Overview of fees options

Nicholas Barr
London School of Economics
http://econ.lse.ac.uk/staff/nb

Who pays? Options for future funding of higher education, Universities UK

London, 11 December 2009

LSE

Overview of fees options

1 The options
2 What determines participation? Myths and realities
3 What should the fees review recommend?

Objectives

- Quality
- Access

1 The options

- Variable fees
- No fees, i.e. all taxpayer financed
- Flat fees
- A graduate tax

Variable fees

- Fees bring in extra resources and make finance open-ended
- Competition creates incentives to use those resources efficiently
- Counter intuitively, variable fees are also fairer
  - Why should a student at a small local institution pay the same fee as at a world-class university?
  - Given the gradient in participation, arguing for higher fee subsidies is like arguing for higher champagne subsidies

Flat fees

- Flat fees mean that funding is closed-ended hence will not provide extra resources except in the short term (Australia)
- Flat fees mute incentives to use resources efficiently
- Flat fees are unfair

No fees: finance through taxation

Over-reliance on taxation fails to achieve any of the main objectives

- Failure 1: quality
  - Shortage of resources
  - Lack of competition
- Failure 2: access
  - UK: 81% professional/15% manual, so tax finance fails the poor
- Failure 3: regressive
  - The real barrier to access: staying on beyond 16
  - Pro-access spending should be on nursery education; improving schools; staying-on post-16; grants
  - Early child development is central

Why loans rather than a graduate tax?

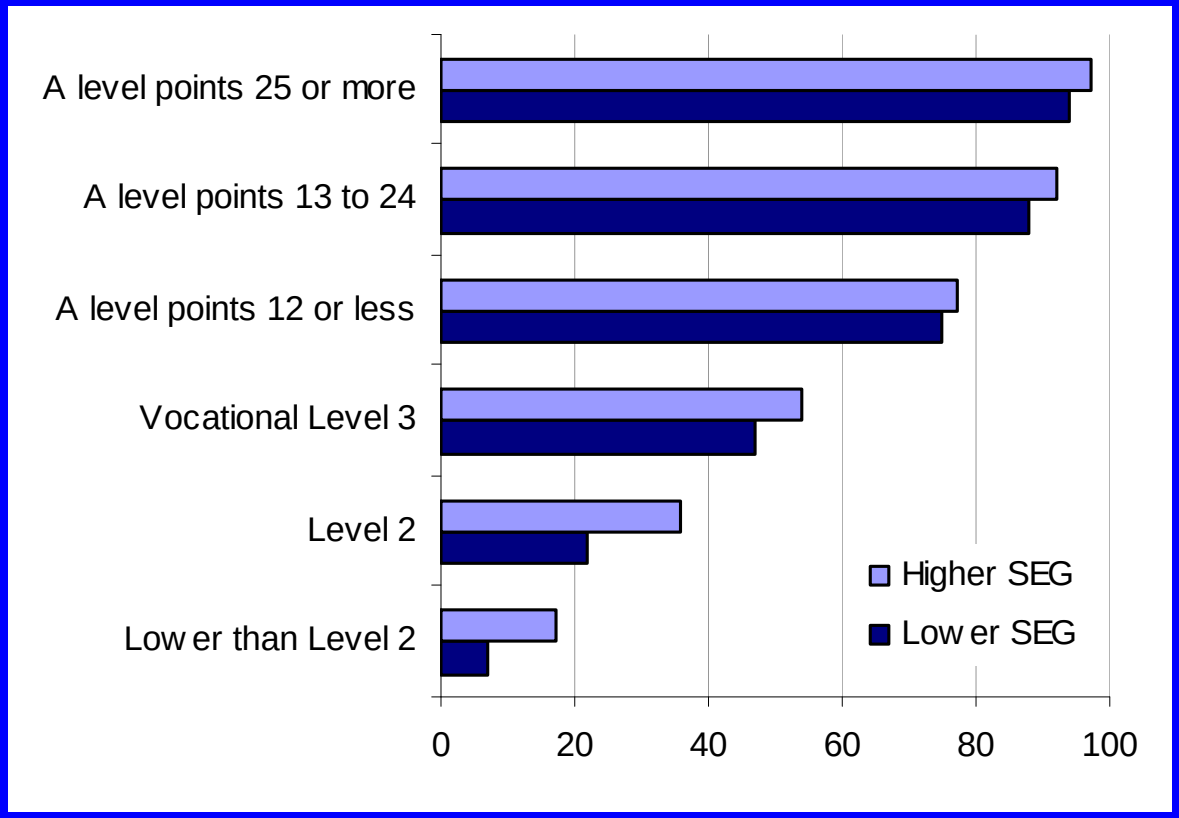
- Loans support variable fees, which
  - Strengthen competition, improving efficiency
  - Make finance open-ended: Treasury no longer wholly controls the funding envelope
- Loans bring in private finance more quickly: can design a loan scheme that is mainly privately financed (Hungary)
- Loans have better incentive effects
  - With a graduate tax, higher earnings mean larger total repayments;
  - With income-contingent loans, higher earnings mean the loan is paid off more quickly, at which point repayments stop
- Loans allow collection of repayments from students from other EU countries
- Loans are fairer: with a graduate tax
  - People must make continuing contributions; no option to pay upfront
  - Contributions are unrelated to costs (the Mick Jagger problem)
  - However, it is possible to build a redistributive element into a loan system
- That said, may be a good idea to call the present system a graduate tax

