

Ways ahead for higher education finance

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Conference in Honour of Professor Sir David
Greenaway

Nottingham, 27 September 2017

Ways ahead for higher education finance

1. Introduction
2. Economic theory and some evidence
3. Higher education finance: Nerdy details
4. Why does this matter – much wider than higher education

1 Introduction

Thumbnail of current system (round numbers)

- Fees: capped at £9,250 per year
- Loans
 - Cover fees and living costs, the latter subject to family means test
 - Repayment: 9% of income above £21,000
 - Real interest rate sliding scale up to 3%
 - Forgiveness of any outstanding loan balance after 30 years
- 2006 reforms (£3,000 fees) got it broadly right
 - Progressive social policy
 - Unfinished business which next reform was meant to fix
- 2012 reforms (£9,000 fees, 3% real interest rate) created problems that were both predictable and predicted

The strategic problem and how to fix it

- Problem

- High headline debt with a leaky loan; thus a scary sticker price but most people don't pay in full, i.e. taxpayer support is via a leaky loan
- And a leaky loan crowds out more powerful pro-access policies earlier in the system

- Solution

- Lower headline debt plus less leaky loan; thus a less scary sticker price
- Some taxpayer support for teaching as explicit recognition of the social benefit of higher education

2 Economic theory and some evidence

Objectives

- Quality (better)
- Access (wider)
- Size (large enough to avoid excess demand for places)

Why fees and loans?

- Fees: three arguments for cost sharing
 - Micro: social benefits but also private benefits
 - Macro: railroad crash
 - Equity: ‘free’ is just another word for ‘some other sucker pays’
- Loans:
 - Students cannot afford to pay
 - Thus need mechanism to provide consumption smoothing – loans

Why this loan design?

- Loans to finance human capital have no collateral, hence risky for borrower and lender (Friedman 1955)
- Thus with conventional loans, lending is inefficiently low
- To ensure efficient level of investment in human capital, consumption smoothing therefore requires an element of insurance
- Insurance comes through
 - Income-contingent repayments; and
 - Forgiveness after n years (i.e. graduates with low lifetime earnings do not repay in full)

Why fiscally parsimonious loans

- Leaky loan systems are expensive in fiscal terms
- That matters because it hinders the achievement of all three major objectives of quality, access and size

Problem 1: Expensive loans are rationed: too small and too few

- Maintenance loans too small and include parental contributions, harming access
- Loans for part-time students inadequate, also harming access
- Loans for postgraduate students inadequate
- Virtually no loans for other parts of tertiary education including vocational education

Problem 2: Expensive loans crowd out other spending on higher education

- Reduced taxpayer support for teaching and research potentially affects quality
- Or student numbers may be capped, with adverse effects on size and access

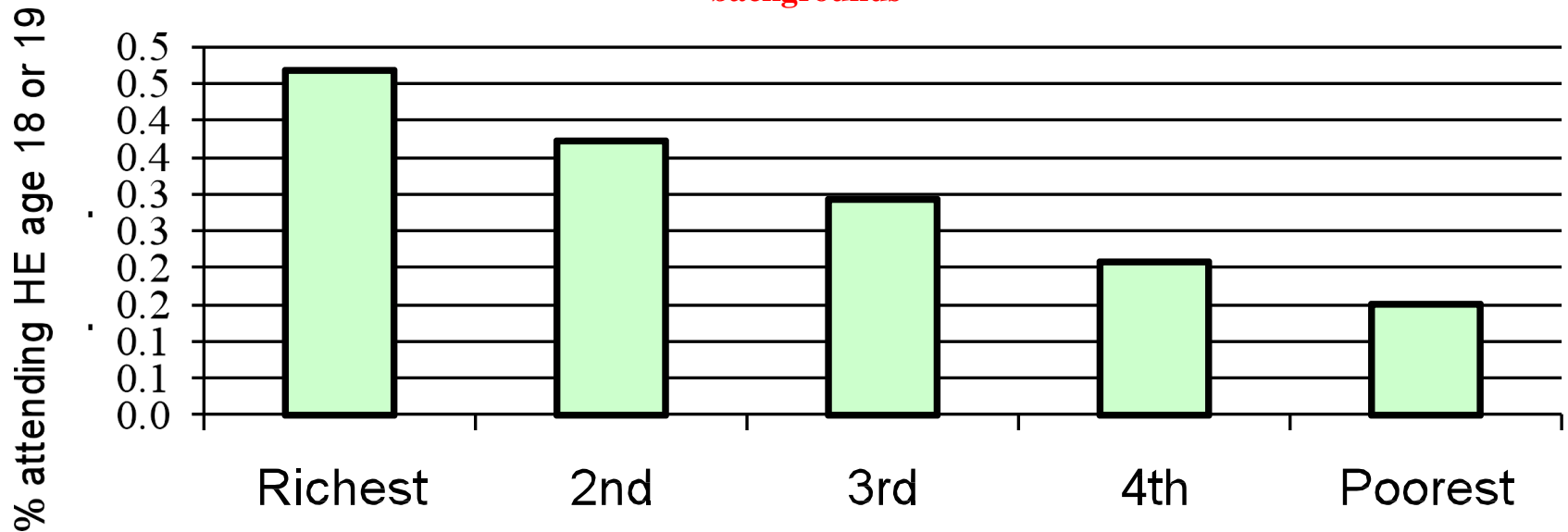
Problem 3: Expensive loans crowd out policies to widen participation

