

Strategic policy directions for tertiary education

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Executive summary

1. OBJECTIVES. Policy should seek to

- Produce the optimal quantity, quality and mix of skills for personal development and labour-market activity, and should do so
- In a way that is accessible to people from all backgrounds.

2. THE PROBLEM. In pursuing these objectives, the major deficiency of arrangements in England is their failure to achieve an optimal mix. This submission argues that a central (though not the only) source of the problem is the way student loans enter the public accounts.

- *A biased measure of the budget deficit* (section 2.1). The method of public accounting of student loans allows government to increase spending on higher education in a way that reduces the budget deficit in the short run and makes losses invisible for decades.

Three sets of ill-effects result:

- *A bias towards loan finance* (section 2.2). The incentive to subsidise higher education through the loss on loans rather than through direct taxpayer subsidies creates a twofold problem: an upward bias in the volume of resources going to higher education (the unit of resource per student is at its highest for 30 years (Belfield *et al.* 2017, p. 28)); and a form of finance with the characteristics of a bubble, whereby all looks rosy today, but with the risk that the bubble will burst. There is an uncomfortable analogy with an unsustainable pension system disguised by misleading accounting.
- *A bias towards 3-year full-time degrees* (section 2.3). Though not the sole cause, the upward bias in resources going to higher education is an important source of the bias towards full-time degrees, crowding out part-time study and level 4 and 5 qualifications that would be a better fit for some individuals and the economy. The system operates like an executive lift, programmed to go from the 3rd to the 6th floor without stopping at floors 4 and 5.
- *Adverse distributional effects* (section 2.4) are a result of the previous two problems.

3. STRATEGIC POLICY DIRECTIONS. A sector-wide approach suggests the following policy directions (section 3 which, at the price of slight repetition, is written to be self-contained):

- *Design policy with tertiary education as a whole in mind.*
- *Fix the way student loans enter the public accounts.* The projected loss on student loans issued this year should score as public spending this year. This is the central recommendation. Doing so is not on its own a solution, but not doing so will make strategic reform ineffective and/or unlikely to be implemented.
- *Rebalance resources within higher education.* The present system has high headline debt and a leaky loan. Thus there is a scary sticker price but most people do not pay in full. A better strategy is a system with lower headline debt and a less leaky loan, hence a less scary sticker price and a more efficient balance between subsidies for loans and direct taxpayer support. Policies include restoring some taxpayer support

for teaching, reducing the loss on loans, and extending the loan system to wider groups of students.

- *Rebalance resources across higher and further education.* Policies include improving the resourcing of non-degree tertiary education, rebalancing support between full- and part-time study, looking at distributional effects across tertiary education as a whole, and expanding pro-access interventions, including earlier in the system.
- *Increase flexibility and diversity within and between higher and further education.*
 - Finance: a central recommendation is to rebalance incentives for individuals and providers to create greater neutrality as between full-time and part-time study and across levels 4, 5 and 6.
 - Delivery: reforms include the development of a system of transferrable credits (i.e. the equivalent of the Bologna process for tertiary education) within and between higher and further education, improving information, advice and guidance, and ensuring robust quality assurance across the sector.

4. POTENTIAL GAINS (section 4). The reforms outlined in section 3 offer:

- A more stable platform for higher education finance;
- A more level playing field between higher and further education;
- A more progressive system in terms of finance and in providing flexible opportunities for part-time study and level 4 and 5 qualifications; and
- Greater diversity and flexibility in terms of (a) the time path by which an individual acquires human capital, (b) the mix of higher, further and technical education through which he/she does so, and (c) modes of delivery.

5. These flexibilities bring multiple gains.

- They assist the efficiency of human capital accumulation.
- They help to widen participation by allowing part-time study as a low-cost experiment.
- They make it easier to take only a small number of courses if that is what a person needs for his/her job, while providing the option to continue later.
- Similarly, the system makes it easier to begin tertiary studies at a local institution, living at home, while providing the option subsequently to move away.
- An ability to start up a staircase which has many small steps, though of general benefit, might particularly benefit the 'left out' parts of the country.

Strategic policy directions for tertiary education¹

Nicholas Barr²

1 The argument in outline

1. OBJECTIVES. Policy should seek to

- Produce the optimal quantity, quality and mix of skills for personal development and labour-market activity, and should do so
- In a way that is accessible to people from all backgrounds.

