

Reconceptualising tertiary education:

and the case for re-crafting aspects of the Abbott
Government's proposed higher education reforms

Mitchell Institute Policy Lecture

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Peter Dawkins.

About the author

Economist and educator, **Professor Peter Dawkins** has served as the Vice-Chancellor and President of Victoria University since 2011, one of the state's four dual sector universities, based in Melbourne's west, Australia's fastest growing region, and an area with disproportionate numbers of people from low socio-economic status and migrant backgrounds.

Between 1996 and 2005 Professor Dawkins spent the best part of a decade at the University of Melbourne as the Ronald Henderson Professor of Applied Economic and Social Research and, for a period, was Dean of the Faculty of Economics and Commerce. Peter Dawkins then spent six years in the Victorian Public Service, first as Deputy Secretary of Treasury and Finance, then as Secretary of the Department of Education and Early Childhood Development, overseeing the state's education system.

Having served for three years as Victoria University's Vice-Chancellor, Professor Dawkins takes stock of his experience across all educational sectors, and outlines the case for reconceptualising tertiary education. He goes on to comment on the recent higher education policy announcements in the 2014 Australian Government Budget, which involved a major deregulation agenda. He examines whether these changes contribute to the reconceptualisation of tertiary education and argues the case for re-crafting aspects of the proposed reforms.

About the Mitchell Institute

The Mitchell Institute for Health and Education Policy at Victoria University is an independent research and policy institute that works to improve the connection between evidence-based research and public policy reform. The Institute was founded on the principle that health and education are critical components of the development and progress of an economically and socially prosperous society. This is reflected in its focus on disadvantaged communities and the transformational change effective education and good health can deliver. The Mitchell Institute was established in 2013 through the generous financial support of the Harold Mitchell Foundation and Victoria University, Melbourne.

1. Introduction and overview

1.1 Harold Mitchell and the Mitchell Institute

It is a great honour to be delivering the inaugural Mitchell Institute Policy Lecture.

Harold Mitchell is an inspirational Australian. He is an outstanding entrepreneur and an outstanding philanthropist. Harold recognises the great power of education to improve social and economic outcomes. Victoria University is very proud to be the beneficiary of his philanthropy in the form of the Mitchell Institute for Health and Education Policy, a joint venture of Victoria University and the Harold Mitchell Foundation.

We are delighted that Harold chose Victoria University as the base for the Mitchell Institute. To a large extent this was because of the importance of improving education and health outcomes in the West of Melbourne where Victoria University is based. It is Australia's fastest growing region. It is very much a region with a high incidence of social disadvantage and associated educational and health challenges, such as developmental problems in early childhood, disengaged young people, obesity, and chronic disease.

If we can learn from research in the West about how to overcome these challenges, the West of Melbourne will benefit as will the nation and the world, to which many of the findings will undoubtedly be transferable.

The Mitchell Institute commenced operations last year, under the direction of Mark Burford and with an Advisory Board chaired by Lindsay Tanner. Research at the local level in the West of Melbourne is well underway, alongside work on state and federal education and health systems. If we can develop policy in a way that clearly has important local impacts, in places like the West of Melbourne, but can also be embodied in state and federal policy innovation, then we are on the right track.

1.2 The Mitchell Institute research program Reconceptualising Tertiary Education

One focus of the Mitchell Institute's research program falls under the title of Reconceptualising Tertiary Education. The work on this commenced when I spent a month at the Mitchell Institute in September 2013 as a Visiting Fellow. It is now being led by Professor Peter Noonan, undoubtedly one of Australia's foremost authorities in this area.

What was the motivation for this program of work? First and foremost it was that we have moved from a system of tertiary education that was for the minority for most of the 20th century, to one that is for the majority in the 21st century.

We need to think about the tertiary system moving from one which included a higher education system for the intellectual elite, and a vocational education system focused on practical skills, to one that provides a more comprehensive tertiary system for everyone.

My hypothesis when I started this project was that tertiary education has not properly adapted to this new world and needs to be reconceptualised. I will elaborate that argument in this lecture, and

a more detailed version will follow in the first policy research paper produced from this research program.

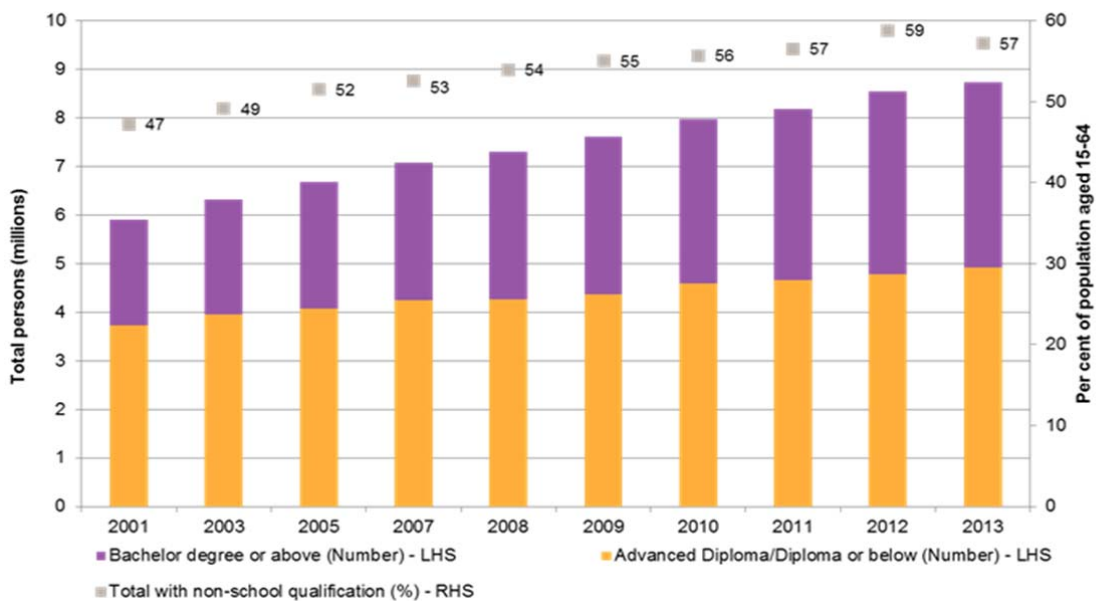
As it turns out, this lecture is taking place just over a week after the 2014 Commonwealth Budget, in which a radical deregulation of higher education was announced. I will assess these measures in the 2014 Commonwealth Budget and whether they assist with the reconceptualisation of tertiary education.

