

# Vouchers as a mechanism for funding higher education

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## Description of vouchers

1. Among the assurances given in the course of the passage of legislation that enabled the new fees arrangements, the Government undertook to conduct a review of experience so far with the variable fees regime introduced in 2006. However, the Government has indicated that it intends the review to go further and will look more widely at the funding of higher education. This is welcome. The review should be extended also to include the question of student support – it is the total affordability of higher education to students and the total cost to Government of all aspects of higher education provision that matters. In effect, for the Government, there are trade-offs between the cost incurred in the funding of institutions and the support of students. But it should also consider alternative approaches to funding, including the graduate tax arrangements proposed by the National Union of Students and, as others have recently proposed, the use of vouchers as a mechanism for funding, which is the subject of this report.

2. Notwithstanding the increased questioning of the neoliberal consensus that has followed the economic problems faced around the world, there has been continuing interest in the use of vouchers as a mechanism for funding higher education institutions. Most recently in this country, an organisation called “Reform” produced a pamphlet<sup>3</sup> that described vouchers as a means to deliver greater productivity, larger export earnings, increased social equity, and a host of other benefits. This continuing interest in such an approach may be surprising, but, as was pointed out in a recent report by HEPI<sup>4</sup>, market mechanisms have delivered a great deal in higher education, and it is important not to throw the baby out with the bathwater as we reappraise the balance between reliance on the market and more direct central interventions.

3. Whereas, until relatively recently, the conventional form of funding for education institutions has effectively been “supply-side” funding, whereby the funding authority provides funds in the form of grants directly to institutions that “supply” the provision – that is to say the universities in higher education – a

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<sup>3</sup> ‘The Mobile Economy’ – Reform, November 2009

<sup>4</sup> HEPI Occasional Report No 1 “The role of the market in higher education” by Professor Roger Brown and Professor Sir Peter Scott.

voucher system is a form of demand-side financing taken to its logical limit – that is to say financing that is wholly reliant on the “customer”. In a voucher system, students (or prospective students) would receive entitlements (vouchers) to buy services from higher education institutions, and the institution would present the vouchers that they had received from the students they had enrolled to the Government in exchange for their monetary value. The Government, therefore, would not be providing direct funding to the universities, but indirect funding by providing “vouchers” – in effect a promissory note – to students who would exchange them at the university of their choice (assuming the university was willing to accept them) for its services. So in place of direct Government funding of institutions, vouchers provide indirect funding.

4. The indirect funding of institutions and the reliance on student choice as the mechanism for distributing public funding are the key and central features of a voucher system, but there are others which can be concomitant but not necessary features. For example, and particularly because vouchers are generally associated with free market economics, there is often a presumption that universities may charge whatever fee they wish in order to top up the value of the voucher, and also that universities may recruit as many students as they wish without Government limitations. However, neither of these two features is fundamental to voucher schemes, though many would argue that they are their logical extensions.

5. Other choices that are required in a voucher scheme include:

- The extent to which to limit the number of years for which the entitlement to vouchers lasts – for example, whether for the three years of most honours degrees, or just two years, or longer;
- The level of study for which vouchers can be used – for example, whether they can be extended to postgraduate level study or whether they are only valid at undergraduate level;
- Whether they can be used in private universities as well as public (if student choice is one of the motivations for introducing vouchers then there are arguments for allowing them to be used not only in public and private universities, but perhaps overseas as well);
- The value of each voucher (and, for example, whether vouchers will have different values depending on where they are used or what subjects they are used to study for – it would provide a huge incentive for institutions to withdraw from the more expensive science, engineering and medical subjects if the funding they receive were no more than for subjects that are cheaper to provide. At present they receive higher grants for more expensive subjects).

