

Compacts, the Review of Australian Higher Education, the Review of the National Innovation System, and a validated metrics approach to the evaluation of research quality.

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[SLIDE 1]

Mission-based funding compacts with public universities are a feature of the unravelling new policy and financing framework for tertiary education. The Government has extensive ambitions for compacts, but their place and potential is not yet clear within the sector.

In the movie *The Cook, the Thief, His Wife and Her Lover*, the cook displayed his culinary expertise but to no-one's liking. So with reference to the title of my comments, who knows what's cooking with compacts?

[SLIDE 2]

Compacts were initially unveiled in 2006 by Labor's then Shadow Education Minister, Jenny Macklin, with 4 funding streams. The previous Labor reference to a compacts policy was under the "Accord" of the Hawke Government with the trade union movement in the early 1980s, involving 'social wage' improvement as a trade-off for monetary wage restraint. It's not hard to imagine some of the ways this could all get played out in relation to tertiary education funding, but that is for another audience. Tonight I will attempt merely to locate compacts in the wider policy agenda and consider how they might function to support reform.

[SLIDE 3]

There are various public policy factors likely to affect the future of tertiary education in Australia. They include:

- aspects of the COAG agenda for productivity, especially in respect of education and training;
- the review of the Australian Qualifications Framework;
- the Skills Australia initiative;
- the (as yet unsettled) review of post-VSU arrangements;
- the review of the Australian taxation system;
- demands emanating from new policy commitments in the fields of early childhood education and schooling (including the development of a national curriculum);
- demands arising from a higher and more diversified immigration program and the Government's broader social inclusion agenda;
- demands that may flow from greater attention to health prevention strategies and changes to the delivery of health and medical services;
- other demands that may flow from adjustments to global economic and environmental pressures, including changes in the skills and understandings needed in the general workforce; and
- demographic and other changes affecting the tertiary education workforce itself.

[SLIDE 4]

Additionally there are five concurrent exercises that more deliberately have been designed to influence future policy and financing for tertiary education:

- the Review of Australian Higher Education;
- the Review of the National Innovation System;
- the Excellence in Research for Australia (ERA) initiative for assessing the feasibility of a validated metrics approach to the evaluation of research quality;
- the Education Investment Fund;
- the Learning & Teaching Performance (Improvement) Fund; and
- mission-based funding compacts with universities.

It is not yet clear how these different strands will be drawn together, presumably by the end of this year, nor how well they will fit together if and when they are joined up. Given the complex and contentious nature of these things it is unlikely that firm policy positions will be settled by the end of this year, notwithstanding expectations that the Government will deliver something substantial to higher education in its next Budget. Indeed, in several areas the prudent course will be to undertake trials to test the workability of options. Political considerations also probably will result in any major policy shifts being phased-in gradually. Clearly there are lead times involved in changing patterns of tertiary education and research, even though the case for reform in certain areas is urgent in view of rapid international developments. Hence, I think we should be looking to the longer-term direction of reform and medium-term bridging arrangements to that end.

As indicated earlier, there are also many additional calls on government spending associated with concurrent policies for intensifying investment for the development of the youngest members of the community while attending to the needs of a growing older population, and dealing with unprecedented environmental challenges. With the notable exception of the HEEF/EIF, now hovering like a waiting excuse, tertiary education did not make it onto the election or post-election A list, and that was before the costs associated with A-list commitments were fully appreciated.

In this light, significant additional public investment cannot be expected realistically without real reform that leads to capacity and performance increases in the contributions that tertiary education and university research make to the very problems the community is facing. The community does not appear too worried about the problems that tertiary institutions – universities and TAFEs – are facing, and perhaps they won't have cause to take much interest until they can connect the dots to the problems they are concerned about.

All of this is to be distinguished from the preoccupation of governments and others over recent years with internal institutional efficiencies. Measurable gains in teaching productivity and research productivity have been delivered over the last decade or so. Increases in output volumes (e.g. graduates per teacher, publications per researcher) have been achieved without apparent diminution of quality. There are now serious concerns that quality is severely at risk – in education and research. We know that in the sector but the community cannot see it. For their part the community may accept the allegations of institutional slackness, but they don't seem too concerned about that either. It's all too internally focussed on institutional interests for them to care too much. In any event, the main game in the future is not to squeeze yet more out of individual institutions but to improve overall cost-effectiveness through structural reform of the tertiary education sector.

