Financing higher education: What policies in what order?

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1 Objectives
2 The current strategy
3 What should the Independent Review recommend?
4 Conclusion

1 Objectives

- Strengthen the quality of teaching and research
- Widen participation
- Protect autonomy
- Protect the fisc

2 The current strategy

2.1 Lessons from economic theory

- Competition between universities helps students
- Graduates (not students) should share in 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 government's cost of borrowing

2.2 The resulting strategy

- Leg 1: paying for universities: deferred variable fees
- Leg 2: student support: free at the point of use
- Leg 3: active measures to promote access

2.3 Pressure points

Pressure points on each element in the strategy

- Leg 1: the fees cap
  - Pressures from universities for more resources
  - Pressures from students concerning the quality of student experience
  - But politically sensitive
- Leg 2: blanket interest subsidies
  - Very costly: in financial terms; also in policy terms
  - Also politically sensitive
- Leg 3: Emphasis on the wrong policies to widen participation
  - Grants are expensive and generally the wrong instrument for widening participation
  - But strong political pressures for more and larger grants

3 What should the Independent Review recommend?

- Four central policies
  - Major publicity campaign to explain how student loans work
  - Expand the loan system
  - Action on the fees cap
- Alongside these, continue action to widen participation

3.1 Explain student loans

- Fight disinformation and scaremongering ('high fees, high debt', conflating student loans with credit card debt)
- Message 1: higher education is free to the student
- Message 2: loans have income-contingent repayments
  - Thus a payroll deduction, not credit card debt
  - 25-year write off (strongly benefits women)
  - Thus equivalent to a graduate tax that stops after a maximum of 25 years, and for most people significantly earlier
- Message 3: keep the scale in context: compare £20,000 payroll deduction with £1 million (cash terms) in income tax and national insurance over a full graduate career

3.2 Expand the loan system

- Address the interest subsidy problem (Barr and Johnston 2009)
- Use the savings to expand the loan system

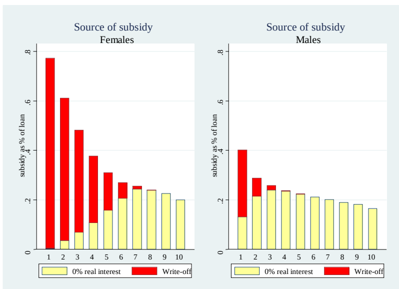
What is wrong with a blanket interest subsidy?

- Two wrong interest rates
  - A zero real rate
  - A 'commercial' rate, i.e. the rate on unsecured loans, such as credit cards and bank overdrafts
- A zero real interest rate
  - Is enormously expensive: about one-third of all money lent to students is never repaid just because of the interest subsidy
  - Impedes quality *and quantity*: 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 career

Why interest subsidies are regressive

- In a conventional loan scheme, an interest subsidy helps people with low earnings
- But in the UK student loan scheme
  - Loans have income-contingent repayments
  - There is forgiveness after 25 years
- These two features turn the conventional argument upside down
- Who benefits from interest subsidies?
  - Students?
  - Low-earning graduates?
  - High earning graduates with low early-career earnings?
  - High earning graduates?

Interest subsidy and write off by decile of lifetime earnings (IFS)



What should be done?

- The default interest rate should be related to the government's cost of borrowing
- Targeted interest subsidies should prevent real loan balances rising for people with low earnings and perhaps also people with caring responsibilities
- Administratively feasible (Hungary), politically feasible (Sweden, Netherlands)
- ***A higher interest rate does not lead to higher monthly repayments***
- ***A higher interest rate has no effect on low-earning graduates, who are protected by the 25-year limit***

Caveat: constraints imposed by public accounting rules

- With income-contingent repayments, a higher interest rate does not increase monthly repayments but extends the duration of the loan, e.g. from 10 years to 12
- Thus savings from a higher interest rate arise only in (say) years 11 and 12 when repayments continue when otherwise they would have stopped

Policy gains

Addressing the interest subsidy problem makes it possible to expand the loan system now

- Larger loans for existing recipients
    - To cover an increase in the fees cap
    - To raise the maintenance loan
- Expanding the system to cover new groups
    - To part-time students, with gains in efficiency and participation
    - To postgraduates (a major national interest)
    - To students in tertiary education and training more broadly

3.3 Action on the fees cap

- The cap should be
    - High enough
        - To bring in significant extra resources
        - To create genuine competition
    - Low enough
        - To maintain political sustainability by giving students, prospective students and their parents time to adjust
        - To give institutions time to put in place management suitable for a more competitive environment
- Should some sort of fees cap be permanent? Yes
    - To protect against exploitation of monopoly elements ('It's time to end the amenities arms race')
- ***An increase in fees has no effect on low-earning graduates, who are protected by the 25-year limit***

What conditions for an increase in the fees cap?

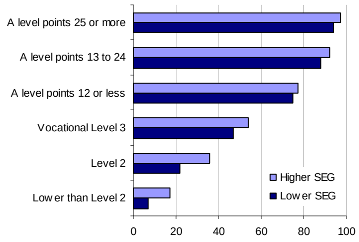
- In 2006, the increase in fees was conditional on bursaries – politically necessary but the wrong instrument for widening participation
- Should an increase in the fees cap be conditioned on measures of the quality of teaching/student experience?
- Should the system accommodate a dual fees cap (Shephard 2010)?

3.4 Continue action to widen participation

- According to 'pub economics' it is obvious that 'free' higher education widens participation
- Pub economics is wrong

Who goes to university? It's school attainment, stupid

Source: Office for National Statistics (2004, Figure 2.15)



Increase in applications from the lowest SEGs

- Rise in applications 2007-2008
  - Total applications, England: +11.7%
  - Applications from lowest 3 SEGs, England: +26.9%
- Annual average rise in applications, 2002-2008
  - Total applications, England: 4.3%
  - Applications from lowest SEGs:
    - England: +6.5%
    - N Ireland: +3.1%
    - Scotland: +0.5%
    - Wales: +3.7%
- HEFCE (2010) finds that 'young people from the 09:10 cohort living in the most disadvantaged areas are around +30 per cent more likely to enter higher education than they were five years previously …, and around +50 per cent more likely … than 15 years previously' (para. 28)

What policies?

- Policies to address the attainment constraint
  - Increased emphasis on early child development
  - Action to improve school outcomes
  - Improving information and raising aspirations
- Policies to address credit constraints
  - Financial support at age 16
  - Income-contingent loans that make higher education free at the point of use
  - Policies that respond to genuine debt aversion
  - Making part-time study easier

4 Conclusion

A regulated market, not a free market

- Universities set fees, subject to
  - A fees cap
  - Quality assurance
- Governments pay block grants; the balance between fees and block grants determines the extent of competition, which can vary by subject
- Students apply to the institutions and courses of their choice

A continuing important role for government

- To provide taxpayer support for tertiary education
- To regulate the system
  - A fees cap
  - In the short run some control of student numbers by institution
  - Ensuring that there is effective quality assurance
- To set incentives, for example
  - Larger subsidies for certain subjects
  - Larger subsidies to universities for some students
  - Thus the role of government changes from that of central planner to that of setter of incentives
- To redistribute within higher education
- To ensure that there is a good loan scheme
- To promote policies to widen participation

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