Shaping higher education fifty years after Robbins

Tuesday 22 October 2013

London School of Economics and Political Science
Shaw Library, 6th floor, Old Building, Houghton Street, London, WC2A 2AE

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Financing teaching: the 2006 and 2012 reforms in England: Where are we? Where should we be?

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Conference on Shaping higher education fifty years after Robbins

London School of Economics, 22 October 2013

Financing teaching: the 2006 and 2012 reforms in England: Where are we? Where should we be?

1 The backdrop
2 What we know
3 Confirming evidence: The 2006 reforms
4 Where are we now? The 2012 reforms
5 Where should we be? The 2016 White Paper

1 The backdrop

1.1 The history of ideas: income-contingent repayments

- The original idea: Friedman, 1955
- LSE writers
  - Evidence to the Robbins Committee: Alan Peacock and Jack Wiseman, Alan Prest
  - Mark Blaug, 1960s
  - Howard Glennerster, 1968 paper
  - Nicholas Barr, from 1980s
  - Mervyn King 1988: the national insurance analogy

1.2 The history of student finance

- 1963 Robbins Report, followed by expansion
- Till 1990: no fees; income-tested maintenance grants
- 1990: mortgage-type loan to supplement maintenance grants
- 1998 (England)
    - Fixed tuition fees of £1,000 per year, but no fees loan
    - Maintenance loans with income-contingent repayments
    - Abolition of maintenance grants

History of student finance (cont'd)

- 2006 (England)
  - Variable tuition fees of up to £3,000, fully covered by a fees loan
  - Increase in maintenance loan
  - Re-introduction of grants
- 2012 (England)
  - Fees cap raised from £3,000 to £9,000, fully covered by fees loan
  - Interest rate on student loans increased to around the government's cost of finance
  - Increase in repayment threshold from £15,000 per year to £21,000
  - Abolition of most taxpayer support for teaching in the arts and humanities and the social sciences
  - Abolition of Education Maintenance Allowances and AimHigher

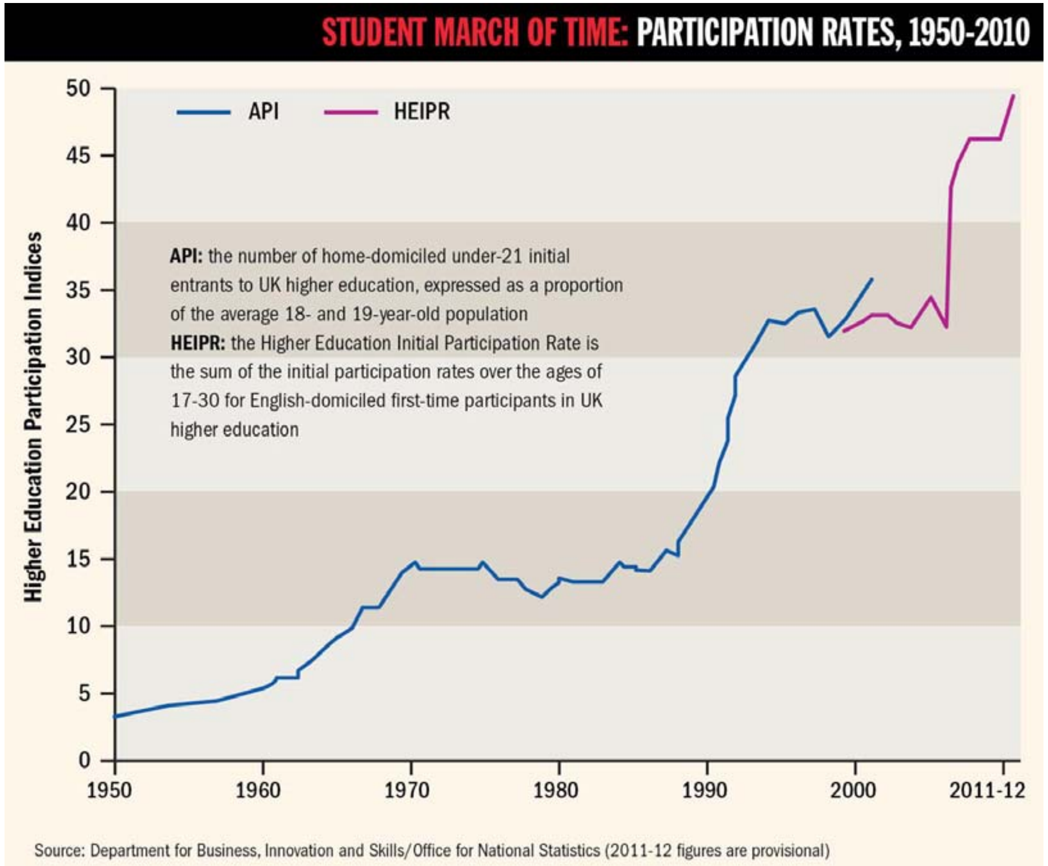
1.3 What are the drivers of change?

