Australian Government
Department of Education

Australian Government
Department of Employment and Workplace Relations

Education and Other Legislation Amendment (Abolishing Indexation and Raising the Minimum Repayment Income for Education and Training Loans) Bill 2022

Submission from the Department of Education and the Department of Employment and Workplace Relations to the Senate Standing Committees on Education and Employment

Contents

Education and Other Legislation Amendment (Abolishing Indexation and Raising the Minimum Repayment Income for Education and Training Loans) Bill 2022

Introduction

The Department of Education and the Department of Employment and Workplace Relations (DEWR) welcome the opportunity to make a submission to the Senate Education and Employment Legislation Committee report on the Education and Other Legislation Amendment (Abolishing Indexation and Raising the Minimum Repayment Income for Education and Training Loans) Bill 2022.

As the Australian Government body with primary responsibility for administering higher education funding and policy, the Department of Education has a strong interest in the content of this bill. The *Higher Education Support Act 2003 (HESA)*, proposed to be amended by this bill, is the primary legislation governing higher education funding.

Through HESA, the Department of Education administers the Commonwealth Grant Scheme (CGS) and the Higher Education Loan Program (HELP). Together these programs provide the largest proportion of Australian Government funding to higher education providers, and the vast majority of Australian domestic higher education students (and some eligible permanent residents) receive Government support through at least one of these programs. The sustainability, distribution and underpinning principles of this funding, and the incentives the funding arrangements create, are core policy issues in higher education.

DEWR has responsibility for administering the *VET Student Loans Act 2016* and the *Trade Support Loans Act 2014*. These acts, together with elements of the *Higher Education Support Act 2003*, govern the VET Student Loans (VSL) program, the historic VET FEE-HELP (VFH) program and the Trade Support Loans (TSL) program.

The Department of Social Services (DSS) provided input to this submission as this bill also amends the *Social Security Act 1991* and *Student Assistance Act 1973*. These Acts govern two student assistance loans that will be impacted by this bill, the Student Financial Supplement Scheme (SFSS), which has been closed for some time, and the Student Start-up Loan (SSL). These are voluntary, income contingent loans (ICL), for eligible student income support payment recipients, to assist with the cost of study, such as textbooks and IT supplies.

Current higher education funding landscape

The CGS supports domestic students to study eligible higher education courses by providing a subsidy for their tuition costs. Students studying in a Commonwealth supported place (CSP), which are the majority of domestic students, pay a regulated student contribution, with the rest of their tuition costs covered by the Government. Contribution amounts, and the ratio between student and Commonwealth contributions, differ according to the field of education.

Eligible domestic students are able to access HELP loans to defer either their student contribution (for students in a CSP) or the full cost of tuition (for other students). Loans do not require repayment through the tax system until the individual earns more than the minimum repayment income. Additional types of HELP loan are available to support the costs of student amenities fees and overseas study. HELP loans are made on generous terms and do not accrue interest but are indexed annually to maintain their value in real terms.

Through CGS and HELP, the Government commits approximately $15 billion annually, which represents around three-quarters of annual funding to higher education providers. In addition, the Government bears ongoing costs associated with HELP. As at 30 June 22, the total value of outstanding HELP debt amounted to $74.4 billion[1], a proportion of which will never be repaid. This expected non-repayment of HELP is a deliberate design of the scheme to reduce the burden on students who do not meet the minimum repayment thresholds.

This significant financial commitment by government supports a system that provides genuine choice and appropriate support for students, removes barriers for under-represented groups and allows institutions to excel and innovate to deliver world class education. At the same time, it is important to ensure this system remains financially sustainable and affordable into the future.

Vocational Education and Training (VET) funding landscape

From 1 January 2017, VSL replaced VFH to help students cover tuition fees for VET courses. VSL is available for approved courses at the diploma level and above. The amount a student can borrow for a particular course is limited by the 'loan cap' applicable to that course. There are currently three loan cap bands of $5,595, $11,191 and $16,788 for 2023. An additional loan cap of $83,949 applies to specific aviation courses. Some providers may offer courses that cost more than the loan cap. In these cases, students must pay the difference between the course cost and the loan cap. Students studying in 'full-fee' courses – that is, where they do not receive a subsidy from their state or territory – are also subject to a loan fee of 20 per cent of the value of their loan which is added to the loan and repaid in the same way.

VET FEE-HELP is a former Australian Government program that ceased to take new enrolments from 31 December 2016 following the identification of inappropriate conduct by a number of VET providers using the program. Students who believe they have incurred inappropriate VFH debts have until 31 December 2023 to contact the VET Student Loans Ombudsman to have their complaint assessed under the VFH Student Redress Measures. While debts from this historic program are directly affected by the Bill, the Explanatory Memorandum overlooks this effect.

