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Source: *The Economic Journal*, Vol. 107, No. 442 (May, 1997), pp. 738-751

Published by: Wiley on behalf of the Royal Economic Society

Stable URL: <https://www.jstor.org/stable/2957798>

Accessed: 11-12-2018 05:14 UTC

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CONCEPTUAL ISSUES AND THE AUSTRALIAN EXPERIENCE WITH INCOME CONTINGENT CHARGES FOR HIGHER EDUCATION*

Bruce Chapman

I. INTRODUCTION

Seven years ago the Australian government introduced its first substantial charge for university tuition since fees were abolished in 1974.¹ While university fees are commonplace elsewhere, the scheme has a feature which made it unique internationally at the time: payment of the student's obligation is income contingent. The Higher Education Contribution Scheme (HECS) was a defining and radical policy decision that has influenced permanently how higher education financing is thought about in Australia, and possibly in many other countries.

HECS was a response to a combination of forces, most of which are familiar elsewhere. First, the government was faced with the prospect of a burgeoning demand for higher education services financed almost solely from general taxation. A demographic bulge and rapidly increasing high school retention rates meant it was clear that pressures were emerging for a considerable expansion in the number of university places.

Second was the widely held view that having a higher education system financed almost completely from tax revenue was regressive in income distribution terms. In the view of some, this was the most regressive and hardest to justify of all public expenditure.

Third, the 1980s was a period of considerable fiscal parsimony that had led, and continues to lead, to a questioning of the rationale for government spending in even the most well established areas of the public sector.

In combination these factors implied the inevitability that the then Labor government would impose a direct financial obligation on the consumers of university services. However, HECS' defining feature – income contingent repayment – was a response to a fourth imperative: the fundamental importance of not erecting financial barriers to participation in higher education for the economically disadvantaged.

While the rationale for this type of policy is convincing, a national scheme using the tax system as the collection agency was without precedent. Thus

* The paper draws on both Chapman (1996a) and Chapman and Smith (1995). The author wishes to thank Tony Salvage, Stephanie Hancock, Damian Smith, and an anonymous referee. Nicholas Barr and David Stager have been inspirational in this area of economic policy. None of the above necessarily agrees with what follows.

¹ Following the recommendation of the committee set up to consider financing options for higher education, chaired by Neville Wran. See *Financing Higher Education*, Australian Government Printing Service, 1988. Bruce Chapman was a consultant to the Committee.

HECS can be seen to be the birth of income contingent repayment of university tuition charges and consequently plays a special part in the history of higher education financing.

With the Dearing Inquiry into Higher Education set to report to the United Kingdom government in the northern summer of 1997, the time is opportune to review alternative funding models for universities. There are now enough data and evidence to allow some confident conclusions to be drawn concerning the effects of HECS, and from these some assessments can be offered on the potential for such a model to be useful in the United Kingdom and other countries.

II. THE CONCEPTUAL BASIS OF HECS

II.A. *HECS Described*

In 1996 all Australian undergraduate students were charged a uniform \$2,442² for a full-time year of higher education study, with there being pro-rata charges for students studying part-time. This is about 23 % of the public sector direct outlays for an average full-time student, although teaching costs differ considerably between subjects.³ Universities do not have any discretion over the level of the charge or the rules under which it is paid.

The fact that HECS in 1996 is a uniform charge is worthy of comment. The Wran Committee's report suggested that there should be three levels of charge (reflecting teaching costs) in which the most expensive charge was to be twice as high as the cheapest. In the end the government did not take this up, offering as a justification the alleged administration costs of having differential charges.

The arguments for having charges which reflect the differential costs of the system to the taxpayer remain strong; HECS, after all, is fundamentally a cost recovery scheme. Of some interest is that the new government has recently announced a forthcoming change to the uniform regime with the introduction of differential HECS charges for the 1997 academic year. The new arrangements, however, are not consistent with a pure cost recovery model (see Section VI).

