PAPER EA026

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THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

A series of background briefings on the policy issues in the May 2015 UK General Election

#ElectionEconomics

Paying for Higher Education

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CENTRE *for* ECONOMIC PERFORMANCE

CEP ELECTION ANALYSIS

Paying for Higher Education

- Additional earnings for degree holders compared to those with A-levels are between £105,000 and £250,000 over a lifetime. The proportion of UK workers with higher education rose from 4.7% in 1979 to 28.5% in 2011. Over the same period the wage return to being a graduate has also risen (from 39% to 56% for men).

- The tuition fee cap increased from £3,375 to £9,000 per year for students beginning their courses in 2012/13.

- Despite this, university applications have continued to increase, and applications from disadvantaged students (on free school meals) have grown at a *faster* rate than those from their richer counterparts.

- Only 15% of disadvantaged pupils who were eligible for free school meals enrolled for university in 2014 (up from 13% in 2011). This is low compared with advantaged groups, whose participation rate stands at 30%.

- The 2012 reforms did not achieve much savings. Fees were intended to shift the cost of higher education to graduates, allowing the government to make large cuts to university funding. But recent estimates show a large cost of financing the government-backed income-contingent student loans – with a loss to the exchequer of 45p in every £1 loaned out.

- Labour intend to reduce the fee cap to £6,000 a year, and compensate universities with money raised by reducing tax relief on pensions. This policy does little to help poor graduates – they do not earn enough to repay their fee loans even at £6,000 so could never benefit from a fee cut. The policy also makes universities more reliant on government rather than their students.

- In an attempt to limit immigration the government introduced tough regulations on universities' right to sponsor overseas students and abolished post-study work visas. Research shows that domestic students benefit from the presence of overseas students, whose unregulated fees boost university finances, increasing the number of places for all students.

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Introduction

The UK has dramatically increased the supply of graduates over the last four decades. The proportion of workers with higher education has risen from only 4.7% in 1979 to 28.5% in 2011 (Machin, 2014). Rather than this enormous increase in supply reducing the value of a degree, the pay of graduates relative to non-graduates has risen over the same period: from 39% to 56% for men and from 52% to 59% for women). This implies a strong and continuing employer demand for education, a factor that pushes up wage inequality.

The expansion of universities helped raise growth and productivity (Besley and Van Reenen, 2013), but placed a strain on government finances as home student costs are subsidised. To help address this, the tuition fee cap was raised to £9,000 per year in 2012 from £3,375. The fee increase was accompanied by large cuts to university funding, with some non-science courses essentially receiving no government teaching subsidy at all. The idea was to transfer the burden of the cost of higher education from the taxpayer to graduates. Students from low income families are protected by a combination of more generous maintenance grants for the very poor, and for the less poor the fact that no loan would have to be paid until the student graduated and earned more than the median wage of £21,000. The hope was that the reforms would also make the sector more competitive: it was expected that only the top universities would charge the full £9,000 per year, while the others could compete on price as well as quality.

Widespread fears that participation in higher education would plummet as a result of the fee increase, and that those from poor backgrounds would be frozen out of university, failed to materialise. In fact, participation continued to grow and is at record levels for poor students. There remains much inequality as only 15% of disadvantaged 18 year olds enrolled in 2014, compared with over 30% of richer students (UCAS, 2014). Of course, much of the inequality arises from the fact that the A-level attainment of disadvantaged young people is far lower than those from better off backgrounds, making them less likely to be accepted to university (Chowdry et al, 2013).

The reforms have not delivered the savings the government hoped for. Recent projections (Crawford and Jin, 2014) suggest that around three quarters of students will not repay their government-backed student loans in full, making the new system almost as expensive as the one it replaced. Nor has a more market based sector yet materialised: there is almost no variation in tuition fees, with the average fee standing at £8,735 per year (OFFA, 2014).

But there has been good news for postgraduate students during this Parliament, with the announcement that fee loans will be extended to postgraduates under the age of 30 from 2016. These loans will be repaid concurrently with current fee loans, potentially increasing exchequer costs.

