

# Financing tertiary education in Australia – the reform imperative and rethinking student entitlements

## Issues paper

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## About the authors

### Professor Peter Noonan

Mitchell Professorial Fellow, Peter Noonan, has played a major role in shaping tertiary education policy in Australia. He has 25 years' experience as a policy adviser, senior executive, and consultant to Commonwealth and state governments, universities, higher education providers, and public and private VET providers. In 2008 he was a member of the Expert Panel for the Review of Australian Higher Education (Bradley Review). In 2010 Peter undertook a Review of Post-Secondary Education in Queensland for the state government. Peter's work as a Mitchell Institute Fellow focuses on the future of tertiary education in Australia, including its interface with secondary education and the labour market. He is Professor of Tertiary Education Policy at Victoria University, Melbourne, and an Honorary Senior Fellow in the Graduate School of Education at the University of Melbourne.

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We would also like to thank Rob Sheehan for his significant editorial assistance with the paper and Tania Angelini for her editorial assistance and advice.

## 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 to 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 a generous donation from the Harold Mitchell Foundation to Victoria University, Melbourne.

# Overview

A longstanding commitment to fair access is evident throughout the history of tertiary education reforms pursued by Australian governments. Over the decades, Australians have endorsed this continuing commitment and have come to expect affordable, high quality tertiary education to be within reach for themselves and their children. Yet our well-intentioned, and at times world leading, tertiary education reforms have lacked policy cohesion, and arguably they have entrenched rather than diminished inequity.

Getting reform right is important to both individuals and the country as a whole. Today's young Australians are growing up at a time when a post-school qualification is becoming a baseline requirement for meaningful social and economic participation. It is critical for them, and all of us, that they are equipped with the skills and capabilities they will need to thrive in an increasingly competitive, global economy. Those who miss out are far more likely to be unemployed or underemployed, and more likely to become trapped in poverty which has consequences for physical and mental health, social isolation, and intergenerational equity.

Many agree that in contemporary Australia both higher education and vocational education and training (VET) should together constitute a national, indeed international, tertiary education sector. Yet, despite decades of reform, that goal is unfulfilled.

The concept of a student 'entitlement' to tertiary education in Australia is not new. It applies in the higher education sector, where domestic students offered a place to study a bachelor degree at public university have an entitlement to support from the Commonwealth government, and an income contingent loan. It also partially exists within the VET system. However, VET student entitlements vary in each state/territory. They are poorly defined and implemented, with widespread differences in eligibility.

This mix of student entitlement designs has led to undue complexity and inequity across tertiary education. Students are treated unequally, leading to the growing risk that financing arrangements, rather than informed choice, will drive enrolments across the tertiary education system.

The situation is readily explained. Higher education and VET were once delivered through public institutions in each state/territory. There was little interaction between governments about overall system design for tertiary education. However, since the 1970s Commonwealth and state/territory governments have responded to evolving aspirations and expectations of tertiary education with a series of reforms.

Broad policy reform has mostly been undertaken nationally. However, higher education and VET policy has suffered from erratic or absent policy coordination, and poorly coordinated implementation between governments.

The evolutionary nature of reform has produced differing tertiary education opportunities across Australia. The legacy is a bundle of policies governing public support for tertiary institutions and students which fails to deliver, simply and consistently, what the nation needs.

The Mitchell Institute has investigated the impact of Australia's failure to think about the education and training continuum – from school education to tertiary education – in an integrated, nationally consistent manner. The Institute's paper, *Expenditure on Education and Training in Australia*,<sup>1</sup> demonstrates the unevenness of our collective investment, both public and private. It calls attention to the lack of a strategic approach to education financing, particularly at the tertiary level.

History explains this result, but history should not dictate our next steps. We have a good opportunity right now to reassess the financing framework's fitness for purpose in meeting Australia's future economic and social needs.

### About this Mitchell Institute project

The task of reforming Australia's tertiary education system to meet future needs is broad and complex. It includes issues related to quality, the provider system, how choice and competition can further improve rather than diminish outcomes, and the right mix of public and private funding.

The needs of young people who do not transition, or make poor transitions, to tertiary education require specific attention. As the population ages and skills needs change, the way older Australians access, and get better outcomes from tertiary education, will be another major challenge. In addition, the particular role of the apprenticeship system (including its administration, regulation and the role of employer incentives within the student entitlement model) merits careful consideration.

This Mitchell Institute project does not propose to cover all these issues or the needs of Australia's diverse learner groups. Instead it looks to get one foundational aspect of that matrix right: a fairer and simpler financing framework, across the different levels of government and tertiary education, that supports a tertiary education student entitlement for young Australians.

The need for a new tertiary education financing model does not rise or fall on the student entitlement proposal. The current framework is dysfunctional. It requires reform, regardless of the how eligibility rules for financing are set.

A new financing model can be adapted to accommodate the needs of older learners and the existing workforce. However, experience in VET suggests that it is not feasible or fiscally sustainable to extend an automatic student entitlement to the full adult population. We recognise that this position will be contested.

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<sup>1</sup> P. Noonan, G. Burke, A. Wade and S. Pilcher (2014) *Expenditure on Education and Training in Australia* Mitchell Institute Background and Analysis Paper.

A student entitlement model requires careful design, key design issues are explored in this paper.

The Mitchell Institute is undertaking the project in two phases.

**Phase 1** is represented by this Issues Paper. The Paper:

- States the rationale for a single student entitlement;
- Identifies the principles on which entitlement design would best operate;
- Identifies the key elements of an entitlement;
- As a precondition for detailed design, determines the best approach to allocating tertiary education funding responsibility between levels of government, within the constraints of the Federation;
- Sets out the factors that need to be modelled so that design of an entitlement is comprehensive and viable; and
- Considers the next steps.

**Phase 2** will be a modelling report which will present the outcomes of detailed modelling on options for a single tertiary education student entitlement. It will propose a final design and an implementation process, including a discussion of the challenges involved in implementation.

### About this issues paper

This Issues Paper is in two parts:

- Part 1 explains why we need a new approach, and why a student entitlement is part of the solution. It then explains why we need to think about this now, taking into account past reforms and their consequences.
- Part 2 explores and proposes a design for an integrated tertiary education student entitlement in Australia, including next steps.

## Key features of the proposal

A new and equitable financing framework for tertiary education in Australia with two core elements:

- **a public subsidy** – paid by either a state/territory government or the Commonwealth government, and based on eligibility to the entitlement; and
- **student contributions** – paid by the Commonwealth to the provider with students taking out an income contingent loan with the Commonwealth.

In broad terms, a tertiary education student entitlement in Australia can be defined as: *guaranteed funding support for tertiary education to a particular qualification level through course subsidies and access to an income contingent loan.*

Governments commit to guaranteed access to tertiary education for eligible young people between the ages of 18-24 years, from Certificate III up to full undergraduate qualifications, and postgraduate qualifications designed for entry to professions.

Learners can directly enter degree qualifications, or transition through certificate, sub-degree, undergraduate and postgraduate qualifications.

Government responsibility for financing under the framework would be allocated as follows:

- **The Commonwealth:**
  - funds all sub-degree and degree level qualifications, regardless of the sector in which they are delivered;
  - provides income contingent loans; and
  - income support on a needs basis.
- **States/territories:**
  - fund Certificates III and IV, including apprenticeships, other forms of entry level training, and post-trade training; and
  - Certificates I and II as pre-tertiary qualifications (which would sit outside the tertiary entitlement).

The entitlement to be designed through policies in five main areas:

- defining the entitlement;
- setting subsidy levels;
- setting student contribution levels;
- determining eligibility to the entitlement; and
- settings for the commonwealth income contingent loans scheme.

Older learners or ineligible learners could still access subsidised qualifications at the discretion of each jurisdiction.

Principles to guide these policies:

- a recognition of the interrelationship between the higher education and VET sectors;
- maximum consistency in operating the entitlement across jurisdictions; and
- minimising or eliminating incentives for cost shifting between the two levels of government.

# Part 1: Why we need a new approach

## 1.1 The social and economic importance of education

Governments of all political persuasions have long recognised that the skills, knowledge, capabilities and ingenuity of its people are fundamental to Australia's future economic prosperity, and to social cohesion and wellbeing. Governments have also long recognised that equity of opportunity enlarges the ability of individuals to claim a share in that prosperity.

Over several decades, this recognition has underpinned expansion and renewal of our schools and tertiary education systems, and more recent investment in early childhood education.

Australians have intuitively understood the importance of education to individuals and families. Participation rates in pre-school, school, and post-school education have risen whenever Australian governments have widened opportunities and access to education.

The value governments, families and individuals place on education is soundly based. It is well appreciated that individuals derive substantial benefits by investing in education. There is now strong, and growing, evidence that links human capital and its accumulation with economic development and economic transformation. There is similarly strong evidence that links higher levels of education attainment with better health and general social cohesion.

Education brings greater choice into our lives. In Amartya Sen's words, education enhances a person's ability to 'pursue a life that they have reason to value.'<sup>2</sup>

## 1.2 Strategic investment in education and training matters

In an advanced economy like Australia, education and training has two broad and interrelated objectives – first, to improve an individual's life chances and wellbeing, and second, to maximise collective prosperity.

For individuals, education and training provides the skills and capabilities to achieve and contribute more than they otherwise could. Education increases an individual's value in the labour market. It can also provide more satisfying, secure working lives, and wider opportunities and choice.

This personal story is also writ large. Education and training power economic growth and innovation. Individuals empowered through education contribute more and greater human capital. The effect is cumulative: when skilled, educated people work together the resulting endeavour is often more than the sum of its parts. That is particularly so when they have the skills and knowledge to harness emerging technology to their endeavours.

These are compelling reasons to invest in education, and to tend that investment with purpose and diligence.

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<sup>2</sup> A., Sen (1985) *Commodities and Capabilities*, New York: North Holland.

It is well understood that education and training deliver private and public benefits. That certain knowledge has led Australian governments to commit considerable public funding and support to both educational institutions and individual students.

