The Australia Institute
Research that matters.

Not “how high” but “for what?”

Submission on the *Higher Education and Research Reform Bill 2014*

Technical Brief
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TAI

Technical Brief

1 SUMMARY

Debate about the government's proposal to deregulate university fees has largely focused on how much students will pay. Critics campaign against $100,000 degrees; the government continues to argue students will pay around half the cost of their degrees.

But this debate has largely overlooked a more important question. When students pay more, *what* will they be paying for? The question is not simply "how high?" but "for what?" If the HELP system is a way to pay for a service, shouldn't higher HELP debts go towards better service?

To our knowledge none have explained what proportion of any fee increase will actually go towards improving education standards for the fee paying students.

Instead, deregulation advocates have focused on increasing university funding to boost research rankings. Similarly, the Prime Minister defended research funding cuts by arguing: "We want to get our higher education changes through because they will be good for universities, they will be good for research".[1]

Student revenue already exceeds teaching costs. Student revenue, including grants and fees, is used to fund the research side of universities and to boost operating surpluses. This 'cross-subsidy' has substantially increased in recent years and is likely to increase under fee deregulation.

Using student revenue to pay more for research is like a co-payment on going to university, or 'profiting' from students.

The higher education sector has long discussed the problems of students paying for research, with bad outcomes for both teaching and research. Increasingly there have been questions about its *ethics*. As late as October 2013, Prof. Ian Young, ANU Vice Chancellor and Chair of the Group of 8, was asking "is it appropriate for students to fund research?" Bruce Chapman, designer of HECS, and Nobel Laureate Brian Schmidt have also raised ethical concerns.

According to national survey data from the Australia Institute, held before the Budget, 77 per cent of Australians agree higher fees should be spent on teaching students.

The Education Minister has proposed empowering the *Australian Competition and Consumer Commission* to prevent 'fee-gouging' and 'unfair' university fees. There is no mention of the ACCC in the Bill, no new powers or new funding; ACCC lost 7 per cent of its staff this year.

While the ACCC can intervene in consumer or competition matters, it has no basis to intervene simply if universities increase fees to fund research. It would need new statutory powers.

If the proposal is simply to ask the ACCC to 'monitor' fees, under the *Competition and Consumer Act 2010*, this would have little impact on fee levels. Such information could be

[1] http://www.smh.com.au/federal-politics/political-news/research-funding-cuts-to-top-6-billion-labor-says-20140826-108r6t.html

valuable for public debate and should be available to a thorough review of fee deregulation. It may require universities to disclose more of their finances, as current data is patchy.

Nonetheless, analysis of publicly available historical data shows universities have increasingly used student income to pay for research.

Research spending grew between 2002 and 2012 (the most recent data) – from 31 per cent to 41 per cent of all university spending. This was due in large part to increased cross-subsidy from non-research income – from 30-34 per cent to 39-48 per cent of all research spending, according to analysis of university budgets in this submission.

Student income provided an increasing share of this cross-subsidy. A conservative analysis estimates student income provided more than $2.8 billion in 2012 – 1 in 6 student dollars, up from a minimum of 3 per cent in 2008. Students paid 76 per cent of the research funding shortfall. In total no discretionary revenue (e.g. donations, investments) went towards teaching.

International and domestic full-fee paying students provide the most substantial cross-subsidies. According to the Victorian Auditor-General, international students on average pay double what it costs to teach them. Here, market pressures clearly do not drive down fees or increase quality.

Regarding domestic undergraduates, the *Base Funding Review* found 6-10 per cent of their grants and fees paid for research in 2010. Under the demand driven system, the rate of cross-subsidy likely increased towards the upper end of this range, and could be higher at some institutions. This needs further investigation—*before* experimenting with deregulation.

Using the *Base Funding Review's* rates, in 2013 domestic undergraduate students (grants and fees) provided $0.6-1.1 billion for research, around 20-30 per cent of the research shortfall. Calculated pro-rata, student fees contributed $260-430 million, or $500-800 per student.

If universities didn't cross-subsidise from student revenue, they could have reduced fees by 15-25 per cent, or around $1,250-$2050 per student in 2013.

If we assume the research was funded only out of government grants, the government's proposals mean students will pay 55-57 per cent of the cost of their education at a minimum – the government's 50:50 claim therefore assumes per-student funding *decreases*.

Deregulation could exacerbate the strong incentives to use student income to fund research.

The Parliament must decide if it is appropriate for students to pay higher fees in order to fund research, rather than increasing the quality of their education. This should be a core principle of any reform.

Vice chancellors and politicians who want to convince the public on deregulation should explain how much of the increased debt will go towards their student's education.

Concerns about fee-gouging should lead the Senate to reject deregulation, or to consider new regulations requiring revenue from increased fees to be spent on teaching students.

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2 Students will pay more for university

2.1 The debate about how much students will pay

The *Higher Education and Research Reform Bill 2014* ("the Bill") is the second attempt to implement the Budget 2014-15 proposals for university funding. Despite some changes, the core funding proposals remain: cuts to funding and deregulation of student fees, allowing universities to set their own fees without a cap.

Opponents are campaigning against $100,000 degrees. The government and deregulation supporters say this is exaggerated. Recent government advertising claims students would only pay "around half" of the costs of their university education.[2] The Education Minister recently repeated the claim that the government is asking students "to pay 50:50 with the taxpayer".[3]

It is near impossible to tell what share students will pay, as most universities have refused to announce what fees they will charge under the Bill.

Last year the University of Western Australia (UWA) announced fees of $16,000 a year for its Bachelor degrees, if deregulation proceeds. This would make a three year Bachelor degree cost $48,000, only half of the feared "$100,000 degrees". However, some qualifications at UWA require further study, adding up to close to $100,000 in fees. Moreover, the new UWA fees contradict the government's claim about sharing costs. All students would pay more than half and some students would pay over 80 per cent. The UWA example does not support the Minister's claim.[4]

The 50:50 claim appears to be based on the assumption that universities would on average only recover lost funding, rather than increasing the fees even further. The claim is unjustified and its "supporting assumptions" are never made clear, even though they are required by the government advertising guidelines.[5]

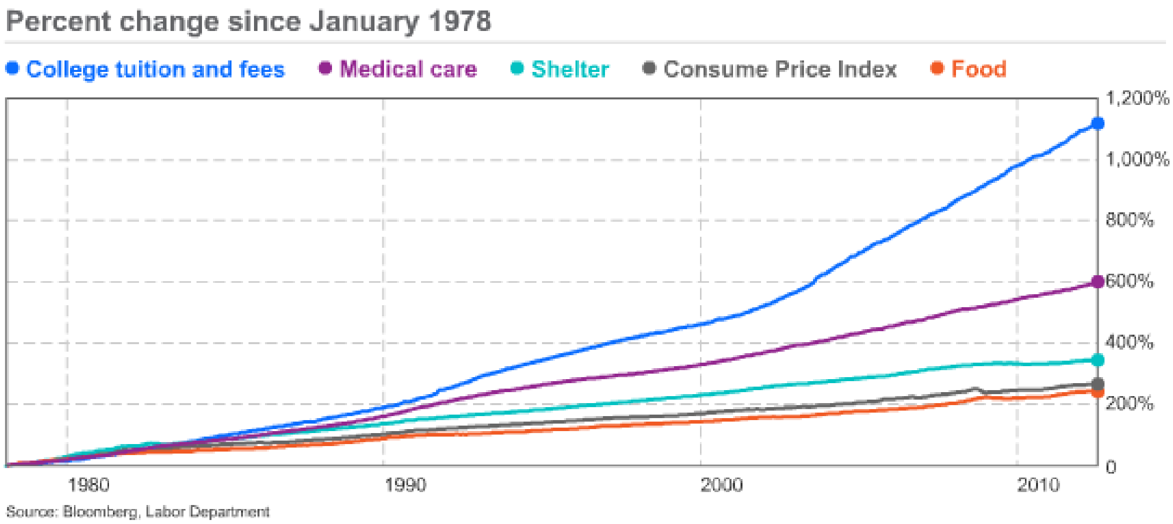
2.2 Fees may rise strongly over time – the US experience

Whatever fees may be in the early years of fee deregulation, under deregulation there may be strong fee inflation over time. If student fees go up more quickly than government funding, students would pay a bigger share over time than the 50:50 claim.

In the US, deregulated university fees have risen almost 1200 per cent over the last three decades, twice as fast as US health care costs and around 10 times faster than inflation, shown in Figure 1.[6]

[2] Department of Education, (2014a) Higher Education Advertising, http://www.highered.gov.au/
[3] Pyne, C (2015), *Triple J Hack*, Interview Transcript, 30 January, https://ministers.education.gov.au/pyne/triple-j-hack-tom-tilley-higher-education-reform
[4] The Australia Institute, (2014) "How much more will university cost?" *Facts Fight Back* - http://www.factsfightback.org.au/how-much-more-will-university-cost-check-the-facts/
[5] Department of Finance (2014) Government Advertising Guidelines http://www.finance.gov.au/advertising/campaign-advertising/guidelines/
[6] Bloomberg, 2012, "Cost of College Degree in U.S. Soars 12 Fold: Chart of the Day", available at <http://www.bloomberg.com/news/2012-08-15/cost-of-college-degree-in-u-s-soars-12-fold-chart-ofthe-

Figure 1: Inflation in US College tuition and fees



Strong fee inflation may be caused by a range of 'market failures', which could push prices up or undermine feedbacks that would bring them down. A market without strong competitive pressures will not deliver good value for money for students, allowing universities to over-charge. Market failures could include:

- Difficulties comparing the quality of education (information asymmetry);
- Marketing based on prestige, which may not reflect quality;
- Prices signaling quality, leading to perverse incentives to increase prices;
- Geographical and prestige based market control;
- Lack of student sensitivity to price.

As Andrew Norton, a proponent of fee deregulation, told the Senate: "history suggests that students are not overly responsive to increases in prices." Deregulation will lead to higher prices that will test whether "will test whether [price] really does make a difference".[7]

Those concerned about higher education market failures think this is a risky experiment. Does Australia want to risk its higher education system to test the theories of deregulation proponents?

2.3 Higher fees = higher costs to government – the UK experience

The Government Committee report from the Senate Inquiry into the original Bill denied that meaningful comparison was possible between the US and Australian university systems.

It pointed to Australia's Higher Education Loans Programme (HELP), through which student fees are loaned. HELP means students only have to pay their fees when they have a reasonable income, with the rate of repayment increasing as income increases.

day.html>
[7] Norton, A (2014), Testimony to the *Education and Employment Legislation Committee*, 9/10/14

HELP is vital to equity, but HELP could make fee inflation worse. The very features that make it attractive reduce the sensitivity to price. While HECS provides equity of access to higher education, higher debt would lead to longer periods of repayment, especially among those on lower incomes. More people would never repay their debts. In turn this increases the cost to government.

The UK has recent experience with this problem, with cost blow outs already increasing since its fee caps were raised in 2012. University fees rose sharply towards the cap, increasing loan payments under their government loan scheme and in turn increasing debt to the government. While the government intended the measures to reduce costs to government, the changes in fact increased loan costs. As many as 3 in 4 graduates may now never fully repay their loan.[8]

As discussed in a November 2014 UK Higher Education Commission report:

> *The current funding system represents the worst of both worlds. The Government is funding [higher education] by writing off student debt, as opposed to directly investing in teaching grants. … The Government is investing, but not getting any credit for it… Students feel like they are paying substantially more… Universities are perceived to be 'rolling in money'… We have created a system where everybody feels like they are getting a bad deal. This is not sustainable.*[9]

Again, the original government Committee report did not explain why this experience was not applicable to Australia. They point only to UK's convergence on the fee cap. As indicated in recent modelling from NATSEM, fee increases could lead to great cost increases to the Australian government:

> *a doubling of HELP debt over 2014 figures, and an increase of bad debt from 17% to 30% – both of which we think are plausible – would lead to an annual HELP budget of around $5 billion compared to $2 billion today, thus erasing future savings from lower Commonwealth grants to universities.*[10]

Proper scrutiny of the government's projections of doubtful debt depends on transparency around assumptions for fee-levels.

3 When students pay more, what will they be paying for?

The debate about how much students will pay for seems to have missed a more fundamental question. As fees rise, what will students get for their extra debt?

[8] Institute of Fiscal Studies, 2014, "The Complicated Issue of HE Finance" http://www.ifs.org.uk/uploads/Lorraine%20Deardren%20-%20The%20complicated%20issue%20of%20HE%20finance.pdf slide 15
[9] UK Higher Education Commission, 2014, *Too Good to Fail,* accessed online http://www.policyconnect.org.uk/hec/sites/site_hec/files/report/391/fieldreportdownload/hecommissionreport-toogoodtofail.pdf
[10] Parker, S and Phillips, B (2015) *Submission to the Senate inquiry into the Higher Education and Research Reform Bill 2014,* http://www.canberra.edu.au/blogs/vc/2015/02/23/submission-to-senate-inquiry-into-the-higher-education-and-research-reform-bill-2014/

People who think markets work well in higher education will think market competition provides good quality education at a fair price. This argument will not convince those who are skeptical about how well markets work in higher education.

Given this, it remarkable how little attention there has been to trying to convince the public that fee increases will be worth paying. As Knott from Fairfax has written

> *When pressed on how they would spend the extra money, vice-chancellors speak of smaller and more personalised tutorials, investments in the latest technology and new scholarships for disadvantaged students.*
>
> *But these arguments have not been made loudly or persuasively enough to cut through the noise about fee hikes. More detail is needed. A better story needs to be told.* [11]

Instead, vice chancellors and the government have mostly argued for deregulation by saying they need more funding and have been unable to convince governments and taxpayers to provide it. In making this argument, lots of attention is paid to international rankings. The government adopts similar arguments, but also argues that the measures are necessary to make budget savings.

3.1 Deregulation is not the only way to make savings or increase funding

The fact that one part of the budget is increasing does not make it unsustainable or undesirable. As argued in our submission to the previous inquiry, given the public returns to public investment in higher education are high, there arguably should be more not less funding. There are many, much fairer ways to address the deficit by increasing revenue. The Australia Institute explored these issues in detail in our submission to the inquiry on the first Higher Education Bill.[12]

Nonetheless, if the goal is just to make savings by shifting costs, it is clear that there are other options. As put in the 2014 *Review of the Demand Driven System Report,* it is possible "to balance any reduction in Commonwealth contributions with an increase in maximum student contributions by an equivalent amount."[13] Similarly, if the main goal is to give universities more money to educate students, it is possible to do so by simply raising the caps on fees, without deregulation.

Whether these options are economically desirable is debatable, but more to the point, the government has not pursued either option. In fact, compromises with the crossbench have dramatically decreased the forecast savings over estimates, suggesting the government is more

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[11] Knott, M, (2015) "University Vice Chancellors Must Step Up on Higher Education Reform" in *Sydney Morning Herald* 19 January, accessed online http://www.smh.com.au/federal-politics/political-opinion/university-vicechancellors-must-step-up-on-higher-education-reform-20150119-12sxkm.html

[12] The Australia Institute, (2014), Submission 135 to the Senate Inquiry into the *Higher Education and Research Amendment Bill 2014.*
Attached to this submission

[13] Kemp, D, Norton, K (2014) *Review of the Demand Driven System*, https://education.gov.au/report-review-demand-driven-funding-system p109
Norton prefers removal of fee caps, but was not asked to consider this in the Review of cap on student *places*, and so only considers fee deregulation briefly later on.

interested in deregulation than in savings. Moreover, as noted, proposals to increase fees could greatly increase costs from doubtful debt.

