Comment on the Browne Review

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1. This note argues that the recommendations in the Browne Review[2] are a genuine strategy in which the components fit together and are mutually reinforcing, and which build on the 2006 strategy. A good strategy, however, can fail because politicians cherry pick or because the strategy is badly implemented. Thus considerable and continuing attention needs to be paid to the way the design of the strategy is fine-tuned and to the details of its implementation.

2. A robust all-terrain car is assembled out of components which are designed to fit together. Section 1 explains the components, section 2 how the car is assembled (the strategy), and section 3 its selling points. Those three sections set out the analytical framework. Section 4 then turns to detailed policy design and implementation, including caveats. Section 5 argues that all alternatives are worse.

3. The objectives are taken to be:

- Quality (improving)
- Access (widening)
- Size (no excess demand for places).

1 The components

4. The Browne Review can be thought of as having eight components.

5. COMPONENT 1: UNIVERSAL LOANS, AS CLOSE A POSSIBLE TO FISCALLY-NEUTRAL.

- The cost of finance is covered by a real interest rate on student loans equal to the government's cost of borrowing, with targeted interest subsidies for low earners. This change, long overdue, is entirely right (see Barr 2010*a*, sections 3.3 and 4.3).
- Low lifetime earnings: a levy on fees above £6,000 covers the loss on low-earning graduates. The levy is the same at all institutions and the same whether fees are paid upfront or deferred; to do otherwise would give higher education institutions (HEIs) incentives to recruit potential high earners and students who pay upfront.
- The strategy is that loan repayments plus the proceeds of the levy should cover the cost of loans in present value terms.[3]
- The loan
    - Is available without income test; the maintenance loan is £3,750; fees loans cover the full fee.

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[2] The report of the Browne Review of higher education in England was published on 12 October. The text is on http://hereview.independent.gov.uk/hereview/

[3] In terms of current spending, the money that students borrow comes from the taxpayer, but because loan outgoings are off-budget there is only a small effect on PSBR (whether or not this is a good way to organise the public accounts is an entirely separate matter, not discussed here). For fuller discussion of the treatment of student loans in the public accounts see Barr, 2010*a*, section 4.3.3.

    - Has income-contingent repayments (9% of earnings above £21,000 – the current threshold is £15,000).
    - Any loan balance still outstanding after 30 years is forgiven.

- The report advocates improved information about the nature of student loans as opposed to credit card debt.

- Result: the bottom 3 deciles of graduate earners repay less than currently, the top 3 deciles repay the greater part of their loan (see the chart on p. 42 of the report).[4]

6. COMPONENT 2: A SYSTEM OF MAINTENANCE GRANTS. The maximum grant (total family income less than £25,000) is £3,250, with some grant for incomes up to £60,000.

7. COMPONENT 3: SELF-FINANCING TEACHING IN MOST SUBJECTS, through a zero Higher Education Funding Council (HEFCE) T grant. The T grant remains for priority subjects including (a) more expensive subjects and (b) those that the government regards as a priority.

8. COMPONENT 4: RELAXATION OF CONSTRAINTS ON STUDENT NUMBERS IN MOST SUBJECTS.

9. COMPONENT 5: A LEVEL PLAYING FIELD FOR NEW HEIS.

- Students at new institutions have access to maintenance and fees loans on the same terms as all students;
- New institutions face the same conditions as all HEIs.

10. COMPONENT 6: FLEXIBLE PRICES.

- No explicit fees cap;
- A progressive tariff on fees above £6,000 creates incentives to contain any excesses.

11. COMPONENT 7: ROBUST QUALITY ASSURANCE.

- Mandatory disclosure of information by HEIs on process and outcomes.

- Student Charters to provide detailed information about specific courses. HEIs charging higher fees will be expected to make stronger commitments.

- A regulatory regime (*not* one-size-fits-all) managed by a new Higher Education Council which takes on the functions of HEFCE, the Office for Fair Access and the Office of the Independent Adjudicator.

12. COMPONENT 8: STRONGER ACTION TO WIDEN PARTICIPATION EARLIER IN THE SYSTEM

- Improved advice at school on choice of subject and HEI, with a new funding stream.

- An Access and Success Fund to assist completion by students from disadvantaged backgrounds, supported by University Access Commitments, with mandatory reporting requirements and updated annually. Scrutiny is to be tougher at HEIs which charge higher fees.