Cost-effectiveness refers to the utility and quality of outputs as well as the efficiency of the use of inputs. Structural reform refers to removing impediments to learning and knowledge flows across the internal sub-sectoral boundaries of the total education system, and between tertiary education and wider communities. Perhaps the community expects to see the worth of tertiary institutions expressed through the access to learning opportunities that they enable, the calibre of the graduates they produce and the contributions they make to problem solving through research and knowledge transfer. It is pretty clear that governments and their advisers, inside and outside the public service, are seeking ways to improve overall system performance, and there are indications of unwillingness simply to invest more, say by way of a generalised rise in the rate of indexation of operating grants, in an unreconstructed status quo.

Additionally, if the experience of the last twenty years is anything to go by, government funding alone cannot be relied upon to sustain a quality system of tertiary education. Over the long run it has been an unstable and diminishing source. We would be foolish to believe that even a government that cares about education will be a reliable investor, and so it is necessary to look also to other funding sources, including increases in the student co-investment.

Our chief responsibility as contributors to the policy discussion is to generate the ideas that will help Australia build a tertiary education system for the future – one that that will be responsive and cost-effective, equitable in providing opportunities for access and success for all, and sustainable at the standards of quality necessary to be internationally competitive.

From all that we can discern about the future demand for tertiary education and university research it suggests that policy should focus simultaneously on five areas:

- broadening the base of the tertiary education system for expanded access by currently under-participating groups;
- improving pathways and learning outcomes in relation to undergraduate and graduate award courses;
- increasing flexible opportunities for professional development and skills upgrading for the tertiary qualified;
- strengthening capacity for excellent research and research training at the top of the system; and
- connecting tertiary education and university research more effectively with the diverse needs for knowledge and know-how in business and industry, government, and the wider community.

If these are broadly the most important areas for policy focus, then one question that arises is what weight to put on each of the five areas in terms of government priorities for public investment. That is to ask: what is the role of government in these areas, and what are the responsibilities of individuals and institutions through their own efforts. No doubt there will be varying answers to such questions.

Let us consider briefly the first need, to expand the access (and success) of non- participating groups and those who are not participating satisfactorily.

If we set our sights on Australia performing as the best among OECD countries in terms of tertiary education attainment by age group, then we have a long way to catch up on the current leaders,

based on 2005 comparisons. Indeed, a major cause for concern is that Australia's younger generations are less well qualified relative to the best in the world than our older generations. The gap in percentage points between Australia and the world leaders (Canada in the case of Tertiary Type B and Korea & Japan in the case of Tertiary Type A) is 12 and 13 percentage points for men and women respectively in the 45-54 age group. But the gap has widened to 17 points for men in the 25-34 and 35-44 age groups, and 18 points for women in the 25-34 age group. For women aged 35-44, the gap has blown out to 20 percentage points, with 54% of Canadian women in that age range having tertiary qualifications compared with 34% in Australia.

For Australia to reach OECD best performance across all age groups, on the basis of the 2006 population census, we would have to increase the stock of tertiary qualified people by 1.7 million. Just over 1 million of those are currently aged between 25 and 44 years. This would be a challenge, given the circumstances of many of the people involved, including for women especially the responsibilities that fall to them disproportionately in respect of family care.

Of course, benchmarking against world's best performance is only one criterion. Adopting equity benchmarks, including inter-generational equity benchmarks, additionally, we would need to give urgent priority to the younger age groups where the education participation rate remarkably is falling – that is to those not participating between the ages of 15 and 25. There are also the very wide gaps for Indigenous people, various ethnic communities, and white working class males among others, who on the available evidence are falling further and further behind.

Also we have to have regard to labour market requirements, to the extent that we can estimate net needs in aggregate and their distribution across occupations and regions. Further, we have to have regard to differences in the preparedness of individuals.

Broadly we can distinguish four types of potential tertiary education learners: (I) tertiary-ready recent school leavers; (II) not-yet-tertiary-ready recent school leavers; (III) tertiary qualified adults; and (IV) adults without tertiary qualifications (whose readiness for tertiary learning is not necessarily known in advance of some form of participation). The main challenge is to increase the participation of groups (II) and (IV).