3.2 Are universities under-funded?

By one clear measure, Australian universities are in good financial health: they are running strong surpluses. Figure 2 shows the operating surplus for the university sector has grown over the last decade.[14]

Figure 2: University sector operating surpluses ($ million)

	2002	2008	2012	2013
Total Operating Revenue	$11,614	$18,956	$25,210	$26,333
Net Operating Result	$495	$364	$1,931	$1,996
Surplus (as % of revenue)	4%	2%	8%	8%

Some deregulation proponents have claimed that *per-student* revenue has declined over time. While per-student revenue eroded in the past, due to how government grants were indexed, this problem was fixed in 2012 through "a new indexation system linked to inflation and labour costs".[15] While the government now intends to cut per-student funding—through cutting government grants and through re-indexing to the Consumer Price Index—it is important to note that ongoing cuts to funding are not inevitable and are ultimately a political choice.

3.3 Should students pay to boost university research rankings?

Arguing for increased funding, the government and some vice chancellors have pointed to the need to boost university rankings. Rankings are typically based on research output – such as how many research papers a university publishes in academic journals and the ranking in turn of these journals. However, research output has little to do with the teaching of students and the quality of this teaching. This strongly suggests that student fees will pay for research.

Prof. Ian Young, Vice Chancellor of the Australian National University (ANU) and Chair of the Group of 8, argued for fee deregulation on the basis no Australian university is in the top 100 in the *CWTS Leiden Ranking*.[16] This ranking is entirely based on research with no consideration of the quantity or quality of teaching.

The 2014-15 Budget pointed out there were only five Australian universities in the top 100 of the *Times Higher Education World Reputation Rankings*.[17] In this ranking, research determines 60

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[15] See Norton, A, (2014) *Mapping Higher Education 2014-15,* The Grattan Institute, http://grattan.edu.au/wp-content/uploads/2014/10/816-mapping-higher-education-20141.pdf page 44
[16]Osborne, T (2014) "ANU Vice Chancellor Ian Young Delivers Damning Uni Report Card" http://www.abc.net.au/news/2014-07-30/anu-vice-chancellor-ian-young-delivers-damning-uni-report-card/5635964
[17] Budget 2014-15, "Education", http://www.budget.gov.au/2014-15/content/glossy/education/html/education-06.htm

per cent of the ranking while teaching only determines 30 per cent.[18] Times Higher Education says this is because “there is greater confidence in respondents’ ability to make accurate judgments about research quality.” [19] If even university rankers are uncertain as to how to judge teaching quality, one could ask whether such rankings are a wise way to shape education policy.

The Prime Minister made the link clear: "We want to get our higher education changes through because they will be good for universities, they will be good for research”.[20]

Universities certainly pay a lot of attention to rankings. Many universities treat rankings as essential to their marketing and consider them important in attracting students.[21] As such, focus on research rankings could drive a perverse cycle under deregulation. This is Nobel Laureate Brian Schmidt’s view:

> *However, allowing uncapped fees in an environment with elite monopoly players, income contingent loans (HELP), and the highly distortive feedback loop where student fees pay for research, research drives esteem, and esteem drives student fees is a recipe for disaster. No more so than for students who will pay much more and get very little in return.* [22]

4 Bigger student debt could be a ‘co-payment’ for research

The debate about university fee deregulation seems to indicate an intention to use the fees to pay for research rather than towards increasing educational quality. Moreover, recent historical data shows universities face strong incentives to spend student fees on research, as discussed below.

Vice chancellors and the government should explain to the parliament and the public how much of the new student debt will end up funding research. If they want universities to use student fees to fund research, they should make this clear and defend it publicly.

It is understandable why they may be reluctant to do so. Asking students to pay for research is similar to making sick people to pay more to see the doctor and using this to fund medical research, as is also proposed in the Federal Government’s budget.

While it is unclear how much students would pay in new ‘cross-subsidy’ for research, they will pay more under a range of scenarios. It seems unlikely that universities would spend *all* of the new revenue they raise from students on their students, given that is not the current practice.

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[18] Times Higher Education (2014), “Methodology”, http://www.timeshighereducation.co.uk/world-university-rankings/2014/reputation-ranking/methodology
[19] Times Higher Education (2014), “Methodology”
[20] In Kenny, M (2014) “Research Funding Cuts top $6 billion, Labor says”, *Sydney Morning Herald,* 26 August, accessed online http://www.smh.com.au/federal-politics/political-news/research-funding-cuts-to-top-6-billion-labor-says-20140826-108r6t.html
[21] In Brissiden, M (2014) “Abbott defends 'fairness' of budget, GP co-payment” ABC RN, accessed online http://www.abc.net.au/am/content/2014/s4074407.htm
[22] Scmidt, B (2014), “Research and Higher Education”, accessed online http://www.mso.anu.edu.au/~brian/IMAGES/Research%20and%20High%20Education%20-%20Australian%20Jun%202014.pdf

Even if the rate of cross-subsidy stays the same, students will be paying more to pay for research.

But universities could direct a large portion of the increase in fees could be directed towards research. To quote Brian Schmidt again:

> *because the full cost of research is not paid, and government investment in research is falling, the increased fees we will charge will primarily be directed at research rather than teaching outcomes*.[23]

If the Parliament is concerned about fee-gouging, it should regulate to restrict the amount of student income that can be spent on research activity. This would in effect ban any increase in student fees from being used to fund research.

5 The role for a regulator?

The Education Minister has proposed to empower Australian Consumer and Competition Commission (ACCC) to "to monitor and act on any price gouging or unfair fee increases in a deregulated market."[24]

The ACCC is not mentioned in the Bill. There is no new funding and it is granted no special powers. Indeed, the Budget projected the ACCC was to lose 55 staff this year, a cut of 7 per cent.[25]

The basic functions of the ACCC include preventing anti-competitive behavior and preventing dishonest dealings with consumers. Universities are already operating in a market, albeit with price caps on domestic undergraduates. But the ACCC has no powers to intervene against 'fee-gouging' or 'unfair fees' per se in higher education per se.

5.1 Price monitoring and cost accounting

Under s95ZE of the *Competition and Consumer Act 2010 Act*, the Minister has the power to direct the ACCC to 'monitor prices' in a sector. This includes reporting on prices, profits and costs. The ACCC has been doing this for the petrol sector since 2008.

Former ACCC commissioner Stephen King said asking the ACCC to monitor fees would be a "waste of time".[26] Specifically, he pointed to the lack of statutory power to intervene, and the lack of basis for determining what constituted unfair fees.

Price monitoring by itself would provide little if any pressure on universities to alter their prices.

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[23] Schmidt, op cit.
[24] Pyne, C (2014) "Great Reform Takes Time", Press Release, http://www.pyneonline.com.au/media/media-releases/great-reform-takes-time-new-higher-education-reform-package-to-go-to-senate
[25] Budget 2014-15, Agency Staffing Levels, accessed online http://www.budget.gov.au/2014-15/content/bp4/html/bp4_part_2.htm
[26] In Trounson, A, (2014) "ACCC Toothless as watchdog", The Australian, 3 December, http://www.theaustralian.com.au/higher-education/accc-toothless-as-university-fees-watchdog/story-e6frgcjx-1227142397484

But better information on university costs and cross-subsidy could be valuable to public debate and should be made available *prior to* deregulation.

The ACCC's ability to provide new information would be limited without access to data about teaching costs that universities are currently not required to disclose. Regulations would have to be introduced to require greater disclosure to the ACCC or another regulator. Public release of data could be aggregated or partially anonymized.

The *Base Funding Review* argued for activity-based accounting practices and standards in the sector. As they argue, this is even more important as the demand-driven system is expanded. Without it, scrutiny of university finances will remain difficult. Clearer activity-based accounting may also help universities plan their own finances.[27]

5.2 Power to intervene against fee-gouging

If the ACCC or another regulator is to intervene against high fees not being spent on educating students, it would have to be given that power. This was argued by Catholic University of Australia Vice Chancellor Greg Craven during the Senate inquiry into the original bill:

> *[Y]ou could have a system where you gave the power to a body, whether that body was TEQSA or the Australian [C]ompetition [&Consumer] [C]omission, to disallow a price increase on a set of statutory grounds. The types of statutory grounds that I would be thinking of would be the relationship of* ***the cost of the degree in delivery****, to future earnings, to any effects on national need in areas of industry or otherwise and to any* ***reasonable degree of cross-subsidisation within a university****.*[28]

Of course, there would be challenges for policy design. The regulator would need to arrange for appropriate accounting and reporting standards. But if the Senate thinks students should not pay for research, these challenges must be addressed.

Alternatively, the Senate could take the view of ex-ACCC commissioner Stephen King "Either competition is going to work or it isn't going to work, and if it isn't going to work why deregulate in the first place?"[29]

6 Students are *already* paying more for research

In the *Review of the Demand Driven Funding System*, the authors discuss whether non-university higher education providers should get less funding, given that they do not conduct research.

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[27] Lomax-Smith, J, Watson, L, Webster, B (2011), *Base Funding Review,* accessed online http://www.hes.edu.au/assets/Resources/Documents/HECQN/HigherEdFundingReviewReport.pdf page 67
28 Quoted in the Report for the Senate Inquiry into the *Higher Education and Research Reform Amendment Bill 2014* http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Education_and_Employment/Higher_Education/Report/c03 Par 3.14, (Bold added)
[29] In Trounson, A, (2014) "ACCC Toothless as watchdog", The Australian

> *Identifying a distinct research element of per student funding could also trigger other complex issues about whether this is the best way to fund research and whether universities should receive it for all their courses.* [30]

However, the complexity of these problems does not remove them. Given their current incentives and given a new source of student revenue, deregulating fees could lead to more per student funding instead going into research.

Recent years have seen a strong increase in research spending, and in cross-subsidy from non-research revenue. This is clear from the historical data, from long debates in the sector, and from the comments of vice chancellors, even as they advocate for fee deregulation.

One driver is the under-funding of research. Every dollar received for specific research projects requires universities to seek more funding to pay for the indirect costs. Deregulating student fees will only provide this existing incentive with a new source of revenue. However, universities are probably also responding to more general incentives to increase research spending by cross-subsidising, for example, the excessive focus on research rankings.

6.1 The higher education sector is well aware of these problems

While it may not be widely known in the general public, the higher education sector is well aware of how universities use student revenue to fund research. Numerous reports have signaled alarms about rising levels of cross-subsidy and called for increased and new forms of funding to remove this incentive.

This problem was pointed out 15 years ago, in 1999 by a Deputy Vice Chancellor:

> *competitive research grant funding does not cover the full cost of undertaking research. A pool of funds has been provided to assist with infrastructure funding, but this falls well short of the actual cost, which has to be supplemented from university operating resources.*[31]

In 2008 the *Bradley Review* for the Commonwealth government argued underfunded research “is leading to a pattern of quite unacceptable levels of cross-subsidy from funds for teaching, adversely affecting the quality of the student experience”.[32]

The *Bradley Review* drew on a report from Thomas Barlow, who showed that cross-subsidy was increasing and argued “cross-subsidisation of research from teaching” was driving perverse outcomes for both teaching and research.[33]

The *Base Funding Review* in 2011 repeated these concerns.[34] It urged the government to consider funding research on an entirely research basis rather than per-student.

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[30] Kemp, Norton, (2014) *Review of the Demand Driven System,* page 81
[31] Coaldrake P, Stedman, L (1999) Academic Work in the Twenty-First Century: Changing Roles and Policies, DETYA, 1999.- Quoted in Barlow, (2008) *Full Funding for Research*, accessed online http://s3.amazonaws.com/zanran_storage/www.deewr.gov.au/ContentPages/792431167.pdf
[32] Bradley et al. (2008), *Review of Australian Higher Education: Final Report*, pxii
[33] Barlow, T, (2008) *Full Funding for Research,* accessed online http://s3.amazonaws.com/zanran_storage/www.deewr.gov.au/ContentPages/792431167.pdf page 13

Neither Barlow nor the *Base Funding Review* argued that research should be fully funded. However, they argued that the level of cross-subsidy was growing too large and causing distortions and urged a relatively small increase in funding to reduce those pressures. By contrast Allens Consulting, in a report to the commonwealth government, endorsed “the basic principle that research undertaken by universities should be fully costed and funded, and not cross subsidised from other sources of revenue – ensuring that universities are sustainable and competitive in the longer term.”[35]

Andrew Norton wrote in 2011 about universities ‘profiting’ from students: “The source of the financial woes of public universities is that they are running integrated teaching-research businesses which rely on profits from teaching to sustain their research.”[36]

Vocal champion of deregulation Prof. Ian Young has raised the issue a number of times. In slides for a presentation in 2013,[37] Prof. Young notes that

> *Student revenue [is] used to cross-subsidise the research funding shortfall…*
> *Augmented by international and postgraduate fee paying students…*
> *large student populations are required to provide the funding to support high quality research…*
> *Not good for either education or research…*

In conclusion, he asks:

> *Is it appropriate for students to be funding research?*

In a 2014 speech following the Budget, Young bemoaned having to enroll large numbers of students, “taking some of the money earned for teaching our next generation and shifting it to cover the shortfall for doing research.” He then argued:

> *Deregulation is not the whole answer. Students can’t carry the full burden…*
>
> *Deregulation, however, is a game-changer and a building block to making our universities brilliant.*[38]

Here Young did not ask the question he had asked less than a year earlier: “Is it appropriate for students to be funding research?”

Responding to concerns about unfunded research, in 2010 the government introduced the *Sustainable Research Excellence* initiative. However it cut this funding in 2012-13. Universities

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[34] Lomax-Smith et al, (2011), *Base Funding Review* pix
[35] Allens Consulting, (2011), *Recognising the Full Cost of Research,* http://docs.education.gov.au/system/files/doc/other/acgfullcostissuespaper.rtf.
[36] Norton, A (2011), *Finding a Cheaper Way of Delivering Higher Education* http://andrewnorton.info/2011/06/13/finding-a-cheaper-way-of-delivering-higher-education/
[37] Young, I (2013), Presentation to the Australian International Education Conference on 16 October http://aiec.idp.com/uploads/pdf/2013-m-003-young-wed-3.55pm-bradman-m-003.pdf
[38] Young, I, (2014) “National Press Club Speech”, https://go8.edu.au/sites/default/files/docs/article/national_press_club_speech_-_ian_young_pdf_version.pdf

Australia criticised this move and called on the present government to replace the funding.[39] The Budget did not replace this funding and further cut other research funding. In their submission to the present budget round, Universities Australia now treat fee deregulation as their priority. They have not addressed whether universities would increase fees in order to pay for research.

6.2 It is "manifestly not fair" to ask students to pay more for research

While debate about cross-subsidy has largely focused on perverse outcomes from unfunded research costs, increasingly commentators have pointed to ethical considerations.

