



NCSEHE

National Centre for Student
Equity in Higher Education



Curtin University

THE EFFECT OF THE 2014-15 FEDERAL BUDGET'S HIGHER EDUCATION PROPOSALS ON STUDENTS:

A focus on low-income graduates

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ERRATUM

In an earlier published version of this report, we presented findings from some preliminary modelling of the proposed changes to the HECS-HELP system. Unfortunately, the findings in that earlier version were based on a miscalculation of the HECS-HELP repayment rates, where the rates were entered in as *marginal* rates when they are, of course, *average* rates of repayment at given income levels. This had two effects: (i) *understating* the annual repayment obligation of students, and (ii) *overstating* the time required to repay a loan. As soon as this error was realised, the report was withdrawn so as not to mislead the debate, and in order for the modelling to be undertaken correctly.

This current report and its underlying modelling have been refereed and we are confident that the estimates generated are in line with our reported assumptions and findings.

We apologise for the errors in the earlier version and for any misunderstanding it may have caused.

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Executive Summary

The 2014-15 Federal Budget announced a number of significant proposed changes to higher education funding in Australia. This report examines the implications of these changes for domestic undergraduate students. These include:

- a cut, on average, of 20% in Commonwealth financial support for new student places from 2016
- allowing universities (from 2016) to set their own fees for students
- lowering the minimum income level at which students start paying back their student loan (HECS-HELP)
- changing how interest is calculated on a student's loan so that in future interest will be set at the Commonwealth 10-year Treasury bond rate, rather than the lower CPI figure.

Assuming these proposals proceed unchanged, we find the following:

1. If universities alter their student fees **only to maintain their current levels of total funding per student** (i.e. combining the government and student contribution), approximately one third of the undergraduate disciplines on offer would see fees for students increase by 10% or less. Almost half of undergraduate disciplines would increase costs to students by more than 15%, with engineering, science and social sciences requiring fee increases of more than 50%, while agriculture, medicine and veterinary science all require increases of more than 30%. Nursing and education fees will be required to increase by more than 15%.
2. However, it is probable that, under fee deregulation, most universities will increase their fees by more than the Commonwealth reduces its support. Combined with the new repayment schedule and method of calculating interest, this will see students experience higher levels of debt through HECS-HELP and, for many students, longer payback periods of that debt.
3. The proposals will have a detrimental effect on graduates experiencing extended periods of absence from or underemployment within the workforce, for example parenting or carer responsibilities, illness or injury, or unemployment during periods of economic downturn.

We note and welcome the decision by the Government to undertake further discussions with the higher education sector on the proposed changes and suggest consideration of the following recommendations which have particular relevance for low income students:

Recommendation 1

Charging interest on HECS-HELP only at CPI until a student graduates.

Recommendation 2

Varying the interest rate charged so that it is on a progressive scale, i.e. lower rates of interest for graduates on lower incomes and higher rates for those earning higher incomes.

Recommendation 3

Suspending interest charges on HECS-HELP loans for graduates experiencing specified periods outside the workforce (such as family or carer responsibilities) and/or situations of unemployment or underemployment.

Recommendation 4

Forgiving HECS-HELP debt after a defined number of years.

Recommendation 5

Ensuring an equitable distribution of the scholarships created under the proposals.

Introduction

The 2014-15 Federal Budget announced a number of significant proposed changes to higher education funding in Australia. These include:

- a cut, on average, of 20% in Commonwealth financial support for new domestic undergraduate student places from 2016
- allowing universities (from 2016) to set their own fees for domestic undergraduate students
- lowering the minimum income level at which students start paying back their student loan (HECS-HELP)
- changing how interest is calculated on a student's loan so that in future interest will be set at the Commonwealth 10-year Treasury bond rate, rather than the lower CPI figure.

Due to their potential impact on the cost of higher education to domestic students, these proposals have attracted significant attention and commentary. Most of it has focussed on how high domestic tuition fees might rise from 2016 and what effect this and the other changes will have on how long it will take students to pay back their loan.

This paper provides:

1. further detail on the current and proposed systems to allow useful comparisons to be made between the two
2. general guidance on how student debt will change under the proposed system, with a particular focus on the potential effects on low-income graduates
3. recommendations on how the proposed system might be changed, to lessen the effects it might have on post-graduation, low-income earners.

The paper has been released to allow sufficient time for it to be considered in discussions surrounding the Budget measures, as well as to encourage further discussion, research and analysis.

How the Commonwealth currently supports domestic undergraduate students

Under current arrangements in higher education, the level of funding provided to a university for teaching a student in a bachelor degree is determined by the Commonwealth, on an annual, per-student basis. This cost is then divided between the Commonwealth and the enrolling student. The student's share of the cost is determined by the broad discipline in which they are enrolled. Figure 1 reports the maximum annual cost of a degree that can be covered by a student for the eight current discipline funding clusters.

