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Fairer funding: the case for a graduate levy

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1. Introduction

The English tuition fee system is designed to be progressive and to ensure that higher education is well funded. As the Government considers how it could be improved, many former detractors are recognising we could do far worse and fear change.

However, at the heart of the system, there is a problem. It breaks the first rule of marketing: think like your customer. As the head of Push, an outreach organisation that visits hundreds of schools a year, my team and I meet those potential customers regularly. They – especially those from disadvantaged backgrounds – see the system as a barricade.

The system is complicated when students need simplicity. It deals in average outcomes when almost no prospective student is average. It expects people, many of whom are not yet officially adults, to think of their hopes and dreams as investment plans and their life-changing decisions as risk assessments.

Worst of all, it claims the large debts are okay, because they are an illusion anyway – not 'real' debt. When your sales pitch involves admitting misrepresentation, then no one should be surprised that, for all its attempts to be progressive and affordable, the system is less than popular.

Consider how the English fees and loans deal looks to a prospective student, perhaps someone from a disadvantaged background but one who – despite the complexity – understands the system and is even keen to make a rational choice.

They are being invited to make an investment, an investment for which they will need to borrow over £45,000 and, broadly speaking, take themselves out of immediate earnings and career progression for at least three years. For this, they will receive no material collateral whatsoever, but rather the promise that, on average, they are likely to earn more – although, on average, not enough to pay off anything like the entirety of the debt.[1]

They will reflect on the fact that their debts on graduation will be higher than for students from more affluent backgrounds, given the abolition of maintenance grants. Meanwhile, their prospects of getting a graduate-level job and of achieving the promise of a higher-than-average salary will be lower.[2] They will be less likely to engage in the extracurricular advantages of the student experience, not least because they are more likely to be studying part-time, living at home or doing part-time work.[3]

When you look at it like this, for all the current system's intended progressiveness, it is almost a wonder that anyone from a disadvantaged background sees it as a fair investment. The fact that so many do is because choices are not rational cost-benefit analyses. They are emotive impulses based on the desire for agency in our lives, often against the odds.

Similarly, the current funding regime fails to meet the needs of employers, leaving large skills gaps. It also fails to meet the needs of taxpayers or society.[4]

We need a solution that can appeal to all sides of the political spectrum: a socially equitable solution to deliver economic and public good, where the market does the heavy lifting, which strengthens labour supply and the higher education sector, while creating opportunity and eliminating (or minimising) student debt.

This could be achieved through a 'graduate levy', a charge comparable to graduates' student loan repayments but paid by employers for each graduate they employ and based on the salary that the graduate receives. These graduate levy revenues should be paid to the higher education institution where the graduate studied, giving the institution an incentive to ensure their graduates' employability.

To boost social mobility, each university should have targets for recruiting students of diverse kinds and from different backgrounds. Those institutions that did not meet those targets would contribute to a national access fund to support those institutions with a better record of meeting targets.

The transition from the current system of student loans to the graduate levy system could be achieved by switching from lending by the taxpayer to students to lending to higher education institutions and phasing out costs to the Treasury over time.

2. Towards a sustainable solution

Since tuition fees were (re)introduced in 1998, the number of higher education students in the UK has trebled from 650,000 to 1,900,000.[5] At the same time, we have shifted from free education to the normalisation of graduate debts of over £50,000, the cost to the taxpayer has risen, some universities are struggling financially and employers continue to complain that graduates are not job-ready and there are skill shortages.[6]

The four key stakeholders of higher education – students, taxpayers, institutions and employers – are like horses hitched to the corners of the same cart, all pulling in competing directions (lower tuition fees, lower public costs, higher funding, better labour market supply). It could be argued this is an ideal way to achieve a balance, but that supposes the horses are equally strong. Time and again, the students' pony has lost out and graduates have borne ever more of the costs. The current review of post-18 education is political acknowledgement that the cart is off kilter.

Even if the cart were ever in equilibrium, it was fragile, incapable of forward motion without destroying the cart. Changes – such as growth in student numbers, shifting skills needs, or new economic challenges – were always bound to unsettle it.

The issue of student finance will never attract consensual support unless the horses are hitched to the front of the cart. We need a funding system that aligns stakeholders' interests rather than setting them against one another. Only then can we achieve an approach that is both politically resilient and responsive to change in the wider labour market.

