Creative Education
2011. Vol.2, No.5, 466-469

Scientific Research
DOI:10.4236/ce.2011.25068

An Introduction of a Financial Model for the Australian Higher Education

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Received September 22nd, 2011; revised October 30th, 2011; accepted November 5th, 2011.

This study examines the global trend in shifting university costs from national governments to individual students and families, with a specific focus on the existing cost-sharing model in Australian higher education. The Australian system is worthy of consideration by other nations as a possible mechanism for enhancing access to higher education for individuals who might otherwise not possess the opportunity to participate.

Keywords: Income-Contingent Lending, Public Policy, Student Loans

Introduction

The rising cost of higher education is a significant and growing public policy issue facing governments around the world. Many nations are struggling with the conundrum of how to expand educational access in an era of smaller governments, shrinking tax bases, and growing demands on federal budgets. This is made more difficult given changing beliefs regarding the relative mix of private and public returns to higher education, and an increasing "user pays" philosophy to match the growing conviction that the individual is the primary benefactor of university-level study.

Consistent with this change is a global trend of shifting an increasing percentage of educational costs from governments to individual students and their families. Within this context, Governments in the majority of countries allow universities and colleges to charge students for tuition. Researchers and policy analysts are devoting increasing attention to the growing worldwide use of student loans to fund higher education, and in many of these countries, for example, Canada and the United States, the financing process is assisted by the provision of commercial bank loans backed with a government guarantee of repayment. The availability of bank loans is usually limited to a subset of the student population, and eligibility and available amounts are often determined with reference to both age and family income. In Australia, however, there is a quite different system of student financing. It is called HECS or the income-contingent repayment.

The Background of the HECS System

The Australian higher education system consists of 42 degree granting universities, the vast majority of which are public. The system is largely federally controlled, with the national government playing a significant role in setting student enrollment quotas, establishing tuition rates, and providing institutional funding. While tuition varies by academic program it is consistent across institutions, so that a student in an Arts course, for example, pays the same tuition at any public university in the country.

What Is HECS

The Australian system, known as the Higher Education Contribution Scheme (HECS), is a relatively well-known and respected financing model that is designed to help the federal government recover a portion of instructional costs while helping to minimize the number of students who are kept away from universities because of an inability to pay. The Australian Higher Education Contribution Scheme (HECS) was introduced in 1989 replacing the previous system (since 1974) in which students were not charged tuition fees. The purpose of HECS was to increase the funds available for higher education to promote its expansion without imposing fees on students which would restrict participation in higher education to those who could not afford the fees. The core element of HECS is a deferred, income contingent loan in which students are charged tuition fees but later pay back part of the cost of their university education through the taxation system. The scheme allows students to defer all tuition until after graduation, at which point fees are repaid through an income-contingent tax. The accumulated debt does not accrue interest but is subject to an annual adjustment for inflation. It involves former students repaying some of the direct taxpayer costs of higher education, but only if and when graduates' personal incomes exceed a minimum threshold. It is progressive in that those earning the highest incomes repay their debts fastest, and therefore have fewer years to benefit from the government subsidy implicit in the debt having a zero real rate of interest. The HECS system was designed to increase private contributions to the higher education sector without the impost of student fees. It is characterized by students' paying a proportion of the cost of their university education through the taxation system once their income rises above a threshold level. Those on higher incomes have a higher rate of repayment than on lower incomes but the total amount repaid is independent of the level of income so HECS is quite different to a graduate tax.

Since its introduction in 1989, HECS has enabled the Australian government to significantly expand the number of available student places in public universities without decreasing access for individuals with fewer resources.

Why Did the Australian Government Introduce HECS

There are several rationales for the Australian HECS system. Primarily, HECS reduces the cost to government of financing higher education. In 2002 HECS contributed about $1.8 billion or 16% of the total expenditure on higher education (ABS 2005). Reducing the per capita cost means that more money can be spent on increasing participation. According to OECD (2004: Table 3.3; 2007: Chart C2.1) indicators the proportion of young persons at university (Type A Tertiary education in OECD terms) in Australia is amongst the highest in the OECD.

Barr (2004) argues that income contingent loan schemes are economically desirable since they provide price signals, increase flexibility and choice, and promote access through expansion of the higher education sector. In an earlier article he makes the point that free tuition is not affordable in mass higher education systems. In addition, there is the social equity argument. Free university education means that workers on low to average wages substantially subsidize the university education of the children of higher income families, whom as a result of their university education will, on average, receive much higher incomes. Therefore, "free" university education involves a substantial transfer of money from low income to high income households. In addition, it cannot be argued that HECS is no longer appropriate since university degrees do not deliver the income premiums they once did. Despite the substantial increases in the proportion of the Australian population with university degrees, the income premium to university degrees, in the region of 30%, is no lower among younger cohorts (OECD 2004: Indicator 11). In other words, there has been no change over-time in the rate of return to university education. University degrees provide even stronger returns to wealth. As can be seen frome Figures 1 and 2, typical Australian with a bachelar degree earn higher than those without the degree. HECS ensures that those who enjoy the benefits of a university education contribute to its costs.