2. THE PROBLEM (section 2). In pursuing these objectives, the major deficiency of arrangements for tertiary education³ in England is their failure to achieve the optimal mix. This submission argues that a central cause of that failure is the way student loans enter the public accounts, which has the effect of making losses invisible for decades. The result is a biased measure of the budget deficit which causes or contributes to three sets of adverse outcomes:

- A bias towards loan finance: the incentive to subsidise higher education through the loss on loans rather than through direct taxpayer subsidies, creates an upward bias in the volume of resources going to higher education.
- Though not the sole cause, that upward bias is an important source of the bias towards 3-year full-time degrees, crowding out part-time study and level 4 and 5 qualifications.
- Adverse distributional effects result from the previous two problems.

3. STRATEGIC POLICY DIRECTIONS. A sector-wide approach suggests the following policy directions (section 3):

- Design policy with tertiary education as a whole in mind.
- Fix the way student loans enter the public accounts by including the projected loss on loans in current spending. This is the central recommendation. Doing so is not on its own a solution, but not doing so will make the reforms outlined below ineffective and/or unlikely to be implemented.
- Rebalance resources within higher education.
- Rebalance resources across higher and further education.
- Introduce policies, including a system of transferrable credits, to increase flexibility and diversity within and between higher and further education.

4. POTENTIAL GAINS (section 4). There is much to play for. The reforms in section 3 offer:

- A more stable platform for higher education finance;

¹ I am grateful to Gwyn Bevan, Howard Glennerster, Ruth Kattumuri, Minouche Shaifik, Anna Vignoles and Andrew Westwood for helpful comments and discussion, and to Andrew McGettigan for an earlier tutorial on the public accounts. The views expressed are personal and remaining errors my responsibility.

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³ Tertiary education is taken to comprise higher education and further education as they relate to level 4 courses and above.

- A more level playing field between higher and further education;
- Greater diversity and flexibility; and
- A more progressive system in terms of finance and in providing flexible opportunities for part-time study and level 4 and 5 qualifications.

5. Several caveats should be noted. This submission sets out a strategic framework, not a set of detailed, costed policies. Analysis is framed in economic rather than in accounting or political terms. And discussion is more about finance than delivery.

6. For readers prepared to take the diagnosis in section 2 on trust, the quick read is sections 3 and 4. The lightning read is text in bold.

2 The root problem: Funny money: Student loans in the public accounts

2.1 How student loans are treated in the public accounts

7. In 2017-18 the Student Loans Company issued about £13 billion in student loans. An IFS study (Belfield *et al.* 2018) projects the loss on those loans (known as the RAB charge) at 31%, i.e. of the order of £4 billion.⁴

8. LOANS AND THE BUDGET DEFICIT.⁵ The headline measure of the budget deficit is Public Sector Net Borrowing (PSNB). Student loans affect the deficit in the following way.

- Interest accruals this year (whether paid this year or not) on all outstanding balances count as government income this year. The figure is currently high because of recently higher inflation and because interest is tied to RPI not CPI.
- Write-offs are treated as a cost at the time that the write-off takes place. The figure is currently small because the only write-offs relate to borrowers who die young. However, from 2035 costs will rise as new write-offs arising from the 2006 reforms are posted each year, and rise further from 2046 because loans from 2012 have to cover fees of £9,000, hence are significantly larger than previously.⁶

9. The effect of this method of accounting is to reduce the measured deficit considerably and over an extended period. As the Office for Budgetary Responsibility (2017) explains,

‘Interest on student loans ... is recorded in PSNB as it accrues, *which we expect to subtract £3.0 billion from the deficit this year*. Interest starts accruing from the time the loan is extended and it is recorded within the public finances for the full amount owed rather than the amount expected to be paid. In reality some of this will never result in actual cash payments, because some borrowers will not earn enough to require their loans to be repaid. Eventually, this initial over-recording will be resolved by writing off any outstanding portion of the loan. But this may not be until years later – the write-offs associated with recently issued loans are not expected to pick up until the mid-2040s. So accruing interest will flatter the fiscal position in the meantime’ (para. 7.13, emphasis added).

⁴ For fuller discussion, see House of Commons Library Briefing notes (Bolton 2018*a, b*).

