Policies for quality and access in the finance of higher education

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1 A general story

1.1 Objectives

- Higher education matters
  - Economic growth
  - Promoting core values
- Specific objectives
  - Quality
  - Access
  - Efficiency

1.2 Lessons from economic theory

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

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) Graduates should contribute to the costs of their degree

- Social benefits
- But also significant private benefits

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
- 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

2 A UK story

2.1 The current system: a wedding and four funerals

The wedding

- Since 1998, the UK has had income-contingent loans with repayments collected by the income-tax authorities

- Repayments are 9% of earnings above £10,000 per year

Four funerals: lessons for other countries to avoid

Continued central planning

- Price
- Quantity
- Quality

- Complexity
- Student loans are too small
  - Inadequate to cover living costs
  - No loan to cover fees
- Loans incorporate an interest subsidy

Loans attract an interest subsidy: 4 killer problems

A zero real interest rate

- Is enormously expensive, around £800 million per year, and post-reform more like £1,200 million
- 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.

2.2 The 2004 Higher Education Act

From 2006

- 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
  - Grants to cover living costs for poor students restored
  - Access regulator

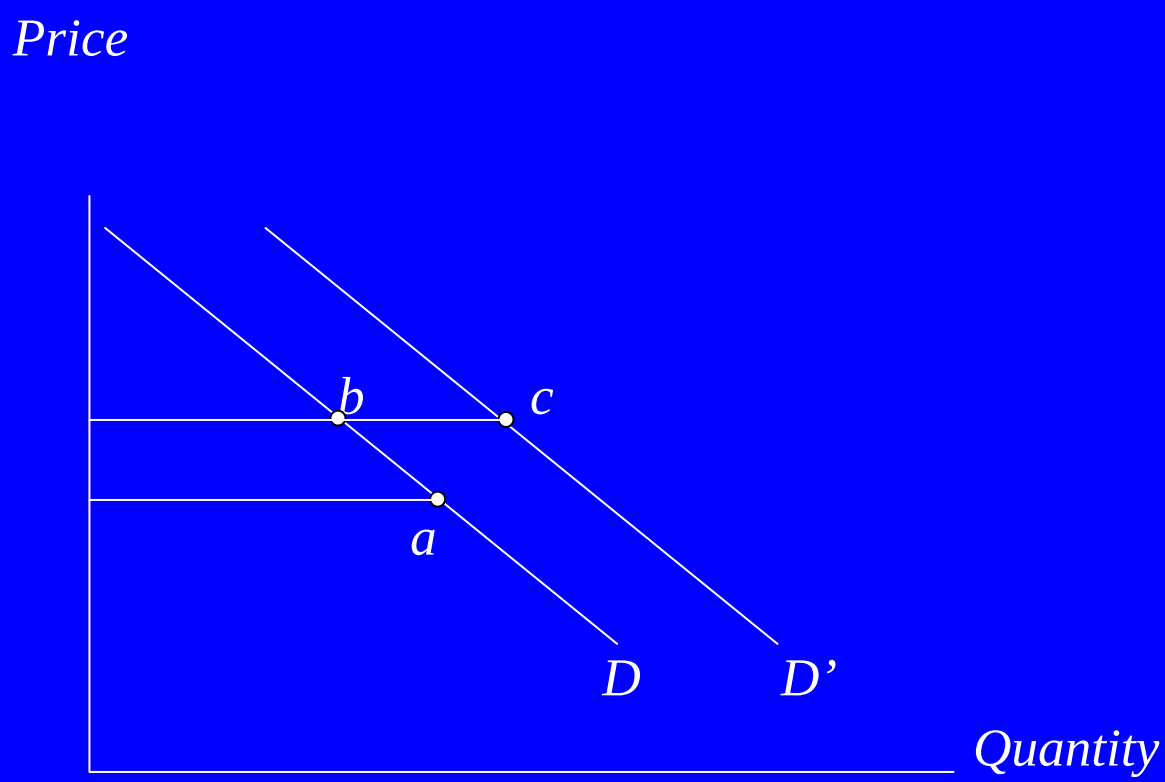
Efficiency gains

- 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

The twofold strategy to promote access



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

3 Some thoughts for other countries

3.1 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

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

3.2 Possible directions

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
- Mistake to avoid: blanket interest subsidies

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
- Access 2: Helping low earners after university

Mistake to avoid: underestimating the information challenge

3.3 Conclusion: policy

1) Technological advance requires **diverse**, **mass** higher education
2) Mass higher education collides with fiscal constraints; thus graduate contributions are essential (macro efficiency)
3) Diverse higher education implies that competition plus consumer and producer choice should replace central planning (micro efficiency); it also implies that price signals (i.e. variable fees) are useful
4) Equity: without (2) & (3) the system is regressive
5) The steamroller is coming – jump on board or get flattened

Conclusion: politics

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

References

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Nicholas Barr and Iain Crawford, *Financing Higher Education: Answers from the UK*, Routledge, 2005.

Parliamentary evidence and assorted newspaper articles can be downloaded from www.econ.lse.ac.uk/staff/nb