

Finance Matters: Students and Institutions

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AC21 International Conference

Warwick, 6 July 2006

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1 Backdrop

Objectives

- Higher education matters
 - Economic growth in competitive knowledge economy
 - Promoting core values
- Specific objectives
 - Quality
 - Access
 - Efficiency

Problems in the UK as exemplars of common problems

- Rapid expansion: age participation rate in 1989, 14%; 1995: 33%; 2005: 43%
- Expansion is good news; *but*
- No parallel increase in resources: real funding per student fell by 40%
- Consequent worries about quality
- Recognition that the situation was unsustainable
 - 1998 reforms: policy mistakes by politicians meant that the situation was not resolved
 - 2006 reforms lay the foundations for financial sustainability

2 Lessons from economic theory

- Lessons rooted largely in the economics of information, i.e. the arguments are largely technical, rather than ideological

2.1 The days of central planning have gone

- No longer feasible
 - Number of higher education institutions
 - Number of students
 - Diversity of subject matter
- Nor desirable
 - Assumption of well-informed consumer generally holds
 - *Except* information problems for students from poorer backgrounds contribute to debt aversion
- Very different conclusion for school education

2.2 Graduates (not students) should contribute to the costs of their degree

- Social benefits
- But also significant private benefits

2.3 Well-designed loans have core characteristics

- Income-contingent repayments, i.e. calculated as $x\%$ of graduate's subsequent earnings
 - For efficiency reasons, to reduce uncertainty
 - For equity reasons, to promote access, since loans have built-in insurance against inability to repay
 - A genuine loan
- Large enough to cover all fees and all living costs; thus higher education is free at the point of use
- An interest rate related to government's cost of borrowing

3 The UK story

3.1 The 1998 reforms: a wedding and four funerals

The wedding

- Since 1998, the UK has had income-contingent loans with repayments collected by the income-tax authorities
- In that scheme, repayments were 9% of earnings above £10,000 per year

Four funerals

- Errors mainly the result of political intervention in the coherent recommendations of an official report
- Continued central planning
 - Price
 - Quantity
 - Quality
- Complexity
- Inadequate student loans
 - Too small to cover living costs
 - No loan to cover fees
- Loans incorporate an interest subsidy

Central planning: price

- UK universities after 1998 were obliged to charge UK/EU students a fixed fee
- It was illegal to charge more
- It was illegal to charge less

Central planning: quantity

'Prince's university penalised for extra students'
Independent (London), 29 March 2002

Prince William's university has been fined £175,000 for attracting too many students.

Applications ... leapt by 45 per cent after it was revealed that the prince planned to start his studies there last autumn.

However, higher education funding rules penalise universities that exceed their recruitment targets. The Scottish Higher Education Funding Council reclaims fees paid for students who are given places even though the university is technically full.

Central planning: quality control



Inadequate student loans

- The full loan is too small to cover living costs; thus students are poor
- The loan is income tested; thus not all students get the full loan
- There is no loan to cover fees; thus there are upfront charges
- Students are forced to resort to expensive credit-card debt and/or long hours earning money

Loans attract an interest subsidy: 4 killer problems

A zero real interest rate

- Is enormously expensive, post-reform at least £1,200 million per year
- Impedes quality. Student support, being politically salient, crowds out the funding of universities
- Impedes access. Loans are expensive, therefore rationed and therefore too small.
- Is deeply regressive, the main beneficiaries being successful professionals in mid career.

3.2 The 2006 Reforms

- Variable fees, capped at £3000; in first year an extra £1.3bn (net of bursaries £1bn)
- Fees covered by an income-contingent loan
- Larger loans for living costs
- Access
 - Restoration of grants to cover living costs for poor students
 - Access regulator

Why fees?

- Why fees and, moreover, why variable fees? Because variable fees
 - Promote efficiency
 - Promote quality
 - Counterintuitively, also promote equity
- Assessment: see OECD (2004, Ch. 4; 2005, Ch. 3)