Current financing policy settings apply curiously across these four types. Type I students these days are mostly able to obtain a taxpayer-funded tuition cost subsidy and access an income-contingent loan (HECS-HELP) with a "student learning entitlement" (SLE) of up to 7 years. Type III students may access the unused part of their SLE, depending on the nature of the course, or obtain an income-contingent loan (FEE-HELP) to undertake further undergraduate or graduate studies, or directly pay tuition fees. Type IV students can access HECS subsidies and loans if they gain admission to a higher education award course with an approved institution. The residual of the Type IV group and the bulk of the Type II group do not enjoy the same benefits as those in the other groups.

One possible option for (Type II & Type IV) is an entitlement to a 'tertiary preparedness program'. For instance, along the lines of the competitive model for the provision of employment services (though not necessarily as a condition of eligibility for benefits), a tender might be called for selecting providers who can offer services to raise the readiness of individuals to undertake successfully a VET or HE Diploma or an Associate Degree program. Individuals wishing to participate in the program could indicate their interest by taking either ACER's UniTEST or Special

Tertiary Admission Test (STAT). Selected providers could be paid a flag-fall amount for taking on each participant together with a performance payment reflecting the rise in the participant's test score, with the aim being to achieve a score that enabled the participant to gain admission at a TAFE or university or other accredited tertiary institution to an award course.

I raise this model, not to advocate its particular adoption so much as to illustrate a number of points about the diverse nature of the demand and potential demand for tertiary education broadly defined, and the diverse nature of the supply required to serve that demand. To increase the supply of graduates with the capabilities required for the future economy (as well as to improve their life chances, and to reduce social outlays on health and security), it will be necessary to draw increasing numbers from the ranks of those who have little current disposition to participate in tertiary education. To make that happen, there will need to be some very strong incentives, to potential students and providers of tertiary education services. Currently these incentives are lacking.

Over the last few years we have seen increasing diversification on the supply side, both in higher education and vocational education and training, and in non-award education, training and professional development, including the rise of private providers and public-private partnerships, as well as corporate, vendor, professional and other suppliers of training accredited in various ways. Additionally, contemporary universities have multiple roles. Teaching represents less than half the budget of several universities. Many are operating in competitive and commercial markets at home and abroad.

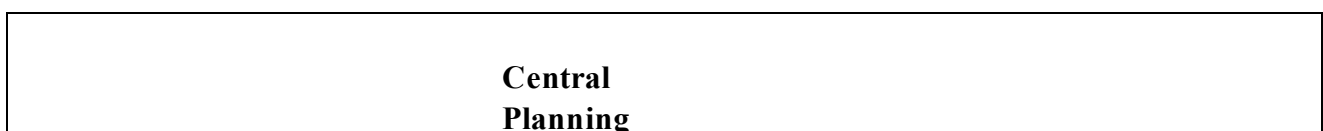
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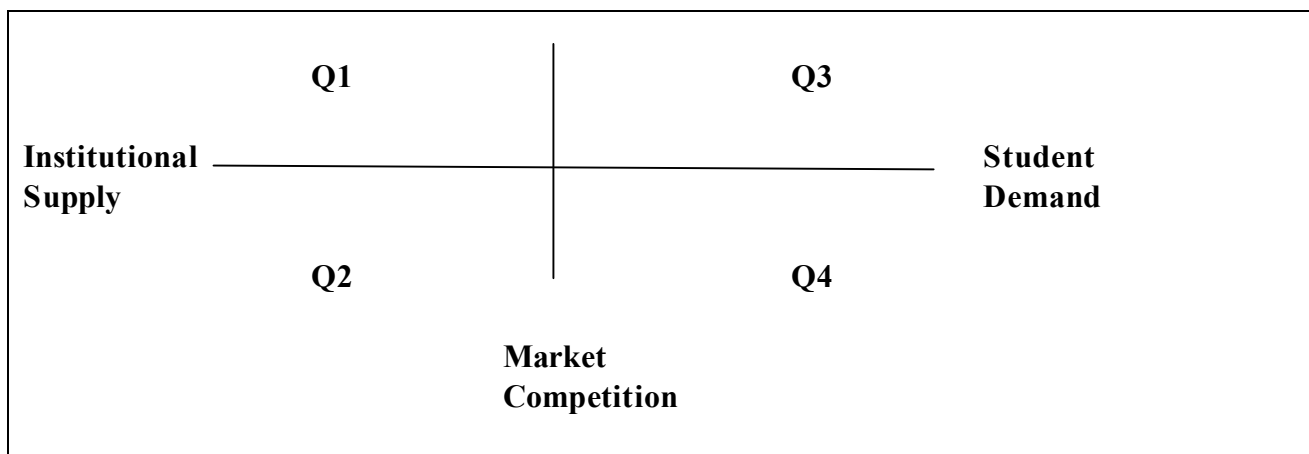
An imperative is created by this dynamism to rethink the basic policy assumptions that derive from a previous era of primarily state-bound, public-sector institutions catering for professional groups in a hierarchical labour market. This slide (figure 1) depicts four basic approaches to tertiary education financing. Each quadrant reflects a different purpose for funding and a different philosophy of funding as well as different funding mechanisms.