- 50 years ago higher education was not very important in economic terms
- Today it matters
    - To transmit knowledge; as always
    - To promote core values (democracy, human rights, social cohesion, protection of minorities, etc.); as always
    - To develop knowledge for its own sake (intellectual freedom, independent voice, innovations, etc.); as always
    - To promote economic growth in a competitive economy (flexible skills, employment and competitiveness) – this is a new element

Long-run trend of rising demand for higher education

- Skill-biased technological change is driving up the demand for skills, requiring more training
- Separately, skills have a shorter shelf life, requiring repeated training
- No accident that participation rates have risen in all countries
- No sign that these trends are slowing

Participation rates, UK, 1950-2010: What Robbins wrought



1.4 Objectives of higher education finance

- Quality: strengthening the quality of teaching and research
- Access: raising participation by students from disadvantaged backgrounds
- Size: ensuring that the sector is large enough

2 What we know

- The railroad crash
    - Skill-biased technical change creates a need for expansion
    - But higher education faces competing pressures on public finance, e.g. population ageing, medical advances and global competition
- This conflict creates pressures to cost sharing
- But students are credit constrained, hence need a device for efficient consumption smoothing, i.e. a well-designed system of student loans to finance tuition fees
- Economic theory offers useful lessons

2.1 Lessons from economic theory

- Lessons rooted largely in the economics of information, i.e. largely technical, rather than ideological
- Where are the value judgements?
  - Quality and size imply a wish to see a flourishing economy
  - Access – not just posturing

Lesson 1: Graduates (not students) should share in the costs of their degree

- Higher education creates external benefits:
  - Growth, social participation, etc.
  - Thus it is right that the taxpayer should contribute
- But also significant private benefits in financial terms *and* non-monetary terms, e.g. job satisfaction
- Thus right that beneficiaries should share some of the costs
- BUT students are credit constrained

Lesson 2: Well-designed student loans have core characteristics

- Large enough to cover fees and living costs, so that tertiary education is free at the point of use
- Income-contingent repayments, i.e. calculated as *x*% of graduate’s subsequent earnings
    - Designed so that graduates with a good earnings record repay in full in present-value terms
    - But with built-in insurance against inability to repay
    - The insurance element contributes both to efficiency and equity
- An interest rate related to government’s cost of borrowing

Pay slips, UK 2013-14

	Bill	Tariq	Richard	Jane
Annual earnings	£21,000	£25,000	£30,000	£50,000
Income tax (monthly)	£192.67	£259.33	£342.67	£818.50
NI contributions (monthly)	£132.52	£172.52	£222.52	£351.22
Total IT and NICS (monthly)	**£325.19**	**£431.85**	**£565.19**	**£1,169.72**
Loan repayments (monthly)	**£0**	**£30**	**£87.50**	**£217.50**

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

Source: http://www.uktaxcalculators.co.uk/
Loan repayments: own calculations

Lesson 3: Competition between universities helps students

- Does competition work? Yes when consumers are well informed
- Are consumers well informed?
    - Students are mostly a savvy, streetwise bunch
    - Much information is available and more can and should be made available
    - Good information is a central source of quality assurance
- Are all students well informed? No. Students from poorer backgrounds face information problems which policy needs to recognise and address

Lesson 4: Government has an important and continuing role

- To provide taxpayer support
- To ensure that there is a good loan scheme
- To adopt, encourage and mandate policies to widen participation
- To regulate the system
    - Price: arguments for a fees cap of some sort
    - Quality: ensuring that there is effective quality assurance
- To set incentives
    - Establishing the degree of competition (can vary by subject)
    - Larger subsidies for certain subjects
- To redistribute within higher education
- To finance research
- To ensure collection of statistics

2.2 Widening participation: What does the evidence show?

- According to ‘pub economics’ it is obvious that ‘free’ higher education widens participation
- Pub economics is wrong
- Access is much more a 0-18 problem than an 18+ problem

Constraints on participation: What stops people going to university?