In 2011, Lawrence Cram, at that time a Deputy Vice Chancellor at the ANU, questioned growing cross-subsidy on ethical grounds:

> *it may be timely and prudent for universities consider the ethics of continuing to ask students and the government to pay rising fees and charges purportedly for their education mission, while expending the revenue on the growth of research activity.*[40]

Brian Schmidt wrote in *Nature Outlook* that our "undesirable method of research funding is unfair to students, who believe they are paying for their education but are in fact paying for the country's research."[41] Elsewhere he argued: "it is manifestly not fair for students to take the lead role in funding Australian research outcomes."[42]

Concerned that deregulation may lead to substantial cross-subsidy, ANU economist Bruce Chapman, who designed the HECS system, argued

> *This is an ethical issue… It is an unreasonable thing for students to cross-subsidise research and other activities… This is a role for government.*[43]

6.3 Three quarters of Australians agree

While Australians may not be broadly aware that universities charge higher fees than the cost of educating their students, when asked directly, most Australians say they are opposed to charging students more than what it costs to educate them.

[39] Universities Australia, (2014) "Pre-Budget Submission 2014-15" Press Release, https://www.universitiesaustralia.edu.au/ArticleDocuments/208/UA%20Pre-budget%20submission%202014-15.pdf.aspx

[40] Quoted in Hare, J, Lane, B, (2011), "Research Spending Consumes a Growing Proportion of University Funding" in *The Australian,* 15 June, accessed online http://www.theaustralian.com.au/higher-education/research-spending-consumes-growing-proportion-of-university-funding/story-e6frgcjx-1226075209789

[41] Schmidt, B, (2014b) "If not funding then teaching" in *Nature Outlook,* http://www.nature.com/articles/511S81a.epdf?referrer_access_token=yuq-86E8HccV8zIU4kTq0NRgN0jAjWel9jnR3ZoTv0OH_EipLJjYi2qC9gsTP-tq4Z-ggxC2m8T17J3_7fsnLYbNtSv5aRCARDzk6_pjNnA%3D

[42] Schmidt, B (2014), "Research and Higher Education" http://www.mso.anu.edu.au/~brian/IMAGES/Research%20and%20High%20Education%20-%20Australian%20Jun%202014.pdf

[43] Woroni Great Debate, http://youtu.be/NYPnKyd6CVY?t=1h28m00s

In early 2014 the Australia Institute conducted a representative national survey of the Australian public. The survey was held before the budget, just after the National Commission of Audit.

The survey asked respondents to say whether they agreed with the following statement: [44]

Student debt should not be increased beyond what it costs to educate the student.

77 per cent said they agreed, including 34 per cent strongly agreeing.

Only 4 per cent said they disagreed.

7 Students increasingly pay for research and surpluses

The easiest way to determine how much students pay for research and other activities would be to compare teaching income and teaching costs. But there is no reliable, regularly reported public data on teaching spending or costs.

There is data on research spending and research income, from which we can determine the growing level of cross-subsidy into research.

There is also data on income derived from students and spending outside of research programs, from which we can produce a minimum estimate of the surplus provided by students.

In addition, there has been some analysis of teaching costs relative to funding per-student costs.

7.1 Universities are spending more of their budgets on research

Universities receive various income streams to conduct research. Total research income is made up of 'direct' external research sources and 'Research Block Grants' (RBGs). RBGs are supposed to pay for the costs of research that are not covered by direct research income. However, there remains a shortfall that must be covered from 'general university funds' (GUF), including student fees, investment income, donations etc.

University total income and spending is reported by the Department of Education.[45] The ABS provides biennial data on research spending at universities, the most recent from 2012.[46]

[44] This survey was conducted before the Budget was announced, but after the National Commission of Audit. Issues of fee deregulation were not widely debated in the media at this time. The same survey also asked whether "The government should not enforce upper limits on how much a course costs, even if student debt increases" -- 27 per cent agree, 26 per cent disagree -- and whether "Greater student debt is acceptable if it leads to improved education standards" -- 37 per cent agree while 29 per cent disagree. This shows considerable uncertainty. Other surveys following the Budget show a much strong opposition to deregulation and higher fees. And yet even before the budget it was clear that most Australians do not think students should pay for more than their education.

[45] Department of Education, (2014), *University Finance Publications*, http://education.gov.au/higher-education-publications
2002 data from WayBack Machine Web Archive - http://web.archive.org/web/20101201213230/http://www.innovation.gov.au/Research/ResearchBlockGrants/Pages/RBGFundingFormulaeData.aspx

[46] ABS Cat No. 8111.0 *Higher Education and Research Development*

Unfortunately, the ABS provides this data only at a sector-wide level. So this analysis cannot be reproduced at an institution level.

Between 2002 and 2012, universities greatly increased the share of total expenditures that went towards research. In 2002, 31 per cent of all spending was on research. By 2012 this had increased to 41 per cent. This is despite a 50 per cent increase in the number of university students over that period.[47]

7.1.1 More research funding is cross-subsidised from 'general university funds'

There are two different sources of data on dedicated research income that can be used to calculate the degree of cross-subsidy into research:

- *Higher Education Research and Development* (HERD) data from the ABS and
- *Higher Education Research Data Collection* (HERDC) figures from the Department of Education, collated as a historical record by Universities Australia.[48]

Both must be complemented with data on Research Block Grants, supplied by the Department of Education.[49]

Figure 3 shows analysis using both the ABS and the Department data sets. Research cross-subsidy has increased substantially, becoming a bigger share of research spending and a bigger share of total university revenue.

Figure 3 Growing research funding shortfall, funded from 'general university funds'

	HERDC		ABS-HERD	
	2002	2012	2002	2012
Research funding shortfall – cross-subsidised from 'general university funds' (Research spending minus identifiable research income)	\$1.40bn	\$4.27bn	\$1.15bn	\$3.57bn
Share of non-research spending	34%	48%	30%	39%
Share of total university spending	10%	20%	9%	16%

Using a similar methodology, previous studies have used the HERDC figures.[50] Barlow notes between 2000-06 the figures are similar to the ABS figures. However, the data sets diverge

[47] Department of Education (2014), *Higher Education Statistics,* Study load by year, *http://highereducationstatistics.education.gov.au/*
[48] Universities Australia, (2014), *HERDC time series, https://www.universitiesaustralia.edu.au/ArticleDocuments/410/HERDC%201992-2013.xlsx.aspx*
[49] RBG data was provided on request from the Department of Education.
In the ABS data, Research Block Grants are not reported separately, but are included in 'General University Funds'. Direct research funding is Total Research Spending – General University Funds.

substantially recent years, as shown in Figure 3. It is unclear why.[51] To produce a conservative analysis of cross-subsidy, the rest of this analysis will focus on the ABS HERD data.

The growth in research spending has been driven by growth in direct research income and greater growth in cross-subsidy, as shown in Figure 4Figure 4**Error! Reference source not found.**. RBGs have grown much slower than direct research funding, so universities have faced a shortfall, requiring them to greatly increase cross-subsidy from general university funds. Figure 5 shows the increase in cross-subsidy towards the research budget.

Figure 4: Growth in research spending and source of funds – 2002-12

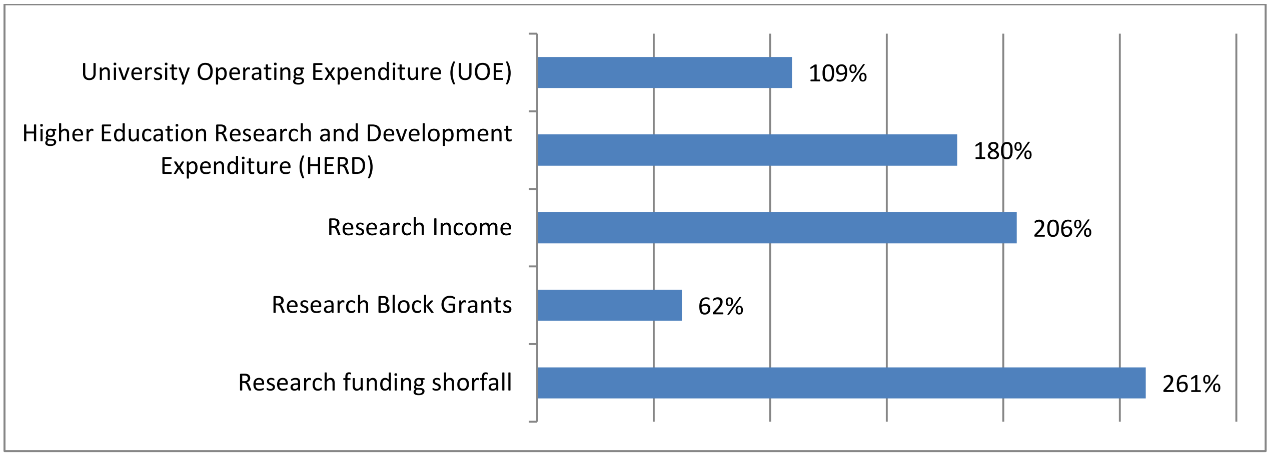

Figure 5: More research is funded from outside of research income

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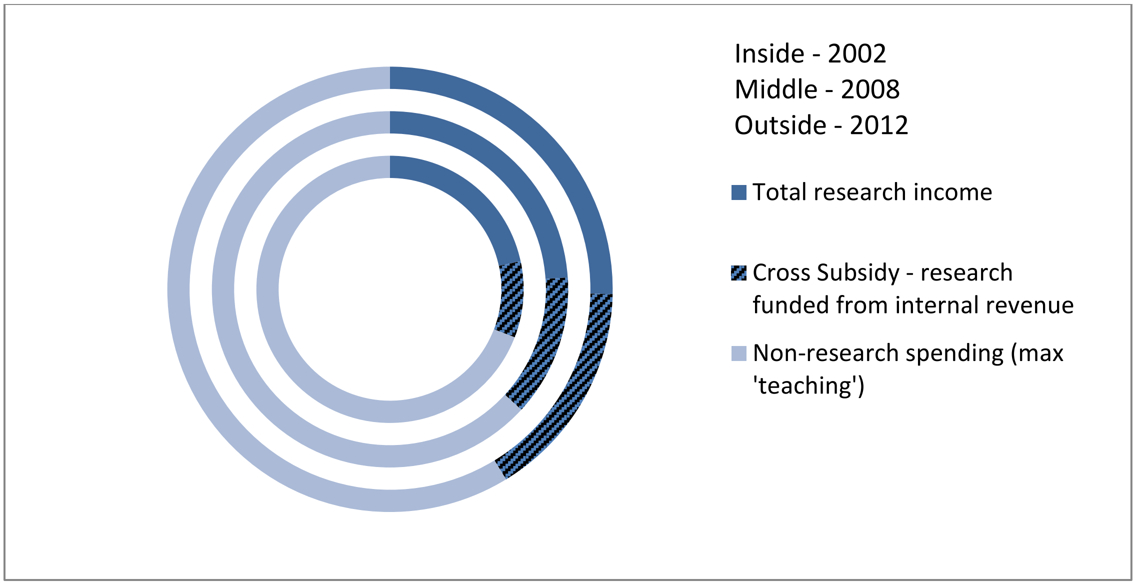
[50] Barlow, 2008, *Full Funding for Research* page 5
Larkins, 2011, "Universities Cross-Subsidised Research Activities by up to $2.7 billion in 2008", LH Martin Institute for Higher Education Leadership and Management.
[51] Universities may be reporting differently in each case, or may be reporting newer funding sources in different ways. HERDC may include only sources relevant to RBG calculation, while ABS may be more expansive. The ABS HERD data reflects source of funds by year *spent*, while the HERDC data reflects source of funds by year *received*.



7.1.2 Students increasingly pay for the research funding shortfall

Universities have many sources of income outside of research that could be contributing to the towards the research shortfall. This includes investment income, donations, international and domestic full-fees, and revenue provided per undergraduate student ("base funding") which includes grants and student fees. How much of the cross-subsidy comes from students?

Figure 6 and Figure 7 shows university spending and income over the decade.

Figure 6 Changes in university income and spending (millions)

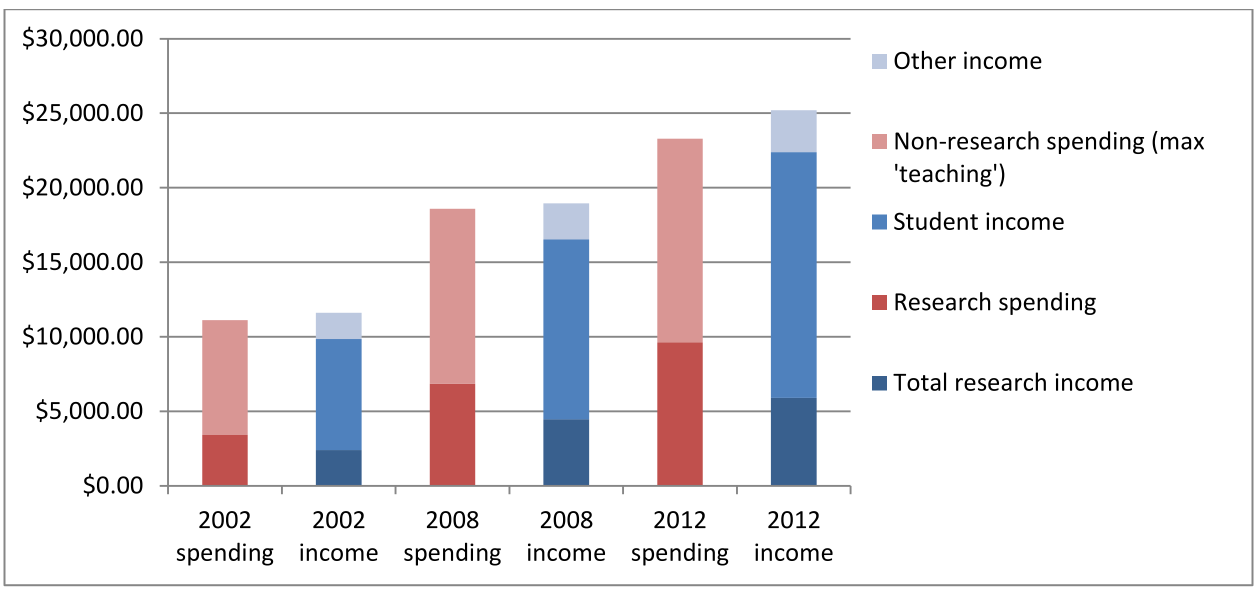
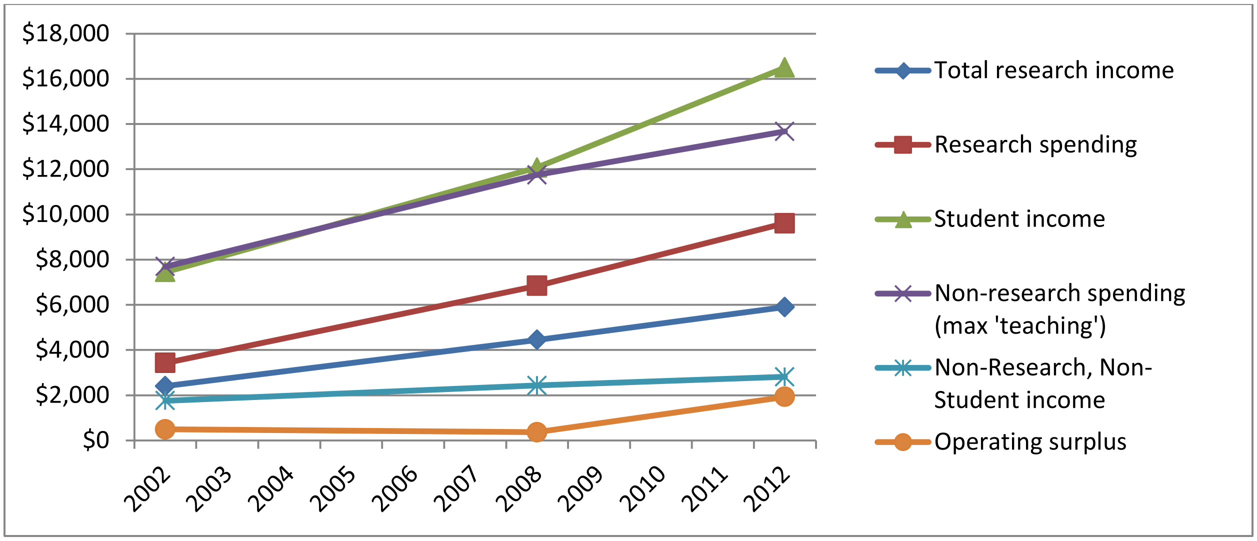


Figure 7 Changes in university income and spending (millions)



A minimum estimate takes non-research spending, as the maximum that universities could have spent on teaching, and subtracts the amount that universities derived from student income.[52] This is an underestimate for a number of reasons.[53] Figure 8 shows these calculations.