A clear 'entitlement' to public support for school education has been widely accepted policy for more than a century. Now we need to extend that acceptance to tertiary education. It is here that advanced skills are formed – the kind of skills needed to effectively participate in, and contribute to, Australia's advanced, dynamic, globalised economy and its changing complex and increasingly sophisticated society.

### **1.3 Changing contribution of tertiary education to individuals and society**

Many older Australians remember a time when completing compulsory schooling in Years 9 or 10 was regarded as sufficient for entering the workforce. It was not necessary in those times to have an interest in, or aspiration for, tertiary education.

Today's economy is knowledge intensive. It relies on advanced skills. Young Australians are growing up at a time when a post-school qualification is becoming a baseline requirement for meaningful social and economic participation. Effective participation also depends increasingly on a sound grasp of literacy and numeracy. The contemporary workplace puts great store in generic capabilities like critical thinking, teamwork and problem-solving.

Australia's stock of knowledge and skills has grown progressively over the past century. It has widened and deepened over the past three decades in particular. Gradual increases in educational participation and attainment have their source in pragmatism and aspiration. The external demands of society and workplaces must be met. Education has come to offer the best chance of meeting them, and of realising the rising personal ambitions Australians now hold for themselves. The innate human desire for self-improvement and betterment found its fast track in education.

The influence of more demanding expectations and changing attitudes is evident in the rising levels of educational attainment. Almost half of all Australians who completed their secondary schooling in the 1960s and 1970s finished their education right there – 43 per cent of Australians aged 55-64 have no post-school qualification.<sup>3</sup> In 1981, only a third of young Australians completed a full secondary education. In 2014, nearly 80 percent did so. It is younger Australians who have contributed most to pushing the post-school qualification attainment rate to 60 per cent of our population – one of the higher rates among OECD countries.

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<sup>3</sup> ABS, 6227.0 Education and Work, Australia, May 2014.



Professor Peter Dawkins, Vice Chancellor of Victoria University, Melbourne, has argued that just as completing secondary education became a universal goal for Australia, access to and completing tertiary education must also become universal.<sup>4</sup>

Ian Macfarlane, former Governor of the Reserve Bank of Australia, noted a growing consensus that 'deep national institutions' are more important to sustained economic development than geography or resources. He identified one of those deep national institutions as:<sup>5</sup>

*Some degree of equal opportunity so that people can invest in human capital formation. In this area, by far the most important component is access to education and an economic structure where positions of importance and authority are open to all comers on the basis of merit.*

Macfarlane observed that deep national institutions take decades to evolve. They are embedded in laws, constitution and culture. They are not amenable to rapid change. He argued that maintaining the standards of these institutions requires constant attention and reform.

#### **1.4 What do we mean by tertiary education?**

Tertiary education in Australia spans VET and higher education but has not been clearly defined.

The distinction between VET and higher education is formalised in the Australian Qualifications Framework (AQF). Qualifications at levels 1-4 of the AQF are clearly defined as VET (Certificates I-IV). Qualifications at levels 6-10 (associate, bachelor, bachelor honours, masters and doctoral degrees) are defined as higher education.

However, diplomas, advanced diplomas, graduate certificates and graduate diplomas can be delivered and awarded within either sector. Qualifications at these levels are considered as either VET or higher education qualifications depending on which sector accredits the qualification. Figure 1 shows the AQF structure, including the overlap between VET and higher education.

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<sup>4</sup> P. Dawkins, *Reconceptualising Tertiary Education: and the case for re-crafting aspects of the Abbott Government's proposed higher education reforms*, Mitchell Lecture, Melbourne, 22 May 2014.

<sup>5</sup> I. Macfarlane, *Geography, Resources or Institutions*, Speech to 'The Bottom Line' Luncheon, Melbourne, 25 August 2004.

**Figure 1: Australian Qualifications Framework**

<b>AQF level</b>	<b>Name of Qualification</b>	
1	Certificate I	
2	Certificate II	<i>Provided in the vocational education and training sector</i>
3	Certificate II	
4	Certificate IV	
5	Diploma	<i>Provided in both sectors</i>
6	Advanced Diploma	
6	Associate Degree	<i>Provided in the higher education sector</i>
7	Bachelor Degree	
8	Bachelor Honours Degree	
8	Graduate Certificate, Graduate Diploma	<i>Provided in both sectors</i>
9	Masters Degree	<i>Provided in the higher education sector</i>

This overlap is further complicated by the fact that providers with primary roles in VET and higher education offer qualifications in the other sector. Some institutions are dual sector providers, such as the six dual sector universities in Australia.

For the purposes of this project, it is important to define which qualifications would be considered part of the tertiary education system, based on the levels in the AQF.

Internationally, the term *tertiary education* is defined by UNESCO's International Standard Classification of Education (ISCED). ISCED defines tertiary education as comprising programs from level 5b (first stage of tertiary education – practical and vocational), level 5a (first stage of tertiary education – theoretical/professional), and level 6 (second stage of tertiary education).

Under ISCED, tertiary education in Australia encompasses VET diplomas and advanced diplomas (levels 5b) and all higher education qualifications. This definition was adopted by the Bradley Review, and in a joint policy statement between Universities Australia and TAFE Directors Australia.<sup>6</sup>

<sup>6</sup> Joint statement by Universities Australia and TAFE Directors Australia, *Towards an Australian Tertiary Education System*, April 2010. <http://www.tda.edu.au/resources/Joint-TDA-UA-statement-April2010>

However there are limitations with this definition. It excludes:

- The apprenticeship system, which clearly falls within the first stage of practical and vocational education in Australia;
- Other Certificate III qualifications than provide entry to important occupations; and
- Certificate IV qualifications, which include qualifications that build on entry level qualifications.

For these reasons, tertiary education in Australia should be defined as spanning Certificate III qualifications in vocational education through to postgraduate coursework qualifications in higher education.

Under this definition, Certificate I and II qualifications are regarded as pre-tertiary but are still regarded as important preparatory qualifications.

### **1.5 What do we mean by a student entitlement?**

Australian governments have already endorsed the principle of a student entitlement to tertiary education.

In broad terms, a tertiary education student entitlement in Australia can be defined as: *guaranteed funding support for tertiary education to a particular qualification level through course subsidies and access to an income contingent loan.*

In higher education, access to a student entitlement is given through the demand based funding system which essentially guarantees a place to all qualified applicants. In VET access is given via a Council of Australian Governments (COAG) agreement to offer a minimum entitlement of a Certificate III qualification.<sup>7</sup> However, eligibility for the VET student entitlement varies widely between jurisdictions, as does the pace of introduction and the kinds of qualifications covered.

### **1.6 How is tertiary education funded?**

As well as a separation in qualifications, there is a division of tertiary education funding roles and responsibilities between the Commonwealth government, and state/territory governments.

Broadly speaking, the Commonwealth government provides public support for higher education students, and state/territory governments primarily fund VET. However, in 2013 the states spent \$3.9 billion on VET and the Commonwealth spent \$2.5 billion. From 2012-2013 the Commonwealth increased its expenditure on VET by \$374 million (17.2 per cent) and the states decreased their expenditure by \$344 million (7.9 per cent).<sup>8</sup>

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<sup>7</sup> Council of Australian Governments (COAG) *National Partnership Agreement on Skills Reform*, 2012.

<sup>8</sup> NCVET Finance Collection 2013.

The Commonwealth also maintains:

- a substantial income contingent loans system, available to all higher education students, but only available to some VET students; and
- a student income assistance scheme that is available on a largely consistent basis to both VET and higher education students.

In sum, the current allocation of responsibilities to each level of government is a policy and program patchwork, as Figure 2 illustrates.

**Figure 2: Current Commonwealth and state/territory government roles in tertiary education**

	<b>Provision of subsidies</b>	<b>Fee settings</b>	<b>Income support</b>	<b>Income contingent loans</b>
<b>VET</b>	<p><b>States and territories</b></p> <p>(Also Commonwealth through National Partnership Agreements, and Industry Skills Fund)</p>	<p><b>States and territories</b></p> <p>Student fees deregulated in some jurisdictions, regulated in others</p>	<p><b>Commonwealth</b></p> <p>Commonwealth sets eligibility criteria, means tested</p>	<p><b>Commonwealth</b></p> <p>Only partial – generally only for higher level qualifications (diploma/advanced diploma, selected Certificate IVs)</p> <p>Trade support loans to apprentices under a separate system</p>
<b>Higher education</b>	<p><b>Commonwealth</b></p> <p>Provides subsidies to all undergraduate domestic students and limited number of postgraduate students</p> <p>↓</p> <p><b>Potentially to be extended to all sub-degree qualifications</b></p>	<p><b>Commonwealth</b></p> <p>Undergraduate domestic fees regulated, and postgraduate fees deregulated except for subsidised places</p> <p>↓</p> <p><b>Potentially to be deregulated</b></p>	<p><b>Commonwealth</b></p> <p>Commonwealth sets eligibility criteria, means tested</p>	<p><b>Commonwealth</b></p> <p>Full entitlement to income contingent loans for all undergraduate and postgraduate domestic students</p>

## 1.7 The case for reform

The policy and program patchwork summarised above is under increasing pressure on a number of fronts.

The Australian economy and labour market has progressively become national, indeed international. This change is reflected in tertiary education, including its institutions and modes of delivery. Higher education funding, policy and regulation are now responsibilities of national government, and governments have worked towards a national approach to VET through the COAG framework.<sup>9</sup> However, the outcome thus far across the tertiary education system is a policy and program mix that is compromised by lack of integration and commonly endorsed strategic goals, and an increasingly inconsistent financing system.

