEES-HELP debtors must start repaying 3% of their income will be lifted to $30,000. However, new levies of 6.5% to 8% of income will be imposed on students or graduates earning over $52,658.

Introduction

Dr Brendan Nelson's higher education reform package, *Our Universities: Backing Australia's Future*, proposes a radical evolution rather than a revolution in policy. It continues the trend to user-pays at public universities that began with HECS in 1989, but who the user pays changes from the Commonwealth to the university. It retains loans schemes for student charges, but extends them to all fee-paying students, irrespective of whether they attend a public or a private university. It still allocates most student places by quota, but gives the Commonwealth more control over which courses are offered where. It preserves a Commonwealth tradition of micromanagement, but changes its emphasis with several new programmes. The continuities are less newsworthy than the changes, but just as important to the way universities will run—if the reforms make it through the Senate.

These continuities mean that the socialist core of the old system, central control of resource allocation, survives. I discuss in detail the most important element of this central control, the quota system, and also a prescriptive incentive scheme, the Learning and Teaching Performance Fund. While less important, a raft of other schemes contribute to pervasive Commonwealth meddling in university management. The Commonwealth wants to change university governance, and so makes funding conditional on that. It wants the universities to offer their staff individual contracts, and so ties money to that goal as well. It wants to affect the way universities pursue equity, and so proposes a revised Higher Education Equity Programme plus two new scholarship schemes. It doesn't like student unions, and so plans to prohibit universities collecting compulsory fees that are non-course related. The new policies on fees and loans are a significant improvement, as I explain immediately below, but these are important additions to a centrally engineered system, not its replacement.

A new fee regime

HECS goes from being a tax to an investment

As when HECS and differential HECS were announced, Dr Nelson's plan to let universities charge up to 30% more than current HECS levels has been met with protest. Whatever other criticisms could be directed against earlier protests, they were consistent with students' rational self-interest. HECS is less the price of a degree than a special tax levied on people who have been to university. Unlike prices in a market, HECS charges don't transmit information or provide incentives to producers. The charges are simply revenue to government. Without a link between HECS charges and what is spent on the student, paying more for the same service isn't a good deal for students (though it has been for other taxpayers).

Protests against Nelson's proposal reflect beliefs about university charges that make sense under the current system, but not what would replace it. *Our Universities: Backing Australia's Future* would see the Commonwealth paying a subsidy per student based on discipline, ranging from $1,509 a year for law to $16,394 for agriculture, and the universities then charging an amount between $0 and a 30% premium on existing HECS levels. In practice, this means maximum prices for students in subsidised places of between $5,010 and $8,355, depending on course. As with the current HECS system, students could borrow this money and repay it through the tax system. The scheme is going to be called HECS-HELP. The crucial difference between HECS-HELP and old HECS isn't the potentially higher charges. It is that the money goes to the university, not the government.

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University setting and receiving fees can benefit students. Under the current system, what fixes the amount spent on students is not educational need or preference. Rather, it is the Commonwealth's overall budgetary situation, plus whatever cross-subsidies universities can afford. For fiscal policy reasons, Commonwealth subsidies to universities have risen less quickly than universities' costs. Since universities have no ability to charge their HECS-liable students, and staff are by far their largest expense, they had no choice but to increase student:staff ratios. Surveys of student satisfaction indicate more time needs to be spent on students and their work, but current policies stretch scarce staff time over ever larger numbers of students. Since 1993, the average number of students per staff member has gone from 14.3 to 21. The ratios are much worse in some universities.[1]

Letting universities set fees means that cost-cutting need not win every cost-cutting/quality trade-off. If the Nelson package is implemented, some universities will be able to halt or reverse the rise in student:staff ratios, or do other things to improve the learning experience. Others are likely to stay at the low cost end of the market. Students will have a choice; pay more for a better service, or make do with less. There are many indications that people are willing to pay to get the educational services they want. Nearly 40% of Year 12 students attend private schools, because there was some aspect of the cheaper government service they did not like. Within the current HECS system, there is strong demand for courses with high charges, like law and medicine. In the already deregulated postgraduate coursework market we are seeing wide variations in what universities offer, and similarly wide variations in prices. It is highly unlikely that, uniquely among educational services, undergraduate students really want the one-size-fits-all within disciplines and between universities model we have now.

