Ensuring access to University education without breaking the bank

Research by Professor Nicholas Barr influenced policies for higher education finance in England, Hungary and the EU

What was the problem?

The share of the population entering higher education in England rose sharply from an elite of 5% in the early 1960s to around 30% by the mid-1990s.

There was growing awareness that public funding of university education was becoming a problem. Rising student numbers were putting pressure on the public finances and raising questions about how far the state should foot the bill for university education. There was much debate over whether and how public funding could be supplemented on a significant scale by private funding.

It was important to find a solution that met the demand for skills, to support national competitiveness, but which did not conflict with widening participation.

What did we do?

In a series of articles and books LSE Professor Nicholas Barr examined what economic theory tells policymakers about the finance of higher education.

He argued that since university education benefits wider society as well as the student, the cost should be shared between taxpayers, in the form of continuing taxpayer support, and the individual beneficiary, in the form of tuition fees. This division, he argued, would be fairer, since the costs would be borne by those who benefited.

It would also make the system more efficient. Barr argued that allowing universities to charge different levels of fees would strengthen competition and thus encourage universities to focus more on the quality of teaching, on improving students' experiences and on boosting students' employment prospects.

One of Barr's key recommendations was that, because most students cannot afford to pay fees upfront, the only large-scale and fair method of paying fees would be out of the future earnings of graduates through a student loan scheme.

But, he argued, the design of the loan is crucial. First, repayments should not be a fixed amount per month, but instead calculated as a percentage of the graduate's subsequent income. Second, it is important to charge the right interest rate. Barr showed that setting the interest rate on student loans below the Government's own borrowing costs would be costly to the Exchequer. It would also lead to the loans being badly targeted: with an interest subsidy, nobody – not even the highest earnings graduates – repays in full. Thus cheap loans benefit high earners who could and should fully repay their loans.

Third, he argued, loans large enough to make education free during student days are essential to ensure that everyone, regardless of family income, can finance fees and living costs.

Barr also carried out research on higher education finance in Hungary, investigating in particular how to design a student loan that combined income-related repayments with private finance.

What happened?

England

Government ministers used Barr's research as a basis for reforms to higher education funding in England in 2006. These reforms introduced variable tuition fees, extended the system of income-based loans to cover fees, and reinforced policies to widen participation.

Between 2007/08 and 2011/12, tuition fee income at English universities from home and EU undergraduates increased by 53% – from £2.65 billion to £4.05 billion. Taxpayer support for teaching remained broadly constant, meaning that the income from fees was a net addition to university resources. This outcome addressed concerns over the rising cost to the public finances while attracting new revenue into the universities.

> "Thanks for the outstanding contribution you made to the debate on our higher education reforms. The maturity of the debate … owed a great deal to your media presentations, and all the painstaking work on which they were based."
>
> **Tony Blair,**
> **former Prime Minister**

The reforms increased the value of loans for living costs, extended loans to cover tuition fees and re-introduced student grants. Between 2007/8 and 2011/12 the number of awards of financial support to English-domiciled students rose by nearly 20%, from 836,000 students to over 1 million.

The reforms also expanded the system, with the number of new entrants into higher education rising by 16%. Within that total the share of applications by people from disadvantaged backgrounds rose by a third, from less than 14% to more than 18%. While one cannot argue with certainty that the reforms were the cause, it is fair to say that they were part of a package of wider reforms that was associated with improved participation.

In terms of his influence on the design of these reforms, Barr was invited to give evidence to the Education Select Committee and his research was cited in many newspaper articles at the time. His contribution was personally acknowledged by then Prime Minister Tony Blair, and current Business Secretary Vince Cable has explicitly stated that the decision to introduce a higher interest rate on student loans in 2012 was based on Barr's research.

Hungary

The Hungarian authorities invited an LSE team to assist in the design and implementation of a student loan, the country's first wide-ranging system of student support. The researchers used their findings to design a system that had repayments related to graduate income, avoided interest subsidies and was privately financed. The combination of income-based repayments and private finance was a major innovation.

The scheme was seen as a success. After 11 years, it had made cumulative loans of 247bn forints (€850m) to a total of 331,000 students. In recognition of his critical contribution, the head of the Hungarian Student Loans Company invited Barr to give the opening keynote address at an event celebrating the 10th anniversary of the loan scheme in 2011.

European Union

Based on the success of the Hungarian scheme, in 2010 the Education and Culture Directorate of the European Commission invited an LSE-led team to produce a feasibility study (PDF) for establishing a loan system available to students across the EU. As a result, between 2013 and 2020 the Erasmus+ Loan Guarantee Facility is underwriting €500m a year in student loans for Master's degree students.

Nicholas Barr is Professor of Public Economics in the European Institute at the London School of Economics and Political Science and the author of numerous books and articles including The Economics of the Welfare State (5th edn, 2012), Financing Higher Education: Answers from the UK (with Iain Crawford) (2005), and Reforming Pensions: Principles and Policy Choices (with Peter Diamond) (2008). Alongside his academic work is wide-ranging involvement in policy, including spells at the World Bank and the International Monetary Fund, and as a member of the World Economic Forum's Global Agenda Councils on Demographic Shifts and on Ageing Society. Professor of Public Economics in the European Institute at LSE.

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