Supplementary Submission

Senate Education and Employment References Committee

Inquiry into

The Principles of the Higher Education Reform Bill 2014 and Related Matters

NTEU Response to Chapman Tax on Higher Education Subsidies

Introduction

The following NTEU analysis of the proposal put forward by Professor Bruce Chapman in his submission to this inquiry to tax universities if they increase fees by more than a certain amount, shows that it is not only likely to result in greater upward pressure on fees, but that it will also have other adverse consequences.

In his submission, Professor Chapman makes a very strong case as to why fee deregulation as it is being proposed by the government presents a very real risk of excessive fee rises due to the "market" being market underpinned by an income contingent loans scheme. He also highlights the *"likely forlorn hope/expectation"* of genuine price competition in such a market.

Therefore, the NTEU agrees with the Professor that, "*there is no clear economic justification for public sector universities to be allowed the use of a government instrument, HECS, to raise substantial revenue, in a situation in which this can lead to unjustifiably very high fees*."

Where we differ however, is in his proposed solution on how to deal with the potential for excessive fee rises under a policy framework with deregulated fees. Chapman suggests that "*the government uses the lever of subsidies to inhibit and limit the extent of likely price increases."* The NTEU continues to argue that maintaining the existing cap on fees is a far more transparent and effective way of achieving the policy objective of containing price increases.

The Chapman/Phillips Proposal

Professor Chapman along with David Phillips (from KPA Phillips) are proposing a University Subsidy Contingent Scheme (USCS) which would see universities lose part of their public subsidy to educate Commonwealth supported students if they increased tuition fees by more than a certain amount. The Chapman/Phillips tax on the public subsidy or grant withdrawal scheme is progressive, with the effective tax rate increasing the more universities raise their fees above specified threshold levels (see Appendix A).

Chapman's submission makes it clear that the rates proposed in his submission are only for illustrative purposes and are not intended to constitute a policy proposal, acknowledging a great deal more modelling, consultation and consideration is needed. Several very important questions remain to be fully answered in relation to the policy's design, and these include:

- What are threshold prices for different disciplines (above which public subsidies would be taxed or withdrawn) and for different marginal tax rates?
- What the effective marginal tax rates would be?
- Would the rate which public subsidies are taxed increase the greater the fee increases, that is would it be progressive as is being suggested?
- What happens after the subsidy has been totally withdrawn or eliminated; will universities (or more accurately students) be expected to pay a tax to the government?
- How will policy work in relation to private providers, will they face the same for threshold and marginal tax rates as public universities?

The importance and sensitivity of the policy to these design questions is demonstrated by the NTEU modelling contained in Appendix A.

In addition to these important questions about policy design however, NTEU would contend that Chapman/Phillips' proposal suffers from a number of far more significant and fundamental problems, including:

- its complexity and obscurity which would makes it subject to manipulation and gaming,
- the inevitability that it will exert even greater upward pressure on fees, and
- Its progressive nature which disadvantages high cost providers.

Complexity and obscurity

The NTEU is somewhat puzzled and bemused by the variety of alternative policies being proposed all of which are clearly aimed at addressing legitimate concerns about excessive fees rises under a higher education system with deregulated fees as is being proposed the government. The variety of alternative policies includes:

- putting a limit on how much students can borrow through HECS (Swinburne University),
- establishing an independent body to monitor aspects of the system, including fees and advise the government on possible policy responses (Universities Australia),
- allowing the Australian Consumer and Competition Committee (ACCC) to monitor university fees (Group of Eight), and
- putting restrictions on how universities are allowed to spend fee revenue (Peter Noonan, Mitchell Institute).

Some of these alternative policies, including the Chapman tax proposal, seem to have been formulated on the premise that why make a policy straightforward and transparent when there is a complex and obscure alternative available.

As the NTEU's initial analysis of the proposal (refer to Appendix A) clearly demonstrates, it is complicated by the fact that currently HECS includes three student contribution bands (ranging from about $6,000 to $10,000), eight Commonwealth contribution bands (ranging from less than $2,000 to over $20,000) which gives about twelve separate funding combinations. If this isn't complicated enough, the Chapman tax would impose three more additional marginal tax rates of 20%, 60% and 80% all of which kick-in at different dollar values depending on initial student fees. The proposal would introduce even more distortions into any already highly complicated funding regime.

Chapman's is a framework with many moving parts, all of which interact very differently depending what values are set for threshold fees at which different marginal tax rates are imposed. Three examples used in Appendix 1 shows that impact of fee increases with a Chapman tax varies considerably depending existing rates of public subsidy further complicating the analysis and understanding of the full implications of the model.