Figure 1: Current per annum funding rates for Commonwealth Supported Places (2014)

| Funding cluster | Discipline ¹ | Cost to Govt. | Cost to Student | Total | Student Share |
|-----------------|---|---------------|-----------------|----------|---------------|
| 1 | Law, accounting, administration, economics, commerce | \$1,951 | \$10,085 | \$12,036 | 84% |
| 2 | Humanities | \$5,419 | \$6,044 | \$11,463 | 53% |
| 3 | Mathematics, statistics, built environment, computing, other health | \$9,587 | \$8,613 | \$18,200 | 47% |
| | Behavioural sciences, social studies | \$9,587 | \$6,044 | \$15,631 | 39% |
| 4 | Education | \$9,974 | \$6,044 | \$16,018 | 38% |
| 5 | Clinical psychology, foreign languages, visual and performing arts | \$11,790 | \$6,044 | \$17,834 | 34% |
| | Allied health | \$11,790 | \$8,613 | \$20,403 | 42% |
| 6 | Nursing | \$13,163 | \$6,044 | \$19,207 | 31% |
| 7 | Engineering, science, surveying | \$16,762 | \$8,613 | \$25,375 | 34% |
| 8 | Dentistry, medicine, veterinary medicine | \$21,273 | \$10,085 | \$31,358 | 32% |
| | Agriculture | \$21,273 | \$8,613 | \$29,886 | 29% |

Source: Department of Education.

Note: Amounts assume Parliament will pass the proposed efficiency dividend, available at: <http://www.innovation.gov.au/highereducation/ResourcesAndPublications/Resources/Documents/Rates2014.pdf>

In all cases, the Government and the student share the cost of education; however the balance is different across degrees. For example, a three-year commerce degree costs about \$36,000, of which the student pays about \$30,000, meaning he/she covers more than 80% of the cost of education. A three-year agriculture degree costs about \$90,000, however the student only pays about \$25,000, less than 30% of the cost.

¹ Note that reference to a particular type of degree by discipline (e.g. Nursing, Science, etc.) assumes that all units of study that make up the degree are in that particular discipline. In reality, many degrees contain a mix of subjects in various disciplines (funded at different levels) and hence the cost of the degree may vary accordingly.

Longer degrees cost more. Engineering, for example, normally takes four years, so students pay over \$34,000 (\$8,613 a year), or 34% of the total cost of the degree.

The Government decides where to set the balance between the cost to student and to government by considering the cost of delivering the education and the perceived benefit to the student and the wider community.

The central feature of this system is price consistency: degrees across Australia in similar disciplines are funded at identical levels by government, which also sets a maximum fee that universities can charge students. Universities are in principle free to adjust fees up to the current cap, but in practice all charge at the maximum rate.

How the Commonwealth will support domestic undergraduate students under the new proposals

Under the Budget proposals, in 2016 the current eight funding clusters will be replaced by five funding tiers. On average, Commonwealth contributions will drop by 20%, though the exact percentage will differ across disciplines. Figure 2 shows the new tiers and amount of Commonwealth funding support. Figure 2 estimates the cost to the student **assuming universities raise or lower their fees to ensure no change to what they receive under the current system**. This is unlikely to be the case, but is the base assumption in estimating impacts on students from the Budget changes. In reality, it is not yet known how universities will respond in setting their fees. Some may raise them across the board; others may choose to vary the level of fee increase between disciplines, and some may reduce certain fees to remain competitive.

If this assumption of no change to existing costs per student per discipline were borne out, then roughly one third of the undergraduate courses on offer would see fees for students increase by 10% or less. This includes the Tier 1 disciplines of Law, Accounting, Economics and Commerce. However, the proposed freeing up of fees has led to suggestions that many of these high demand courses and the nature of higher education competition in general, will see many universities charging higher fees, even though government financial support for them remains relatively constant.²

Almost half the courses listed in Figure 2 would increase costs to students by more than 15%. Engineering, science and social studies require fee increases of more than 50% for total costs to remain the same; agriculture, medicine and veterinary science all increase by more than 30%; and nursing and education fees increase by more than 15%. The share of the total cost of a place borne by an engineering student increases from around a third (34%) currently, to over half (53%) the cost of the degree.

A small number of disciplines, such as mathematics and humanities will experience an increase in government support per place, suggesting that there is some flexibility for universities to reduce student fees in these disciplines.

² For instance, see: Gittins, R (2014) "Why 'competition' means university fees will rise", *Sydney Morning Herald*, 31 May.

