



Australian Vice-Chancellors' Committee
the council of Australia's university presidents

***Laying the Foundations:
the AVCC submission to the
Review of the Indexation of University Funding***

December 2004

AVCC submission to the Review of the Indexation of University Funding

The lack of effective indexation of university grants and student payments under the Higher Education Contribution Scheme (HECS) has been a critical concern for universities since the present indexation arrangements were introduced in 1997.

Through its *Our Universities: Backing Australia's Future* and *Backing Australia's Ability* packages the Government has substantially renewed its investment in universities. *Backing Australia's Future* provides for future increases to university base grants through the new Commonwealth Grant Scheme. It also gave universities the flexibility to set the rate of student contributions up to a limit of 125% of previous HECS levels. The major flaw is that the additional Government and student investment will reliably and steadily decline in value due to the lack of an effective index.

In passing the *Higher Education Support Act 2003* to implement *Backing Australia's Future* the Government agreed to review the indexation arrangements by February 2005. The index is used on all Government funding from the DEST Portfolio, including research grants, and to the maximum amounts of student contributions (previously HECS).

The Terms of Reference for the review as set down in the Act are to consider the following:

- a. the alternative indices to use for wage costs – for example, the relative merits of average weekly earnings, the Commonwealth's education wage cost index, baskets of domestic professional wage rates and purchasing power parity adjusted indices for academic labour;
- b. the alternative indices for non-wage costs, noting the high reliance of universities on advanced equipment, information technology, research infrastructure and international book and periodical stocks; and
- c. the application of any agreed index or indices to the actual Commonwealth-funded staffing and financial profile of each university rather than the application of an assumed uniform profile .

In this submission the AVCC makes its case for a new index in which the salary component of the index is changed from the present safety net adjustment to the Labour Force Index (Education), previously known as the Wage Cost Index (Education).

1. The Value of University Education and Research

An effective university sector is central to ensuring a well educated Australia. Universities provide Australia with high quality education, research, professional training, research training, advice and regional support. These are essential for Australia's future as a successful nation fully linked to the international economy. Investment and quality outcomes are inextricably linked: universities cannot provide quality services without the necessary resources.

The value of university services is clear.

- University graduates are more likely to be employed than non graduates¹. They earn on average higher incomes². Their quality of life is generally higher.
- Recent university graduates continue to attract starting salaries at about 80% of average weekly earnings despite the rapidly growing proportion of previous graduates in the workforce³.
- University research is increasingly being funded by business and other external organisations, eager to make use of the knowledge and skills within universities⁴.
- Universities attract over 210,000 international students to Australia each year, making it one of Australia's leading export earners and giving testament to the value of an Australian university education⁵. If that value were perceived to have reduced these students would go to other countries for their university education.
- Universities provide regional hubs for economic development all across Australia.

Central to the value of our universities is the quality of the services they provide. If that quality is put at risk, the value of universities to Australia will reduce, limiting our future economic and social wellbeing.

The changing demographic base for Australia over coming decades reinforces this. With fewer people of traditional working age, compared to those not working, there will be even greater need for continued productivity growth, innovative approaches to the provision of all goods and services, and for re-skilling and retraining of older workers to increase their capacity to stay in the workforce. Effective provision of education will be a key driver in meeting these needs, with post school education able to make the major difference.

The question of effective indexation is key to the ongoing quality of university services. Each year the Australian Government and Australian students invest several billion dollars in Australia's universities through the Government's higher education and research programs and through students' Higher Education Contribution Scheme obligations. Each year the value of that investment steadily declines due to the inadequate indexation measure now used.

¹ ABS; *Australian Social Trends* (Catalogue Number 4102.0)