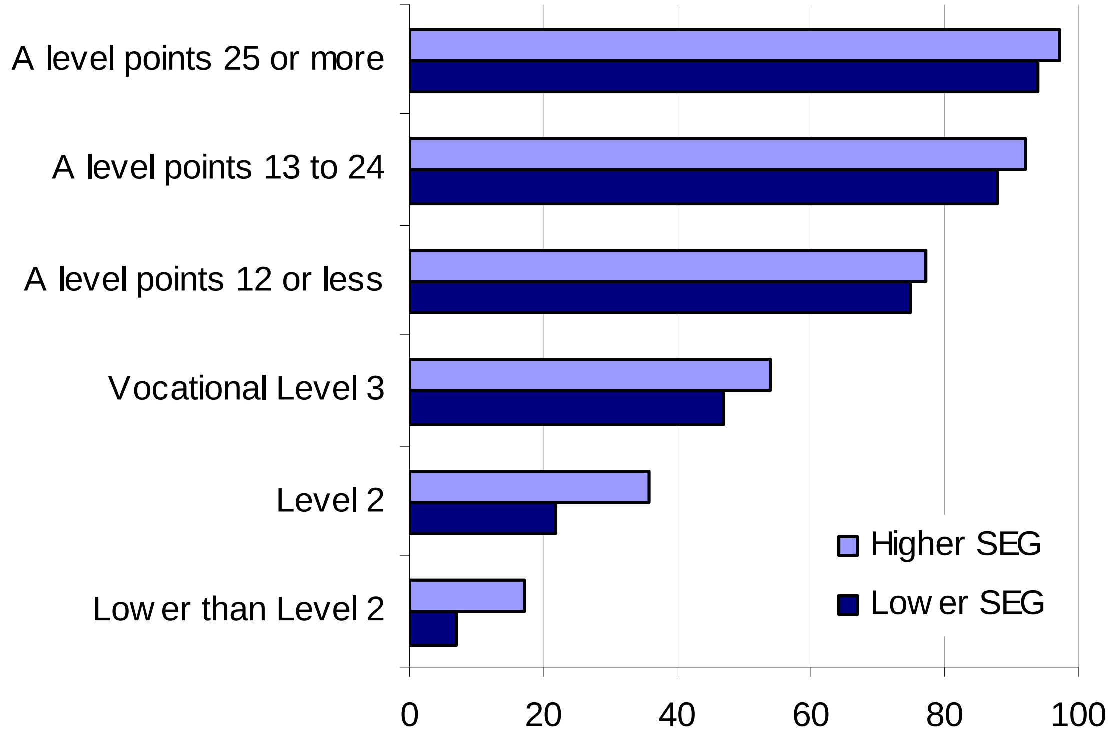
- Credit constraints: a good loan system addresses this problem for most people
- Constraints with earlier roots: growing awareness that the major impediments to participation are
    - Lack of attainment in school
    - Deficient information, including uncertainty

Early child development is central

- Evidence on critical developmental windows, e.g. first 22 months
- Tests of cognitive abilities from 22 months onwards
- August babies

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

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



The right policies to widen participation

- Policies to address credit constraints
  - Financial support to complete high school
  - Income-contingent loans that make higher education free at the point of use
  - Policies that respond to genuine debt aversion
  - Flexible options for part-time study
- Policies to address prior constraints
  - Increased emphasis on early child development
  - Action to improve school outcomes
  - Improving information and raising aspirations
- ‘If I were a real socialist, I wouldn’t spend a penny on higher education. I’d spend it all on nursery education’ (Charles Clarke, 2003)

What is wrong with tax finance?