Since price caps artificially constrain spending, the 30% above HECS limit is not ideal for students and universities wanting to improve quality significantly. Some of this 30% is necessary just to maintain the status quo for the next few years, as the powerful National Tertiary Education Union (NTEU) extracts pay rises in new enterprise agreements with the universities. This reduces scope for the things that a more flexible pricing system might offer, such as much smaller classes, employing better teaching staff, or significantly improved infrastructure. Yet some scope for improvement is better than no scope, and HECS-HELP establishes the important principle that undergraduate students are entitled to invest in their own education.

Full-fee paying made easier

Dr Nelson plans to increase the number of Australian full-fee paying students in public universities. Under his package, universities could increase supply, from 25% of their Australian undergraduates in each course to 50%. Theoretically, universities could take one Australian full-fee paying student for every one subsidised student and maintain the 50% ratio. The Commonwealth would encourage demand by letting full-fee paying students take out Commonwealth loans of up to $50,000, with an interest rate of 3.5% plus inflation indexation payable for ten years, and just inflation indexation after ten years. As with HECS-HELP, students could repay this money through the tax system. This scheme will be called FEES-HELP.

FEES-HELP is needed in the public university system as a policy patch-up on the quota system which the Commonwealth plans to retain and tighten.

FEES-HELP is needed in the public university system as a policy patch-up on the quota system which the Commonwealth plans to retain and tighten. Under the quota system, each university is given a set number of 'fully funded' student places.* This means that the number of subsidised places can be below both student demand and the university's willingness to supply. As a result, students miss out on their first preference course, and the universities miss out on added revenue. Victorian data suggests that only 30% of university applicants receive an offer from their first preference course and university, with another 14% receiving an offer on their second preference.[2] Since the most popular universities cannot expand indefinitely to meet demand, these figures cannot be blamed just on the quota system. They do, however, indicate the scale of potential demand.

With unknown variables on both the supply and demand sides, predicting FEES-HELP's impact is difficult. On the supply side, there are physical constraints on how many additional places universities can offer. In theory, the policy allows for around 400,000 new places (because if there were 800,000 places, the around 400,000 FEES-HELP places would be 50% of the total). There are simply not enough staff to teach them, or classrooms to put them in. It could be possible in some courses, but not the system as a whole. Even existing capacity won't necessarily be offered to full-fee paying Australian students. If the $50,000 loan ceiling acts as a de facto price cap for some universities, full fee-paying overseas students who are willing to pay above that amount will be more financially attractive than local students.

Demand is constrained by the pool of possible university applicants. The number of prospective students who missed out in 2003 was between 18,700 and 25,700.[3] The existing pool of subsidised places needs to expand by around 6% to fully absorb this group, well short of the 100% possible expansion. Population growth and improved school retention will increase the number of school leavers, and so demand in the short and

*'Fully funded' is the Commonwealth's term. In reality, the subsidies are based on costings completed well over a decade ago, and inadequately indexed since a decision of the then Keating government in 1995. Hence the skeptical quotation marks around 'fully funded'. The universities have remained solvent only by recruiting large numbers of full-fee paying overseas students and increasing student:staff ratios.

medium term will increase among the largest single source of university students. Yet even assuming these people will pay any price to attend university, there are nowhere near enough of them to fill all the theoretically available places. As with supply, demand can increase rapidly only in niche areas.

The actual effect of higher prices on demand can only be guessed at. The Industry Commission calculates good rates of return on some courses even with full fees,[4] so subsidies are not necessarily essential to make studying economically viable. The issue is less affordability in absolute terms than the relative benefits of the full-fee course compared to the alternatives. We know that students' interests are highly influential in course selection.[5] For students whose first and second (or lower) preferences are close substitutes, such as the same course at similar universities, demand for a higher-priced first preference course is likely to be low (unless the price difference is small, which is a possibility as HECS-HELP charges rise). The key market is students who are not offered a subsidised place in anything like their first preference. Universities could only guess at what proportion of people who miss out on their first preference fall into this category, and how sensitive they will be to price.

The $50,000 loan limit will reduce demand for courses costing, or likely to cost, more than that amount. Law or veterinary science at the University of Melbourne, for example, already cost over $50,000 for the full degree. Even very expensive degrees may have good rates of return, so the issue is not that the high cost makes them uneconomic. Rather, for students without the ability to pay up-front, the difference between $50,000 and the course cost means the loan cap is an absolute barrier to enrolment. System-wide the number of courses caught by this fee cap is likely to be relatively small, but it will reduce demand for degrees in high-cost disciplines.

The $50,000 loan limit, with no clear relationship to course costs or ability to repay, seems arbitrary.