⁵ For fuller discussion, see McGettigan (2015, 2018).

⁶ Someone who took out a loan in 2006 (when fees of £3,000 were introduced) at the start of a 3-year degree, graduated in July 2009 and became liable to make loan repayments from 6 April 2010. Forgiveness (under the 2006 regime after 25 years) applies to any balance outstanding on 5 April 2035. Analogously, someone who took out a loan in 2012 qualifies for forgiveness (under the 2012 regime after 30 years) in 2046.

The problem is twofold: this method of accounting postpones the cost of loans *and* exaggerates the gain in the early years because it records as income interest that is owed, not interest that is actually paid. The OBR report (2017, para. 7.65) points out that,

‘The IMF describes accounting treatments that do not adequately reflect reality as ‘fiscal illusions’. These include any transaction that improves or worsens measured fiscal aggregates without genuinely affecting the true health of the fiscal position in the same way’.

10. A Treasury Select Committee Report (2018) summarises the situation:

‘[S]hifting the vast majority of all higher education spending into loans that are written off in 30 years has shifted nearly all higher education spending out of the deficit. Policy decisions taken today will have no impact on the public finances for the next 30 years. Based on the current RAB charge, £6–7 billion of annual write-offs are missing from the deficit’ (para. 27).⁷

11. THE EFFECT OF SELLING OFF STUDENT DEBT. The Treasury Select Committee (2018), citing the head of the National Audit Office, points out that:

‘[I]f student loans are sold off at a loss before they are written off after 30 years, *there is no impact on the deficit whatsoever*. The policy of selling off student loans prior to their write-off allows the Government to spend billions of pounds of public money without any negative impact on its deficit target at all, creating a huge incentive for the Government to finance higher education through loans that can be sold off (para. 28, emphasis added).

‘The Government concluded its first sale of income contingent student loans in December 2017, when it sold £3.5 billion of loans, writing off £1.8 billion (51 per cent) of those loans in the process. The Government plans to sell off £12 billion of loans over the next five years. If the rate of losses on these sales is maintained, billions of pounds of student loan losses will be crystallised without having any impact on the deficit’ (para. 29).

12. IN SUM. The government can increase spending on higher education in a way that reduces the budget deficit in the short run and postpones losses for decades. This method of financing higher education on the ‘never never’ contributes to three problems: a bias towards loan finance, a bias towards 3-year full-time degrees, and adverse distributional effects.

2.2 Problem 1: A bias towards loan finance

13. THE 2006 REFORMS. Economic theory and empirical evidence point to a strategy with three elements:⁸

- Finance institutions from a mix of fees and direct taxpayer support;
- Finance students through loans that make study free, or largely so, at the point of use;
- Expand interventions to improve attainment earlier in the system.

Those elements lay at the heart of the 2006 reforms. Between 2006 and 2012 tuition fee income rose by 87%, the number of grants and loans by 25%, the number of students by 20%, and the number of applicants from most disadvantaged background by a striking 53%.

14. Box 1 illustrates the bias towards loans demonstrated by the 2012 reforms.

⁷ The OBR estimates that the accounting of student loans flatters PSNB by £3 billion (para. 9, above). The reality is that the loss on this year’s loans is about £4 billion (para. 7, above). Thus a deficit of 100 appears as 97 when the true picture is 104, hence the Treasury Select Committee’s estimate that £6-7 bn is missing from the deficit.

⁸ See Barr (2012), and for detailed discussion of the analytics, Barr (2017).

Box 1 A bias towards loan finance

THE LOSS ON STUDENT LOANS. Over time losses have increased for three reasons:

- More students, rising from under 1 million in 1992 to 1.87 million in 2016.
- Larger loans: the maximum loan has grown from £1,500 for a 3-year degree in 1990⁹ to £60,000 today.¹⁰ Though the point is simple, it is often overlooked that the marginal loss increases with the size of the individual loan (repayment is high on a £10 loan and low on a £1 million loan). Thus losses rise disproportionately as the average size of the loan increases.
- Changed loan parameters: the repayment threshold (i.e. the level of income at which a borrower starts to make repayments) increased from £10,000 in 1998 to £15,000 in 2006 to £21,000 in 2012 to £25,000 in 2018, reducing the flow of repayments, hence with more people qualifying for forgiveness.