This means a system that minimises student debt, requires the taxpayer to pay only for the public benefits of higher education, ensures sustainable funding for universities and maximises the employability of graduates. We may be closer than we think.

3. The solution

This paper proposes a solution comprising three interdependent policy changes without a significant change to the level of public funding for higher education.

3.1. Step 1: Eliminating student debt

Instead of tuition fee loans, we should introduce a graduate levy – broadly equivalent to current loan repayments – charged to employers for each graduate they employ.

Debt repayment is normally based on what a debtor owes, not on what they earn. That is why government-funded student loans have often been described as a graduate tax in all but name.[7] However, the common perception is different among students and school-leavers. Despite higher rates of participation among school leavers, there is evidence that debt aversion dissuades some potential students, particularly those from disadvantaged backgrounds.[8]

This effective denial of higher education to the most disadvantaged is not only a betrayal of fairness, but also a rejection of the economic gains of greater social mobility. It also means that public investment in higher education effectively subsidises the most affluent disproportionately.

A graduate levy means the graduate no longer pays. Rather than the current repayments being collected alongside the employee's National Insurance Contributions, the levy would be paid alongside the employer's Contributions.

Depending on how the employer chooses to absorb the levy, their costs may be no more than the current funding arrangements. Consider a graduate on a salary of £26,000: under current arrangements, their loan repayments amount to £90 over the year (9 per cent of earnings over £25,000) and, before other deductions, their salary is £25,910.

Under the graduate levy, the employer can choose to offer the same job at a salary of £25,910.[9] Assuming they still employ a graduate, their outgoings will be the same £26,000 as previously because they are paying the graduate levy on top of the salary. It has cost the employer not a penny more and the graduate takes home not a penny less, but the graduate has no tuition fee debt.

Of course, the employer could choose to employ a non-graduate and save £90. That is no different from now: employers often do employ non-graduates at lower rates, but the graduate earnings premium, for which evidence remains clear, demonstrates that employers do consider it worth paying more.[10]

3.2. Step 2: A well-served labour market

The graduate levy is neither a loan repayment nor a graduate tax, because it would not be paid into Treasury funds. Instead it would be channelled directly back to the institution where the graduate studied.

This means that, by providing an effective higher education, each university invests in the future employability of its graduates.

Employers' complaints about the 'job-readiness' of graduates may be divided into two separate issues.

3.2.1. Skills shortages

In the current fee regime, funding follows students who are 'at the heart of the system'. Their choices have become the key determinant of graduate labour market supply. This relies on the hope that labour demand will match supply because students will make decisions, informed by an appreciation of long-term labour market trends, to prefer courses in skills shortage areas instead of over-competitive careers.

However, from the perspective of the individual, the fact that too many other people are chasing the same dream does not make that dream less attractive. Moreover, the high cost of tuition does little to nudge people towards better-evidenced course choices. They are just as likely to think, if it is going to cost so much, 'I am not compromising my ambitions' (especially since they will not repay if it goes wrong).

To chase the student demand, universities lay on more of the popular courses (regardless of labour market need), perpetuating the impression to students that there is an open career path. Forensic Science, with roughly 60 graduates to every vacancy, illustrates the problem. However, on graduation, they find themselves qualified in a subject that sends the wrong message to employers, unless they can evince broader employability skills (see below).

It would be better for students and the labour market if universities, with greater access to expertise than individual students, had an incentive to consider future demand. Excessive student demand to study a subject might drive up entry requirements, encouraging some students to explore broader subjects or undersubscribed disciplines where universities are seeking to expand graduate output because they can see future secure revenue from the long-term employability of graduates in those areas.

The graduate levy incentivises institutions to match the supply of their graduates better in terms of subjects studied to future labour market needs. It even incentivises institutions to undertake recruitment marketing not just for their institution, but also for individual, economically important subject areas.

3.2.2. Employability skills

Other than careers where specific qualifications are necessary, most employers do not recruit on the basis of the subject a graduate has studied.[11] Other than specialised roles, most are looking for a rounded set of attributes that together comprise employability: knowledge; hard and soft skills; character attributes (such as personality, attitude and behaviours); and social capital.[12]

Apart from a few specific subject areas (such as Medicine), if a university wishes to ensure its future financial prosperity under a graduate levy system, it will focus on developing students' fluid employability that will make them attractive in the labour market in the long-term. One of the best ways to achieve this is to ensure they enjoy and engage with their learning. That means having the opportunity to study a well-taught course of their choice, and so universities have an incentive to balance what students want to study with what will deliver an income return.