The $50,000 loan cap will clearly be a problem for both students and universities. There is a policy rationale for some limit on borrowing. Taxpayers should not endlessly sustain students enroling in successive degrees without any intention of working and paying back the loan. But the $50,000 limit, with no clear relationship to course costs or ability to repay, seems arbitrary. The week after the package's release Dr Nelson contemplated relaxing this limit, which is encouraging. A possible alternative constraint would mirror an innovation in HECS-HELP, which is to create a five year learning entitlement, letting students receive loans for five years before having to pay without loan assistance (with exceptions for longer courses). This would ease the restraint on undergraduate investment, while not offering open-ended underwriting of endless study.

Private higher education

Nelson's reforms would bring private universities and colleges into the funding system by extending Commonwealth loans to their undergraduates on the same terms as full-fee paying students at public universities. The Australian Democrats criticised this for undermining the differences between public universities and private colleges.[6] However, there is no clear public-private split to undermine. The Australian Catholic University (ACU) is nominally private, but more dependent on public funds than public universities. For no reason except a quirk of history, ACU's Western Australian counterpart, the University of Notre Dame, was excluded from public funding, though the Howard government has slowly extended publicly funded student places to them. In legislation passed last year, a number of private institutions were given access to PELS, the postgraduate student loans scheme, but those institutions' undergraduates still had to pay up-front fees, despite being less likely than postgraduates to be able to afford fees without loans. Consistent access to a loans scheme would end these absurd anomalies.

By removing anomalies, new opportunities for private entrepreneurial activity in higher education would be created. While these private institutions will mostly charge full fees, the fact that the existing public universities, and many small private higher education institutions, already do so without loans suggests that demand is there. Without the necessity to raise money to pay up-front, as students in this market must now do, their numbers are likely to grow. In time, the private higher education industry may expand beyond the mostly niche forms of education it now offers, and move, like the private Bond University, to offer higher quality versions of the traditional academic programmes of the public university. This will allow more students to choose degrees suited to their abilities and aspirations, and provide much needed competition for the public universities.

The real interest rate

With inflation of 2.5% a year, full-fee paying students would pay 6% interest on their Commonwealth loans for the first ten years, and 2.5% after that. The Australian Vice-Chancellors' Committee (AVCC) opposes the real interest rate, preferring the existing postgraduate loans scheme, PELS, which indexes to inflation. It says using PELS as the basis of loans for fee-payers would show long-term policy consistency.[7]

However, it is PELS, not the real interest rate, that departs from long-term consistency. Since HECS began, there has been some kind of debt charge for student loans. At present, students get a 25% 'discount' for paying HECS up-front (it was 15% in 1989, and will be reduced to 20% under the Nelson reforms). Of course, this is another way of saying that students who defer HECS pay a 33% surcharge for not paying up-front. Take for example a course that costs $6,000. A 25% 'discount' brings the price down to $4,500, which is effectively the real price. To defer, students pay one-third of $4,500, or $1,500, as a debt charge. On top of this, the debt is indexed to inflation. The 3.5% real rate of interest is novel only in its form, being a debt charge levied after the debt is incurred rather than simultaneously. Whether the 3.5% real interest rate or the surcharge plus inflation indexation is cheaper for the student depends on how quickly the debt is repaid. One financial adviser calculated that on a $5,000 a year degree a student paying off within six years was better off paying 6.5% interest than the surcharge.[8]

Debt charges, whether surcharges or interest rates, recognise that lending students money is an expense, just as much as direct subsidies to universities are an expense. There is the interest the Commonwealth is paying on its outstanding debt, which it could otherwise reduce if it was not lending money to students, and there is the money written off in bad debts, and some administrative costs in managing the scheme.

The PELS scheme that the AVCC wants to preserve is even more expensive than this. People with PELS debts are eligible for an incentive scheme encouraging HECS debtors to repay their debt more quickly. These debtors get a 'bonus' of 15% (to be reduced to 10% under the Nelson package) on each early payment. Take a hypothetical postgraduate student who does not need a loan enrolling in a course with a fee of $10,000. That student could take out a PELS loan and then, shortly before it was due to be indexed, repay just under $8,700, with the rest of the debt wiped out with the 15% 'bonus'. Effectively, the Commonwealth would end up paying $1,300 for a course that is supposed to be full-fee paying. One Dean of a business school is reported to have said that any student not taking out a PELS loan should be failed automatically for not taking advantage of such a good deal. With a shopping list of other spending suggestions, the AVCC should not be promoting subsidies for students who do not need them.

The current problem is not so much that low-income prospective students cannot afford a place. It is that nobody will sell them one.

What about low-income students?