2 What determines participation? Myths and realities

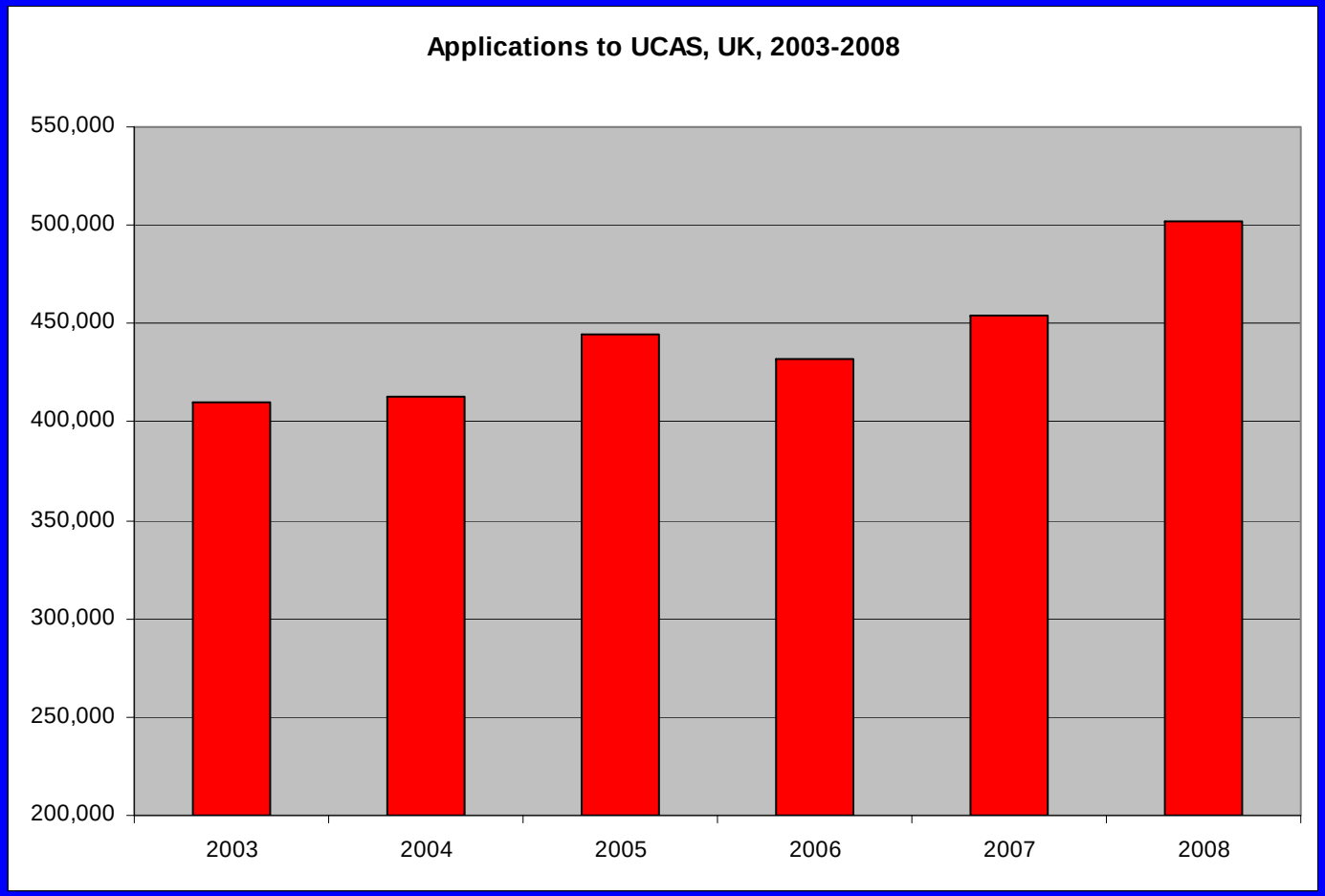
- According to ‘pub economics’ it is obvious that ‘free’ higher education widens participation
- Pub economics is wrong