Efficiency gains

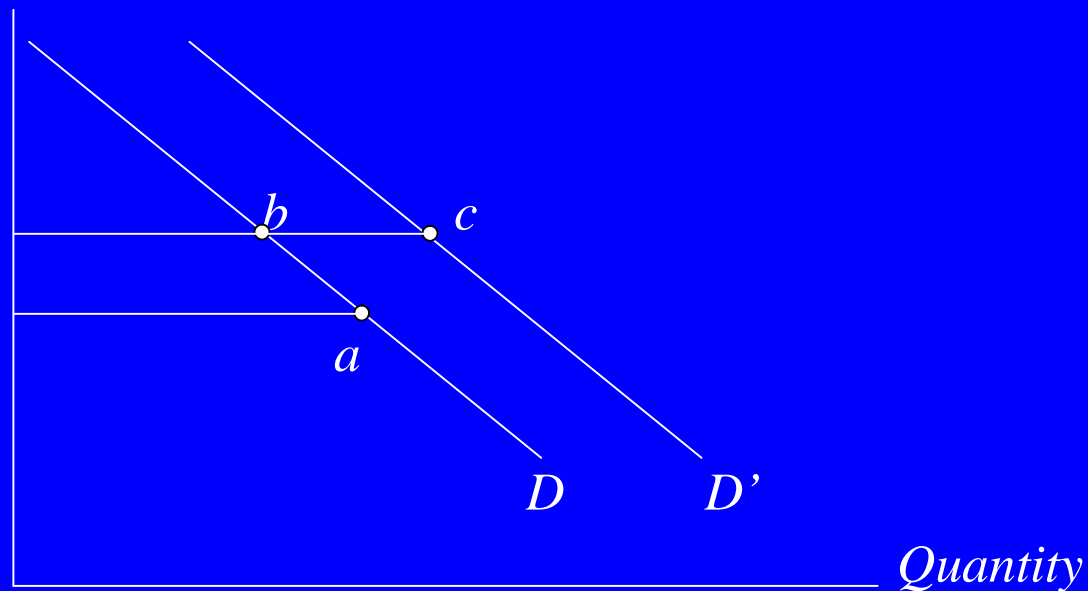
- Variable fees improve efficiency
 - By making funding open-ended, thus increasing the volume of resources going to universities. Flat fees perpetuate Treasury control.
 - By strengthening competition, thus improving the efficiency with which those resources are used. An implication of well-informed consumers is that competition is welfare-improving

Equity gains

- The reforms shift resources to the worst off
 - Those who can afford to contribute more do so
 - This releases resources to promote quality and access
 - Shift up demand curve, but also outward shift of demand curve
 - Thus the strategy is deeply progressive; it shifts resources from today's best off to today's and tomorrow's worst off
- Variable fees are also directly fairer: why should a student at a small local university pay the same fee as at a world-class university?

The twofold strategy to promote access

Price



Over-reliance on taxation fails to achieve any desirable objectives

- Failure 1: access
 - 81% professional/15% manual, so tax funding fails the poor
 - Who pays? 82% of UK working-age adults not have a degree
- Failure 2: quality (shortage of resources)
- Failure 3: deeply regressive
 - The real barrier to access: staying on beyond 16
 - If raise €5bn, should spend it on nursery education; improving schools; staying-on post-16; grants
 - Early child development is central

Misleading guides to policy design

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

4 Lessons in an international context

4.1 Lessons from other countries

Financing universities: lessons about fees

- Fees relax the supply-side constraint
- Big-bang liberalisation of fees can be politically destabilising
- But failure to liberalise is also a mistake
 - Harms quality
 - Harms access
 - Continues regressivity

Lessons about other sources of finance

- Potential sources of private finance
 - (a) Family resources – but fail to widen access
 - (b) Student's earnings while a student – but at the expense of studies
 - (c) Student's future earnings, i.e. loans
 - (d) Employers – but weak incentives to contribute in a world with high labour mobility
 - (e) Entrepreneurial activities by universities – but easily overestimated
 - (f) Gifts – but easily overestimated
- For all these reasons, (c) is central

Student support: lessons about loans

- Income-contingent loans do not harm access
- Interest subsidies are expensive
- Positive real interest rates are politically feasible
- The design of the student loan contract matters
- Implementation matters

4.2 A strategy for financing tertiary education

- General strategy applies to all OECD countries
- Specific implementation a matter for country specifics

Leg 1: paying for universities: deferred variable fees

There is a key distinction between *upfront* fees and *deferred* fees. The latter

- Promote quality
 - by bringing in more resources, and
 - by increasing competition assist efficiency, diversity and choice
- Are fairer than any other method

Mistake to avoid: ‘big bang’ liberalisation

Leg 2: student support: free at the point of use

- Loans should be
 - Adequate, i.e. large enough to cover all fees and all living costs
 - Universal: all students should be entitled to the full loan
- As a result
 - Higher education is free at the point of use
 - Students are no longer poor
 - Students are not forced to rely on parental contributions
 - Students are freed from expensive credit card debt and overdrafts
- Mistakes to avoid:
 - Blanket interest subsidies
 - Underestimating the implementation challenge

Leg 3: active measures to promote access

- Is debt aversion real? Two groups of students
 - Well-informed: income-contingent loans suffice
 - Under-informed, creating problems of debt aversion
- Access 1: Getting people into university
 - Money measures
 - Information measures
 - Early education measures
- Access 2: Helping low earners after university

Mistake to avoid: underestimating the information challenge

4.3 Drivers of the future: policy

- Key driver: the railroad crash
 - Technological advance requires diverse, mass higher education
 - But mass higher education collides with fiscal constraints
- Implications
 - Mass HE implies that graduate contributions are essential
 - Diversity implies that competition plus consumer and producer choice should replace central planning; it also implies that price signals (i.e. variable fees) are useful
- Key pressure points
 - The fees cap: an important element in design, but a variable, not a constant
 - Blanket interest subsidies: a fiscal black hole, but fixing it requires adjusting the national accounts

Drivers of the future: getting the politics of change right

- Not an attack on public funding, which should remain a permanent part of the landscape
- The reforms, rightly, do not create a free market, but a regulated market
- The reforms concern a payroll deduction, not credit card debt
- Students get higher education free – it is graduates who repay

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