People from low-income backgrounds are the socioeconomic group least likely to go on to university. Gough Whitlam's abolition of fees from 1974 was designed to make university more accessible for this group, and every subsequent increase has been opposed on the grounds that it will make university less accessible. While this argument has an intuitive plausibility, the evidence does not support it. When university charges are combined with income-contingent loans, as with HECS, there is no discernible negative effect on participation rates.

The misleading way low-income group university participation is often reported obscures its long-term rise. The statistic usually heard is low-income background students* as a proportion of the total student population. The trouble with this statistic is that provided middle class numbers at university grow more quickly than low socio-economic numbers the latter will 'drop'. This is what happened over the last decade. The *proportion* of low-income background students fell slightly from 14.7% in 1991 to 14.5% in 2002, despite their *absolute* numbers increasing from 74,309 to 97,156.[9]

Isolating the effect of fees on low-income group demand—if any—is difficult. Actual enrolment patterns are not a definitive guide, because in our supply-constrained system there are too few places to go around. At the margins, the current problem is not so much that low-income prospective students cannot afford a place. It is that nobody will sell

* 'Background' is used here, because this data series is based on postcode analysis. It contains no information on actual socio-economic status.

them one. This means that we need to use applications data, which signals interest in, and presumably willingness to pay for, university education.

Taking Victoria as an example, in 2003 the number of university applicants with grades in the top 20% *exceeded* the number of Year 12 students with that score in the previous year.[10] This is possible because total applicants include some who did not do Year 12 in Victoria the previous year. As some top 20% students presumably prefer TAFE or immediate workforce entry and so never apply for university, these figures strongly suggest that nearly everyone likely to do well at university and wanting to go eventually applies to attend—irrespective of background. To put it another way, there is no evidence of any widespread aversion to current charges or debt levels.

Opponents of the Nelson reforms need to show why this might change in future. Our experience since HECS was introduced shows that prospective university students from low-income groups are perfectly capable of working out what is in their own long-term interest. They understand that the benefits of a degree exceed the costs. Nelson's opponents expect us to believe that a maximum of $2,000 extra a year for HECS-HELP places will make a difference to this cost-benefit calculation, but this is implausible. The brighter students at least are still likely to be hundreds of thousands of dollars better off over their lifetimes.

Weak Year 12 results

More complex issues arise for students with weaker Year 12 results. Around 90% of the Victorian university applicants who missed out for 2003 had Year 12 scores below 70, and I expect other states see similar patterns. The issues are complex because the 'more students the better' philosophy assumed by most (including, I admit, myself at earlier times) seems based on an over-extrapolation from the success of earlier, brighter, and smaller groups of students. Students with lower scores have a greater risk of not completing their degrees, potentially leaving them with little to show for their effort.[11] We also see that about 20% of graduates are working in jobs that do not require degrees.[12] We don't know whether these are graduates who had weaker school results (though it is plausible to think they may be over-represented), and we don't know the mix between graduates permanently and temporarily doing less skilled work. But these are worrying signs for those believing in an expanded higher education system.

It is important to understand that we'd have cause for concern even if the students concerned pay no fees at all (as they won't, if their incomes stay below the suggested $30,000 annual income threshold for repayment of HECS debt). Even after the Nelson reforms, the major cost for most people attending university won't be the fees charged, it will be the income lost from not working full-time, and delaying the accumulation of work experience. That average fees will be higher under the Nelson package, though, increases the risk that people who drop out before completing, or complete but work in low skill jobs, could end up with low, no, or negative returns on their investment. Whatever happens to fee increases in the Senate, we need more research into what's happening to weaker students proceeding to university, better advice given to them before starting study, and teaching staff better trained to deal with students needing more help than the traditional, academic high achiever, student.[13]

Teaching quality

A history of protected mediocrity

Though Australia's universities have always had some brilliant teachers, overall their teaching performance has been very patchy. When nationwide surveys of completing students started a decade ago, universities were rightly embarrassed by the results. Students were most likely to regard their teachers as mediocre or poor. Though teaching survey trends have been positive since the mid-1990s, they are still unimpressive. Of the six questions completing students are asked about teaching, none achieve more than a 50% clearly positive response. In 2001, the results ranged from 33% agreeing with the proposition that 'the staff put a lot of time into commenting on my work, to 50% agreeing that 'the staff worked hard to make their subjects interesting'.[14]

While some blame funding shortfalls for student dissatisfaction, money cannot more than partly explain what is going on. Otherwise, recent funding pressures should have

When nationwide surveys of completing students started a decade ago, universities were rightly embarrassed by the results.

made student satisfaction decline, not improve. The underlying cause of student dissatisfaction is that the higher education incentive structure is rigged against teaching. In other service markets the pricing system creates incentives for quality, but it is absent from the HECS system. Beyond a non-academic service fee, there is no financial relationship between universities and HECS-liable students. The amount government pays the universities per student is the same, whether teaching performance is poor, mediocre or good. Since poor or mediocre teaching is cheap to provide, the financial incentive is to offer just that.

