# APPENDIX 4

# LEAKED CABINET SUBMISSION

# PROPOSALS FOR REFORM IN HIGHER EDUCATION

**MINISTER(S):** The Hon Dr David Kemp MP

Minister for Education, Training and Youth Affairs

## MINISTER'S EXECUTIVE SUMMARY

**PURPOSE:** (JH99/0222/CAB) requires I provide information on a range of matters to inform a decision on an approach to higher education reform and workplace reform in the sector. This submission provides that information and seeks endorsement in-principle of a preferred reform package, prior to considering a major policy paper on higher education reform.

**KEY ISSUES:**

Imperatives to reform the higher education system are at paragraphs 1 to 4. Information is provided on cost projections for a demand-driven, more deregulated higher education system (Attachment B), private returns to higher education (Attachment C), options to encourage greater participation from disadvantaged groups (Attachment D) and mechanisms for quality assurance (Attachment E). Consistent with imperatives for reform and with this further information, my preferred reform option - a demand driven system characterised by fee and admissions deregulation, improved quality assurance arrangements, a universal public subsidy for undergraduate students in a broad range of accredited institutions, and a loans scheme to finance the costs of tuition - is described at paragraphs 6 to 12. An alternative approach based on funding additional higher education places within a less flexible framework is described at paragraphs 13 to 14. My preference on workplace reform is to pursue reform in the sector vigorously, as described at paragraphs 22 and 23 and at Attachment F. This has immediate financial implications. Initiatives to improve access to higher education for some groups are described in paragraph 25.

**Budget Estimates 2014-15**
**Education and Employment Senate Committee**
**Document No:** 7
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**Tabled by:** Senator Carr

I seek Cabinet's agreement in principle to my preferred higher education reform package, and agreement to consider a detailed package and a policy paper on reform in higher education based on this package before the end of this year.

**CONSULTATION:** PM&C, Treasury, DoFA, A-Gs, ATO, DCITA, DEWRSB, FACS,

HAC, DIMA, DISR, DTRS

[Yes/No], there is/not agreement; coordination comments are at Attachment A).

**FINANCIAL IMPLICATIONS**: Costs for workplace reform are below [agreed with DoFA]. All other costs, C paragraphs 15, 21 and 24 [agreed with DoFA] are indicative.

| | Impact on operating Balance ($m) | Impact on Net Assets ($m) | Impact on Net Cash Flows ($m) | Capital Injections ($m) | Impact on Fiscal Balance ($m) |
|---|---|---|---|---|---|
| Y1 | -84.9 | -84.9 | -42.5 | 0.0 | -84.9 |
| Y2 | -86.5 | -86.5 | -85.7 | 0.0 | -86.5 |
| Y3 | -87.5 | -87.5 | -87.0 | 0.0 | -87.5 |
| Y4 | -88.2 | -88.2 | -87.8 | 0.0 | -88.2 |

## RECOMMENDATIONS

1. I recommend that Cabinet agree in principle to the approach to higher education reform described at paragraphs 6 to 11.

2. I recommend that Cabinet agree to the staging of this approach described at paragraph 12, noting the cost implications.

3. I recommend that Cabinet note that I will be pursuing the revised quality assurance arrangements described in Attachment F as part of any higher education reform package.

4. I recommend that Cabinet agree to the workplace reform option described at paragraphs 22 and 23 and authorise me to announce immediately the availability of contingent funds.

5. I recommend that Cabinet note that I will return to Cabinet before the end of 1999 after consultation with the Minister for Transport and Regional Services with recommendations for reviewing rural education.

6. I recommend that Cabinet agree in principle to the equity initiatives complementing the longer term reform agenda described at paragraph 25.

7. I recommend that Cabinet agree to consider before the end of 1999 the final details of the proposed reform package, together with a policy paper describing the key features of a new higher education policy and financing framework.

## IMPERATIVES FOR REFORM

1. The government has committed itself to education being a major theme of its second term. Good education policies will have major benefits in terms of jobs, wealth creation, social inclusion, cultural dynamism and intellectual creativity. In particular, the generation and transmission of new knowledge through our universities expands the capacities of our economic, social and cultural institutions. Better educated, better skilled people and the commercialisation of good ideas create new market opportunities, improve our capacity to adapt and change, - drive regional and national enterprise and employment growth and underpin the aspiration to be a 'can do' country. Unfortunately the higher education system as it stands is not going to make the contribution that it could. This is due to the highly regulated nature of the existing system, the problems of which are becoming increasingly apparent.

