

Markets in higher education: The good, the bad and the avoidably ugly

Nicholas Barr
London School of Economics
<http://econ.lse.ac.uk/staff/nb>

Conference on the Operation of the Market in Higher
Education: Opportunities and Constraints,
Experience and Ideology
London, 14 January 2008

Markets in higher education: The good, the bad and the avoidably ugly

- 1 The backdrop
- 2 Lessons from economic theory
- 3 The resulting strategy
- 4 Widening participation
- 5 Efficiency and quality
- 6 Conclusions

Nicholas Barr January 2009

1

1 The backdrop

- Talk about how to pay for teaching, not research
- Framework based on economic theory and international experience

Nicholas Barr January 2009

2

The world has changed

- **Proposition 1: the world has changed:** 50 years ago higher education was not important in economic terms. Today it matters:
 - To promote core values (as always)
 - To pursue knowledge for its own sake (as always)
 - To promote economic growth in competitive economy
 - Technological advance a major driver
 - Higher education is vital both for national economic performance and for individual life chances
- Specific objectives: widening participation, quality, efficiency

Nicholas Barr January 2009

3

What's ideology and what isn't?

- Balance between market and state, in particular the role of competition: mainly technical, rooted in the economics of information
- Ideological: widening participation
- **Proposition 2: students matter**

Nicholas Barr January 2009

4

What's the problem?

- Countries pursue three goals in higher education
 - Larger quantity
 - Higher quality
 - Constant or falling public spending
- Can achieve two but only at expense of the third
 - Large and tax-financed, but with worries about quality (France, Germany, Italy)
 - High-quality and tax-financed, but small (UK till 1989)
 - Large and good-quality, but fiscally expensive (Scandinavia)
- The only sustainable way to achieve all three is to supplement public finance with private finance

Nicholas Barr January 2009

5

2 Lessons from economic theory

- Lessons rooted in the economics of information
- Central conclusion: regulated markets (not free markets)

Nicholas Barr January 2009

6

2.1 Competition between universities helps students

- **Proposition 3: competition helps students**
- Does competition work? Yes when consumers are well informed
- Are consumers well informed?
 - Many students are savvy and streetwise
 - Much information is available and more can and should be made available
 - Good information is a central source of quality assurance (more later)
- Are all students well informed? No. Information problems for students from poorer backgrounds can create impediments including debt aversion
- The same body of theory leads to a very different conclusion for school education

Nicholas Barr January 2009

7

The argument for competitive fees

- Fees bring in extra resources
- Competition creates incentives to use those resources efficiently
- Counter intuitively, variable fees are also fairer
 - Why should a student at Balls Pond Road Tech pay the same fee as at a world-class university?
 - Given the gradient in participation, arguing for higher fee subsidies is like arguing for higher champagne subsidies

Nicholas Barr January 2009

8

International evidence

- Flat fees mean that funding is closed-ended hence will not provide extra resources except in the short term (Australia)
- Competitive systems appear to produce higher quality (at least as measured by world rankings)
- Big-bang liberalisation of fees can be politically destabilising (New Zealand)
- But failure to liberalise is also a mistake; excessive reliance on taxation has major problems

Nicholas Barr January 2009

9

2.2 Graduates (not students) should share in the costs of their degree

- Higher education creates external benefits:
 - Growth social participation
 - Thus right that society (aka taxpayer) should contribute
- But it also confers significant private benefits; thus beneficiaries should share some of the costs
- BUT students generally cannot afford to pay
- Thus need a mechanism whereby higher education is free to students – loans

Nicholas Barr January 2009

10

2.3 Well-designed loans have core characteristics

- Income-contingent repayments, i.e. calculated as $x\%$ of graduate's subsequent earnings
 - For efficiency reasons, to reduce uncertainty
 - For equity reasons, to promote access, since loans have built-in insurance against inability to repay
 - A genuine loan
- Large enough to cover all fees and living costs, so that higher education is free at the point of use
- An interest rate related to government's cost of borrowing

Nicholas Barr January 2009

11

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

Nicholas Barr January 2009

12

International evidence

- 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, Norway, Hungary)

Nicholas Barr January 2009

13

3 The resulting strategy

Nicholas Barr January 2009

14

Leg 1: paying for universities: deferred variable fees

Variable fees

- Promote quality
 - by bringing in more resources, and
 - by strengthening competition, creating incentives to use those resources efficiently
- Are fairer than any other method

Mistake to avoid: 'big bang' liberalisation

Nicholas Barr January 2009

15

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
- Thus
 - Higher education is free at the point of use
 - Students are no longer poor
 - Students are not forced to rely on parental contributions, extensive paid work or expensive credit card debt
- Mistake to avoid: blanket interest subsidies

Nicholas Barr January 2009

16

Leg 3: active measures to promote access

- Widening participation (more below)
 - Raising attainment
 - Improving information/raising aspirations
 - Money measures

Mistake to avoid: underestimating the influence of attainment

Nicholas Barr January 2009

17

What role for government?