Students can accumulate VSL and VFH loans, together with HECS-HELP and FEE-HELP loans, up to the renewable combined Higher Education Loan Program (HELP) loan limit which is $113,028 for most students in 2023. Loan fees are not counted towards this limit.

TSL is available to eligible apprentices to assist with everyday costs while completing their apprenticeship. These loans provide up to $22,890 (for 2022-23) in total and are paid monthly in arrears. Apprentices who successfully complete their apprenticeship receive a 20 per cent discount on their loan amount. Trade Support Loans do not count towards the renewable combined HELP loan limit.

Repayment settings and indexation rules for VSL, VFH and TSL are consistent with the HELP loan settings. Compulsory repayments for VSL and VFH debts incurred prior to 1 July 2019 are made as part of any HELP debt repayment. Compulsory repayments for debts incurred

[1] Australian Tax Office annual statistics, HELP statistics 2021–22 | Resources | data.gov.au - beta

after this date begin once any HELP debt has been repaid. Compulsory repayments for TSL debts commence once any HELP, VSL, SFSS, SSL and ABSTUDY SSL debts have been repaid.

Unlike higher education, funding for the VET system is a shared responsibility between the Commonwealth and the states and territories. The Commonwealth provides around $1.6 billion to states and territories for skills and workforce development every year, as well as significant government investment in supporting apprentices and other Australians undertaking training. The Commonwealth has funded more than $1.4 billion in loans to close to 170,000 students since VSL began in 2017.

At the September 2022 Jobs and Skills Summit, the Prime Minister announced a two-stage approach to skills reform, comprising a 12-month Skills Agreement from January 2023 and a new long-term National Skills Agreement (NSA) to commence in 2024.

The $1 billion 12-month Skills Agreement, with costs shared with the states and territories, makes available 180,000 Fee-Free TAFE and vocational education places in 2023. All states and territories have signed up to the 12-month Agreement, which has commenced. This significant commitment is targeted at priority groups (including First Nations Australians, young people (17-24), people who are out of work or receiving income support payments, unpaid carers, women facing economic insecurity, women undertaking study in non-traditional fields, people with disability and certain categories of visa holders) to remove financial barriers to study.

Student income support loan repayments

The Student Start-Up Loan (SSL) is a voluntary, income contingent loan to assist eligible student payment recipients with the cost of study, such as purchasing textbooks or IT equipment. The SSL commenced on 1 January 2016. At 30 June 2022, the outstanding debt for SSL was approximately $1.0 billion.

The Student Financial Supplement Scheme (SFSS) was a voluntary, income contingent loan offered between 1993 and 2003 that allowed eligible student payment recipients to trade in one dollar of their income support payment for two dollars as a repayable loan. This loan was offered to support students with the additional costs of their education. While the SFSS has now closed, as at 30 June 2022 the outstanding debt for SFSS was approximately $2.1 billion.

Repayment settings and indexation rules are consistent with HELP loan settings. Compulsory repayments commence once any HELP and VET Student Loan (VSL) debts have been repaid. As a result, any increase in the time taken to repay HELP and VSL debts will have a flow on impact on recovery of SSL and SFSS debts.

As with HELP debts, the Government acknowledges and accepts that some loan recipients will never have the financial capacity to repay their SFSS or SSL debts. Raising the minimum repayment threshold will decrease the likelihood that these debts will be recovered.

Income contingent loan repayments

Students repay their income contingent loans through the tax system, and do not need to begin making repayments until their income exceeds the minimum repayment income. The intention of this system is to protect students from burdensome repayment obligations by basing repayments on students’ capacity to repay, rather than the total value of their debts.

While this leads to significantly slower repayment rates than would occur at commercial rates, it ensures that students are protected from the financial pressures of fixed term repayments and the risk of default.

For a range of reasons, some individuals will never have the financial capability to make repayments, and it is expected that a certain amount of student debt will never be repaid. The idea that some individuals will never repay their loans has been central to student loans policy since its creation in 1989. Government accepts this liability, as it recognises that individuals who have not realised the financial benefits of a higher education qualification are not required to make repayments that could lead to significant hardship.

On the other hand, it is expected that individuals who have received a personal benefit from tertiary education and have the financial capacity to repay their debts, do so. Higher educational attainment leads to higher total incomes and more diverse sources of income compared to the average Australian[2]. The current system has been designed under the assumption that individuals who have realised individual benefits from their tertiary education should make some financial contribution towards the cost.

Repayment Thresholds

The minimum repayment income, subsequent repayment thresholds and associated repayment percentages are legislated and indexed annually. Indexation of repayment thresholds is in accordance with the legislation, against the Consumer Price Index (CPI), which is a quarterly measure of inflation published by the Australian Bureau of Statistics (ABS). Prior to 2019, repayment thresholds were indexed against average weekly earnings as determined by the ABS. Alignment of thresholds with indexation means that debts and repayment thresholds are growing in sync, and not at different rates, as occurred previously.