1.3 The expansion of tertiary education

In 1980, only 30 per cent of school students completed secondary education. Now it is over 80 per cent. For the vast majority of people in the 21st century, tertiary education will be critical for their success in the labour market and as citizens. In a sense, tertiary education is the new secondary education. And more than that, it will be important for most young people to take advantage of tertiary education, and increasingly important for the mature adult workforce to take advantage of tertiary education. Tertiary education needs to be increasingly viewed as a core part of the education system, rather than an add-on. We have moved from a system of higher education that was for the minority through most of the 20th century, to one that is increasingly a mass system. We have recognised the importance of vocational education and training (VET) beyond the traditional apprenticeship system.

The proportion of Australia’s population gaining a tertiary qualification through either the VET or higher education sectors has grown rapidly over the last decade as the following chart shows.

Chart 1: Post-school qualifications in Australia



Source ACIL Allen Consulting drawn from ABS Survey of Education and Work May 2013

In this context, the Rudd-Gillard Government followed the advice of the Bradley Review of Higher Education (Department of Education Employment and Workplace Relations, 2008) to move to a demand driven system of higher education (at least for bachelor degrees) by uncapping Commonwealth Supported Places, resulting in a further significant expansion of higher education. At the same time, especially in Victoria, there has been a significant expansion of VET, the other part of the tertiary system.

At well over 50 per cent (see Chart 1), the proportion of the adult population with tertiary qualifications, is now one of the highest of the OECD countries. Our national interests are well served by this growth in qualification attainment. This growth represents a deeper, broader pool of skills and knowledge – Australia’s human capital – that can be progressively called on to exploit the opportunities presented by the structural shift to a knowledge economy.

Economists who have analysed the future demand for labour generally concur that while there may be some ups and downs, this strong growth in tertiary qualified workers will be required over coming decades (see for example, forecasting conducted by Access Economics and Birrell et al for the Bradley Review (Department of Education Employment and Workplace Relations, 2008), Shah et al (2007), and Deloitte Access Economics (2013)).

Some commentators have questioned this broad agenda of raising participation in tertiary education, especially higher education, concerned about the impact on the quality of that education. The current Commonwealth Minister for Education, Christopher Pyne, at first appeared to be influenced by that counter view, but decided to undertake a review of the demand driven system of higher education. He asked Dr David Kemp and Andrew Norton to undertake that review (Kemp and Norton, 2014).

1.4 The Kemp-Norton Review of Demand Driven Funding System and the Government’s response

The Review findings were unequivocal: the demand driven system is a good idea and needs to be expanded. Kemp and Norton argued that it needed to be expanded by uncapping sub-degree higher education programs.¹ They also argued that non-university higher education providers should be brought into the Commonwealth funded system, which is analogous to the way that Victoria has expanded its VET system.

The Abbott Government decided to accept the thrust of the Kemp-Norton Review: that is, to expand the demand driven system. Paradoxically, however, the Government has done this at a time when it has decided, simultaneously, to cut the growth in spending on tertiary education in its own higher education spending and its future transfers to the states which are currently largely responsible for VET. To undertake such a major reform at the same time as substantially restraining spending is seriously problematic.

The way the Government has decided to do this in higher education broadly follows the advice of the Commission of Audit (National Commission of Audit, 2014), which was to substantially transfer

¹ This is a step that Victoria University argued strongly for in its submission to the Review (Victoria University, 2013).

the costs of higher education to the student to be achieved by an average 20 per cent cut (and reduced indexation) to per student funding from government, alongside the deregulation of fees.

Unfortunately they had not asked their reviewers to advise on the deregulation of fees and have adopted an approach that carries significant risks. In my view, these risks should be ameliorated by adopting some amendments to the approach to fee flexibility, and/or reform of the income contingent loan system.

Also, I will argue in this lecture that the Government should have given more thought to market design issues in the process of bringing non-university higher education providers into the subsidised system. Hopefully it is not too late to re-craft some of this.

There are two further problems that need to be addressed which interact with the market design issues. Along with Professor Glyn Davis, the Vice-Chancellor of the University of Melbourne, in an article written during the Kemp-Norton review (Davis and Dawkins, 2014), I argued that if they recommended a deregulation option, especially if they proposed opening up the system to private providers, then two key issues needed to be addressed.

First, it would be necessary to undertake a substantial review of the whole structure of subsidies for different types of students in different types of courses. Second, it would be necessary to review the interface between higher education and VET.

These issues are both addressed in this paper.

1.5 Contents of this paper

In section 2, I will elaborate on the need to reconceptualise tertiary education, what its aims should be, and what measures of success should be applied. This leads on naturally, in section 3, to an explanation of the need to rethink the divide between VET and higher education and the reform agenda that should flow from that. I will also touch on the role and future of dual sector universities, such as Victoria University (VU).