² GCCA; *Gradstats 2004*

³ GCCA; *Gradstats 2004*

⁴ DEST; *Higher Education Research Data Collection Time Series*

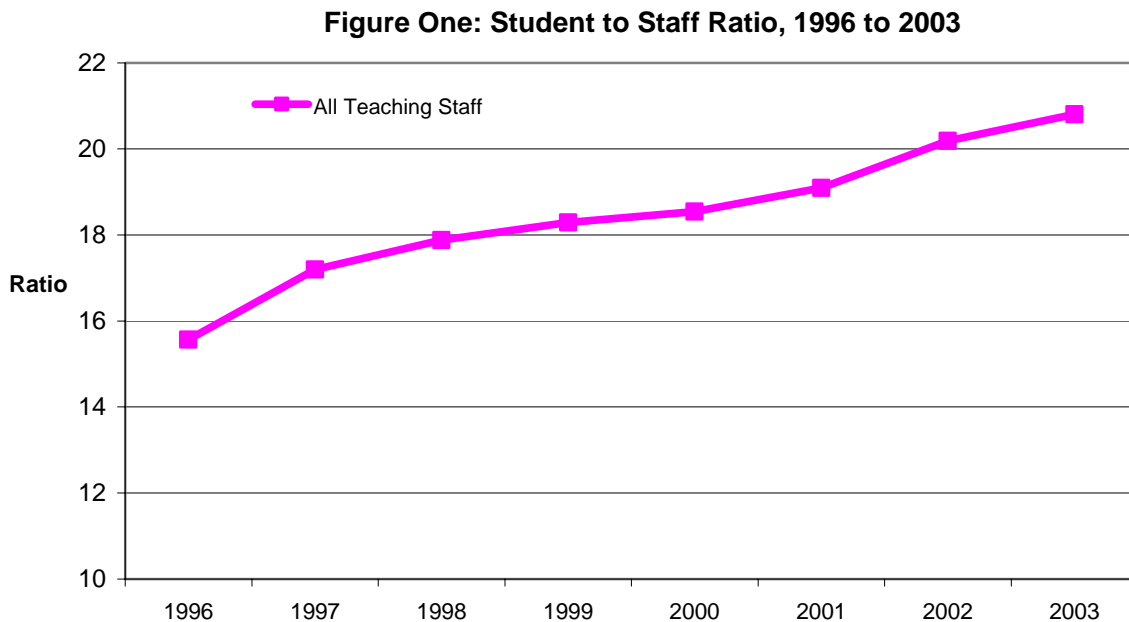
⁵ DEST; *Selected Higher Education Statistics, Students*. ABS; *International Goods and Services* (Catalogue Number 5368.0) and *Balance of Payments* (Catalogue Number 5302.0)

The real increases in funding levels due over 2005 to 2008 partly obscure the reduction in the value of the ongoing funding. Once those commitments to additional funds are complete they too will decline in real value year to year without effective indexation. As a result the positive outcomes of *Backing Australia's Future* and *Backing Australia's Ability* will steadily be lost and the quality of Australia's university education and research will once again be put at risk.

2. Efficiency of Universities

There are a number of broad indicators of the efficiency of Australia's universities.

Figure One sets out the ratio of students to staff from 1996 to 2003, which has risen from 15.6 to 20.8. The change in the ratio is driven by the steady increase in student numbers, mostly international and other fee paying students, against staff numbers that declined at points during the 1990s and which have only grown marginally since⁶.



Source: DEST Selected Higher Education Statistics, Staff and Students.

