Shaping higher education fifty years after Robbins

Tuesday 22 October 2013

London School of Economics and Political Science
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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

**STUDENT MARCH OF TIME: PARTICIPATION RATES, 1950-2010**

**API**: the number of home-domiciled under-21 initial entrants to UK higher education, expressed as a proportion of the average 18- and 15-year-old population.

**HEIPR**: the Higher Education Initial Participation Rate is the sum of the initial participation rates over the ages of 17-30 for English-domiciled first-time participants in UK higher education.

Source: Department for Business, Innovation and Skills/Office for National Statistics (2011-12 figures are provisional)
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

<table>
<thead>
<tr>
<th></th>
<th>Bill</th>
<th>Tariq</th>
<th>Richard</th>
<th>Jane</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual earnings</strong></td>
<td>£21,000</td>
<td>£25,000</td>
<td>£30,000</td>
<td>£50,000</td>
</tr>
<tr>
<td><strong>Income tax (monthly)</strong></td>
<td>£192.67</td>
<td>£259.33</td>
<td>£342.67</td>
<td>£818.50</td>
</tr>
<tr>
<td><strong>NI contributions (monthly)</strong></td>
<td>£132.52</td>
<td>£172.52</td>
<td>£222.52</td>
<td>£351.22</td>
</tr>
<tr>
<td><strong>Total IT and NICS (monthly)</strong></td>
<td>£325.19</td>
<td>£431.85</td>
<td>£565.19</td>
<td>£1,169.72</td>
</tr>
<tr>
<td><strong>Loan repayments (monthly)</strong></td>
<td>£0</td>
<td>£30</td>
<td>£87.50</td>
<td>£217.50</td>
</tr>
</tbody>
</table>

- 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/](http://www.uktaxcalculators.co.uk/)

Loan repayments: own calculations

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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
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

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

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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
References


Nicholas Barr (2012b), The Economics of the Welfare State, 5th edn, OUP, Chapter 12.


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