The attached modelling also shows that the system is capable of being gamed and manipulated. Greater complexity means less transparency and greater opportunities for gaming and manipulation. The best and most transparent way to avoid excessive fee

increases is to keep a cap on the maximum fee Commonwealth supported students can be charged.

Price pressures

According to Chapman's submission:

> "*as the grant reduction increases with the fees imposed by institutions, it would therefore introduce a constraint on excessive fee increases."*

With respect, this conclusion is not supported by an evidence or analysis of the policy proposition being put forward.

Indeed, the Conservative government in the UK rejected a very similar proposal contained in the 2010 Browne Review of higher education funding in England. The rationale for rejecting the proposal, by then Education Minister David Willets, was because of concerns it would put upward pressure on prices as is apparent from the following statement he made to the Higher Education Funding Council for England (HEFCE) shortly after the Browne Review's release:

> *It means that as soon as universities raise their fee above the threshold level, they face a rapidly rising levy which can drive their fees up even higher in order to reach a given level of income.* (David Willets, Minister for Education, Speech to 2010 HEFCE)

Willetts clearly understood that the imposition of the proposed tax, like the imposition of any tax, will put upward pressure on prices. This is demonstrated by a very simple example. Take the situation where a university has determined that its needs an additional $5,000 in income (revenue) per student to provide a quality education. Under Chapman's proposed tax, fees would need to increase by $6,250, with 20% ($1,250) going to the government (via reduced subsidy) and only $5,000 going to the university. For fee increases up to $5,000 the Chapman model would mean that only $800 of every $1,000 of increase in tuition fees would be available to the University for teaching, student support and so on. It gets even worse for fee increases of more than $5,000 where only $400 of every extra $1,000 increase in fees being available to universities to improve the quality of education and student support. Increases above $10,000 would see universities only keep $200 out of very $1,000,

The NTEU's initial analysis of the Chapman tax proposal contained in Appendix 1 confirms that it will have very different impacts on university income from given fee increases depending upon current student and Commonwealth contributions. In summary the analysis shows that to receive the same gain in income per student, universities would have to raise fees by more in those discipline areas that attract the highest level of public subsidy. While some, including no doubt Professor Chapman, might argue this would act as a deterrent to fees increases, other would legitimately argue that it puts even greater upward pressure on fees.

High Cost Providers

The progressive nature of Chapman's proposed tax means that universities facing higher costs to deliver a quality higher education will be inherently disadvantaged. Numerous government reports, including the Review of Regional Loadings, clearly show the significant cost disadvantages universities face in servicing regional and rural communities, which includes having a higher proportion of low SES and other disadvantaged students.

Therefore, any progressive tax on public subsidies would by definition have a greater impact on institutions that need to increase fees by a greater amount simply to cover higher costs of providing an educational experience to match that offered by their lower cost competitors.

The best and most transparent way to avoid excessive fee increases is to keep a cap on the maximum fee Commonwealth supported students can be charged.

Appendix A

Analysis of the Impact of Chapman/Phillips Tax Proposal on Fees and University Income

The following analysis shows the impact of the Chapman/Phillips tax proposal on fees and university income for students enrolled in three different discipline clusters, namely:

- Business/Law etc. (High Fee / Low Subsidy).
- Engineering (Medium Fee / High Subsidy).
- Humanities (Low Fee/ Medium Subsidy).

In order to undertake the analysis we have had to make certain assumptions about the values of different parameters, an in particular:

- Threshold fee levels at which the tax on public subsidy applies,
- Public subsidies paid to different disciplines,
- The marginal tax rates on public subsidies.

The threshold fee levels and public subsidies for each of these disciplines is the estimated 2016 values of current student and Commonwealth Contribution amounts (rounded up to nearest $100), namely:

Discipline	**Student Contribution/ Threshold Fee**	**Commonwealth Contribution/ Public Subsidy**
Business/Law	$10,800	$2,100
Engineering	$9,100	$17,800
Humanities	$6,400	$5,800

The marginal tax rates used as those include in the Chapman submission, which means that public subsidies would be taxed (withdrawn) taxed at the following rates:

- Fee increases of between $1 and $5,000 taxed at 20%,
- Fee increases of between $5,001 and $10,000 taxed at 60%,
- Fee increases of $10,001 or more taxed at 80%.