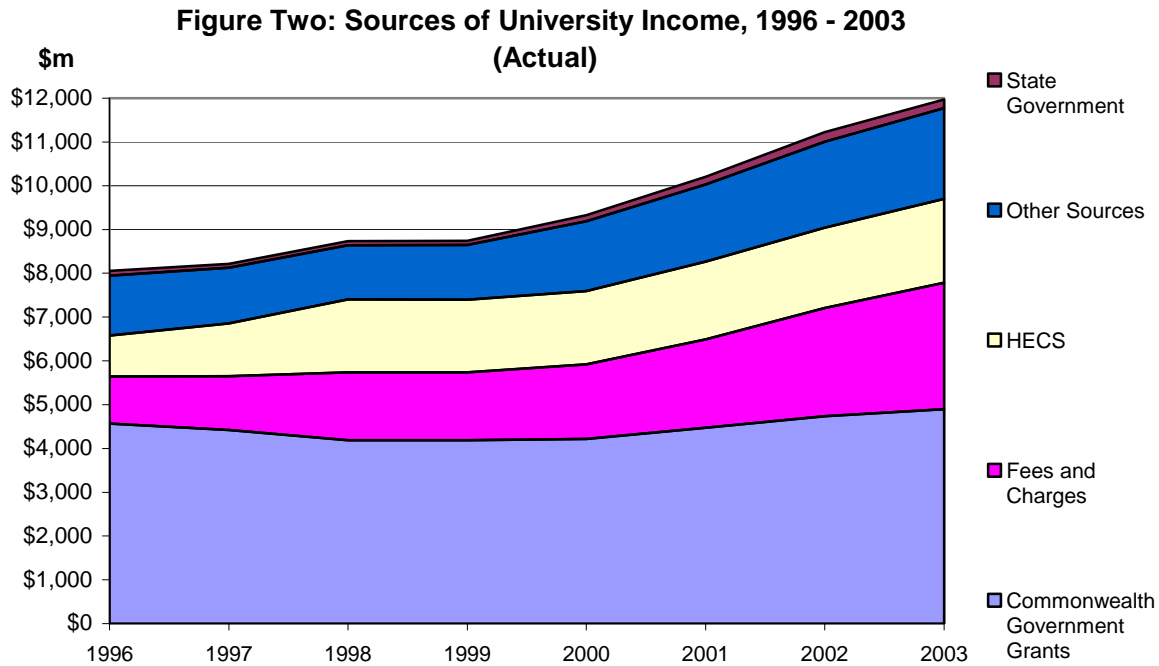
Education is a labour intensive industry. Developments in technology have not replaced the need for staff but changed the way in which staff support the learning of students. This has been shown by universities' success with the use of information and communication technologies in teaching that is built on ensuring regular and effective access to staff (whether in person, via email or other communications) to support students in their use of the materials available on line.

Universities have managed the increase in the ratio through the retention of existing staff that have provided greater productivity that can be rewarded through promotions and salary increases where affordable. The moderate upward movement in staff classification reflects the greater skill base of universities but also points to future challenges when substantial numbers of staff begin to retire over the next ten years.

⁶ DEST; *Selected Higher Education Statistics, Students and Staff*.

Hence continued increases in the ratio of staff to students will create the risk of reduced effectiveness of university learning and teaching.

Figure Two sets out the changing size and composition of universities' major income sources. It shows that Government investment has provided the basis for considerable non Government investment. In 2003 each Government dollar attracted a further \$1.35 in non Government investment. In 1996 each Government dollar attracted \$0.72.



Source: DEST Triennium Selected Higher Education Finance Statistics.

The capacity to attract non Government income is dependent on the base funding for universities being sufficient to provide the key services expected of universities – quality learning and teaching at undergraduate and postgraduate levels and research across the broad range of disciplines.

Sustaining the base of universities requires effective annual indexation that permits universities to maintain those base services and develop them further to lead broad general changes in learning and research. If the base is not sustained, universities will lose the capacity to respond to external needs effectively.

As long as universities have an effective sustainable base income:

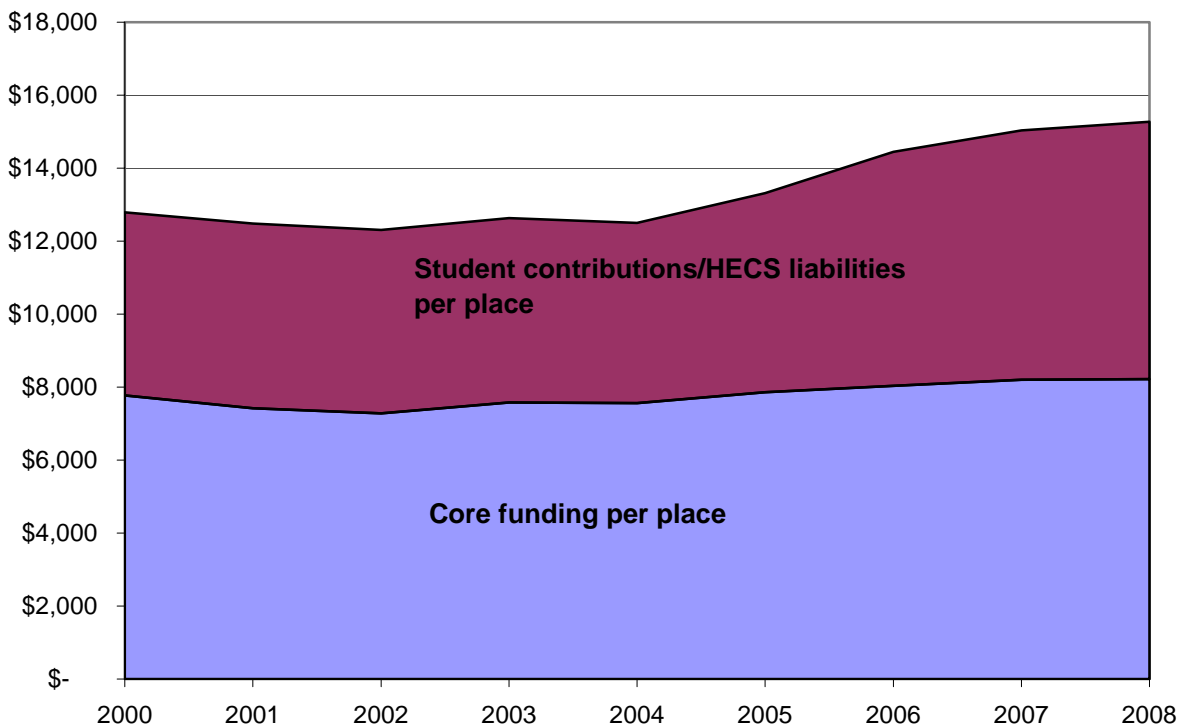
- Australia will continue to attract international students. The attraction of international students is a prime indicator of the perceived quality of Australia's universities;
- industry can continue to seek out advice and solutions for the problems it needs solved; and
- Governments can continue to seek advice as issues arise.

