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

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.
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> 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


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-

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,

> These include any transaction that improves or worsens measured fiscal aggregates without
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> .

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

are many reasons why further education has not fared well[12], 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

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 students doing a full-time degrees 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.

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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 (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.

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 -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

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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

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

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 char

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