Context note

This document was first published in 2012.

The Job-Ready Graduate proposal to raise the level of charge to $14,500 for approximately 38% of student learning renews the relevance of this 2012 IRU comment about the capacity of HECS to handle ever-increasing student charging rates.

The note is republished without amendment.

At what point does HECS break? (2012)

IRU comment on Grattan Report: Graduate Winners

The Grattan Institute Report *Graduate Winners* argues that Government support for higher education should be through support for student income contingent loans (HECS-HELP and related schemes), with little or no direct investment in university and other higher education. The report interacts with the ongoing debate about how much and under what conditions students should pay for university education.

The comments below address this argument against:

- the implications for HECS from its recommendations and other proposals for major increases in student charges;
- the balance between Government funding and Government loans; and
- the value from having graduates.

The final section considers the basis of the modelling which supports the Report.

In sum the IRU argues that there are strong reasons to retain a mix of Government direct funding and Government loans to students as the main revenue sources for undergraduate higher education.

Breaking HECS?

HECS is very successful, we must be wary of changes that could break it.

The HECS scheme has two major features:

- the Government advances universities money to cover the students' contribution to the costs of their courses and recovers much, but not all, once graduates earn sufficient income; and
- students are not deterred from pursuing the qualifications they desire by cost because they understand that they do not have to pay upfront but will pay later once they are earning.

Both features will fail if the level of charge rises too high. The Grattan report recommendations lead us in that direction. Its base position is that the Government subsidy ranging from $1861 to $20,284 a year should be transposed into student payments. This would increase the average student charge from about $7300 to about $17,000. The Report pulls back from full implementation to suggest that

$3 billion, half the current Government funding, could be so transformed. This is without any additional funds to meet the gaps the Bradley and Base Funding Reports identify.

The risk is clearest for the Government. Raising the charge for students raises the debt per student and hence increases the number of students who will not repay the whole debt. Once non-repayment grows to a higher level the pressures to subject the loans to administration fees or caps will be stronger, risking undermining the system. Indeed, Andrew Norton has argued as much previously (The Australian, 1 February 2012 “Student loan costs blow to $1bn a year”).

Current estimates suggest about 20% of the loans to students will not be repaid, due to students not earning sufficient income in their working lives, leave the country or otherwise avoid the taxation system. In its initial form, with a single lower charge, the estimate for non-repayment was about 15%. By contrast in the English system of up to £9000 fees the UK Government estimates that 30% will not be repaid, and English equivalents of the Grattan Institute argue it could be as high as 50%. This means that of the $3 billion the Grattan Report would change into loans at least $600 million, and more likely $1 billion would not be repaid. At what point is it simplest to pay the funds directly?

The question of student deterrence is harder to assess since ultimately it is about how individuals assess their financial options. In theory no level of charge is deterring if the loan is income contingent. If you never need to repay then you should not worry. That is good economic theory but ignores the reality of people’s choices. It also ignores that for many the issue is that as charges rise the more work years they will be subject to the HECS surcharge. Rather than ten years for repayment, standard times will blow out to fifteen or twenty years. These periods push out to the end of planned working life for the significant numbers of older students, people who have made the decision to study and work. There are also growing number of examples of HECS debts interacting with housing and personal loan decisions by lenders.

Direct Government funding also supports students choose their preferred course by counteracting the reality that some courses cost more to delivery than others. Australia requires graduates across a range of disciplines as the best basis to ensure a well-balanced graduate population with a mix of knowledge and skills. To charge some students more for the benefit of their degree either punishes them for pursuing their interests or encourages them to choose differently.

If the result of students being charged the full course by course cost is that it changes their choice or their willingness to enrol it will reduce longer term productivity, a loss not just to them but to all of us.

Direct funding versus loans

The Report is grounded in a general argument about whether and how Government should support important national services from the perspective that Government intervention should be as rare as possible. Its recommendations apply equally to school education, childcare, and to many other Government programs.

It argues that once a service is established Government should leave it to the general market to pay for use, and where intervention is necessary to lend money to the service users and only then as a last resort to fund the program directly. In the case of higher education, the Report supports Government involvement, to ensure equal take up of higher education, and hence looks to loans as better than direct funding.

The argument to use loans over direct funding is subject to the observation that the successful graduate will pay either way. The question is whether it makes more sense to fund the program directly from taxation revenue, with the graduate to pay higher levels of taxation once earning, or make some or all funding a loan that is then repaid by the graduate once earning.

The report argues that graduate incomes are sufficiently high that it does not matter significantly whether the cost of a degree is nil, $20,000, $40,000 or $100,000. The Report uses this to argue that the charges may as well be higher; equally they show that if lower, and funded through taxation, the additional subsequent taxation burden to support future students will also be insignificant.

As the Report comments (p2), the direct funding is a subsidy from the general public, many of whom are graduates and increasingly so. Hence the issue is about how graduates pay for education, whether their own or that of others.

There is nothing simple about HECS arrangements. It requires more administration and a long-term obligation between Government and former student. Direct funding is simpler. The Report is correct that current taxation arrangements can support only so many Government programs. That is why the current system uses HECS-HELP to generate part of the revenue required. We have a mix that reflects the importance of encouraging people to gain learning and skills and the reality that extending this to the large number of people now needing higher education is costly.

The value from having graduates

The Report takes a very precise version of the public gain from higher education, focused at the taxation revenue graduates pay. The value to the general public is wider.

Through our education and skills, we each contribute to the complex weave that is our current economic and social structure. The reason we have over 30% of people in their 20s and 30s with degrees, with the proportion rising, is that we require more complex levels of knowledge and skills for work and living. To generate economic change, we need more people with higher education skills. The capacity to earn and live well is heavily dependent on others doing so as well. The varying individual gains each contribute to, and gain from, each other. The point of the education system, from preschool and beyond, is to assist and encourage each person to contribute so we can more effectively harness the population's full capability.

The basis of the modeling

The Report repeats the work of previous studies that compare graduate financial outcomes against those of the year 12 school leaver, most recently studies for the Base Funding Review. The Report provides more nuance by examining graduates in discipline deciles. However, it is subject to two key limitations, common to the previous studies, limitations that could and should be avoided.

As many have pointed out the modelling is always based on 18-year-olds who undertake three to four years' study and then enter the workforce. With significant numbers of older students, people who have made the decision to study and work or to give up work or reduce their income significantly, it is important to understand what this means for lifetime earnings and the relationship to student charges and debt. The work to do this is no greater than the standard 18-year-old modelling.

The second issue is the comparison point used of the average income of the year 12 school leaver without further education.

This is reasonable when considering all graduates or simply to provide a point of reference. Once the focus turns to graduates by discipline or profession the comparison falters since the latter group is not also broken up into the broad area of employment or skill. This would provide a better sense of testing the counter factual of what would graduates be doing and earning if they had not undertaking a degree. This shows up most clearly in the case of visual and performing arts graduates who, on the Report's statements, either are losing out from their degree or making a very modest return. The comparison would be more relevant if compared to those in the creative arts industries without degrees. Ultimately the question is whether the graduate is better off than they would have been without the degree, and to the extent that justifies the investment in their education.

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