For example Australia's universities enrolled over 210,000 international students in 2003. As the gap between international student fees and income for Australian students grows, universities become less able to provide the education expected by international students since both sets of students rely on the same base resources and staffing.

If the gap is not reduced in coming years, and kept low, Australia’s substantial education exports will be put at considerable risk from Australia’s competitors in the international student market. A high quality university sector is essential to maintain this major Australian export earner.

Figure Three shows the average income per Government funded student from 2000 to 2008 expressed in constant 2004 dollar values using the Labour Force Index (Education) and CPI as the deflator (in a 75:25 balance). It shows that income per student fell up to 2004 and will pick up from 2005 with the implementation of *Backing Australia’s Future* from 2005. This falling income per student sits against substantial cost pressures for universities to upgrade technology and information resources.

Figure Three: Funding Per Commonwealth Funded Student Place, 2000 - 2008



Source: DEST Triennium Higher Education Reports and unpublished data. Constant 2004 prices

Universities capacity to work within these limits has been due to strong leadership determined to improve effectiveness and reduce costs. This has involved more effective collaboration in teaching and research, focussing teaching and research on key strengths and areas of demand, reducing unhelpful duplication of courses⁷, and stringent changes to university administrative support arrangements including much greater use of outsourcing. This is despite the ever increasing ‘red tape’ imposed by the Commonwealth.

3. Student Payments

Since the introduction of HECS, students have made a significant contribution to the cost of their education. This has been extended through the creation of fee paying postgraduate

⁷ See AVCC, *Forward from the Crossroads*, September 2002, pp 77-80 for the evidence that Australian universities do not all offer every field of study.

courses and now undergraduate courses and the recruitment of international students. For fee paying students and international students universities are able to set fees in direct relationship to the cost of providing the education those students require.

For students in Government funded places universities have not been able to balance the value of the course with the charge. Rather universities have been forced to provide education with increasingly less effective value in resources. The changes from *Backing Australia's Future* increase the amount that universities can charge students and create some capacity to balance services with charges. However the underlying restraint remains. Through setting limits to the student contribution, and not indexing its value effectively, the Government draws universities away from focusing on productivity to improve effectiveness.

In the context of a limit on the student contribution, the Government must ensure that those limits retain their real value. Where universities wish to compete through a more efficient service provided at a lower cost they are now able to do so but universities should also be able to compete for students through providing a more effective service for payment of the highest permitted student contribution.

4. A Suitable Index

Indexation means ensuring that the Government's and students' investment will fund the same education, research and community engagement that it did the previous year against the rising cost of salaries and resources such as information and communication technology, library materials, and research infrastructure.

The existing index is not realistic. It was created by the then Labor Government in 1996 and in the ensuing eight years it has remained unchanged by the Coalition Government. Using this index the Government has indexed funding and student contributions by a mixture of the Consumer Price Index (CPI) (25%) and the Safety Net Adjustment for wages (75%).