The 1996 HECS parameters mean that a typical student completing a four-year degree in the minimum time will have incurred a debt of \$9,768. The debt is indexed to inflation, meaning that it has a real interest rate of zero.

HECS can be paid on enrolment with a discount of 25 % (implying a full-time annual up-front charge of \$1,832), or deferred until students are earning at least the current average taxable income of Australians working for pay (\$27,675 per annum in 1996). The vast majority of students choose to postpone payment with the charge being collected through the tax system at different rates depending on annual taxable (indexed) income, now described in Table I.

² At the current exchange rate this is equivalent to about £1,200, or around \$US1,900.

³ Medicine, for example, costs about five times as much to teach as Law, Accounting and general Arts subjects.

Table 1
HECS 1996 Repayment Rates

Taxable income	Annual repayment rate (%)	Annual repayment at minimum threshold
\$27,675–31,449	3	\$830.25
\$31,450–44,029	4	\$1,258.00
\$44,030 or more	5	\$2,201.50

Source: HECS Your Questions Answered, Australian Tax Office, 1996.

The economics of education was the guiding framework in Australia for the introduction of HECS. The essential arguments from this perspective now follow.

II.B. *The Case for a Charge*

Private Benefits

The benefits of higher education accrue to both individuals and to society. For individuals they take the form of personal, cultural, and economic rewards, with there being little doubt that graduates enjoy substantial income advantages over non-graduates. Lifetime incomes are typically much higher, unemployment rates are lower and the expected duration of unemployment is relatively short for those with higher education.⁴

The most obvious method of measuring the private benefits of higher education is to treat the process as an investment and calculate the returns, a technique which has been applied in a plethora of studies both in Australia and overseas. The major cost of full-time study is the income foregone by students, with the benefit taking the form of the eventual receipt of relatively high incomes.

All Australian studies show that on average higher education is associated with high private economic returns (Miller, 1982; Chia, 1990). This implies a case for charging, with the next question being, how much? That is, if there are externalities, how big are they?

It is not currently possible to quantify accurately the extent of spillover benefits from higher education, with there being a broad range of opinion concerning the nature and value of higher education externalities, and the extent to which these might diminish as the system expands. In the Australian debate the setting of the HECS charge at about 20–25% of the public subsidy relied more on precedent than it did on research or argument. That is, the order of magnitude is a rough reflection of the fees charged in public fee-paying institutions in other countries, and about the level that had been previously levied in Australia before fees were abolished in 1974.

Given the existence of spillovers from higher education there is a rationale for

⁴ *Financing Higher Education*, Australian Government Printing Service, Canberra, 1988.

some form of government subsidy to ensure that society receives the appropriate level of investment. That is, the right charge is less than 100 % of the direct cost, but because there are net private benefits it should exist.

Distributive Justice

At the time of the introduction of HECS there was a commonly expressed equity argument for charging for higher education. This was that there was overwhelming evidence that those who gained access to the system come from advantaged socio-economic backgrounds, and certainly as graduates ended up in the upper echelons of the income distribution.⁵ For example, in the 1980s, students whose father was in a professional or managerial occupation had four times the chances of experiencing higher education than others. The argument is that higher education in a no-charge system is paid for by all taxpayers, with around 85 % of contributors not having had access to the private benefits. In short, before HECS the Australian higher education financing arrangements were seen to be regressive.

II.C. Income Contingent Repayment and the Failure of Capital Markets

The next important question is, what is the appropriate way in which the charge is to be collected? This should be uncontroversial given the plethora of economic analyses promoting income contingent repayment,⁶ with which the HECS arrangements are consistent. It is worth noting the major issues.

It seems clear that a significant part of the population faces economic barriers to participating in higher education, meaning that if fees are imposed without a loans system there will be adverse economic and social outcomes. Charging fees with an inappropriate collection system will mean, for example, that academic talent will be wasted since qualified but poor students will not enrol. Further, this will mean a reinforcement of the distributive justice problem that being born in a poor or ungenerous family becomes a fundamental determinant of one's eventual professional success.