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[4] How much the highest graduate earners repay will depend on the detailed design of the loan. Under modifications suggested in section 4, the top 3 deciles would repay in full in present value terms.

2 The strategy

13. The main argument in this note is that the recommendations of the Review are a genuine strategy, in which the components fit together to achieve the objectives set out earlier in a way that is fiscally sustainable. Like any strategy, it will need fine tuning and careful implementation, discussed in section 4.

14. SIZE. Excess demand is eliminated by setting quantity free for most subjects

- Number of places
  - Quantity controls are lifted for most subjects (component 4).
  - New HEIs face the same terms as current ones (component 5).
  - These policies are possible because:
- Finance: low cost (in present value terms) of expansion:
  - Teaching is self-financing in most subjects (component 3).
  - Loans are largely self-financing (component 1).

15. QUALITY. Incentives to quality arise through:

- Competition, via
  - Flexible prices (component 6)
  - Elimination of excess demand (component 4)
  - A level playing field for new entrants (component 5)
- Robust quality assurance (component 7)
- Note: for competition to have beneficial effects on quality it is necessary to have all three of flexible prices, no excess demand, and robust quality assurance.

16. ACCESS is promoted by:

- Relaxing liquidity constraints through:
  - Grants (component 2);
  - Universal loans with income-contingent repayments (component 1);
  - Forgiveness for those with low lifetime earnings (component 1).
- Stronger action to widen participation earlier in the system (component 8).
- Better information about student loans, as opposed to credit card debt (component 1).

17. Looking at the wider panorama of government policy, a strategy that finances a larger share of the costs of higher education from the earnings of graduates and transfers resources to spending at younger ages, such as the pupil premium, has the potential to be profoundly progressive by tackling the problems of participation in higher education at their roots.

3 Selling points

18. A GENUINE STRATEGY for achieving quality, access and size.

19. FISCALLY SUSTAINABLE.

20. ELIMINATES THE CURRENT SHORTAGE OF PLACES.

21. AFFORDABLE FOR STUDENTS AND GRADUATES.

- There are no upfront charges.
- There are grants for students from poor backgrounds – on one interpretation this is a *de facto* fee subsidy delivered via targeted grant rather than a blanket fee subsidy. The combination of full grant and maintenance loan provides £7,000 per year.
- Loan repayments are designed to be affordable.
    - Repayments are a payroll deduction that instantly and automatically track changes in earnings.
    - Low earners make low or no repayments.
    - Low earners receive targeted interest subsidies.
    - Any loan balance outstanding after 30 years is forgiven.

22. SIMPLER. everyone is entitled to a full fees loan and the standard maintenance loan (i.e. no income test for loans), and the complex system of bursaries awarded by institutions is replaced by a larger maintenance grant.

23. ASSISTS PART-TIME STUDENTS. In contrast with present arrangements, part-time students with an FTE of one-third or more are eligible for fees loans. Assisting part-time students has benefits in terms of efficiency (matching students and courses) and widening participation (e.g. facilitating 'taster' courses).

24. ASSISTS UK STUDENTS. There is less discrimination against home students, to the extent that the gap between the fees for home and overseas students declines.

25. PROGRESSIVE. The proposals are more progressive than the current system. Calculations by the IFS show that '[t]hose in the bottom 30% of lifetime earnings would actually pay back less than under the current system, while only the highest-earning 30% of graduates would pay back the full amount of their loans. The resulting spread of repayments would be more progressive than under the current system, in the sense that lower-earning graduates would pay less and higher-earning graduates would pay more' (IFS 2010).

26. It is often not understood how progressive the proposals are. There are higher fees for those who can afford them (note that with income-contingent loans, 'can afford' refers to a person's earnings as a graduate, not to family circumstances while a student); and redistributive policies help students from disadvantaged backgrounds to pay those charges. To an economist, these elements are staggeringly familiar: the first, a price increase, represents a movement along the demand curve. Taken alone, this element would harm access. However (a) the fees are deferred. not upfront, and (b), there are transfers to students from disadvantaged backgrounds. This moves their demand curve outward. Thus the strategy is deeply progressive. It shifts resources from today's best-off (who lose some of their fee subsidies) to today's worst-off (who receive a grant, and benefit from the Access and Success Fund and pupil premium) and tomorrow's worst-off (who, with income-contingent repayments, do not repay their loan in full).