The Development Process of HECS in Australia

After a 15-year period where no tuition was charged in Australia universities, the Higher Education Contribution Scheme (HECS) was introduced in 1989. HECS initially required most undergraduate students to pay an annual fee of 1800 Australian dollars for their university education, and the income threshold was $27,675 (Chapman, 1997).In order to avoid disadvantaging individuals of lesser means, the fee was deferred until students graduated from or left the university. Students who were able and chose to pay the fee upfront were given a 15% discount. Deferred fees did not accumulate interest, but were annually adjusted by an amount equal to the rate of inflation. Repayment was made through a HECS payroll tax and contingent upon income. While no payment was required until a student earned over $22,000 annually, an amount of up to 3% of one's total income was deducted from his/her paycheck depending on the level of earnings above the minimum payment threshold.

Various adjustments in the HECS system have been made since its introduction. The discount for paying fees up-front was increased to 25% in 1993.

In 1997, the conservative Coalition government reduced the income threshold to $21,000 (in 1996 dollars), accelerated the repayment schedule, and introduced three tiers of fees at $3300, $4700, and $5500 per year. The tiers were designed to partially reflect the teaching costs and expected income returns associated with different courses (Chapman, 1997). Medical, dental, veterinary science and law students were charged the highest rate, while arts, humanities, and nursing students were charged the lowest rate. The other major change in 1997 was encouraging the up-front payment of tuition fees by offering a 25% discount (which is essentially the same as imposing interest). Up-front payment means that the government receives the income sooner and provides increased flexibility to students for payment. However, only a minority of students choose to pay up-front. Approximately 80% of full-time students chose not to pay up-front but take the deferred payment option, although a higher proportion of part-time students pay up-front (Long & Hayden, 2001).

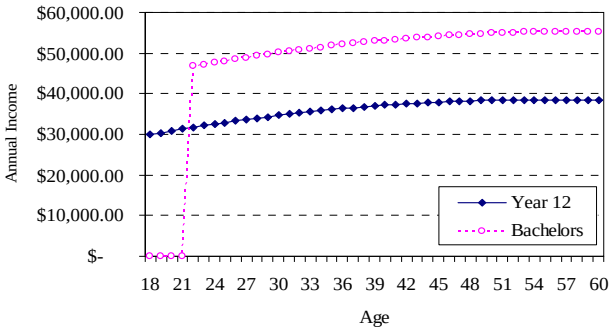

Figure 1.
Typical Australian female age-earnings profiles: 2004.

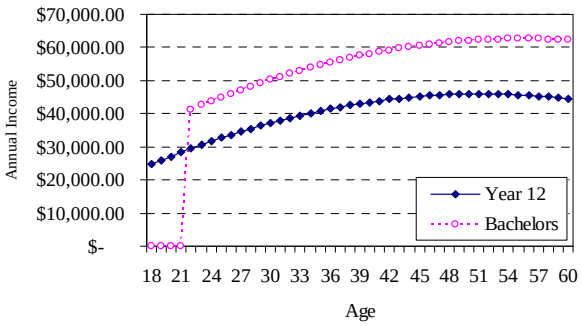

Figure 2.
Typical Australian male age-earnings profiles: 2004.

The Advantage of HECS Compared with Bank Loan

Bank and HECS repayments can be very different in impact. Table 1 gives us a clear idea of the HECS income thresholds and repayment rates. From the table, we can see that when income below $35,000, one needn't repay the money. The more the income, the higher the repayment percent.

As can be seen from Figure 3, HECS system adds no additional load to the unlucky women when she was struggling to make her ends meet. Though the amount of the repayment to the bank is consistent, it exerts great pressure to the unlucky women because the amount comprises a large portion of her income. So the biggest advantage of HECS system is its consumption smoothing effect compared with bank loan.

What Pre-Requirement for the Implementation of HECS System

As has been shown through a review of related literature and

Table 1.
HECS income thresholds and repayment rates.