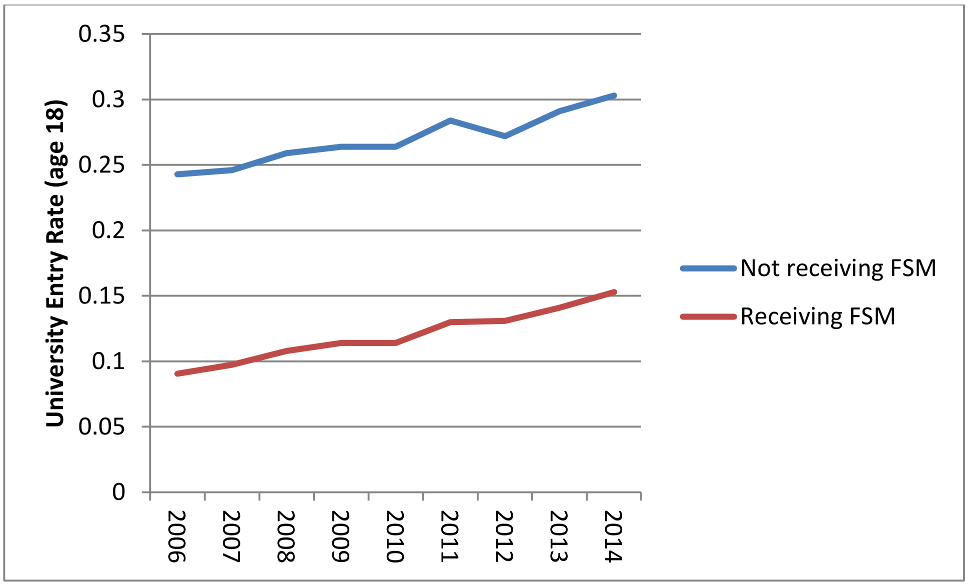
Labour have declared that they will cut the tuition fee cap to £6,000 per year.

Participation continued to grow despite the fee increase

The fee increase passed through parliament in December 2010. But apart from a sharp decline in applications in 2012 (largely as a result of a spike in 2011 as students anticipated the fee increase), they have continued to grow and now stand at record levels, with over 214,000 18 year olds applying in 2014 (UCAS, 2014).

Participation rates among poor students have grown at a faster rate than richer students since 2012 (see Figure 1). This is reassuring as it implies that university access hasn't been harmed. But this is starting from a pretty small base: only 13% of disadvantaged pupils who were eligible for free school meals applied to university in 2011, compared with nearly 30% of those who were not eligible (UCAS, 2014). In 2014, the figures had moved to 15.3% and 30.3% respectively – indicating a continuing wide gulf in access. It is hard to know for sure what would have happened to participation growth in the absence of £9,000 fees, but there is no clear change in trend after fee introduction.

Figure 1: Participation in UK universities (UCAS)



Source: UCAS 2014.
Notes: Entry rates for English 18 year old state school pupils by free school meal (FSM) status at age 15.

Despite the steady increase in the number of graduates, the labour market for graduates remains favourable. Graduate unemployment stands at just 4% (compared with 8% among those with just GCSE level qualifications – see ONS 2013) and returns to degrees are still considerable. Recent evidence estimates returns for degree holders (compared with those with A-levels) at between £105,000 and £250,000 over the lifetime (BIS, 2013).

Postgraduate students are set to benefit

There is a growing trend towards postgraduate education (Machin and Lindley, 2014) with more than a third of all graduates in the UK having a postgraduate qualification by 2009 – around 10% of the workforce. But the relative wages of postgraduates have also risen, which means that their earnings premium outstrips that of graduates.

Many feared that the undergraduate reforms would have a knock-on effect on demand for postgraduate qualifications, if already debt-ridden graduates were put off from further study.

Financing a postgraduate degree is already difficult for many students, since, to date, government loans have been unavailable and funded places limited.

It was announced in the 2015 budget that fee loans up to £25,000 will be available for research-based masters and PhD programmes from 2016/17[1]. This is on top of the 2014 announcement that fee loans of up to £10,000 will soon be available for taught postgraduate degrees. The loans will be repaid concurrently with undergraduate fee loans, which could potentially increase costs to the government. But it is likely that the government will charge these loans at a higher rate than undergraduate loans to increase the likelihood of their being paid back. The government is planning to carry out a consultation to examine how best to design these loans.

Not only is this policy good news for students considering a postgraduate degree, but it could also have an impact on wage inequality. Rising relative wages of post-graduates means that there is a strong connection between the increased presence of postgraduate workers in the labour force and rising wage inequality over time. Improving access to postgraduate qualifications for poorer graduates, therefore, help reduce wage inequality.

Student support remains a contentious issue

Of potentially greater concern to students than tuition fee debt, is the issue of how they support themselves while at college. Students with no other means of support can borrow up to £5,555[2] for maintenance loans. Poorer students – those with parental incomes below £42,000 – can also access non-repayable maintenance grants worth up to £3,387 in 2014.

The value of student grants rose just 1% in 2013, and was frozen in 2014 and 2015. Students who rely on these grants and loans face a funding shortfall according to recent estimates (NUS, 2013). The figures, which analysed available statistics for the cost of living for students for the 2013 academic year and compared it to typical payments for government maintenance loans and grants for the same period, showed an estimated average funding shortfall of about £7,600.