The differing financing arrangements for each sector, and their effect on the capacity for tertiary education to operate as a more coherent and better connected system, was highlighted in *The Review of Australian Higher Education (Bradley Review)*.<sup>10</sup>

These concerns are also raised in the recent Issues Paper on roles and responsibilities in education, released by the Department of the Prime Minister and Cabinet as part of the Federation White Paper process.<sup>11</sup>

The shortcomings in the current financing framework for tertiary education, and the differential approaches to student entitlements, have the following effects:

- differential treatment of students;
- inconsistency in eligibility, subsidies and fees
- inconsistent access to income contingent loans
- inconsistent access to student income support
- widening investment gap between higher education and VET;
- a growing gap in per student funding levels;
- potential distortion of student choice; and
- diminished overall effectiveness of the tertiary education system.

These effects are discussed below.

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<sup>9</sup> *National Partnership on Youth Attainments and Transitions* (2009), *National Agreement for Skills and Workforce Development* (2012) and *National Partnership Agreement on Skills Reform* (2012).

<sup>10</sup> D. Bradley, P. Noonan, H. Nugent and B. Scales, *Review of Australia's Higher Education: Final Report*, 2008.

<sup>11</sup> Commonwealth Department of Prime Minister and Cabinet, *Reform of the Federation White Paper: Issues Paper 4 – Roles and Responsibilities in Education*, December 2014.

## Differential treatment of students

Two Australian students of the same age and in the same circumstances may receive very different types and amounts of public funding and support for similar types of courses in VET and higher education, and within VET across jurisdictions.

These differences do not necessarily relate to course costs.

The variations in the support they receive will depend on a number of factors, including:

- the **state/territory** in which they undertake education or training;
- the sector in which their qualification is accredited and delivered – **VET or higher education**;
- whether they undertake education and training at a **public or private institution**; and
- the **qualification** in which they enrol.

## Inconsistency in eligibility, subsidies and fees

In higher education there is effectively a student entitlement to a public subsidy for undergraduate study and some postgraduate courses. Eligibility to the entitlement is very broad and determined by institutions through their admissions policies. However, the entitlement currently only applies to specific groups of institutions. This will change if the proposed higher education reforms are implemented, although subsidy levels for the same qualification will vary between university and non-university providers.

The student entitlement to a subsidised place in a VET qualification is less straightforward. The COAG commitment to a VET student entitlement is implemented differently in every state/territory – the result is eight different systems.

This reflects a practical reality. State/territory governments do not have the resources to meet the ongoing resourcing requirements of the VET system,<sup>12</sup> particularly the costs of the agreed COAG entitlement commitment. Nor do they accord sufficient priority to meeting those requirements, casting doubt on the viability of the original COAG commitment.<sup>13</sup>

Rather, states/territories increasingly use subsidy settings and eligibility criteria to control VET outlays. Some qualifications receive subsidies in some states/territories, but not in others. There are wide differences in subsidy levels, based on assessed public benefit. These variations are the result of applying statewide criteria that are often inappropriate to local and individual needs and circumstances.

To receive a public subsidy under the VET student entitlement in most states, students must enrol in a qualification that is at a higher level than their existing qualification. This limitation does not apply in higher education.

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<sup>12</sup> The exception to this is Victoria, which has increased in expenditure by more than 60 per cent in the past four years. See: P. Noonan, G. Burke, A. Wade and S. Pilcher (2014) 6-8.

<sup>13</sup> P. Noonan, *VET Funding in Australia and the Role of TAFE* (2014) Mitchell Institute.

Some VET diplomas and advanced diplomas receive public funding in some states, but not in others. These anomalies will increase if the demand based system is extended to higher education but not to VET. A student who holds an existing equivalent or higher qualification will be ineligible for a public subsidy in VET in most states, but eligible for a public subsidy for a similar higher education qualification in all states.

### **Inconsistent access to income contingent loans**

Access to income contingent loans, and the nature of income contingent loans, differ between VET and higher education, between qualification levels, and between provider types.

The Commonwealth offers income contingent loans to all domestic higher education students who enrol in an undergraduate or postgraduate qualification under HECS-HELP for subsidised courses, or FEE-HELP for full fee courses outside the subsidised system. If proposed higher education reforms are adopted, all higher education students in subsidised programs will have access to HECS-HELP.

However, VET students have more limited access to income contingent loans. Currently a range of providers is approved for VET FEE-HELP (the name used for income contingent loans offered in the VET sector). VET FEE-HELP is available for subsidised courses (under the VET student entitlement) and for full fee courses. VET FEE-HELP is only available to students who enrol with an approved provider in a higher level VET qualification – a diploma, advanced diploma, or a small number of Certificate IVs.

When fees for Certificate III and IV qualifications were relatively low this anomaly was not a major inequity. However, fees for these qualifications are increasing significantly. In several states they exceed \$3,000, and range over \$4,000 and beyond depending on the level of subsidy they attract. Full fee certificate qualifications can range from \$10,000 to \$20,000.

Without access to an income contingent loan, these fee levels represent a major potential barrier to access for many students and their families.

### **Inconsistent access to student income support**

Many Australian tertiary students are ineligible for student income support, despite the reality that both eligible and ineligible students often struggle with living and study expenses.

Eligibility for student income support is consistent across the VET and higher education sectors. However, eligibility for additional support varies between the sectors.

The previous Commonwealth Start Up Scholarship was paid to higher education students as part of its income support system but was unavailable to VET students. Under new arrangements if implemented, that Scholarship will now be repayable through the income contingent loans system. However, it would remain unavailable to VET students. Higher education students, but not VET students, can also access income contingent loans to help meet the costs of provider amenities fees and overseas study. Some higher education students, but not VET students, can also receive assistance for relocation expenses.

The Commonwealth government has introduced a new system of income contingent loans to help apprentices and trainees with study expenses, provided they are undertaking training in skill shortage occupations. These loans can be valued at up to \$20,000. This benefit is unavailable to other students in either VET or higher education, who are not yet employed in the area in which they are studying and also face study expenses.

The Commonwealth government is proposing to introduce a higher education scholarship scheme as part of its fee deregulation reforms. If these reforms are introduced, higher education institutions will be required to provide financial assistance to disadvantaged students. Scholarships will be funded by a specified proportion of the revenue raised from increased student fees that are supported by income contingent loans.

The structure of scholarships, how they are targeted, and how much money is attached to each scholarship, will vary widely between higher education providers. At this stage these scholarships are not required under VET FEE-HELP, further exacerbating differences in student 'entitlements' between the VET and higher education systems.

### **Widening investment gap between higher education and VET**

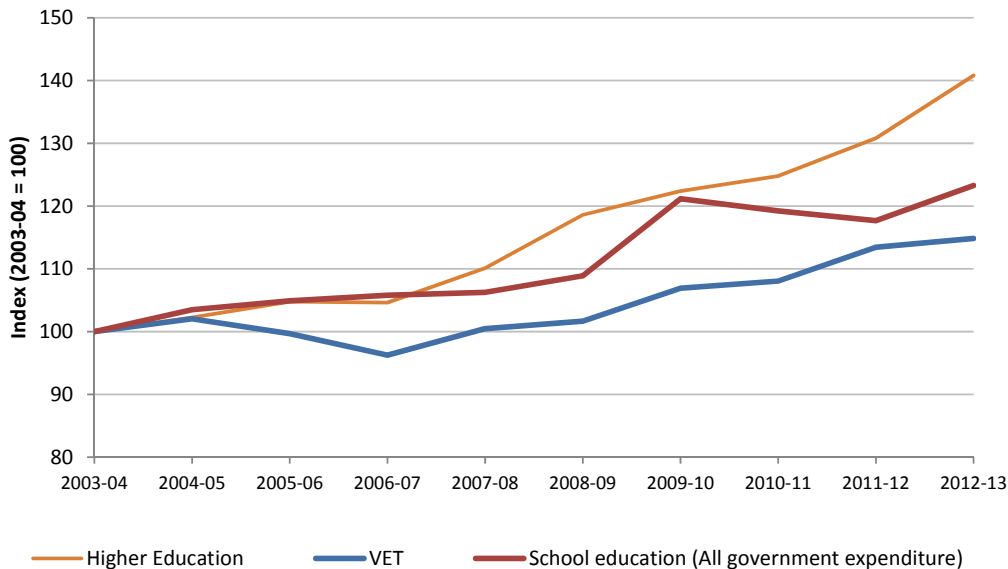
As previous Mitchell Institute analysis has demonstrated,<sup>14</sup> expenditure in the VET sector has stalled, yet it has grown strongly in higher education. On current trends, this expenditure gap will widen.

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<sup>14</sup> P. Noonan, G. Burke, A. Wade and S. Pilcher (2014) 5.



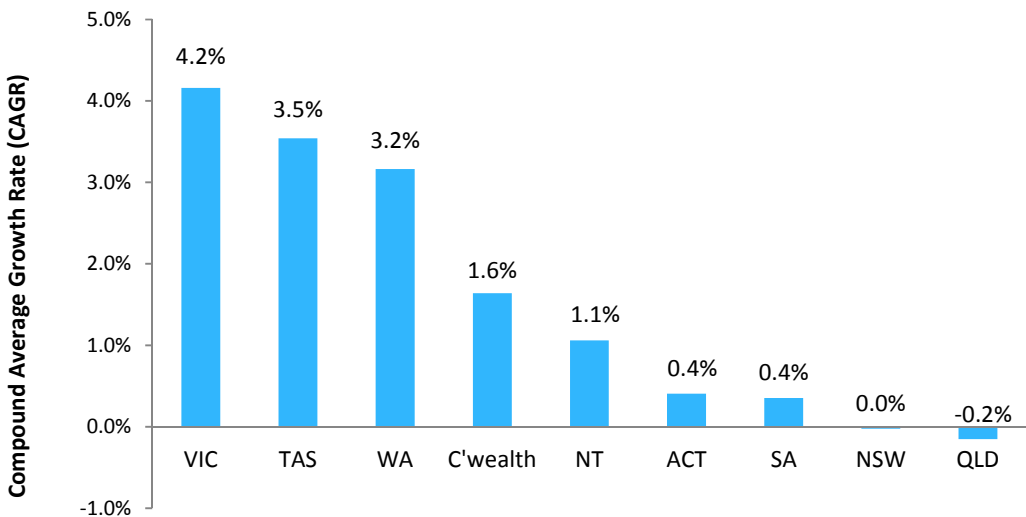
**Figure 3: Expenditure on education and training in Australia, 2003-4 to 2012-13**



ACIL Allen Consulting analysis based on Australian Bureau of Statistics data

The widening gap is partly explained by rising demand in Australia for higher level skills and rising aspirations for higher education. However, the growing investment gap between the two sectors also reflects different financing arrangements and funding levels. In the years after the introduction of demand based funding in higher education, enrolments levels in both VET and higher education continued to grow. But public expenditure on VET has slowed, and even fallen in some jurisdictions.