2. The university system has only weak incentives to be responsive to the actual needs of students and the economy. The poor incentive structure flows from two main features of the current system. Firstly, the supply of subsidised university places is set by the government, and allocated to particular institutions. As the number of places supplied is less than actual demand, universities know that they do not need to be highly competitive; somebody will want every place and aspiring students who do not get into their first preference course will take a second best option. Places are

available where they have been historically allocated, rather than where current and future demand is likely to be. As a consequence, demand in the population growth corridors in Queensland, NSW, WA and Victoria is unlikely to be met, with concomitant economic, social and political problems. The system has no capacity to reduce huge regional disparities in higher education participation. 19 to 21 year olds in the top five participation areas - affluent capital city suburbs - are five times more likely to go to university than their counterparts in the five areas at the bottom of the list. The second feature of the current system contributing to the poor incentive structure is that income derived from universities' principal service, undergraduate education, is controlled. Government subsidies and the amount students contribute are fixed, irrespective of whether universities offer a basic or premium service. The incentive is to provide education as cheaply as possible rather than to provide education that students and the community want. One effect of this is in the generally small shifts over the last decade in the proportions of people studying particular fields, despite significant changes in the economy over the same period.

3. Universities are currently in a difficult financial position. While government funding is stable, they face rising costs in salaries and investment in new technology. The current regulation of undergraduate fees limits university revenue and perversely prevents students from investing in their own futures. Already, eight institutions appear to be operating at a deficit and some regional campuses are at risk. The current enterprise bargaining round is not giving universities more staffing flexibility. This will restrict the capacity of universities to use their staff effectively, further weakening the performance of Australian higher education.

4. The scale of these problems means that higher education will remain a contentious issue for the government through this term. Higher student:staff ratios, less frequent lecture and tutorial contact, the persistence of outdated technology and gaps in key areas of professional preparation (including practical skills development) are fuelling a perception of declining quality. Essentially we face a choice - shoring up the existing system as it becomes progressively less capable of delivering what government wants, industry needs and the community expects, or putting in place a new system, albeit with controversial elements, which delivers the educational goals we have set, secures our future in the global knowledge economy and underpins lifelong learning.

## PRINCIPAL OPTIONS

5. On 28 June 1999 Cabinet noted (JH99/0222/CAB) specific goals for higher education based on access, choice, quality, responsiveness and a fair sharing of the costs of higher education between individuals and the community. In my submission (JH099/0222) I indicated a preference for deregulating admissions and fees as central elements of a reform of higher education, and in that context Cabinet required that I come back with further relevant information and with options for workplace reform.

**Option 1 - A demand-driven system**

6. The principal option for which costings are provided is my preferred package of reform measures, and comprises:

(a) abolition of current controls over the number of places a university can offer, allowing students greater choice over where they study;

(b) a universal tuition subsidy which follows the student to accredited higher education courses offered by quality-assured public and private providers;

(c) student fees for tuition set by providers;

(d) institutions being obliged to reserve a fixed proportion of premium fee income for equity purposes (together with equity measures described in paragraph 25 and Attachment D);

(e) a universal loans scheme to help students pay tuition costs, with a real rate of interest and repayable through the tax system on an income contingent basis;

(f) a total Commonwealth funding envelope which meets government policy

and fiscal objectives and achieves a fair-sharing of the costs, reflecting both public and private benefits from higher education; and

(g) revised quality assurance arrangements which facilitate the entry of new players and underpin Australia's international standing as a provider of quality higher education services (see Attachment E).

7. Under these arrangements, student numbers, course choices and the price of higher education would be determined more closely by student demand, with government providing a standard subsidy, sensitive to discipline-specific teaching costs, for each student enrolled at an accredited public or private higher education institution. Institutions, rather than government, would set the price for a course of study. The current HECS system would be abolished. Income contingent government loans repayable through the tax system would be available instead to finance the cost of tuition at any accredited higher education institution, whether public or private, for study at both undergraduate and postgraduate level.