As an aside, let me say one or two things about Victoria University, and let me acknowledge the presence of the Chancellor, George Pappas, and other Council members, management and staff of the University. I was attracted to being the Vice-Chancellor of Victoria University for a number of reasons. Most important was that I saw VU, a dual sector university with a high proportion of students from low socio-economic status and non-English speaking backgrounds, as being at the forefront of widening participation in tertiary education: a matter of major national importance. VU was a place where there was a real chance of taking a lead in reconceptualising tertiary education. The question is: how do I view this now, in the context of changes in tertiary education which have taken place since I arrived, and where do I think that tertiary education should be heading?

In section 4, I discuss the problems with the proposed approach to deregulating higher education fees, as announced in the 2014 Commonwealth Budget.

In section 5, I discuss the importance of good market design in the process of a market-based reform of the kind being currently contemplated in higher education.

In section 6, I draw together some conclusions.

2. Reconceptualising tertiary education

2.1 What is tertiary education?

At the simplest level, tertiary education is what comes after secondary education. In Australia we aim to retain as many young people in secondary education as possible until they reach adulthood. We are explicit that by the time they complete secondary education, we aim for young people to be:

- successful learners
- confident and creative individuals
- active and informed citizens.²

There are, then, various ways in which we attempt to measure these three attributes, with greater or lesser success. However, the fundamental idea is that by the end of secondary education, young people should have a basic preparation for being successful in work and in life.

However, it has become clear that to be successful in work and in life, a combination of more education, training and experience will be necessary to convert the basic set of capabilities into capabilities that have more direct application, particularly in the labour market. That education and training will come from the tertiary education system.

There are challenges in getting a more detailed definition of tertiary education, and therefore what the tertiary system needs to incorporate. First, it is not clear where secondary education ends and where tertiary education begins.³ Second, there is no clear framework for understanding the combination of knowledge, skills and capabilities that are needed to build on the foundations of secondary education so that adults are helped to be successful in the labour market, and as citizens. Third, the education and training that currently fills the tertiary space has grown up under two quite different traditions – those of vocational education and higher education respectively.

2.2 The need to rethink the divide between VET and higher education

Over the course of history, the academic tradition of universities increasingly became one of enquiry based learning, complemented by teachers also being researchers. Higher education was developed for the academic elite, or more accurately, for those who had already shown high levels of academic achievement before they entered university. In recent history, however, universities have been progressively confronted with the need to provide large scale professional/vocational education, and to teach larger and larger numbers of students, many of whom need additional learning support to succeed in their studies.

VET, on the other hand, has been concerned essentially with trades and other entry level qualifications and paraprofessional qualifications. In recent history, this has become defined in

² (Ministerial Council on Education Employment Training and Youth Affairs, 2008). The current author chaired the committee that drafted the *Melbourne Declaration on the Educational Goals of Young Australians*.

³ The forthcoming Mitchell Institute Policy Paper on *Reconceptualising Tertiary Education*, will discuss whether tertiary education could perhaps be defined as certificate 3 upwards in the AQF, how the AQF might need to be further developed to make this meaningful, and what the implications are for secondary education.

terms of quite narrowly based competencies, which in turn have become embedded in national training packages. The motivation for this was good: that the curriculum should be driven by the outcomes that are desired by industry. The problem has been that the outcomes became too narrowly defined. There are generic capabilities, such as problem solving, teamwork and communication skills, that VET has under-emphasised.

The truth is that both VET and higher education need to impart a range of knowledge, skills and capabilities, in varying proportions that are determined not just by whether they are VET or higher education, but also by how vocational the course is. So nursing qualifications in VET, and nursing qualification in higher education, should have a similar framework of knowledge, skills and capabilities. The ability to transition from a VET qualification in nursing to a degree in nursing should be quite seamless.

Similarly, the ability to transition between a VET qualification and an Arts degree should be quite seamless. Media and communications VET qualifications should be easily recognisable within a framework of knowledge, skills and capabilities that also applies to higher education Arts degrees with media and communications specialisations.

2.3 The importance of know-how and know-who as well as know-what and know-why

Productivity improvement is driven by applying skills and knowledge in and across firms, not just by accumulating qualifications. Workforce participation is driven by the capacity of individuals to apply their skills in workplaces and the capacity of graduates to quickly meet employer expectations and requirements.

In its highly influential work on the Knowledge Economy the OECD (1996) identified the kinds of skills required in a knowledge economy as:

- **Know-what** – knowledge about ‘facts’.
- **Know-why** – scientific knowledge of the principles and laws of nature.
- **Know-how** – the skills or the capability to do something.
- **Know-who** – information about who knows what and who knows how to do what.

The OECD concludes that:

Learning to master the four kinds of knowledge takes place through different channels. While know-what and know-why can be obtained through reading books, attending lectures and accessing databases, the other two kinds of knowledge are rooted primarily in practical experience.

Both VET and higher education should incorporate a blend of all four types of knowledge/skills. As a general principle:

- VET needs more know-what and know-why. This would enable those completing VET to be more adaptable in the workforce, and more capable of proceeding into higher education.
- Higher education needs more know-how and know-who. This would help to make

graduates of higher education better prepared for the world of work through programs like work-integrated learning and it would make movements between VET and higher education easier.

Why shouldn't an engineering apprenticeship be the starting point, via an ongoing program of structured work and learning, for a high skill cadetship articulating through post-trade qualifications into degree and even postgraduate qualifications?

Tertiary education must also be the primary source of the generation of new knowledge through both pure and applied research, and the involvement of tertiary education institutions in the innovation process and innovation networks. Tertiary education must encompass the training of researchers and scientists, including through partnerships with industry as the Chief Scientist Professor Ian Chubb has long advocated. Similarly, we need more internships and cadetships for higher education students of social sciences and business.

