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## University funding: discuss

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Universities need cash, students need support and there are too few working-class entrants. After a two-year extension, Charles Clarke and the class of '73 are all set to deliver answers to these problems. Nicholas Barr offers a guide to how you, the examiners, should mark their responses

Before embarking on any answer to the tangled question of university funding, students should first identify the flaws in the current system. They should touch on the following:

- Underresourcing of universities
- Inadequate student support: the full student loan is too small; not everyone gets it; parental contributions work badly; the system is impossibly complicated; and untargeted interest subsidies cost £800 million a year
- The fact that the proportion of students from poor backgrounds has barely changed in 40 years.

It follows that the objectives of policy are to improve quality and to promote access.

*Examiners should reward evidence of a genuine strategy addressing these three core problems as opposed to a lucky-dip of policies. Answers should be compatible with political constraints: the vice-chancellors want more money - a lot of it, now; the National Union of Students wants fees to be abolished and grants restored for poorer students; parents are worried about student debt. Answers should also respect fiscal constraints, particularly given increased spending on the National Health Service and schools.*

### Lessons from economic theory (optional) :

First, the days of central planning are over. Second, taxpayers should continue to subsidise higher education due to its social benefits, but students should pay for the benefits they accrue. Third, student loans should be repaid as a percentage of earnings.

### Paying for universities

#### Tax funding

Higher education receives - and should continue to receive - substantial tax funding because of its social benefits. Public funding beyond that, however, is problematic.

- It is closed-ended (ie the government decides the resources going to higher education) and wholly public
- Central planning continues, muting incentives to efficiency

- It is highly regressive, ie it benefits the better off. A candidate who argues for funding through more progressive income tax must justify why the resulting revenue should be spent on students (on average from better-off backgrounds and themselves destined to be high earners), rather than on nurses' pay, schools, child benefit, or the targeted measures to promote access discussed below.

### **A graduate tax**

An answer that favours a pure graduate tax (ie repayments for, say, 25 years or until retirement) would rightly claim that it solves the regressivity problem. But the other problems remain.

- Funding remains closed-ended since the government continues to control the volume of resources going into higher education. Thus universities compete in a zero-sum game
- Higher education remains irredeemably publicly funded
- Incentives to efficiency are weak, since government continues to decide on the division of resources between institutions
- The system is unfair (and hence politically difficult) since repayments are unrelated to the cost of a person's education.

### **Flat fees, that is, fees that do not vary across universities**

Proponents can rightly claim that flat fees address the regressivity of tax funding and, properly implemented, can bring in private resources. But they do not solve the other problems.

- Funding remains closed-ended. Since fees are set centrally, the government continues to determine the sum of resources going to universities. If the government responds to rising fee income by reducing the taxpayer contribution, the result is a funding crisis - exactly what has happened in Australia and the UK
- Price ceilings erode incentives to improve quality (whose costs cannot be covered by price increases); price floors erode incentives to increased efficiency (whose benefits cannot be appropriated through lower prices). The current fees regime is both a floor and a ceiling, and thus particularly inimical to efficiency gains
- The system is unfair on two counts. It discriminates against UK students getting into the best universities. And why should a student at Poppleton pay the same as one at Oxbridge?

### **Deferred flexible fees**

In this regime (whatever its name) institutions set their own fee levels up to a ceiling. The (old Labour) counter-argument is that flexible fees harm access. Answers must make the critical distinction between upfront fees (which do harm access) and deferred fees, as in Scotland. With deferred flexible fees:

- Funding is open-ended. If tax funding falls, each university has a policy response under its own control
- It is possible to bring in private resources immediately, for example, by selling student debt, making vice-chancellors happy
- Institutions face incentives to use resources efficiently. Incentives also facilitate diversity and choice - desirable for their own sake, and because they contribute to

access and quality

- The system is fair. Deferred flexible fees resolve the serious inequities of tax funding, a graduate tax or flat fees. They protect access since people pay only if their earnings warrant it. And they actively promote access by focusing resources on those who need help most, rather than spending wastefully on blanket subsidies.

### **Improving student support**

To avoid upfront charges, loans should be large enough to cover all fees and all living costs, making higher education free at the point of use, eliminating student poverty, and relieving students from parental contributions, credit-card debt or excessive part-time work.

*A particularly good answer would point out that this policy is equivalent to restoring grants, given the analytical equivalence between (a) an income-contingent loan, and (b) a grant financed out of an income-related graduate contribution. Income-contingent repayments differ from income tax in only two ways: they are paid only by people who go to university, thus the taxes of the hospital porter do not pay for the degree of an old Etonian; and they do not go on for ever.*

Student support should also be simple enough to be easily understood.

*A good answer would point out that simplicity plus free-at-the-point-of-use should make parents happy. They should also make the NUS happy, giving them more than they have dared ask for at least ten years.*

It is necessary also to keep the Treasury happy. That requires a somewhat higher interest rate on student loans - the government's cost of borrowing, not the credit card rate. An answer favouring retention of the present zero real interest rate needs to address the following problems. A zero real rate:

- Is enormously expensive, currently of the order of £800 million a year
- Impedes quality. Expensive 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.

*A good answer will show a clear grasp of the interest rate point.*

### **Promoting access**

#### **Helping low earners**

Candidates might also follow the education department and NUS in arguing that some benefits from interest subsidies spill over to low earners. To a limited extent this is true. But this approach attempts to protect the poor by subsidising the commodity for everyone. Raising the interest rate removes the imperative to ration loans and simultaneously releases considerable resources for better-targeted measures to help low earners.

- Income-contingent repayments automatically protect low earners; someone with low earnings makes low - or no - repayments; someone with low earnings in the long term never fully repays.

Candidates could propose in addition:

- Introduce targeted interest subsidies for people with low earnings
- Reintroduce debt forgiveness after 25 years to protect people with low long-term earnings
- Write off 10 per cent of outstanding loans for each year in which a nurse works in the NHS or a teacher in the state-school system.

### **Getting people into university**

*A good answer should address two different causes of exclusion: financial poverty and information poverty.*

- Targeted financial support in higher education. Restoring grants for poor students is vital; so are financial incentives to universities to widen participation; so are extra resources to provide intellectual support for access students when they first arrive, to ensure that they make the transition successfully
- Improving information. Action to improve information and raise the aspirations of schoolchildren is equally critical. The greatest impediment to access is a low staying-on rate post-16. Action to prevent this needs to start at an early age.

*A minimum pass requires policies that (a) give universities more money in an open-ended system, (b) greatly enlarge and simplify the student support package, and (c) devote many more resources to promoting access. The latter two elements will require (d) more effective targeting, including an increase in the interest rate on student loans. A rant about access and quality (the "what" questions) without clear analysis of ways of promoting them (the "how" question) fails.*

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<http://econ.lse.ac.uk/staff/nb> .

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