**Figure 2: Proposed funding rates for Commonwealth Supported Places,
Per annum³**

| Funding Tier | Discipline | Cost to Govt. per annum | Cost to Student per annum ⁴ | Total per annum | Student Share | Change in cost to student from 2014 |
|--------------|------------------------------------|-------------------------|--|-----------------|---------------|-------------------------------------|
| 1 | Law | \$1,805 | \$10,231 | \$12,036 | 85% | +1% |
| | Accounting | \$1,805 | \$10,231 | \$12,036 | 85% | +1% |
| | Administration | \$1,805 | \$10,231 | \$12,036 | 85% | +1% |
| | Economics | \$1,805 | \$10,231 | \$12,036 | 85% | +1% |
| | Commerce | \$1,805 | \$10,231 | \$12,036 | 85% | +1% |
| 2 | Humanities | \$6,021 | \$5,442 | \$11,463 | 47% | -10% |
| | Social Studies | \$6,021 | \$9,610 | \$15,631 | 61% | +59% |
| | Communications (Exc. Audio-visual) | \$6,021 | \$9,610 | \$15,631 | 61% | +59% |
| 3 | Computing | \$9,033 | \$9,167 | \$18,200 | 50% | +6% |
| | Behavioural Science | \$9,033 | \$6,598 | \$15,631 | 42% | +9% |
| | Welfare Studies ⁵ | \$9,033 | \$6,598 | \$15,631 | 42% | +9% |
| | Education | \$9,033 | \$6,985 | \$16,018 | 44% | +16% |
| | Visual and Performing Arts | \$9,033 | \$8,801 | \$17,834 | 49% | +46% |
| | Built Environment | \$9,033 | \$9,167 | \$18,200 | 50% | +6% |
| | Other Health | \$9,033 | \$9,167 | \$18,200 | 50% | +6% |
| 4 | Mathematics | \$12,045 | \$6,155 | \$18,200 | 34% | -29% |
| | Clinical Psychology | \$12,045 | \$5,789 | \$17,834 | 32% | -4% |
| | Allied Health | \$12,045 | \$8,358 | \$20,403 | 41% | -3% |
| | Nursing | \$12,045 | \$7,162 | \$19,207 | 37% | +18% |
| | Engineering | \$12,045 | \$13,330 | \$25,375 | 53% | +55% |
| | Science | \$12,045 | \$13,330 | \$25,375 | 53% | +55% |
| | Surveying | \$12,045 | \$13,330 | \$25,375 | 53% | +55% |
| | Environmental Studies ⁶ | \$12,045 | \$13,330 | \$25,375 | 53% | +55% |
| 5 | Dentistry | \$18,067 | \$13,291 | \$31,358 | 42% | +32% |
| | Medicine | \$18,067 | \$13,291 | \$31,358 | 42% | +32% |
| | Veterinary Science | \$18,067 | \$13,291 | \$31,358 | 42% | +32% |
| | Agriculture | \$18,067 | \$11,819 | \$29,886 | 40% | +37% |

Source: <https://education.gov.au/public-universities> and NCSEHE calculations.

³ As a result of the restructure, it is possible that some courses, or units of study, will be reclassified.

⁴ This cost assumes that the university does not pass on the cost of setting aside \$1 out of every \$5 to fund scholarships, as required under the new proposals.

⁵ Assuming Welfare Studies was previously classified under Funding Cluster 3.

⁶ Assuming universities classify specific units of Environmental Studies as science (e.g. biology), which is in Tier 4, and not as social studies (e.g. sustainability studies), which is in Tier 2.

How the student loan (HECS-HELP) system currently works

Presently, students in bachelor degree courses have two options in regard to the payment of their university fees. They can pay their fees upfront and benefit from a 10% discount, or they can access a loan through HECS-HELP. Under HECS-HELP, students pay their fees through a loan from the Commonwealth on a unit by unit basis; in other words a student does not have to graduate with a degree to incur this debt. Alternatively, students can mix the two methods i.e. pay some of the cost upfront and use HECS-HELP for the remainder, combined with future voluntary repayments where they gain a further 5% discount on each repayment.⁷

The HECS-HELP system is an 'income contingent' loans scheme which originated in Australia in 1989 as HECS. Income contingent means repayments are dependent on the student's income in a given year after they leave university and bear no relation to the level of debt or interest on that debt. Under the scheme, students pay back the loan through the Australian taxation system once they commence employment at an income above the minimum repayment threshold for HECS. The student is charged interest on the balance of the loan, equal to the current rate of increase in inflation as measured by the consumer price index (CPI), which in recent years has generally been between 1.5% and 3.5%.⁸ Changes in debt do not affect the minimum (or threshold) rate of repayment, but instead, increase the number of working years required to pay off the debt at a given level of income. Students can of course pay off more than the minimum repayment rate at any time if they choose and are able to do so.

In effect, the balance of HECS debt currently grows at this level until the student finally pays off the loan through the HECS-HELP system via the Australian Taxation Office as part of a student's income tax assessment. Figure 3 shows the current HECS-HELP repayment thresholds and rates for 2014-15. The current minimum income after which HECS-HELP repayments are made is \$53,344, with the repayment rate being 4% of HRI⁹ for HRI levels up to \$59,421.