In the Australian Qualifications Framework (AQF), most VET qualifications are between level 1 and level 6,⁴ and all higher education qualifications are between levels 5 and 10. The underpinning conceptual framework about the range of knowledge, skills and capabilities that these qualifications represent could do with further development. The OECD work outlined earlier might be a useful starting point.

2.4 Diplomas in VET and higher education

This problem of the divide between VET and higher education is exposed most clearly at AQF levels 5 and 6. For example, at level 5 there are diplomas in both VET and higher education.

Diplomas in VET – such as the Diploma of Veterinary Nursing (General Practice) and the Diploma of Building and Construction (Building) – are designed to train people for particular occupations. They focus on the competencies required in that occupation. They tend not to give much weight to generic capabilities (such as problem-solving), to underpinning disciplinary knowledge, or to the kind of learning skills that would be helpful to students who progress to a degree.

Diplomas in higher education – such as Victoria University's Diploma in Business Enterprise, and the Diploma in Information Technology – are designed to be useful to those who want to enter employment in business or IT. Simultaneously they develop students' problem-solving skills, their learning skills, and their knowledge, in ways that will enable them to progress successfully onto the second year of a bachelor degree.

There is growing evidence that a narrow, competency based approach to some diplomas in VET restricts their value in the labour market.⁵ This is one reason why we have created diplomas in higher education at Victoria University which are also a better pathway into a degree. However, the Labor Government took diplomas out of the uncapped demand-driven system, which has been a serious deficiency.

⁴ Levels 1 and 2, although currently taught in the VET sector, are pre-vocational qualifications.

⁵ There is a significant body of work produced by the NCVER on this issue, including Karmel (2012) which can be found at their website: www.ncver.edu.au. For more generic qualifications such as business the outcomes should be broadly framed rather than through narrow competencies.

2.5 Uncapping sub-degree program qualifications

Thus the decision announced in the 2014 Commonwealth Budget to include sub-degree programs, including diplomas, in the demand-driven system is a very positive move. I saw this as an important priority for the Kemp-Norton Review and it featured prominently in Victoria University's submission to the reviewers (Victoria University, 2013).

If we are going to achieve the objective of broadening participation in tertiary education, to promote economic growth and social inclusion, there are many students who can and will get a bachelor degree in due course, who need a strong pathway program to help them on their way, which will also be valuable in its own right if the student decides not proceed. The capping of sub-degree higher education programs did not make logical sense and the removal of the cap is to be applauded.

However, what must be realised, now, is that this will be a competitive threat to VET diplomas. While a number of these qualifications are very robust and highly sought after, for reasons outlined earlier in this lecture, many of them are not.

A number of people have argued that there is an urgent need to reform the national training packages to make for more desirable qualifications that transmit both the kind of generic skills needed in the labour market (like problem-solving), and the industry and occupation specific skills that students need. Desirable qualifications will also nurture the learning skills that will support those who want to progress more rapidly into a degree.

It may be that the inclusion of diplomas in the demand driven higher education system will render the reform of national training packages unnecessary, as alternative and better products in the higher education system can now be expected to emerge.

2.6 Subsidies, fees and Commonwealth-State financial relations

The Commonwealth Budget uncapped sub-degree programs in the demand-driven system of higher education, and extended funding to non-university providers (including TAFEs) that provide such programs. These are positive steps in helping to foster a more integrated tertiary system at AQF levels 5 and 6. This should lead to reforms of diplomas that will strengthen pathways between VET and higher education programs, and provide greater value to those completing them than is the case for many who currently complete diplomas in VET. For this the Government should be congratulated.

However, we are left with eight different VET systems, with different fees and subsidies, mostly poorly funded by comparison to higher education. This leaves students for whom a VET qualification at certificate 4 or below should be the preferred option, poor cousins compared with those going into higher education. Commonwealth VET funding for the states will be cut by almost \$500 million in 2017-18⁶ and the VET funding trend at a state level is bleak.⁷

⁶ Commonwealth Budget Paper 3 Table 2.2

⁷ This latter point is clear from the NCVET 2013 financial collection which shows static or declining VET funding in most jurisdictions except Victoria

We should explore a federal-state negotiation to achieve a more coherent approach to funding tertiary education students, which in turn supports a more coherent tertiary system.

2.7 Measuring the success of tertiary education and its constituent institutions and providing information to students

Central to the design of a viable market is that price and value signals are apparent to buyers. For our purposes, students are buyers who weigh up the expected return from the fees they pay for their tuition.

The reputation of universities and their brand is a major determinant of the demand for places. This is often driven, to a significant extent, by national and international league tables of universities. But are we happy that this is what will tend to drive the prices that Universities can charge in a deregulated market? League tables are mostly driven by research output and not by teaching, although some league tables have teaching related aspects.

What kind of league tables should Australian universities aim to do well in? Different league tables give different weights to different criteria. It is important to understand their differences. It is also important to realise what the rankings do not measure. The biggest deficiency of the three major world rankings (THE, ARWU and QS) is that none of them incorporate measures of the effect of universities on their students, or on the broader community.

The ARWU is a prestige ranking based on measures of research reputation. It has a strong historical bias in favour of older universities which, for example, have produced Nobel Prize winners. The THE ranking is a more broadly-based measure that tries to take into account teaching as well as research, albeit in a somewhat unconvincing way. The QS rankings place considerable emphasis upon surveys of academics who are asked to assess the leading universities in their fields.

There is considerable overlap between Australia's top ten universities in these rankings. All of the Group of Eight, plus Macquarie University, is in the top ten for all three league tables in 2013. The University of Newcastle is getting into the top ten in the THE rankings, Flinders University in the ARWU, and University Technology, Sydney in the QS rankings.

Ask anybody what a great university is, and they may well mention Harvard. Harvard came first in the world in the ARWU ranking, and second in both the THE ranking and the QS ranking.