Fee paying overseas students' opinions about teaching performance matter in a way that HECS students' opinions do not.

Compounding the problem, the government allocates student places to universities not on demand, or performance, or anything else that might take students' interests into account. Rather, the main reason a university gets the number of places it does is that this is how many places it received last year. Making a bad situation worse, the total number of subsidised places the government makes available is less than demand. So if a prospective student wants to go to university, he or she will eventually have to take whatever is offered. Just to completely crush any incentive universities had to focus on undergraduates, the government does fund research, the other main activity of universities, on performance. It is a system designed to produce second-rate teaching, and it just does that.

This leaves unexplained the upward trend in survey results since the mid-1990s. The trend coincides with large increases in the numbers of fee-paying students, principally from overseas. The universities are financially dependent on these students. I believe there is a link between universities' financial dependence on fee-payers and improved teaching. With word-of-mouth important in overseas students' decisions about where to study, their opinions about teaching performance matter in a way that HECS students' opinions do not. Putting the entire student body up for competition between universities would do much to focus minds on teaching quality.

The immediate effect of Dr Nelson's package will be increase competition with one hand and reduce it with the other. It will increase because price flexibility can reward universities for quality services, and they will compete on that basis for students willing to pay higher fees. That balances the financial incentive to focus on research. However, competition to fill all student places may be weakened, because through 'negotiations' with universities the Commonwealth wants to impose stricter whole-of-institution student number targets, plus new discipline student number targets as well.

An impractical quota

Though universities currently have student quotas, these are not rigorously enforced. To the contrary, since the Howard government came to power a $2,700 per student payment for students enrolled above that quota, the so-called 'over-enrolments', has encouraged quota busting. In most years, over-enrolments are equivalent to adding a reasonably large university to the system. Under the Nelson package, almost all existing over-enrolments will be converted into places subsidised according to discipline, with universities free to add their own charges within Commonwealth limits.

In future universities will be penalised, not rewarded, for exceeding their quota by more than 2%. They will have to pay the highest HECS rate they charge ($8,355 for those charging the maximum) to the Commonwealth, plus incur the actual costs of educating the over-enrolled student. As 'excess' students may pay less than this amount to the university, if they are enrolled in cheaper courses, exceeding the 2% margin could turn into a costly mistake. Avoiding this expense will require big changes from current practice, as over-enrolling is the norm. I examined the last three years of over-enrolments. In 2000, 80% of universities exceeded their undergraduate quota by 2% or more, in 2001 it was nearly 90%, and in 2002 it reached 100%.[15]

As a general principle universities should not enrol more students than they can financially support. That some universities are over-enrolled by large margins—in 2002 five of them were 15% or more above their funded number—suggests that average spending per student at those institutions must be low. So there is some case for bringing them back toward manageable numbers. Yet the penalties for exceeding the target number by more than 2% make little sense. If universities just kept their fee, and went without the Commonwealth subsidies for students classified as HECS-HELP, they would receive much more than the current $2,700 each. Add to this additional fee revenue from within-quota students and from full-fee payers, and average income per student would be much higher than it is today. The package improves the financial capacity for over-enrolment, but then wipes it out by regulation.

Even if the 2% limit was desirable, it is based on an excessively optimistic view of how precisely universities can control their numbers. There are two important variables affecting numbers, the proportion of offers university applicants accept, and the proportion of students leaving without completing. Neither can be more than partially controlled by the universities.

The Victorian Tertiary Admissions Centre publishes data on the percentage of offers resulting in enrolment. Overall, in 2002 just under 70% of offers were converted into enrolments. This was up from just under 69% in 2001. A drop in the total number of offers may have increased acceptance rates, but other factors the universities cannot control, such as job opportunities for school leavers, may also have an effect. While the aggregate acceptance rate changed only slightly, individual universities experienced much larger variations. RMIT University's acceptance rate went up by 7.4%, despite its number of offers also increasing. Victoria University had a similar experience.[16] Unexpectedly high acceptance rates could send universities over their 2% margin, despite offer numbers that seem prudent based on historical acceptance rates.