Figure 8 Student contribution to research – minimum estimate (millions)

Minimum Estimate	2002	2008	2012
Student revenue	$7,449	$12,075	$16,493
Spending outside of research (UOE – ABS HERD)	$7,689	$11,745	$13,667
Surplus from student revenue – Minimum estimate	-$240	$330	$2,826
As share of student revenue	-3%	3%	17%
As share of research shortfall	?[54]	14%	76%

In 2012 university income from student sources was $16.5 billion.[55] This included government grants and fees for domestic undergraduates ($10.0 billion), international student fees ($4.1 billion), domestic full-fee paying students ($2.0 billion) and other charges and scholarships.

52

53 Larkins (2011) has criticised the assumption that non-research spending is therefore teaching spending. However, this means the figure for ‘non-research spending’ provides an upper boundary on teaching costs. If we can identify non-research non-teaching spending, then teaching spending will be lower. But per-student income will remain the same. So the current method provides a minimum estimate of student cross-subsidy to research.

54 Teaching was either cross-subsidised, or there were substantial non-teaching non-research activities not counted in the analysis.

55 Department of Education (2014) *University Finance Publications.*

University spending on activities other than research was $13.7 billion. (University expenditure was $23.3 billion, minus research expenditure of $9.6 billion).

Therefore, as a minimum estimate, income from student sources exceeded spending on non-research activities by at least $2.8 billion, or 17 per cent. More than 1 in 6 dollars raised from students or on a per-student basis did not go towards teaching students.

This compares with a surplus from student revenue of 8 per cent in 2008

In 2012, the surplus from student revenues was 76 per cent of the research funding shortfall, up from 14 per cent in 2008.

A higher estimate would assume some investment, donations and other discretionary revenue is spent on teaching. Non-research, non-student revenue was around $3 billion in 2012. Even if less than teaching's pro-rata 'share' of any surplus from these revenue streams went towards teaching, the surplus from students would be higher.

In short, over recent decades less of the funding students deliver to universities was spent on teaching them. Universities have used larger portions of this revenue to cross-subsidise research and provide university operating surpluses.

7.2 The limited available data on teaching costs

Teaching cost data is the only way to show *which* students are providing that surplus. Students in certain disciplines, and especially international and domestic full-fee paying students, can provide higher surplus revenues to universities than Commonwealth Supported domestic undergraduates.

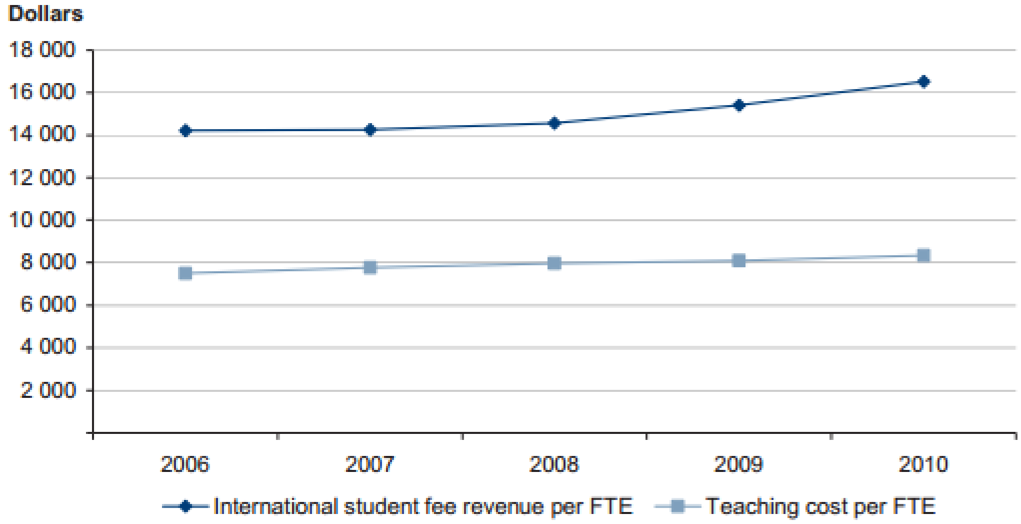
However, this information is not publicly available. Universities are not required to disclose it and are reluctant to do so. Nonetheless, there are some existing studies which provide a starting point for analysis.

7.2.1 International students

Figure 9, from a report from the Victorian Auditor-General,[56] shows that for Victorian universities international students (full time equivalent) bring in close to twice as much income per student than what it costs to educate them.

[56] Victorian Auditor-General (2010), *Tertiary Education and Other Entities: Results of the 2010 Audits*, http://www.audit.vic.gov.au/publications/2010-11/20110525-Tertiary-Ed.pdf page 34

Figure 9 International student fees vs teaching costs, Victorian universities



Source: Victorian Auditor-General's Office.

It is clear that in the market for international students competitive pressures have been insufficient to reduce the price or increase the quality of the service for these disciplines. A deregulated market in domestic fees could show similar qualities. Universities will be able to treat undergraduate domestic students in a similar way to international students: as a source of research funding. Of course it remains unclear how high the market will allow the rate of surplus could go across different subjects in the domestic context.

7.2.2 Domestic undergraduates

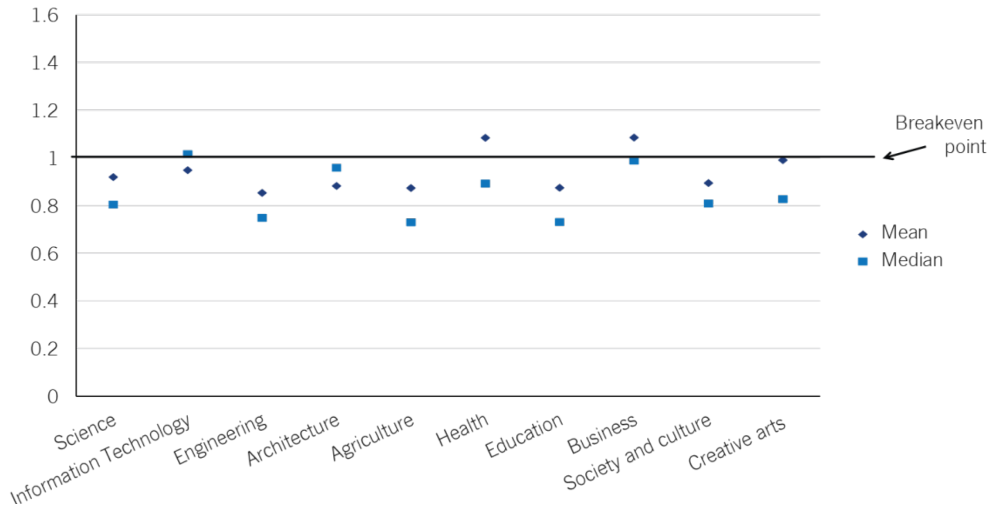
Rates of surplus from domestic undergraduates have, historically, been much lower than for international students.

For the *Base Funding Review,* Deloitte Economics was commissioned to investigate domestic undergraduate per-student funding levels (government grants and fees) compared to teaching costs at a sample of eight universities. This allowed the *Review* to estimate how the levels of funding per-student compare to costs per-student in different areas, and how much of this per-student funding went towards research.[57]

The costing study showed that costs were lower than funding for most disciplines, although there was variation between institutions, as seen in Figure 10.

[57] The costing study showed the average cost for teaching and scholarship per-student was $15,000. But the per-student cost, when it included “unfunded” research costs, was $19,600. Per-student funding was between these.

Figure 10: Ratios of costs to funding per-student, 2010 costing study[58]



The *Base Funding Review* Panel "reached the conclusion that for undergraduate places on average, 6 per cent of base funding is used to support base capability in research."[59] Elsewhere they say "notionally 6–10 per cent of base funding could be identified as supporting a reasonable level of base research capability".[60]

In other words, 6 cents in every dollar received per domestic undergraduate student was going towards research. The Panel considered it 'reasonable' to allow it to increase to a maximum of 10 per cent.[61]

7.2.3 Undergraduate student cross-subsidy has probably increased

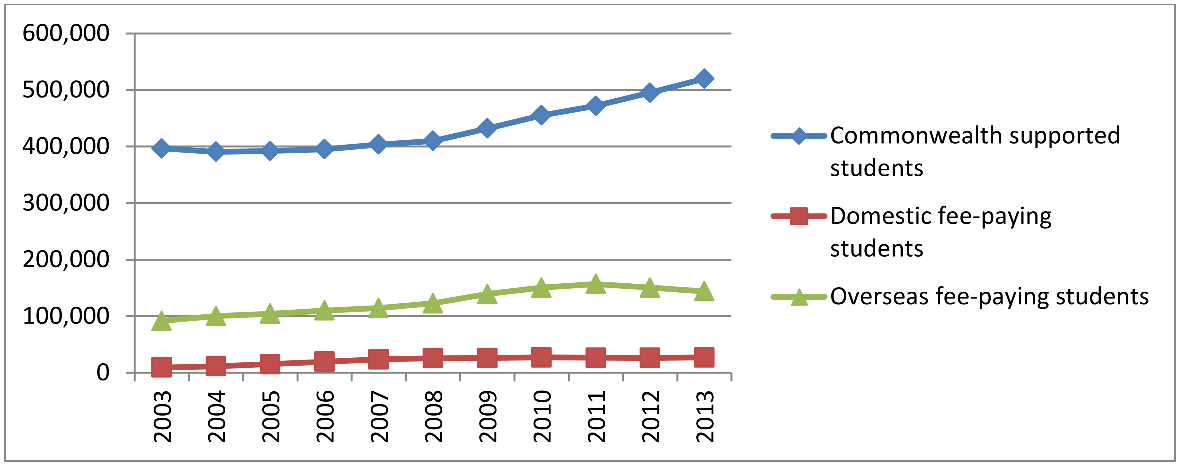
The *Base Funding* costing study was conducted in 2010. Given subsequent changes in university funding, that study is now out of date.

From 2009, the government phased-in allowed universities to enroll as many undergraduate students as they like, to deliver greater funding. This drove a large increase in enrolments, as shown in Figure 11. The possibility of new research funding from new students "explains willingness to supply additional places".[62]

Figure 11: Undergraduate student load[63]

[58] As reproduced in the *Review of the Demand Driven Funding System*, page 73
[59] *Base Funding Review* (2011) page 48
[60] *Base Funding Review* (2011) page xii
[61] The Panel also consider costs per-student when including "research funded from general revenue", which they found to be 22 per cent higher than the level of per-student funding. The figures together allow us to calculate that 21 per cent of the total unfunded research costs were derived from domestic undergraduate student revenue.

[62] *Base Funding Review* (2011) p91
[63] Department of Education, *Higher Education Statistics*



In addition, new students often have "low marginal costs". If *extra* students can be accommodated at a lower cost, they provide a greater surplus for research per new student.[64] For example, as Ian Young has said there is a "perverse incentive for universities to cram hundreds of students into lecture theatres".[65] The lecture is a fixed cost while each new student is extra revenue.

Given that this does not lead to fees going down or to an increase in teaching spending, new students at low marginal cost have probably driven up the rates of cross-subsidy.

Therefore the cross-subsidy from undergraduates could be *at least* as high as the maximum deemed 'reasonable' in the *Base Funding Review*. It could be higher, certainly at some universities. Moreover, deregulation risks exacerbating this dynamic.

7.2.4 Calculations for domestic undergraduate student cross-subsidy

Assuming the rate of cross-subsidy has stayed the same, we can estimate student payments for research in 2013. Figure 12 shows domestic undergraduate student fee contributions pro-rata.

Figure 12: Cross-subsidy from domestic undergraduate student revenue (2013)[66]

	Total domestic undergraduate student revenue	Domestic undergraduate student fees	Payment per student from fees – ($ per year)
Total	$10,888m	$4,308m	
Cross subsidy at 6%	$653m	$259m	$489
Cross subsidy at 10%	$1,089m	$431m	$813

[64] Grattan Institute (2014) *Mapping Higher Education 2014-15*, page 57
[65] https://go8.edu.au/sites/default/files/docs/article/national_press_club_speech_-_ian_young_pdf_version.pdf
[66] CGS, HELP payments (minus FEE-HELP), upfront contributions – Department of Education, (2014) *University Finance Publications*

The total level of cross-subsidy from domestic undergraduate students in 2013 was at least $650 million and may have been as high as $1.09 billion. That is around 20-30 per cent of the research funding shortfall in 2012.

Through student fees, undergraduate domestic students contributed $260-430 million for research, or around $500-800 extra per year on average.[67]

However, if we are interested in how much students are “overcharged”, it may be more appropriate to treat the cross-subsidy as coming only from student fees.

If universities did not use student revenue in order to pay for research, they could lower fees or increase educational quality. Similarly, if universities increased their fees in order to increase spending on research, it would be plausible to say the students themselves are paying for the increased cross-subsidy towards research.

On this basis, the current level of ‘overcharging’ is calculated in Figure 13.[68] If universities did not use student revenue to pay for research, they could reduce fees or increase teaching spending on average by 15-25 per cent, equivalent to $1,232-2056 per student in 2013.

[67] In 2013 there were around 530,000 Commonwealth Supported students in undergraduate study (full time equivalent). Department of Education, *Higher Education Statistics*
[68] Excluding payments through FEE-HELP for full fee paying domestic students. These students are likely to produce a larger surplus to universities.

Figure 13: Student fees in excess of teaching costs (2013, using 2010 rates)

Total cross subsidy – here paid from student fees	Per student ($ per year)	Share of student fees ($4,308m)
$653m	$1,232	15%
$1089m	$2,056	25%

Alternatively, we can assume the government provides the per-student research component. In this case, we must exclude it as a contribution towards the "cost of the student's education". Combined with cost-shifting from the 20 per cent cut to government funding, this would mean students are being asked to fund 55-57 per cent of the actual costs of their education on average. This is assuming fees do not increase beyond the cost-recovery scenario.

In other words, the only way the government could be correct to say students and taxpayers will pay 50:50 for their education is if student funding on average *decreases.* That means universities would on average not recover the lost funding through fees.