There is no doubt that Harvard is a great university and is widely recognised as such. Its reputation has been built up over almost 500 years. Its contribution to knowledge through research is outstanding, and many of its alumni are very famous. A larger number are in very important positions in many countries around the world.

It grew up, however, in a period in which tertiary education was an elite activity, selecting already very high academic achievers as its students. This is true of most universities in the world that are regarded as great universities.

In the 21st century, however, tertiary education is a mass system, and universities now have a broader role than providing opportunities to the academic elite. Australia will need most of its population to receive a high quality tertiary education for the country to remain competitive.

This raises a question: Should universities established in the last 50 years, and that aim to be great, try to become the Harvard of the 22nd century? Or, given the broader role of universities in the modern era, is there a new style of great university that should emerge? And should there be metrics that will help students to identify which universities they are?

Outstanding contributions to knowledge creation through research should still be expected from any great university. But there is a case for some universities to claim greatness from adding value to students who may not be high academic achievers when they enter university. Many such students may come from lower socio-economic backgrounds, and their lack of academic achievement may be due to fewer opportunities rather than an inherently lower capacity to achieve. We need universities that have a big impact on such students. They need to add demonstrable value.

Washington Monthly National University Rankings of US universities are an interesting case in point. Under these rankings, the Washington Monthly rates universities based on their contribution to the public good in three broad categories. One is research, such as producing cutting-edge scholarship and PhDs. One is social mobility, for example by recruiting and graduating low-income students. The third is service, for instance encouraging students to give something back to their country.

The overlap between the US top ten in the three best known rankings, is similar to the Australian situation. But in the Washington Monthly rankings, while four of the top ten appear in the better-known rankings, six new names appear. They get there by being strong in research, and also by having a big impact on their students and communities, and by promoting social mobility. I am very familiar with the seventh listed US university, the University of Texas at El Paso, which has done an outstanding job in raising participation amongst Hispanic students in El Paso.

I make these points not to say that these particular league tables are the ones that should be championed by the government. Rather I want to pose a question: are we happy that universities with strong brands could now charge high fees to make margins that are then reinvested in the brand via increases in research funding, rather than in enhancing the student experience?

Or perhaps the student experience is a major determinant of student presence and their willingness to pay.

It is important that students have access to reliable and useful information that will help them make good choices. The Government has announced its intention to improve the availability of that information. We have to be careful about jumping to conclusions about what information that is. The issue a student should assess is how much value the university under consideration will add for the student in question.

Also, in thinking about the size of public subsidies to university places, ideally we would have measures of the public impact of universities.

Interesting and similar questions arise about non-university higher education providers.

2.8 The future of dual-sector universities

I have argued above that there is too great a divide between VET and higher education, in curriculum, and in subsidy and fee arrangements. Given this dichotomy in curriculum, in dealing with different governments and lack of alignment in funding arrangements, this does make it challenging to be successful as a so-called dual sector university, aiming to achieve seamless pathways between VET and higher education, and to provide alternative entry and exit points in the tertiary education continuum. It has been particularly challenging in recent years in Victoria with the cuts in funding to public providers in VET. And with future Commonwealth funding to the states reduced in the recent Budget, the funding outlook for VET shows no signs of improving.

However, the uncapping and deregulation of sub-degree higher education programs is a positive move which opens the opportunity to reform dual sector and TAFE offers at levels 5 and 6. This will improve their ability to provide seamless pathways into bachelor degrees, as well as reforming the curriculum which is currently constrained by national training packages.

But students below level 5 (at certificate 4 or below) remain poor cousins compared with those going into higher education. It is noticeable that increasingly some dual sector universities have been getting out of those qualifications.

At Victoria University, we would like to stay active at certificate 4 and below. We would argue that there should be federal-state negotiation to achieve a more coherent approach to funding students in tertiary education, which in turn supports a more coherent tertiary system.

If there was a more coherent tertiary system, the term 'dual sector' might become a misnomer. The title of 'omniversity', a term that has been used by Professor Stephen Parker (2011) and by Dr Tom Karmel (2011), might become a better description of a university that more than any other tertiary institution would provide outstanding opportunities for students from diverse education backgrounds to enter and exit tertiary education at levels that help them to achieve the success they are after. This is the aspiration of Victoria University.

3. Fee deregulation and the reform of income contingent loans

3.1 Introduction

In the Budget, the Government announced the decision to remove caps on both the fees that can be charged for higher education programs and the income contingent loans they can receive to finance the payment of the fees.

It is acknowledged by the Government that this will substantially increase the size of the HECS debt that students will hold and that governments will have on their balance sheet. It will also increase the default on the debt, with more students unable to repay the debt than before.

In order to make this reform possible, the Government has moved the loans onto a more commercial basis than before. Until now, there has not been a rate of interest charged on loans to undergraduate students. The debt has been indexed by the CPI. If that had not been reformed there would have been very large increases in the subsidies embodied in the loan system, by government covering the interest costs. Further, these subsidies would have been larger the higher the fees charged, resulting in a potentially very serious moral hazard. That is that the higher the fees that a university charges, the greater the government subsidy to the student. Thus we could have expected universities, especially those with strong market power, to have charged excessively high fees.

3.2 The problem of moral hazard and 'gouging'

It is not clear, however, that this moral hazard has been eradicated by charging the government bond rate to the cost of the loans. Indeed, economist Henry Ergas (2014) argued recently in *The Australian* that this problem of 'gouging' was potentially a very significant issue with the reform.

First, this interest rate is a favourable rate compared to loans that are generally available to the public. Second, students don't have to start paying back the loans until their income reaches around average weekly earnings. And third, it is acknowledged that there will be higher default rates than before, which ultimately represents another transfer of the cost of high prices to the government. There is a serious question here as to whether the price signals will be as clear to students as they should be in a market with completely unregulated prices.