The first economic problem associated with charging up-front fees for higher education is that for those who can't afford to pay there is only an ineffective capital market available for borrowing. The concern for a bank lending for human capital investments is that, unlike many other purchases, there is no saleable collateral in the event of default – such as would be the case for the housing capital market – and no slavery market in which to sell the human capital being developed.

The other problem of lending to students relates to collection costs in the event of default, an issue which assumes greater importance given the absence of collateral. The associated costs appear to be very real.⁷

Governments typically address these problems by acting as a guarantor for student loans, and by paying the interest for the period before graduation.

⁵ *Financing Higher Education*, Australian Government Printing Service, Canberra, 1988.

⁶ For example, see Friedman (1955) and Barr (1989).

⁷ The evidence on default rates from more traditional fees and loans schemes is disquieting. For example, Harrison (1995) shows that in the United States around 10–30 % of loans are defaulted for college, and that the percentage increases to around 50 for two year Proprietary School borrowers.

However, loans are usually only made available to people from poor families or those who can establish independence through satisfying a complex set of conditions related to age and/or work experience. This suggests that some prospective students who need financial assistance because their families do not provide help will be unable to access the system.

The financial barrier will not be completely removed through means testing because when done on the basis of family income it presupposes that parents or partners are willing and able to share resources.⁸ However, if that assumption does not hold, the use of family income to determine support is a flawed criterion. In essence, the idea of means tested loan arrangements to excuse upfront fees for deserving students relies on the assumption of willingness to help within the family, and can thus fail because of it.

The central point about access is this: it is the high cost of participating in higher education (both through direct living costs and foregone income), combined with a lack of family and capital market sources of finance, that creates a significant barrier for many students. HECS, like most possible income contingent repayment arrangements, considerably diminishes these problems because it makes much less relevant the economic situation of the prospective student's family.

II.D. *Income Contingent Repayment and Default Protection*

There is a further issue implying strongly that income contingent repayment is the correct approach. It lies in the key to understanding the basic problem of the alternative, 'mortgage'-style loans. Normal loan arrangements involve the borrower's repayments being made over a specified period of time – for example, the term of a mortgage. Usually no weight is accorded the consequences of low income – repayments are still due within the given period of time.

The essential difference between the two types of loans is that the income contingent variety serves to protect prospective students from the costs of the exigencies associated with the returns to higher education investment. What HECS offers is a form of 'default insurance', such that the former student does not have to bear the costs of renegeing on their debt as a result of periods of low future incomes. This is quite different from a mortgage-style loan, in which the costs of defaulting may be very high in terms of being locked out of other capital markets (most notably for housing) through damage to a person's credit reputation.

Default protection from income contingency overcomes the fundamental problem for prospective borrowers inherent in other loans. With the HECS parameters there will be no concern with the possibility of not being able to repay a loan or only being able to repay it with hardship.

Some part of an aversion to borrowing for human capital investment is perfectly understandable. After all, the returns have a very high variance – many students do not graduate, unemployment exists, and the differences in

⁸ It is not just a matter of parents or partners being ungenerous. They may not share the view of the prospective student concerning the value of the investment.

income between graduates are very high.⁹ But when there is no chance of default the issue disappears.¹⁰

III. HECS IN PRACTICE

III.A. *HECS Revenue*

Since 1989 HECS has become an increasingly important part of the revenue stream for the Australian higher education system. Fig. 1 presents the receipts, distinguishing up-front payments from those collected through the tax system.

Fig. 1 reveals that HECS has contributed well over \$1.6 billion dollars since 1989. Currently this revenue represents around 10% of outlays, a contribution which has grown consistently and which will increase in the future. All of the repayments have been used to help finance higher education, a legislative requirement which operates via a trust fund.¹¹ HECS revenue will increase over the medium term as more former students reach repayment thresholds.

Of great interest is how much of the debt will be collected from income contingent arrangements. Obviously answers depend on the parameters of a policy and the assumptions used concerning future graduate incomes. The best current way to model this is through the use of microeconomic simulation¹² and this has been done for HECS by Harding (1993, 1995).