8 Conclusion

In the debate about how high fees could go, little attention has been given to a more fundamental question. When students pay higher fees, what will they get?

It seems that a major principle underlying the proposal is to allow universities to use greater student revenue to fund research. There is a long practice of cross-subsidy at universities and an equally long debate about the problems it causes. Increasing cross-subsidy levels show universities face strong incentives to charge students more in order to pay for research—which could increase under deregulation.

The Parliament must decide whether it is appropriate for students to pay more to fund research.

Vice chancellors, certainly at our public universities, should explain how much of the higher fees will go towards their students' education.

Any future reform must involve a clear and honest public debate on the ethics and economics of whether students should pay for research.

Those concerned about rising fees should closely consider the possibility of regulations limiting the appropriate amount of cross subsidy. This would require giving a regulator new statutory powers, which are not included in the Bill.

The Parliament should increase research funding so it more fully cover the costs of research. The research funding regime should be reorganised so that every new dollar for research does not requires large cross-subsidy from elsewhere in the university's budget.

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The Australia Institute

Research that matters.

Unsustainable Higher Education

Submission to the Senate Inquiry

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TAI

Technical Brief

The Australia Institute

Research that matters.

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TAI

To the Senate Education and Employment Legislation Committee,

The Australia Institute welcomes the opportunity to make this submission to your inquiry into the *Higher Education and Research Reform Amendment Bill 2014*.

Just as there is no budget emergency requiring urgent and drastic austerity, there is no urgent need to rush through radical changes to our higher education sector. Rather there is a need for a longer and better informed debate.

Given the scale of the reforms and the complexity of the issues involved, a responsible decision on these matters would be difficult in the short period allotted. Nonetheless, the following arguments are important to consider.

We are also being told there is a need for savings to the budget and arrest financial dire straits in the sector. But the savings measures are not necessary and will do little to help the deficit. More not less public funding would better serve the public interest. Nonetheless the financial status quo for the sector is ‘sustainable’. Contrary to what many argue, even if funding is cut, this does not require fee deregulation.

However, for graduates, the Bill will create unfair and unsustainable HELP debt. All graduates will bear more debt, make more repayments and take longer to repay. But the impacts are much greater on those with the lowest incomes, those in lower paying careers and women. More than one in ten graduates, who would have repaid their debt, now would not. The impacts would be even greater on the one in five students who accrue a debt but do not graduate, and so do not experience the earnings premium. In turn, increasing unsustainable HELP debt will increase costs to government and offset they intended savings.

The Minister wants to take our system goes in the direction of the US system. The evidence shows this would risk increasing social inequality. It would also risk very large and wasteful fee inflation. US fees have increased at twice the rate of their health care.

We are being told that students are simply being asked to pay a bit more for their education. But in reality we will be asking them to make larger ‘co-payments’ to cross-subsidise research. This is unfair and unpopular.

Resisting the government’s false urgency would allow the Senate and the sector to purse a more considered debate about the future of Australia’s higher education and research, the public goods it provides and the funding and policies they need.

We welcome the opportunity to present these important issues to the Committee.

Sincerely,

The Australia Institute

Cuts are not needed and do not necessitate deregulation

There is no budget emergency

The government has frequently argued that the budget must be made 'sustainable'. The cuts to funding and application of real interest to HELP debts appear to be cuts to expenditure with little greater policy purpose. They will have a small impact on the budget in the short term, just $3.2b over estimates. That is far smaller than alternative and fairer savings, such as winding back the $36b we will spend this year on superannuation tax concessions that overwhelmingly favour the wealthy. Yet the smaller, less fair cuts to higher education will lock in large, long-term negative impacts on graduates.

The cuts rest on the pretext of a "budget emergency". As 63 Australian economists argued in a recent open letter, there is no crisis requiring urgent and drastic austerity.[1] Indeed, this would make our situation much worse, deepening inequality and eroding public services.

Australia is among the richest countries in the world at the richest moment in world history. Yet our elected government seems intent on telling us what we cannot afford. If we cannot afford the benefits of a well-funded higher education system, it is because we are not collecting enough revenue in a fair way.

The claimed savings will do little to the repair the budget

Shifting costs onto students, or increasing the interest rate on their HELP debt, will do little in the short term to repair the budget deficit. In accrual terms the government saves on merely notional outlays and some spending goes off budget. In cash terms the government deficit goes up, and it may too in accrual terms.

One cost of the student loan schemes, as reported in the budget papers, is the implicit subsidy on the outstanding debt at any one time. The government says that it can borrow at the government bond rate, so when it provides loans using interest below that rate, the difference is recorded as a subsidy. This is a quirk of what is called accrual accounting and it is only a notional payment. Since there is no actual cash changing hands, it is not recorded in the budget's cash accounting.

The cash accounts only reflect money loaned for fees and reflects the repayments of debt when that takes place. In the cash accounts the money that the government pays on behalf of students is treated as an outlay while debt repayments are treated as revenue. Of course eventually under the proposed new rules, more cash will be paid back but that will occur well into the future.

In summary the present indexation arrangement is treated as a notional expense that would be eliminated by the budget proposal to index student debt against the bond rate. However, there is little additional revenue raised in the near future so there is effectively no impact on the cash budget. In the short term repayments would only change significantly if there were a change in the repayments schedules administered by the tax office.

Any increases in fees are reflected in higher loans (or higher up-front payments). The government loans the fees to students and it pays directly to universities. While the cost shifting is a cost saving in accrual terms, the headline cash balance is unchanged. Payments from the government to the university go down but the payment on behalf of the student goes up by the same amount. So there is no impact on total outlays at all.

[1] 2014, "Economists Statement on Commonwealth Budgetary and Economic Principles", available at <http://www.tai.org.au/content/economists%E2%80%99-statement-commonwealth-budgetary-and-economic-priorities>

Of course, uncapping fees means universities will likely increase them by more than the amount needed to recover lost revenue. In that case, students will borrow more and so the headline cash balance will in fact worsen.

In addition, in accrual terms the deficit may go up if repayment periods for debt and in particular 'doubtful debt' make the value of loans written off increase by more than the reduction in cash outlays. The UK Institute for Fiscal Studies found this is likely the UK, following the dramatic increase in fees from 2012 under their HELP-like loan scheme.[2]

Cutting funding does not require fee deregulation

There is no immediate need to cut higher education funding, but if there were, it could be resolved without deregulating fees.

Chair of the Go8, Prof. Young described deregulation as a 'lifeline' out of a lose-lose situation, where university funding per student has eroded over recent decades, while total funding from the government has increased.[3] Again, if this were the sole concern, it could be resolved without fee deregulation.

The government could shift costs onto student HELP debt. That would leave per-student university revenues at the same level while varying the contributions from student fees and from government funding. This sort of cost shifting has happened many times in the past.

The status quo for universities is 'sustainable'

There is no immediate crisis in university finances, but if there were, it could be solved without deregulating fees.

Status quo funding arrangements would *not* lead to further erosion of per-student funding. Per-student funding fell due to the fact that between 1997 and 2012, government contributions were not correctly indexed to wage costs.[4] This lead to a slow, but material decrease in per-student funding in real terms. Other cuts to government funding were offset by increases in student fee caps. In 2012 government contributions were indexed to the relevant wage indices, preventing further erosion. Labor has rescinded its 2013 commitment to impose an extra 'efficiency dividend'.

By contrast, the government proposes to cut government contributions for courses by 20 per cent on average. In addition, they propose lower indexing of government funding, which would lead to further erosion over time. That is clearly not sustainable without shifting costs onto students. But the pressure comes from the funding cuts, which are not inevitable.

The government should be expanding not cutting funding

Part of the reason for increasing the share of higher education costs borne by the student seems to be the view that the benefits of education go to the student and so the student should pay. This view is certainly reflected in the Government's National Commission of Audit which said:

> *The Commission considers that a rebalancing of the public and private contributions to higher education is warranted, reflecting the substantial private benefits that arise from higher education. … Changes should be made to the existing Higher Education Loan Programme arrangements to increase repayment rates by lowering the income*

[2] Crawford et al, 2014, "Estimating the public cost of student loans", Institute for Fiscal Studies, Available at <http://www.ifs.org.uk/comms/r94.pdf>
[3] Young, 2014, "Survival of the deregulated", 14 July, SHM, available at <http://www.smh.com.au/comment/survival-of-the-deregulated-20140714-zt6lq.html>
[4] Grattan Institute, 2013, "Mapping Australian Higher Education", p42, available at <http://grattan.edu.au/wp-content/uploads/2014/04/184_2013_mapping_higher_education.pdf>

threshold at which student loans are repaid and ensure interest rates reflect the Commonwealth's full costs in making these loans including the cost of bad and doubtful debts.[5]

A large proportion of the benefits of higher education accrue directly to the individual students, through improved employment prospects and higher lifetime incomes.[6]

However the Commission of Audit's view is not supported by the OECD, which has pointed out that education generally and higher education in particular generates higher public returns, benefits for society as a whole. Indeed, Australian data quoted by the OECD shows that the private return to higher education when expressed as a rate of return on outlays and foregone earnings is 9.0 per cent for males and 8.9 per cent for females. However, the public return on investment is 12.9 and 13.5 per cent respectively for males and females.[7]

That figure though large is also a large underestimate since it really only measures the net fiscal contributions of the graduate and that is mainly the greater tax contributions on the higher expected income. Those calculations do not include the increases in the value of an educated employee to a future employer or the increased opportunities for economic development with a large pool of educated people. Other OECD studies that have examined the impact of education on economic growth find that the equivalent of each extra year of education increases economic activity by approximately 4 to 7 per cent across OECD countries in the long run.[8] Higher education drives innovation and productivity, supplies vital skills for a knowledge economy, and improves health outcomes.[9] Public returns to public investment in research are also substantial, between 20-40 per cent in most cases in some cases much higher.[10]

Figure 1 shows OECD figures for public costs and benefits from a man's higher education in different countries. Australia is very close to the average for benefits but has lower public investment costs. Note the majority of the benefits considered here are increased tax. This does fully not consider the broader increases in productivity.

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5 National Commission of Audit (2014) *Towards responsible government: The report of the national commission of audit, Phase one*, February, p. xxiii.
6 ibid, p. 153.
7 OECD (2013) *Education at a Glance 2013: OECD Indicators,* OECD Publishing.
8 OECD (2003) *The sources of economic growth in OECD countries*.

9 KPMG Econtech, 2010, "Economic modelling of improved funding and reform arrangements for universities", available from Universities Australia.
10 Ibid.

Figure 1: OECD data for public costs and benefits of tertiary education

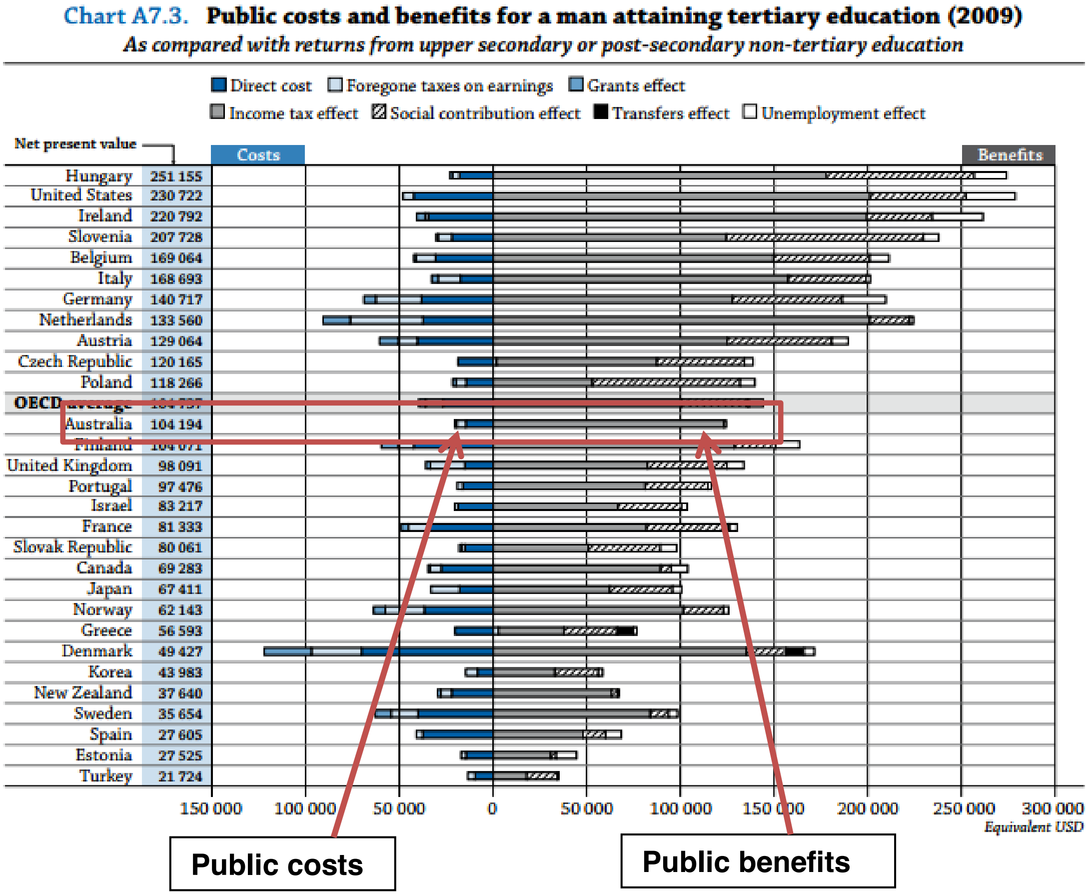
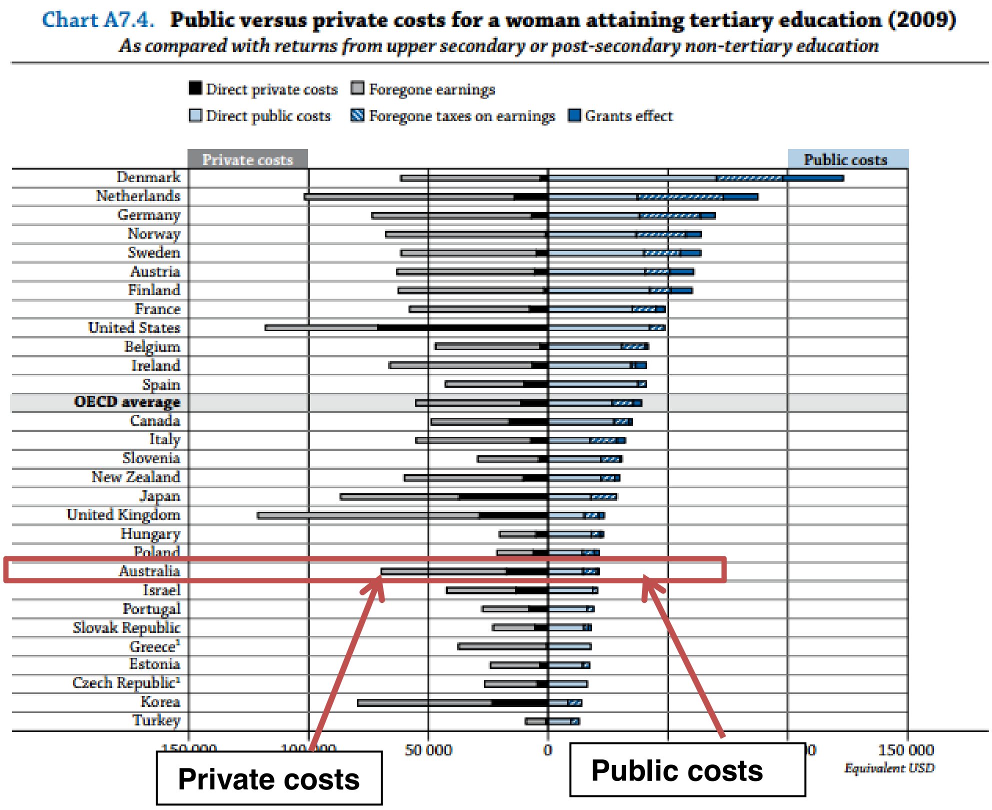


Figure 2 shows Australia has slightly higher private funding but much lower public funding for higher education in compared to many OECD countries. Australia seems very well placed to benefit from increased public investment.