- Loan subsidies spend money on those who have made it to university rather than on activities earlier in the system
- Thus the high repayment threshold benefits insiders at the expense of outsiders
- Strong evidence that earlier intervention to improve GCSE and A-level performance is the most powerful way to widen participation

England: Fewer poor people go to university

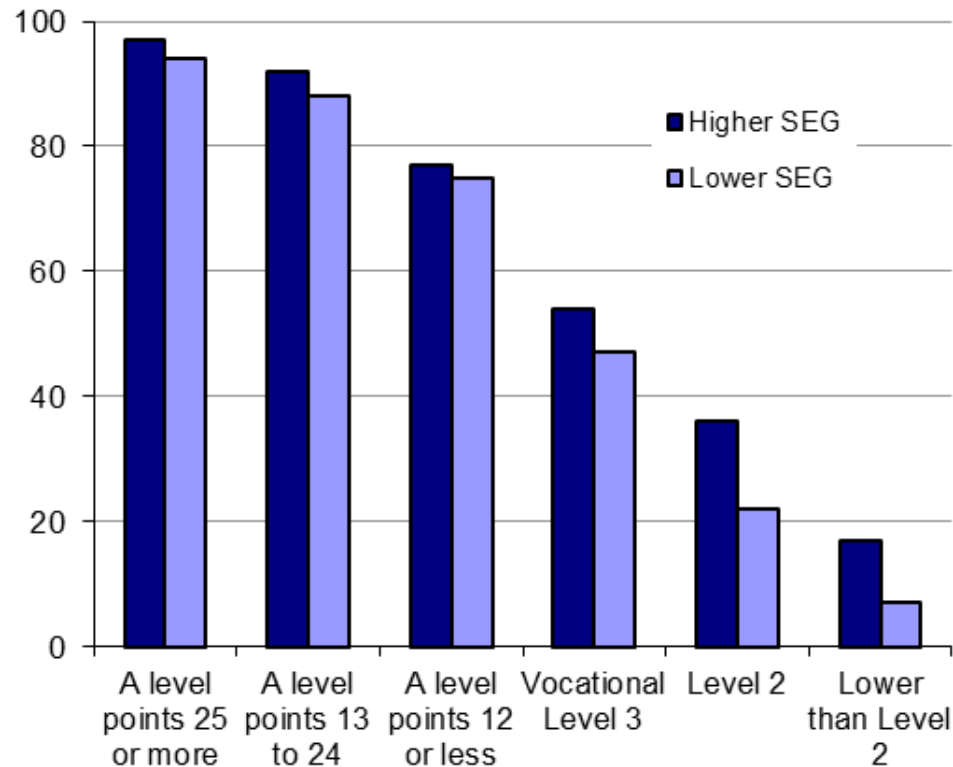
Chowdry, Haroon, Crawford, Claire, Dearden, Lorraine, Goodman, Alissa and Vignoles, Anna (2013), 'Widening participation in higher education: analysis using linked administrative data', *Journal of the Royal Statistical Society*, Series A, 176, Part 2, pp. 431–457

25% of young people from the best off backgrounds get top grades, only 3% of those from the poorest backgrounds



England: Who goes to university? It's school attainment, stupid

Office for National Statistics (2004), *Focus on Social Inequalities, 2004 edition*, London, Figure 2.15)



2.5 Conclusions from economic theory

- Most graduates should repay their loan in full
- Loans are an ineffective instrument for addressing equity goals
- Increasing social mobility is a separate objective from consumption smoothing and should mainly be done with different instruments

These arguments suggest a strategy with three elements (e.g. 2006 reforms)

- University finance from a mix of fees and taxpayer finance
- Well-designed loans to address credit constraints
- Expanding interventions earlier in the system to address prior constraints

Does the strategy work?