Labour have pledged to increase maintenance grants by £400 to ‘help students from lower and middle-income families’. While this is a fairly small increase, student support is important since costs do matter for participation. Dearden et al (2014) finds a £1,000 increase in maintenance grants increases participation by just under 4 percentage points.

Is the current system financially sustainable?

Fee and maintenance loan repayment terms are still very generous under the new system. Though an interest rate has been added, the repayment threshold and length of the loan have been increased. And because loans are even bigger than before (driven by the increase in tuition fees), even more money will remain unpaid (around three quarters of graduates will not clear their government-backed loans before the end of the 30-year repayment period[3]) and have to be covered by the taxpayer.

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[1] http://www.wonkhe.com/blogs/budget-2015-loans-for-phd-and-masters-students/.

[2] Based on a full-time undergraduate student living away from home, outside London in 2014. Equivalent figures for students living at home: £4418 and living in London: £7751.

[3] https://theconversation.com/is-the-new-student-loan-system-more-progressive-than-its-predecessor-25468.

The latest estimate of the Resource Accounting and Budgeting (RAB) charge (which takes account of both the fact that not all loans will be repaid, plus what it costs the government to borrow the money it lends to students) is 45% – in other words, for every £1 it loans out, the government loses 45p.[4]

The upshot is that increasing fees to £9,000 per year actually costs the taxpayer money. It is only after taking account of the large cuts in the universities teaching grant – which saw many courses losing funding altogether – that the government will eventually make a saving – of around £760 million on the previous system (Chowdry et al, 2012).

Nevertheless, the announcement of the 45% RAB was controversial, particularly since the government originally estimated a RAB of 28%.[5] Much speculation has followed that the system is unsustainable, some suggest that a 48.6% RAB charge would make the new system more expensive than the system it replaced.[6] There is much uncertainty surrounding what will be the eventual level of student debt that will have to be written off. Since the system has only recently come into being much depends on the future evolution of the level of wages for graduates, which is hard to predict and the degree of delinquency in paying. Certainly, the real wages of young people have fallen very rapidly over the last 7 years (see CEP Election Analysis on Living Standards, 2015), but it is likely that things will be much better in the future than they have been since the onset of the crisis. Further, since the new system has only recently come into being, changing it rapidly again would create a lot of undesirable uncertainty in the university system.

A more competitive university sector?

The government also hoped that by setting a high cap of £9,000 per year that price competition would drive university quality. This marketplace has not yet materialised. This is partly why the RAB charge is so high: the government underestimated the amount that universities would charge, and hence the unpaid fee and loan liability.

For prices and information to be converted into a functioning market, supply must also become flexible. To date, universities have faced strict caps on the number of students they can recruit, making demand far outstrip supply and enabling universities to charge the maximum price. But these quotas have been slowly relaxed and will be completely removed in 2016, improving the chances of a functioning market. Hence, it may be advisable to see how the new system works before beginning a new overhaul of university finances.

There is also a problem of information, since for a functioning market consumers need to be well informed. CEP research (McGuigan et al, 2014) suggests that this is not the case. The study, which aimed to find out what school pupils know about the costs and benefits of going to university, revealed large gaps in pupil knowledge. Fewer than half of pupils knew that fees are paid after university once they have a job, while fewer than half regarded student loans as a ‘cheaper/better way to borrow money than other types of borrowing’. It is likely that knowledge about fees will improve as the regime beds down.

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[4] Source: http://www.davidwilletts.co.uk/content/business-innovation-and-skills-questions-3.
[5] http://www.theguardian.com/education/2014/mar/21/student-fees-policy-costing-more
[6] Source: http://londoneconomics.co.uk/wp-content/uploads/2014/03/Whats-the-breakeven-associated-with-the-reforms-of-Higher-Education-Final-Version-docx.pdf.

Tougher immigration rules have threatened demand from lucrative overseas students

The government attempted – and failed - to reduce net immigration to under 100,000 (CEP Election Analysis on Immigration, 2015). Since EU immigration and UK emigration cannot be controlled, it turned to restricting foreign students. Post-study work visas were abolished in December 2010, so non-EU students are forced to go home straight after their course is finished, rather than being allowed to work temporarily after completing a degree. The policy has been blamed for a sharp decline in foreign students, from India in particular.[7]

From 2014, the laws on universities' ability to sponsor foreign students were also tightened: universities can now lose their sponsorship powers if more than 10% of those to whom places have been offered, are refused a visa. This followed a crackdown that saw London Metropolitan temporarily lose the right to sponsor their 2,700 international students.

Vice-chancellors are right to be concerned about these measures. CEP research (Machin and Murphy, 2014) shows that domestic students benefit from the presence of overseas students, whose unregulated fees boost university finances, increasing the number of places available for all students. Rather than being crowded out, domestic students actually benefit from an increased availability of places subsidised by foreign fees.