High public returns to investment show that increased funding to the sector is in Australia's national interest. The fact that some portion of government budgets is increasing faster than others does not make it unsustainable. Higher education is best viewed as a superior good: we should invest a higher proportion of our income as we get wealthier. It is inherently valuable but it also helps boost our economic productivity and transform our society.

Figure 2: OECD data for private and public cost of tertiary education[11]



Even commentators who support fee deregulation, and so higher private costs. have argued the strong public good component of higher education and research also requires greater public funding.[12] Without public funding and direction, the system will pursue incentives provided by private interests, not Australia's national interest.

Many of the public goods from higher education and research relate to technology, health, agriculture and other applied fields. While some cannot be quantified, they still provide valuable public goods.[13] Focus on quantified, monetary returns to investment is "anti-educational" if it ignores those other goods.[14]

The Bill increases unfair and unsustainable debt

Lower income graduates and women will be harder hit

Increasing fees and the interest rate on HELP debt will increase repayments and repayment periods for all graduates. But the impacts will be biggest for those who earn less. It will impact those who take time out of the workforce, for example to raise a family, or who are under employed. Women are more likely to fall into lower income groups and more likely to take time off to raise a family, meaning they will be hardest hit by the proposals. Again lower income women will be hit harder still.

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[11] Ibid.

12 Withers, 2014, "The solution for universities is more than just a simple boost to competition", 14 Aug, AFR, available at <http://www.afr.com/p/national/education/the_solution_for_universities_competition_v2sC1p0E5gfv2Wta795QVO>

[13] Yet universities and governments do admit its value: all research contributes to university rankings with which universities and governments are obsessed.

[14] NORRAG, 2007 "Rate Of Return To Education: Best Practice?" available at < http://www.norrag.org/es/publications/boletin-norrag/online-version/best-practice-in-education-and-training-hype-or-hope/detail/rate-of-return-to-education-best-practice.html>

This has now been explored by a number of commentators. Extensive treatment is provided by Chris Ryan's recent report "Impact of the Australian Higher Education Funding Reforms".[15] Ryan uses Household Income and Labour Dynamics in Australia (HILDA) data to model the effects of the reforms on graduates at different places in the male and female graduate income distribution. He uses a 'base' scenario of fee increases, where fees are assumed to be $19500 per year. The results are similar across other scenarios.

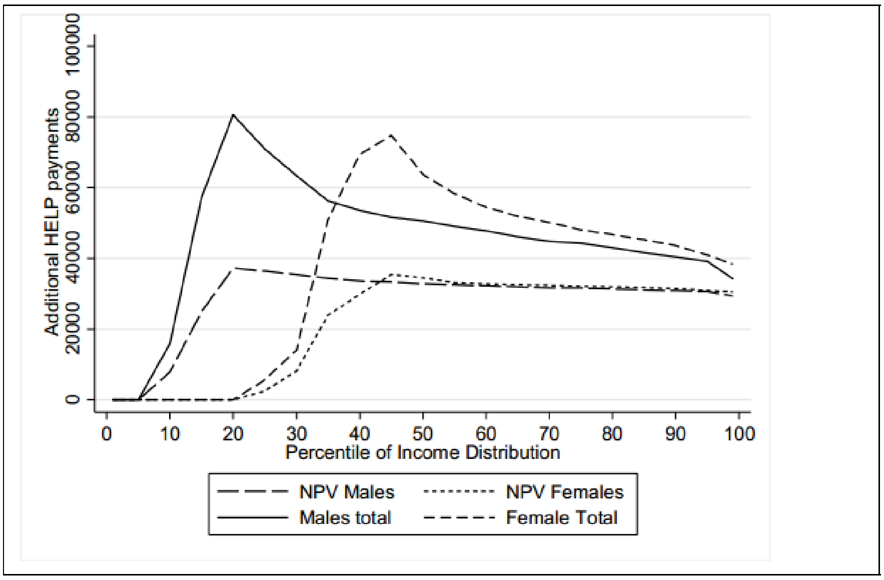
In short, Ryan finds:

- total repayments increase, a lot more for lower income graduates,
- repayment periods double,
- more graduates never fully repay, despite paying more -- up to 10 per cent of male graduates and 15 per cent of female graduates,
- all parts of the proposal contribute to unequal debt, not just the interest rate.

Ryan's focus on distribution is important. Graduates on average have higher incomes, at a particular time and over time, but not all graduates have high income. A recent report by the Go8 includes three case studies of HELP debt repayment, but the lowest income example is at the 40th income percentile.[16] Ryan's study shows the biggest impacts are at the 10-20 per cent mark for men and 35-45 per cent for women, lower than 40 per cent of the total.

Figure 3 shows additional HELP repayments. All graduates repay more, but the increase is far bigger for low income graduates, especially for those who repay for the longest. Male graduates at the 20th percentile repay the most, with an additional $80,000 over their life.

Figure 3: Additional HELP repayments across income distribution[17]



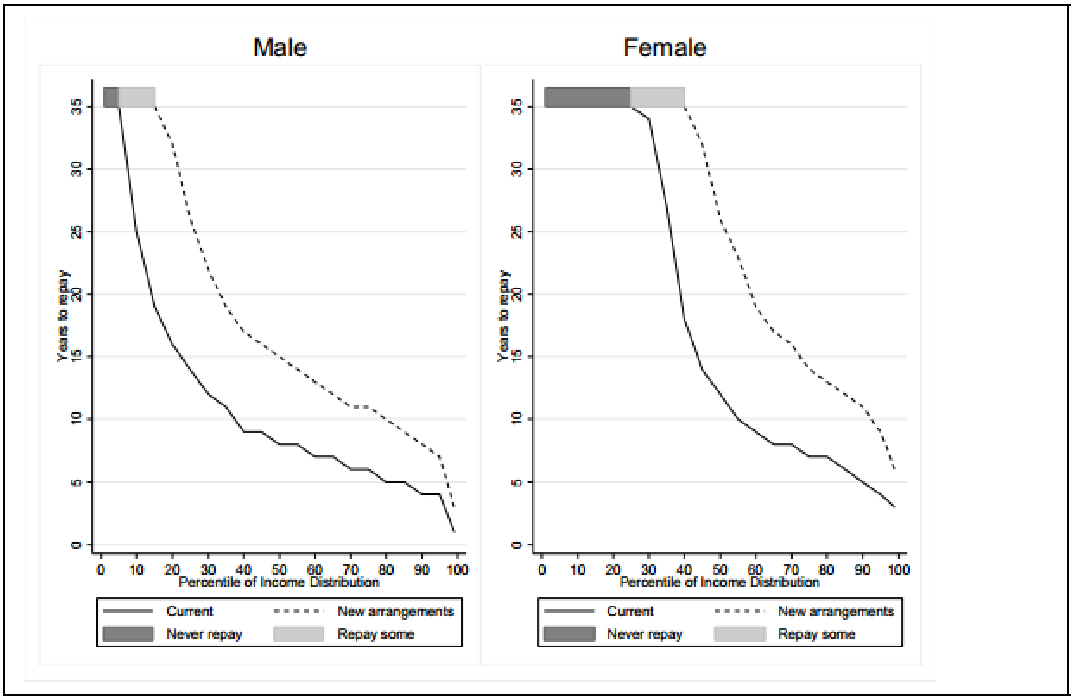
[15] Ryan, 2014, "Impact of the Higher Education Funding Reforms", Melbourne Institute, Policy Brief Available 2/14, available at <http://melbourneinstitute.com/downloads/policy_briefs_series/pb2014n02.pdf>

[16] Group of 8, 2014, "Policy Note - Paying off HELP debts: case studies", August, p4 available at <https://go8.edu.au/sites/default/files/docs/publications/new_txt_paying_off_help_debts_case_studies_final.pdf>

[17] Ryan, 2014, "Impact of the Higher Education Funding Reforms", p5

Figure 4 shows repayment periods double for most graduates. At median incomes, men take 15 years and women 26 years to repay. Increases in repayment periods are much bigger for lower income graduates. In addition, many more people never fully repay their debt, despite making greater repayments over their lifetime. The reforms mean an extra 15 per cent of male graduates and an extra 25 per cent of female graduates never fully repay. That is, more than one in ten graduates will make loan repayments over their lives but never fully repay their debt.

Figure 4: Increased time to repay across the income distribution[18]



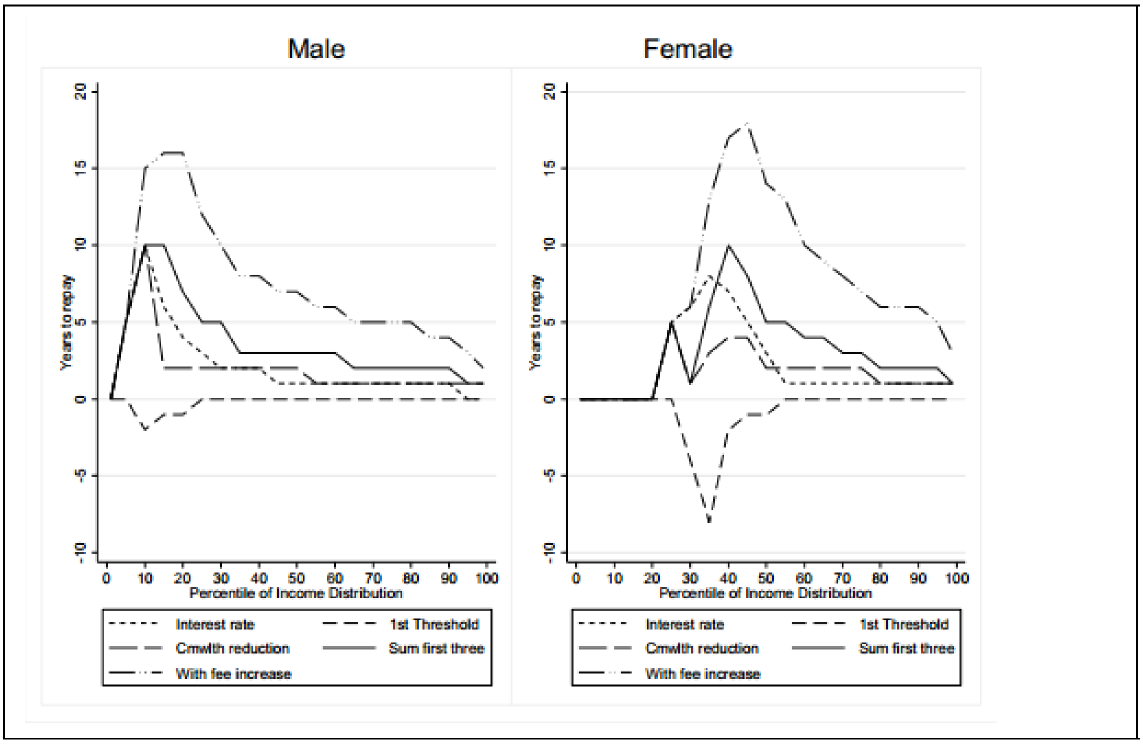
Ryan's results obscure the impact on those who face periods with lower incomes. For simplicity Ryan's modelling assumes that people stay within the same income bracket for their whole lives. But time spent at lower incomes, for example, time out of the workforce or time spent unemployed and looking for work will all increase the debt burden.

All impacts would be worse for someone who does not finish their degree. One in five people who start higher education in Australia do not graduate.[19] These people do not experience an income premium from their degree. That means they are likely to experience a larger debt burden for a given level of debt than shown in Ryan's analysis.

Figure 5 shows all aspects of the proposal – funding cuts, further increased fees and increased interest rate – contribute to Ryan's results in their own right.

[18] Ryan, 2014, "Impact of the Higher Education Funding Reforms", p6
[19] OECD, 2013, "Education at a Glance", p66, available at <
http://www.oecd.org/edu/eag2013%20(eng)--FINAL%2020%20June%202013.pdf>

Figure 5: How different parts of the Bill impact repayment periods[20]



The budget papers describe the increase in the interest rate on HELP debt as creating "Sustainable Higher Education", and has spoken much about reducing government debt. But the government seems unconcerned about creating unsustainable HELP debt for graduates. The Bill will increase the number of graduates who have debt that increases faster than they can repay it.

[20] Ryan, 2014, "Impact of the Higher Education Funding Reforms", p7

If unsustainable HELP debt is a problem, then so is this Bill

Increasing debt that is never repaid impacts on graduates, but it also impacts on the budget. The government seems to think the large increase in outstanding HELP debt in recent years is itself a problem. Discussing “unsustainable and rising costs”, the Regulatory Impact Statement (RIS) notes “the value of student HELP debt is also estimated to rise to around $29.9 billion at 30 June 2015”.[22] Yet the Bill increase outstanding HELP debt. Moreover, it will increase the HELP debt that will not be repaid, in volume and in proportion of total debts.

If the government is concerned to cut spending and reduce government debt, it is not clear how increasing total HELP debt and unsustainable HELP debt will to a sustainable system. It will increase outlays and increase costs.

The UK is already some way down this path. After a big increase in fee caps in 2012, the UK government already thinks 45 per cent of the debt will not be repaid, up from 28 per cent initially projected.[23] The Institute for Fiscal Studies argued this means accrued costs to government may have actually increased.[24]

Already, there are concerns about increasing HELP debt under our current system. Facing increasingly large volumes of accumulated doubtful HELP debt, future governments may be tempted to drop the repayment thresholds, increase repayment amounts or introduce upfront. That would increase inequity for the graduates and undermine HELP’s policy purpose.[25] One could argue that makes the changes unsustainable for the HELP system.

Governments in the future may try to recover some doubtful debt. Additionally, governments could also view some level of doubtful debt as part of a modest annual cost of an income contingent loan system that works well. But the current government has not considered the dramatic increase in doubtful debt that will ensure and which appears to counter its stated aims.

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[22] Commonwealth Government, 2014, “Regulatory Impact Statement”, p28, available at <http://www.comlaw.gov.au/Details/C2014B00180/Other/Text>

[23] BBC, 2014, “More student loans won't be repaid, government believes”, BBC Online, 22 May, available at <http://www.bbc.com/news/education-26688018The>

[24] Crawford et al, 2014, “Estimating the public cost of student loans”, Institute for Fiscal Studies, Available at <http://www.ifs.org.uk/comms/r94.pdf>

HELP supports access but unfair debt creates social inequity

Unlike in the US, Australia's income contingent government loan system for student fees means the loans cannot cause severe financial hardship. This limits the extent to which increased debt burdens restrict access to those on low incomes.