## Arguments for vouchers

6. The reasons for the espousal of vouchers are often but not entirely ideological. In general, support for vouchers goes hand-in-hand with support for free market economic models, and the arguments proposed in their favour are common to other such liberal positions. For example, it is argued by the proponents of vouchers that:

- Increasing the power of the consumer and reducing that of the supplier and the funding body (the Government or an agency like HEFCE) will increase competition and, thereby, improve quality and efficiency;
- Putting cash (or a cash substitute) in the hands of individuals will empower them by increasing choice (though it is not generally suggested that these vouchers could be used for anything other than as a payment to the university they eventually attend);
- Providing vouchers to young (and not necessarily young) people as an entitlement will have the psychological effect of making them aware of the value of higher education and, therefore, more likely to exercise their choices rather than waste the resources that are potentially theirs. And so vouchers, it is argued, will have a positive effect on widening participation and increasing demand.

7. If, as is argued, vouchers have the effect of increasing competition – including greater competition from private providers – they will have the impact that increased competition generally has in the marketplace, which is to improve quality, reduce cost and increase efficiency, and will allow the good to flourish and the poor to wither away if they do not improve.

8. Other benefits that are claimed are that:

- The introduction of vouchers will increase the amount of private funding in higher education, as individuals are required to top up the voucher to match the fees that universities charge (on the assumption that they will be allowed to charge fees higher than the value of the voucher);
- Because governments no longer need to fund universities directly the amount of bureaucratic controls will be reduced.

9. For the most part these benefits are theoretical rather than empirical, since there is no experience of the successful use of the vouchers in higher education. The limited experience that exists is discussed below, but it does not provide empirical evidence to support these arguments.

## **Experience with vouchers in higher education**

10. Although there are examples around the world of effective voucher systems, that can no longer be thought of as experimental, to fund school-level education, there is only very limited experience of vouchers in higher education. Indeed, the only case in the developed world where vouchers have been introduced and have effectively and comprehensively funded higher education is the state of Colorado in the USA. The Republic of Kazakhstan has also introduced vouchers, but these are limited to a relatively small number of the highest achieving students. For the majority of students and universities there is no government funding available at all, and so few lessons can be learned from the voucher experience of Kazakhstan<sup>5</sup>.

11. In England, the Individual Learning Accounts in further education, which resulted in serious administrative failure and had to be wound up, were a form of student voucher, but on a very limited scale – they supplemented state grant funding for universities, they did not replace it. And the Government's recent report on Social Mobility recommended using the existing Train to Gain budget to create a form of demand-side funding which recipients could spend in higher education as well as further education. But there is no suggestion that this should replace Government grant to institutions.

12. More pertinently, since 1992 the HE funding regimes in England have incorporated different elements that are integral to voucher schemes. In particular, until 1998, universities received public funding for teaching from two sources – grant from the funding council and a 'fee' per student, paid by the student's local education authority. This fee was in effect a voucher (every student accepted by a university was entitled to have it paid on his or her behalf), and for a number of years universities were able to recruit 'fees only' students, in respect of whom the only income they received was the local education authority fee<sup>6</sup>. Even now, the public funding that universities receive for teaching is dependent on the recruitment of students – if students are not recruited then grant is not paid – and so public funding for universities is substantially demand-led.

13. The recent Bradley report on higher education in Australia considered the introduction of vouchers. It contains an illuminating discussion of their benefits and the problems associated with their introduction, and provides a valuable contribution to any consideration of the issues associated with voucher schemes.

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<sup>5</sup> In a study for the OECD, Jamil Salmi of the World Bank identified Chile, Georgia and Hungary as also having introduced vouchers for those students with the highest entry scores, but these are not fully functioning voucher systems and have not been studied for the purpose of this report.

<sup>6</sup> The main effect of this 'voucher' experience was to drive down the unit of funding per student, which fell by 35 per cent or so in the early years of the 1990s.

The Bradley report, in fact, carefully avoided references to vouchers (a close reading of the report reveals that although vouchers are described in some detail as the preferred method for funding universities, the actual word "voucher" only appears once in the entire report), but strongly supported a demand-side funding regime where funding is channeled through students rather than directly to institutions.

14. However, because of the problems that the report acknowledges would accompany such a funding system, it also recommends refinements, such as a cap on the tuition fees that universities may charge, the continued direct funding of some courses (because of the fear that an entirely market-driven system would deter universities from offering certain important but expensive and low demand subjects), and that part of the funding that universities receive should be based on negotiated performance targets, reflecting national priorities which a purely voucher-based system could not be relied upon to deliver. The Bradley report is pragmatic and clearly sees the benefits of a voucher system but in the end shies away from proposing what most supporters of vouchers would regard as an acceptable arrangement because of its recognition of its serious disadvantages.