THE DYNAMIC. In 2012:

- The fees cap was raised from £3,000 to £9,000.
- The headline interest rate was increased from RPI to RPI+3%.
- The repayment threshold was raised from £15,000 per year to £21,000.
- Loan repayments of 9% of income above the threshold remained in place, with any balance outstanding after 30 years (previously 25 years) forgiven.

In April 2018, the repayment threshold was increased from £21,000 to £25,000.

The higher fees cap and interest rate each increase interest accruals, and the increase in repayment threshold eased the politics of reform. An accounting system that created only minor distortions when loans were small became increasingly dysfunctional. The 2012 reforms, it can be argued, were the straw that broke the camel's back.

15. Heavy loan subsidies have a series of ill effects.

'No good can come from having an accounting system that doesn't capture accurately the effects of policy decisions. It's worse if such distortions are presented as a virtue of student loans. Above all, it's a problem if alternative policies are being excluded from consideration because of how they would be classified differently in terms of income and expenditure' (McGettigan 2018).

16. HIGH COST OF LOANS. Belfield *et al.* (2018) estimate that raising the repayment threshold from £21,000 to £25,000:

- Increases the long-run taxpayer contribution to higher education by £2.3 bn per year.
- Raises non-repayment from 31% to 45% of total lending.
- Increases the fraction of borrowers who will not repay in full from 77% to 83%, i.e. only 17% of borrowers will repay in full.

The intention to index the £25,000 threshold to average earnings perpetuates the problem.¹¹

17. A BIAS AGAINST TAXPAYER FINANCE. In 2017-18, public spending on higher education was £17.8bn, and on further education £9.7bn (Department for Education, 2017, para. 11). There

⁹ The maximum top-up loan in 1990 was £420.

<http://researchbriefings.files.parliament.uk/documents/SN01079/SN01079.pdf>, p. 5

¹⁰ In 2017-18 the maximum fees loan was £9,250 per year, and the maximum maintenance loan for a student living away from home in London was £11,002; <https://www.gov.uk/student-finance/new-fulltime-students>

¹¹ An additional reason why loans are expensive is the incentive for each institution to charge £9,250 since the cost of non-repayment falls on taxpayers not the institution – see Barr and Shephard (2010, paras 24-26).

are many reasons why further education has not fared well¹², but part of the story is that the expansion of higher education has made going to university more feasible and the higher unit of resource made it more attractive. Other things equal, both effects are desirable; what is not desirable is the bias.

18. AN UNSTABLE BASIS FOR HIGHER-EDUCATION FINANCE. Since write-offs have little short-run impact, it is easy to adopt politically popular policies, with costs left to future governments. Some commentators argue that the 2012 reforms saved higher education from austerity. That may be true in the short run but is not a stable platform. Higher education finance has the characteristics of a bubble, whereby all looks rosy today, but with the risk that at some stage the bubble will burst, risking pressures on public spending generally and the education budget in particular. There is an uncomfortable analogy with an unsustainable pension system disguised by misleading accounting.

19. IN SUM. England has the right system (tuition fees plus income-contingent loans) but with the wrong parameters. The accounting method makes losses on loans largely invisible, creating a bias towards loan finance. Thus the system subsidises higher education via the large loss on loans. Those losses are badly targeted in efficiency and distributional terms.

2.3 Problem 2: A bias towards 3-year full-time degrees

20. Though not the sole cause, the bias towards loans is an important source of bias towards 3-year full-time degrees. Box 2 amplifies the dynamic.

Box 2 A bias towards 3-year full-time degrees

INFLUENCES ON CHOICES BY STUDENTS

There are good reasons for an individual to do a 3-year full-time degree, including:

- Informed choice, given significant financial and non-financial returns to a degree.
- More arguably, changing social expectations, whereby going to university becomes a new norm.

But there are also biases:

- Inadequate support for part-time study.
- Weaknesses in options outside higher education, including vocational training and apprenticeships.
- Maintenance loans are less available for levels 4 and 5 than for level 6.
- Biased information, advice and guidance: advisers typically know more about three-year degrees; it is not in a school's financial interest to lose sixth formers; and getting students to university improves a school's position in league tables.

WHY PROVIDERS ARE BIASED TOWARDS FULL-TIME DEGREES.

Inertia:

- Historically higher education (particularly for pre-1992 institutions) was largely full-time.