Not every student who accepts a university place completes his or her degree. This means that to target their total student numbers accurately, universities must estimate what proportion will leave early. The proportion leaving early is quite high, 22% or 23% each year (not all of these are drop-outs, as some enroll elsewhere or return to study at a later date). Over the period 1992-1999, an average of 14 universities a year had their proportions leaving early vary by 2% or more on the previous year.[17] Given the modest year to year changes in university practices, it is likely that much of this fluctuation is due to matters beyond universities' control. So a university which got its offer-acceptance ratio right could still estimate a non-completion rate that turns out to be too high, leaving them more than 2% above their target by the end of the year (alternatively, it could create perverse incentives to cull numbers). Universities which guess both numbers incorrectly could end up seriously out-of-pocket.

Negative effects on competition

When universities plan to offer FEES-HELP places, they must first fill all their HECS-HELP places in the relevant courses. This means hitting or exceeding their HECS-HELP target. However, in courses which are unlikely to attract FEES-HELP students, the cheaper enrolment mistake to make would be under-enrolment. While persistent under-enrolment will result in a loss of student places, the short-term penalty will be loss of the subsidy plus whatever fees a student might have paid, less the saving from not enrolling the student. At least the university would not have to pay to the Commonwealth revenue it may not have received. The sensible thing for universities to do with HECS-HELP only courses would be to aim for less than their target number, perhaps the -2% after which they might lose places, leaving a margin for enrolment error of 4%.

Unfortunately, what protects universities won't protect students. To the extent universities meet their targets or under-enrol, fewer student places will be on offer. This is particularly bad news for the prospective students who miss out, but not good news for those who successfully win a place either. By effectively penalising universities for being attractive to students, this policy undermines competition between universities for students and weakens the incentive to focus on student concerns. Regrettably, the more rigid quota system is working against the improved incentives from the more flexible price system.

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These anti-competitive effects will be exacerbated by attempts to target by discipline as well. Under the current system universities must meet aggregate number quotas, but can shift student places between disciplines with their quota. This provides limited capacity to build up some faculties, perhaps in competition with other universities. With quotas by discipline as well, this scope for competition and for responding to shifts in student demand will diminish. The added central planning in the Nelson package will help make university classrooms safer places for mediocre teachers.

Unsatisfactory explanations

In the package there are two justifications given for tougher quotas, neither of which are convincing. Targeting by discipline is ostensibly to 'ensure that universities provide the courses and the numbers of graduates that are needed by the nation'.[18] As there are actual or forecast shortages of graduates in only a handful of disciplines, it is hard to see why *every* discipline needs targets. If universities shuffle some places between law, arts, commerce, and science it makes no difference to the nation's needs, but helps meet shifts in student demand. Nor is a give-them-no-other-choice strategy, cutting off other higher education opportunities through quotas, likely to produce a sustained supply of motivated graduates. Increased dropping out, whether during the course or in the first few years of work, is the more likely outcome.

If particular disciplines need their numbers boosted, it should be done through marketing and incentives, not deprivation of choice. Fortunately, the government has this part of the package partly right, and for nursing and teaching it intends offering incentives to the universities through subsidies and to the students through prices. Since the government already has, in these incentives, the policy mechanisms needed to achieve its national needs goals, targeting by discipline seems redundant.

The government justifies institutional quotas by saying that 'the Commonwealth is not prepared to countenance outcomes that would result in significant changes in institutional enrolment patterns, which may particularly affect smaller and regional universities'.[19] This statement perfectly reflects the historic culture of the university system. The interests of students count for less than the interests of institutions. The continued existence of smaller and regional universities, no matter how out-of-date or badly taught their courses might be, is the over-riding priority.

In reality, abandoning the quota system is unlikely to cause rapid rural-urban shifts in enrolment patterns. Unlike urban universities, rural campuses benefit from local monopolies, enrolling the many students reluctant to move for study. While course preference lists of city university applicants usually show several versions of the same course at different universities, rural university applicants are more likely to put different courses at the same university. For these rural students, location is more important than vocation. Rural students wanting to study in the city are constrained by their relatively poor school results. In Victoria in 2000 the median Year 12 score for regional students was 67.45, compared to 81.55 in the affluent areas of Melbourne.[20] In addition to this semi-captive market, under the Nelson package rural universities will be allowed to compete on price, a capacity they currently lack.