The main policy purpose of a Q1 approach is to establish and maintain educational institutions (e.g. through block funding for an agreed range of activities and/or outputs). The main policy purpose of a Q2 approach is to obtain service provision (e.g. through procurement via competitive tendering). The main policy purpose of Q3 is to enable access for those who can benefit from higher education (e.g. through rationed scholarships). The main policy purpose of a Q4 approach is to meet the varying needs and preferences of individuals (e.g. through flexible tuition pricing and student loans).

The Dawkins reforms of 1989 adopted a supply-side planning approach (Q1) in terms of government funding of higher education institutions through block grants for a profile of student enrolments, with normative government funding rates per student place and controlled tuition prices through the Higher Education Contribution Scheme (HECS). Initially it was envisaged that graduate volumes would be shaped through the profiles process to meet projected labour market requirements but that approach was abandoned early in the light of deficient central forecasting.

Figure 1: Tertiary education policy and financing models





Subsequent policy changes have increased the role of student preferences (Q4) through the student contribution scheme (HECS) and growth in fee-paying students – international and postgraduate students and domestic undergraduate students (curiously about to be prohibited in public universities). Hence, funding through the Q1 model now represents less than half of higher education income, yet the Q1 policy model of central control of supply persists, jarring up against the operation of market mechanisms and creating frictions and anomalies for students and educational institutions.

At the core of the contemporary policy conundrum is the fact that government-managed funding for student enrolments (a demand side concern) remains a mechanism for protecting institutional interests (a supply side concern). Within that framework, options for differentiation of institutional establishment are constrained, thereby limiting student choice. Additionally, normative funding and common incentives promote sameness in aspiration and expectation notwithstanding differences in actual performance standards (although we lack hard evidence about the extent of variation in learning outcome standards).

In order for policy and financing to be coherent in the contemporary, marketised environment – nationally and internationally – ideally there needs to be a deliberate shift from the supply side to the demand side in terms of the management of student enrolments.

Accredited tertiary education institutions should be free to determine the number of students they are prepared to accept and the terms on which they accept them. That is, current government controls over student volumes and tuition prices should be deregulated across the tertiary education system. Associated controls, such as Ministerial approvals for course openings and closures, should be disbanded, as they reduce responsiveness to student demand. That is, government should accept that the tertiary education industry operates in competitive markets, recognise that the mass market has become too complex for central planners, and allow market forces to work as well as they can (Q4). Cases of market failure can be addressed more appropriately and efficiently in other ways, such as through ‘mission-based funding compacts’ (Q1) and competitive tenders (Q2).

Of the main rationales for government control over student volumes, only one remains relevant in an era of wide-scale tertiary education participation and extensive dispersal of graduates from different fields of study across diverse occupations; that is the need for the government of the day to control its expenditures. Importantly, government can very effectively exercise direct control over outlays through demand-side financing (Q3) by determining annually the number of scholarships it is

prepared to fund and the value of those scholarships, as well as loan limits, without intruding into the internal operations of institutions.

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Hence it is timely to propose that government support for students seeking to undertake initial studies leading to a Diploma or higher award (within either the higher education or vocational education and training sectors) of the Australian Qualifications Framework should be allocated directly to students in the form of scholarships, on a national order of merit basis. Let's exclude Certificate level VET qualifications from this model, at this stage, given the role of employers in apprenticeships and related arrangements, and the current review of policy in that domain. Even so, there are structural implications of this limited 'cross-sectoral' approach that I will discuss shortly.