The repayment rate increases in 0.5% increments until it reaches 8% for all HRI income levels above \$99,070. In recent years, the repayment rate structure has remained reasonably constant over the 4.0% to 8.0% range, with the income levels defining the structure being raised annually to avoid bracket creep.¹⁰

⁷ An existing proposal to remove the 10% upfront discount and 5% voluntary repayment bonus is being considered by Parliament, with the Higher Education Support Amendment (Savings and Other Measures) Bill 2013 yet to pass the Senate.

⁸ Interest is charged during the student's studies as well as from the time of graduation. On 1 June each year indexation is applied to the part of an accumulated HELP debt that has remained unpaid for more than 11 months. Indexation is in line with changes in the cost of living as measured by the consumer price index (CPI). The indexation figure is calculated each year after the March CPI is released. It is based on financial figures collected by ABS over the previous two years. The rate for 2014 is 2.6%. See Australian Taxation Office (2013), *HELP Indexation Rates*, accessed at: <https://www.ato.gov.au/Rates/HELP-indexation-rates/>

⁹ HRI = HECS-HELP repayment income.

¹⁰ See Australian Taxation Office (2013) *HELP Repayment Thresholds and Rates*, accessed at: <https://www.ato.gov.au/rates/help-repayment-thresholds-and-rates/>

Figure 3: Current HECS-HELP repayment thresholds and rates (2014-15)

| HECS-HELP repayment income (HRI) | | HECS-HELP Repayment Rate |
|----------------------------------|----------|--------------------------|
| Lower | Top | |
| \$0 | \$53,344 | - |
| \$53,345 | \$59,421 | 4.0% |
| \$59,422 | \$65,497 | 4.5% |
| \$65,498 | \$68,939 | 5.0% |
| \$68,940 | \$74,105 | 5.5% |
| \$74,106 | \$80,257 | 6.0% |
| \$80,258 | \$84,481 | 6.5% |
| \$84,482 | \$92,970 | 7.0% |
| \$92,971 | \$99,069 | 7.5% |
| \$99,070 or more | - | 8.0% |

Source: Australian Taxation Office (2014), HECS-HELP repayment thresholds and rates, accessed at: <https://www.ato.gov.au/rates/help-repayment-thresholds-and-rates/>

The column on the right hand side reports HECS-HELP debt repayment rates for a given HRI bracket.

Note: HRI = Taxable income plus any total net investment loss (which includes net rental losses), total reportable fringe benefits amounts, reportable super contributions and exempt foreign employment income.

How long it takes to pay back the loan depends both on the level of debt the student has incurred and the salary they earn upon graduation. The higher the debt or lower the student's income, the longer it takes to repay – and vice versa.

Figure 4 below outlines a simplified example of how long it takes a student to repay a HECS-HELP loan of various sizes, under the current HECS-HELP system, after the student graduates. All examples are for the incurred HECS-HELP debt – with this debt already attracting interest before the student graduates. It assumes an interest rate equal to the current CPI increase of 2.6% that is applied to debt on an annual basis, commencing a year after it is incurred (on a semester basis – see footnote 7 above) and an income after graduation that is projected to grow at 3.5% per annum, allowing for real wage growth as well as the steeper incremental growth in income witnessed by young graduates as they become more productive.

A 2013 report from Graduate Careers Australia finds that new (bachelor degree) graduates see median wage increases of 32% over the first three years of entry into the workforce (2009 to 2012) or an average growth rate of 10%.¹¹ This equates to a growth in median salaries from \$50,000 in 2009 to \$66,000 in 2012. This also implies that half of graduates have average salaries below \$66,000 after three years in the workforce. To allow for these factors, we present fairly high starting salaries from \$60,000 with a steady rate of increase at 3.5% per annum.

Further, we assume that the HECS-HELP repayment brackets are indexed to wage growth such that bracket creep is eliminated. The results presented are for a relatively

¹¹ Graduate Careers Australia (2013) *Beyond Graduation: The Report of the Beyond Graduation Survey*, available at: <http://graduatecareers.com.au/wp-content/uploads/2013/04/Beyond%20Graduation%202012.pdf>

high salary for graduates – all above the minimum repayment threshold. Clearly, where graduates earn less than the minimum threshold level of \$53,344, they incur an interest charge which extends the time taken to repay their loan.

Figure 4 shows how these repayments affect outstanding HECS-HELP debt in terms of the number of years to pay off a loan. Students who never earn more than the minimum repayment threshold for HECS-HELP, never repay the loan, instead, it accrues interest at a rate equal to the CPI increase. These results confirm the relative ease with which most students repay their HECS-HELP loans if they are earning median salaries under current arrangements where starting debt is relatively moderate, usually between \$10,000 and \$ 30,000 for a degree (see Figure 1), and the interest rate equals the rate of increase in the CPI.