What do the party policies mean for universities, graduates and students?

That tuition fees do not appear to have harmed participation strengthens the argument for an increase in the fee cap[8] (which the Conservative Party have so far refused to rule out) and could help create a market-driven system, with the likely impact being greater variation in tuition fee levels.[9]

But such a system could be more expensive, given that it would mean fewer graduates repaying their loans in full. Thus, to make such a policy financially sustainable, the Conservatives would have to accompany their fee increase with punitive changes to the repayment system – potentially through raising the interest rate or reducing the threshold at which graduates repay their loans.

Labour have taken the opposite stance promising to reduce the fee cap to £6,000 per year from 2016.[10]

Among graduates, the only beneficiaries of this policy would be high earners. A cut to £6,000 would only benefit those graduates who earn enough to repay their loans in full, or who manage to pay back annual fee debts somewhere between £6,000 and £9,000 – top earning graduates.[11] The remainder – low earning graduates, many of them female - don't earn enough to repay

[7] See: http://www.timeshighereducation.co.uk/news/visa-rules-no-bar-to-post-study-work-says-greg-clark/2016913.article.

[8] http://www.timeshighereducation.co.uk/news/cable-warns-that-tories-could-raise-tuition-fees-significantly/2016231.article

[9] http://www.telegraph.co.uk/education/educationnews/11009244/Fees-at-Oxbridge-could-rise-to-16000-a-year.html.

[10] http://www.labour.org.uk/blog/entry/labours-plan-to-cut-tuition-fees-five-things-you-need-to-know?subsource=labour_twitter.

[11] http://www.bbc.co.uk/news/education-30922032.

their loans even at £6,000 so could never benefit from a fee cut. The Conservatives have picked up on this point, with George Osborne calling the policy 'neither progressive nor fair' in his budget statement.

Will it encourage more students to go to university? There is some evidence that many young people are still put off from going to university because of the cost (McGuigan et al, 2012). But it is unclear that potential students should ignore all potential costs in making a decision – we should be most worried about whether highly able students from low income families are put off. Labour's change would not help them, but maybe it would have a psychological effect. However, the fee increase seemed to have no effect even for the disadvantaged students, so this seems unlikely.

Labour intend to compensate universities for the loss in tuition fee income by cutting the lifetime pension cap, reducing the amount of pension contributions attracting tax relief and by reducing tax relief on pensions for higher earners. The pension policy is misguided as it involves doubly taxing people when they save for pensions and when they receive the pension income (IFS, 2015). Elsewhere in the budget, however, the Conservatives declared that they intend to cut the lifetime pension cap from £1.25m to £1m, meaning that at least part of the money Labour earmarked for their policy will no longer be available. The Shadow Chancellor Ed Balls responded to this news by promising to find the money elsewhere[12].

If Labour do compensate the £2.7 billion[13] cost of the reform from tax rises, universities will be no worse off financially. Collectively, they actually came out of the 2012 reforms with a funding increase of roughly £5,370 per graduate (Chowdry et al, 2012), although this varied a lot between universities depending on their proportion of home students.[14]

On the other hand, the policy would end the hopes of creating a more competitive system for universities to increase quality and cost effectiveness. A larger part of university budget would again become reliant on the whim of government. And yet another change in the funding system is a recipe for further uncertainty and instability in the system.

Conclusions

The university system has successfully produced a huge increase in mass higher education over the last 40 years to meet an increased demand for skilled workers. It is one of the UK's most successful export industries in terms of attracting foreign students and is second only to the US in terms of scientific prestige.

The coalition government's efforts to transfer the financial burden of higher education away from the taxpayer and towards graduates, and create a more efficient, competitive sector, have not yet materialised. In fact, the current system has almost no price variation and is almost as expensive as the one it replaced.

[12] http://www.theguardian.com/politics/2015/mar/18/ed-balls-labour-pledge-cut-tuition-fees-george-osborne-labour-shot-fox.

[13] http://labourlist.org/2015/02/labour-confirm-pledge-to-slash-tuition-fees-by-a-third-in-email-to-supporters/.

[14] http://www.universitiesuk.ac.uk/highereducation/Pages/LettertotheTimeshighlightingconcernswith%C2%A36,000tuitionfeesproposal.aspx#.VOs_iSy2V8E.

Labour's intention to reduce the fee cap to £6,000 per year at a cost of around £2.7 billion a year will do nothing to help low income graduates and there is no evidence that the hike in fees discouraged poor (or rich) students from participating. On the other hand, the low recovery rate from student debt is a cause for concern. The question is whether the new system should be given some time to work before launching into yet another costly overhaul.

Higher education may again prove a tough nut to crack.

March 2015

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Further reading

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