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“University Funding Models, Private Investment and Governance”

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You may have noticed that the title of my presentation is a bit different from that of my colleagues. Theirs all begin, “The Australian funding model, comma”. Mine begins, “University funding models, comma”.

This is truth in advertising. I have worked for most of the last two decades within the University of California system, and I have only been back in Australia for a bit more than a year.

Ten years ago I got my first exposure to university-wide issues when I became a member of the University of California (UC) system wide planning and budget committee, part of the UC Academic Senate, which contributes to the governance of the system.

Five years ago I became the chief operating officer, and the chief academic officer, of the University of California, Los Angeles. I then served on the UC system’s administrative budget committee.

I am therefore, in some senses, still a slightly bewildered observer of the Australian higher education system. The University of California, which I know better, exists within a social framework, in a national higher education ecosystem, and has a university governance structure all quite different from those in Australia. I will mention those differences where I see that they may be relevant to today’s discussion.

Anyway, that’s why the title of my presentation is different.

Although the focus of the conference is money – financing – I will also comment now, and again towards the end of my presentation, about structural aspects of higher education.

Professor Gaehtgens began yesterday by welcoming some steps towards increased university autonomy in Germany, and Mike Gallagher explained the origins of the high degree of autonomy in university governance in Australia.

I may be in a minority, but I believe that Australia has too much institutional autonomy, in most respects, to best serve the needs of Australian society, and not enough national governance of the university sector. We have a lot of government regulation, but this is quite different, in my mind, from good governance for the sector. There is a bit of a language problem here, and it's not a matter of English versus German – we have trouble with that difference just in English.

So although I'll try to talk mostly about funding, I will talk a little towards the end of my presentation about national governance needs: ways to organise our system better. I'll say it now, then I'll say it again then, that I think that getting governance right, and the shape of the sector right, is even more important – more necessary - than getting financing right, if we wish to create good social outcomes. One can have quite sensible funding arrangements, even good funding arrangements in the social sense, and still have a university sector that serves society poorly.

I would like to acknowledge the enormous German contribution to the development of present-day universities. This is not just to flatter our hosts, although there is nothing wrong with that. I want to emphasise the social value of what you created. A major part of the social value of what universities can do was invented here.

The unique development of focused, graduate-level research training and research activity, pioneered in the new discipline seminars of German state universities in the mid-1800s, transformed many of the world's universities, and is still the prime model for part of a well-structured university sector.

As you may know, because of the very obvious effects on the state and national economies that followed focused, graduate level research and research training in the new disciplines, and because of the attractiveness to American baccalaureate graduates who flocked here to train towards your invention, the PhD, American Universities began to follow the same pattern.

John Hopkins University was established with the absolute intent to mimic the German model, and to help solve the Nation's problems through graduate-level research. The land-grant universities began to follow suit, then the great private universities in the US, Harvard and Yale, and then later the other great European universities, like Oxford and Cambridge and Paris.

The prime focus of this conference is university financing, and in particular the utility of the Australian HECS model as a contributor to that financing.

I state at the outset, with no hesitation, that in my view HECS has been and is good social policy. That's a fancy way of saying that I agree with it. Unless the effective majority of citizens are prepared to fully fund the costs of higher education through tax revenues, then some form of fee is necessary, if you want good quality education and research. HECS is a very effective way to enable individuals to provide that fee.

You will be interested to learn that the chief financial officer of the University of California system contacted me recently – through his deputy, he was too frantic to contact me himself, I guess - to inquire about HECS and how it operates.

As you may know, California is facing a crisis in public financing of quite devastating proportions, and they are looking at all options in attempts to maintain quality in the face of substantial cuts in State support. I think that they will decide that HECS won't work for them, unless they can collect through Federal taxes. Maybe Governor Schwarzenegger and President Bush can do a deal.

I have been asked to address two things in relation to university funding – **private investment** and **governance**.

The individual contribution, in our case HECS, in California's, various student fees, which are not called 'tuition' for political reasons, but are about the same proportion as Australia's HECS, is **one form of private investment**, and I will address that first.

In re-considering HECS levels and repayment parameters, as we are now doing, Australia is continuing to work to determine the appropriate balance between public investment and individual contribution towards the individual educational component of university activity in the country. Each society that has any commitment to social democracy in higher education has to make that determination.

There is no doubt that benefits accrue to individuals through university education – things such as increased personal satisfaction, increased intellectual capabilities and in the great majority of cases increased personal income throughout life. There are also substantial benefits to society as a whole from investments in education – measured principally through increases in the quality of life for the whole society.