**Figure 4: Compound change in VET Expenditure, 2003-4 to 2012-13**



ACIL Allen Consulting analysis based on Australian Bureau of Statistics data

VET enrolments in publicly funded courses fell in 2013, but continued to grow in higher education.

## **A growing gap in per student funding levels**

Per student funding levels have fallen significantly in VET in Australia for more than a decade. After a period of decline, they rose in higher education over that time, although there is ongoing concern in the higher education sector about per student funding levels.<sup>15</sup>

The decline in VET per student funding levels has reflected conscious policy decisions to fund growth in VET through greater efficiency. But the decline is now increasingly associated with growing concern about the quality of qualification delivery and assessment, as many providers have sought to deliver qualifications at lowest cost, and states have reduced subsidy levels for many qualifications assessed as low priority.

This concern about quality, prompted by the growing gap in per student funding levels, exacerbates the perception that VET qualifications have lower prestige value. That is particularly so for younger full time learners seeking a high quality, campus based learning experience. Poor quality detracts from outcomes for VET learners, in particular gaining the pre-requisite skills and knowledge that enable them to successfully undertake qualifications at higher levels.

## **Potential distortion of student choice**

The effect of these differences and anomalies on student choice is difficult to assess. School leaver choices about tertiary study options are essentially driven by schooling outcomes, notably ATAR scores, family background, aspirations, and students' awareness of study options and labour market outcomes. For many young people, VET is not a preferred option immediately after leaving school. Those who receive an offer from a university are most likely to accept it.

However, there is a cohort of young people who face real and significant choices about whether to enrol in VET or higher education qualifications. Examples include those who wish to enrol in a highly vocationally oriented qualification offered in either sector, and students for whom an initial VET qualification may provide both employment and a learning pathway to higher education.

Australia – in common with many other countries – has sought to build up VET options as a legitimate and valued pathway for young people, including through expanding VET provision in schools. Students should be able to make choices based on an expectation that courses in which they enrol will be resourced at a level that is adequate to meet quality outcomes. Their choices should be framed by consistent and equitable access to income contingent loans that ensure they do not have to meet the upfront costs of their studies.

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<sup>15</sup> P. Noonan, G. Burke, A. Wade and S. Pilcher (2014) 9.

## **Diminished overall effectiveness of the tertiary education system**

These diverging trends are likely to continue. Potentially they will:

- Lead to a potential oversupply of skills from the higher education sector which are out of balance with future labour market needs.
- Result in diplomas, advanced diplomas, and associate degrees increasingly being offered as higher education qualifications, leading to further cost shifting from states/territories to the Commonwealth, and potentially shifting the focus of these qualifications from workforce skills to higher education pathways.
- Result in higher tertiary education costs, given the higher cost base in higher education.
- Limit the capacity of the VET sector to respond to emerging priorities, in particular training opportunities linked to welfare-to-work measures, and workforce retraining arising from structural change in the economy.
- Further entrench existing attitudes and preferences about the relative standing and prestige of VET and higher education.
- Limit growth in tertiary participation and attainment rates in some jurisdictions.

Separately and together, these factors have perverse effects. They constrain the tertiary education system's efficiency. They restrict its capacity to meet the challenge of balanced growth that accounts for rising demand associated with population growth, and changing demands associated with workforce needs.

### **1.8 Why Australia needs a new approach**

The preceding analysis presents a compelling case for:

- a new financing framework for the financing of tertiary education in Australia; and
- within the framework, a fresh look at the way student entitlements are implemented in VET and higher education, with the view to implementing a coherent and consistent approach.

The case for a new financing framework for tertiary education sits independently of the case for a student entitlement model.

There will be understandable reservations about a commitment to a new form of student entitlement as a major priority for governments is to manage public finances in a fiscally sustainable manner. Governments are wrestling with growth in outlays for existing programs, such as childcare and the aged pension, and with the costs of funding new programs such as the National Disability Insurance Scheme (NDIS).

We must balance this priority with another priority claim: every young Australian needs the skills and capabilities to contribute effectively to Australia's future as a productive nation. Young people who lack those skills and capabilities are far more likely to be unemployed or underemployed, and to leave the workforce early. Those with low skills are more likely to receive minimum levels of income

support. Over time they are more likely to become trapped in poverty, which has consequences for physical and mental health, social isolation, and intergenerational equity. It is no exaggeration to assert that when it comes to education and training, people's lives are at stake.

From a practical, fiscal perspective, we diminish the benefits of our national investment in schooling if young people cannot carry the benefits of that investment into tertiary education. Governments must also ensure that public funding is aligned with public policy objectives on one hand and individual need on the other.

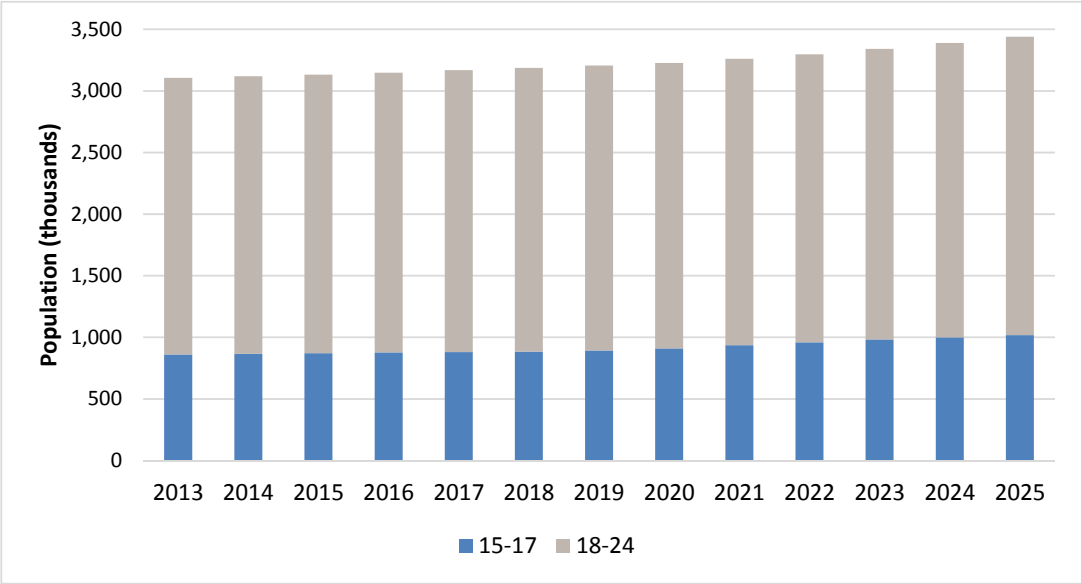
The proposed approach to a tertiary education student entitlement has six clear benefits. The entitlement will:

- Provide a clear signal from governments to young people that a tertiary qualification is both necessary and available for successful and ongoing participation in the modern labour market.
- Create greater certainty for young people that they will be able to undertake tertiary studies.
- Allow governments to set clear criteria and to manage eligibility for access to public support for tertiary education.
- Shift decisions on provision from providers to individuals, and empower individuals to make decisions about course and provider options.
- Help to further build learning pathways across qualification levels and between the VET and higher education sectors.
- Provide a transparent and shared basis across governments for modelling and estimating future tertiary education resourcing requirements.

Investment must be sufficient to ensure that the tertiary education system can meet rising demand from two quarters: population growth and changing workforce skills.

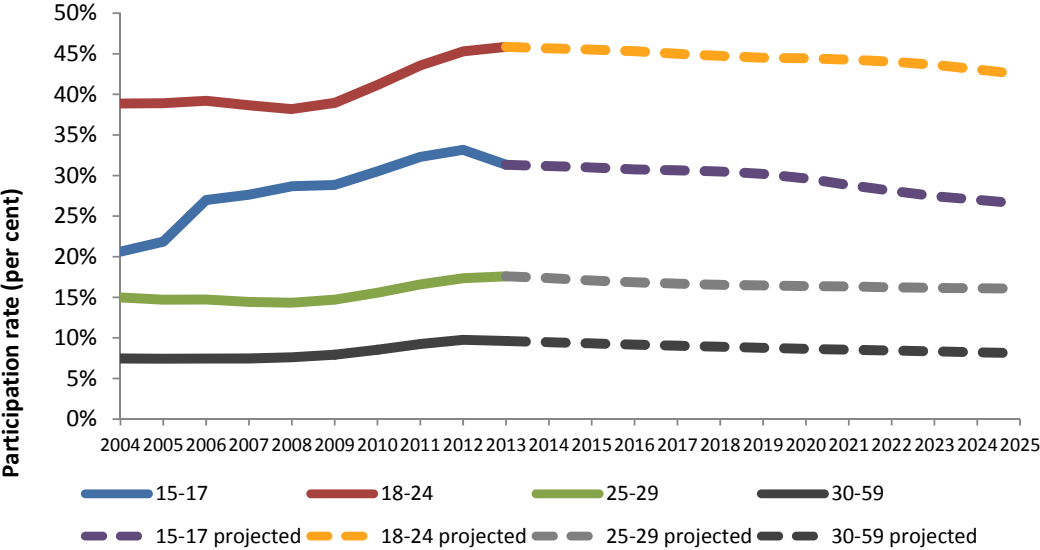
As Figure 5 shows, projected growth in the key age cohorts of 15-17 and 18-24 is relatively modest. In this context, ensuring that young people have a clear opportunity to access tertiary education should not be beyond the fiscal capacity of Australia as a wealthy nation with an advanced economy. Equity of access tertiary education benefits the nation through increasing our stock of human capital. It must continue to be seen as part of Australia's deep national institutional framework.