The analysis suggests that 96 and 77% of all male and female HECS debts respectively will be paid by the time graduates are aged 65. These estimates are likely to turn out to be conservative, given that the simulations used the 1993, repayment rates which are lower than those in 1996. The estimates suggest, then, low levels of non-repayment.

III.B. *HECS Repayment Levels and Timing for Students*

It is useful to illustrate what HECS implies in repayment terms for typical students. It is too early to know exactly how the repayment experience will turn out in practice, but there are some fairly straightforward tools available with which to assess the issue. The most obvious is through the use of average graduate age-income profiles by sex, or through analysis of a range of such profiles by occupation.¹³

The extent and timing of repayment implied by HECS can be illustrated with the use of hypothetical examples, deliberately made extreme to illustrate possible polar, although credible, cases. In what follows it is assumed that there are two students enrolling at university at age 18, both completing four-year degrees in the minimum time and subsequently experiencing very different professional outcomes.

⁹ In the Australian context, Miller and Volker (1993) demonstrate this strongly.

¹⁰ The point is made very clearly by Barr (1989).

¹¹ This was done to promote the notion that repayments would not be used directly for other purposes, such as changing the budget balance.

¹² This method is strong because it takes into account individual incomes, not just averages. See Harding (1995).

¹³ Chapman and Chia (1989) report the former, and Chapman and Chia (1993) analyse aspects of the latter.

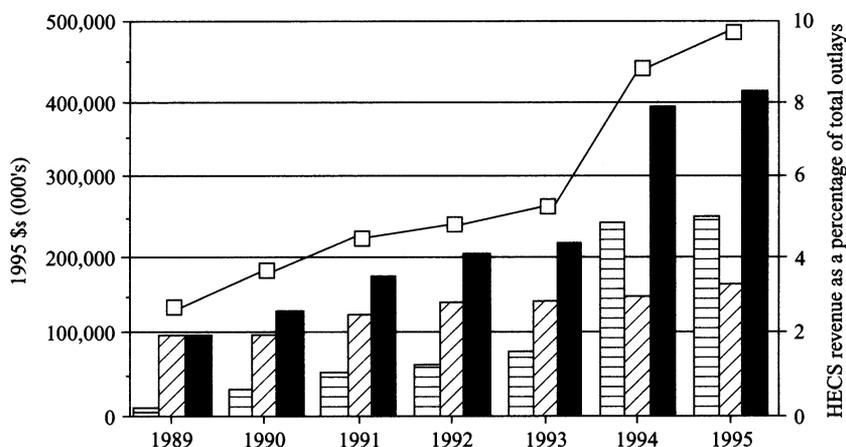


Fig. 1. HECS revenue: 1989-95 (1995 dollars). Sources: National Board of Employment, Education and Training (1989-96). □, HECS revenue as a percentage of total outlays; ▨, loan repayments; ▩, up front payments; ■, total.

The first is a very high income group, male lawyers who earn the average income by age for male lawyers (in 1996 dollars).¹⁴ The second is a relatively low graduate income group, school teachers who earn a typical award wage.¹⁵ To allow further comparisons of fairly extreme but nevertheless plausible scenarios, it is assumed that the teacher spends five years from age 27 out of the labour force and receiving no income, and five years from age 32 working half-time and earning half pay. This is a realistic and useful hypothetical example given labour market outcomes in Australia related to child rearing. Fig. 2 shows the age-earnings profiles for the two scenarios which have been used in HECS repayment calculations.

The HECS repayment calculations suggest the following. The average (hypothetical) male lawyer will start paying HECS at age 22, and will have repaid the debt in full by age 27. Our hypothetical teacher also begins paying straight after graduation but, essentially because there are 10 years in which annual income is below the threshold, the debt is not paid in full until age 39. Relative to average male lawyers, and because of their comparatively low annual incomes, the hypothetical teachers pay less in each year in which some repayment takes place: about \$1,200 on annual average compared to \$1,650 for male lawyers.