The graduate levy would encourage universities to ensure that no graduate leaves without a good understanding of what it takes to contribute and generate value in the world.

In no way is this a model of universities as production lines for the workforce. It is entirely consistent with the acquisition of knowledge for its own sake and universities as hallowed seats of learning. Long-term employability means becoming a rounded person. Rounded people make more attractive employees, more able entrepreneurs and better academics too.

3.3. Step 3: A fair and diverse HE system

Each university should have targets for its student intake and retention. Those who miss their targets would contribute to a Fair Access Fund. Those who outperform would receive subsidies from the Fund.

Steps 1 and 2 minimise student debt and align universities' interests with employment outcomes that benefit graduates, employers and the wider economy. However, a key component of employability is social capital and so these two steps alone would create a perverse incentive to embed advantage: to recruit students from affluent backgrounds over poorer ones, men over women, young students over mature, white students over black and minority ethnic students, and able-bodied students over those with disabilities.

Under current access arrangements, universities - such as Oxford and Cambridge - spend proportionately far more on access measures than universities with a far better track record of admitting non-traditional students.[13] The very universities that spend the most are, when it comes to getting results, least cost-effective, because for them the task is hardest.[14] Meanwhile the institutions that achieve wider access with minimal expense need further support. This proposal would redistribute large amounts of funding according to where it is best invested to ensure a fair and sustainable higher education system.[15]

4. Transition

If we start from the assumption that the current system is affordable, then it should be equally affordable for the Government to continue to foot the bill by lending direct to the higher education institutions rather than to the students. The institutions would use funds they receive from the graduate levy to repay those loans on the same terms as students repay theirs now.

It would take at least 30 years to take the Treasury out of the equation altogether, but that is no longer than the terms of loans that have already been extended to students and could be accelerated by introducing the graduate levy at lower than the current repayment threshold, but setting higher education institutions' loan repayments at the current £25,000, and using the difference to reduce future loans. Moreover, this gives universities an incentive to ensure graduates are supported into the workplace as soon as possible, which is, after all, the part of a graduate's career where a university's direct support is most likely to be effective.

As generations of graduates start creating income for universities, the Treasury can phase out lending. Some public subsidy would still be necessary but this could and should be directed to support subjects where there is a public interest in maintaining the number of graduates but where either the salaries are low or the course costs are high (such as Teaching, Social Work, Medicine and Engineering).

Although there are other ways to achieve transition, this mechanism ensures no interruption to higher education revenue, no shock to the public accounts and no additional public expense.

5. Conclusion

While the current system balances competing interests to achieve the least worst outcome for the stakeholders with the most power, a graduate levy aligns stakeholders' interests. Given the complexity of the problem of higher education funding, criticisms of any proposal are inevitable. However, because this graduate levy proposal hitches all the horses to the front of the cart, most difficulties can be addressed satisfactorily in the development of the detail of the policy.

For example, a graduate levy could be seen as cause for concern for arts subjects because earnings are lower. However, because these courses are cheaper to teach and students want to study them, they would provide an opportunity for universities to maintain a diverse income stream with plenty of low-cost, low-return courses. Many other objections to a graduate levy either disappear similarly or can be addressed in the design of the system's details.

The key is to recognise the 'market' in higher education is not built on the student as customer. If we must use the ill-suited language of markets, then students are a precious resource and universities are suppliers of educated graduates to employers and to the nation as a whole. It is they who are the so-called customers.

The need for a graduate levy follows almost self-evidently. Employers and taxpayers hold the purse strings and are in a position to exercise demand in a way that prospective students cannot. Diverse institutions that meet the demand should thrive. That means treating students as precious, educating and nurturing them, which will serve their interests far better than being crowned customer kings and queens.

Whenever we talk of markets, we must remember that higher education is at the core of our culture and prosperity. It is only by realising we share a common goal that we can shape the market to our needs. Market forces will not provide solutions, but if we contrive solutions that suit us all, we can set up the market forces to deliver them.