¹² House of Lords Economic Affairs Committee (2018).

- Rising demand: more young people are qualified by increased school attainment; and investment in human capital is a rational response to weaker labour-market options after the economic crisis.

Financial biases:

- Student numbers in higher education have been uncapped since 2015.
- The unit of resource per student in higher education is at its highest for 30 years (Belfield *et al.* 2017, p. 28) and nearly twice as high as in further education.
- Tuition fees of £9,250 allow cross-subsidies from lower- to higher-cost subjects.
- Student accommodation and wider facilities offer a potential surplus, particularly during vacations, e.g. for conferences.
- Incentives militate against credit-based routes. A student doing a full-time degree brings in £9,250 per year for three years. Taking in students from level 4 and 5 courses for (say) the final year of a degree brings in the £9,250 tuition fee for only one year.

21. IN SUM. The accounting method contributes to a financial bias towards full-time degrees, crowding out level 4 and 5 courses that would be a better fit for some individuals and the economy. The system operates like an executive lift, programmed to go from the 3rd to the 6th floor without stopping at floors 4 and 5.

2.4 Problem 3: Adverse distributional effects

22. Some commentators argue that student loans should be progressive: that view oversimplifies. It is a fundamental principle of public economics that what matters is the progressivity of a system as a whole, not necessarily of each element.

23. HIGHER EDUCATION. Subsidies to student loans benefit lower-earning graduates, hence are progressive within the cohort of university students but not when considering all potential students in tertiary education. The loan subsidises those who have made it to university, i.e. benefits insiders at the expense of outsiders. In back-of-envelope terms, suppose that the top half of the distribution goes to university and that loan subsidies benefit the bottom half of that group. Thus loan subsidies benefit the bottom half of the top half.

24. FURTHER EDUCATION. Under-funding further education reduces options for non-degree students, disproportionately from less well-off backgrounds. Policies with more powerful benefits for access include more resources (including loans) for vocational training and apprenticeships, a better offer for part-time students, and action to improve attainment earlier in the system.

25. THE ACCOUNTING PROBLEM. Savings from reducing losses on loans cannot be diverted to current uses (e.g. to further education or pro-access measures earlier in the system) without increasing measured public spending.

3 Reform directions

3.1 Design policy with tertiary education as a whole in mind

26. If strategic thinking goes against the tide of faulty accounting, strategic thinking, with rare exceptions such as Alison Wolf's (2016) writing and House of Lords (2018), will not

happen, let alone action based on strategic thinking. Thus the starting point is to address the biases described in Boxes 1 and 2.

27. Though the economics is relatively straightforward, the politics is not. The lifetime perspective of human capital conflicts with short-term political pressures. ‘Policy churn’ is common (Norris and Adam 2018), an example being the incentive for a new Minister to come up with an eye-catching initiative.

28. Elements that assist a strategic approach include setting policy with the sector as a whole in mind and with a medium-term perspective. This section sets out such an approach. To repeat the earlier caveat, what follows is a strategy, not a set of detailed policies.

3.2 Fix the way student loans enter the public accounts

29. **INCLUDE PROJECTED LOSSES ON LOANS IN CURRENT SPENDING.** There are two aspects to a sensible accounting framework.

- The projected loss on student loans issued this year should score as public spending this year. It is true that projections are just that – only projections, but this is a case where it is better to be approximately right than exactly wrong.
- Resource claims in higher education should be presented in the same terms as those in further education.

30. A complication is the need to comply with international accounting standards. The Treasury Select Committee (2018) outlines a compliant approach:

‘The Government is not responsible for the international accounting rules that allow the fiscal illusions within student loans to exist. However, the National Accounts accounting rules regarding financial transactions were not intended to be used for loans that, as the Government readily promotes, are designed to not be paid back in full. Loans that are intended to be written off are, in substance, a partially repayable grant rather than a loan. The ONS should re-examine its classification of student loans as financial assets—which they are in legal form—and consider whether a portion of the loan should, in substance, be classed as a grant’ (para. 31).

31. What needs to happen is clear: projected losses should count as public spending. Lacking accounting knowledge, I point to the solution in general terms but leave it to those with the specific expertise, notably the ONS, to establish a method that marries good economics and international accounting standards.