8. The package provides substantial benefits to students, institutions and the community. Most importantly, the package delivers a universal entitlement to higher education for all who can meet entry qualifications. Students will have greater choice about where they study, subject only to meeting admissions criteria, and the range of courses available will be wider and more appropriate as institutions are freed up to respond more directly to demand for particular courses and in particular locations. Two disincentives to study in the emerging private sector - the absence of a tuition subsidy and a mechanism to finance student fees - will be removed. More rigorous quality assurance processes and the provision of information to guide student choice

will mean students can be more confident that their choices are well informed, and that the institutions at which they choose to study will deliver quality education. The availability of loans to finance tuition costs, under arrangements which preserve the best features of HECS but extend its reach, will ensure that no qualified student is denied access to higher education because of their inability to pay fees up front.

9. Institutions will also gain significant benefits. The package re-establishes certainty in the policy framework and will ease resource pressures. Institutions' income will depend directly on their decisions about the level of fees, the diversity and appropriateness of their offerings and their capacity to attract students. They will have greater choice about how they package courses, greater incentives to design new courses, and repackage old ones as conditions change, and in particular the capacity to offer different levels of service at different prices without sacrificing the basic quality of a degree. Private sector institutions will be put on a fair competitive basis, able to exert genuine pressure for increased quality and responsiveness.

10. For the community the benefits are also substantial. Increased investment, in education will pay economic dividends, and the deregulation of fees will allow the proportion financed by taxpayers to decrease. The package directly addresses public concern that demand for higher education is not being met, either totally or geographically, and that quality is declining as a result of resource pressures. The requirement to reserve a specified proportion of premium fee income for equity initiatives should be a political plus. Such initiatives, funded by institutions rather than government, might include part or full scholarships to cover fees, or other outreach or student support initiatives as institutions see appropriate. Institutions' compliance with quality assurance processes, a condition for receiving a government subsidy, would underpin the export of education services and facilitate the emergence of new, quality assured providers.

11. The possibility that universities will charge higher fees and the application of a real interest rate on loans will be the most contentious aspects of the package. The pricing behaviour of universities after fee deregulation cannot be predicted with certainty. Some universities may seek to position at least some courses at the premium end of the market; others may seek to grow market share, including by exploiting delivery technologies which reduce costs. The average annual undergraduate fee paid by overseas students is currently \$11,500 (see Attachment G) and the average fee in a deregulated environment is expected to be slightly lower, at around \$11,000. If this were the price for an undergraduate course in the deregulated system, after government subsidies of \$7050, students would pay \$3950 on average (the average up-front HECS charge is currently \$3150). Our decision on the level of subsidy will therefore be a critical determinant of the impact of deregulation on fees. Reduced subsidies per student may contain fiscal pressures but will add to pressures for price rises. Pressures to increase fees will be reduced if we adopt the measures to accelerate workplace reform outlined in paragraphs 22 and 23. In selling fee deregulation and loans with an interest rate to the public I propose emphasising the significant private returns from higher education (Attachment C), the lower rates of unemployment enjoyed by graduates (Attachment H) and the good sense in allowing students to

invest more in their own education. If necessary, I will examine the possibility of constraining or capping fee increases during a transitional period, and a waiver of interest where a person's income is below the minimum repayment threshold to allay community concerns about these components of the package.

12. I propose implementing the reform package in two stages. From 2001 loans would be available in public and private institutions for full fee paying students and current constraints on the number of fee paying students and on charging for ancillary services would be relaxed. Modest growth would also be provided to meet pressure points in demand and to smooth transition. Commitment to growth is an essential signal to obtain community acceptance of loans. From 2002 admissions and fees would be deregulated for commencing students. This, combined with my proposals to accelerate workplace reform (see paragraphs 22 and 23) would relieve the immediate pressures in the sector, give institutions time to prepare for deregulation, facilitate the handling of transitional issues and ease the fiscal impact of the package in the next two financial years. The downside is that staging will prolong our political exposure.