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

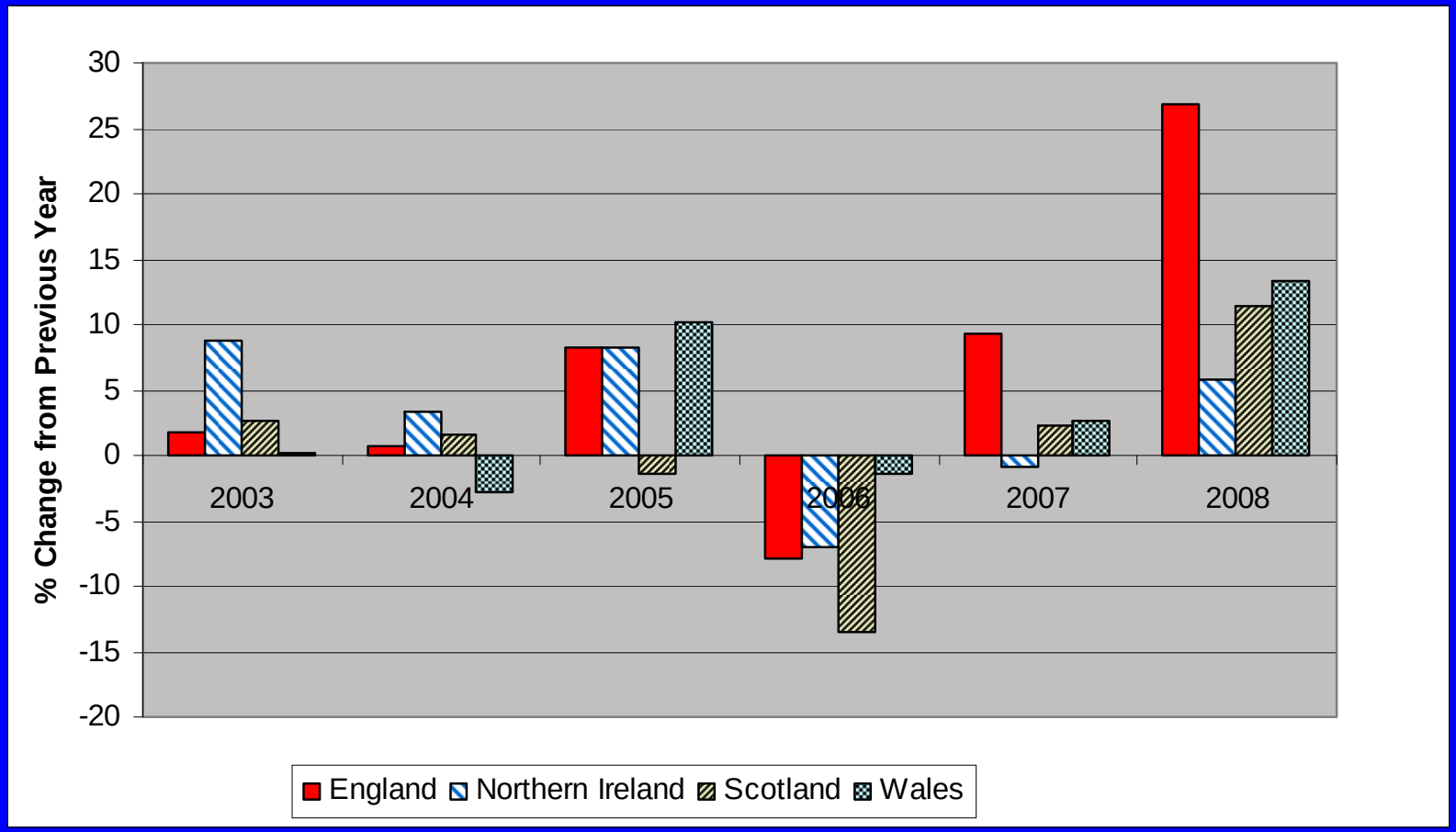
Source: Office for National Statistics (2004, Figure 2.15)