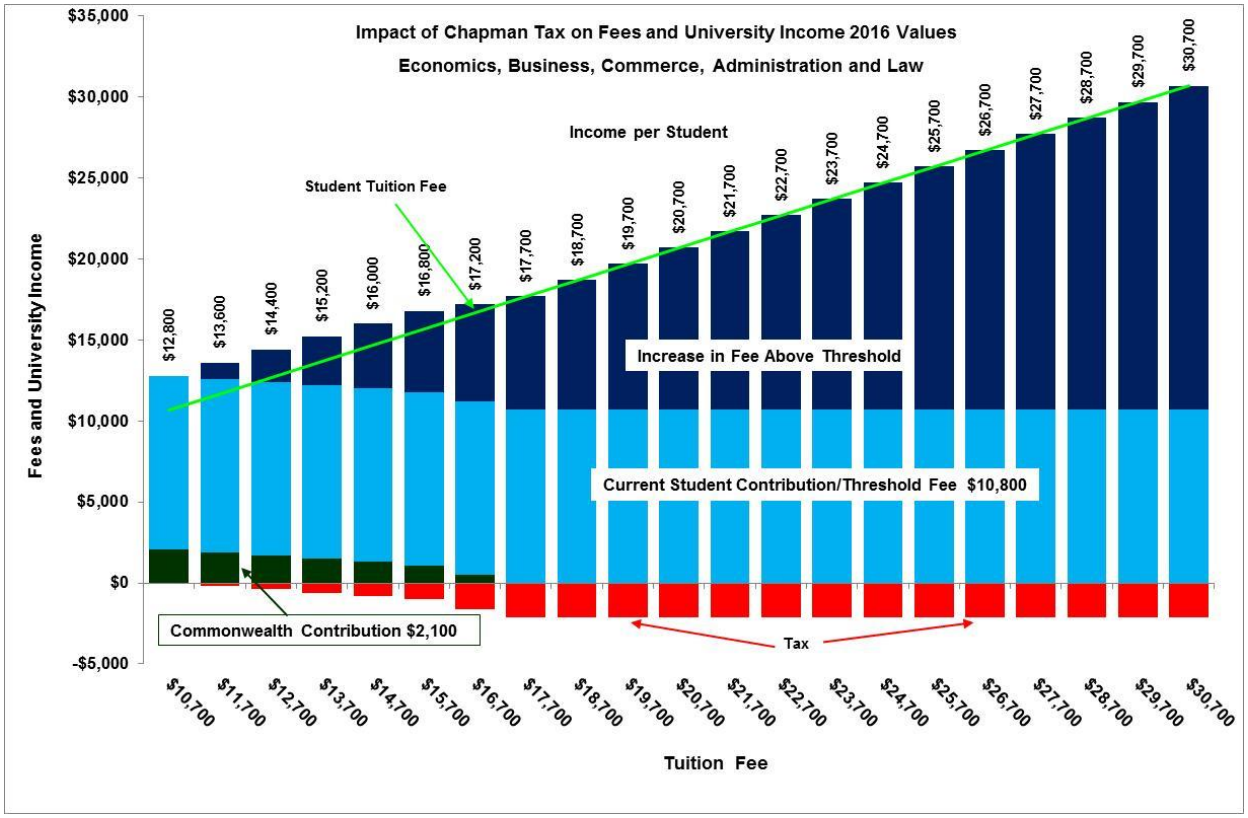
Economics, Business, Commerce, Administration and Law

Using the values above, Figure 1 shows the impact of the Chapman Tax on university income per student for every $1,000 increase in fees above the threshold level for business and law students. In summary, Figure 1 shows that for fee increases of less than $7,000 per student, the university loses income because of the reduction in the Commonwealth Contribution (initially $2,100) due the operation of tax (reduction in Commonwealth Contribution), but for fee increases above $7,000 the university gets to keep all of the fee increase.

This is because the value of the public subsidy has been eliminated or exhausted and further increases are taxed at the maximum of $2,100 per student regardless of the level of fees.

Another way of using the data in Figure 1 is determine how much a university would need to increase it fees in order to achieve a given increased level of income per student to allow it to offer its students a high quality education. For example, Figure 1 shows that if a university wanted to increase its income per business/law student by about $10,000 (from $12,800 to $22,700) it would need to increase its fees from $10,800 to $22,700 or about $12,000.