At the lowest income threshold, debtors are only required to pay one per cent of the value of their annual income towards their debts, the equivalent of between $9 and $11 per week. This amount scales upwards with income, so that debtors in the top income threshold are required to repay ten per cent per year. There are a total of 18 repayment increments, ranging from $48,361 to $141,848 and above for 2022-23.

An increase in the minimum repayment threshold may significantly increase the proportion of debt that is not expected to be repaid, in turn impacting the long-term financial sustainability of the loan programs, due to the delay in persons commencing making repayments, and more never meeting or exceeding the minimum repayment income.

SFSS and SSL loans were previously required to be repaid concurrently with HELP debt repayments, until the much less burdensome order of repayment was introduced from 1 July 2019 with the separation of VSL debt at the ATO.

Raising the repayment threshold and ceasing indexation of these loans will likely create inequities in the system, disadvantaging individuals who have already repaid their loans, including indexation.

[2] Department of Education, Integrated Data Research, Income - Department of Education, Australian Government; Employee earnings, August 2022 | Australian Bureau of Statistics (abs.gov.au)

Indexation

HELP, VSL, VFH, SFSS and SSL loans do not accrue interest, but they are indexed annually by the CPI. Indexation occurs on 1 June each year and is calculated through a legislated formula based on the CPI figures for the previous year. Indexation is necessary so that debts maintain their real value over time, ensuring that there is no adverse incentive for individuals to reduce their financial contribution - and thereby increase the taxpayers' contribution - by not seeking to increase their incomes and thus delaying repayments until a later time.

CPI indexation has remained historically low for most of the past decade; indexation was 3 per cent in 2011, 2.9 per cent in 2012, and remained below 3 per cent for the following decade. Indexation was at an historical low in 2021 at 0.6 per cent.

In 2021 and 2022, due to a range of circumstances including significant global disruption, the CPI rose rapidly. Indexation for 2022 was 3.9 per cent, and the 2023 figure is also likely to be higher than the decade average. However, it is unclear how long this rate of inflation will continue.

The departments are aware that rapid changes in indexation levels, while uncommon in the last decade, can cause distress to individuals, even though indexation does not have an impact on the rate at which they need to repay their loan. There may be long-term financial implications to a high rate of indexation. As repayment amounts are tied to income levels rather than total value of debts, if indexation increases faster than average wage growth for any length of time, a greater proportion of an individual's compulsory repayment will offset indexation rather than reducing the principal debt amount. This means that it will take longer for these individuals to repay their debts, and a larger number will not be able to repay all debt than would otherwise be the case.

Policy change and the reform environment

The interactions between the CGS, ICL programs and the wider economic landscape are highly complex and a change to one policy setting can have consequences in future years.

The departments have not attempted to model the potential effects of removing indexation or changing repayment thresholds, but nonetheless raise potential revenue sustainability effects for ICL programs and unintended or perverse outcomes for scheme participants. That said, for higher education we have estimated that cash costs of the bill over the forward estimates would be in the order of $2 billion, and $9 billion for ongoing revenue effects for loans made during that period.

The departments recommend taking advantage of the current Universities Accord process and the ongoing NSA process to consider any immediate relief for students or long-term policy changes, so the implications for the broader higher education system and social security system can be considered holistically.

Potential consequences of removing indexation

At a minimum, there are financial implications of allowing debts to lose their real value over time and their effects both on sustainability of HELP and VSL and potential regressive effects for individuals. Due to the extended nature of the repayment of loans, there is a significant cost to Government, and ultimately to taxpayers, in providing loans at a discounted rate. Allowing debts to lose their real value may also act as a disincentive for students to make voluntary repayments towards their debts, again with financial implications that have not been modelled but may be significant.

Voluntary repayments increased significantly in 2021, predominantly in the months of April and May, ahead of the 1 June 2022 indexation event. The amount of voluntary repayments in 2022 increased by 44 per cent on 2021, with the average amount per debtor increasing from $800 to over $1000.

While the current rapid increases in indexation are atypical, there is no immediate financial hardship for individuals as repayment is based on income not the level of debt. The ongoing effect of increased indexation on repayment rates and debt not expected to be repaid for some individuals will depend on future economic circumstances. In this respect the departments note the November 2022 forecast of the Reserve Bank of Australia has CPI returning to 3.2 per cent in the December quarter of 2024[3]. Major changes responding to the current situation and without consideration of the broader policy context and the Accord and NSA will have long-term effects and consequences.