15. Colorado is the only significant jurisdiction where vouchers have been applied in earnest and comprehensively as the Government's mechanism for channelling public funds to higher education institutions. In 2005 all Colorado residents became eligible for a stipend to be used to offset their tuition costs at the in-state public and eligible private higher education institution of their choice. As with the proposals in the Bradley report in Australia, Colorado too shied away from a pure voucher scheme, for example, introducing a "fee-for-service", whereby some of the money that the state provides for higher education is withheld and allocated following negotiation with individual institutions in order to ensure that state priorities are met. The "fee for service" also, pragmatically, provides a means of recognizing that some institutions are necessarily higher cost than others and that a single value voucher would not recognise this (thereby effectively undermining the efficiency argument for vouchers). The Colorado scheme also includes a performance contract – which has never been implemented, but which enables the state to identify its priorities and reward universities for meeting them.

16. According to a review recently conducted by the Western Interstate Commission for Higher Education (WICHE) on behalf of the State of Colorado, there were three motivations for the introduction of vouchers. The first was a technical and important one – to remove the revenue received from the state by higher education institutions from the expenditure limits imposed by the Taxpayer's Bill of Rights (TABOR) (because under the Colorado voucher scheme the institutions do not receive funds from the state but from the student). The second and third motivations reflected the theoretical arguments in favour of vouchers rehearsed

above – that vouchers would compel institutions to become more disciplined and efficient, and also that they would promote access.

17. The WICHE evaluation is quite clear: “despite these ambitions, the evidence suggests that the Colorado Opportunities Fund (the voucher scheme) has not succeeded in reaching these aims, other than providing for higher education to be exempted from TABOR's revenue and spending limitations”. In particular, the evaluation found that the introduction of vouchers had had no impact whatever on student demand, and the qualitative research undertaken by WICHE suggested that it had had no impact on institutional behaviour either.

### **Arguments against vouchers**

18. The arguments against the use of vouchers to fund higher education are numerous, and are basically of two types – financial and political on the one hand and practical on the other. Among the strongest arguments put forward for vouchers is that they will reduce the cost of education per student (as universities compete to recruit students), and will allow Governments to purchase more for their money. However, the public interest is not served solely by producing the maximum number of students as cheaply as possible. Public universities have other functions – for example, they provide a resource and services for their local community and more widely, and they conduct research. They are part of the national infrastructure. In an education system where Government funds are provided only through student vouchers, and especially where Government funding provided through vouchers is available for use in private universities as well as public, the Government is indifferent to the health of individual universities, and indeed of the public higher education sector more generally. Such an approach may have the effect of producing graduates more cheaply, but it is unlikely to benefit the public university system or society as a whole.

19. It is such a perspective that led a recent Policy Exchange report<sup>7</sup> to regret that no university had gone bankrupt in recent years, suggesting that the system as a whole would have been healthier if some universities had done so, and that the absence of university bankruptcies was a mark of the failure of the present arrangements. This slightly surprising view – that bankruptcies would be a positive and that the absence of bankruptcies was a negative – is in fact an unsurprising conclusion if a healthy public university sector is not seen as being in the public interest.

20. Providing vouchers that can be used in private universities would dilute the amount of public funds provided to universities in the public sector, with consequences for their continued financial health. It is, of course, possible to have

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<sup>7</sup> ‘Sink or Swim’ – Policy Exchange, April 2009

a voucher system that excludes private universities, but if so then some of the benefits claimed for vouchers – in particular increasing student choice and putting pressure on public universities through competition with privates – would be lost. Similar considerations arise concerning the extension of vouchers for use in overseas universities.

21. There are, anyway, some who argue that student choice in higher education cannot be properly exercised when the information on the basis of which to make decisions is necessarily partial and imperfect, and in their opinion inevitably misleading<sup>8</sup>. On this view, the claimed benefit made for vouchers that they lead to increasing student choice is no benefit at all.