Figure 1

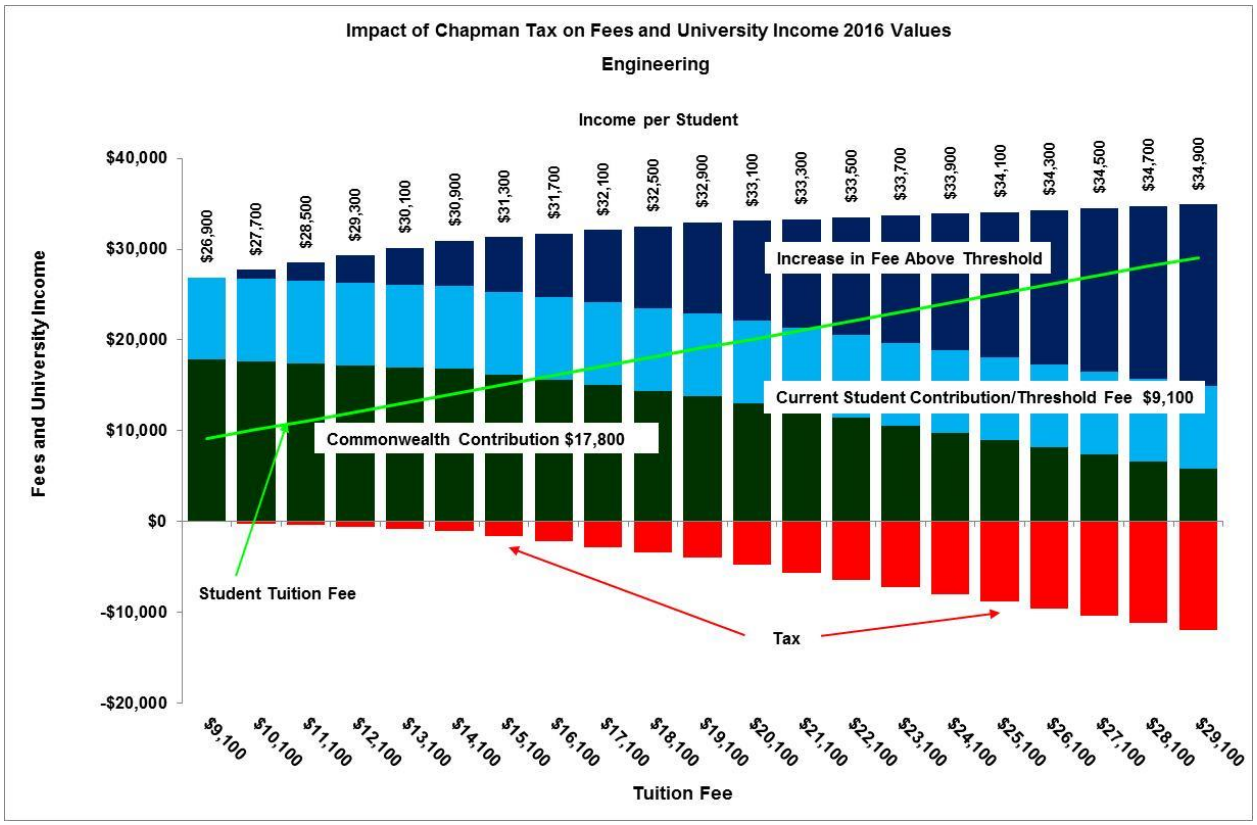


Engineering

Using the values above, Figure 2 shows the impact of the Chapman Tax on university income per student for every $1,000 increase in fees above the threshold level for engineering students. Compared to the results for business and law students shown in Figure 1, Figure 2 shows that for every $1,000 increase in engineering student fees yields the university considerably less in income. This is essentially because the reduction in the Commonwealth Contribution ($17,800) takes much longer to be exhausted compared to business law students. That is, the high effective tax rate applies for a much higher range of fee increases.

Compared to the situation for business and law students, if the university's objective was to increase total income per student by $10,000 (from $26,900 to $36,900) it would need to increase its fees from $9,100 to about $34,000 (not shown on Figure 1) or by about $25,000.