Endnotes

1 The average graduate debt in England is £46,000 according to C. Cullinane, R. Montacute, *Fairer Fees*, London Economics / Sutton Trust (Nov 2017), bit.ly/HEPI-FF-SuttonTrust. According to the Universities Minister Sam Gyimah (*Hansard*, 11 Oct 2018), the anticipated write-off of unpaid loans (the Resource Accounting and Budgeting charge) is 45 per cent.

2 C. Cullinane, R. Montacute, *Fairer Fees*, London Economics / Sutton Trust (Nov 2017): 'Students from households in the lowest 40 per cent of earners take on average debts of £51,600, compared to £38,400 in the top 20 per cent of households'. Graduate Outcomes (LEO) shows a £3,100 gap in earnings between graduates from the most and least affluent quintiles after one year. The gap widens over time. See Department for Education, SFR 15/2018 (15 Mar 2018), bit.ly/HEPI-FF-LEO.

3 Universities UK, *Working in partnership: enabling social mobility in higher education: The final report of the Social Mobility Advisory Group* (Oct 2016), bit.ly/HEPI-FF-SMAG

4 Universities UK found that that 73 per cent of UK engineering employers reported difficulty in employing graduates with the necessary skills (*Solving future skills challenges* (Aug 2018), bit.ly/HEPI-FF-UUK). For example, Engineering UK estimates a shortage of 39,000 Engineering graduates per year (*The State of UK Engineering 2018* (Jan 2018, bit.ly/HEPI-FF-EngUK, p6).

5 Comparison from HESA: bit.ly/HEPI-FF-HESA and bit.ly/HEPI-FF-HESA16-17

6 The Institute for Fiscal Studies calculates the up-front cost of higher education (excluding research) as £9.7bn in 2015/16 (see Chris Belfield et al, *Long-run comparisons of spending per pupil across different stages of education*, IFS (Aug 2018), bit.ly/HEPI-FF-IFS), however, this includes loans, some of which will be repaid. Based on Public Expenditure Statistical Analyses, public spending on all of tertiary education is only £6.31bn in 2018, but this compares to £3.77bn in 1993 (bit.ly/HEPI-FF-PESA)

7 See, for example, Hugo Rifkind, 'University tuition fees are a tax. It's time to admit it', *The Spectator* (5 Apr 2014), bit.ly/HEPI-FF-Spectator

8 Due to the fall in part-time students, overall participation among disadvantaged students has fallen. See Mark Leach, 'Is there really a record number of disadvantaged students in HE?', *Wonkhe* (20 Nov 2017) bit.ly/HEPI-FF-Wonkhe. Evidence regarding the role of debt aversion may be found in C. Callender and G. Mason, *Research Paper 58: Does student loan debt deter Higher Education participation? New evidence from England*, Centre for Learning and Life Chances in Knowledge Economies and Societies (2017), bit.ly/HEPI-FF-LLAKES

9 This simplified example would entail an almost insignificant reduction in income tax and NI revenue by HMRC, which means the example is not perfectly cost-neutral.

10 Paul Bolton, Sue Hubble, *Returns to a degree, Briefing Paper number 8389*, House of Commons Library (19 Sept 2018), bit.ly/HEPI-FF-HoCL

11 See, for example, *BIS Research Paper 231: Understanding Employers' Graduate Recruitment and Selection Practices: Main report*, BIS, (Nov 2015), bit.ly/HEPI-FF-BIS231: '30 per cent of employers look for specific degree subjects when recruiting and this has remained relatively stable over time, thus 70 per cent recruit from any discipline'.

12 See Johnny Rich, *Employability: Degrees of value*, HEPI (Dec 2015), bit.ly/HEPI-Employability

13 'Oxford "spends £108,000" to recruit each extra low-income student', *The Guardian* (19 Sept 2018), bit.ly/HEPI-FF-Guardian

14 This is not a criticism of those efforts, but recognition of the fact that, for many students from non-traditional backgrounds, the full-time, live-in experience of Oxbridge may not be what they want or need.

15 An alternative, more radical, approach to ensure universities do not use student selection to unfairly 'game' their future revenues would be to adopt a 'comprehensive' system of higher education as proposed by Prof Tim Blackman, *The Comprehensive University: An alternative to social stratification by academic selection*, HEPI (July 2017), bit.ly/HEPI-FF-Blackman

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