The vast majority of graduates will receive incomes and make HECS repayments within the boundaries of these two potential experiences, a point illustrated by Harding's micro-simulations. Her analysis shows that women on average will take longer than men, which is a reflection of women's lower

¹⁴ The data are derived from the earnings function coefficients presented in Blandy (1992), which is why the profile is smooth. They come from the 1991 Census.

¹⁵ In 1996 the majority of Australian wage and salary earners were paid wages at levels laid down in law by arbitrated awards. The Teachers' Award used here is for the most highly populated State, New South Wales.

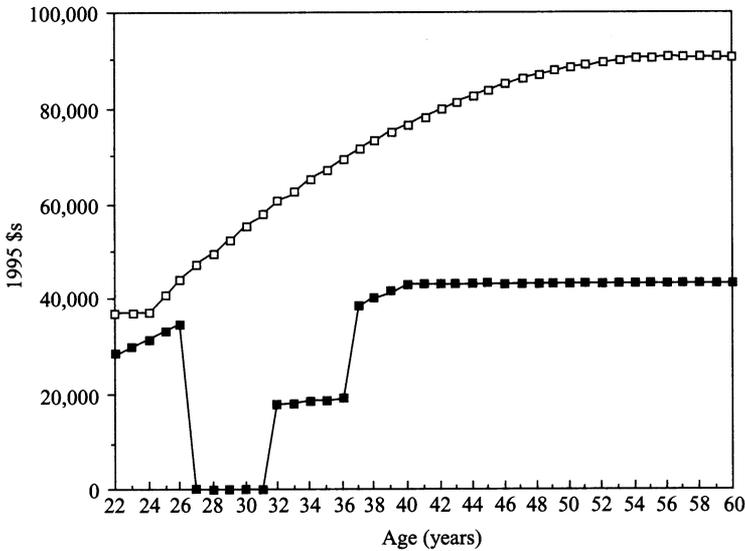


Fig. 2. Assumed male lawyers' (□) and teachers' (■) income profiles. (Teachers 5 years out of the workforce (age 27–32), back at half-pay (32–37), then full-time again.)

annual incomes from lower hourly wages, lower labour force participation probabilities and fewer hours worked per week given participation. The result also means that in net present value terms women pay less HECS than men on average given the zero real interest rate, an issue now explored.

III.C. *Net Present Values of HECS for Students*

The fact that the HECS debt has a zero real rate of interest has important implications for the size of the charge faced by each prospective student in net present value terms. This feature of HECS means that, in essence, those who do best over their lifetimes in economic terms pay more than those who do poorly. This was a conscious decision in the design of the system¹⁶ and it implies that HECS is consistent with the framework provided by Friedman (1955), in which the payments of the charge are argued to be higher for those who gain the most from the investment.

Using the hypothetical lawyer and teacher scenarios it is possible to illustrate net present values of HECS from student expectations of very different lifetime incomes in the context of a zero real rate of interest. In what follows the charge facing the two students at age 18 is calculated for 3, 5 and 8% discount rates. Table 2 shows the extent of 'subsidies' implicit in HECS arrangements.

Students with a 5% rate of time preference expecting to earn the average income of male lawyers face, at age 18, a discounted stream of HECS repayments equal to about \$6,800. For the student expecting to earn a

¹⁶ The motivation for this aspect of HECS was to offer greater protection for those who expect to earn lower lifetime incomes – in a sense HECS offers life cycle scholarships. Many Australian economists continue to argue for a real interest rate on the debt, which would decrease the propensity of the system to subsidise (and thus protect) poor graduates. It should be noted that the same additional revenue from a real interest rate could be raised by increasing the charge, which would preserve the scholarship aspect of HECS.