Between 2006 and 2012:

- Tuition fee income +87%
- Number of grants and loans +25%
- Number of students +20%
- Number of applicants from most disadvantaged background +53%

3 Higher education finance: Nerdy details

- Right system, wrong parameters
 - Fees cap too high
 - Interest rate on loans too high
 - Repayment threshold too low

3.1 Fees cap (illustrative numbers)

- The externality argument suggests bringing back some taxpayer support for teaching
- Example: fees cap £7,000, taxpayer subsidy £2,250, hence university income unchanged
- Could have larger subsidy for institutions that charge lower fees (Barr and Shephard 2010)
- The case for taxpayer support is an *efficiency* argument not a distributional one

Legacy debt and regressivity

- Legacy debt
 - IFS calculations (Britton *et al.* 2017) show that writing off fees loans above the £3,465 charged in 2011 would add £10 billion to government debt in 2050
 - Writing off fees loans above £7,000 would cost £3 billion
- Regressivity
 - The main beneficiaries of lowering the fees cap for past, current and future students are high-earnings graduates
 - As Britton *et al.* (2017) point out, the government could pay for the write off ‘with a modest increase in the top rate of income tax’

Cost of scrapping post-2012 tuition fees, £ billion, 2017 prices^a

Calculations kindly provided by Laura van der Erve of the Institute for Fiscal Studies

^a The figures show the impact on government debt in 2050 of writing off post-2012 tuition fees above the various fee caps, measured in 2017 prices

Fees cap	Starting in		
	September 2017	September 2018	September 2019
£7k	£3bn	£4bn	£5bn
£6k	£5bn	£6bn	£7bn
£5k	£7bn	£9bn	£10bn
£4k	£10bn	£12bn	£13bn

3.2 Interest rate

- Long-term government cost of borrowing, or close to it
 - Not lower: blanket interest subsidies are badly targeted
 - Could be slightly higher (New Zealand cohort risk premium)
- Important to avoid a grace period in order to keep loans fiscally parsimonious
 - Method 1: charge the government's cost of borrowing from the time the loan is drawn down
 - Method 2: include a surcharge (e.g. £1,100 per £1,000 of loan) plus no interest during student days

3.3 Repayment threshold

- Aim to lower the repayment threshold in real terms as soon as politically possible
- It would be a large and costly mistake to increase the repayment threshold (rumoured as an option)
- A leaky loan absorbs resources better spent elsewhere in the tertiary sector and earlier in the education system
- Possible *quid pro quo* for a lower threshold is a lower repayment rate at lower incomes
- Classic proposition in public finance that it is generally better to have a wider tax base and lower marginal tax rate

3.4 Fix the way student loans appear in the public accounts

- Topic suitable only for those who have been wicked in a previous life
- How student loans affect the budget deficit (Public Sector Net Borrowing (PSNB))
 - Interest accruals this year reduce PSNB this year
 - Write-offs this year increase PSNB this year
 - The first is high, the second is low until about 2036
 - Not a trivial sum: ‘Interest on student loans ... is recorded in PSNB as it accrues, which we expect to subtract £3.0 billion from the deficit this year’ (OBR 2017, para. 7.13)
- The issue matters because, under present rules, savings from improved loan design cannot be spent on pro-access policies earlier in the system

4 Why does this matter – much wider than higher education

Policy directions: higher education

1. Restore some taxpayer support for teaching
2. Reduce the fiscal cost of loans
 - Graduates with good earnings trajectories should repay in full in present-value terms
 - Consider principle that (say) 2/3 of borrowers should repay in full
 - Barr and Shephard (2010) discuss how to do so
3. Extend the loan system
 - Full maintenance loans (i.e. no parental income test)
 - More loans for part-time and postgraduate students
4. Strengthen quality assurance

But that's not enough

- Mistaken to think about higher education in isolation. Necessary to break down the silos
- Treating HE and FE as largely separate systems harms access and the accumulation of human capital
- Concern about progressivity of loan repayments overlooks the fact that leaky loans crowd out spending
 - Elsewhere in tertiary education, and
 - On improving school attainment

Policy directions: a holistic view

1. Look at distributional effects across all of secondary and tertiary education, not higher education in isolation
2. Think about tertiary education as a whole
 - Finance:
 - A common framework
 - Extend loans to non-degree tertiary education and apprenticeships
 - Delivery: flexible routes through the system (Wolf 2011, 2016), including a spectrum of options concerning
 - Part-time and full-time
 - Academic, vocational, apprenticeships
 - Residential and distance, etc.
3. Increase pro-access spending earlier in the system, restoring EMAs and AimHigher or successor policies

The railroad crash

- The economics is obvious; and the politics are obvious. The problem is that they point in opposite directions
- Good economics says
 - Allocate resources as above to maximise improvements in quality, access and size
 - If there are additional taxpayer resources for investment in skills, higher education is not the only candidate
 - The biggest mistake would be to increase the repayment threshold
- But politics says
 - Students, parents, and universities are a powerful lobby
 - Outsiders to higher education have a less powerful voice
 - Fiscally costly loans and the resulting ill-effects are a consequence

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