What is the appropriate balance between private and public investment, given the various benefits to the individual and to society? As I see it, the correct answer can only be determined in the context of the overall value systems of a particular society – and some of these overall values can be measured, or at least have measurable parameters from time to time. Prime examples are the differentials in incomes that a particular society allows between various occupations; and the differentials between those supported through social services, such as the unemployed and the elderly, and those employed; and the structures and calibrations of graduated income tax.

It is reasonable that the political process be used to find all of these balances, and this is what is going on relative to university fee levels in Australia at the moment. We all have to accept that the political process is the only way that such value decisions can be made, in any system even vaguely related to social democracy.

As university academics we can contribute in a reasoned way to this debate. Our best chances of success, I think, will be if we do proceed on the basis of rationality, understanding and highlighting the social value that we can provide, relative to other social needs.

The Australian situation has been made a little more complex by a unique series of decisions related to allowing universities to charge full fees to some individuals, in parallel with others who receive state subsidy.

The first decision was to allow full-fee access for foreign students, not in itself unusual – it is very similar to the out-of-State or out-of-country fee arrangement for students in State-supported public universities in the US. In Australia this has allowed us to build capacity, largely removed from government regulation of enrolment profiles, which otherwise could not have happened. I think that we are a stronger sector now than we would have been without being able to do this, although as was noted earlier, we are vulnerable to fluctuations in the market for such students.

This decision, to allow fee-paying international students, was followed by what I believe was the equity-based decision to also allow full-fee access to Australian students. These are

academically qualified for university entry, but do not qualify for acceptance into a limited pool of government subsidised places, what we call HECS places, in a particular university. This arrangement is unusual. There is a significant conflict between two equity principles inherent in what we call the full local fee option. The debate around this option in Australia has been particularly intense, both nationally and in individual universities. Some universities have not taken up the option, even though they may have been able to attract such students.

The third complexity is the proposal that HECS might be varied, by individual universities and for different courses of study, upwards by a maximum of 30%, or downwards to any level. This has been put forward as a mechanism to help the sector differentiate, as Mike Gallagher mentioned yesterday. It might do that, or all universities might simply increase the HECS by 30%. That is certainly the broad expectation in the Australian community. It will be interesting to see what does happen, if the proposal survives the political process.

I will now address some other forms of private investment in universities. As I see it there are four other possible types of private investment, in addition to private investment through contribution to the basic costs of tuition:

- (1) the systems of investment and support that lead to the creation of **private universities**;
- (2) the more general contribution that some individuals make in exchange for the personal benefits to themselves or their families which accrue from university education – what is generally called **alumni support**;
- (3) the contribution that organizations such as industrial companies make in exchange for direct benefits that accrue to them through research outcomes – **private research support**; and
- (4) **philanthropic support** - the contributions that philanthropic individuals, charitable foundations or other entities make to promote broad social benefits that universities can provide to societies.

First, **private universities**.

Australia has very few private universities, and they have only joined us recently. We have a quite different historical tradition to that of Europe and North America.

Our first, and therefore our most influential universities were established at the time when state-supported universities in Germany, in particular, and then North America were

demonstrating their social value. Each of our six states established one university only, and for about 100 years maintained only that one university.

These universities were state-supported – by the Australian States, not by the Federal government - from their beginning, and we have no tradition of strong private universities to provide us examples or guidance.

This is a pity. Private universities serve on one hand as a simple beacon, an example of personal and social value in a quite pure form. They need not be linked to political decisions. They simply prosper, survive or fail depending on the value that they provide to individuals and to society, and very importantly depending on the perception by citizens of that value. They must continually define and effectively articulate what that value is, and refine and change that value and its public articulation, if they are to continue to survive and to serve.

The US has an impressive spectrum of private universities, as well as a rich spectrum of public, state-supported universities. Among the privates are:

- a few extremely successful research-intensive universities covering a broad range of disciplines, such as Harvard and Stanford;
- many very successful and highly focused smaller universities teaching liberal arts and sciences extremely well, but in the great majority of cases having little or no graduate or research mission;
- and many other, more experimental or entrepreneurial and newer constructs such as the University of Phoenix network, which operates with very low overheads, little or no permanent physical structure. This last group generally deliver a teaching product only in the most cost-effective way possible, consistent with remaining attractive in the market, and usually have no research mission.

As the degree of commitment to social democracy in many societies has lessened over the last one or two decades, and I see both California and Australia having moved that way, private universities have provided useful guidelines for defining core values in higher education, as public universities have had to find ways to compensate for declining levels of state support. The full-fee options that I have described are good examples. So are the things that I will talk about now.

Alumni support throughout life

Systems that generate life-long commitment of graduates to the support of a particular university can be extremely valuable. Both political support, and therefore effects on public financing, and direct private financial support can flow from such commitment. Private universities in the US do well; public universities do less well. Australia's universities are all working to increase the levels of commitment and support. To develop and maintain enduring alumni support universities must provide evident value, and they must continually and clearly articulate that value, both to individual alumni and to society.