32. The reform is fundamental. If loans are in funny money, savings from reducing the loss on loans are also in funny money hence cannot be diverted to other uses without increasing public spending. In contrast, if the loss on loans counts as public spending, government faces very different incentives.

- The increase in repayment threshold from £21,000 to £25,000, would visibly increase public spending. Thus higher education would compete on an equal basis with spending elsewhere in tertiary education.
- Savings from making loans more self-sustaining could be diverted to other uses such as extending loans to a wider range of investment in skills, maintenance grants, taxpayer support for teaching and/or pro-access policies earlier in the system.

33. IN SUM. Including projected losses on loans in current spending removes a major cause of the ill-effects discussed in section 2 and is thus the central recommendation of this submission. Doing so is not on its own a solution, but not doing so will make the strategic reforms outlined below ineffective and/or unlikely to be implemented.

3.3 Rebalance resources within higher education

34. The 2012 arrangements have high headline debt with a leaky loan. Thus there is a scary sticker price but most people do not pay in full. A better strategy is a system with lower headline debt and a less leaky loan, hence a less scary sticker price and a better balance between subsidies for loans and direct taxpayer support.

35. **RESTORE SOME TAXPAYER SUPPORT FOR TEACHING.**¹³ Restoring some teaching grant (T grant) makes it possible to lower the fees cap or, at a minimum, to freeze it in nominal terms. As Box 3 explains, the choice of fees cap is difficult because economic and political arguments point in different directions.

Box 3 The fees cap conundrum

WHY A FEES CAP: THE AMENITIES ARMS RACE. Though universities compete in terms of teaching, some are also selling access to the student's network of peers. Thus they are selling a positional good, giving them an element of monopoly power which, it can be argued, partly explains the high fees at leading US universities. The resulting additional income is ploughed back into facilities, a distortionary upward bias in spending, contributing to what the President of an Ivy League university has called an 'amenity arms race'.

LOWERING THE FEES CAP. A lower sticker price, lower headline debt and a less leaky loan make it possible to target resources more efficiently and equitably across tertiary education.

The economic arguments for doing so by restoring some T grant are (a) to reflect the social benefits of higher education and (b) to restrict borrowing per student to what a typical graduate can repay.

Political arguments go both ways:

- Lower headline debt would be politically popular.
- However, lowering the fees cap benefits the best off (the only ones who currently repay their loan in full). Since the externality justification is an efficiency argument, this outcome is not a problem in economic terms, but that argument has no political resonance.

NOT LOWERING THE FEES CAP. Keeping the fees cap at its current level does not lower the sticker price nor reduce headline debt. Thus loans remain large, making it difficult to reduce losses significantly, hence largely ruling out redirecting resources across higher and further education. And keeping the current high levels of debt would be politically unpopular.

36. These arguments suggest:

- Restoring a basic T grant and lowering the fees cap in parallel, the balance between the two reflecting the tradeoffs outlined in Box 3. An additional flexibility is the option of a higher grant for some subjects or institutions or modes of study.¹⁴

¹³ For fuller discussion, see Barr and Shephard (2010, paras. 6-19).

¹⁴ Requiring further study is the possibility that T grant could be included as part of capital spending.

- Providing a medium-term funding commitment to bring higher education some stability.

37. **REDUCE THE LOSS ON LOANS.** There are two aspects: reducing the size of the fees loan, and increasing the repayment flow.

38. Reducing the size of the loan has two elements.

- Restoring some T grant makes it possible to lower the fees cap.
- The interest rate should be based on the government's cost of borrowing, i.e. should give students access to the government's risk-free rate.¹⁵ As noted in Box 1, a reduction in the size of loans leads to a greater-than-proportionate reduction in losses; and with sensible accounting, those savings offset some of the cost of the T grant.

39. Increasing the flow of repayments involves lowering the repayment threshold, perhaps in combination with a repayment rate lower than 9% at lower earnings. The political difficulty is obvious. However, as discussed in section 2, the cost of a high repayment threshold is large and badly targeted, and smaller loans and a lower interest rate could be at least a partial political *quid pro quo*.

40. Combining smaller loans with a stronger flow of repayments might usefully be embodied in a principle that (say) two-thirds of borrowers should repay their loan in full in present-value terms.

