

## Legislation for a demand-driven system

July 2011

### Introduction

One of several important pieces of higher education legislation in Parliament in 2011 is the *Higher Education Support Act Amendment (Demand-Driven System and Other Measures) Bill*. As its title makes clear, this Bill is intended to bring into effect the Government's commitment (announced in March 2009) to uncap the supply of Commonwealth-supported places (CSPs) in universities, as recommended by the Bradley Review. The Bill qualifies the commitment, by setting up mechanisms to limit growth in places and Commonwealth spending, should this become necessary in the future. The Group of Eight (Go8) – like other higher education stakeholders – views this as sensible public policy. Proposed changes will contain the future fiscal impact of growth in the system and reduce incentives to badly planned growth. While the Government's decision not to proceed with a fully uncapped system is welcome, the approach set out in the Bill continues to rely completely on the public university sector to accommodate growth in demand at common funding rates. A more effective policy framework would adopt Bradley's further recommendations to open access to CSPs to a wider range of providers, and would reconfigure both Commonwealth and student contributions to provide for flexibility, choice and value for the student's and the Government's dollar.

### Policy intent and design

The Bradley Review's recommendation that CSPs should no longer be subject to Government-imposed caps, but should be allocated on the basis of student demand was and is part of a broader agenda to increase higher education participation significantly. The 40 per cent Bachelor degree attainment for the 25-34 year old age group is the clearest expression of this goal. The target is based on comparison with international averages, rather than on an assessment of the needs of the Australian economy, levels of Australian student demand or the capacity of the Australian higher education sector to deliver the goods. While the logic of the target was that a more educated population is needed to compete in a global knowledge economy, the policy response was largely silent on the kind of skills and qualifications that would be needed. Current funding incentives might suggest that expansion towards the target would be in low cost 'chalk and talk' subjects, especially where the ratio of revenue to costs was relatively favourable (e.g. Business).

Uncapping CSPs also fit into Government rhetoric about reducing Government intervention in the higher education sector, and allowing institutions and students to make decisions about the most appropriate patterns of supply.

### Problems with a fully uncapped system

An open-ended commitment to fund unlimited growth in CSPs would be fiscally unsustainable.

Government underestimated likely growth in a fully demand-driven system with an open-ended commitment to Commonwealth funding because domestic participation growth had been relatively flat for much of the 2000s, and 'unmet demand' for places was low. Between 2002 and 2008, domestic undergraduate enrolments grew 6.8 per cent at an average of 1.1 per cent year, compared to 4.7 per cent in 2009 alone<sup>1</sup>. Over the period 2002 to 2008, the number of applicants for domestic undergraduate places fell by 3 per cent, and 'unmet demand' roughly halved<sup>2</sup>.

<sup>1</sup> DEEWR Higher Education Statistics Collection, Student Statistics, various years

<sup>2</sup> DEEWR (2011), *Undergraduate Applications, Offers and Acceptances 2010*, Table A1.1, [www.deewr.gov.au/HigherEducation/Publications/HEReports/Pages/UndergraduateApplications2010.aspx](http://www.deewr.gov.au/HigherEducation/Publications/HEReports/Pages/UndergraduateApplications2010.aspx)

However, flat demand occurred in the context of a system where supply was constrained. As the last two years have shown, the situation changes once supply constraints are relaxed, to be removed, and universities start recruiting students more actively and on a bigger scale. As Ministerial press releases have pointed out, domestic undergraduate enrolments have risen by 80,000, compared to 2007, while postgraduate CSPs have doubled<sup>3</sup>.

Compared to 2009 Budget estimates, the 2010 Budget papers revised forecast undergraduate EFTSL upwards by nearly 30,000 per year over the forward estimates<sup>4</sup>. The 2011-12 Portfolio Budget Statement revised the forecasts upwards again: by 13,000 in 2011-12 and around 19,000 in the out years<sup>5</sup>.

In dollar terms, these revisions represent increases in budgeted CGS funding of half a billion dollars in 2011-12, and nearly \$800 million in 2012-13, compared to 2009 estimates. In percentage terms, the increase in budgeted CGS funding is 10 per cent in 2011-12, rising to 15 per cent in 2012-13.