Figure 4: Years to repay HECS-HELP debt for a given debt level and starting salary, under current system

| Starting Salary | HECS-HELP Debt Incurred | | | | |
|-----------------|-------------------------|----------|----------|----------|----------|
| | \$10,000 | \$15,000 | \$20,000 | \$30,000 | \$50,000 |
| \$60,000 | 4 | 6 | 8 | 11 | 18 |
| \$70,000 | 3 | 4 | 6 | 8 | 13 |
| \$80,000 | 2 | 3 | 4 | 6 | 10 |
| \$90,000 | 2 | 3 | 4 | 5 | 8 |
| \$100,000 | 2 | 2 | 3 | 4 | 7 |
| \$110,000 | 2 | 2 | 3 | 4 | 6 |
| \$120,000 | 2 | 2 | 3 | 4 | 6 |
| \$150,000 | 1 | 2 | 2 | 3 | 5 |
| \$200,000 | 1 | 1 | 2 | 2 | 4 |

Source: NCSEHE Calculations.

Note: Under current arrangements, HECS-HELP debt is typically between \$10,000 and \$30,000 for a three year bachelor degree, with average HELP debt (all HELP loans including HECS) equal to \$16,800 in 2013-14.¹² This example assumes that the debt incurs a 2.6% per annum interest charge (equal to CPI for 2014), while income grows at 3.5% which includes both an allowance for CPI adjustments as well as a productivity increment.

The system allows for the possibility that students will earn relatively modest incomes after university. Repayment does not commence until a student's earnings exceed the threshold, while a student earning \$60,000 a year can repay a \$20,000 loan within 8 years.

However, when graduates earn less than the threshold amount or are not in the workforce, the debt continues to accumulate at a rate equal to CPI. Reasons for this occurring include working overseas; taking parental leave, unemployment or other absences from work due to illness or injury; or to undertake further training.

¹² See Australian Government (2014) *Commonwealth Budget 2014-15*, Department of Education Budget Statements 2014-15 Section 2 Outcome 3, p. 76. Data for HECS-HELP alone are not available.

As with any loan using compound interest, graduates who earn more and/or are able to make additional payments (especially early ones) will benefit the most. Those in low-income employment, or who take extended periods of absence from work, and are unable to make payments, are impacted the most.

How the student loan (HECS-HELP) system will work under the new proposals

Under the new proposals, the essence of the HECS-HELP system is retained. However the three factors that determine how long it takes debt to be paid off (i.e. size of debt, HRI levels and interest charged) will all change.

First, average HECS-HELP debt will probably increase. Media and educational stakeholder speculation to date has varied significantly about whether and by how much fees may rise. Estimates range from predicting average student debt being as low as \$30,000 to exceeding \$200,000 for certain degrees.¹³ International student tuition fees may provide some guidance: a recent study estimated that in 2013, annual fees averaged \$27,000 for international students in Australia,¹⁴ or \$81,000 for a three-year degree. If domestic fees rose to two thirds of the international student rate, then a three-year degree would incur a \$54,000 debt.

Second, the proposed minimum threshold for repayment will be lowered to \$50,638 in 2016-17. The effect of this change is to bring more graduates into a situation of making repayments.

Third, interest on the HECS-HELP loan will now be calculated using a rate equal to the 10-year Treasury bond rate (currently at 3.75%), capped at 6.0%, which will be higher than the current interest rate equal to the CPI. This change in interest implies that the interest charged on HECS-HELP debt will now always exceed the CPI, resulting in a faster increase in the compound growth of debt. By way of example, \$20,000 accruing at 2.6% will grow to \$29,393 after 15 years. That same \$20,000 accruing at the current 10-year bond rate of 3.75% will grow to \$34,742 over that period and at a bond rate of 5% it will grow to \$41,579 – effectively doubling in 15 years. So the new interest rate has the impact of increasing outstanding debt from the time it is first incurred and further lengthening the time it takes to pay back the loan.

As Figure 5 shows, the 10-year bond rate has consistently exceeded the inflation rate, as measured by the CPI. The average rate for bonds has been 5.21% over the last decade, while the CPI has averaged 2.73%, for an average gap over this period of 2.48 percentage points. This compares to a current differential of only 1.15 percentage

