

Financing higher education: Where are we now? What are the next steps?

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Financing higher education: Where are we now? What are the next steps?

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1 The backdrop

- Specific argument: the 2006 reforms of higher education in England are the right strategy and are already showing success
- General arguments
 - The world has changed
 - Students matter
 - Competition matters

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Objectives

- The world has changed: 50 years ago higher education was not important in economic terms
- Higher education matters
 - Promoting core values
 - Today also to foster economic growth in competitive world economy
- Specific objectives
 - Quality
 - Access
 - Efficiency

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What's the problem?

- Rapid expansion: age participation rate in 1989, 14%; 1995: 33%; 2005: 43%
- The good news: more people with better qualifications
- The bad news:
 - No parallel increase in resources: real funding per student fell by 40%
 - Consequent worries about quality

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2 Lessons from economic theory and international experience

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2.1 Lessons from economic theory

Lessons rooted in the economics of information, i.e. largely technical, rather than ideological

- The days of central planning of higher education have gone
- Graduates (not students) should contribute to the costs of their degree
- Well-designed loans have core characteristics
 - Income-contingent repayments
 - Large enough to cover fees and living costs
 - An interest rate related to the government's cost of borrowing

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Key conclusions from economic theory

- Competition is beneficial
- Income-contingent loans are central

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2.2 Lessons from international experience

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Student support: lessons about loans

- Income-contingent loans do not harm access (Australia, New Zealand, UK, Hungary)
- Interest subsidies are expensive (Australia, New Zealand, UK)
- Positive real interest rates are politically feasible (Netherlands, Sweden, Hungary)
- The design of the student loan contract matters

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Why not taxation?

Over-reliance on taxation fails to achieve any desirable objectives

- Failure 1: quality (shortage of resources)
- Failure 2: access
 - UK: 81% professional/15% manual, so tax funding fails the poor
 - But gradient largely disappears if restrict data to those with good high school leaving grades, i.e. access fails well before age 18
- Failure 3: deeply regressive
 - The real barrier to access: staying on beyond 16
 - If raise £5bn (e.g. higher tax on very high earnings), should spend it on nursery education; improving schools; staying-on post-16; grants
 - Early child development is central

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Why not flat fees?

- With flat fees, funding is closed ended; the Ministry of Finance continues to control the funding envelope (UK, Australia)
- No competitive pressures
- Unfair: why should a student at a local university pay the same fee as one at an internationally famous one?

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3 Where are we now?

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3.1 The 2006 reforms

- Fees: flat fee of £1175 replaced by variable fees between £0 and £3000
- Loans:
 - Income-contingent loans extended to cover fees (not true of previous system)
 - Larger loans to cover living costs
- Access
 - Restoration of grants for poor students
 - Access regulator

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Why fees?

- Why fees and, moreover, why variable fees? Because variable fees
 - Promote efficiency
 - Promote quality
 - Counterintuitively, also promote equity
- Assessment: see OECD (2004, Ch. 4; 2005, Ch. 3)

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Efficiency gains

- Variable fees improve efficiency
 - By making funding open-ended, thus increasing the volume of resources going to universities.
 - By strengthening competition, thus improving the efficiency with which those resources are used. An implication of well-informed consumers is that competition is welfare-improving

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Equity gains

- The reforms shift resources to the worst off
 - Those who can afford to contribute more do so
 - This releases resources to promote quality and access
 - Shift up demand curve, but also outward shift of demand curve
 - Thus the strategy is deeply progressive; it shifts resources from today's best off to today's and tomorrow's worst off
- Variable fees are also directly fairer: why should a student at a small local university pay the same fee as at a world-class university?

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Loan repayments in the UK (2006 scheme)

	Bill	Tariq	Tim	Jane
Annual earnings	£15,000	£20,000	£30,000	£50,000
Income tax (monthly)	£161.19	£252.86	£436.19	£945.58
NI contributions (monthly)	£91.26	£137.10	£228.76	£274.93
Loan repayments (monthly)	£0.00	£37.50	£112.50	£262.50

- Low earners make low or no repayments
- Repayments automatically and instantly track changes in earnings, exactly like income tax and national insurance contributions
- Loan repayments are generally much smaller than income tax or national insurance contributions

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3.2 The strategy underpinning the reforms

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Leg 1: paying for universities: deferred variable fees

There is a key distinction between *upfront* fees and *deferred* fees. The latter

- Promote quality
 - by bringing in more resources, and
 - by increasing competition assist efficiency, diversity and choice

- Are fairer than any other method

Mistake to avoid: 'big bang' liberalisation

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Leg 2: student support: free at the point of use

- Loans should be
 - Adequate, i.e. large enough to cover all fees and all living costs
 - Universal: all students should be entitled to the full loan
- As a result
 - Higher education is free at the point of use
 - Students are no longer poor
 - Students are not forced to rely on parental contributions
 - Students are freed from expensive credit card debt and overdrafts
- Mistake to avoid: blanket interest subsidies