Research-for-hire – relationships with corporations and industry to deliver research outcomes for fee – there can be great benefits, but there are also ethical constraints. I believe firmly that we can manage those constraints. Our research must be seen to be of benefit to society as a whole – that is one of the two core values of research-intensive universities. This imperative should place limits on the degree to which sponsoring businesses can do exclusive deals. There is real social value in the open exchange of knowledge, and we must not let that be bought.

I will step aside from private investments for a few moments to comment on the second major component of public investment in university activities, public investment in research. As my colleagues have mentioned, Australia is working through considerations of the relative benefits of block grants to individual universities for research relative to competitive funding for research, based on merit.

Many of the newer universities have successfully advocated for block funding for research, making the argument that in order for them to become research active they should receive research funding on a per capita basis, and on a per-publication basis. Not surprisingly, some of the more established universities have argued that the country is better served by the greater part of research funding being available on the basis of competition based upon quality.

Each of us, I am sure, will have an opinion about the relative merits of these two approaches. I think that the former is bad social policy – which is a fancy way of saying that I don't like it. Competition for grant funding may be imperfect, but it's better than the alternative, and we should work to find ways to make it less imperfect.

There is also some debate about **what should be paid for** in publicly-funded, competitive research. At present our governments do not pay the salary components of investigators if they are university academic staff, arguing that these costs are already covered through the base operating grants, which are student-enrolment-based. I also see this as bad social

policy, for two main reasons. First, it is a disincentive to try to succeed in competitive funding – it makes the block grant approach more attractive, and therefore supports and promotes mediocrity. Second, it creates a bad example for industrial support of research – why should industry pay the real costs of research if government does not?

Similarly, the full indirect costs of research are not provided, using the same logic. This creates the same problems.

One of the Australian Federal funding agencies, the Australian Research Council, has recently been asked to find ways to begin funding some investigator salaries, but within its existing budget. It's a beginning.

As other people have mentioned here, Australia has a long way to go to get the research funding part of university financing right in Australia. In addition to the structural problems, the absolute levels of social investment in research are much lower than they should be.

Philanthropic support – from individuals, foundations, corporations. The development of an endowment base in support of the university's work is an extremely valuable adjunct to university funding.

Most of the great private universities in the US are great because they have substantial endowments, on which they can draw to support and strengthen their programs. They all work vigorously to maintain and to add to those endowments.

Private philanthropy in support of universities in Australia is not well developed. Mike Gallagher's data yesterday showed, in fact, that the proportion of philanthropic support has declined substantially since the Federal government took over responsibility for funding from the States.

Like us, public funded universities in the US were also not strongly involved in seeking philanthropic support, until about 20 years ago - when it was recognised that public investment was unlikely to meet the full, future needs of the sector, particularly if it was to remain competitive with private universities in the US.

The University of California system undertook a very substantial effort designed to increase the level of philanthropic and industrial support to universities, believing (quite correctly as it turned out) that the level of State support would decline over time. The political philosophies of Margaret Thatcher and Ronald Reagan did, in fact, bring about such a reduction in public support. The efforts of the University of California system to increase

industrial and philanthropic support were extremely beneficial in maintaining the quality of the University as that decline occurred.

Australia's universities have been less successful in increasing the level of support from non-government sources, but we are each in different ways engaging with this area much more vigorously than we have in the past. My own University is investing substantially in both academic planning; to clarify what it is that we do and will do that is of unique value to society, and in systems support, particularly building expertise and building relevant relationships, to increase philanthropic support in the future.

Governance

The second major area that I have been asked to address is governance. I will try to be brief.

First, some brief comments on governance of individual universities. Each of Australia's universities has its own governing board, with function and structure defined by an act of State Governments in almost all cases, or of Federal Parliament for two, one of which is the Australian National University.

In most cases, our governing boards have a strong presence of representatives elected from various constituency groups, for example alumni, academic staff, general staff and students. They also include parliamentary representatives.

These things are consistent with some deeply-held Australian social values – fair play, helping each in times of difficulty, representative government, one vote, one value.

However some people believe that in a time of decreasing commitment to social democracy, and increasing emphasis on financial self-reliance and government inducements towards competition, the governance arrangements for individual universities should be changed, to reflect the increasingly competitive and commercial nature of university operations.

With the strong encouragement of the Federal Government, Australian universities and State Governments are at present critically examining the suitability of the governing boards' structures for the present and predicted future needs of our universities. The debate is quite lively, and the outcomes are likely to differ among the various Australian states.

I think that there is some general agreement that decreasing the proportion of elected representatives and increasing the proportion of individuals who are chosen on the basis of expertise to act as trustees, rather than representatives, will be beneficial. Certainly the present Federal Government is encouraging change in this direction.