**Option 2 - An alternative package closer to current arrangements**

13. An alternative is to go some way to improving access to higher education while retaining the key features of current arrangements. This can be achieved by amending the reform package outlined in paragraph 6 to read as follows:

(a),(b) retain current controls over the number of government funded places as the basis for allocating tuition subsidies;

(c) retain the prohibition on charging fees for HECS liable places but liberalise the capacity of universities to introduce additional fee-paying undergraduate places by relaxing the 25% cap on fee-paying places in each course, and to charge for ancillary services;

(d) preserve HECS as per current arrangements but provide loans, at a real rate of interest and repayable through the tax system on an income-contingent basis, to non-overseas fee-paying students in public and private institutions;

(e) fund a modest increase in places in publicly-funded institutions to meet demographic needs. An additional 2,000 equivalent full-time commencing students per year, plus standard pipeline, would deliver an additional 21,000 places by 2005; and

(f) improve quality assurance arrangements (as per my preferred package).

14. Such a package, beginning in 2001, would demonstrate the Commonwealth's commitment to funding some of the growth in the demand for higher education places. Directing new places to the fastest growing regions would be welcomed as a significant advance for regional equity of access to higher education. Providing access to income contingent loans would partly remove anomalies whereby most students currently have access to a public subsidy and HECS loans but others (full fee-paying

undergraduates and postgraduates in public institutions and students in private institutions) can access neither.

## COST PROJECTIONS AND FURTHER INFORMATION

15. Cost projections for a demand-driven system, including variations based on different forms of tuition subsidy and on different arrangements for the provision of student loans are at Attachment B. An alternative and less costly package building on existing arrangements (Option 2) is also costed in Attachment B. Indicative costs are summarised below:

| **$m indicative impact on fiscal balance** | **2000-01** | **2001-02** | **2002-03** | **2003-04** |
|---|---|---|---|---|
| *Option 1 - demand driven system* | | | | |
| - undergraduates only | -22.2 | -238.8 | -544.1 | -634.5 |
| - undergraduates + non-higher degree postgraduates | -22.7 | -361.1 | -702.7 | -798.3 |
| *Option 2 - alternative package* | | | | |
| - undergraduates only | -22.2 | -30.8 | -46.6 | -65.9 |
| - undergraduates + non-higher degree postgraduates | -22.7 | -38.7 | -55.1 | -75.3 |

16. Costings for option 1 assume that existing HECS-liable students are grandfathered - students can continue to pay their higher education contribution at existing rates if they choose to do so. Some existing students are expected to exit the HECS system to take up lower cost course options. Existing subsidy arrangements for 'grandfathered' students will continue during the transitional period - government will continue to provide tuition subsidies by way of operating grants to institutions, and to meet the costs (explicit and implicit) of the current HECS arrangements. Costings also assume the extension of a standard tuition subsidy to new students commencing from 2002. This ensures that similar subsidies are available for similar activities, establishing competitive pressures to sustain high quality course offerings.

17. I do not propose setting a limit on the duration of the public subsidy. This would be administratively complex and inconsistent with lifelong learning and could produce significant losers. I propose rationing entitlement to the subsidy instead by abolishing subsidies for higher degrees by coursework, except for retaining some subsidies for teaching and nursing courses at this level. Lower cost options also exclude subsidies for postgraduate certificate, diplomas and equivalent qualifications, except for teaching and nursing qualifications. Sensible prudential limits would also be set on student loans to manage the Commonwealth's exposure to bad debts and manage the risk that an individual might become over-indebted. Proposed subsidy arrangements for higher degrees by research are separately outlined in my discussion paper New Knowledge, New Opportunities (JH99/0223 refers).

18. Information on private returns from investing in higher education is at Attachment C. Additional information on university graduates' lower risk of unemployment and estimates of future demand for higher education are at Attachment H.

19. Options to address equity concerns are canvassed in paragraph 25 and at Attachment D.

Regional concerns are addressed in paragraph 26.

20. Relatively simple measures to improve quality assurance arrangements, essential irrespective of the path government takes to reform higher education, are at Attachment E.

These measures can be implemented unilaterally by the Commonwealth if required but are best progressed in cooperation with the States.