What happened to applications?



Year on year change in applications from the three lowest SEGs



Increase in applications from the lowest SEGs

- Increase in applications 2007-2008
  - Increase in total applications, UK: +10.6%
  - Increase in total applications, England: +11.7%
  - Increase in applications from lowest 3 SEGs, England: +26.9%
- Average annual increase in applications, 2002-2008
  - Annual average increase in total applications, England: 4.3%
  - Annual average increase in applications from lowest SEGs:
    - England: +6.5%
    - N Ireland: +3.1%
    - Scotland: +0.5%
    - Wales: +3.7%

3 What should the fees review recommend?

- Four central policies, in the following order
  - Major publicity campaign to explain how student loans work
  - Expand the loan system
  - Action on the fees cap
- Alongside these, continue action to widen participation

3.1 Explain student loans

- Fight disinformation and scaremongering (‘high fees, high debt’, conflation of student loans with credit card debt)
- Message 1: higher education is free to the student (it’s graduates who make repayments)
- Message 2: loans have income-contingent repayments
  - Thus a payroll deduction, not credit card debt
  - 25-year write off (strongly benefits women)
  - Thus equivalent to a graduate tax that stops after a maximum of 25 years, and for most people significantly earlier
- Message 3: keep the scale in context
  - £20,000 credit card debt is scary
  - £20,000 as payroll deduction; compare with £1 million in income tax and national insurance over a typical full graduate career
  - Student loans and pensions are both life-cycle redistribution

Pay slips 2009-10

	Bill	Tariq	Richard	Jane
Annual earnings	£15,000	£20,000	£30,000	£50,000
Income tax (monthly)	£142.08	£225.42	£392.08	£827.50
NI contributions (monthly)	£85.10	£130.95	£222.61	£354.90
Loan repayments (monthly)	£0.00	£37.50	£112.50	£262.50

- Low earners make low or no repayments
- Repayments automatically and instantly track changes in earnings, exactly like income tax and national insurance contributions
- Loan repayments are considerably smaller than income tax and national insurance contributions
- Income tax and NI contributions from UK PAYE Income Tax Calculator 2009; why does the tax calculator not include loan repayments as well?