- **Proposition 4: not a free market but a regulated market**
 - Universities set fees, subject to a fees cap
 - Governments still pay block grants; the balance between fees and block grants determines the extent of competition
 - Students apply to the institutions and courses of their choice
- A continuing broad role for government
 - To provide taxpayer support for higher education
 - To regulate the system
 - A fees cap
 - Ensuring that there is effective quality assurance (more below)
 - To set incentives, e.g. larger subsidies for certain subjects
 - To ensure that there is a good loan scheme
 - To promote policies that widen participation

Nicholas Barr January 2009

18

What is wrong with the US system?

- Bottom line: it isn't a system
- Leg 1
 - In principle the right model
 - But fees unregulated, notwithstanding elements of monopoly power
- Leg 2
 - Loans based mainly on the model of conventional loans (cf US adherence to private medical insurance)
 - Only embryonic income-contingent loans
 - Interest subsidies
 - Adverse incentives for collection of repayments
- Leg 3:
 - Complexity and fragmentation of student support
 - Pro-access measures targeted largely on 18+

Nicholas Barr January 2009

19

Back to the core objectives

- Widening participation
- Quality and efficiency

Nicholas Barr January 2009

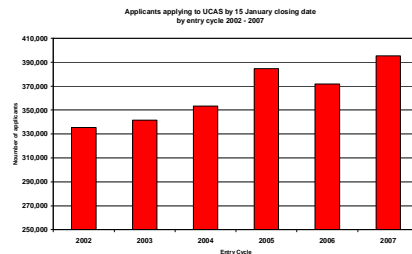
20

4 Widening participation

Nicholas Barr January 2009

21

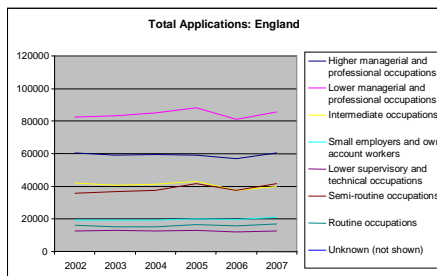
4.1 What happened to applications after the 2006 reforms?



Nicholas Barr January 2009

22

What about socioeconomic factors?



Nicholas Barr January 2009

23

Key lessons

- Continuing growth in applications
- Why?
 - Loans cover fees and living costs
 - Thus higher education is *free to the student*
- Access has not worsened, but nor has it yet improved – more action is needed

Nicholas Barr January 2009

24

4.2 What determines participation?

Nicholas Barr January 2009

25

Why not pay for it all out of taxation?

Over-reliance on taxation fails to achieve any of the main objectives

- Failure 1: quality and efficiency
 - Shortage of resources
 - Lack of competition
- Failure 2: access (in most, though not all, countries)
 - UK: 81% professional/15% manual, so tax funding fails the poor
- Failure 3: regressive
 - The real barrier to access: staying on beyond 16
 - If raise £5bn, should spend it on nursery education; improving attainment while at school; reducing high-school drop out; grants
 - Early child development is central

Nicholas Barr January 2009

26

If all else fails, look at the evidence

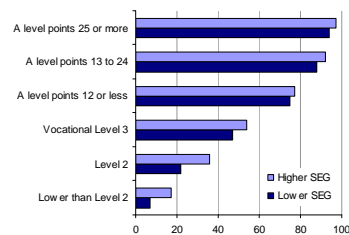
- Where are there the biggest social benefits?
 - Answer: at younger ages
- Where is the most public money spent?
 - Answer: at later ages
- Who gets the best GCSEs?
 - Answer: the children of professionals
- Who stays on after 16?
 - Answer: those with the best GCSE marks
- Who goes to university?
 - Answer: those with the best A level marks