The wage adjustment is much less than the real increase in salaries in universities, which in turn have been less than increases in average weekly earnings.

The AVCC accepts that the index cannot be tied directly to changes in university costs, especially to salary increases, since these are within the control of universities to determine. The AVCC has considered a number of options to replace the existing index, focusing on an acceptable means to adjust the salary component of the index. These include Average Weekly Earnings, the Government School Recurrent Cost Index, and the Labor Force Index (Education). The annual increase in these is shown below, compared with the existing index (see Table One).

Table One: Annual increase of different indices

Index	1998	2000	2002	2003	2004	Average
Schools Index	4.6%	7.4%	5.2%	5.6%	n/a	5.5%
Average Weekly Earnings*	4.2%	4.9%	5.2%	5.5%	3.4%	4.5%
Labor Force Index (Education)	3.6%	3.2%	3.8%	3.8%	4.8%	3.8%
Safety Net Adjustment	1.5%	1.4%	1.9%	1.9%	2.1%	1.7%

Source: Gerald Burke and Paul White, Price measures in education and training: opening a discussion (2003) p15 and ABS for recent years.

* 2004 calculation only based on 3 quarters of data. ABS will release last quarter in February 2005.

The Labor Force Index (Education) measures the underlying increase in education salaries, net of productivity gains. It was developed specifically to provide a valid means of indexing Government grants and replace the current index which was only ever intended to be temporary.

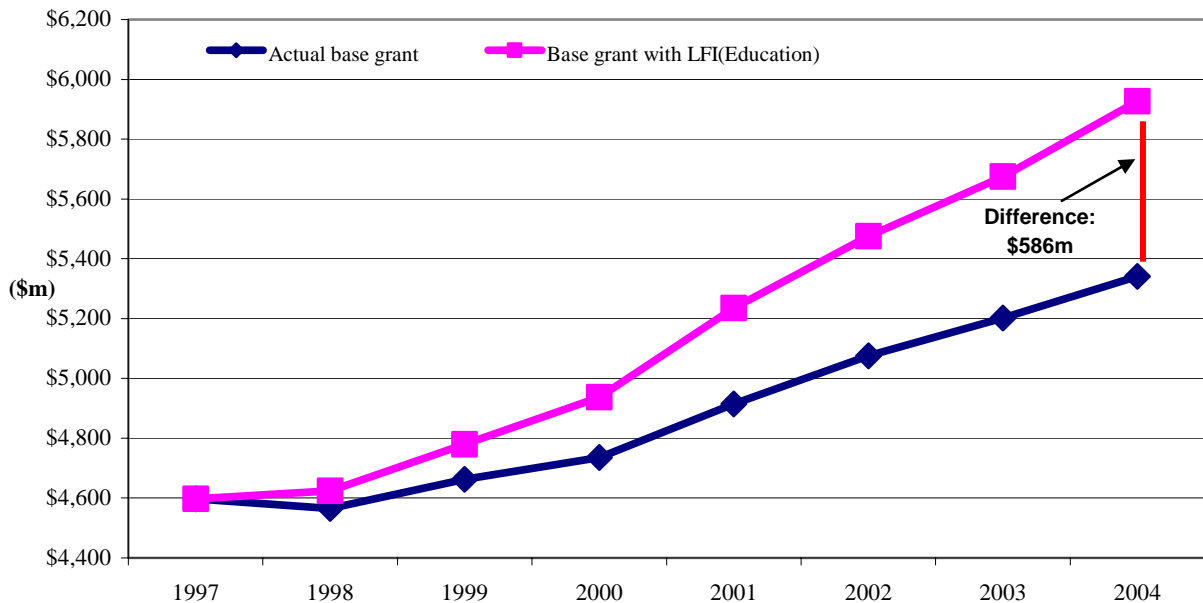
It is very clear that the schools index is notably larger than other possible indices. It provides a clear indicator of the cost pressures on school education as reflected in State Government investment in their schools. Similar cost pressures exist for all levels of education.

Based on its analysis, the AVCC recommends that the Government replace the salary component of the current index with the Labor Force Index (Education) retaining the 75% weighting. Since universities are but one part of the education sector, changes in university salaries could not drive the Labor Force Index (Education) but it would be a reasonable indicator of general changes in the underlying level of education salaries. Universities would still be required to be efficient and the indexation will still be less than increases in average weekly earnings.