Students who are offered scholarships should be free to choose the programs they want at an accredited institution of their preference, and have access to income-contingent loans to close any gap between the value of their scholarships and the tuition prices set by institutions. Student choice should ideally be exercised across public and private institutions. The students should be the ones that decide the trade-offs they want to make between relevance, convenience, quality and price. An open policy framework that maximises their choices is more likely than a closed one to give rise to increased responsiveness and innovation for the benefit of students.

The ACER's UniTEST could be used to determine the national order of merit for recent school leavers. The ACER's Special Tertiary Admission Test (STAT) could be used to determine the national order of merit for other prospective students. These are well-designed and tested instruments, and they can be administered through arrangements that fit Australian circumstances.

As flagged earlier, Tertiary Education (Preparation) Scholarships could be available also for those applicants who do not meet the cut-off score required to obtain a scholarship, and for those who do gain the offer of a scholarship but need further preparation in the field of their choice in order to gain entry to an award course of study.

This approach has particular advantages from an equity perspective. First, the opportunity for enlarged funding enables institutions to enrol greater numbers of students and improve educational quality. Second, UniTEST and STAT scores can be linked to student identifiers and background indicators and provide information, for instance, about the number of students from low socio-economic backgrounds who are capable of succeeding in tertiary education. Scholarship allocations and associated tracking arrangements could provide enhanced information about the equity mix of students, their progression and success rates, and their graduate destinations. Currently we lack such information.

Third, it would also be open to government to weight scholarship values to encourage wider participation of particular groups. Additionally, this model offers new ways and means for government to influence tertiary education responsiveness to changes in labour market requirements. Government might, for instance, expand the number of scholarships it offers and/or increase the value of scholarships taken up in particular areas.

Finally, this model avoids the ‘two-queues’ problem that arose with the previous government’s approach to permitting full fee places outside quotas of funded places. Under the preferred model scholarships would be allocated according to merit rather than means.

Compacts in the student-based financing model could be negotiated along the lines of the recent COAG reforms to special purpose payments to the states, with a core grant for a base level of activity and a performance-based supplement for agreed additional activities.

Hence, a university compact would have a core fabric grant, reflecting the conditions of the institution in its area and location-specific costs associated with its teaching and research functions.

Another payment could be allocated for research training based on evaluations of research performance quality; that is the allocations would be ERA-informed.

The performance-based supplementary funding through compacts could support community outreach, innovation and programs of national significance (such as retention of classics, languages, physics or other fields of scholarship for which student demand may be low).

In this Go8-preferred model, funding compacts support the public good functions of different universities according to their missions in a largely deregulated, student-driven, competitive environment.

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A variant on a broad demand-side financing model is to allocate funding envelopes to institutions for a set of their student enrolments. Pricing flexibility under this model might be offered only to those institutions that meet certain performance criteria, that is according to the principle of regulation proportional to risk.

Under this modified-Macklin model, student volume and tuition pricing controls are relaxed for some universities. In this approach, a compact might involve an undertaking by the university to provide equity scholarships as a quid pro quo for pricing flexibility. Indeed, given the magnitude of the challenge of increasing drawing in new learner cohorts, it may be reasonable for the Government to expect in return for increased institutional flexibility a commitment to increase the access and success of students from disadvantaged backgrounds.

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Both approaches may be seen to be consistent with the originally stated role for compacts:

“to give Australia’s universities the freedom necessary to form and implement strategies for their future role in competitive markets, while safeguarding public good benefits for the Australian community.”

The Go8-preferred (student-based) financing model envisages tuition subsidies being portable as scholarships to any accredited tertiary provider, VET and HE, public and private. This model would promote much greater institutional diversification within the overall tertiary education sector and offer wider choices for diverse learners.

The modified Macklin (institution-based) financing model limits to universities the allocation of funds for government-subsidised student places. The limited model might offer a bridge to the more open model over time.

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Both models provide new steering mechanisms and have implications for the structure of supply. The more open model offers prospects that market forces will drive structural adjustment, with compacts providing some safeguards for institutions that can continue to perform services of community value.