**Figure 5: Projected population growth for young people aged 15-17 and 18-24**



We must be careful not to see modest growth in the numbers of young people as meaning that the demand for tertiary education will fall. Our national task must be to increase participation in tertiary education. The present rate is insufficient to meet our future needs for a skilled, flexible and knowledgeable workforce. Participation must grow at a rate higher than the population increase. Yet, as Figure 6 shows, overall rates of participation in tertiary education will flatten or decline if we only maintain enrolments at current levels.

**Figure 6: Projected participation rates (when enrolments kept constant at 2013 level)**



Put simply, both VET and higher education must expand just to maintain current levels of participation. At the same time, expansion must be balanced across skills and occupational levels, and account for the broader economic and social purposes each sector serves.

Investment levels must be sufficient to support high quality teaching, learning, and assessment. Tertiary education can only justify public and private expenditure if the outcomes are valued by graduates, employers, and the community. Private and social rates of return – the benefits to individuals and to the nation – that flow from tertiary education must be sufficient to attract funding from governments, and to encourage individuals to invest their financial resources and their time in completing post-school qualifications.

We must also recognise that many older Australians also need to access or re-enter tertiary education so they can upgrade or acquire new skills. This is both predictable and necessary given Australia's ageing workforce, structural changes in the economy, and technology driven transformation of workplaces. Demand for 'old' skills is gradually eclipsed by demand for skills we didn't know we needed just ten years ago, and for knowledge we didn't have even five years ago.

However, while a worthy ambition, our assessment is that is not viable to extend an automatic student entitlement to tertiary education across the full working age population in Australia. To do so would lead to significant cost blow outs (as happened with the implementation of the Victorian Training Guarantee). Inevitably an entitlement of this kind will lead to the imposition of tighter eligibility criteria, and reductions in subsidy levels.

A more targeted approach is required to address the needs of older learners, particularly in VET with its wide range of accessible offerings and its important role in workforce reskilling. Policy attention is also needed to shape a more engaged role for industry in financing industry related workforce training for older workers. Support for older learners can be accommodated within the financing framework proposed in this Issues Paper, but is not its principal focus.

## 1.9 The concept of a student entitlement

In the past 30 years many policy proposals and government initiatives have advanced the concept of a youth or student guarantees or entitlements. They have shared a common objective of ensuring that, on leaving school, all young people have access to education, training, or work experience.

In a comprehensive review of international approaches to student or learning entitlements, Curtain identified five principles for funding an initial post-school qualification:<sup>16</sup>

- *The right to funding is to achieve a specified outcome.*
- *The take-up of the entitlement also imposes obligations on the recipient.*
- *The funding usually follows the recipient of the entitlement.*
- *Additional funding is available to address identifiable disadvantages of the recipients.*
- *The entitlement includes funding for support services.*

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<sup>16</sup> R. Curtain (2001) *An Entitlement to Post-Compulsory Education: International Practice and Policy Implications for Australia*, NCVET Research Paper.

Curtain identified additional principles for funding participation in the ‘second stage’ of post-compulsory education:

- *An entitlement which is contingent on meeting academic entry requirements.*
- *A requirement, in many instances, for a personal contribution to tuition costs as a condition for receiving the entitlement.*
- *An obligation to demonstrate satisfactory performance.*
- *A move away, in some instances, from parental means-tested student support to making students responsible for funding their own support, in the form of loans*

Most of these principles are evident in Australia’s current student entitlement models.

### **1.10 A brief history of student entitlements in Australia**

Australia has a patchy and sporadic record of interest in, and implementation of, student entitlement models.

In 1985, the Victorian government was the first to introduce a Youth Guarantee. However, the Youth Guarantee strayed from the comprehensive financing system for post-school education its architects had envisaged. Like current European Union<sup>17</sup> practices, the Youth Guarantee was limited to a small range of labour market programs and it became oriented to interventions that addressed youth unemployment. However, the term reappeared in 2009 in the form of the Victorian Training Guarantee.

In 1999, the West Review of Higher Education Funding in Australia<sup>18</sup> proposed a higher education student entitlement. The design incorporated a system of vouchers, or scholarships with public subsidies, complemented by deregulated student fees. However, the Howard government did not accept the proposal.

A later review of higher education, undertaken by Minister for Higher Education Brendan Nelson,<sup>19</sup> led the Howard government to introduce in 2003 a student entitlement to higher education, that eligible students must exercise within seven years. This entitlement model had limited effect. It was constrained by the structure of the higher education funding system at that time, which was characterised by caps on student places, and by planning and funding negotiated between universities and government.

However, a demand driven student entitlement was central to the recommendations of the 2008 Review of Australian Higher Education (Bradley Review),<sup>20</sup> although the term ‘entitlement’ is now not used in government policy which guides the current operation of the demand based system. (The

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<sup>17</sup>European Commission *Youth Guarantee What is It?*

<sup>18</sup>R. West, *Learning for Life* (1999) (West Review).

<sup>19</sup>B. Nelson, *Higher Education at the Crossroads* (2002).

<sup>20</sup>Bradley Review, Recommendation 44.

seven year time limit associated with the Nelson entitlement model was abandoned on the recommendation of the Bradley Review.)

In 2008, an OECD Review of VET in Australia recommended that Australia introduce a student entitlement for the VET system. The OECD linked the concept of a student entitlement to the need for broader reform of VET funding in Australia. The Review concluded that:<sup>21</sup>

*Tangled state and Commonwealth responsibilities linked to complex funding arrangements require unravelling and the establishment of clearer principles and a simpler architecture. Bringing state and Commonwealth governments together to seek agreement on these principles – as is already happening – will help to reach a solution. Entitlement to funding should be clarified by defining entitlement in terms of specific categories of individuals seeking particular types of training as the centrepiece of a demand-led system.*

The Bradley Review, in recommending the introduction of a demand driven student entitlement in higher education, also considered the interface between higher education and VET. The Review concluded that:<sup>22</sup>

*Moving to a demand-based approach to funding higher education cannot be done in isolation from VET. Changing higher education funding but leaving VET funding untouched would compound existing distortions. Research shows that VET diploma and advanced diploma graduates are in direct competition with and are substitutes for higher education diploma and bachelor graduates in the labour market.*

The Review recommended introducing a tertiary student entitlement across the higher education and VET sectors. The recommendation was not accepted by the Rudd-Gillard governments. Rather separate student entitlement models were introduced for higher education and through COAG for VET, leading to the current arrangements – and the shortcomings of those arrangements - outlined earlier in this Issues Paper.

Australia's higher education and VET sectors are well developed in their own right. But as we have established, each sector is financed separately, works to separate policy settings, and attracts differing perceptions of prestige. The result of these variations is that tertiary education, taken as a whole and as a national institution, does not realise its potential for effective and equitable investment in human capital development.

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<sup>21</sup> OECD (2008) K. Hoeckel, S. Field. T. Justesen and M. Kim, *Learning for Jobs, OECD Reviews of Vocational Education and Training, Australia*,

<sup>22</sup> Bradley Review, 185.



# Part 2: A new financing framework and entitlement design

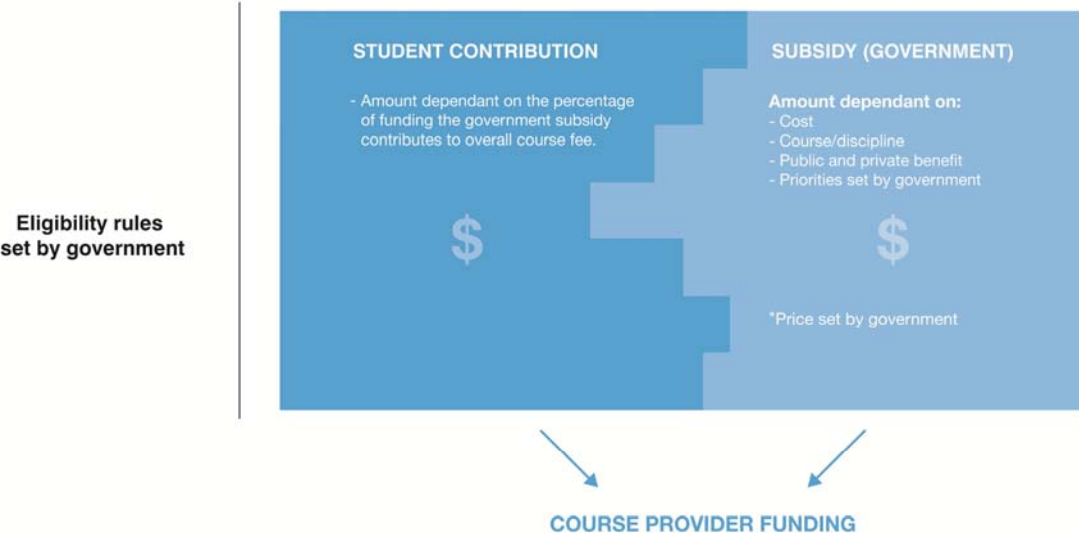
## 2.1 Key elements of a tertiary education financing framework

A tertiary education financing system has two core elements that are derived from existing arrangements in Australia:

- **A public subsidy** – paid by either a state/territory government or the Commonwealth government, and based on eligibility to an entitlement; and
- **Student contributions** – paid by students to the provider, or paid by students who take out an income contingent loan with the Commonwealth.

Together these elements constitute the revenue paid to providers to deliver qualifications. As Figure 7 illustrates, the ratio between public subsidies and student contributions can and will vary significantly between qualifications in each sector, and between each sector.