Yet those who end up on low to middle incomes and have to repay their HELP debt for longer will face extra debt burdens as graduates for longer than higher earning peers. That means graduates will have less income with which to invest. This could affect housing affordability or retirement savings. It could affect ability to start a small business. It may also affect the decision to start a family.

As these impacts become more widely known, some from lower income backgrounds may show higher aversion to these risks, counteracting the insurance mechanism. That would hold especially if those from low income backgrounds go into degrees for lower paying careers. Those with wealthy parents are more likely to avoid these debt burdens, as their parents may pay HELP debts up front or assist in payment early in the life of the loan. Together, these impacts would further exacerbate social inequality and hinder social mobility. They would also drive stratification by wealth within the sector.

They may also further deter people from going into lower-income careers options following expensive degrees, for example medicine and general practitioners, or law and community legal services. It would not be in the public interest to further discourage people from making those career decisions.

"We have much to learn" from USA, namely what not to do

The Minister has said that we have "much to learn" from the US system.[26] Based on the outcomes from the US system, we should be trying to learn what not to do to ours. Nobel Laureate Joseph Stiglitz said it would be "a crime" to take our system in the same direction as the US sector, having direct experience of the US system and having studied it at length.[27]

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[25] HELP is an equity measure. By design, people with HELP debt cannot default on that debt, as repayments are determined by income. This is the government acting as 'risk manager', preventing financial hardship from the loan during times of lower income. It also provides macro-economic stabilisation for periods of downturn.

[26] Knott, 2014, "Education Minister Christopher Pyne: set universities 'free' to create a US-style system", 28 April, SMH, available at <http://www.smh.com.au/federal-politics/political-news/education-minister-christopher-pyne-set-universities-free-to-create-a-usstyle-system-20140428-zr0vc.html>

[27] Martin, 2014, "Nobel prize-winning economist Joseph Stiglitz says Abbott government budget changes are 'a crime'", 3 July, Available at <http://www.smh.com.au/federal-politics/political-news/nobel-prizewinning-economist-joseph-stiglitz-says-abbott-government-budget-changes-are-a-crime-20140702-3b8vb.html>

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An appendix includes an Australia Institute infographic which outlines some major problems with the US system. It produces very unequal results for those from lower socio-economic backgrounds, especially in enrolment and completion rates.

It is important to recognise that HELP will to some extent protect Australia from some of the worst outcomes of the US system. For example it stops tuition loans from causing severe financial hardship, which is all too common in the US. It may also prevent some inequity of access issues, although once fees increase and the sector stratifies it is unclear how much. However, the Bill would move the HELP system substantially towards the US style of higher education.

One theme the government and universities emphasise, when praising the US sector, is the role deregulation could play in allowing 'diversity' and 'autonomy', as well as driving higher peaks of research 'excellence'. But it must be recognised that this is not a sufficient argument for cost cutting, cost shifting and deregulation.

Again, Germany provides an important counter example. Following domestic political pressure Germany recently made its higher education system entirely free to students, entirely publicly funded. It conducts excellent research, reflected in the fact that it has institutions that perform very well in global rankings. Their admissions system involves a number of equity safeguards while still focusing on merit selection, and high local diversity. The sector and funding arrangements involve substantial differentiation of institutional tiers. There is also marked differentiation in 'missions' and institutional culture within tiers. While the German system no doubt has its own problems, it shows the proposals in the Bill are not the only way to improve higher education, if there is sufficient political will.[28]

Deregulating fees risks wasteful fee inflation

There has been considerable debate about how high fees will go under a deregulated system. Whatever initial fees are set at, fees are likely to increase further over time. It is unclear what checks in our current system would stop this. A spiral of fees could make deregulation hard to undo.

Supposedly high market competition has not prevented dramatic increases in tuition fees in the US. Figure 4 shows how US tuition fees compared against indices of other goods and services over the last 30 years. Tuition fees have increased by almost 12 times over the last 30 years, far faster than US healthcare.

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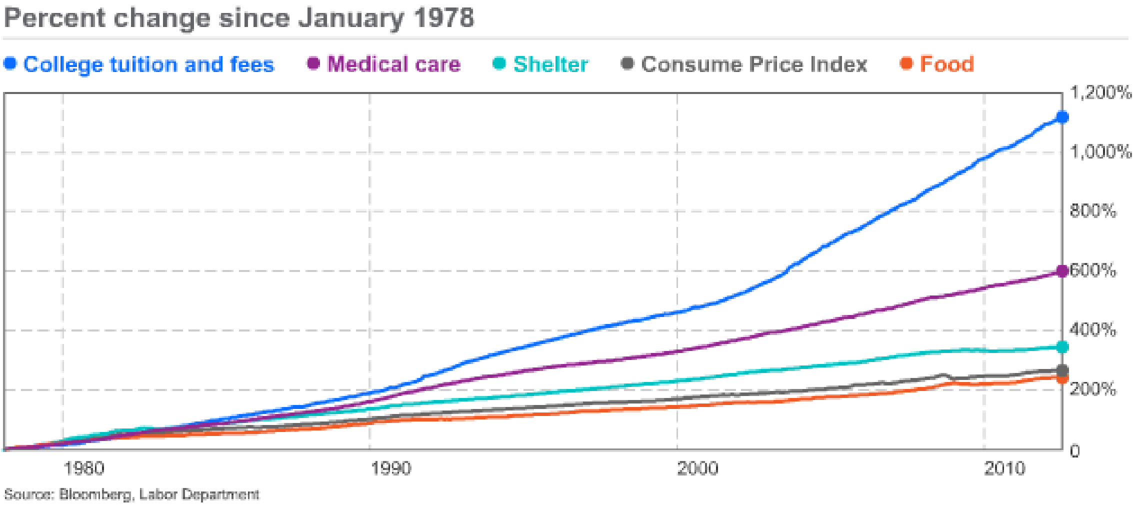
28 Some of this is a matter funding volumes. Some is also a matter of funding methods. The Australian system arguably imposes onerous reporting and inefficient competition for funds, which in turn promotes excessive managerialism and wasteful administrative churn. For example, on the waste caused by ARC grant applications, see
Herbert et al, 2013, "Australia's grant system wastes time" in *Nature*, 495, 314, available at <http://www.nature.com/nature/journal/v495/n7441/full/495314d.html>

Figure 6 Increase in US tuition fees, compared with other indexes[29]



Prestige projects, endowments, expensive infrastructure and bloat in administration have all been alleged to be drivers of this tuition spiral. Whatever the incentive from universities, it is clear the competitive market constraint on the market side has not worked as promised. US policy making, far from arresting the spiral, has made it worse.[30] There seems little reason to think the HELP system will prevent this sort of dynamic. Indeed, the lack of upfront costs and income contingency, themselves virtues, may even make inflation worse, since they insulate students from the price and provide no budget constraint.

Deregulating fees encourages fee-gouging to pay for research

Under the Bill, more of the current costs will be shifted onto student debt. As the vice chancellor of the Melbourne University has noted, students “will get nothing new for this extra debt”.[31] Beyond that, universities will increase fees even further. There is no guarantee extra debt will all or even primarily go towards that student’s education.

The Minister has said that students are being asked to contribute more for their education. In reality they are likely to be asked to contribute more for research.

Higher education does not work like markets for steel

Allowing the preferences of teenagers or young adults to direct decisions about large amounts of debt for which they are insured through the HELP system seems a very odd way to create a competitive market. As Joseph Stiglitz and has argued, higher education markets do not work like markets for commodities like steel. Originator of the HECS scheme Bruce Chapman, economist and ANU Director of Policy Impact, has frequently argued that enrolment decisions are likely to be highly insensitive to price. A market that is not sensitive to price does not encourage feedback mechanisms that would keep prices under control. Hence the ‘market’ would not work well.

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29 Bloomberg, 2012, “Cost of College Degree in U.S. Soars 12 Fold: Chart of the Day”, available at <http://www.bloomberg.com/news/2012-08-15/cost-of-college-degree-in-u-s-soars-12-fold-chart-of-the-day.html>

30 Frank, 2014, “Colleges are full of it: behind the three decade scheme to raise tuition, bankrupt generations and hypnotise the media”, Salon, available at <http://www.salon.com/2014/06/08/colleges_are_full_of_it_behind_the_three_decade_scheme_to_raise_tuition_bankrupt_generations_and_hypnotize_the_media/>

31 Davis, 2014, “Working through the budget implications”, 30 May, available at <http://vcblog.unimelb.edu.au/2014/06/02/working-through-the-budget-implications/>

The HELP system provides no budget constraint to enrolees. That means there is no optimising at the margins. But even if there were, there are a number of other market failures that undermine the claimed competition of higher education fee markets.

One problem is that the system will follow private incentives. Providers have an incentive to meet student desire to pay for qualifications. Thus there is a strong incentive, and pressure on academics, for to provide lower quality education or inflate marks.

One problem is that higher education quality is very hard to ascertain from the enrolee's perspective. Another is the private interest in higher education as a positional good. Together that creates the *wrong sort* of price signal: price itself signalling prestige. As in the US, this means government policy would reward prestigious institutions simply for having a high price. Others would try to follow. In addition universities may post excessive fees but then discount through complex and fast changing 'scholarship' schemes. But that would leave the student poorly placed to judge value in the market, again undermining the premise of the reform.

Soaring student debt will be a 'co-payment' for research

Universities have strong incentives to use student debt to fund research and will have the ability to raise revenue through student debt.

Since some research funding depends on research output, there is an incentive to boost one revenue stream to boost another. There will also be both political and market incentives. Most global ranking systems overwhelmingly favour research. Yet governments, administrations and students alike attach prestige to these rankings. Universities often feature rankings in promotional material. The focus is on these rankings even when discussing education quality, despite the fact that the rankings are poor measures of educational quality.

Incentives to cross subsidise are exacerbated by cuts to research funding, such as those in the Bill. Yet the RIS cites a reduction in temporary research funding programs as a reason to push on with the reforms rather than allow "no change". [32] That assumes that student debt will plug the shortfall, presumably also of the research funding cut in the Bill.

Vice chancellors have been reluctant to talk about how much of any increased fees will go to research. Yet as the Minister recently said the reforms are intended to arrest a looming decline in research rankings.[33] Vice chancellors have also linked fee deregulation with increased research rankings. That makes sense only if the intention is to use student debt to fund research.

The Go8 Chair Prof. Young has argued there is a perverse incentive to provide volume over quality in both teaching and research.[34] We address some concerns about research metrics

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[32] "Beyond its teaching related impacts, the no change option would have some broader impacts on the funding available to HEPs. More specifically, as the funding for time-limited programmes (such as the NCRIS and the Future Fellowships scheme) would not be renewed, public universities would have access to less research funding. This would likely have flow-on impacts to the ability of public universities to maintain their current research capabilities and comparative standings."

Commonwealth Government, 2014, "Regulatory Impact Statement, 2014-15 Budget Higher Education Reforms", available at <http://www.comlaw.gov.au/Details/C2014B00180/Other/Text>

[33] On the Bolt Report, 2014, available < http://ministers.education.gov.au/pyne/interview-andrew-bolt-bolt-report-network-ten>

[34] Osborne, 2014, "ANU vice-chancellor Ian Young delivers damning report card on Australian universities", 30 July, ABC Online, available at <http://www.abc.net.au/news/2014-07-30/anu-vice-chancellor-ian-young-delivers-damning-uni-report-card/5635964>

in an appendix. On teaching, Young's claim is instructive. It shows research expenditure is more valuable to university administrators than offering the best quality education available at a price point. That is, there is a strong incentive to cross subsidise. Deregulation will only feed that incentive.

This points to a need for greater research funding. But even that would not necessarily decrease the incentive to cross subsidise from deregulated fees. If administrators see marginal benefits to university finances from shifting student derived revenue towards research, they will try to do so, even if research is better funded.

The potential to cross subsidise will entrench the advantages of the Go8. The universities with existing prestige will be best able to charge more for their degrees. This will give them more resources to fund research, boosting research rankings, and so boost prestige, and so capacity to raise fees. Universities with less initial prestige will be less able to enjoy this feedback. If we accept that buying prestige alone should not be the goal of deregulated fees, this would again be a wasteful outcome.

Using student debt to fund research is not fair and is not popular

Putting students into more debt for their study so that universities can fund research is akin to forcing the sick to make a 'co-payment' for future medical research when they to go and see the doctor.

Research that benefits the public good ought to be publicly funded. It is unreasonable to expect it to be funded by student debt. The point is reinforced when we remember the increased debt hits hardest those with the least. This position has been made by high profile higher education commentators, including Nobel Laureate Brian Schmidt[35] and the author of the HECS scheme, ANU economist Bruce Chapman.[36]

It is also the position of the majority of Australians. In a representative survey of the public held after the Commission of Audit but before the Budget, The Australia Institute asked people if "Student debt should not be increased beyond what it costs to educate the student". 77 per cent said no and only four per cent said yes.[37]

Cross subsidising research is already standard at universities, and increasing

The drive towards cross subsidy in research funding is clear in recent university finances. This is something of an open secret in the sector but not well known externally.

A report by Prof. Larkins in 2011 from the LH Martin Institute looked at the gaps between university revenue for research and university expenditure on research in 2002 and 2008.[38] We updated the study using figures for 2012, the most recent data. Details are outlined in an appendix.

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[35] Schmidt, 2014, "Students Should not Shoulder the Burden of Research", 7 June, The Australian, available (out from the paywall) at <http://www.mso.anu.edu.au/~brian/IMAGES/Research%20and%20High%20Education%20-%20Australian%20Jun%202014.pdf>

[36] Chapman, 2014, "Woroni debate", 3 June, available at <https://www.youtube.com/watch?v=NYPnKyd6CVY#t=5288>

[37] Admittedly our question did not address commonwealth contributions, but it does indicate strong opposition to cross-subsidy as such. Public opinion was measured before the debate about higher education fees that followed the budget and in the absence of any widespread awareness of current levels of cross subsidy.

38 Larkins, 2011, "Universities Cross-Subsidised Research Activities by up to $2.7 billion in 2008", LH Martin Institute, available at < http://www.lhmartininstitute.edu.au/insights-blog/2011/07/52-universities-cross-subsidised-research-activities-by-up-to-27-billion-in-2008>

Universities have spent an increasing proportion of total operating expenditure on research, up from 31 per cent in 2002 to 41 per cent in 2012. Research funding is also increasing, but slower than the growth in research spending. That means a gap is growing, which is being sourced from other revenue streams.

Figure 7 Research funding shortfall

	2002	2008	2012
Research funding minus research spending	$1.3b	$2.8b	$4.8b
Shortfall as % of operating research spending	37%	41%	50%

Clearly there is an increasing cross subsidy coming from other parts of university budgets to fund research. As Larkins argues, this includes government funding and student fees.

Cross subsidy also occurs between education costs for different disciplines. High revenue low cost degrees like law cross subsidise other degrees. Fee amounts currently bear at best a loose connection with the costs of education itself. This may suggest deregulation as a solution, to allow markets to align prices more closely with costs through competitive pressures. But given insensitivity to price and poor information on the student side, and desire to cross subsidise on the university side, competitive pressures are likely to be weak. It is unlikely that law degrees will become cheap. There is little reason to think cross subsidy will decrease under fee deregulation.