An earlier analysis by the Go8 found that the annual additional cost to the Commonwealth (compared to 2008 CGS funding levels) of absorbing the likely increase in demand at current funding rates would be \$2.5 billion (in constant 2011 dollars) by 2030, or \$3.1 billion to maintain SSRs at 2008 levels<sup>6</sup>.

A fully uncapped system, under current funding arrangements, would threaten to offer some fairly perverse incentives to universities. For a start, where funding is inadequate to support teaching, scholarship and base research, universities are encouraged to expand enrolments simply to gain access to increased funds. This is likely to exacerbate current problems of high student-staff ratios and inadequate infrastructure. While new infrastructure funding is available through the Education Investment Fund (EIF), there is no longer earmarked funding for general capital and maintenance costs, so expansion at current funding rates could be expected to worsen problems of deferred maintenance and overcrowding.

More worryingly, a fully uncapped funding system, without reforms to ensure an adequate funding rate, is likely to encourage recruitment of more students without regard for the educational needs of the students themselves or the country as a whole. It is likely that a large influx of less prepared students without a significant increase in learning support, would lead to increased attrition rates<sup>7</sup>. Large numbers of students would fail to complete degrees or otherwise benefit from university study, but universities would still receive additional funding for the increased volume of enrolments.

At the same time, a fully uncapped system may – over time – have come to threaten the viability of some smaller institutions (e.g. some regional universities), as well as some fields of education with low enrolments and/or high costs. There would have been little protection for such institutions and fields if unconstrained (and undirected) growth had received a guarantee of Commonwealth funding.

It is doubtful that even a fully demand-driven system would have brought about as big a change in the interaction of demand and supply as the original policy rhetoric seemed to suggest. Universities are not (and cannot be) set up and operated in a way that allows large-scale redeployment of resources from year to year in response to changes in demand. Institutional investment in staff, plant, equipment, buildings etc would delay responses to changes in demand. Secondly, the proposed system deregulated volume only. Price remained fixed, and fixed at levels which were not necessarily related to the cost of delivering specific programs (to say nothing of the inadequacy of funding rates overall).

<sup>3</sup> Senator the Hon Chris Evans, media release, 4 July 2011, '100,000 additional university places delivered by Gillard Government's reforms', [www.deewr.gov.au/Ministers/Evans/Media/Releases/Pages/Article\\_110704\\_100603.aspx](http://www.deewr.gov.au/Ministers/Evans/Media/Releases/Pages/Article_110704_100603.aspx)

<sup>4</sup> Group of Eight (2010), *Backgrounder 10 Future Demand for Higher Education in Australia*, [www.go8.edu.au/university-staff/go8-policy-\\_and\\_-analysis/2010/go8-backgrounder-10-future-demand-for-higher-education-in-australia](http://www.go8.edu.au/university-staff/go8-policy-_and_-analysis/2010/go8-backgrounder-10-future-demand-for-higher-education-in-australia)

<sup>5</sup> DEEWR (2011), Portfolio Budget Statement, Outcome 3, Table 2.3.1, [www.deewr.gov.au/Department/Budget/Documents/20112012/2011-2012\\_DEEWR\\_PBS\\_05\\_Outcome\\_3.pdf](http://www.deewr.gov.au/Department/Budget/Documents/20112012/2011-2012_DEEWR_PBS_05_Outcome_3.pdf)

<sup>6</sup> Group of Eight (2010), *Backgrounder 14 Higher Education Financing*, [www.go8.edu.au/university-staff/go8-policy-\\_and\\_-analysis/2010/go8-backgrounder-14-higher-education-financing](http://www.go8.edu.au/university-staff/go8-policy-_and_-analysis/2010/go8-backgrounder-14-higher-education-financing)

<sup>7</sup> See for example Julie McMillan (2005), *Course Change and Attrition from Higher Education*, LSAY Research Report no. 39, ACER, Camberwell, p.30

## The Amendment Bill

For the reasons listed above, a funding system that fully uncapped volume and left funding rates and prices untouched – as originally proposed – would have had negative consequences for the Commonwealth Budget, for students, for the labour market, and ultimately for universities. The funding system set out in the *HESA Amendment (Demand-Driven System and Other Measures) Bill 2011* makes significant changes to the policy design and is a real improvement.