3.2 Expand the loan system

Two-part policy

- Expand loan system
  - Larger loans for existing recipients
  - Expanding the system to cover new groups
    - To part-time students
    - To postgraduates
    - To students in tertiary education and training more broadly
- Action on the interest subsidy

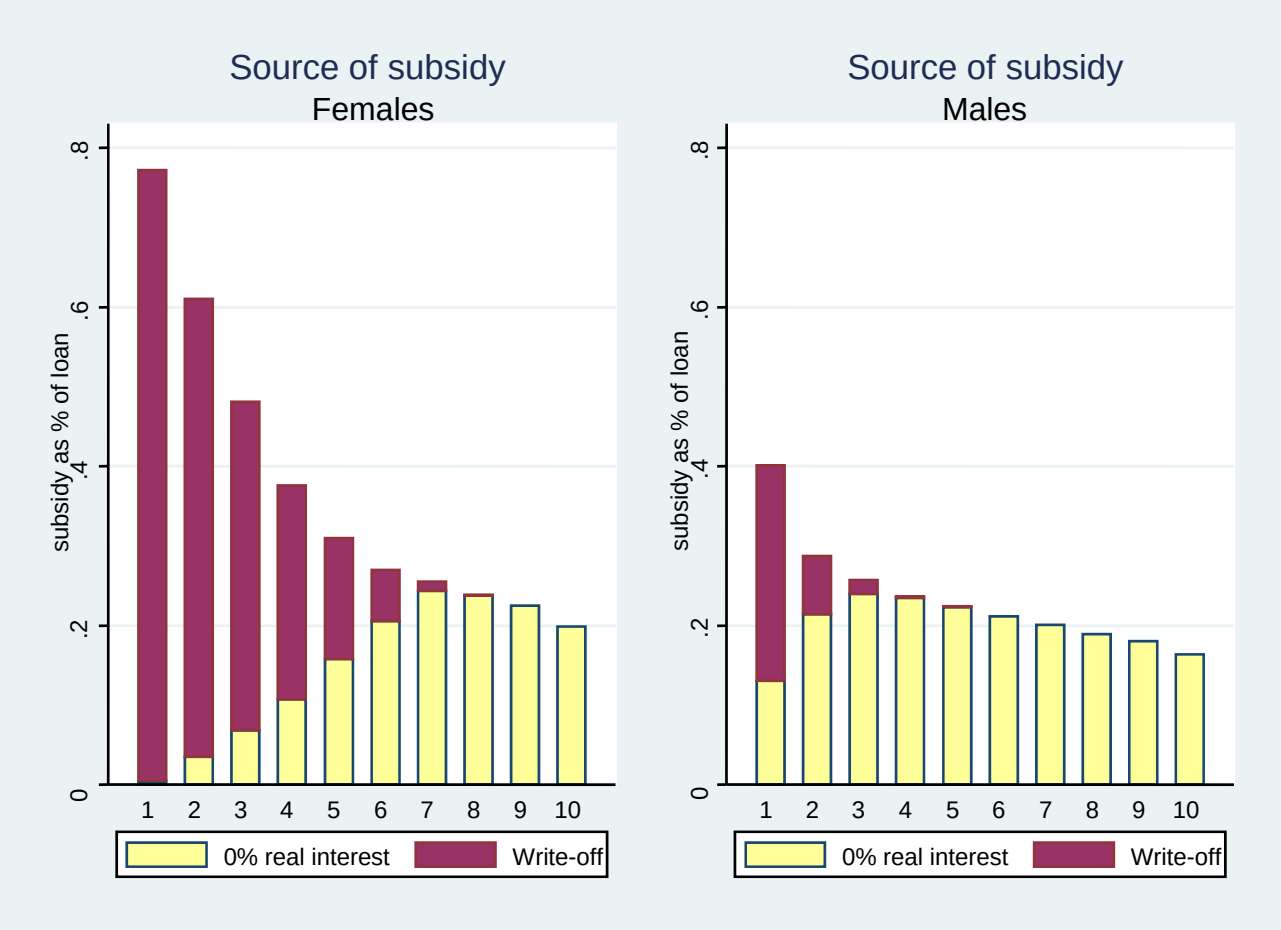
What is wrong with a blanket interest subsidy?