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Leg 3: active measures to promote access

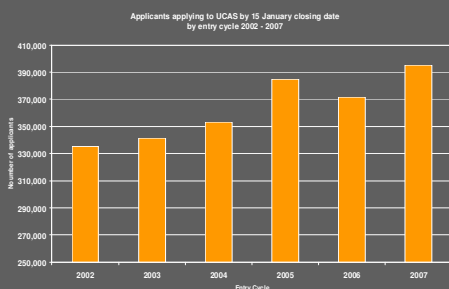
- Is debt aversion real? Two groups of students
 - Well-informed: income-contingent loans suffice
 - Under-informed, creating problems of debt aversion
- Access 1: Getting people into university
 - Money measures
 - Information measures
 - Early education measures

- Access 2: Helping low earners after university

Mistake to avoid: underestimating the information challenge

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What has happened?



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Key lessons

- Continuing growth in applications
- Largely because of growing understanding that *there are no upfront fees* - a central part of the 2006 strategy
- Access has not worsened, but nor has it yet improved - more action needed on Leg 3

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4 Next steps

- Leg 1: The fees cap
- Leg 2: Blanket interest subsidies
- Leg 3: Policies to widen access

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4.1 The fees cap

Why fees?

- To bring in extra resources
 - Replace fee income with taxpayer resources
 - £3,000 x 1 m students = £3bn, i.e. 1p on basic rate
 - If each department has pet project, 20p on basic rate
 - What would Chancellor say?
 - *And* assumes Education Department spends its entire £3bn on higher education (what about nursery education?)
 - Not replace fee income with taxpayer resources
 - Korea has 82% participation rate
- Competition makes system more efficient, and more responsive to students

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Why a fees cap?

- The fees cap should be
 - High enough
 - To bring in significant extra resources
 - To create genuine competition
 - Low enough
 - To maintain political sustainability
 - To give institutions time to put in place management suitable for a competitive environment
- Should a fees cap be permanent?

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Thoughts about the fees cap

- A balancing act
 - Message to the access warriors: don't perpetuate a middle-class subsidy
 - Message to the market warriors: don't overshoot (USA)
- Keep your eye on the medium term
 - Higher education is essential to national economic purpose
 - Thus it needs long-run evolution not short-term crisis measures

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What should happen

- An increase in the fees cap
 - A large step change is undesirable for both political and economic reasons
 - Better a smaller initial increase plus subsequent phased increases
- Essential that any increase in the fees cap is fully covered by an increased loan entitlement

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4.2 Blanket interest subsidies

- How does the interest subsidy arise?
 - The interest rate on student loans is equal to the inflation rate
 - Thus students/graduates pay a zero real interest rate, lower than the rate at which the government borrows
- The argument for the interest subsidy is that it promotes access; that argument is profoundly wrong

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What is wrong with a blanket interest subsidy?

A zero real interest rate

- Is enormously expensive, at least £1,200 million per year
- Impedes quality. Student support, being politically salient, crowds out the funding of universities
- Impedes access. Loans are expensive, therefore rationed and therefore too small
- Is deeply regressive, the main beneficiaries being successful professionals in mid career³⁰

A much better policy

- The blanket interest subsidy should be replaced by targeted interest subsidies
- Default interest rate should be related to the government's cost of borrowing
 - Equal to the long-term bond rate, or
 - Incorporating a cohort risk premium (New Zealand in the 1990s)
 - *Not* talking about a 'commercial' rate, e.g. the unsecured individual rate such as credit card rate
 - Countries that charge a positive real rate include Sweden, Netherlands
- Targeted interest subsidies should prevent real debt rising for
 - People with low earnings
 - People with caring responsibilities
- Targeted subsidies are administratively feasible³¹ (Hungary)

A UK problem

- Student loans are off budget
- Thus savings from removing blanket interest subsidy are off budget
- Thus if save (say) £1bn and spend it promoting access, measured public spending rises by £1bn
- Technical problems have technical solutions

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5 Concluding comments

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The resulting system

- A regulated market (*not* a free market)
 - Universities set fees, subject to a fees cap
 - Students apply to institutions and courses of their choice
- A continuing important role for government
 - To provide taxpayer support for higher education
 - To ensure that there is a good loan scheme
 - To ensure policies to promote access
 - To set incentives, e.g. larger subsidies for certain subjects
 - To regulate the system
 - A fees cap
 - Ensuring that there is effective quality assurance

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Drivers of the future: getting the politics of change right

- Not an attack on public funding, which should remain a permanent part of the landscape
- Not a free market but a regulated market
- Loan repayments are a payroll deduction, not credit card debt
- Students get higher education free – it is graduates who repay

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