Nicholas Barr January 2009

27

Who goes to university? It's attainment, stupid

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



Nicholas Barr January 2009

28

4.3 What policies *really* widen participation?

Nicholas Barr January 2009

29

Before and during university

- Why does access fail? Substantially a 0-16 issue
 - Low attainment
 - Lack of information/aspirations
 - Lack of money
- Need policies to address all three
 - Early education measures
 - Early child development
 - Life cycle approach to education spending
 - Information/aspirations: an important role for universities:
 - Mentoring by students visiting schools
 - Visits by pupils to university, e.g. Saturday School, Summer School
 - Money measures include
 - Education Maintenance Allowances
 - University grants/bursaries

Nicholas Barr January 2009

30

After university

- Income-contingent repayments
- Targeted interest subsidies
- Write off loans for selected groups
 - Public service workers
 - Teachers, nurses
 - Doctors
 - Carers, e.g. 10% pre-school age, 5% school age

Nicholas Barr January 2009

31

5 Efficiency and quality

Nicholas Barr January 2009

32

5.1 Competition

- Fees bring in extra resources
- Competition creates incentives to use those resources efficiently

Nicholas Barr January 2009

33

5.2 Quality assurance: What role for government?

- Two approaches
 - Inspection
 - Mandating relevant consumer information

Nicholas Barr January 2009

34

Inspection



Nicholas Barr January 2009

35

Mandating relevant consumer information

- The best sort of quality assurance is to have well-informed consumers
- Not useful in areas like medical care but useful for higher education
- An intelligent 16-year old will ask
 - Will I be well taught?
 - Will it be fun?
 - Will I get a good job
- Thus important parts of quality assurance are mandatory publication of
 - Evaluations by students and others
 - Surveys of the student experience
 - Next destination statistics, i.e. a market test of employers' view of quality
- Some of these are hard to measure; that is a challenge, but not a reason for avoidably bureaucratic forms of quality control

Nicholas Barr January 2009

36

The role of information

- The philosophy behind this approach is the opposite of one size fits all, instead concentrating resources where they are most needed
- Such a system of quality assurance would have three strategic elements
 - Mandatory publication of relevant data in a timely and accurate way on university web sites
 - 'Light touch' self-evaluation by institutions in terms of criteria agreed with the quality assurance body (note that 'light touch' works well only with well-informed consumers)
 - Concentrated assistance for institutions with significant quality problems

Nicholas Barr January 2009

37

6 Conclusions

Nicholas Barr January 2009

38

Some responses

- The US system is a straw man
 - It shows the ill-effects of under-regulated markets and little strategic thinking
 - But that is not an argument against well-regulated markets as part of an explicit strategy
- Resist the temptation to corner solutions
 - Illustration from politics
 - Market forces
 - Who should pay?
 - What role for grants?
- What role for market forces?

Nicholas Barr January 2009

39

- Not an attack on public funding, which should remain a permanent part of the landscape
- Reform should not create a free market but a regulated market
- Students get higher education free – it is graduates who repay
- The economics of reform is straightforward – it's the politics that are difficult

Nicholas Barr January 2009

40

References

- Vidha Alakeson (2005), *Too Much, Too Late: Life chances and spending on education and training*, London: Social Market Foundation.
- Nicholas Barr (2002), 'A way to make universities universal', *Financial Times*, 22 November 2002, p. 21, downloadable from www.econ.lse.ac.uk/staff/nb
- Nicholas Barr (2004), 'Variable fees are the fairer route to quality', *Financial Times*, 30 March 2004, p. 21 downloadable from www.econ.lse.ac.uk/staff/nb
- Nicholas Barr (2004), 'Higher education funding', *Oxford Review of Economic Policy*, Vol. 20, No. 2, Summer, pp. 264-283.
- Nicholas Barr and Iain Crawford (2003), 'Myth or magic', *Guardian*, 2 December 2003, pp. 20-21, downloadable from www.econ.lse.ac.uk/staff/nb
- Nicholas Barr and Iain Crawford, *Financing Higher Education: Answers from the UK*, Routledge, 2005.
- Pedro Carneiro and James Heckman (2002), *Human Capital Policy*, NBER Working Paper No. w9495, Cambridge: Mass.
- OECD (2004), *OECD Economic survey of the UK 2004*, especially Ch. 4.
- OECD (2005), *OECD Economic survey of the UK 2005*, especially Ch. 3.
- OECD (2008), *Tertiary Education for the Knowledge Society, Volume 1: Special Features: Governance, Funding, Quality and Volume 2: Special Features: Equity, Innovation, Labour Market, Internationalisation*, Paris: OECD.
- Office for National Statistics (2004), *Focus on Social Inequalities, 2004 edition*, London: TSO.

Nicholas Barr January 2009

41