HECS Income Thresholds and Repayment Rates:2004/2005(debt = $16,000)	
HECS repayment incomes in the range: (A$) per year	Percent of income applied to repayment
Below $35,000	Nil
$35,001 - $38,987	4
$38,988 - $42,972	4.5
$42,973 - $45,232	5
$45,233 - $48,621	5.5
$48,622 - $52,657	6
$52,658 - $55,429	6.5
$55,430 - $60,971	7
$60,972 - $64,999	7.5
$65,000 and above	8

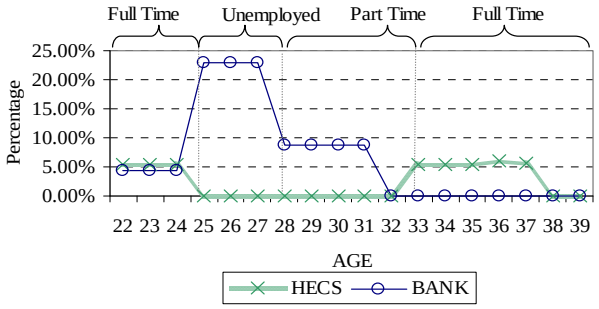

Figure 3.
The big story: *Debt Repayment as a proportion of taxable income for an unlucky graduate*: *females*.

an in-depth qualitative study of the experiences of students in Australia, a HECS type system can result in numerous benefits to both national governments and participants in higher education and can be used as a model for countries that are trying to address problems related to inequitable access to higher education. While a number of particular economic, political, and cultural factors enable the system to work effectively in Australia, these variables may not exist in the same form in other nations.

A number of critical issues would need to be addressed before a system similar to the Australian HECS model could be implemented in countries possessing the required resources and necessary infrastructure. These include the role of private financial institutions in student support programs, the potential scope and cost of an income-contingent loan scheme, and the opportunity to conduct pilot studies, perhaps in a single or small number of states, provinces, or universities. Governments must devote serious consideration to the limits of financial strategies to address social and cultural problems related to higher education. While a lack of adequate financial resources undoubtedly keeps millions of otherwise qualified and capable individuals out of universities, many other psychological, sociological, cultural, and structural variables also are involved in maintaining, if not exacerbating, class inequality in higher education. For example, debt aversion and related sociological barriers to higher education will likely not be solved through the implementation of an income contingent loan scheme. Rather, these issues require additional and varied uses of time, talent, and financial resources to discuss, research, and problem solve for the long-term benefit of society.

Given the role of education in promoting economic development and social mobility, it is important to more fully understand the process by which certain individuals decide that the benefits of a university degree outweigh the various costs of attendance. Additional research can assist a wide variety of individuals who help shape the educational aspirations and opportunity structures of youth—parents, teachers, and school guidance and careers counselors among others—to better recognize and understand the needs and concerns of adolescents and the various forces that influence thinking about future plans and goals. This knowledge can enable those who teach, counsel, encourage, mentor, and motivate youth to do so in a manner that communicates empathy and understanding while expanding students' views of what is possible and achievable. University admissions and promotion officers might apply the insight gained from research to the development of more effective educational outreach initiatives. Research might also assist public policy makers in creating programs that more successfully target talented, lower income youth and promote access to various forms of educational opportunity. These efforts are necessary to help reverse the trend of talent wastage among the low-income youth of many nations, to improve the lives of individuals by removing obstacles in the pursuit of their goals and aspirations, and to promote stronger, more cohesive societies for future generations.

The Effect of the HECS System in Australia

A common criticism of HECS and associated policies is that it increases socioeconomic inequality in university education. There are several reasons why HECS may increase socioeconomic inequality. Students from lower socioeconomic backgrounds are more debt adverse so are less likely to participate in higher education than students from more advantaged backgrounds. The option of a 25% discount in course fees for up-front payment (later revised down to 20%) favors students with wealthy or high income parents. Similarly, such students are advantaged by the flexibility allowing universities to charge up-front fees to a maximum of 25% of enrolments (later increased to 30%) per course. Marginson (2005) speculated that the HECS system in its original formulation—all universities were deemed of equal standing and a standard tuition fee—had minimal impact on social access, but the 1997 and subsequent reforms to the HECS system had increased social stratification and closure.

There is little evidence that HECS increased socioeconomic inequalities in higher education. Andrews (1999) found no change in the proportion of low SES students (identified by area-based measures) enrolled at university since the introduction of HECS and the 1997 reforms. He concluded that HECS had little to do with the low participation rates of low SES students. Similarly, Aungles et al. (2002) concluded that "the introduction of HECS and its variants since that time, have not discouraged overall participation in higher education among persons from a low SES background". However, they noted a substantial decline in the number of low SES males applying for places in the most expensive courses. Chapman and Ryan

(2005) found that wealth inequalities in university participation had not increased after the introduction of HECS, and participation at university of those in the middle of the wealth distribution had increased.

Since the introduction of HECS in Australia, income contingent loan schemes have been introduced in other countries. In 1992, New Zealand implemented a scheme where students can borrow from the government for both their tuition and living expenses. In the United Kingdom a HECS-style scheme began in 2006. Institutions are allowed to charge students £3000 per annum, which they repay once their annual income exceeds £15,000 (DES 2004). Governments in other countries where university education is presently free are likely to consider HECS-like schemes if they wish to reduce the costs of higher education or increase the number of university places by reducing the per capita cost to government (Chapman & Greenaway, 2006).

The Australian system can serve as a source of insight and guidance for policy makers who are seeking solutions to new or perennial issues related to higher education access and equity.

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