Table 2
Net Present Values of HECS for Different Income Scenarios

Discount rate (%)	Male lawyers	Teachers
3	\$7,808.60	\$6,826.61
5	\$6,759.20	\$5,514.56
8	\$5,481.66	\$4,134.03

teacher's income and to spend 10 years from age 27 repaying no debt, the discounted expected cost of the charge is around \$5,500, or about 80% that faced by the prospective male lawyer.¹⁷

At the higher discount rate of 8% the discounted expected costs of HECS are necessarily reduced further, and the percentage differences in repayments between the average male lawyer and teacher increase. This latter result is a consequence of the decreased weight given to the teacher calculation of repayments at relatively high ages.

Two points are clear from this exercise. First, the potential impact of HECS on demand for higher education will be less than is apparent from the size of the on-paper debt. Concomitantly this means that the returns to the government from HECS are lower than the on-paper charge. The size of the implicit subsidy could be as much as 35% on average.¹⁸

Secondly, the data suggest different implications for demand between those expecting high and low incomes as graduates, since the scheme in effect charges less from those expecting to be relatively unsuccessful students or graduates.¹⁹ The result means that every student faces a unique price, which depends on the time stream and level of expected future income, and the individual's rate of time preference. In an economic research context this is a curious and untouched area worthy of further investigation; services for which the price faced is different for each consumer are rare.

III.D. *Administration Costs of HECS*

When HECS was first proposed there was a cacophony of complaints reflecting apprehension related to the alleged administrative burden of new and untried arrangements. It is fair to note in retrospect that these were seriously exaggerated.

In practice what HECS means is that all students would either have to pay the charge up-front, to be collected by university administrators, which results

¹⁷ Taking into account the benefits of default protection is likely to increase the benefits of HECS, particularly for those expecting to earn low and/or high variance incomes (Chia, 1990).

¹⁸ Simple conclusions are not possible, however, because an assessment must take into account the government's discount rate.

¹⁹ Chia (1990) makes this point somewhat differently, arguing that the zero real rate of interest penalises the most able, which implies that this aspect of HECS cannot be optimal in an allocative efficiency sense. However, the extent of the penalty and thus its likely implications for choices and resource allocation are shown to be very small.

in an equivalent decrease in their operating grants, or students could choose to incur the debt. In the latter case they need a tax file number, and given this the level of their debt is then forwarded to the Australian Tax Office (ATO) which registers the size of each person's debt. Once the individual's income exceeds the threshold an automatic trigger imposes the appropriate charge.

Recent correspondence with the ATO reveals that the administrative burden of the new arrangements are about \$5.5 million per year, or just over 1% of current annual HECS revenue. This cost can reasonably be described as very small. Even so, other countries interested in implementing income contingent repayment schemes need to assess potential collection costs, and these will be influenced by the sophistication of the existing tax system (or possibly in the United Kingdom context, the National Insurance Scheme²⁰); in general, countries with unsophisticated revenue collection mechanisms will face higher, possibly unacceptable, collection costs.

The administrative costs for universities are similarly not large. When HECS was introduced the government allocated (in 1995 terms) about \$12 million in total. In real terms this annual compensation remains the same currently.

IV. THE EFFECT OF HECS ON THE ACCESS OF THE DISADVANTAGED

IV.A. *Introduction and Enrolment Data*

Perhaps the most important question about the likely consequences of HECS is, has it in any way diminished access to higher education? After all, the Australian system was formerly without fees, and basic economics tells us that when the price of a service increases, so too will the quantity demand for it fall. Related to this truism is the all-important issue of whether those from relatively poor backgrounds have been affected, as predicted by a host of HECS opponents at the time of its institution.

There are several levels on which the question of access to higher education can be examined. The simplest is through the use of enrolment data. However, establishing that higher education enrolments changed during a given period says nothing about the causes of those shifts. Moreover, the Australian higher education system is often supply constrained since domestic enrolments are determined by the number of places financed by the government. This suggests that better data are not the number of students, but instead enrolments plus the level of unmet demand, information which is not available.

Even so, enrolment figures do give some pointers as to the aggregate level of demand for higher education, and all suggest a robust expansion after the introduction of HECS. That is, from 1988 the number of higher education students rose in each successive year with an average increase of over 4%.²¹ The increases reflect increased government outlays, encouraged in part by the promise of higher future revenue from HECS.