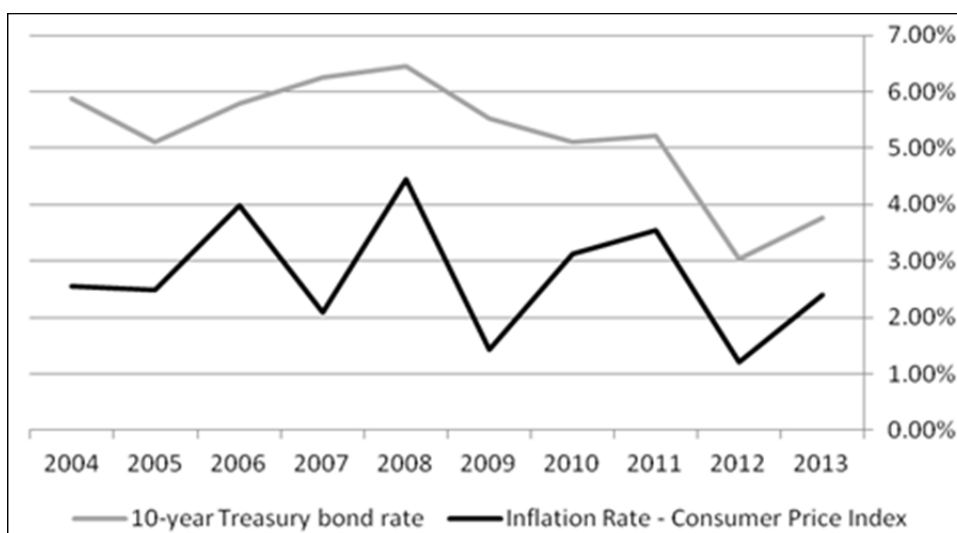
¹³ For predictions at the lower end see example, <http://andrewnorton.net.au/2014/05/19/higher-education-reform-clarifier-2-are-students-facing-100000-degrees/>
For predictions at the higher end see e.g. <http://www.dailytelegraph.com.au/news/nsw/universities-get-green-light-to-set-their-own-tuition-fees/story-fni0cx12-1226916595286>

Additional predictions can be found at http://www.nteu.org.au/1stdegree2ndmortgage/latest_news

¹⁴ Source: Study undertaken by HSBC Australia details at <http://www.hsbc.com.au/1/2/about/news/13/130813>

points. If the spread between the CPI and 10-year bond rate widens in future to a figure closer to the average experienced over the past decade, then the debt incurred for HECS-HELP loans will increase accordingly, and will be greater than the amounts estimated in the discussion below.

Figure 5: Comparison of CPI Inflation and the 10-Year Treasury bond rate, June, 2004-2014



Source: Australian Taxation Office (2014) – official estimates of the 10-year bond rate and consumer price index, www.ato.gov.au

How does the new system affect repayment? Figure 6 uses the same structure as Figure 4 (i.e. payback times in the current system) but factors in the proposed higher interest charges. The overall impact of these changes will be to push out payback periods for students at most levels of debt. The effects are mostly felt by lower-income earners and this effect will be magnified further if universities use fee deregulation to increase certain course costs in excess of \$50,000.

If these proposals are passed then, in general, the combination of higher starting loans and a higher interest rate will combine to increase the time needed to repay loans. The differences between the current and proposed system are slight when HECS-HELP debt is low and/or graduate income is high. For example, under the current system a graduate earning on average \$90,000-\$120,000 will be able to pay off a \$10,000 HECS-HELP debt in the same number of years under the proposed system. For any given level of debt, payback periods increase slightly for graduates with lower earnings. For example, a graduate with a commencing salary of \$60,000 will take an extra three years to pay back a \$50,000 debt, rising from 18 years to 21 years.

However, under the new system it is anticipated that the size of average student debt will increase, and this will impact on repayment times over and above (and in combination with) the increased interest rate charged on the debt. For example, a graduate with a \$15,000 debt earning \$60,000 currently takes 6 years to pay off the debt (Figure 4), but if that debt increases under a deregulated fees environment to \$30,000, then they would take 13 years to pay it off, a more than doubling in the

repayment time (see Figure 6). If much higher graduate fees (and debts) become more normal, then payback periods increase accordingly. Figure 6 includes a column for debts of \$75,000. Repayment times at this level range from as little as six years for someone earning \$200,000 in salary to as much as 31 years at \$60,000 in salary.

Figure 6: Years to repay HECS-HELP debt for a given debt level and starting salary, under proposed system

| Starting Salary | HECS-HELP Debt Incurred | | | | | |
|-----------------|-------------------------|----------|----------|----------|----------|----------|
| | \$10,000 | \$15,000 | \$20,000 | \$30,000 | \$50,000 | \$75,000 |
| \$60,000 | 4 | 6 | 8 | 13 | 21 | 31 |
| \$70,000 | 3 | 5 | 6 | 9 | 15 | 22 |
| \$80,000 | 3 | 4 | 5 | 7 | 11 | 16 |
| \$90,000 | 2 | 3 | 4 | 6 | 9 | 13 |
| \$100,000 | 2 | 2 | 3 | 5 | 7 | 11 |
| \$110,000 | 2 | 2 | 3 | 4 | 7 | 10 |
| \$120,000 | 2 | 2 | 3 | 4 | 6 | 9 |
| \$150,000 | 1 | 2 | 2 | 3 | 5 | 7 |
| \$200,000 | 1 | 1 | 2 | 3 | 4 | 6 |

Source: NCSEHE Calculations.

Note: This example assumes that the debt grows at 3.75% per annum and income and the repayment levels are constant over the repayment period.