If the loans are not indexed, there may be increased incentive for debtors to manage their incomes to remain below repayment thresholds, as there is no penalty for delayed repayment. While this may appear to have no immediate impact on the outstanding loan debt, there is an increased cost to Government if the time to fully repay is significantly extended.

While it may be argued that students who repay quickly are likely to be more financially secure than those who do not, faster repayment may also result from debt aversion. There is evidence that disadvantaged groups are relatively debt averse. This generates a regressive effect, where debtors from disadvantaged groups may pay off their debts earlier, transferring less of the cost of debt to the taxpayer than students who are more able to repay but are not as debt adverse.

Potential consequences of changing repayment threshold levels

Funding for income contingent loans is complex and must balance financial sustainability and value for money with the need to ensure fairness and equity. In a restricted fiscal environment, it is important government funding is used in a way that meets both of these needs.

Because the total value of income contingent loan debt is so large, even comparatively minor changes to repayment thresholds can have a significant cost to the Budget, and therefore taxpayers, in the long term. For example, even at current rates, the total value of HELP debt is increasing every year – rising from $68.7 billion in 2020-21 to $74.4 billion in 2021-22. While the total value of VSL/VFH debt is much smaller, comparative to HELP, the proposed changes are likely to significantly reduce the amount of debt that gets repaid. Any changes to repayment thresholds must therefore be modelled carefully so that the long-term implications can be recognised and the full cost of the proposal can be taken into consideration.

[3] Forecast table – November 2022 | RBA

Current repayment threshold levels are intended to balance equity and financial concerns and encourage students to make repayments where it is not unduly financially burdensome for them to do so. This is also in students' interest. An individual's HELP, VSL, VFH, SFSS and SSL debt may be taken into consideration when they apply for other financial products, such as home loans, and affect the amount they are able to borrow. It is therefore in individual students' interest to repay their loans quickly; but changes to thresholds essentially make payments more discretionary. The consequence of changing thresholds may make the adverse effects of these debts worse for debtors, not better.

The current funding system for higher education is based on the principle that costs should be shared between individual students, who generally receive a significant personal benefit from the higher lifetime earning potential associated with higher education qualifications, and the Australian Government – ultimately, Australian taxpayers. The shared approach is in recognition of the broader economic, social and cultural benefits for society as a whole linked to higher rates of higher education qualifications. By shifting the balance between student and Commonwealth contributions to reduce the amount paid by individual students and increase the amount paid by the Commonwealth (including through an increase in debt not expected to be repaid), the effect of the proposed changes would be that a greater part of the costs of higher education would be borne by Australian taxpayers.

However, the cohort of Australians with higher education qualifications has higher average incomes than Australian taxpayers overall. This means that many Australians with lower incomes are, through their taxes, subsidising the cost of higher education for high-income, high net worth individuals without realising any of the direct individual benefits of higher education themselves.

While this is inevitable to a certain degree, any consideration of how higher education is funded should keep this aspect of the funding system in mind.

Australian Universities Accord, National Skills Agreement and opportunities for reform

Given this is a complex system, there may be other mechanisms to address concerns regarding student loans. Reconsidering aspects of the operation of HELP, SFSS and SSL to ensure these programs continue to operate as intended, should be part of a holistic process that takes the system as a whole into consideration. Changes driven by short-term circumstances are more likely to introduce unintended consequences which may cause greater issues in future than those they were initially introduced to correct.

A large scale, systematic review of the Australian higher education system, the Universities Accord, is currently underway. The intention of this process is to improve the quality, accessibility, affordability and sustainability of higher education, in order to achieve long term security and prosperity for the sector and the nation.

This process will include a comprehensive analysis of the current state of higher education funding, including the balance of responsibility between Government and individuals, the sustainability of the system, and any inefficiencies or areas for improvement. An interim report is due in June 2023, with the final report to be delivered by the end of the year.

The new NSA, being developed with states and territories, will help create a VET sector that provides high-quality and accessible education and training to boost productivity and support more Australians into secure work. The vision statement and guiding principles for the new NSA have been agreed by Skills Ministers and endorsed by the National Cabinet.

The departments suggest that any changes to the design of HELP, VSL, VFH, SFSS or SSL take place in the context of the Accord and broader skills reforms, which will allow for detailed analysis and modelling to occur so that the full cost of any proposals can be understood. It will also provide an opportunity for wide and deep consultation with the sectors.

This includes, but is not limited to, universities, higher education and VET providers, educators and researchers, students, parents, unions, business, State and Territory governments and groups who have been under-represented in higher education. A key aim of the consultation process will be to ensure the voices of First Nations Australians and people from under-represented groups are heard and reflected in the interim and final report.

All parties with an interest in issues of higher education funding and student support are encouraged to participate in the Accord process. The discussion paper and call for submissions can be found at: https://www.education.gov.au/australian-universities-accord/accord-consultations