²⁰ Nicholas Barr has recommended the use of this system for the United Kingdom. See Barr (1989) and Barr and Crawford (1996).

²¹ Women and Aboriginal enrolments have increased considerably. Both groups were predicted by some to be adversely affected at the time of the introduction of HECS.

IV.B. *Surveys of the Disadvantaged*

There have been a number of academic surveys addressing the effect of HECS. In 1989 the government commissioned researchers from Curtin and Flinders Universities to explore the matter. The methodology employed was to use a control group to allow a comparison of those qualifying and choosing to participate and those qualifying and choosing not to, to determine whether or not HECS was a contributing factor.

In general, HECS was not very important in limiting access, with the possible exception of post-graduates who had intended to re-enrol. Even for this group, about 70% gave other factors a greater weight than HECS as an influence on their decision.²²

In 1991 the consulting firm of Ernst and Young surveyed individuals from sub-groups thought to be traditionally disadvantaged in terms of access to higher education. The study drew its sample from final-year high school-leavers in 1991, and adults who were potential entrants to higher education. Sample sub-groups based on aspects of perceived disadvantage (such as low socio-economic background, living in a rural area, non-English speaking background, and Aboriginal or Torres Strait Islander background) were surveyed.

The results were used in the 1992 National Board of Employment, Education and Training Report on HECS, and are as follows. Of 17 factors which might contribute to a final year high school student deciding not to participate in higher education, HECS was not frequently cited, and rated 13th overall. Moreover, there was no significant relationship found between an issue being cited and the socio-economic status of the student. The following conclusions were drawn:

It seems unlikely that there are no identifiable groups for whom HECS is the critically important influence on decisions about participating in higher education... It is therefore likely that most qualified applicants from across all sub-populations in the study would not be significantly deterred by HECS (p. xii).

IV.C. *'Youth in Transition' Data from the Australian Council of Educational Research (ACER)*

The ACER has available one of the most interesting data sets for analysing changes over time in the composition of the higher education student body, at least for young people. The data include a host of information on family background and educational participation. What follows is a comparison of the composition of 18-year-olds in higher education in 1988 (before HECS) and 18-year-olds in higher education in 1993.

An indirect measure of family wealth in these data was constructed by the ACER using responses to questions concerning the presence in the home of material possessions, such as telephones, dishwashers, bedrooms, and bath-

²² For descriptions and analyses of the reports, see NBEET (1990).

rooms. The distribution of the index was grouped in the three categories, high, low, and medium, representing respectively the upper and lower quartiles and the middle fifty per cent. Fig. 3 presents the results.

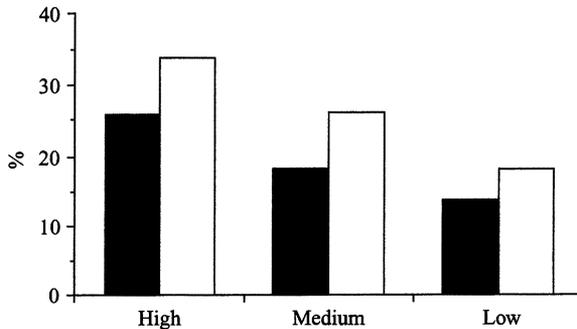


Fig. 3. Family wealth and higher education enrolment, 1988 (■) and 1993 (□). Source: Australian Council of Educational Research (Chapman, 1996*a*).

Each bar in the figure represents the proportion of 18-year-olds enrolled in higher education in 1988 and 1993. As examples: around 25% of the high wealth quartile were enrolled in 1988, and this number increased to about 33% in 1993 (an increase of around a third); of the low wealth cohort around 13% were enrolled in 1988 and about 17% in 1993 (an increase of 31%).

Two points are worth noting. The first is that in 1988 there was a much greater likelihood of those from wealthy backgrounds being enrolled, data which vindicate the position held by those at the time of the initial HECS debate that higher education expenditure in Australia without a charge seems to be regressive. Second, the introduction of HECS does not seem to have had any discernible effects on the socio-economic composition of the student body.