22. As mentioned previously, in systems where Government funding for universities is provided entirely by providing students with vouchers, the Government loses its most powerful tool for steering the higher education system in the national interest. That was clearly recognised by the Bradley committee in Australia, which proposed a number of measures effectively to dilute the voucher scheme to a point where many of the potential benefits claimed for such a system would be lost. For example, modifications were proposed to enhance widening participation, the affordability of university (by the imposition of a fee limit), and performance-based funding (where the performance to be measured related to national policies). One example of the national interest that could be damaged by the introduction of a voucher scheme – or where at least some action would be required to dilute its effect – relates to subjects of strategic importance. Such considerations are troublesome for supporters of vouchers. For example, in its recent report Reform commented on the lack of physics and engineering students, using this as an example of the dysfunctional effects of the present arrangements for governing and funding higher education and of the incentive systems that these had created. And yet, a few pages later, it criticized the present arrangements for keeping places in these subjects artificially alive!

23. As far as financial considerations are concerned, one of the most troublesome aspects of voucher systems concerns the control of Government expenditure. If the Government fixes the value of the voucher, committing itself to provide funding of that value without limiting the total number of students that can attend university, then this effectively represents an open-ended financial commitment by the Government, which it is difficult to see being acceptable to the Treasury. The alternatives though are either for the Government to limit the number of students – which would defeat one of the key aims of the voucher system, which is to widen and increase participation and also to increase choice and would require decisions about who should receive the vouchers and who should not– or for the value of the

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<sup>8</sup> Ibid, Professor Roger Brown

voucher to vary as student numbers (or the Government's means to pay) vary – leading to a different form of unfairness as students on one year of a course might have to pay more from their own pockets than those on another. This was one of the problems encountered in Colorado, where towards the end of the experiment the voucher was worth not much more than half what had been planned at the outset.

24. The possible volatility of student demand in a voucher arrangement is a problem not only for the Government and Government funding, but for universities as well for whom planning would become extremely difficult. Investment decisions require a degree of certainty and stability, and if all the public funding which universities receive is voucher-based and reliant on student demand, and if that demand is not secure from year to year, then they are likely to exercise extreme caution in investing heavily on the assumption of increased demand. And if they do invest then there is the possibility of wasted infrastructure investment if the numbers that have been invested for do not enroll. Financial considerations are likely to make universities more cautious, and the sum total of this caution may be a dampener on recruitment, having the opposite impact on participation from that hoped for.

25. So even if the psychological impact claimed for vouchers does have the effect of stimulating demand, it is quite possible that universities will not be willing to meet that demand. However, there is no empirical evidence for such a psychological impact – the Colorado experience suggests the opposite – and in any case, the value of an arrangement that is intended to stimulate demand in a situation, as is emerging in England, where demand is having to be constrained because of public finance considerations, is questionable.

26. The risk to widening participation that could be posed by the introduction of a voucher scheme with open-ended fees was recognised by the Bradley report in Australia, which proposed modifications and refinements to offset such risks. That is one of problems with vouchers – their negative consequences are readily apparent and are such as to oblige the authors of voucher schemes to water down and constrain their proposals to the point where the theoretical benefits are in doubt.

27. Among the concerns even with the present arrangements in this country for funding higher education is the pressure that universities may feel to admit more students and lower standards. And there is concern too that universities and their staff may feel increasing pressure to award more favorable degree results in order to remain attractive to students. That concern was expressed in the Reform report referred to above, and repeated by the Innovation, Universities, Science and Skills



Select Committee in their Report on Students and Universities<sup>9</sup>. Although such concerns are often expressed by those very people whose instincts and politics are in favour of greater marketisation, it is difficult to see how the greater reliance on the market that a voucher scheme would introduce would do anything but increase such pressures and such risks.

### **Market-based alternatives to vouchers**

28. So the arguments against vouchers, and the disadvantages that the introduction of voucher scheme would bring, are substantial and serious, and it is difficult to conclude other than that whatever benefits the introduction of a voucher scheme would bring would be more than offset by the disadvantages. Moreover, the only significant voucher scheme in higher education in the world is judged by those who have evaluated it to have been unsuccessful.

