Financing tertiary education to promote quality and access

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3 Lessons from international experience
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1 The backdrop

- Talking about how to pay for teaching, not research
- Not talking about any particularly country, but offering a toolkit which policy makers might find useful in thinking about reform
- Will suggest a broad OECD framework based on economic theory and international experience
- Proposition 1: students matter

The world has changed

- Tertiary education matters
  - Promoting core values
  - Economic growth in competitive economy
    - Technological advance a major driver
    - Tertiary education is vital both for national economic performance and for individual life chances
- Proposition 2: the world has changed: 50 years ago tertiary education was not important in economic terms
- Specific objectives
    - Quality
    - Access
    - Efficiency

What is the problem?

- Countries pursue three goals in tertiary education
    - Larger quantity
    - Higher quality
    - Constant or falling public spending
- Can achieve two but only at expense of the third
    - Large and tax-financed, but with worries about quality
    - High-quality and tax-financed, but small (UK till 1989)
    - Large and good-quality, but fiscally expensive (Scandinavia)
- The only sustainable way to achieve all three is to supplement public finance with private finance

Illustration: problems in the UK

- Rapid expansion: age participation rate in higher education in 1989, 14%; 1995: 33%; 2005: 43%
- The good news
    - More people with better qualifications
    - No decline in the relative earnings of graduates (demand rose broadly in step with supply)
- The bad news:
    - No parallel increase in resources: real funding per student fell by 40%
    - Consequent worries about quality

2 Lessons from economic theory

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

2.1 The days of central planning of tertiary education have gone

- No longer feasible
  - Number of tertiary education institutions
  - Number of students
  - Diversity of subject matter
- Nor desirable
  - Assumption of well-informed consumer generally holds; the key argument is that student choices, though not necessarily perfect, are better than those of central planners
  - *Except* information problems for students from poorer backgrounds contribute to debt aversion
- Proposition 3: competition matters
- Very different conclusion for school education

2.2 Graduates (not students) should contribute to the costs of their degree

- Social benefits
- But also significant private benefits

2.3 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
  - A genuine loan
- Large enough to cover all fees and, as far as possible, living costs; thus tertiary education is free, or largely free, at the point of use
- An interest rate related to government's cost of borrowing

3 Lessons from international experience

Why fees? Why variable fees?

- Variable fees promote efficiency
  - By making funding open-ended, thus increasing the volume of resources going to tertiary education
  - By strengthening competition, improving the efficiency with which those resources are used
- Variable fees promote quality via competition
- Counterintuitively, variable fees are also fairer
  - Shift resources to the worst off
    - Those who can afford to contribute more do so
    - This releases resources to promote quality and access
    - Thus strategy is deeply progressive; it shifts resources from today's best off to today's and tomorrow's worst off
  - Variable fees are also directly fairer: why should a student at a small local institution pay the same fee as at a world-class institution?
- Assessment: see OECD (2004, Ch. 4; 2005, Ch. 3)

International lessons about fees

- Fees relax the supply-side constraint (UK)
- Competitive systems appear to produce higher quality (at least as measured by world rankings)
- Flat fees mean that funding is closed-ended hence will not provide extra resources except in the short term (Australia)
- Big-bang liberalisation of fees can be politically destabilising (New Zealand)
- 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 (Australia, New Zealand, UK, Hungary)
- Interest subsidies are expensive (Australia, New Zealand, UK)
- But positive real interest rates are politically feasible (Netherlands, Sweden, Norway, Hungary)
- The design of the loan contract matters
- The design of the loan matters: it is possible, with care, to design a system with income-contingent repayments but mainly private finance (Hungary)

But implementation matters

- It is easy to give away money; the difficult part is collecting repayments
- A country cannot implement income-contingent repayments effectively unless it can collect income tax
- But it is mistaken to think that collecting conventional loan repayments is easier
  - Banks deal with small, short-term, secured loans
  - Government guarantees
    - Reduce banks' incentives to collect repayments (USA)
    - Violate international criteria for private finance (IMF, Eurostat)
  - Conventional loans still require an income test
- If institutional capacity is insufficient, the *only* solution is to improve institutional capacity; the world is littered with failed loan systems that were introduced prematurely
- But note synergy between tax collection and loan repayments

Why not 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 (in most, though not all, countries)
  - UK: 81% professional/15% manual, so tax funding fails the poor
- Failure 3: 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

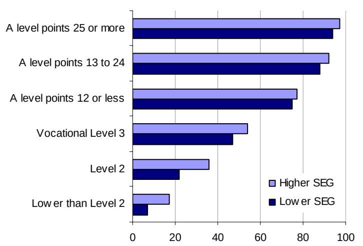
What role for means-tested grants?

- Means-tested grants are important for access, particularly where students are badly informed
  - Indicative evidence in Canada
  - The option of scholarships for first-year students
- But mistaken to think that this is the main story
- The major determinant of participation is attainment in school
- Important that policies to widen participation take a holistic view – on which more later

The major determinant of participation is attainment

% participation in terms of high school leaving grades

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



Why not other sources of private finance?