[SLIDE 10]

Governments at all levels are unlikely to sit back and allow institutional structures to be hostage to fortune, so compacts would become a potent shaping mechanism. The more limited model also sees compacts having a strong role, including a differentiating role in terms of institutional discretion, alongside links via hubs & spokes arrangements that will concentrate capacity and expertise.

[SLIDE 11]

A fundamental question is what strategic purpose is to be achieved through diversification, as diversity is not an end in itself. There are several reasons for wanting to see diversification but discussion about the real ends has been limited indeed.

[SLIDE 12]

Another significant question is to what extent compacts should be pursued more deliberately with a view to systemic stratification.

In order to optimise the cost-effectiveness of tertiary education across Australia, supply-oriented policy (Q1) needs to focus on the structure of the system – the missions and functions of different institutions, and the inter-connections among institutions that facilitate lifelong learning.

In order to safeguard public good interests in the more competitive environment, funding compacts need to be negotiated with each institution consistent with its mission, capacity and performance. This provides a base of protection for institutions that may be adversely affected from time to time by fickle student demand. Additionally, to sustain a cost-effective, equitable and responsive tertiary education system it is necessary to be able to determine which institutions will make the primary contribution to greater graduate output and greater research output to meet national needs over the next decade.

[SLIDE 13]

Compacts become the balancing mechanism in this context.

- Compacts recognise that universities have multiple roles in contemporary society and that different universities have different roles.
- Compacts offer dedicated funding for additional community outreach and innovation activities.
- Compacts provide funding for these additional activities on a performance basis.
- Compacts offer flexibility according to the principle of regulation proportional to risk.
- Compacts potentially allow for tuition and associated services for students to be packaged at varying prices across institutions.

- Compacts ensure that HDR student places are allocated to institutions that meet threshold standards of research performance, as validated through the ERA research quality evaluations by field of research.

[SLIDE 14]

In view of their importance, it is necessary to agree some basic principles for the operation of compacts. The Go8 has identified six main principles:

The Autonomy principle: Universities are responsible for determining their missions, and they need greater operating autonomy in order to function effectively and competitively in local and international markets

The Fitness for Purpose principle: Public funding should be sufficient to the task, and it should be provided in ways that enable each university to pursue its distinctive mission and to excel in what it does best.

The Accountability for Outcomes principle: Universities have a reciprocal responsibility to explain their purposes, and to report publicly on how well they have performed against their own goals and the performance standards expected of them. The terms of accountability should be clear and measurable, and agreed at the same time as the compact is negotiated.

The Simplicity principle: Compacts, including associated performance reporting, will be agreed in relation to block grants on a broad not detailed basis, will involve less regulation, and will lead to a reduction in the current administrative and reporting burdens of universities.

The Transparency principle: Decision making in respect of compact agreements and funding will be open to external scrutiny, and based on a fair application of consistent rules.

The Predictability principle: Compacts will provide the capacity for universities to plan ahead; they will be resourced according to published criteria, and changes to funding will be based on known parameters.

[SLIDE 15]

Additionally, compacts negotiation needs to be at arms length from government and informed by performance information and good judgement. There are three main reasons: the need for decision making transparency; the need for discriminating judgement; and the need for sustainability of reform.

First, and consistent with the transparency principle, there is the need to avoid even the perception of opaque deals being made by ministers or vice-chancellors through negotiated arrangements.

Second, the natural tendency of public servants is to be even handed administratively, when what is called for in the initial compacts process is the exercise of discriminating judgement in relation to mission, capacity and performance. It is unreasonable to expect public servants to make these calls by themselves, and at least, they should have the benefit of support from some people with experience and credibility in the academic and business worlds.

Third, the process of reform needs to continue past the direct involvement of the immediate ministerial and other players. It is necessary not only to monitor performance against undertakings but also to remember the rationale for particular arrangements being agreed. Otherwise, the checks on drift are too weak to sustain the intended reform.

The Government might give consideration to the formation of a transition advisory body to work alongside the public service to help develop coherent responses to the five concurrent tertiary education policy and financing exercises coming together at the end of this year. Such body might be formed at least for an interim period, including the first round of compact negotiations, to help drive structural reform. If it works well, the Government would have the option of building on the approach to design a more contemporary regulatory framework for tertiary education, along with a capacity to monitor developments and advise on the need to address market failure.