29. Nevertheless, some of the benefits claimed for voucher systems, if real, would be worth having – increased competition, for example, and responsiveness to student demand. And many of these are available in the sort of market orientated system that exists in this country, without resorting to vouchers.

30. In England, universities at present receive two streams of money for teaching students: the fee paid by each student (or rather paid by the Government on their behalf and then recouped through the taxation system); and the Government grant paid by HEFCE<sup>10</sup>. As already discussed, the grant is dependent on the number of students recruited, and the value of the grant received for each student depends on the subject studied. And if a university fails to recruit the number of students in respect of whom grant is paid (within a permitted margin of 5 per cent), then part of the grant has to be repaid.

31. So, under the present funding system universities are funded only to the extent that they succeed in recruiting students – if they do not recruit students then they lose money – but within limits and with safeguards, intended to protect public investment in the higher education infrastructure. It is true that there is a limit on the number of students that each university may recruit, but the main purpose of that limit is to do with the control of public expenditure – to limit the overall number of students recruited in the system as a whole – and for reasons described above, it is difficult to see the Government abandoning its control of total recruitment. It is notable also that before the limit on the number of students was introduced during the late 1990s the most popular universities nevertheless were,

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<sup>9</sup> IUSS Committee, 11<sup>th</sup> Report “Students and Universities” published 2<sup>nd</sup> August 2009

<sup>10</sup> It is worth noting that the proportion of the funds that universities receive for teaching that comes from the Government grant has reduced rapidly – from 74 per cent in 2005-06 to 60.7 per cent in 2008-09 (estimated).

in general, the ones that chose not to expand, certainly not as much as the average. So the impact on choice of a voucher scheme is likely to be illusory in any case.

32. In truth, vouchers are simply a device for allocating funds at the end of a continuum of funding mechanisms. This is well articulated by Professor Nicholas Barr, who has concluded that it is a mistake to think that the simple-minded voucher model (universities compete for students; those who attract large numbers flourish; those who fail to attract students will not survive) is the only approach to competition<sup>11</sup>. He argues that “vouchers should be thought of as a continuum, from 0 per cent constrained (“law of the jungle”) to 100 per cent constrained (“pure central planning”) or anywhere in between.” The UK system is already well on the continuum towards a fully blown voucher system, but retains pragmatic constraints that are needed to protect the public interest – and the interests of students in particular – and to optimize investment, quality, and the total amount of Government expenditure – not dissimilar to the modifications of the voucher systems introduced in Colorado and proposed by the Bradley Committee for Australia.

33. Finally, the present arrangements probably offer students as much choice as any realistic voucher system, and it is difficult to see how a voucher system would increase this. The reality is that even within a voucher system popular universities are unlikely to expand at the expense of less popular universities – they did not in the past when they were not constrained, and there are reasons, beyond student demand and market forces, and to do with quality, institutional ambition and mission, that will continue to constrain them. And in any case, in the future, as at present, the biggest constraint on student choice is likely to be an institution's assessment of a student's suitability for admission to that university, not any external constraint on recruiting students.

## **Conclusion**

34. The problems to which vouchers would give rise are such as to render them an unattractive and unacceptable basis for funding universities. And while there may be political and theoretical benefits attached to vouchers, the reality has been that where vouchers have been introduced or seriously considered, these benefits have not materialized, and the potential problems to which their introduction and use would give rise have led to their being largely emasculated. And the only serious attempt at the use of vouchers in higher education has been judged largely to have failed to meet their objectives.

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<sup>11</sup> Professor Nicholas Barr: *The Economics of the Welfare State*, Oxford University Press 1998

35. Moreover, the present market-based funding mechanism that is employed to fund universities in this country – which provides grants directly to universities, but only to the extent that they succeed in recruiting students - brings most of the significant benefits that are claimed for vouchers while avoiding the most serious disadvantages. They, nevertheless, remain a serious alternative approach to the funding of universities and should be considered in the review of HE funding planned by the Government.