41. **EXTEND STUDENT SUPPORT.** A fiscally more parsimonious design makes it possible to extend student support in desirable ways:

- Higher maintenance loans, if necessary supplemented by grants, to reflect realistic living costs.
- Extending the size and scope of loans for part-time and postgraduate students and for other parts of tertiary education.
- Introducing targeted loan subsidies, e.g. writing off (say) 10% of the loan for each year of nursing in the NHS, and similarly for doctors, and for each year teaching in the state school system.

3.4 Rebalance resources across higher and further education

42. **IMPROVE THE RESOURCING OF NON-DEGREE TERTIARY EDUCATION.** One option is to extend the basic T grant beyond higher education. Given fiscal constraints, additional resources for further education are likely to involve some rebalancing between higher education and the rest of the sector. Any such adjustment has two elements. It should be phased, since sharp cuts and sharp increases in funding each has ill-effects. Second, as noted, a medium-term funding commitment would assist planning.

43. **REBALANCE SUPPORT BETWEEN FULL- AND PART-TIME STUDY.** As discussed below, redirecting resources towards part-time study is necessary to assist flexibility and to protect institutions (e.g. the Open University) whose primary mission is part-time study.

¹⁵ A related option (Barr and Shephard, 2010, paras 23-30) is to charge an interest rate slightly above the government's cost of borrowing as a cohort risk premium that covers part of the loss on loans. As a result higher earners cover some of the loss of lower earners, introducing a social insurance element into the design.

44. **CONSIDER DISTRIBUTIONAL EFFECTS HOLISTICALLY.** As discussed, loan subsidies benefit those who get to university.

- Policy should look at the distribution of taxpayer support across the whole of tertiary education, not higher education in isolation.
- Policies to widen participation should also take into account the distributional effects of earlier intervention, since improving school attainment has powerful beneficial effects on participation (Chowdry *et al.* 2013).

3.5 Increase flexibility and diversity within and between higher and further education

45. The policies outlined in sections 3.1-3.4 aim to create a supportive environment to promote the main purpose of the Review – a system with greater flexibility and diversity.

Finance

46. Writers like Alison Wolf (2016) advocate loans as a lifetime entitlement for higher education, non-degree tertiary education, apprenticeships and degree apprenticeships. On the specifics, I defer to those with greater knowledge of non-degree tertiary education. What is clear, however, is the need to rebalance incentives for individuals and providers to create greater neutrality as between full-time and part-time study and across levels 4, 5 and 6.

47. **CONSIDER GRANT- AND LOAN-FINANCE TOGETHER.** Introduce a framework in which the design of loans and grants is based on a view of the sector as a whole. That does not necessarily mean a single system but one that facilitates flexible pathways. The arguments for a mix of grants and loans in higher education apply to further education, but not necessarily in the same proportions.

48. Grant finance for vocational training could come in part from the apprenticeship levy – a useful approach to counteract the incentive for firms to free-ride on training provided or financed by other firms.

49. It is commonly argued that repayment performance for loans in further education would be poor. That proposition needs to be tested. Loans are likely to be smaller in further- than in higher education because fees are generally lower and because the greater incidence of part-time study reduces the need for maintenance support. As noted in Box 1, smaller loans boost repayment performance.¹⁶

50. A major effort is needed to promote understanding that student loans involve a payroll deduction, not credit-card debt.

51. **REBALANCE INCENTIVES WHICH CURRENTLY UNDULY FAVOUR THREE-YEAR FULL-TIME DEGREES.** If universities or colleges are to offer more part-time provision and more level 4 and 5 courses, the overall pricing and funding system must be supportive.

¹⁶ Though only indicative, I did some simulations many years ago (Barr and Falkingham 1993) and was surprised at how well hypothetical loans in further education worked.

52. If part-time study is more expensive the problem is obvious – lower demand if the extra cost falls on students or lower supply if it falls on institutions. One option to create a better balance is a higher T grant for part-time study.

53. The same point arises for sub-degree courses. Flexibility (e.g. starting on a level 4 course with the option then or later of proceeding to a degree) requires that finance and student support have relativities that make choices between levels 4, 5 and 6 more neutral for students and providers.

54. **DESIGN SAFEGUARDS TO AVOID ‘POACHING’ BUDGETS.** There are already examples of study at university financed by the apprenticeship levy. That is not necessarily adverse, but the boundary between supply-side responsiveness on the one hand and gaming the system on the other needs policing, both to prevent bad behaviour and to offer reassurance to more vulnerable parts of the sector. For such reasons, some witnesses from further education in evidence to a Parliamentary inquiry¹⁷ opposed the idea of a single budget for the whole of tertiary education.