4 Detailed design and implementation

27. The strategy is clear and coherent. But a continuing sadness for policy analysts is that the world is littered with good strategies that fail because they are not well-implemented. Thus considerable and continuing attention needs to be paid to the way the design of the strategy is fine-tuned and to the details of its implementation. It is necessary:

- To be clear that the strategy is *not* that of a free market but of a regulated market, hence using a mix of regulation, incentives and public subsidy to keep the system tuned to public policy objectives
- To phase in changes, for example the relaxation of controls on student numbers. Clearly complete liberalisation of price and quantity simultaneously would be highly destabilising and, rightly, is not what the report recommends.
- To monitor outcomes closely, e.g. through the annual report of the Higher Education Council.

The discussion in this section is intended only to be indicative of the sorts of issues that need to be considered.

4.1 Financing universities

28. REMOVAL OF THE HEFCE T GRANT. The report recommends removing the grant from most of the arts and humanities and the social sciences. That income will have to be replaced, wholly or in part, by increased fees. The move raises two areas of concern:

- Student numbers: higher fees may lead to a significant decline in the demand for degrees in the arts and humanities and for some social science degrees. If the effect is strong some courses may become unviable.
- Quality: if demand is weak, some HEIs might not be able fully to replace HEFCE grant by fees; unless real efficiency savings are possible, the effect is downward pressure on quality.

29. The situation, rightly, will be monitored. The report states (p. 47) that '[the Higher Education] Council will regularly review the investment it provides to adapt to changes in delivery costs or the priority of certain courses.' Thus in principle any course that could demonstrate significant public returns could be eligible for Priority Subject investment.

30. There are good arguments against complete withdrawal of public support since, as the report acknowledges, higher education creates significant (albeit hard to quantify) social benefits. Note, however, that it is the withdrawal of T grant which frees student numbers. Thus taxpayer support for teaching in the arts and humanities and/or the social sciences would be better as a block grant than a payment-per-student, to decouple university decisions about student numbers from government decisions about public spending.

31. THE LEVY ON FEES ABOVE £6,000. The levy is an important part of the strategy, to make the loan system largely fiscally neutral and to curb excessive fee increases.[5] However, the gradient of the levy is steep, rising from 40% of fee income between £6,000 and £7,000 to

[5] On the need for a mechanism to regulate fee levels, see Barr 2010*a*, section 4.2.

75% at £12,000. A case can be made for a smaller levy on fees below £8,000; and the evolution of the levy needs to be kept under review.

4.2 Financing students

32. VARIATIONS IN LIVING COSTS. Some students face higher costs, while students living at home generally face lower costs. The report did not discuss this aspect, but is clear about the need for a coherent support package to accommodate such differences, for example a larger maintenance loan for London students. Discussion of details is necessary.

33. FURTHER WAYS OF ASSISTING PARTICIPATION. A range of mechanisms exist additional to those in the report (Barr 2010*a*, section 4.4). There could be full fee scholarships for the first year for students from the most disadvantaged backgrounds, addressing the information problem such students face about whether they are good enough to flourish at university. Medical students potentially face the largest loans; it would be possible to forgive (say) 10 per cent of each person's outstanding loan for each year practising medicine in the NHS; similar options could be used for nurses in the NHS and teachers in the state school system.

4.3 The performance of the loan system

34. HOW MUCH WILL BE REPAID IN AGGREGATE? The higher interest rate extends the duration of repayments, and the maximum duration is increased from 25 years to 30; both factors increase repayments. But raising the threshold at which repayments start from £15,000 to £21,000 is expensive because the increase is large and because at each level of income it reduces the monthly repayments of *all* graduates. The cost of the loan system depends on the relative strength of these two sets of effects.

35. The good news is that the reformed loan system does better than the current system. Even though loans will be larger, a larger fraction will be repaid. However, the report recognises that non-repayment will be significant.[6] There are two reasons for non-repayment. People with low lifetime earnings qualify for forgiveness after 30 years; this is well-targeted spending with a clear social purpose which the loan system is designed to achieve.

36. In contrast, a second source of non-repayment is problematical. The intention of targeted interest subsidies is to prevent the outstanding loan of low earners from spiralling into very large numbers – numbers which would be scary and the subject of lurid newspaper headlines even though in some sense spurious because of forgiveness after 30 years. Thus it is right that there should be targeted interest subsidies. However, it is a mistake to take the statement that 'nobody's real debt will be allowed to rise' too literally. If that is the case, even the best-off graduates will not repay in full because all students receive targeted interest subsidies while they are students and all graduates, even those who go on to be high earners, receive targeted interest subsidies until they earn enough to pay a positive real interest rate.