3.3 Ameliorating the risks

To summarise the risks that the Government is taking with this policy:

- Increased debt levels on students and high levels of HECS debt on the Government's balance sheet
- Increased default on the loans

- The significant possibility of excessively high prices being charged, especially by providers with strong market power, because of insufficiently clear price signals under the income contingent loan system

There are three ways that these risks might have been ameliorated. First, there could have been a cap on the size of the loans, a proposal favoured by Ergas (2014). Second there could have been a cap on the size of the fee. Third, some restraints on higher fees could have been introduced by a reduction in the Commonwealth subsidy when fees increase above certain levels. This is a proposal that has previously been put forward by Professor Stephen Schwartz (Lane, 2014), which I will return to under the heading of equity.

I think all these possibilities should continue to be explored.

3.4 Equity issues (and associated efficiency considerations)

A number of commentators have already raised serious questions about the effects of this reform on equity.⁸ In my judgement this is the biggest question mark against these reforms. And with it go some efficiency questions as well. If students from low socio-economic backgrounds are discouraged from participating in higher education, or receive lower quality education and training as a result of these policies, we are at risk both of increasing inequality, and of not making full use of the human capital potential in the economy. If anything, policy should be biased in the other direction, towards increasingly promoting the participation of under-represented groups in tertiary education and training, and the quality of education and training that they receive.

It is clear that the burden on students will rise significantly and with interest being charged from the time the student commences, significantly higher levels of debt will accumulate. In the past the income contingent loans system has produced very low elasticities of demand, but in the new environment they may become higher and the prices will be higher too, so there may be significant numbers of discouraged participants. This is most likely amongst students from low socio-economic backgrounds for whom greater risk aversion about debt accumulation can be expected.

Professor Glyn Davis, Vice-Chancellor of the University of Melbourne, has pointed out that fairness will be the main point of contention under the Pyne reforms (Davis, 2014). As a Vice-Chancellor of a University that stands to gain a great deal from the reforms, it is pleasing that he has done that. He outlines four principles of fairness that follow from thinkers like philosopher John Rawls:

1. Higher education must be available to every qualified student on terms that make it accessible;
2. The benefits from higher education must be greater than the costs, so the less well-off are not discouraged from participation;
3. The same rules must apply to everyone;
4. Inequality of treatment must be tilted toward the most disadvantaged.

⁸ See for example Bruce Chapman (interview by Andrew Trounson), *The Australian* 19 May 2014 and Simon Marginson, *The Conversation* 16 May 2014.

It will be helpful to examine the proposed reforms against these principles. There are significant risks in relation to Principle 2, and there would need to be more proactive effort to promote Principle 4.

The requirement in the package that universities that charge high fees use a proportion of that revenue to fund scholarships to fund disadvantaged students is unlikely to make a big impact on the disadvantaged. Most of these students are unlikely to get access to universities that are at the high price end of the spectrum.

An ameliorating measure that has a lot of merit is based on the idea put forward by Professor Stephen Schwartz (Lane, 2014). He proposes that as fees are raised above a certain level, a certain fraction of that increment be deducted from the Commonwealth subsidy and redistributed around the system. This could be to support more disadvantaged students.

Similarly, per student funding amounts in the government's subsidy could include an element based on socio-economic disadvantage.

4. Market design

4.1 Opening up Commonwealth supported places to non-university higher education providers

On the subject of opening up Commonwealth Supported Places to non-university providers, I endorse the position of Universities Australia that universities are not opposed to increased competition in the higher education sector. Further, competition can, and usually does, lead to increased innovation, differentiation, efficiency and effectiveness, and a stronger orientation to client needs. That is all positive.

I also endorse the Government's decision that there should be a differential subsidy for non-university higher education providers because of the requirements on public universities to undertake research and make important contributions to the communities in which they operate.

4.2 Market design and implementation

But it is important to emphasise the importance of getting the market design right.⁹

First, this is a market in which there is very imperfect information, where most customers are purchasing a complex product for the first time, and where a mistaken purchase can be very costly to them.

Second, in this reform the Government is bringing together into one market for higher education, providers from two quite different existing higher education markets and potentially providers from eight different state and territory VET markets. Efficient markets don't just happen overnight. They have to have a coherent institutional framework and a suitable range of providers.

New markets need to be nurtured, especially when substantial public funding is being injected into a new part of the market. It is in this area of market design that the Government is at significant risk of making some serious errors.

In higher education there are currently two domestic markets in operation:

1. A partially publicly funded and fee regulated market, mostly for universities, at the undergraduate level (and in some postgraduate areas for some universities), supported by HECS-HELP.
2. A more open full-fee market at undergraduate level (mostly outside universities), and at the postgraduate level for universities and other higher education providers.

In the publicly funded market the Commonwealth has acted as the price setter for publicly funded higher education through setting subsidy levels and in regulating student fees. The Commonwealth

⁹ In the process of designing the new market it would be a good idea to review the evidence of how the market for VET has operated in Victoria since it was opened up to private providers. There is expected to be significant difference (e.g. ease of entry into the higher education market would be more difficult), but it would be a useful exercise to get a picture of the potential challenges and pitfalls.

also influenced institutional behaviours through targeted funding and reward payments in areas such as equity; in effect, a form of market intervention.

HECS-HELP was designed, and has operated, as a cushion to mitigate the effect of requiring a reasonable contribution from students for publicly funded courses. Access to the publicly funded market is now relatively open for students under the demand-based funding system, although caps were imposed on publicly funded sub-degree provision.