- Potential sources of private finance
  - (a) Family resources – but fail to widen access
  - (b) Student's earnings while a student – but at the expense of studies
  - (c) Student's future earnings, i.e. loans
  - (d) Employers – but weak incentives to contribute in a world with high labour mobility
  - (e) Entrepreneurial activities by education institutions – but easily overestimated
  - (f) Gifts – but easily overestimated
- For all these reasons, (c) is central

4 The 2006 UK reforms

4.1 The pre-reform system

- The good news: since 1998, the UK has had income-contingent loans with repayments collected by the income-tax authorities

The bad news

- Continued central planning
  - Price
  - Quantity
  - Quality
- Complexity
- Inadequate student loans
  - Too small to cover living costs
  - No loan to cover fees
- Loans incorporate an interest subsidy

Loans attract an interest subsidy: 4 killer problems

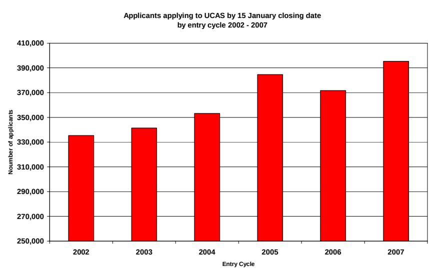
A zero real interest rate

- Is enormously expensive – some 30-35% of total lending to students fails to come back because of the interest subsidy
- Impedes quality. Student support, being politically salient, crowds out the funding of tertiary education
- Impedes access. Loans are expensive, therefore rationed and therefore too small.
- Is deeply regressive, the main beneficiaries being successful professionals in mid career.

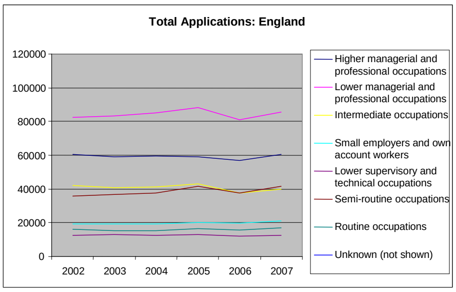
4.2 The 2006 reforms

- Variable fees, capped at £3000; in first year an extra £1.3bn (net of bursaries £1bn)
- Fees covered by an income-contingent loan
  - Repayments are 9% of earnings above £15,000/year
- Larger loans for living costs
- Access: restoration of grants to cover living costs for poor students

What happened to applications?



What about socioeconomic factors?



Key lessons

- Continuing growth in applications
- Why?
  - Loans cover fees and living costs
  - Thus higher education is *free to the student*
- Access has not worsened, but nor has it yet improved – more action is needed

5 A general strategy

- General strategy applies to all OECD countries
- Specific implementation a matter for country specifics

Leg 1: paying for quality: 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 promote quality by assisting 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
  - Tertiary 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
- Mistakes to avoid:
  - Blanket interest subsidies
  - Underestimating the implementation challenge

Leg 3: active measures to promote access

- Is debt aversion real? Two groups of students
  - Well-informed: income-contingent loans suffice
  - Not well-informed, creating problems of debt aversion
- Sources of exclusion
  - Low-quality schooling
  - Shortage of information/aspirations
  - Shortage of money
- A holistic approach to widening participation addresses all three:
  - Improving nursery and school education
  - Measures to improve information and raise aspirations
  - Money measures
- Helping low earners after their studies
  - Targeted interest subsidies
  - Forgiveness after 25 years
  - Forgiveness for public service workers and caring activities

Mistake to avoid: underestimating the importance of attainment

6 Concluding comments

- Financing tertiary education: high quality is essential; this requires more resources
  - Taxpayer support for post-compulsory education will decline in the face of competing fiscal imperatives
  - Variable fees (with a fees cap)
    - Provide extra resources
    - Create incentives to use those resources efficiently
- Financing students
  - Upfront fees are inefficient, inequitable and politically inept
  - Deferred fees are very different; if loans cover fees tertiary education remains free for students

The resulting system

- A regulated market (*not* a free market)
  - Universities set fees, subject to a fees cap
  - But governments still pay block grants; the balance between fees and block grants determines the extent of competition
  - Students apply to the institutions and courses of their choice
- A continuing important role for government
  - To provide taxpayer support for tertiary education
  - To regulate the system
    - A fees cap
    - Ensuring that there is effective quality assurance
  - To set incentives, e.g. larger subsidies for certain subjects
  - To ensure that there is a good loan scheme
  - To adopt policies to promote access

Misleading guides to policy design

Is it immoral to charge fees?

- Tertiary education is a basic right and should therefore be free
  - Food is a basic right, but market allocation is entirely accepted
- It is immoral to charge for education
  - It is immoral if a bright person from a poor background cannot study at a top institution
  - Morality applies to the outcome, not the instrument
- Elitism has no place in tertiary education
  - Distinguish social elitism and intellectual elitism – the latter is both necessary and desirable

Drivers of the future: getting the politics of change right

- None of this is an attack on public funding, which should remain a permanent part of the landscape
- Reform should not create a free market but a regulated market
- Students get tertiary education free – it is graduates who repay
- Across the OECD, the politics of higher education are a minefield – but the mines are in very different places in different countries
  - Fees are 'taboo' in some countries (Norway, older member states of the EU) but not in others (USA, new member states)
  - Positive real interest rates are 'taboo' in some countries (UK), not in others (Norway)

Points to ponder

- Students matter
- The world has changed
- Competition matters

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