

Assessing the White Paper on higher education

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Assessing the White Paper on higher education¹

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Executive summary

The proposed new system creates the same strategic problem – the cap on student numbers – for the same reason as current arrangements – the high cost to the taxpayer of extra students. The White Paper proposes mechanisms to improve quality via competition, but with the number of students fixed, the reforms are more likely to reduce price (and hence public spending on loans) than to improve quality. Thus the strategy is flawed, and the White Paper mechanisms will not (because they cannot) sidestep the problem. As formulated, the reforms do little or nothing to promote quality, widen participation or increase the size of the sector. The only solution is to fix the strategy by improving the design of loans so that the numbers cap can be relaxed, giving the market more influence on price, quantity and quality.

This submission starts with a brief summary of previously-announced reforms which establish the context of the White Paper. Section 2 summarises the White Paper mechanisms, and section 3 discusses their likely effects on quality, access and size. The concluding section suggests what should happen next.

1 Earlier decisions that shape the White Paper

1. The shape of the White Paper is largely determined by previous changes. My earlier evidence to the BIS Committee (Barr 2011) argued that the objectives of policy are improved quality, wider participation, and larger size, and highlighted two strategic problems with the proposed reforms in pursuing these objectives. First, they replace taxpayer support for teaching in the Arts and Humanities and the social sciences (the T grant) by a loan. The main driver for that policy is that T grant is part of public spending whereas most spending on loans is off-budget; thus the move reduces public spending as measured by the PSBR. Second, in an attempt to make the resulting larger loans politically more palatable, the reforms raise the threshold at which graduates start to repay from £15,000 to £21,000 and index that threshold to changes in earnings.

2. The results are two-fold. Though little has changed in cash terms (since the government has to finance the upfront cost of loans), there is an apparent reduction in the BIS budget; it is not unfair to say that an accounting trick is driving deleterious policy change. Secondly, the combination of larger loans (to replace T grant) and the higher repayment threshold means that, notwithstanding the increase in the interest rate on loans, the fiscal cost of each additional student continues to be high.

3. The central argument of this submission is that the new system creates the same strategic problem – the numbers cap – for the same reason – the high cost of extra students.

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The White Paper proposes mechanisms to improve quality via competition, but with the number of students fixed, the effects of competition are more likely to reduce price (and hence public spending on loans) than to improve quality. Thus the strategy is flawed, and no amount of clever tinkering can sidestep the problem. The only solution is to fix the strategy by improving the design of loans so that the numbers cap can be relaxed, giving the market more influence on price and quantity and hence also on quality (for detailed discussion, see Barr and Shephard 2010).

2 The White Paper proposals

4. The requirements announced in the White Paper that universities publish timely, accurate and relevant information are unambiguously good.
5. The effects on competition are shaped by the inescapable implications of having a fixed number of students:
 - Admissions are a zero-sum game. If some universities expand others must contract.
 - If the number of institutions increases (e.g. because of new private entrants), the average size of each must fall.
6. On competition, the White Paper says (Executive summary, p. 10):

‘We will free around 85,000 student numbers from current controls in 2012/13 by allowing unrestrained recruitment of the roughly 65,000 high-achieving students, scoring the equivalent of AAB or above at A-Level and creating a flexible margin of 20,000 places to reward universities and colleges who combine good quality with value for money and whose average charge (including waivers) is at or below £7,500.’
7. Thus, the White Paper creates a market with three parts:
 - (a) ‘Top’ universities accept mainly AAB students and can expand. Competition within the group is a zero-sum game. For the group as a whole, expansion is by bidding AAB students away from ‘middle’ universities.
 - (b) Middle’ universities: for the group as a whole, student numbers are reduced by the size of the margin and, because they charge more than £7,500, these universities cannot bid for margin students.
 - (c) ‘Low price’ universities have an average net fee of less than £7,500, so the group as a whole can expand by the size of the margin. An institution can combine a fee of £9,000, if it has a top department, with lower fees in other subjects, together with fee waivers calibrated to bring the average to below £7,500. The group includes three types of institution: new private providers, further education colleges, and access universities.

The Financial Times refers to these groups as the ‘new elite’, the ‘squeezed middle’, and the ‘insurgents’, respectively (<http://www.ft.com/cms/s/0/cc088644-a416-11e0-8b4f-00144feabdc0.html>).

3 Assessment

8. Successive sections discuss likely effects on quality, access and size. Section 3.4 discusses some additional worries.

3.1 Quality

9. GROUP (A) UNIVERSITIES. The White Paper argument is that, by liberalising numbers, universities in this group can expand, and that the option to do so creates competitive incentives to improve quality. That argument is weak for the best universities for two reasons. First, they are unlikely to want to expand much (it is implausible to imagine significant expansion by Oxford, Cambridge, LSE, or Imperial College; and University College London has already made an announcement to that effect). Second, and more fundamental, any increase in domestic competition facing those institutions is completely dominated by the international competitive pressures they have faced for many years. To imagine otherwise is to argue that those universities teach well enough to attract foreign students, but need domestic competition to encourage them to teach UK students well.

10. If increased domestic competition through liberalised student numbers is to have any effect, it would be on the second tier of group (a) universities.

11. GROUP (B) UNIVERSITIES. The average university in group (b) can avoid a reduction in student numbers only by reducing price enough to join group (c), allowing it to bid for margin. There is no mechanism for the average university in group (b) to increase student numbers by improving quality (i.e. shifting its demand curve to the right); its only lever is to reduce price (i.e. moving down the demand curve). To the extent that there is competition in group (b), it is within a zero-sum game.