Figure 7 shows how repayment times increase at higher interest rates. A student on a starting income of \$70,000 will take 13 years to pay off a debt of \$50,000 at the CPI rate (2.6%). At 3.75% the repayment time is 15 years. This rises to 16 years for a higher interest rate of 5%. The difference between the lowest and highest rate is three years. However for a \$75,000 debt, at 2.6%, the loan takes 15 years to repay, 22 years at 3.75% and 26 years at 5%. For a loan of \$100,000, it takes 25 years to repay at the 2.6%, rising to 29 years at 3.75% and 37 years at 5% - representing a 12 year difference between the lowest and highest rates.

Figure 7: Years to repay HECS-HELP loan for a given debt level for a student on an income of \$70,000

| Indexing/Interest Rate | \$50,000 | \$75,000 | \$100,000 |
|-------------------------|----------|----------|-----------|
| CPI = 2.6% | 13 | 19 | 25 |
| 10-YR Bond Rate = 3.75% | 15 | 22 | 29 |
| 10-YR Bond Rate = 5.0% | 16 | 26 | 37 |

Source: NCSEHE Calculations.

Conclusions and recommendations

Previous research indicates that, because of HECS-HELP, the cost of education does not necessarily deter Australian students from disadvantaged backgrounds from entering university.¹⁵ However in the current policy environment this research can become dated quickly, as it relates to relatively low levels of student debt, in comparison to what might occur under fee deregulation and the new interest charges.

We note that a period of consultation is already underway by the Government to seek comment on the Budget proposals. We further note that, if fee deregulation proceeds, the Government will not be responsible for determining future levels of student debt, since maximum domestic tuition fees will be set by individual universities. Accordingly, our recommendations below relate mainly to ameliorating the effects of how interest will be charged under the new proposals, which remains the purview of the Commonwealth. They will also help offset the negative effects of the projected higher debt levels when held by graduates earning lower incomes and/or experiencing periods of absence from the Australian workforce.

1. Charging interest on HECS-HELP at CPI until a student graduates

We recommend that while students are still studying, their debt should continue to incur interest at the rate of inflation. Once they graduate, the rate could then be lifted to the 10-year bond rate (or variations as recommended below). This would be fairer for students doing part-time study (which includes many equity students who work to help pay for their studies) or those enrolled in longer courses. As shown above in Figure 6, higher interest rates – with rates up to 6% being feasible under the proposed system – impact disproportionately on lower income graduates.

2. Varying the interest rate by income level to make it fairer for lower income graduates

Reducing the interest rate applied to the student loan at lower incomes would benefit people struggling with their HECS-HELP debt. The interest rate charged to high income earners could be increased to offset this adjustment. One suggestion has been for graduates earning below the repayment threshold to continue to just pay inflation (or less - for example, those earning up to \$60,000 could pay half the 10-year bond rate), with the full bond rate being applied on earnings above that. Students earning more than \$70,000 could be charged 150 per cent of the bond rate, rising to 200 per cent for those above \$100,000.¹⁶ However, detailed modelling should be conducted to determine the most equitable formula.

¹⁵ A concise review of the research is found in "Tuition fees and accessibility: the Australian HECS" by Hans Vossensteyn and Erik Canton, Centre for Higher Education Policy Studies: <http://doc.utwente.nl/85205/>

¹⁶ Gavin Moodie, in personal communication to NCSEHE and as quoted in Trounson, A. (2014). Reforms to HECS a 'heist on taxpayers' Retrieved 23 May 2014, 2014, from <http://www.theaustralian.com.au/higher-education/>

3. Suspending interest charges for specified periods and/or conditions of unemployment or underemployment

As with all compound interest schemes, the severity of its impact increases when payments stop or slow. For many Australians this will occur because of circumstances beyond their control (e.g., illness, injury) or for natural and socially-beneficial reasons (e.g. childbirth, parenting or other carer's duties).

Figure 8 shows the implications of time spent out of the workforce or on reduced salary in a graduate's first years of earning. For instance, a HECS-HELP debt of \$50,000 escalates to \$60,105 if a 5-year break from the workforce is taken, assuming a 3.75% interest rate, escalating to \$72,252 over ten years at the same rate of interest and workforce activity. A similar analysis applies to other debt levels and periods spent outside the workforce later in life.

Figure 8: Growth in HECS-HELP Debt: When graduate is out of the workforce for one, five or ten years upon graduation, at 3.75% interest rate

| Years Out of the Workforce | HECS-HELP Debt | | | | | |
|----------------------------|----------------|----------|----------|----------|----------|-----------|
| | \$10,000 | \$15,000 | \$20,000 | \$30,000 | \$50,000 | \$75,000 |
| 1 | \$10,375 | \$15,563 | \$20,750 | \$31,125 | \$51,875 | \$77,813 |
| 5 | \$12,021 | \$18,031 | \$24,042 | \$36,063 | \$60,105 | \$90,157 |
| 10 | \$14,450 | \$21,676 | \$28,901 | \$43,351 | \$72,252 | \$108,378 |

Source: NCSEHE Calculations.