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

- Failure 1: quality
    - Shortage of resources
    - Lack of competition
- Failure 2: access
    - Spend money on nursery education, improving schools
    - The taxes of the poor pay for mainly better-off people to get the degrees that keep them better off. Why should the truck driver pay for the degree of the Old Etonian?
    - ‘Free’ higher education crowds out the policies that widen participation
- Failure 3: size

Arguments of principle

- Elitism has no place in tertiary education
  - Distinguish social elitism and intellectual elitism – the latter is both necessary and desirable
- Tertiary education is a basic right and should therefore be free
  - Food is a basic right, but market allocation is entirely accepted
- It is immoral to charge for education
  - It is immoral if a bright person from a poor background cannot study at a top institution
  - Morality applies to the outcome, not the instrument

Concluding comments on participation

- Not just an exercise in logic chopping: the arguments are important
- 'Free' is just another word for 'someone else pays'
- Pub economics leads to the wrong diagnosis and therefore to the wrong prescription
- The resulting policy spends money on 'free' higher education instead of improving earlier education, providing more and better information, and raising aspirations, and thus spends money on a policy that not only does not work, but actively harms participation

2.3 The resulting strategy

Element 1: quality and size

- Universities should be financed from a mix of taxation and variable fees (lessons 1 & 3)
- Variable fees promote quality and size
    - By bringing in more resources
    - By strengthening competition
- Are fairer than any other method

Element 2: loans to address credit constraints

- Higher education should be free at the point of use
- Loans (lesson 2) should
  - Be large enough to cover all fees and living costs to provide consumption smoothing
  - Have income-contingent repayments to provide insurance
- Such loans fix problems of participation for well-informed students with good school attainment (i.e. middle class). If the world comprised only such students, the strategy would end there

Element 3: policies to address prior constraints on participation

Why might someone with the ability and aptitude not go to university?

- Can’t afford it: loans are the main instrument for addressing credit constraints
- Failure to get to the starting gate: policies include
    - Raising attainment in school
    - Improving information/raising aspirations
- Problems at the starting gate: not applying even though qualified, or applying to a local university not an elite one
    - Both problems arise in part from risk aversion
    - Solutions include
        - Improved information
        - Wider part-time options

3 Confirming evidence: The 2006 reforms

The 2006 strategy got it broadly right

- Financing universities: variable fees
- Addressing credit constraints: income-contingent loans to cover fees and living costs
- Policies to address earlier constraints on participation

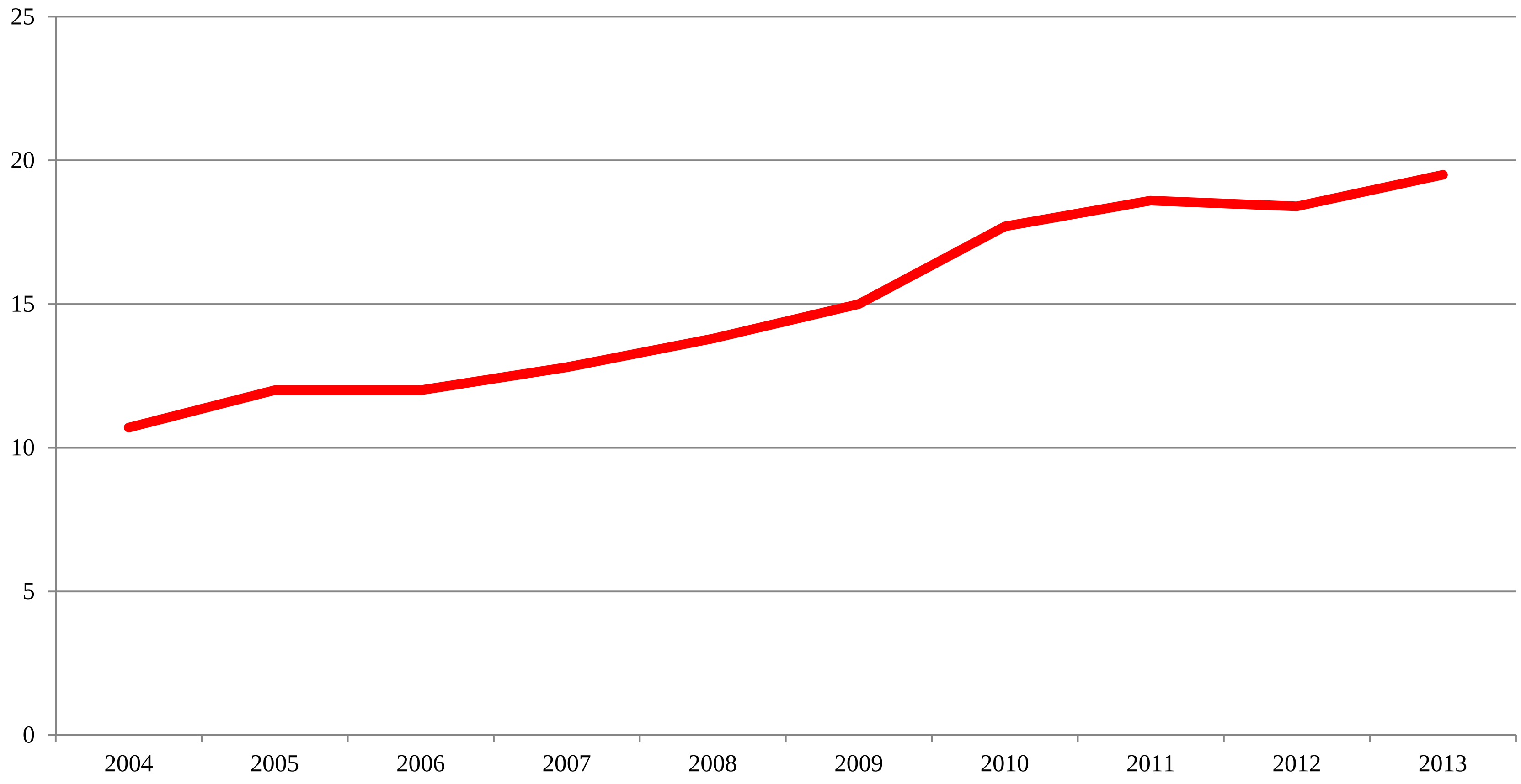
What happened: English higher education 2006-2012