37. The latter subsidy is a mistake.

- It is badly-targeted, in that even borrowers who become the best-off graduates gain.

[6] See the table on p. 44, which shows spending on maintenance grants of £2.5bn, with offsetting repayments of £1.8bn; for fees loans the comparable figures are £2.2bn and £1.6bn.

- It is very expensive, since the subsidy accrues to all borrowers and, moreover, does so at the start of the loan.
- It would encourage arbitrage: students from well-off families would take out the maximum loan if only to make a profit by putting the money into an asset with a positive real return, repaying in full as soon as their earnings rose to the point where a real interest rate applied. The result is both regressive and discourages upfront payments by families who can afford to make them.

38. Non-repayment by people with low lifetime earnings is a deliberate intent of the report. The second type of subsidy is probably not. Discussion of the detailed design of the loan should include ways of addressing the issue – discussed shortly.

39. HOW PROGRESSIVE IS THE SYSTEM? Though loan subsidies remain, their distribution is very different from the present system. As noted earlier, the new arrangements are considerably more progressive than present arrangements.

40. HOW SUSTAINABLE IS THE SYSTEM? The report proposes that the threshold at which loan repayments start should rise in line with changes in average earnings. Suppose that earnings rise by 5 per cent across the whole income scale, and hence that the threshold rises by 5 per cent. As a result, everything is 5 per cent larger, hence so are repayments at each level of earnings. Thus the real repayment flow improves. On the other hand, suppose that average earnings rise by 5 per cent because earnings in the lower deciles rise significantly but those in higher deciles not at all. In that case, the threshold rises by 5% but higher earnings do not, hence real repayments fall except in the lower deciles; if that happens it might be necessary to increase the levy on HEIs to ensure that loans continue to be self-financing. Though the latter case is unlikely in practice, this aspect will need continuing review.

41. Under the report's proposals, losses because of low lifetime earnings are covered by the levy on fees higher than £6,000. The resulting revenue is hard to predict, since it will depend on what institutions do in practice – another element to keep under review.

42. IMPLICATIONS FOR LOAN DESIGN. Two issues require discussion.

- There should be no grace period for interest. The system should charge a positive real interest rate during student days. There is also a case for letting real debt rise for a few years (say 3) after graduation to prevent subsidies leaking to people who are at the lower end of a high-earning career. The purpose of this arrangement is to ensure that high-earning graduates repay in full. Failing to do so continues, albeit on a smaller scale, the present blanket interest subsidies which are expensive and regressive. There are various mechanisms for improving targeting. The system could charge an explicit real rate of interest. A logically equivalent but perhaps presentationally more attractive, alternative would be to give interest subsidies to students and low graduate earners, but to claw them back at the end of the repayment period. Or there could be a repayment extension – see Barr (2010*b*).
- Should the repayment threshold be indexed and, if so, to what? If policy makers wish to index the threshold, indexing it to prices would be more prudent, leaving future governments the option of increasing the real value of the threshold if the performance of the loan system warrants. Note the link between a higher threshold and the size of the levy on fees above £6,000 – if a higher threshold reduces real repayments it implies a larger levy.

4.4 Quality assurance

43. The report makes it clear that effective quality assurance is central, and rightly puts considerable emphasis on the importance of giving prospective students timely, accurate and relevant information. Greater competition is beneficial to quality but only in combination with quality assurance. The effectiveness of quality assurance should be kept under review in any case, whatever the system, but such review is particularly relevant to plug any gaps that emerge in a more competitive environment.

5 All alternatives are worse

44. Compared with the arrangements proposed by the Review, all other options are worse. For example a graduate tax (or greater reliance on taxpayer finance) is deleterious to the achievement of all three objectives (Barr 2010*c*):

- Size: a graduate tax and/or restoration of HEFCE T grant risks creating a shortage of places.
- Quality: because a graduate tax leads to a shortage of places it erodes competitive incentives to quality; so does central planning.
- Access is harmed in several ways. Since a graduate tax is public finance it risks crowding out grants and earlier pro-access activities. Separately, a shortage of places itself harms access. Third, a graduate tax perpetuates the current incentives to prefer overseas to home students because it constrains HEI income per home student.

45. Challenge to readers: a prize for suggested modifications which harm none of the three objectives and improve at least one.

References

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