Figure 2

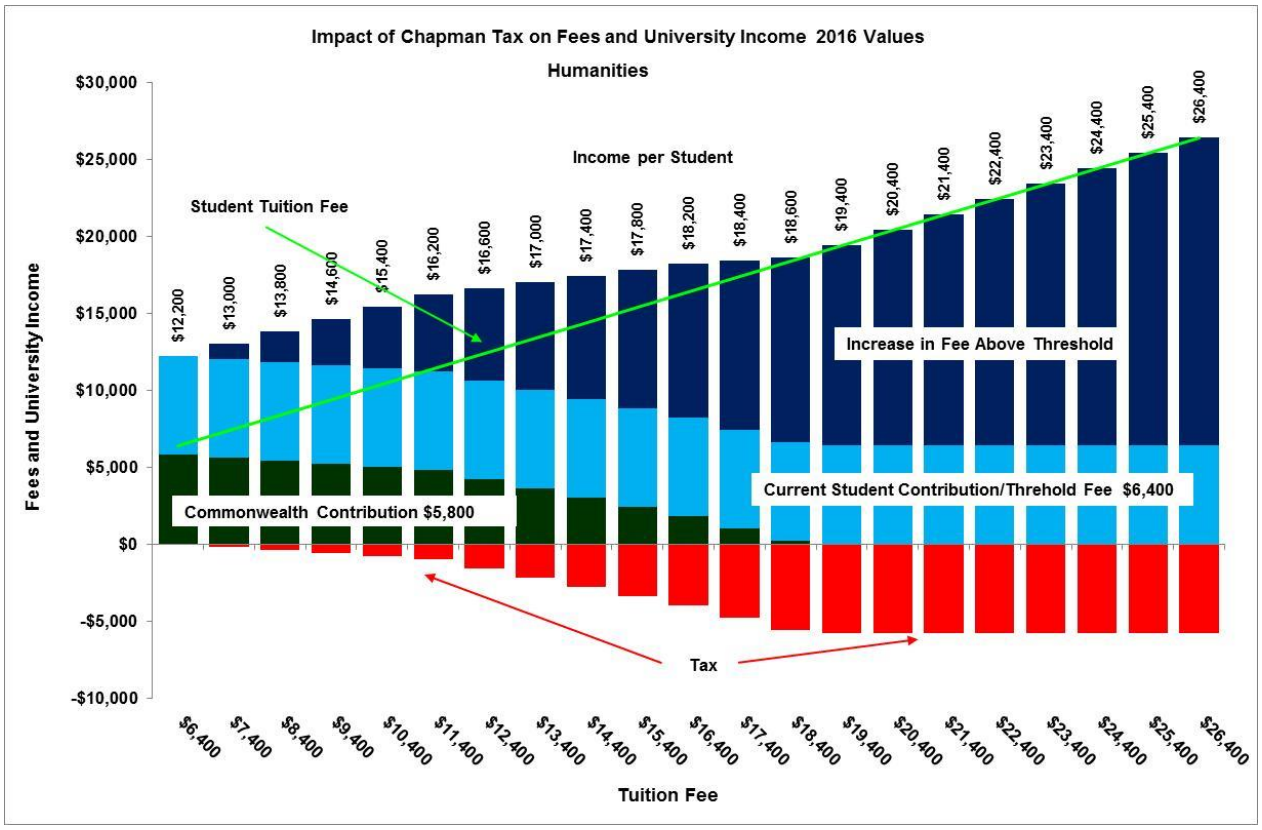


Humanities

Figure 3 shows the impact of the Chapman Tax on university income per student for every $1,000 increase in fees above the threshold level for humanities stories. The results for engineering shown Figure 2 highlighted the importance of the value of the initial Commonwealth Contribution on the impacts of the Chapman tax. In the case of Humanities (Figure 3) the data shows the university would gain a relatively small yield in extra income up to fee of $18,400, because it is that level that the Chapman tax exhausts the public subsidy. For any increase in fees above $18,400 the university would keep all of the additional income because the tax would be capped at the initial Commonwealth Contribution amount of $5,800 per student.

Compared to the situation for business and law students and engineering students, if the university's objective was to increase total income per student by about $10,000 (from $12,200 to $22,400) it would need to increase its fees for humanities students from $6,400 to $22,400 or $16,000.

Figure 3



Summary

The importance of the analysis above is that it clearly demonstrates the very different impact the imposition of the Chapman tax would have on different disciplines, depending largely on the size of the public subsidy which the tax would erode. Of course the government could remove this problem by making universities actually "pay" a tax once the subsidy was totally exhausted. The only problem with that is students would be paying more than 100% for the cost of their university education.

The modelling also shows that the proposal is unlikely to have any moderating effect on university fees rises; in fact it would have the opposite effect. Assuming that the primary motivation for fee increases is for the university to raise the additional income or revenue it needs to provide a quality education, then the extent of the fee increase will be determined by how much extra income they want to raise not the price per se. Our modelling shows that for a university to increase its income by about $10,000 per student, it would need to raise its fees by:

- $12,000 for business, law, etc. student.
- $25,000 for engineering student.
- $16,000 for humanities student.

Therefore, engineering and other high cost disciplines such as science, medicine and so on (which attract relatively large public subsides) will, all other things being equal, suffer relatively larger increases in fees compared to other disciplines for the same increase in additional university income.

The analysis demonstrates also shows how the proposed model is likely to be manipulated and gamed by universities and other providers. For example, if universities were motivated by the objective to maximise total revenue or income, then they are likely to target those disciplines that provide the greatest gain (yield) of increased income per student (business, law etc.) for relatively large fee increases. That is, some universities might elect to target these courses and use additional income (surplus) from these students to cross subsidise other students.