**WORKPLACE REFORM**

| **$m impact on fiscal balance** | **1999-00** | **2000-01** | **2001-02** | **2002-03** |
|---|---|---|---|---|
| *Workplace reform package* | -84.9 | -86.5 | -87.5 | -88.2 |

21. Higher education institutions' capacity to respond flexibly and efficiently to emerging student and employer demand is hamstrung by continuing workplace rigidities, by the retention of unwieldy governance structures and by the persistence of a NTEU-dictated pattern bargaining agenda. In the current round the NTEU is seeking to impose conditions which will worsen the rigidities in the sector. In particular, it is demanding salary increases of 19 per cent over 3 years, prohibiting AWAs, reducing staff workloads, limiting operating times and including matters outside the 20 allowable matters. The Commonwealth could allow workplace reform in the sector to proceed in the manner and at the pace which suits individual universities' management objectives. However, with some exceptions, the reform process is likely to be protracted. There is a real risk that some existing institutions, particularly in the regions, will become financially unviable as unsatisfactory pay and conditions arrangements in the sector become locked in until at least 2002-03. In introducing fee deregulation from 2002 the risk is that institutions will pass on the costs of inefficiencies and unfunded salary increases in higher fees if workplace reform is left until after fees have been deregulated.

22. In my view some salary increases for academic staff are warranted (selected salary relativities are at Attachment I). A quality higher education system requires high calibre staff, and low rewards in academia are driving quality staff to other fields of work or universities overseas. The limits on institutions to raise revenue when government controls the volume and price of their main activity inhibits their capacity to afford adequate salary increases. Workplace reform could be pursued immediately

through an up-front injection of funds contingent on the achievement of specific workplace relations reforms (in particular, the inclusion of satisfactory provisions in Enterprise Bargaining agreements) reflecting government policy objectives (see Attachment F). The Australian Government Solicitor considers it appropriate to act on the basis that the Workplace Relations Act's prohibition of coercion, in relation to agreement-making, does not apply when a government imposes conditions on a proposed grant of funds. Legal advice is being obtained on minimising the risk of legal challenge. A Regional Impact Statement is at Attachment J.

23. The timing of the delivery and the quantum of any additional funds is critical. On timing, the availability of additional funds would need to be announced as soon as possible to influence outcomes in the current round of negotiations. On quantum, current indexation arrangements already provide sufficient funds to finance at least a one per cent increase in academic and general staff salaries. I propose an injection of funds from January 2000 sufficient to underwrite a further two per cent salary increase in the sector - enough in my judgement to persuade universities to hold firm during what is likely to be extensive industrial unrest. I prefer delivering additional funds by increasing universities' operating grant over altering current indexation arrangements, to avoid any flow-on to other Commonwealth own-purpose outlays.

## OPTIONS TO ADDRESS EQUITY CONCERNS

| **$m indicative impact on fiscal balance** | **2000-01** | **2001-02** | **2002-03** | **2003-04** |
|---|---|---|---|---|
| *Equity package* | -25.3 | -27.3 | -29.5 | -31.8 |

24. Key features of current higher education financing arrangements already support our equity objectives. In particular, means tested income payments cover living expenses and HECS ensures that most students do not have to pay fees up front. In my preferred package, the proposed loans scheme would ensure that all students can access income contingent loans to finance their fees. The hypothecation of a set proportion of premium fee income to pursue equity objectives will also assist.

25. Nevertheless, participation, success and completion in higher education remains low for some groups. We could improve access to higher education for Indigenous students and students with disabilities by explicitly rewarding universities which recruit and retain these students. I also propose a modest programme which would fund, on a competitive basis, institutional initiatives to increase access to students from low socio-economic status backgrounds, and rural and isolated groups. Details of this package are at Attachment D.

## OPTIONS TO ADDRESS REGIONAL CONCERNS

26. In addition to delivering higher education locally, regional campuses of universities play an economic, social and cultural role in their regions which is irreplaceable. In my view it would be sensible to take stock of the education and training needs of rural communities. I will consult with the Minister for Transport and Regional Services on a review of regional education and training needs and will report to Cabinet on this matter before the end of 1999.

## NEXT STEPS

27. Cabinet's endorsement of a preferred reform package, and of an approach to workplace reform in the sector, is critical to setting the timetable for reform. The proposal to provide additional Commonwealth funding contingent on workplace reform needs to be announced immediately if it is to influence outcomes from the current round of salary negotiations. I propose returning to Cabinet before the end of 1999 with a detailed package based on the agreed approach to reform, and a policy paper on reform in higher education based on this approach, to be released as soon as possible. Stakeholders would be consulted on implementation of the reforms set out in the paper in early 2000, with implementation of loans for fee payers from 2001 and deregulation of admissions and fees from 2002.

OCTOBER 1999