Sitting alongside the publicly subsidised and regulated market is the full fee market supported by FEE-HELP. FEE-HELP was introduced after HECS-HELP and has expanded significantly. It has effectively operated without controls on price, except for the lifetime limit on the level of FEE-HELP debt.

It is important to note, however, that FEE-HELP is in effect a publicly established and subsidised market. Price elasticity is substantially reduced by deferred and income contingent loans. There is an almost total transfer of risk of bad and doubtful debt to the Commonwealth. The full fee higher education market would be much smaller, and fees probably much lower, if it wasn't for FEE-HELP.

There is also significant provider differentiation in this market; at the undergraduate level, smaller and generally niche private providers and some public TAFE institutions and at the postgraduate level, mainly large multi-disciplinary public universities that were precluded from the undergraduate fee for service market by the previous government.

In the Budget, the Commonwealth has in effect, and in broad terms, conflated these two markets.

There is a logic in bringing these markets together, from the point of view of horizontal equity for students attending non-universities and those attending universities.

There are also potential real benefits in encouraging universities to carefully set fees and in calibrating fees to different programs, delivery modes, choices about levels of support, and access to services.

However, there are some significant risks of what the economists call 'dead weight loss' and the creation of moral hazards from the changes in the market. Unless great care is taken in the design of, and transition to, the market the following may arise:

- As outlined earlier, due to the effect of deferred and income contingent loans on price elasticity and the positional advantage of some universities, price-gouging could occur and consumer surplus could become producer surplus.
- Government subsidies may distort existing and successful fee for service markets, especially in the short run, before new entrants arrive. In the short run, government subsidies may simply represent windfall gains to private investors if students in current full fee courses are charged the same, regardless of the payment of the subsidy.
- Long established public universities enjoying significant positional advantage will be able to exploit their dominant market position, and also continue to receive the same level of public subsidies regardless of their capacity to increase student fees.

As fee levels rise there will be a progressive transfer to the Commonwealth of risk in terms of bad and doubtful debt.

As I have said, there are three ways that these risks might have been ameliorated. First, there could have been a cap on the size of the loans. Second, there could have been a cap on the size of the fee. Third, some restraints on higher fees could have been introduced by reducing the Commonwealth subsidy when fees increase above certain levels.

The system of fee flexibility, the transition arrangements, and the structure of government subsidies, are all important elements of the market design. Depending on how they interact in such a major change, there are significant risks of unintended consequences.

Given the challenges in getting market design right, and the importance of monitoring progress of the market, the effect of different subsidies, pricing policies and loan arrangements, and equity considerations, one idea that should be considered is establishment of an independent entity to provide some surveillance and oversight of the market.

This policy has been adopted in some other markets, such as in the area of utilities, when moving from a more regulated, public provider market towards a deregulated market with private providers.¹⁰

¹⁰ The Victorian Essential Services Commission was asked to conduct a Review of VET Fees and Funding in 2011 although this review did not include subsidy levels.

5. Government subsidies

In announcing the reforms to higher education, the Government announced a re-working of the structure of funding for Commonwealth Supported Places into five new clusters, down from the previous eight. While that simplifies the structure of funding it does raise many questions about why it is so, just as there were many questions about why the previous eight were so. It seems the Government was influenced, to a greater or lesser extent, by different pieces of evidence and judgements about the cost of providing courses of different kinds, the returns that students get from the different types of courses, and the public value of the courses. By being a 'mish-mash' of all of the above, there is a lack of transparency and clear rationale. The same is true in vocational education, compounded by jurisdictional differences.

A number of interesting questions arise. The conceptual issues are outlined below, but to illustrate the kind of choices that government has to make, we may ask: is it appropriate if a student from a high socioeconomic status background, with high previous academic achievement who chooses to study medicine receives a subsidy of \$18,600 per year, while a student from a low socio-economic background studying accounting receives a subsidy of \$1,800 per year?

This is a serious problem because large amounts of public money are being distributed in ways and for purposes that are unclear. In the past, tertiary education places were largely funded by government, with a modest contribution from the student. In that circumstance the cost of the education was the major determinant of the subsidy.

We are now moving into a world in which (at least in higher education) increasing numbers of students will be paying for most of the cost of their education, and receiving a top up from the government. In this circumstance it is less clear that the cost of the education should be the main determinant.

In other similar situations, such as schooling and the way that the Government has established an employment services market, there are other ways of determining the level of the public subsidy for different needs and outcomes.

Minister Pyne has indicated that an enrolment based subsidy will go to universities, and at a lower rate to non-university providers (Pyne, 2014). This recognises that universities have responsibilities they are expected to fulfil and which are not required of non-university providers. This includes research, which all universities are required to do. Universities also make major contributions to the broader communities in which they operate. Universities are a great asset to the nation. There would be major risks in watering down their public contribution to research and community engagement, and treating them purely as private providers of courses. It would be a threat to our export earnings and to the community benefit of universities.

Second, as in the case of schooling, there is a strong case for a subsidy for students from disadvantaged backgrounds, probably using a measure of socio-economic status, though other forms of disadvantage could be considered. This could help to counter the negative equity effects of the package discussed above.

Third, there would be a case for additional funding for students who need additional learning support, using some measures of prior education attainment, or diagnostics about learning needs.

Another question is whether the subsidy should vary with the fee that is charged. In school systems around the world, schools that charge high fees tend to get lower subsidies than schools that charge low fees or no fees. This is an idea well worth exploring and could also help to deal with the equity issues raised earlier.

Arguably the basis on which most of the subsidy should be distributed is the public good associated with that student studying that subject. It is very hard, probably impossible, to identify how these vary between different courses of study. One way it might vary between students is that for some students a higher subsidy is more likely to encourage them to enrol, in which case the public benefits associated with their enrolment is more likely to accrue than if the subsidy was lower. Students from poorer backgrounds are more likely to be risk averse and more likely to be encouraged to enrol if they receive a higher subsidy, especially if that is associated with a lower fee.