In circumstances of unavoidable absence from the workforce, the individual should not be punished by having his or her interest accumulate during this period. This exemption could also apply to individuals experiencing under- or un-employment due to economic downturn, where they are making all reasonable efforts to seek employment or are undergoing retraining or skilling.

4. Forgiving HECS-HELP debt after a defined number of years

Another suggestion is that the Commonwealth might consider forgiving HECS-HELP debt after some prescribed time, such as 15 years. This would reduce the impact of interest compounding in loans likely to take longer than this at various income levels, as marked in green in Figure 9 below. As Figure 9 demonstrates, such a policy would likely only apply to relatively significant debts owed by lower income earners (for instance, a debt of \$50,000 or more for someone earning \$70,000, while a graduate earning \$80,000 would only see this policy applied on debts of more than \$75,000).

Figure 9: Forgiveness or Freezing of HECS-HELP Debt: Level of debt that might be forgiven, under proposed system

| Starting Salary | HECS-HELP Debt | | | | | |
|-----------------|----------------|----------|----------|----------|----------|----------|
| | \$10,000 | \$15,000 | \$20,000 | \$30,000 | \$50,000 | \$75,000 |
| \$60,000 | 4 | 6 | 8 | 13 | 21 | 31 |
| \$70,000 | 3 | 5 | 6 | 9 | 15 | 22 |
| \$80,000 | 3 | 4 | 5 | 7 | 11 | 16 |
| \$90,000 | 2 | 3 | 4 | 6 | 9 | 13 |
| \$100,000 | 2 | 2 | 3 | 5 | 7 | 11 |
| \$110,000 | 2 | 2 | 3 | 4 | 7 | 10 |
| \$120,000 | 2 | 2 | 3 | 4 | 6 | 9 |
| \$150,000 | 1 | 2 | 2 | 3 | 5 | 7 |
| \$200,000 | 1 | 1 | 2 | 3 | 4 | 6 |

Source: NCSEHE Calculations and based on Figure 6.

5. Ensuring an equitable distribution of the scholarships created under the proposals

The new financing arrangements for higher education will allow for the generation of substantial levels of new funding for scholarships within the higher education system. Specifically:

“Higher education providers will be required to direct 20 per cent of the additional revenue raised to Commonwealth Scholarships, supporting access for disadvantaged students. This will deliver participation initiatives including scholarships and bursaries... It will also provide other support, including outreach activities, assistance with the costs of living and fee exemptions.”¹⁷

Scholarships have great potential; for example, a system of even partial scholarships has the impact of shifting repayment schedules for low income students. For instance, in Figure 9 above, a tuition scholarship which reduces fees by half will see the repayment time for a \$20,000 loan for someone earning \$60,000 fall from 8 years to 4 years (equal to the repayment time for a \$10,000 loan), with similar falls for larger loans. In effect, this represents debt forgiveness at the start of the loan, with the reduction in payment occurring from that point before compounding becomes a factor.

Under the proposed changes, the individual scholarships will be developed and administered by the universities who pay for them. This means that those universities who have the ability to raise fees higher than others will be able to offer more, or more valuable, scholarships.

¹⁷ From the *Higher Education Budget Statement*.
http://www.budget.gov.au/2014-15/content/glossy/education/download/Budget_Glossy_education_web.pdf

On the one hand this is positive: as Figure 10 below shows, the more elite the university, the less accessible it tends to be for disadvantaged students. More scholarships in these institutions, therefore, would possibly increase opportunities for disadvantaged students where they are needed the most.

On the other hand it has the potential to negatively impact (for example) the regional universities, who will be unlikely to be able to set their fees high enough to match the scholarships offered by the richer universities in the capital cities. This might increase the trend of younger students away from the regions. There is also the possibility that some universities might use the new scholarships scheme to subsidise current programs rather than create additional ones.

Figure 10: Representation of Indigenous and low-SES students in Australian universities (by group)

| University group/Alliance | Indigenous students | Students from a low-SES background |
|-------------------------------|---------------------|------------------------------------|
| Group of Eight universities | 0.7% | 8.7% |
| Regional Universities Network | 2.3% | 27.6% |
| Sector Average | 1.4% | 15.5% |

Source: Using 2012 equity data from www.innovation.gov.au/highereducation/HigherEducationStatistics

Note: Figures are for all domestic undergraduate students, as a percentage of all students. Low SES student calculation derived from the SA1 measure.

Administratively, a crucial aspect of the scholarships initiative is to ensure that the identification of eligible equity students is fair and transparent, and not subject to gaming by either students or institutions. We recommend that consideration be given to having an equity scholarships scheme administered by the Commonwealth, with a loading in equity places going towards the universities that generate greater income through fee deregulation. Having one scheme should lower system overheads, and will ensure that the universities raising the most money will still gain the greatest benefit, which they can direct towards improving access for disadvantaged students. At the same time the scholarships can be managed more efficiently by the Government, allowing for greater transparency as well as strategic targeting of support where it is needed the most.

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