## Designated and non-designated courses of study

The Bill divides courses of study into ‘designated’ and ‘non-designated’ courses. Demand-driven funding applies only to ‘non-designated’ courses (though non-designated courses are potentially subject to ‘maximum basic grant amounts’).

CSPs in designated courses will continue to be allocated by the Minister. Designated courses are non-research postgraduate courses, undergraduate courses in Medicine, and other courses that the Minister designates by legislative instrument.

The explanatory memorandum gives some examples of reasons why the Minister may designate courses, namely, to avert over-supply of graduates in particular fields, and to restrict the number of places available in fields where study includes a clinical placement or practicum, but where not enough placements are available.

## Maximum basic grant amounts

Non-designated places are essentially ‘demand-driven’. However, the Bill does not commit Government to fund non-designated places without limit. Rather, the Bill allows Government to freeze funding for non-designated places if growth is excessive in the aggregate or if growth moves in directions with which Government is uncomfortable. The mechanism for doing this is a ‘maximum basic grant amount’, which Government may choose to specify in an annual funding agreement with a given university. It will be a matter for the Minister to decide when either the overall scale of growth or where it occurs has moved beyond what Government is prepared to fund. Government has indicated that this is a safeguard for use in unforeseen circumstances in the future. There is no intention to use this power in the immediate term.

There are separate maximum basic grant amounts for designated and non-designated courses.

For non-designated courses, the maximum basic grant amount for the grant year must not be less than the maximum basic grant amount specified in the provider’s funding agreement with the Commonwealth for the previous year, or (if no maximum basic grant amount had been specified in the previous year’s funding agreement) the total value of CSPs provided in non-designated courses of study in the previous year.

For designated courses, the maximum basic grant amount must not be less than the total value of CSPs in designated courses of study allocated to the provider.

## A limited demand-driven system

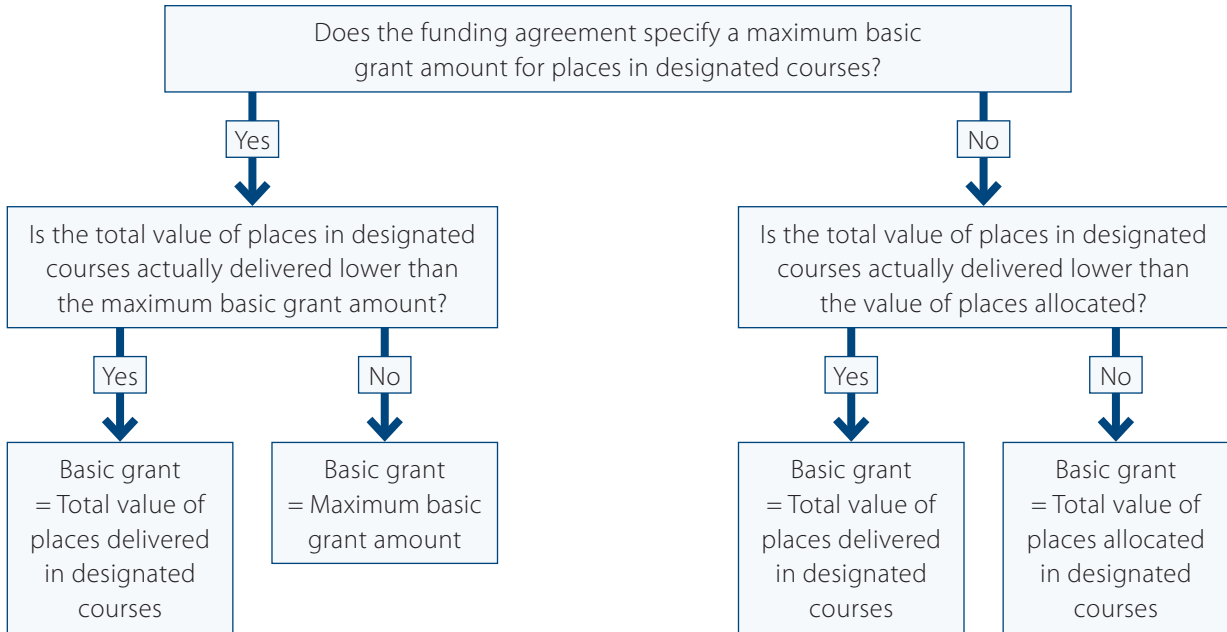
Taken together, these measures will set up a limited demand-driven system. The ‘reserve powers’ which the Bill makes available to Government are reasonable limitations and safeguards. While large-scale expansion of enrolments – even without any improvements to base funding – will inevitably be costly, the power to set a maximum basic grant amount limits the capacity for excessive impact on the Budget. Similarly, the power to limit growth, and to supervise growth by course, limits the risk of adverse consequences which could arise from reckless expansion of enrolments without regard for students’ educational needs and universities’ capacity to deploy staff and infrastructure to teach a larger body of students.