**Figure 7: Key elements in tertiary education financing**



In addition to the two core elements described above, many students also receive income support from the Commonwealth government. Student income support is important to enable participation and completion. However, this paper concentrates on the design of the financing system as it applies to revenue flowing to providers for qualification delivery. The Issues Paper briefly addresses options for using income contingent loans to supplement student assistance, or to help students meet other study costs.

## 2.2 Allocating responsibilities for funding tertiary education to each level of government

A viable framework must also be clear about which level of government has funding responsibility for tertiary education. Below we examine the three broad options that are open to governments in Australia in reforming the financing framework.

Each option seeks to extend the Commonwealth government's proposed single and consistent income contingent loans scheme to all subsidised VET Certificate III and IV qualifications, and to VET diploma and advanced diploma qualifications. Under the framework, the Commonwealth would continue to make available income contingent loans (in the form of FEE-HELP) for full fee courses outside the student entitlement system. The difference between the options is which level of government provides the subsidy for course delivery under the student entitlement.

In the context of our assessment of realistic reform of the Federation, Option 3 is the preferred alternative.

### **Option 1: Commonwealth assumes responsibility for funding tertiary education, and states/territories assume responsibility for funding schools and school equivalent programs**

Under Option 1, the Commonwealth assumes total responsibility for funding tertiary education. As part of a major reassignment of roles and responsibilities under the Federation, states/territories assume total responsibility for funding schools and school equivalent programs.

Option 1 was proposed by the Keating Government in 1992 which offered to assume full responsibility for funding TAFE (VET). That offer was declined by the states/territories. The 1996 Commonwealth Commission of Audit recommended this model, as did the Bradley Review in 2008.

This model would most likely provide for the development of a more consistent and integrated funding system, including the relationship between subsidies, student fees, and income contingent loans. It elevates VET as a national responsibility, on the same footing as higher education. In conceptual terms it is the preferred model.

It is likely that Option 1 would be considered only if accompanied by a full transfer of school funding responsibility to the states/territories, and similar trade-offs in other areas such as health. Past experience suggests that Option 1 would be difficult to effect, particularly as it would require the agreement of all jurisdictions.

### **Option 2: States/territories resume full responsibility for funding all levels of tertiary education.**

Option 2 would reverse the 1973 agreement between the Commonwealth and the states under which the Commonwealth assumed full funding responsibility for universities. This constitutes a radical departure from the current system. However, it is a reasonably common arrangement in other Federal systems, notably in Canada and the United States. Variations are also found in other Federal systems in which state governments fund state and local level systems and institutions, and the national government funds a smaller number of specialist, highly focused national institutions.

The 2014 Commonwealth Commission of Audit recommended that VET, but not higher education, funding responsibility be transferred back to the states.

However, Option 2 would divide responsibility for tertiary education financing. States/territories would be responsible for subsidies and the Commonwealth would be responsible for income contingent loans if they continued. This division would leave the Commonwealth bearing increasing levels of responsibility for underwriting the student entitlement, and for bearing the risk of rising levels of student debt.

Without significant changes to state/territory revenue raising capacity, Option 2 would also leave the higher education system exposed to the same risk of potential underfunding, or increasingly uneven patterns of funding by the states/territories now evident in the VET sector. This was a primary reason for the Commonwealth assuming full responsibility for university funding in 1973.

### **Option 3 Each level of government assumes responsibility for funding a specific set of qualifications.**

Under Option 3, responsibility is allocated as follows:

- The Commonwealth funds all sub-degree and degree level qualifications, regardless of the sector in which they are delivered.
- States/territories fully fund:
  - Certificates III and IV, including apprenticeships, other forms of entry level training, and post-trade training;
  - Certificates I and II as pre-tertiary qualifications (which would sit outside the tertiary student entitlement); and
  - Preparatory and secondary school equivalent education.

Option 3 was first proposed by the Commonwealth in 1987 in its higher education reform Green Paper. The Commonwealth offered to consider taking over responsibility for funding TAFE diplomas and advanced diplomas as part of the new national higher education financing system. However, this proposal was not pursued by any state/territory, and subsequently not included in the White Paper that established the current arrangement of responsibilities for higher education.

Option 3 has two advantages. First, it creates a more coherent financing framework for tertiary education linked to a student demand driven entitlement. Second, it does this without requiring a total realignment of responsibilities between Commonwealth and state/territory governments. This option builds on the current higher education reform proposals that seek to extend higher education student entitlements to sub-degree qualifications. It avoids the complexity entailed in either the Commonwealth or states/territories fully assuming responsibility for VET, as has been proposed in the past.

The roles of the Commonwealth and the states/territories under Option 3 are shown in Figure 9.

**Figure 9: Funding responsibility for qualifications**

	PRE -TERTIARY		TERTIARY				
AQF LEVEL	1	2	3	4	5	6	7
<b>FUNDING RESPONSIBILITIES</b>							
- State subsidy & fee policy	Blue	Blue	Blue	Blue	White	White	White
- Commonwealth subsidy & fee policy	White	White	White	White	Blue	Blue	Blue
- Income Contingent Loans (Commonwealth)	White	White	Light Blue	Light Blue	Light Blue	Light Blue	Light Blue

Option 3 in itself does not address the significant and growing inconsistencies between the states/territories regarding eligibility criteria, subsidy levels, fee levels and fee settings. These inconsistencies may continue to distort provision of education and training, and student choice. However, these inconsistencies could be minimised under an agreed policy framework for the design and implementation of the student entitlement.

Option 3 does not deal with the capacity of the states/territories to resource the areas of VET for which they would have responsibility. The process now underway, which seeks to reform the Australian Federation, will deal with the critical question of vertical fiscal imbalance – the inability of states/territories to raise sufficient revenue to fund the services for which they are responsible. Without this additional capacity public expenditure on VET at a state level will continue to be constrained and costs increasingly passed onto students and through income contingent loans, to the Commonwealth.

**2.3 Designing a student entitlement**

There are six major tasks associated with designing a student entitlement system:

- defining the entitlement;
- setting subsidy levels;
- setting student contribution levels;
- setting and managing eligibility;
- reforming the Commonwealth’s income contingent loans scheme; and
- establishing, managing and regulating the provider system.

Each government will make decisions on the detail of these elements of a student entitlement. However, for a single national tertiary student entitlement to work it is essential that Commonwealth and state/territory governments inform their decisions by reference to a consistent approach which achieves three policy objectives to:

- recognise the interrelationship between the higher education and VET sectors;
- ensure some consistency in operating the student entitlement across jurisdictions; and
- minimise or eliminate incentives for cost shifting between the two levels of government.

Possible and preferred approaches to each of these tasks and objectives are canvassed briefly below, recognising the complexities involved in each and the intricate interrelationships between them.

### 2.3.1 Defining the entitlement

As we noted earlier, a tertiary education student entitlement in the Australia context can be defined as: *guaranteed funding support for tertiary education to a particular qualification level through course subsidies and access to an income contingent loan.*

There are two broad ways in which a tertiary education student entitlement can be made available:

- Qualification based – entitlement to a program of learning to achieve a qualification or qualifications through an approved provider.
- Financially based – an entitlement to a defined level of funding that could be paid to the student or the provider for a program of learning to achieve a qualification or qualifications.

For the reasons outlined below, a qualification based student entitlement model is proposed in this Issues Paper.

#### **Qualification based**

The current implicit model in Australia is qualification based. Under this model, eligible individuals can access a subsidised place for qualifications in the Australian Qualifications Framework from Certificate I through to bachelor degrees. Some subsidised places are also available for higher education masters qualifications, but only for specific courses at some institutions.

Under the current model, governments set parameters within which the student entitlement operates. For example, the COAG VET entitlement is to a Certificate III as a minimum. However, some jurisdictions provide a student entitlement up to an advanced diploma as long as the qualification in which they enrol is at a higher level than their current qualifications. If the Commonwealth government's current reform proposals are adopted then the higher education student entitlement will extend to higher education diplomas and advanced diplomas.

An additional condition in a qualification based model could be that students may have to meet specific entry criteria to access the qualification. These entry criteria may include Australian Tertiary Admission Rank (ATAR) scores for particular courses at specific institutions, pre-requisite subjects or

qualifications, and in some vocational courses industry experience or access to structured work based learning such as an apprenticeship.

### **Financially based**

A financially based student entitlement model entitles eligible students to a defined subsidy which, together with their own contribution, they can use to purchase a course of study from approved providers.

This was the model for higher education proposed in the West Review and earlier advanced by the pre-eminent educational leader, Professor Peter Karmel. This model is, in effect, a voucher system. Government did not pursue it in either case.

A variation is the school resource standard recommended by the Review of Australian Government School Funding (Gonski Review).<sup>23</sup> The standard is based on the principle that all students should receive a minimum level of resources from all sources to achieve agreed outcomes, with additional funding available for students with specific learning needs (such as students with disabilities).

However, the school resource standard has evolved quite quickly to serve two other purposes. First, it has become a means of assessing the funding needs of different schools which then informs agreements between the Commonwealth and states/territories, and between the Commonwealth and non-government schools. Second, states/territories are now using the school resource standard to allocate resources within their school systems. Nonetheless, the school resource standard implies a guarantee of a minimum level of resourcing per student to the end of senior secondary education, combining qualification based and financially based student entitlement models.

A significant disadvantage of a uniform financial entitlement is the likelihood that it will lead providers to offer courses in qualifications that have lower cost bases. Doing so would maximise returns, but comes with the potential for significant market failure in critical qualifications that are high cost.

#### **2.3.2 Setting subsidy levels**

As highlighted above, there is substantial divergence in how funding bodies set subsidy levels for the higher education and VET sectors.

All governments progressively moved away from funding institutions on the basis of historical budgets and costs. They have adopted relative cost models based on the differing costs between qualifications or fields of study. Over time these models have been adjusted further to:

- address anomalies in the relativities;
- reflect perceived public and private benefits; and
- encourage provision in areas of skills shortage.