The AVCC recommends that the Consumer Price Index (CPI) continue to be used to index the non-salary component of Government grants due to the lack of a viable cost measure that concentrates more on industrial and office goods rather than household items. As a general indicator of price changes the CPI has proved sufficient.

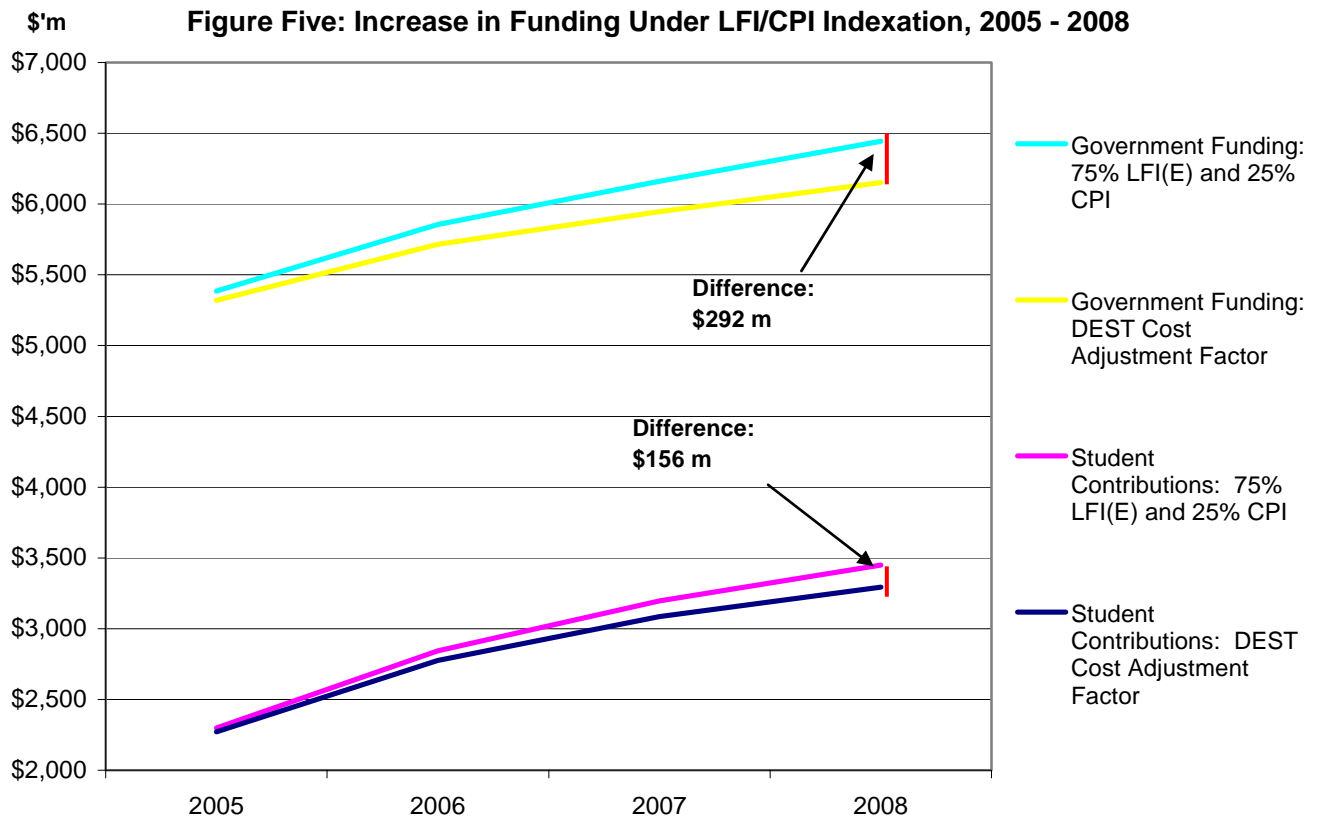
The impact of under-indexation since 1996 can be estimated by comparing the annual funding using the current index to the annual funding that would have been provided using the Labor Force Index (Education) – see Figure Four. Universities’ core income from the Commonwealth and from HECS by 2004 was \$586 million less than it would have been using the Labor Force Index (Education) developed for the purpose. This is nearly 10% of universities’ core education funding.