- Two wrong interest rates
  - A zero real rate
  - A ‘commercial’ rate, i.e. the rate on credit cards, bank overdrafts
- A zero real interest rate
  - Is enormously expensive: about one-third of all money lent to students is never repaid just because of the interest subsidy
  - Impedes quality. Student support, being politically salient, crowds out the funding of universities
  - Impedes access
    - Loans are expensive, therefore rationed and therefore too small
    - Hidden subsidies are misleading and actively harm access
  - Is deeply regressive, the main beneficiaries being successful professionals in mid career

Why interest subsidies are regressive

- An interest subsidy in a conventional loan helps people with low earnings
- But in the UK student loan scheme
  - Loans have income-contingent repayments
  - There is forgiveness after 25 years
- These two features turn the conventional argument upside down
- Who benefits from interest subsidies?
  - Students?
  - Low-earning graduates?
  - High earning graduates with low early-career earnings?
  - High earning graduates?

Interest subsidy and write off by decile of lifetime earnings (IFS)



What should be done?

- The blanket interest subsidy should be replaced by targeted interest subsidies
- The default interest rate should be related to the government's cost of borrowing
- Targeted interest subsidies should prevent real outstanding loan balances rising for
  - People with low earnings
  - People with caring responsibilities
- Targeted subsidies are administratively feasible (Hungary)

3.3 Action on the fees cap

Why have a fees cap?

- The fees cap should be
  - High enough
    - To bring in significant extra resources
    - To create genuine competition
  - Low enough
    - To maintain political sustainability by giving students, prospective students and their parents time to adjust
    - To give institutions time to put in place management suitable for a more competitive environment
- Should some sort of fees cap be permanent? Yes
    - To protect against exploitation of monopoly elements

What conditions for an increase in the fees cap?

- In 2006, the increase in fees was conditional on bursaries – politically necessary but the wrong instruments for widening participation
- Should an increase in the fees cap be conditioned on measures of quality of teaching/student experience?

A regulated market not a free market

In this strategy there is a major and continuing role for government

- To provide taxpayer support for higher education
- To regulate the system
  - A fees cap
  - Ensuring that there is effective quality assurance
- To set incentives
  - Establishing the degree of competition (can vary by subject)
  - Larger subsidies for certain subjects
- To ensure that there is a good loan scheme
- To promote policies to widen participation

3.4 Continue action to widen participation

- Policies to address the attainment constraint
  - Increased emphasis on early child development
  - Improved school outcomes
  - Improving information and raising aspirations
- Policies to address credit constraints
  - Financial support at age 16
  - Income-contingent loans that make higher education free at the point of use
  - Policies that respond to genuine debt aversion
  - Make part-time study easier

References

Nicholas Barr (2002), ‘A way to make universities universal’, *Financial Times*, 22 November 2002, p. 21, downloadable from www.econ.lse.ac.uk/staff/nb

Nicholas Barr (2004),‘Variable fees are the fairer route to quality’, *Financial Times*, 30 March 2004, p. 21, downloadable from www.econ.lse.ac.uk/staff/nb

Nicholas Barr (2004), ‘Higher education funding’, *Oxford Review of Economic Policy*, Vol. 20, No. 2, Summer, pp. 264-283.

Nicholas Barr (forthcoming), ‘Paying for higher education: What policies, in what order?’.

Nicholas Barr and Iain Crawford (2003), ‘Myth or magic’, *Guardian*, 2 December 2003, pp. 20-21, downloadable from www.econ.lse.ac.uk/staff/nb

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

Nicholas Barr and Alison Johnston (forthcoming), ‘Interest subsidies on student loans: A better class of drain’.

Office for National Statistics (2004), , *Focus on Social Inequalities, 2004 edition*, London: TSO.

OECD (2008), *Tertiary Education for the Knowledge Society, Volume 1: Special Features: Governance, Funding, Quality* and *Volume 2: Special Features: Equity, Innovation, Labour Market, Internationalisation*, Paris: OECD.