12. Thus the quality of universities in group (b) is at risk for two reasons: they lose money because they lose quota; and they risk losing their best (AAB) students to group (a), not least because savvy parents will recognise the unhappy position of universities in group (b).

13. Over time, the risk is that these effects will ‘hollow out’ group (b) – universities which in many ways are the core of English higher education, but also enormously attractive worldwide. Hollowing out puts at risk the export performance of the sector.

14. GROUP (C) UNIVERSITIES. The ability of a university in group (c) to expand is by bidding for students from the margin on the basis of price and quality, competing for places with new private providers and further education colleges. Places are allocated by HEFCE, not the market. Thus the system is one with a shortage of places and a central-planning approach. Even a rudimentary knowledge of the communist experience suggests scepticism.

3.2 Access and participation

15. FAIR ACCESS. The use of AAB or equivalent as the metric in group (a) militates against the use of contextual data (e.g. the fraction of pupils at an applicant’s school achieving 5 good GCSE passes). The effect might not be acute in a handful of top universities, but otherwise risks potential adverse effects on fair access

16. **WIDENING PARTICIPATION.** Group (c) contains different types of institution. Private providers might offer good teaching at a lower price. Universities in group (c) face incentives to bring down their average net fee either directly or through fee waivers. The evidence suggests that fee waivers do little to widen participation. The most powerful policies for doing so are twofold: interventions earlier in the system (hence the decision to abolish Education Maintenance Allowances and AimHigher is profoundly mistaken³); and expansion of university places, on which the White Paper does nothing.

3.3 Size

17. **UNDERINVESTMENT IN HUMAN CAPITAL.** The White Paper takes the cap on student numbers as given. Within a given funding envelope, numbers could be increased if the White Paper has the effect of reducing fees, hence reducing total public spending on fee loans. That approach, however, is problematical in two ways.

- The increase in student numbers is unlikely to be large. To under-invest in human capital in today's world is mistaken for the reasons set out in my earlier evidence (Barr, 2011, Appendix 1). In South Korea in 2008, the participation rate in tertiary education was 71 per cent (OECD 2010, Table A2.4).
- Any such expansion is based on reduced fees. As noted earlier, the mechanisms in the White Paper are more likely to reduce prices than to increase quality. The title of the White Paper puts students at the heart of the system. It is not clear how a structure designed to reduce price will lead to improved student experience. Quality matters for the same reason as size – the country's international competitiveness – as well as for the student experience.

3.4 Other worries

18. **A SEGMENTED SECTOR.** A vibrant system of higher education has a spectrum of institutions like the colours of the rainbow. The proposed market structure drives a wedge between universities in group (a) and group (c). More specifically:

- Group (a) universities face a slightly relaxed numbers constraint to the extent that they choose to attract AAB students from group (b) institutions.
- Group (b) universities face declining income, both because of lower student numbers (quantity) and from pressures to reduce fees (price) in order to join group (c).
- Group (c) will expand by the size of the margin. But within that higher numbers total, if new private providers and further education expand, access universities face contractionary pressures.

19. Such segmentation is inefficient. In the extreme, the system will move towards what has been called 'soft binarism'.

20. **STABILITY OF THE SECTOR.** At a practical level, there is no detail about how the margin will work, for example, when universities will be told what their numbers quota will be. This may not be a problem when, as at present, changes in quota are small, but if the size of the margin increases changes might be larger; but expansion or contraction needs advance notice.

³ Whether or not there was a case for reforming these policies, abolition was a mistake.

21. More generally, HEFCE will be doing a juggling act: rapid change may cause some institutions to fail because the numbers cap denies them an important degree of freedom. If there is significant instability, HEFCE will stabilise the system by keeping changes small. But in that case, competition is limited – the system is complex, but to no useful effect.

4 Conclusion

22. THE CURRENT REFORMS DO LITTLE OR NOTHING FOR QUALITY, ACCESS OR SIZE. They fail on size, since the high cost of loans constrains student numbers. The White Paper does little, if anything, to widen participation, and the AAB metric could harm fair access. The effects on quality are likely to be divergent, with little effect for the top universities in group (a), which already face intense international competition, possible benefits for the rest of group (a), and potentially deleterious effects for the other groups.

23. WHAT NEXT? The bare minimum action now is to put indexation of the £21,000 repayment threshold in abeyance for the time being. Barr and Johnston (2011, Fig 1a) estimate that this change, with a slightly higher interest rate, would save around 15 per cent of the total cost of loans (i.e. would roughly halve the total loss on loans) for the 2012 cohort of students, even taking account of the larger loans necessitated by higher fees, with larger savings for later cohorts.

24. If these problems are not addressed now, it will have to be left to the next White Paper to tackle the root problem – the high fiscal cost of expansion. As argued in Barr and Shephard (2010), policy should (a) restore an element of T grant as a block grant, thus reducing the size of loans and hence the cost of loans, and (b) increase the fraction of loans that is repaid. If loans are smaller and less leaky, the remaining loss from non-repayment is smaller, making it more feasible to share those costs between the cohort of graduates on the one hand, and universities, on the other. These changes, as a package, greatly reduce the taxpayer cost of expansion. Relaxing the numbers constraint has benefits for quality (through genuine competition), for participation (since expansion per se has a significant beneficial impact), and for size.

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