It appears to be a general principle that when a large proportion of the governing board of a public interest body such as a university consists of elected representatives, the predominant behavioural pattern and focus of the governing board tends to be the control of the operations of the university through legislation. When a functional majority is comprised of trustees, appointed on the basis of expertise, the predominant behavioural pattern tends to be one of monitoring of, and advice to, the appointed executive.

Decisions related to both operations and financing in Australian universities are therefore strongly influenced by the representative nature of our governing boards, in those areas where Commonwealth legislation allows us options. In most cases there is firm legislative control, however – the Federal Government, in general, pays the piper, at least enough to call most of the tune.

These concerns about single university governance are relatively minor, however. Our greatest defect in governance, in my view, is that we do not have informed academic governance at the centre. We do have public servants and politicians who are prepared to make regulatory decisions on behalf of the sector, but we have no academically-informed governance structure for the public system, either nationally or at the state level. Either would help, in my view.

I see a major need for central planning to guide our state-assisted universities. Consistent with the overall shift in political philosophy, we have moved dramatically towards the 'free market' in higher education, and the 'free market' is a poor mechanism for developing a diverse sector, which is what Australia needs, in my view, to serve society well. Some flexibility at the institution level is desirable, but so is master planning.

I draw a comparison with California, where there is a quite rigid demarcation into three tertiary sectors, with quite different goals, and different levels of funding. The system there is far from perfect, but it has some very valuable features.

The California Master Plan for higher education divides publicly-financed higher education into three distinct sectors.

The University of California system has a mission of graduate-level training and research, in addition to masters and baccalaureate education. It is expected to serve society through research outcomes, and through doctoral level research training. There are now ten University of California campuses, and six are among the top 50 research universities in the US. This is a higher proportion than California's population would suggest, relative to the population of the country, I believe because of guided diversity and academic focus.

The California State University system teaches at the bachelor and graduate course-work degree levels only. Its academics are expected to be active scholars, but need not conduct research. The system cannot grant research doctoral degrees. There are twenty-one universities in the State University system, and they teach very well at the bachelor and coursework masters' level.

The California community colleges teach at the sub-bachelor's level, are open to all high school graduates of any age, at a low cost. It has no research mission at all. It has strongly articulated programs for transfer to the other two sectors. One-third of the UC system's graduates are community college transfer students, who enter into the third of the four-year bachelor's program. This has enormous social equity benefits.

The first two of these sectors are in some ways equivalent, as I understand it, to the two sectors in Germany, the universities and the universities of applied science, but the distinction in California is more rigid – there is no research mission, because of the prohibition on research doctoral degrees, and very limited capacity to undertake strong research, in the second level in California.

Unfortunately Australia has lost the distinctions between the equivalents of the first two of these sectors, and does not have broad and planned links between its community college equivalent, the technical and further education sector, and the universities. So Australia now lacks both structure and governance to promote sectoral diversity. Instead, we have a strong tendency among our universities, because of uniform regulation and uniform funding arrangements, towards equal mediocrity.

Through historical good fortune the University of California system has only one governing board – the Board of Regents - for all ten universities of the UC system. Good governance in the UC system is helped by several factors:

- the overwhelming majority of the Regents are appointed, on the basis of expertise;

- the Academic Senate plays a very strong role, by conscious delegation by the Regents, in student selection, curriculum, and academic appointment and advancement; and
- the combination of strong Regents and Academic Senate tend to counterbalance the natural tendency of government to regulate.

I now need to create a rousing finish. But before I get there, despite all of my enthusiasm for central planning, I do admit that time, and private sector incentives, can create a diverse and valuable tertiary sector over time. The US privates do compete and have differentiated. I think that their long history helps. It has taken several hundred years to create that diversity.

There are some benefits, in seeking to create a diverse and valuable higher education sector, in a reasonable degree of individual university autonomy. But for the public sector, there are also benefits also in some degree of informed central governance, particularly to moderate the tendency of government to regulate, if you want to improve a sector in decades, rather than centuries.

So I will conclude by stating that:

- Government loans that are repayable on an income-contingent basis are good public policy – they work well.
- In the public sector, we have a lot to learn from private universities about defining and articulating our social value; about creating enduring and supportive relationships with our alumni, and about building systems in support of substantial philanthropic support.
- It is both reasonable and logical that if there is significant public funding of higher education, there should be significant central governance. The governing structure should be informed by a rigorous planning process, should involve very substantial academic expertise. Policy should not be determined solely on the basis of either political ideology or the political process.
- We should not confuse strong regulation by government with good governance.

- In my view rational structure of the public university sector should be determined ahead of, even independently from, systems of financing; the financial arrangements should be tailored to meet the structural goals.

I look forward to discussing these matters with you.

Thank you