## Basic grant amounts

The Amendment Bill sets new rules for calculating the basic grant amount for a provider. There are separate amounts for designated and non-designated courses, which are calculated separately and then added together to form the total basic grant. Two flowcharts below show how basic grant amounts are calculated.

For **designated courses**, the basic grant amount is the lower of:

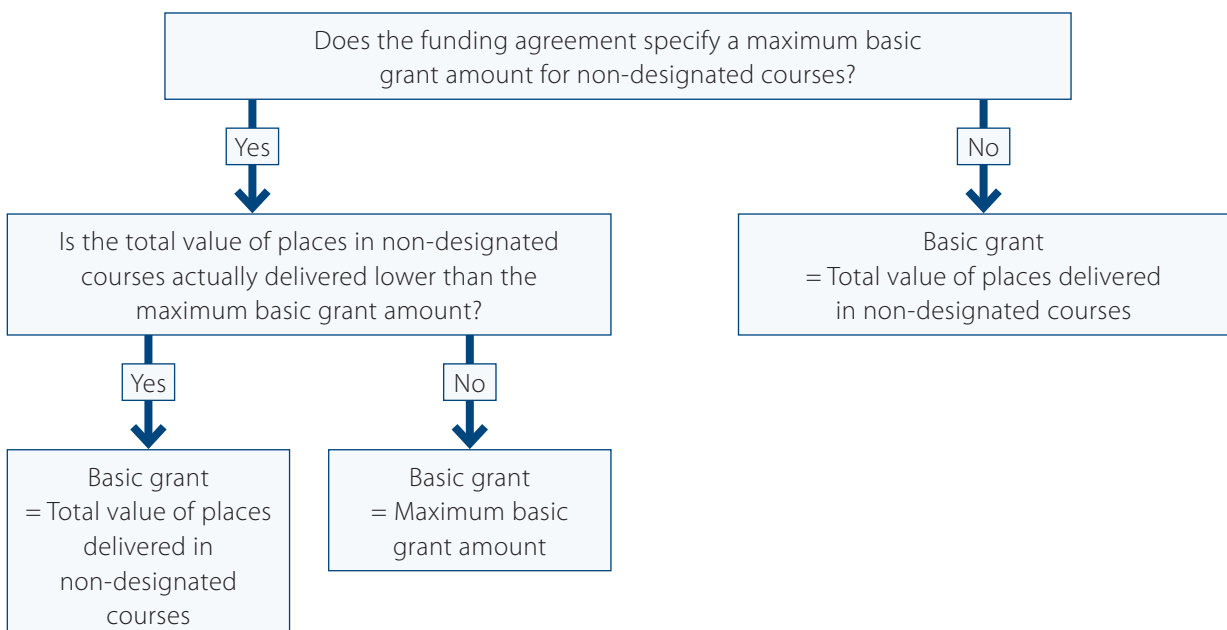
- total value of CSPs in designated courses actually provided;
- the maximum basic grant amount for designated courses specified in the funding agreement, or if no maximum was specified, the total value of CSPs allocated in designated courses.



For **non-designated courses**, the basic grant amount is the lower of:

- the total value of CSPs in non-designated courses actually provided;
- the maximum basic grant amount for non-designated courses specified in the funding agreement.

If no maximum basic grant amount for non-designated courses is specified, then the basic grant amount is the total value of CSPs in non-designated courses actually provided, as per the first dot point above.