As with the argument that discipline quotas are needed to meet national needs, the rural quota argument is made redundant by other parts of the package. The government is promising regional campuses subsidy premiums ranging from 2.5% to 30%, depending on size and distance, increasing their ability to compete on price, and giving them more financial capacity to deal with any loss of students. Adding two new advantages, subsidies and prices, to regional universities' natural protection ought to be more than enough to prevent 'significant changes in institutional enrolment patterns'.

The quota system could cost the regional universities a lot, and all for a protection they do not need.

For regional universities, the unasked for quota protection (they had already signed up for more enrolment flexibility through the AVCC) is worse than redundant. It is likely to be positively harmful. As it is, a couple of them are chronic major over-enrollers, and risk having to scale back their enrolments significantly. For those two institutions, the new rigid quotas will cause rather than prevent the 'significant change in institutional enrolment patterns'. The rest of them face similar uncertainties to the urban universities in managing their numbers. In at least some years, they would end up paying the Commonwealth's over-enrolment penalties because they made a wrong estimate of their acceptance or attrition rates. In no year would they be able to exploit fully the potential price advantages the Nelson reforms could give them. The quota system could cost the regional universities a lot, and all for a protection they do not need.

A bureaucratic incentive

Though tightening quotas reduces incentives to focus on teaching, the Nelson package offers a countervailing bureaucratic incentive to improve teaching, a Learning and Teaching Performance Fund. Its proposed budget is $54.7 million in 2006, rising to $83.8 million in 2007. To get the money, universities will need a learning and teaching strategy, evidence of systematic support for the professional development of teaching staff, student evaluation of teaching, and promotion practices that must include effectiveness as a teacher.

Within a system of bureaucratic incentives, this balances the existing research inducements. The trouble with any bureaucratic scheme like this, though, is that everyone focuses on the indicators that lead to dollars, whether or not this is the best use of resources for the institution or its students. The research funding scheme, for example, rewards 'publications'. So we now have a culture within academia of 'publish or perish', with academics writing book and articles regardless of whether they have anything important to say, or there is anybody who wants to read what they write.

The indicators suggested for evaluating the success of a learning and teaching strategy include 'student progress', which is the percentage of subjects passed, and 'graduate employment outcomes', which is graduate employment rates and starting salaries. Both these things are obviously important, and I am all for information about them being readily available. As performance indicators on which government dollars depend, though, they are unlikely to be reliable. The easiest way to improve student progress rates isn't to improve teaching, it is to lower the academic standard required for passing. At least in the short term, graduate labour market outcomes have more to do with general and local economic conditions than they do with whatever the universities are doing. They also bias the funding system against disciplines that don't lead directly to well-paid jobs. Students should be told about their likely employment outcomes, but provided their choice of course is well-informed Canberra should not try to interfere.

No Commonwealth set of indicators is ever going to satisfy the diverse demands on and expectations of the university sector. In fostering one potentially good attribute, they smother others. Market systems, by contrast, let niche markets form and let producers vary their strategies as required, rather than being forced to match someone else's idea of what's best. Abolishing Commonwealth controls on prices and places would create vastly larger and more flexible financial incentives than the Learning and Teaching Performance Fund.

For all the flaws in the Nelson package, it is better than the available alternatives, the status quo or the ALP.

Conclusion

Though *Our Universities: Backing Australia's Future* lessens the Commonwealth's control over prices, on a socialism-market spectrum it is still closer to the socialist end. The Commonwealth is not content to be a facilitator, helping with subsidies, loans and information but letting universities and students make the key decisions about what to study, where to study, and how much to spend. Through its rigid quotas, its price and loan caps, and a raft of micromanagement programmes it still wants to control all or influence all these things. Dr Nelson has said in jest that the Secretary of his Department is a Commissar running a Politburo. This is one joke about the university system he'll be able to use for a long time yet.

What the government acknowledges at the level of general principle it seems unable to implement in policy. On page seven of *Our Universities: Backing Australia's Future* we are told that pressures on universities are exacerbated by 'excessive and restrictive regulatory and reporting demands' and that 'heavily centralised Commonwealth bureaucratic arrangements have produced a sector that is not maximising its potential'. It is odd, then, that in most of the next forty pages this analysis is forgotten, and is replaced with a proposal for escalating bureaucracy. The flexibility on fees takes us two steps forward, but we take one step back again with increased central control of almost everything else.