The bottom line is that there is no evidence of HECS diminishing access to higher education of the disadvantaged, nor indeed, in an aggregate sense. These are important results on the issue of the effects of income contingent repayment schemes on the size and composition of the student body.

V. CONCLUSION

The economic and social rationales for income contingent charges in higher education are overwhelming. But until recently it was unclear how such arrangements might work in practice, what the revenue implications would be, and what consequences would follow for the access of the disadvantaged to the system. The Australian experience with HECS has clarified all three issues.

It is now clear that income contingent arrangements can be designed to be administratively feasible, even straightforward. As well, the revenue potential for higher education is considerable. Perhaps most importantly, the Australian experience with HECS reveals strongly that even a radical movement away from a no-charge system can be instituted without jeopardising the

participation of disadvantaged potential students; this is all traceable to income contingent repayment.

The political disquiet surrounding the introduction of HECS has gone. Those originally opposed to the scheme seem now to accept it as fair, with it being very clear that none of the dire consequences predicted at the time has come about. These changed perspectives in Australia should be of no surprise to the growing international community of scholars and policy-makers advocating income contingent arrangements for higher education financing.

VI. A POSTSCRIPT: THE 1996/7 AUSTRALIAN BUDGET

In August 1996 the newly elected (conservative) government announced significant changes to HECS. In essence there are three significant variations to the scheme.

One is that the first income threshold of repayment has been reduced, from around \$A28,000 a year to just under \$21,000. This has been accompanied by increases in rates of repayment at all levels of income above the first threshold. Because of the zero real rate of interest on the debt this means that current HECS debtors will pay more in present value terms after 1996 because they will pay back more quickly.²³

Second, the charge will increase considerably and differ by broad subject area. There will be three tiers: \$3,300, \$4,700 and \$5,500 per full-time year, compared to the 1996 level of around \$2,500, implying a weighted average increase (not in net present value terms) of about 70%.

The new differential charges do not just reflect teaching costs, although in general the more expensive courses (such as Medicine, Dentistry and Veterinary Science) will attract the highest charges. So too, however, will some of the cheapest courses, such as Law, and for students undertaking other inexpensive options – such as Economics and Business – the charge will be at the medium level of \$4,700. A relatively expensive course of study, Nursing, is to be charged the lowest fee.

In essence the new charge arrangements are a hybrid model, with both costs and the presumed benefits from studying in a particular course being given weight. The latter aspect is controversial in that the new system raises for the first time the issue of whether or not it is appropriate for the government to charge individuals on the basis of what the expected direct benefits on average from a course are. It is likely that this will result in a plethora of both criticism and research on the conceptual basis and the empirical justification for such an approach.²⁴

The third change announced has the potential to be the most significant in terms of the original HECS system. It is that from 1998 universities will be allowed to charge whatever (up-front) fees they choose for up to 25% of

²³ Calculations suggest that those expecting to earn average nursing and lawyer incomes, for example, have respectively had their financial obligations increased by the order of 5–15%. To put this differently, someone receiving \$35,000 paying a HECS debt owed \$1,050 in 1996 but will owe \$1,575 in 1997 at the same income.

²⁴ For an early analysis, see Chapman (1996*b*).

students. For scholars and policy analysts who approach university financing issues on the basis of the economics of education this change is the hardest to justify, because of one extraordinary matter: in announcing the change the government has made no allusion to the provision of a loans scheme to help those students interested in purchasing a place but without the financial resources enabling them to do so.

A cursory understanding and acceptance of the arguments for the provision of an income contingent loan mechanism to underwrite the payment of university charges would not lead to the initiation of a fees regime without such a mechanism. Indeed, the conceptual issues raised above, and the compelling evidence that a HECS-type system has little potential to diminish the access of the disadvantaged, suggest that the new Australian approach might both waste academic talent and further entrench the already strong nexus between one's socio-economic background and professional life opportunities.

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