## Transitional arrangements for postgraduate coursework places

As explained above, the Amendment Bill makes CSPs in postgraduate coursework designated places. This is an interim arrangement, pending development of policy for allocation and funding of postgraduate coursework places in the longer term.

In 2012, total funding available for CSPs in postgraduate coursework will be equal to funding for actual CSP load in 2011, plus funding for 'pipeline' (i.e. continuing enrolments) for postgraduate CSPs allocated in 2011. While there were some successful applications for upwards variations in postgraduate load profile in 2011, DEEWR has indicated that funding for such variations will be more limited from 2012 through the period in which interim arrangements apply. However, Government may approve increases to allocations for postgraduate coursework – provided that funds are available – where a postgraduate coursework award is, or is 'moving towards' being an entry level qualification for a profession, where the award meets 'an identified need in an area of skills shortage', or where it is of 'national significance'. It is not yet clear how these concepts will be operationalised<sup>8</sup>.

While these are only transitional arrangements, it is helpful for universities to have a degree of clarity on the criteria for Commonwealth funding of postgraduate coursework places. Of course, the Review of Higher Education Base Funding is considering the proper scope of Commonwealth funding for postgraduate coursework, and the proper rate of funding for such courses, and is expected to make recommendations to Government on these questions when it reports in October.

DEEWR will also release a consultation paper and conduct discussion forums to seek stakeholders' views on Commonwealth funding for postgraduate coursework places. DEEWR aims to make recommendations to the Minister in November.

## Advantages and disadvantages of the proposed new arrangements for universities

The advantages for Government (and the taxpayer) of the system proposed in the Amendment Bill over the open-ended demand-driven system discussed from 2008 onwards are clear, and have been discussed above. The system envisaged in the Amendment Bill also has significant advantages for universities over both a fully uncapped system and the centrally allocated system that has prevailed up to now.

The demand-driven elements of the system will make it easier for universities to be flexible with their course offerings and align their offerings to student demand. It will be easier for universities to move CSPs between disciplines. Universities will have more autonomy to vary the mix of places offered in accordance with their operational priorities and budgetary strategy. Rules for maximum funding for designated places, and – should they ever be set – for non-designated places, set a floor on Commonwealth funding. Up to now, it has been possible for the Commonwealth to reduce CGS funding by allocating fewer places. This will not be possible under the new system, as set out in the Amendment Bill. Finally, exercise of reserve powers to designate courses under the amended Act – while characterised by open-ended and poorly defined rules – will be by means of a disallowable legislative instrument, providing a level of scrutiny and protection. Similarly, maximum basic grant amounts for non-designated places will be set through funding agreements, so will be part of a bigger negotiated agreement between Government and universities.

However, the proposed arrangements also involve some disadvantages for universities, when combined with other elements of the higher education policy agenda framework.

First, the lack of any guidelines around the possible introduction of maximum basic grant amounts for non-designated places limits predictability for universities. It is possible that a university's growth and mission could be interrupted suddenly and without much warning or explanation, for example, under a new Minister (or new Government) with different ideas and budget priorities.

Second, limits on designated places mean that strong growth in enrolments in (Commonwealth-supported) coursework postgraduate places has been halted, posing strategic dilemmas in the short term for universities that have been seeking to grow enrolments at this level.

<sup>8</sup> Letter from David Hazlehurst, then Group Manager, DEEWR Higher Education Group, to Vice-Chancellors, 24 May 2011

Third, while legislative instruments designating courses of study will be subject to Parliamentary scrutiny, it is of concern that there are no guidelines on the circumstances in which the Minister may designate courses or the criteria for such designation.

Fourth, it is not clear that the power to designate courses would enable preservation of important fields of scholarship where student demand is low (e.g. Physics or Classics). Neither, for that matter, is it clear that intervention would support skills supply in skills shortage fields, since providers will only be funded for places actually delivered, regardless of the number allocated.

Fifth, maximum basic grant amounts are not indexed, meaning that total funding will decline in real value over time.

Sixth, universities will be operating in a more constrained regulatory environment. Table 1 shows regulatory requirements on universities before and after the Government's round of reforms.