While I don't believe that central planning can ever replicate the information flows and incentive structures of a market, I am prepared to believe that there is better and worse central planning. Some aspects of the package, such as extra assistance for nursing and teaching, or extra money for rural campuses, address real policy or political problems. The penalty for exceeding quotas by more than 2%, by contrast, doesn't achieve any identifiable policy or political goal. It won't save the government money, it will give them increased political problems as unmet demand rises, it will hurt rather than protect rural campuses, and it will take 'excessive and restrictive regulatory and reporting demands' to new levels. It suggests that Dr Nelson's Department lacks what every central planner must have, which is a detailed working knowledge of whatever they are regulating. At absolute minimum, the 2% must be increased to between 5% and 10%.

Yet for all the flaws of what we are now offered in the Nelson package, it is better than the available alternatives, the status quo or the ALP. The status quo offers too little money and incentives heavily biased against teaching, while the Nelson package goes some way toward correcting both. The ALP plans to outline a policy in the coming weeks. The signs, however, are not encouraging. Labor offered higher education small sums in the 1998 and 2001 elections. They continually attack university fees. Without that private money, and with serious constraints on public money, it is hard to see how they could match what the Coalition has on offer. Even if they come up with more public money than the government, without using market mechanisms they are not going to be able to target it effectively, or to change universities' incentive structures. At this stage, the status quo and the ALP are just variations on each other, and no solution at all. With a few modifications the Nelson package will begin the long overdue structural reform of Australian higher education.

Endnotes

1 Figures from the Australian Vice-Chancellors' Committee, http://www.avcc.edu.au/policies_activities/resource_analysis/key_stats/index.htm

2 See Victorian Tertiary Admissions Centre Annual Reports 2001 and 2002, Section E, available www.vtac.edu.au. My calculations.

3 Australian Vice-Chancellors' Committee, *Survey of Applicants for Undergraduate Higher Education Courses, 2003*, Available: http://www.avcc.edu.au/policies_activities/resource_analysis/key_stats/Survey_Apps_HigherEd.htm

4 Industry Commission, *Submission to the Review of Higher Education Financing and Policy*, (Canberra: Industry Commission, 1997), p.101.

5 Andrew Norton, *The Unchained University* (Sydney: CIS, 2002), esp. pp.78-82.

6 Natasha Stott Despoja, 'Our Universities: Hacking Australia's Future', press release 14 May 2003.

7 Australian Vice-Chancellors' Committee, *Excellence and Equity: Foundations for the Future of Australia's Universities*, issued 2 June 2003, available www.avcc.edu.au, p.19.

8 Kevin Bailey, 'A crash course in high finance', *Herald-Sun*, 24 May 2003, p.111.

9 Brendan Nelson, *Higher Education Report for the 2003 to 2005 Triennium*, (Canberra: DEST, 2003), p.19.

10 AVCC, *Survey of Applicants for Undergraduate Higher Education Courses, 2003*, Table A1.

11 Mark Urban et al., *Completions: Undergraduate academic outcomes for 1992 commencing students*, (Canberra: DETYA, 1999), p.15.

12 This is shown in both ABS labour market statistics and a survey which directly asked people if they needed a degree for their job. See Australian Bureau of Statistics, *Education and Work 2002*, Catalogue 6227.0, (Canberra: ABS, 2002), p.21 and Mariah Evans and Jonathan Kelley, 'Why is Education Rewarded—Necessary Skills or Arbitrary Credentialism?', *Australian Social Monitor*, December 1998, pp.37-38.

13 My book, *The Unchained University*, expands on these ideas.

14 Graduate Careers Council of Australia, *Course Experience Questionnaire* 2001, (Melbourne: GCCA, 2002), p.8. I take the top two points of a five point scale as signalling unambiguious agreement with the proposition. For an expanded version of the argument that follows, see my book *The Unchained University*, esp. Chapter 4.

15 Calculated from institutional performance tables in Brendan Nelson, *Higher Education Report for the 2003 to 2005 Triennium* and *Higher Education Report for the 2002 to 2004 Triennium*,(Canberra: Department of Science, Education and Training) and David Kemp, *Higher Education Report for the 2001 to 2003 Triennium*, (Canberra: Department of Education, Training and Youth Affairs).

16 See Victorian Tertiary Admissions Centre Annual Reports 2001 and 2002, Section C, available www.vtac.edu.au

17 Own calculations based on Department of Education, Science and Training data, available http://www.dest.gov.au/archive/highered/statistics/outcomes/crude/retention.htm

18 Department of Education, Science and Training, *Our Universities: Backing Australia's Future*, (Canberra: DEST, 2003), p. 10.

19 DEST, *Our Universities*, p.12.

20 For a more detailed argument on why the concerns of regional universities are unfounded, and for sources on these statistics, see chapter 7 of *The Unchained University*.

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