	2006-07	2011-12	Change
More resources for universities			
Tuition fee income from home/EU undergraduates	£2.17bn	£4.05bn	+86.6%
Taxpayer support for teaching	£4.31bn	£4.37bn	+1.4%
More financial support for students			
Number of awards (grants and loans) (000)	814.6	1,023.2	+25.6%
Expenditure on financial support (grants and loans)	£4.29bn	£7.64bn	+78.1%
More students: number of new entrants	284,000	342,000	+20.4%
Wider participation: % from most disadvantaged backgrounds applying to university	12%	18.4%	+53.3%

Improved participation

- 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)

Application rates from people in most disadvantaged areas (UCAS 2013)



4 Where are we now? The 2012 reforms

- The good
  - Raising the fees cap
  - Raising the interest rate on student loans
- The bad
  - Abolishing taxpayer support for the arts and humanities and the social sciences
  - Raising the threshold at which loan repayments start – the killer problem
- The unprintable: abolishing Education Maintenance Allowances and AimHigher

The bottom line: a correctable flaw in the design of the loan system

- In the 2006 system the interest subsidy made loans fiscally expensive, leading eventually to a cap on student numbers
- The 2012 reforms rectify this problem
- But loans continue to be fiscally expensive because of the large increase in the repayment threshold from £15,000 to £21,000 and indexed to wage change
- Thus the new system creates the same problem – the numbers cap – for the same reason – the high cost of loans
- Thus the strategy is flawed; the only solution is to fix the strategy

5 Where should we be? The 2016 White Paper

- Partially restore taxpayer support for teaching (T grant)
- Reduce the marginal cost of extra students by
  - Giving each university a capped T grant
  - Capping spending on student maintenance grants
- Make loans as close as possible to fiscally neutral by
  - Minimising leakages, e.g. a lower repayment threshold
  - Sharing the loss on graduates with low lifetime earnings between (a) the cohort of graduates, (b) universities and/or (c) taxpayers
- Strengthen the policies that really widen participation
  - Restore EMAs and AimHigher, or successor policies
  - Full first-year scholarships, especially at the elite universities
  - Consider forgivable loans for some professions
  - Strengthen qualifications and pay of nursery school teachers
- These policies are rooted in economic theory and empirical evidence. I like to think that Lionel Robbins would regard them as fitting inheritors of 1963

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