**Table 1. The regulatory environment for Australian universities – before and after reforms**

As at end 2010	Likely position at end 2012
Annual funding agreement allocates CSPs	Annual funding agreements allocate CSPs in designated courses (medical, coursework postgraduate)
	Ministerial power to designate other courses – extending the scope of funding agreements
Learning and Teaching Performance Fund (LTPF) rewards excellent and improving performance in learning and teaching ex post	Compacts set a broader range of performance funding targets – for improvement, not excellence – ex ante: <ul style="list-style-type: none"> <li>• Equity targets</li> <li>• Student experience targets (CEQ; UES)</li> <li>• Learning outcomes targets (CEQ; CLA)</li> <li>• Detailed research and research training targets</li> </ul>
Quality audit every 5 years – can recommend improvements where necessary	Universities must be re-registered by TEQSA every 7 years
Quality assurance based on 'fitness for purpose' principle	Regulation based on 'fitness of purpose' and mandated national standards
National Protocols describe attributes of providers and courses	Provider standards (based on National Protocols) become legislative instruments
Australian Qualifications Framework describes typical attributes and nomenclature of awards	Qualifications standards (based on revised Australian Qualifications Framework) becomes a prescriptive legislative instrument
Academic standards are a matter for academic professional judgement; audited on a 'fitness for purpose' basis	Academic standards (teaching & learning, research) mandated by Government as legislative instruments; regulation on a 'fitness of purpose' basis
Courses in priority areas cannot be closed without Ministerial approval	Courses in priority areas cannot be closed without Ministerial approval
Allocation of research bloc grants based on various indirect quality indicators	Research performance assessed by ERA: research bloc grants allocated on the basis of ERA results
	SRE using Transparent Costing moderator to allocate funding for differing indirect costs

It is interesting to note that the main argument for a more interventionist, national regulator in the higher education sector was that stronger Government-backed oversight would be needed to maintain quality and prevent unscrupulous provision in a completely deregulated system. Now that the Government's HESA Amendment Bill proposes significant powers to oversee and intervene in the system, it may be questioned how much the rationale for TEQSA's powers applies to public universities. Fortunately, the final design of TEQSA, now enshrined in legislation, guarantees universities' autonomy.

## What next?

The *Higher Education Support Act Amendment (Demand Driven System and Other Measures) Bill* sets reasonable and balanced foundations for growth in public universities over the next few years. It is unlikely in the medium term, however, that Government will be able to achieve its participation and equity goals through expansion in public universities alone. The TEQSA provider category standards make it clear that all universities must do research, and even 'universities of specialisation' and 'university colleges' must be research active, though in a narrower range of fields. Research universities are the most expensive form of higher education provision. TEQSA standards have ruled out teaching-only universities, and have not sought to delineate other provider types such as polytechnics or liberal arts colleges. So far, it appears that all growth will have to be accommodated in the highest cost providers.

The sheer numbers of new students entering the system from the middle of the current decade as the youth population grows, combined with the much broader variety of students in terms of background, interests and academic preparation mean that it will not be possible to rely on already stretched public universities to accommodate all of the growth. A bigger student body will need a bigger system and a more diverse student population will need a more diverse range of courses, teaching styles and provider types. The very logic of opening up the system to demand implies the need to deregulate supply also, in order to meet this demand.

The Australian Council for Private Education and Training (ACPET) has suggested that private HEPs can teach undergraduates for 25 per cent less than current university base funding rates<sup>9</sup>. TAFEs are increasingly active in Bachelor degree provision, and offer another lower cost model of supply. TAFEs are spread widely across the country, including in regions where higher education provision is limited. In addition to their geographic accessibility, TAFEs can be more accessible to students whose prior educational attainment does not truly reflect their academic potential, as well as many students from demographics traditionally under-represented in higher education. TAFEs offer a diversity of pathways which can boost participation in a cost-effective way. TAFEs represent a significant sunk investment (of both Commonwealth and State/Territory funds). It would be sensible to leverage this investment to further advance the participation agenda.

Finally, allowing universities more freedom to set student contributions would help to cover costs and align demand and supply. Strengthening the role of other provider types would encourage competition and provide greater choice for students.

A more diverse and competitive higher education environment can widen participation further, contain costs to Government (and students) and encourage further development of accessible educational pathways.

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<sup>9</sup> Martin Cass (2011), 'Best funding is student-driven', *Australian Financial Review*, 27 June 2011