It is an interesting question whether the cost of provision should be another factor that affects the subsidy. While this was a key factor when most of the costs were covered by the government, it is less clear that it should be included when the students are paying most of the cost. On the other hand, this could lead to some very high fees in the case of very expensive courses to run. In theory this would be economically efficient, but could be a problem if there were caps on fees or loans. Where there are no caps on fees or loans then in principle the student could pay the higher costs, if the labour market worked efficiently to set their expected salaries higher so they could be paid under the income contingent loan system. It might take time for the labour market to adjust, however, and there may be market failure in some labour markets.

It is very important to get the rationale for these subsidies right, especially when for-profit private providers are seeking to enter the market in response to the margins they can achieve. They are likely to be attracted to the high subsidy courses especially if they can find innovative ways of running the course cost effectively. We would need to be clear that those are the courses that we want to attract private providers into, rather than other courses where there is not so much money to be made.

We would also want to try to avoid the risk of having to vary the prices very much over time as a result of making early mistakes. Again, there is a case for an entity that oversees the setting of subsidies and prices in an orderly and transparent way.

6. Summary and conclusions

Let me in conclusion summarise the main points I have made tonight.

To be successful in work and in life, most people in the twenty-first century will need some tertiary education. We need to give full effect to moving from a tertiary system which included a higher education system for the intellectual elite, and a vocational education system focused on practical skills, to one that is more comprehensive and seamless for everyone.

With strong growth over the last decade, it is good that the proportion of the Australian adult population with tertiary qualifications is now one of the highest of the OECD countries. Economists who have analysed this, generally concur that strong growth in demand for tertiary qualified workers will continue over the coming decades.

Some commentators, concerned about the impact on quality, have questioned the agenda of raising participation in tertiary education, especially higher education. However, the Federal Minister for Education, Christopher Pyne, commissioned a review of the demand driven system to explore this and other questions.

The findings of the Kemp-Norton review were unequivocal. The demand driven system was a good idea and it needed to be expanded by uncapping sub-degree higher education programs. They also argued that non-university higher education providers should be brought into the Commonwealth funded system. The Abbott government has decided to accept the general thrust of the Review.

Bringing sub-degree higher education programs, such as diplomas into the uncapped system of higher education funding, is a big break-through. If we are going to promote economic growth and social inclusion by broadening participation in tertiary education, we need to recognise that many students will benefit from strong pathway programs to assist them to enter and successfully complete a bachelor's degree. But it is equally important that these pathway programs are valuable in their own right for students who don't continue to a bachelor's degree.

The need to reform the national training packages may not be so critical now. They tend to limit the value of VET qualifications by making them too narrowly focused on competency standards and not so good at developing generic skills such as problem solving, and not so good for preparing students for higher education. The broadening of diplomas in higher education could now substitute for many of the diplomas in VET.

For that reform the Abbott Government should be congratulated. How about the other parts of the higher education reform package?

There are three main planks to it: deregulation of fees; bringing non-university providers into the subsidised and "uncapped" demand driven system; reducing the per-student subsidies and changing the structure of them between different disciplines.

Complete deregulation of fees and uncapping of income contingent loans brings with it a number of risks: substantially increased debt levels on students which may deter more disadvantaged students from participating in courses they would otherwise have enrolled in; high levels of HECS debt on the government's balance sheet; increased default on loans; and the significant possibility of excessively high prices, (or 'gouging') especially by providers with strong market power, because of insufficiently clear price signals. These effects could be ameliorated in three ways: a cap on the size of the loans; a cap on the fees; and/or a reduction in the Commonwealth subsidy when fees increase above certain levels.

It is the likely equity effects of the reforms that are most concerning and while these policies are aimed at expanding tertiary education, they would be counter-productive if they discourage disadvantaged students from participating in their preferred course of study, and /or diminish the quality of education that students from poorer backgrounds receive, relative to those from more advantaged backgrounds. This is a real risk.

The opening up of the subsidised market to non-university providers has the potential to encourage healthy competition, innovation and better services for students. But there needs to be much more attention to the market design and the transition to its operation. New markets need to be nurtured, especially when substantial public funding is being injected into a new part of the market¹¹.

This includes getting the structure of subsidies for different students in different courses right. These have been modified but need a thorough review. The subsidies set continue to be influenced, to a greater or lesser extent, by different pieces of evidence and judgements about the cost of providing course of different kinds, the return that students get from different types of courses, and the public value of the courses. By being a "mish-mash" of all the above, there is a lack of transparency and clear rationale. One aspect that needs to be considered is whether there should be a supplement for disadvantaged students.

It is very important to get the rationale for these subsidies right especially when for profit private providers are seeking to enter the market in response to the margins they can achieve.

There also needs to be thorough review of the interface between VET and higher education. While the reforms provide an opportunity for better integration of VET and Higher Education at the level of Diplomas, and Certificate 4 and below the position of VET in this new world is precarious. We need a federal-state negotiation, to achieve a more a more coherent tertiary system.

What looks increasingly clear is that it will be a market based system, increasingly shaped by student choice and provider responsiveness. This makes the challenge of design, one of achieving a rigorous and coherent approach to market design. This should be seen as both a challenge and an opportunity. It is not an easy task and carries with it very significant risks. Unless there are some changes to the plan as outlined in the budget, these risks look too high.

¹¹ In the process of designing the new market it would be a good idea to review the evidence of how the market for VET has operated in Victoria since it was opened up to private providers. Significant differences can be expected (e.g. ease of entry into the higher education market would be more difficult), but it would be a useful exercise to get a picture of the potential challenges and pitfalls.

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