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<sup>23</sup> *Review of Funding for Schooling (2011) (Gonski Review).*

The real value of subsidies has also declined over time, particularly in VET. Their relative contribution to costs is now quite low in areas of perceived high private return in higher education, and low public return in VET.

There is a risk that under the proposed framework the states/territories will have an incentive to further reduce their subsidy levels and transfer costs to the Commonwealth through the income contingent loans scheme. Indeed, this is already happening. This risk must be addressed in the policy framework supporting a student entitlement.

The relationship between government and student contributions is also important for the total revenue available to providers.

In both higher education and VET, a fundamental reassessment is required of the purpose of public subsidies and the principles under which they are set. However, an agreed and consistent approach to the purpose of subsidies and the principles that underpin them would assist in reducing the significant and growing anomalies between the sectors, and in relation to VET, between jurisdictions. That reassessment should extend to the actual price paid via subsidies, recognising that Commonwealth and state/territory governments will ultimately determine subsidy levels.

Another major consideration in setting subsidy levels is the extent to which a subsidy should incorporate the additional costs associated with the role of public providers. All states/territories, except Victoria, have recognised the specific and additional roles of TAFE in their student entitlement funding models. In Victoria, the previous state government removed the TAFE loading. The current Andrews government has committed to reinstating funding for the role of TAFE, and has asked the recently announced Review of VET Funding to recommend a mechanism for doing so.

There is also an ongoing debate in higher education about the need for greater institutional differentiation between research institutions and teaching only institutions. A further consideration that influences the subsidy level is the extent to which, in higher education, the subsidy for undergraduate qualifications should incorporate a contribution to the costs of research. Associated with this issue is whether the same subsidy level should be applied to universities and other higher education providers if they become eligible for public funding.

In addition, there are proposals for new forms of tertiary education institutions specialising in sub-degree and applied degree qualifications.

Taking account of the issues outlined above, the factors that should be considered in setting public subsidies include:

- a standard cost for a qualification;
- weighted qualification costs;
- the volume of learning (qualification length);
- efficient and effective pricing – the efficient price required across different qualifications for learners to meet required learning outcomes and standards;

- public policy objectives – for example, higher subsidies in areas assessed as having particular social and economic importance;
- private benefits – lower subsidies in areas of high private return;
- weightings for specific learner needs (for example, students with disabilities);
- types of institutions in higher education, including greater differentiation in teaching and research;
- the role of public institutions; and
- delivery and assessment modes – prices that more closely reflect different costs of delivery, and recognition of prior learning in the VET sector.

Institution specific funding would also be available for specific initiatives, delivery of specialist qualifications and community service obligations.

Across these factors the relative cost of qualifications remains an important consideration in setting subsidy levels, particularly under a student entitlement approach. If subsidy levels are increasingly unaligned with costs of delivering a qualification, then provision is likely to be skewed to areas where margins are highest.

### 2.3.3 Setting student contribution levels

In higher education, student contribution levels directly reflect relative subsidy levels. Under current reform proposals, higher education providers would assume responsibility for setting their own fees.

In VET, fees are still largely set by government on a uniform basis across qualifications (with some capacity for providers to charge fees for materials or consumables).

In Victoria, VET fees are currently fully deregulated under the Victorian Training Guarantee (VTG). However, under the VTG a student has no financial commitment at stake. Consequently, some providers issue qualifications while charging no fee, minimising delivery and inappropriately assessing competence.

A key decision for each jurisdiction is the extent to which fees remain regulated. If fees are deregulated, policy will need to avoid both overpricing and inappropriate undercutting in the market.

Previous Mitchell Institute publications outline measures that could be used to mitigate the risks of overpricing. These include:

- developing principles and guidelines for fee setting by institutions to ensure that fee levels relate directly to teaching and learning, and student outcomes;
- tapering subsidies to providers as fee levels increase;
- capping loan limits under income contingent loans;
- establishing oversight bodies, or using existing national and state/territory pricing and competition bodies, to oversee and advise on market development and market failure; and



- ensuring students have access to independent and objective advice and information on provider quality, course quality, qualification outcomes, and fees and income contingent loans.

### 2.3.4 Setting and managing eligibility

Setting equitable but financially sustainable eligibility criteria is the most challenging policy task in designing a tertiary student entitlement. Experience in some states/territories, in both VET and higher education sectors, has shown that broad, open-ended eligibility criteria can lead to significant enrolment increases with consequential concerns about fiscal sustainability. Conversely, experience in other VET systems has shown that overly restrictive eligibility criteria can produce major inequities between potential learners and between qualifications at the same AQF level.

An additional complexity is the differing age profiles and missions of the VET and higher education sectors. VET students are generally older. VET is more accessible and has a much wider range of offerings. Compared to higher education, VET is delivered by many more providers and in many different settings.

Eligibility for a tertiary education student entitlement can be determined by a number of criteria. They can operate in combination and can also be used to influence the setting of subsidy and fee levels. Eligibility here is defined as access to a public subsidy and an income contingent loan. Individuals are free to enrol in courses of their choice outside the subsidised system and still have access to an income contingent loan.

Eligibility criteria include age, cohorts defined by specific characteristics, prior qualification levels, and pre-requisites. Each of these criteria is outlined below.

#### **Specific age cohorts**

As part of its commitment to increasing adult skills and qualifications levels, COAG agreed to a VET student entitlement for 15-64 year olds for qualifications up to and including Certificate III. This means that adults undertaking a Certificate IV qualification and VET diplomas and advanced Diplomas are not formally covered by the COAG agreement.

There is no age limit for the higher education student entitlement under the demand based funding system.

#### **Prior qualification levels**

VET student entitlement models in some states/territories limit eligibility to a higher qualification in the AQF than one already held, except for 15-19 year olds. This limitation was designed to promote upskilling in the adult population, and to address the problem of repeat enrolments at the same level.

## **Cohorts defined by specific characteristics**

Related to an age cohort definition, a tertiary student entitlement could be directed to:

- school leavers – eligibility requires them to take up their entitlement within a defined period (for example, within two years of leaving school);
- young people more broadly – for example, those aged between 18-24; and
- the full adult population, but with other limitations on eligibility.

## **Pre-requisite or merit based**

Access to a student entitlement could also be conditional on eligible students meeting specific entry criteria. These could include completing senior secondary education or equivalent, achieving a minimum ATAR score and institutional entry criteria.

Within these population cohorts, it is important to note that a tertiary education student entitlement is not an automatic entitlement to any course at any provider. Nor is it for undefined periods.

A student entitlement can be limited or made conditional in other ways:

- restrictions on the number of places – individuals compete for places in courses, such as those in highly specialised areas, high cost areas, areas of low priority and/or significant oversupply;
- restrictions on eligible courses as some courses may not be appropriate for eligible cohorts – for example, highly specialised courses requiring industry experience and access to industry equipment and facilities, or firm specific courses;
- time limits – an entitlement must be exercised in a defined time period (for example, seven years); and
- satisfactory progress – an entitlement is continued only if a student meets a provider's subject completion and progression requirements, with limits placed on withdrawals and non-completions.

The primary focus of the student entitlement framework proposed in this paper is to provide young people, upon leaving school, with universal access to tertiary education, and an affordable means of completing a tertiary qualification. This approach is consistent with the original policy objectives of the various initiatives associated with youth guarantee, youth entitlement, and learning entitlement models.

Raising the post-school qualification rate in the adult population is an important goal. However, extending an *automatic* student entitlement to the full adult population is not fiscally sustainable. It would require a secondary set of eligibility criteria (such as higher qualification levels), or additional limitations on access to funding and on student debt levels. Such criteria can lead to inequitable outcomes: for example, in jurisdictions where VET students can access an entitlement only for a qualification at a higher level than the one they already hold, many adults with dated and irrelevant qualifications are ineligible, while others who are eligible are inappropriately enrolled in qualifications.

A prudent starting point for introducing a student entitlement is for all governments to agree to a tertiary student entitlement for young people aged 18-24. That is, they must commence their first tertiary qualification between those ages. The entitlement would cover completion of a first qualification from Certificate III up to full undergraduate qualifications, and those postgraduate qualifications designed for entry to professions.

This set of 'starting rules' could also impose a time limit on the period within which that qualification must be completed. Under this model learners could either:

- directly enter and complete degree qualifications; or
- transition with credit through certificate, sub-degree, and undergraduate qualifications.

As outlined above, older learners, or learners ineligible for the student entitlement, could still access subsidised qualifications at the discretion of each jurisdiction. For example, workforce development and workforce retraining programs are available in the VET sector but are funded and provided on a different basis to VET student entitlement funding, including through industry co-contributions. The Commonwealth could opt to retain demand based funding outside the agreed entitlement cohort for older age cohorts, but could also consider introducing a time limit on the entitlement.