Research rankings are not just problematic for student debt, but also for the nature of research itself. We discuss this in an appendix.

Australia should not rush into radical changes to the sector

The sector does not support the Bill

Given all of its problems, it is unsurprising that there is no major part of the Bill that receives broad support from the sector. Many parts face strong opposition.

The Regulatory Impact Statement (RIS) downplays this by emphasising the views of university administrators. Universities Australia goes further, saying support for deregulation is the consensus view of the sector.[39] Yet student, alumni and academic bodies have challenged the components and the direction of the proposals, including fee deregulation. These groups represent parts of our university communities. There is no consensus on deregulation.

At least one vice chancellor, Prof. Stephen Parker of the University of Canberra, opposes all major parts of the Bill, including fee deregulation. While other dissenting vice chancellors have muted initial concerns, Parker says the reforms are "unfair, unethical, reckless, poor economic policy, contrary to the international evidence and being woefully explained, raising suspicions about how much thought has actually gone into them".[40]

[39] Universities Australia, 2014, "Universities need sustainable funding", 23 Sept, available at <https://www.universitiesaustralia.edu.au/news/media-releases/Universities-need-sustainable-funding#.VCI2aPmSyCI>
[40] Parker, 2014, "ANU-UC Forum on Deregulation", available at <http://www.canberra.edu.au/blogs/vc/2014/06/03/anu-uc-forum-on-deregulation-of-student-fees/>

We recommend the Committee consider Parker's account. His presentation to an Australia Institute event is available online.[41]

In addition, a number of other peak bodies have expressed strong concerns about the impacts of the proposed changes on their sector. That includes the Nurses and Midwifery Association,[42] the Australian Medical Association[43] and Engineers Australia.[44] This inquiry should consider their concerns as well.

Universities Australia initially called the reforms a "huge gamble" with potentially "devastating" consequences.[45] Administrations now seem to take the funding cuts to be inevitable. They now ask for less reduction in funding and for fees to be deregulated to make up the difference.[46]

It seems the government has succeeded in gaining support of vice chancellors and university administrations by trading cuts to funding in exchange for the ability to recoup more than those cuts from student debt. This was driven in particular by strong support from the Go8 elite universities, who stand to benefit the most from the arrangement.[47] That does not make it in the national interest.

While Australia would be following the UK and other countries in moving towards a 'US-style' system, this is not a universal trend. For example, as mentioned above, following domestic political pressure Germany recently made its entire higher education system entirely publicly funded. There are a range of institutions with a range of missions, collaboration with industry and excellent global research rankings. Even overseas students can get publicly funded higher education.

There is no need to ram this through

The Minister says the reforms are urgent but it is unclear why. The sector is making a surplus and is performing well. Yet there is also serious stress from decades of funding cuts and perverse consequences of regulations. Any serious need for reform would require serious debate and should not be rushed.

The Minister said the reforms must be in place before December to provide certainty for students and universities.[48] More certainty would be provided by maintaining the status quo,

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[41] Parker, 2014, "Politics in the Pub", available at <https://www.youtube.com/watch?v=5doXGR8dzko&feature=youtu.be>

[42] NMAA 2014 "Graduate Nurses Chained to HECS for life", 3 Sept, press release, available at <http://anmf.org.au/media-releases/entry/media_140903>

43 AMA, 2014, "AMA raises concerns over university deregulation push", 2 Sept, press release, available at <https://ama.com.au/ausmed/ama-raises-concerns-over-university-deregulation-push>

[44] Engineers Australia, 2014, "Higher uni fees a threat to future growth, warns Engineers Australia", Canberra Times, 30 August 2014, available at <http://www.canberratimes.com.au/act-news/higher-uni-fees-a-threat-to-future-growth-warns-engineers-australia-20140830-109xji.html#ixzz3CluZHa4P>

[45] Knott, 2014, "Education Minister Christopher Pyne: set universities 'free' to create a US-style system", 28 April, SMH, available at <http://www.smh.com.au/federal-politics/political-news/education-minister-christopher-pyne-set-universities-free-to-create-a-usstyle-system-20140428-zr0vc.html>

[46] Universities Australia, 2014, "Universities need sustainable funding", 23 Sept, available at <https://www.universitiesaustralia.edu.au/news/media-releases/Universities-need-sustainable-funding#.VCI2aPmSyCl>
Young, 2014 "Fee Deregulation Debate", 2 June, press release available at <http://vcdesk.anu.edu.au/2014/06/02/fee-deregulation-debate/>

[47] Priess and Moncrieff, 2014, "Leaked Modelling forecasts massive windfalls for top unis", 26 August, SMH, available at <http://www.smh.com.au/federal-politics/political-news/leaked-modelling-forecasts-massive-windfalls-for-top-unis-20140826-108jz6.html>

[48] "Higher Education Changes must Pass Before December, Coalition Warns" <http://www.theguardian.com/world/2014/aug/26/higher-education-changes-must-pass-before-december-coalition-warns>

or grandfathering funding arrangements for students enrolled before any changes are legislated. While the government praises those institutions that have done so voluntarily, it appeals to those who haven't to create a sense of urgency. Similarly, if the government is concerned about disruption to university planning, they could create a more measured design and implementation process.

It has been alleged that the government was considering reductions in research funding if the higher education changes are not passed.[49] It is difficult to see how any purported crisis in teaching or research quality would be served by cuts to funding and rushed reforms. Universities have suffered ongoing funding cuts to both higher education and research.

The Minister has said that this is a 'one shot' situation and if we don't do it now, our universities will go the way of manufacturing, in particular due to declining rankings.[50] It is more accurate to say fee deregulation is a 'one-way' reform: it is much harder to undo than to unleash. It therefore needs deep scrutiny. If there is a risk of 'decline' that makes it essential for the government to take time to ensure it gets the reform right.

Australia needs more and better informed debate on these issues

Despite previously praising "masterly inactivity" in the sector,[51] the government's budget proposals were unexpected and unexpectedly radical. Sources close to Minister Pyne's office have alleged the office arrived at the package as late as March or April this year, mere weeks before the budget.[52]

Even the National Commission of Audit recommended an initial review period of 12 months before trying to deregulate fees.[53]

The sector and the Australian public would be best served by an extended debate and a reform process convened around clearly articulated goals for what the reforms are supposed to achieve and how they are in the public interest. The Minister has given the Senate the opportunity to start that debate by refusing to be pressured into passing this Bill.

Conclusion

Higher education and research policy is as complex as it is important. Clearly there is need for reform. But it does not serve Australia's interests to rush radical changes to the sector. Nor does it serve Australia's interests to cut funding, create large and unfair debt that will never be repaid, or allow wasteful fee inflation. The arguments in favour of increasing student debt and creating deregulated markets for fees are far weaker than the government says. Indeed the government does not seem to have come to terms with some serious inconsistencies in its arguments.

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[49] Knott, 2014, "Government may target university research funding if education reforms are blocked", 21 August, SMH, available at <http://www.theage.com.au/federal-politics/political-news/government-may-target-university-research-funding-if-education-reforms-are-blocked-20140823-107fvp.html>

[50] 2014 "One shot for University Reform, says Pyne" 27 August, The Australian, <www.theaustralian.com.au%2Fnational-affairs%2Feducation%2Fone-chance-for-university-reform-says-christopher-pyne%2Fstory-fn59nlz9-1227038023822>

[51] Abbott, 2013, "Address to higher education conference" available at <http://www.liberal.org.au/latest-news/2013/02/28/tony-abbotts-address-universities-australia-higher-education-conference>

[52] Hare, 2014, "Lunchbox debate: Beyond the Budget, What's Next for Tertiary Education", at 4:00, available at <http://canberralive.act.gov.au/events/event/lunchbox-debate-beyond-budget-next-tertiary-education/>

[53] National Commission of Audit, 2014, Recommendation 30, <http://www.ncoa.gov.au/report/phase-one/part-b/7-13-higher-education-arrangements.html>

Appendix: Research Cross Subsidy

	2002	2008	2012
Total Higher Education Research and Development Expenditure (HERD)[63]	3,430	6,844[64]	9,610
Total University Operating Expenditure[65]	11,119	18,589	23,277
HERD as %	31%	37%	41%
Dedicated Research Funding[66]	1,270	2,810	3,412
Research Block Grants[67]	901	1,208	1,362
Total	2,171	4,018	4,774
Research funding shortfall	1,259	2,826	4,836
% of HERD	37%	41%	50%

The methodology is from a 2011 report from LH Martin by Frank Larkins.[68] That study looked at 2002 and 2008. We have included and updated those numbers, and repeated the calculations for 2012, the most recent year with data available. Following that study, we included Australian Competitive Grants, Other Public Sector Research Funding, Industry and Other Funding for Research (including international) and Cooperative Research Centre Funding, as well as Research Block Grants.

The data show universities have becoming increasingly focused on research. Yet, despite steady growth in income for research, an increasing proportion of that funding comes from sources of revenue not intended to fund research.

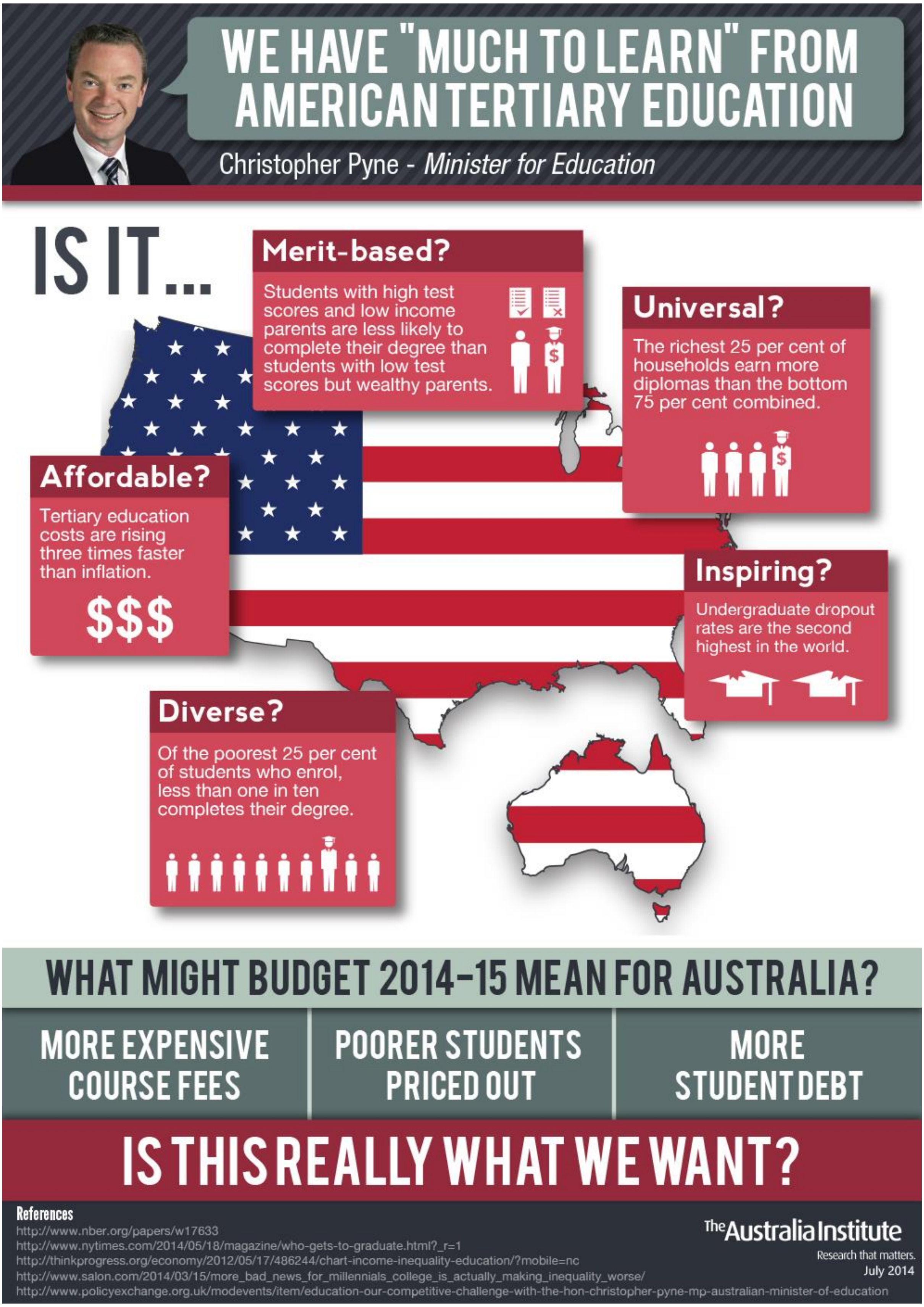
Some of the extra revenue is coming from 'export' education, or international students. Their fees became a bigger part of university budgets over that period, as shown below. However, the total amounts are less than the research short fall and do not include education costs for those students. Moreover the research funding gap is growing faster.

Figure 8 Overseas Student Fees

	2002	2008	2012
Overseas student fees	$1.4b	$3.0b	$4.1b
As % of university operating expenses	13%	16%	18%

63 ABS Cat. No. 8111.0 available at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8111.0Main+Features12012?OpenDocument>
64 Revised slightly up, according to recent ABS release, previous note.
65 Department of Education, "Finance Publications", available at <https://education.gov.au/finance-publication>
66 Universities Australia, 2014, HERDC time series, available at <https://www.universitiesaustralia.edu.au/ArticleDocuments/410/HERDC1992-2012.xls.aspx>
67 Department of Education, "Research Block Grants", available at < https://www.education.gov.au/research-block-grants>
68 Larkins, 2011, "Universities Cross-Subsidised Research Activities by up to $2.7 billion in 2008", LH Martin, available at <http://www.lhmartininstitute.edu.au/userfiles/files/Higher%20Education%20Research%20Policy%20Analysis_Frank%20Larkins_July%202011(1).pdf>

Appendix: Infographic, "Much to learn" from the US higher education system?



Appendix - Research rankings create perverse incentives

If the goal is to have more universities in the elite strata of world rankings, as the government and the Go8 seem to want, we should fund it properly. As Prof. Parker, vice chancellor of the University of Canberra has joked, the government could amalgamate the Go8 into one and watch it shoot into the top tier. The joke reveals the questionable nature of the goal.

It is unclear why Australia should want to excel in these rankings in themselves, rather than meet other goals we set for ourselves, or to some extent let universities set for themselves.

Beyond encouraging universities to fee-gouge students, devotion to research rankings drives numerous perverse incentives in research itself. For example, publications in US journals tend to attract higher research prestige and ranking weight. But these journals favour writing on US topics. This distorts research which Australians pay for. Economics provides a clear example, as Ross Garnaut has argued:

> *A focus on being published in high-impact 'international journals – in practice mostly US publications – led [over the last few decades] to a low professional value being placed on contributions to understanding Australian reality. This discouraged younger academic economists in Australia form work on local policy.*[69]

Universities now even poach international academics for this purpose, rather than funding Australian research on local economics and policy. This is arguably one factor behind the troubled state of our public economic debates in Australia. Similar dynamics occur in other fields.

[69] Garnaut, 2013, *Dog Days*, Redback, Collingwood, p74-5

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Commonwealth Government, 2014, “Regulatory Impact Statement”, p28, available at <http://www.comlaw.gov.au/Details/C2014B00180/Other/Text>

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