Delivery

55. The system should offer flexible routes including over time path and mix in an individual’s accumulation.

56. **ASSIST THE DEVELOPMENT OF A SYSTEM OF TRANSFERRABLE CREDITS.** An implication of those objectives is a system of transferrable credits both within and between higher and further education. The Bologna process did this for higher education internationally; a domestic analogue covering tertiary education is needed.

57. **SIMPLIFY PATHWAYS WITHIN AND BETWEEN DIFFERENT PARTS OF TERTIARY EDUCATION.** Alongside transferrable credits, is the need to reduce the complexity of the system (Johnston 2018; Hupkau *et al.* 2016). An approach that merits detailed consideration is a one-stop shop for further education and apprenticeships, analogous to UCAS for higher education.

58. **IMPROVE INFORMATION, ADVICE AND GUIDANCE.** As well the bias discussed in Box 2, information, advice and guidance is fragmented and of variable quality (Education Policy Institute 2017). The problem arises partly because responsibility for careers advice on the complex problem of matching individuals and courses rest with schools and colleges. An arrangement that can exploit economies of scale, including the use of expert systems, has clear potential advantages.¹⁸ The one-stop shop mentioned above might have a useful role.

59. **ENSURE ROBUST QUALITY ASSURANCE ACROSS THE SECTOR.** Quality assurance (a) raises concerns about a lack of robustness and (b) has separate systems for different parts of the sector. Allowing for-profit providers to access student loans is a stress test for higher education; and concerns have been raised about abuse of the apprenticeship levy (Richmond 2018), raising echoes of earlier abuse of Individual Learning Accounts.

60. The provision of flexible routes through further and higher education has important implications for quality assurance. First, it needs to be robust in all parts of the sector. In the

¹⁷ House of Lords Economic Affairs Committee (2018).

¹⁸ See <http://www.bestcourse4me.com/> for an early attempt to provide online information (but not advice and guidance). On using nudges to assist decisions, see Castleman and Page (2013).

case of the apprenticeship levy and Individual Learning Accounts, poor implementation should not discredit what in principle are good policies. Second, though quality assurance may take place separately within higher education and further education, it is necessary to have comparability, so that the credits earned in one part of further education can be evaluated effectively elsewhere in further education or by universities.

4 Conclusion: Benefits for tertiary education

61. The recommendations in section 3 offer the prospect of important policy gains.

62. A MORE STABLE PLATFORM FOR HIGHER EDUCATION FINANCE. As noted, present arrangements have the characteristics of a bubble. A realistic presentation of student loans assists stability. Further assisting stability, government should make medium-term funding commitments to both higher- and further education.

63. A MORE LEVEL PLAYING FIELD BETWEEN HIGHER AND FURTHER EDUCATION.

- A realistic presentation of public spending places higher and further education on an equal footing in terms of political incentives when bidding for resources.
- Removing the bias towards full-time degrees further improves the choice architecture.

64. A MORE PROGRESSIVE SYSTEM. The resulting system is more progressive across the sector as a whole.

65. GREATER DIVERSITY AND FLEXIBILITY. The previous three gains facilitate wider reform, including flexibility over:

- The time path of accumulation of vocational and/or academic credit, including faster options (e.g. a 2-year degree), a wide range of part-time options, and the ability to move between part-time and full-time study.
- The mix of higher, further and technical education in an individual's accumulation: it should be possible to gain vocational credits in further education (e.g. a plumbing qualification) and subsequently to add credits towards a degree, for example units in business studies or accounting, or wider options.
- Modes of delivery, including varying mixes of face-to-face and online teaching and training on and off the job.

66. These flexibilities bring multiple gains.

- They assist the efficiency of human capital accumulation.
- They help to widen participation by allowing part-time study as a low-cost experiment.
- They make it easier to take only a small number of courses if that is what a person needs for his/her job, while providing the option to continue later.
- They make it easier to begin tertiary studies at a local institution, living at home, while providing the option subsequently to move away.
- An ability to start up a staircase which has many small steps, though of general benefit, might particularly benefit the 'left out' parts of the country.

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