### **2.3.5 Reforming the Commonwealth's income contingent loans scheme**

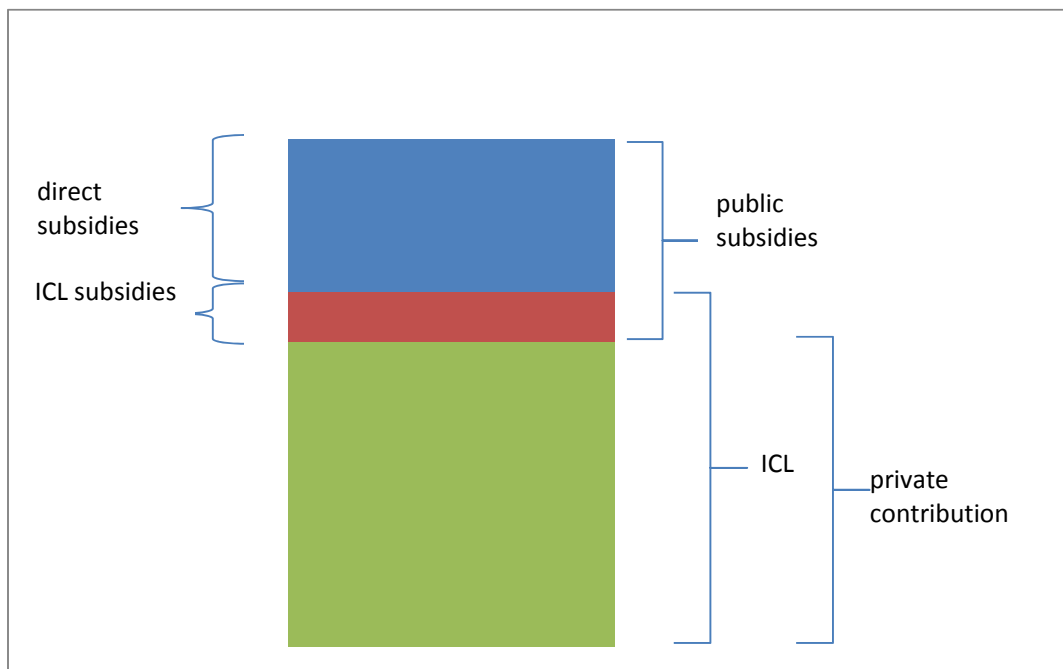
Phase 2 in this Mitchell Institute project involves modelling the implications of using an extended income contingent loans scheme across the tertiary education system, including for a student entitlement. Professor Bruce Chapman and Dr Tim Higgins of the Australian National University will undertake the modelling. Modelling specifications are at Attachment 1.

There is a close interaction between public subsidies, student fees, and graduate income levels. It is important that choices concerning these variables ensure that the sustainability of the income contingent loans scheme is maintained, particularly in the light of recent evidence and concern about high levels of doubtful debt under the current VET FEE-HELP system. In this regard it is also important to recognise that public subsidies under the student entitlement comprise:

- payments to providers;
- effective subsidies to students arising from the administrative cost of an income contingent loan scheme; and
- net government borrowings to finance the scheme.

The elements of an income contingent loan scheme, and their relationship to forms of public subsidy, are shown in Figure 10.

**Figure 10: The relationship between subsidies and income contingent loans**



Key issues for extending income contingent loans across the tertiary sector include:

- the potential trade-off between higher VET student contribution levels through income contingent loans compared to upfront student fees;
- income profiles of different types of VET graduates and how these profiles compare to those of higher education graduates;
- differences in attrition rates between VET and higher education students, and the implications of these for repayments and doubtful debts (that is, the amounts not expected to be repaid);
- options to ensure that the commonwealth does not bear the costs – or the full costs – of extending income contingent loans to the student entitlement;
- the extent to which current loan indexation rates, income repayment thresholds and repayment rates, would need to be varied to ensure that income contingent loan subsidies are not unacceptably high;
- identification of, and methods to mitigate, the potential risks of adverse selection and moral hazard; and
- mechanisms to prevent cost shifting from the states to the commonwealth – for example, if subsidy levels are reduced for state funded programs and student fees are increased.

Modelling will also consider the potential use of income contingent loans to provide student financial assistance, potentially as part of the student entitlement framework but not necessarily an essential component of it.

### 2.3.6 Establishing, managing and regulating the provider system

There are substantial differences between the higher education and VET provider systems.

The Tertiary Education Quality and Standards Agency (TEQSA) has on its national register 140 higher education providers, forty universities, one University of Specialisation, and two overseas universities. Many non-university providers and universities that do not receive Commonwealth Grant Scheme funding may enter the publicly funded system. If they do become subject to the relevant legislative provisions, and they have more than 500 funded students, then they must enter into a Compact with the Commonwealth government.

On the other hand, there are more than 5,000 Registered Training Organisations in the VET system. Most are now registered with the Australian Quality Standards Agency (ASQA), with some registered by state VET regulatory bodies in Western Australia and Victoria. In most states a large number of Registered Training Organisations are approved providers for state funding. Some VET providers are also approved by the Commonwealth as VET FEE-HELP providers.

Concerns about quality in VET, inappropriate marketing and enrolment practices, and overlaps between the Commonwealth and the states/territories, all require careful consideration of regulatory, contractual, and compliance arrangements across the tertiary education system.

Specifically and inevitably, concerns within the Commonwealth about inappropriate provider practices in relation to VET FEE-HELP must be addressed before income contingent loans could be extended further in VET. Given experience with the existing model to date, particularly in some jurisdictions, states/territories will also need to consider future contractual arrangements with funded providers in the VET system in terms of the quality and sustainability of a student entitlement model.

More thought needs to be given by governments as to what characterises the most effective, high quality, sustainable provider system required to deliver a student entitlement in VET. They must then shape the provider system accordingly, rather than continue with the ad hoc, incremental approach which has been adopted to date.

## Conclusion and next steps

This paper has identified issues raised in previous reports and policy papers which, to date, have never been considered in a coherent or systematic way by COAG or successive ministerial councils for education and skills. The Reform of the Federation initiative now presents an opportunity to undertake that work.

The *Reform of the Federation Issues Paper – Roles and Responsibilities in Education*, clearly and succinctly identifies the shortcomings of current financing arrangements across the VET and higher education sectors.

The Green Paper on Reform of the Federation, scheduled for the latter half of 2015, provides a powerful opportunity for the Commonwealth to present detailed options to address those shortcomings through proposals that would:

- Reform the Federation by creating a more transparent financing framework for tertiary education with clear responsibility and accountability for each level of government.
- Through this framework, provide the opportunity for all young people to participate in tertiary education through a student entitlement and, at the discretion of each government, extend the framework to other groups.

The transfer of responsibility for VET from the Commonwealth Industry portfolio to the Education portfolio will greatly assist in developing more coherent policy proposals for reforms across the tertiary education system, and for their implementation.

The framework for tertiary education financing, and agreements on details of design for a tertiary education student entitlement, would be determined within the future decision making and governance arrangements for the Australian Federation.

A shared policy framework, and state by state arrangements for implementation, will need to be put in place to ensure that cost shifting does not occur. Future demand for tertiary education will vary significantly between states/territories, given differing population growth rates and differences in labour markets. State by state agreements will need to reflect these differences.

The Phase 2 report for this Mitchell Institute project will further develop the framework proposed in this Issues Paper, and examine approaches to its implementation.

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# Attachment 1: Modelling of Income Contingent Loans

The purpose of the modelling exercise is to explore the implications to private outlays and public loan subsidies of different income contingent loan scheme designs for the entitlement. The models will consider different levels of scheme parameters, including loan amounts, income repayment thresholds and rates, loan indexation options, and risk sharing arrangements. Modelling will involve two parts.

## 1. Hypothetical student cases

The first modelling exercise will involve generating a range of hypothetical students with different qualifications, and reporting on repayment patterns, time to repayment, forgone interest, unpaid debt, and private costs. Hypothetical cases will differ by sex, future income assumptions, qualification level, and loan amounts.

## 2. Aggregate ICL costs

The second modelling exercise will involve generating estimates of the aggregate costs of the income contingent loan scheme under different entitlement scheme design options.

## Data and methodology

Information that is required to undertake the modelling includes:

- The sex and age composition of the expected student population at each qualification level. This includes the cohort that incurred debt but withdrew prior to completing their qualification.
- The annual fees for each qualification, which, when coupled with choices for the entitlement and existing HELP rules, will be used to determine possible loan amounts.
- Future incomes for the pool of potential debtors. Income estimates are required to estimate the compulsory repayments made in each future year.

Each of these data components is discussed briefly.

### Population composition

Information on the potential population of debtors (including non-completion rates) will be taken from statistics from the Department of Education, and the National Centre for Vocational Education Research (NCVER).



## **Fees and loan amounts**

Information on fees and existing maximum ICL loans charged that are associated with different higher education qualifications are available from a number of online sources. The Grattan Institute also compiles and reports on a range of statistical information from the higher education sector, and these reports may be referenced for data.

## **Future incomes**

The 2011 Australian Census contains data on income by age, sex, non-school qualification level and employment status. This enables the construction of income profiles and employment and labour force participation rates. Graduate Careers Australia (GCA) and NCVER also conducts student outcomes surveys and information from these surveys will be used to cross-check and supplement the Census income data. The Census, and data from GCA and NCVER, will be used to construct the hypothetical student cases.

Aggregate costings require more accurate income estimates. A limitation with using cross-sectional data is that it does not provide information as to how incomes and employment states can change over time for each individual. For the aggregate costings the Household Income and Labour Dynamics of Australia survey (HILDA) will be used to supplement the cross-sectional census and survey material. HILDA is a panel data set and allows generation of income transitions within full-time and part-time employment states, and mobility between labour force experiences. Income models will be developed where future income is dependent on current income, allowing for transitory and permanent income shocks. Employment status will likewise be modeled such that it is dependent on previous employment status.

The models developed using HILDA data will provide an indication of the level of individual income and employment status variability over an approximate ten year period by age, sex, and qualification level. Because the number of graduates with tertiary qualifications within HILDA data is limited compared to the Census, the models will be matched to the Census data to ensure that simulated income and employment status transitions conform to the observed income distribution from the Census. Income levels will be adjusted to current graduate earnings levels using recent survey information from the GCA and NCVER, and ABS statistics. Finally, simulated future earnings will be adjusted with economy-wide earnings growth assumptions.

## **Modelling process**

The modelling process for aggregate costs is summarised broadly as follows:

- the population of debtors will be identified for each qualification level;
- each student in the population will be assigned a loan amount based on their qualification level and completion status;
- future earnings will be simulated for each student in the population; and
- repayments and loan subsidies (in aggregate and per student) will be estimated.

Aggregate loan subsidies, and loan subsidies per student, will be reported for different qualification levels under different ICL scheme options.

### **Uncertainties around the results**

Estimating the costs associated with income contingent repayments is subject to considerable uncertainty. Sensitivity analysis will be performed to illustrate how the cost estimates change when we vary assumptions about long-run income growth, student numbers, completion rates, loan levels (for fees and income support), and the government's cost of borrowing.

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