Figure Four: Impact of Under Indexation since 1996



Source: ABS LFI and CPI publications and AVCC Funding Tables (selected Years)

Figure Five shows the likely increase in Government funding and student contributions from 2005 to 2008 through use of the Labor Force Index (Education) to replace the current Safety Net Adjustment in the index. Full details of the estimate are provided in the Attachment. It shows that university base income would be stronger in 2008 by \$292 million from Government and \$156 million from students. The impact if introduced for 2005 would be \$64 million from Government and \$27 million from students.



Source: ABS selected catalogues; AVCC funding tables

The return to Government from committing to the Labor Force Index (Education) will be to ensure that the base capacity of universities is maintained. This will allow universities to continue to service students, industry, employers, community and Governments and develop ways to improve the provision of those services.

5. Use of the Index

The Terms of Reference for the Review question whether the index should be applied to the particular staffing and financial profile of each university rather than assume a common profile. The implications of such a shift would be to allow each university to influence its future funding by shifting its profile to maximise its index. As a result the index would be driving decisions about whether to employ more or fewer staff in comparison to non-labour expenditures. Differential application of the index would obscure the clarity of the funding for each university under the Commonwealth Grant Scheme, reducing the transparency of the new funding arrangements.

Decisions on expenditure should be driven by the need to maximise educational and research outcomes. The index should therefore be applied consistently to all universities.

Action required by Government

The AVCC urges the Government to amend the existing arrangements to index all university grants (for teaching, research training and research) and maximum student contribution rates. The Government should use the Labor Force Index (Education) as the basis for measuring changes in the cost of salaries and retain the Consumer Price Index as the basis for measuring changes in non-salary costs.

With this change in the factor used as the basis for measuring changes in the cost of salaries, the balance between the two factors should remain 75% for salary and 25% for other costs.

The index should be applied consistently to all higher education providers funded under the *Higher Education Support Act 2003*.

**Attachment: Likely Impact of Labour Force Index (Education): Consumer Price Index
Indexation 2005 - 2008**

	Forecast			
	2005	2006	2007	2008
DEST Cost Adjustment Factor 2004 Base	117 102	120 104	122 106	125 109
75% LFI(E) and 25% CPI 2004 Base	132 103	136 107	141 110	145 114
Funding using different indices (\$m)				
Core Funding	\$3,204	\$3,336	\$3,476	\$3,538
Indexation using:				
DEST Cost Adjustment Factor	\$3,271	\$3,478	\$3,700	\$3,843
75% LFI(E) and 25% CPI	\$3,310	\$3,563	\$3,834	\$4,025
Student Contributions	\$2,225	\$2,662	\$2,898	\$3,031
Indexation using:				
DEST Cost Adjustment Factor	\$2,271	\$2,776	\$3,085	\$3,293
75% LFI(E) and 25% CPI	\$2,298	\$2,843	\$3,196	\$3,449
Program Funding	\$261	\$324	\$342	\$356
Indexation using:				
DEST Cost Adjustment Factor	\$266	\$338	\$364	\$386
75% LFI(E) and 25% CPI	\$269	\$346	\$377	\$405
Research Funding	\$1,747	\$1,822	\$1,769	\$1,769
Indexation using:				
DEST Cost Adjustment Factor	\$1,784	\$1,900	\$1,883	\$1,922
75% LFI(E) and 25% CPI	\$1,805	\$1,946	\$1,951	\$2,013
Total Government funding (excluding student contributions)	\$5,212	\$5,482	\$5,587	\$5,663
Indexation using:				
DEST Cost Adjustment Factor	\$5,321	\$5,716	\$5,947	\$6,151
75% LFI(E) and 25% CPI	\$5,384	\$5,855	\$6,162	\$6,443
Total Government funding & student contributions	\$7,436	\$8,144	\$8,485	\$8,694
Indexation using:				
DEST Cost Adjustment Factor	\$7,592	\$8,492	\$9,032	\$9,444
75% LFI(E) and 25% CPI	\$7,683	\$8,698	\$9,358	\$9,892

Source: ABS selected catalogues; AVCC funding tables.

Note: Least-Squares Linear Regression used for forecasting likely indices. Actual \$ (2004 Price Level)