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Creating Competition and Efficiency in English Higher Education: Economic myths and realities

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Outline

- Quick tour of the Economics of Higher Education
- Outline recent reforms in UK that have been driven by increasing competition
  - 2012 Fee reform (fee competition)
  - 2016 reforms allowing private providers to provide university courses and get access to government subsidised student loans
- What does economics and international experience tell us about the likely outcomes of these reforms aimed at increasing competition?

Why might the market alone lead to inefficient outcomes in HE provision?

1. Credit market failure
2. Externalities
3. Risk and uncertainty
4. Information problems

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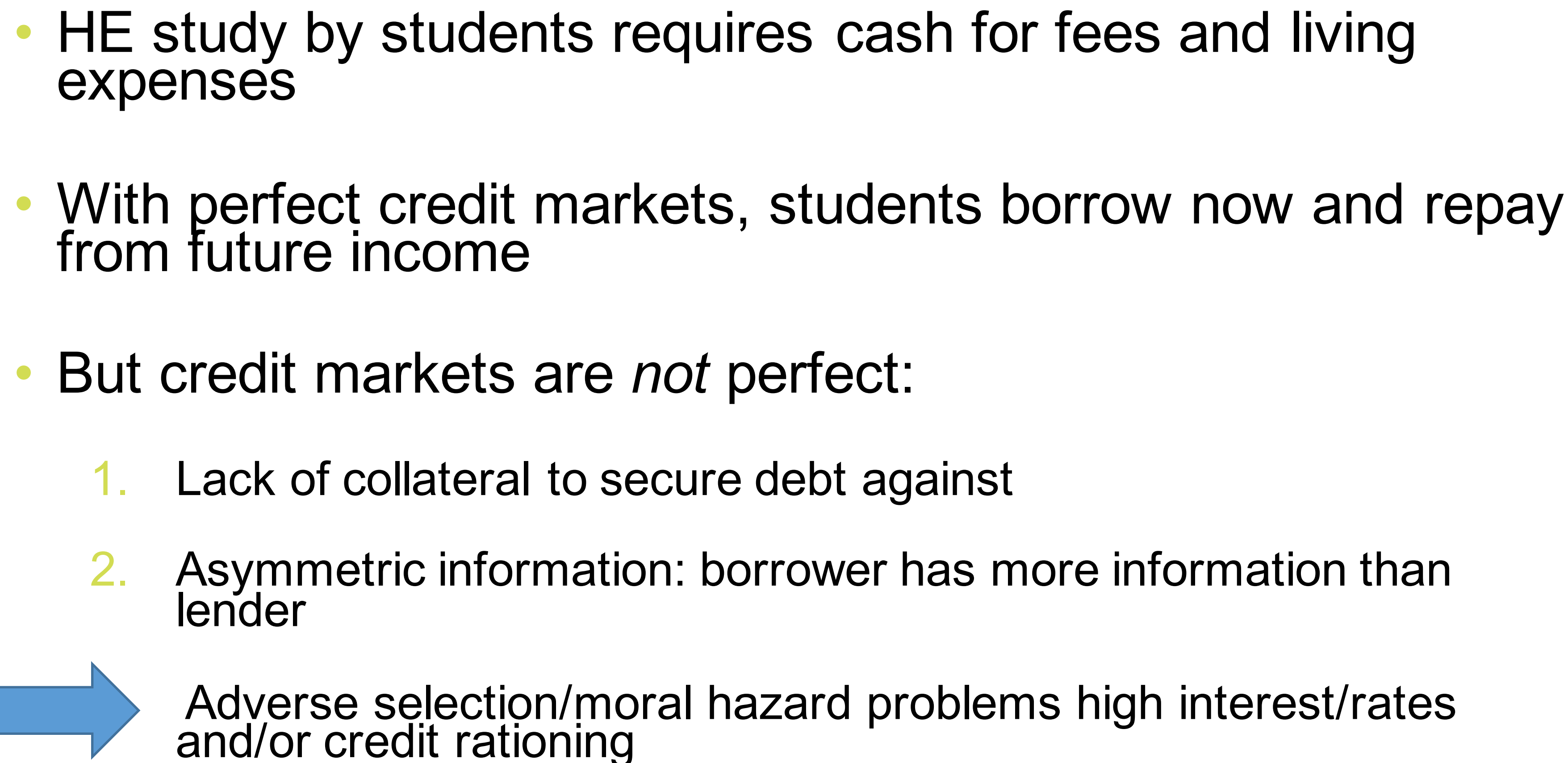
1. Credit market failure



- HE study by students requires cash for fees and living expenses
- With perfect credit markets, students borrow now and repay from future income
- But credit markets are *not* perfect:
  1. Lack of collateral to secure debt against
  2. Asymmetric information: borrower has more information than lender

→ Adverse selection/moral hazard problems high interest/rates and/or credit rationing

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2. Externalities

- Education may create benefits to society over and above those that accrue to the individual
  - Total return to education = private return + social return
- Individuals do not generally incorporate *social* return to education in weighing up costs and benefits?

3. Risk and uncertainty

- Student may be reluctant to borrow
  - Perceived risk of failing the degree
  - Uncertain returns to a degree: positive on average but high variance
  - Might need high risk premium to make the investment worthwhile
  - Debt aversion
  - Understanding behavioural responses crucial

4. Information problems

- To make rational decisions, individuals must be informed about
  - Nature of product (e.g. university and/or subject quality, HE experience) – what economists call "Experience Good"
  - Prices (e.g. fees, living costs, foregone earnings, debt repayments)
  - Future benefits (e.g. earnings), health, happiness....
- Expectations affect not only whether an adult goes to university, but also the aspirations of younger teenagers which could impact on earlier school outcomes

Consequences for good policy making?

- All of these arguments can justify state interventions and subsidies on **efficiency** grounds
  - Externalities → the financial burden of HE should be shared between the government and individuals; but how much?
  - Other market failures → student loans guaranteed by government, loans have insurance against risk, and transparency
- There also exist **equity** arguments for government intervention

Income Contingent Loans

- One important way of achieving these aims is having income contingent loans (ICLs) – crucial feature of English System
  - Loan repayments are *contingent* on income
  - Pay 9% of earnings above £21,000 until loan paid off or written off after 30 years (so loan repayment is never more than 9% of your income)
- Provides insurance against repayment hardship and avoids default

Bad 'pub' economics can lead to bad policy design

- Lots of economists and non-economists think that opening up higher education to 'market forces' will:
  - Save taxpayers money
  - Provide better outcomes for students through more varied choice and more competitive prices
- Quite often it will in fact have the opposite effect for good economic reasons
  - Relying on simple economic theory about competition gets the policy very wrong

Bad economics example 1: 2012 Fee reforms

- **Reform involved:**
  - Lifting cap on fees (from £3,000 to £12,000) and
  - Reducing direct government subsidy for all HE courses in 2012

- **The 'pub' economics logic:**
  - This reform would provide *price competition* and deliver a more efficient HE system with a range of fees between £6,000 to £9,000 with significantly reduced government expenditure
  - Treasury modelling predicted average fees of around £7,500 with very few institutions charging £9,000

The economic reality

- Fee competition will not work in English HE sector
  - High prices unlikely to deter students because graduates protected by ICL
  - With ICL bigger debt means paying ICL for a few years longer, too far away to matter
- Economics tells us that universities should charge the maximum price to maximise their revenue (profits)
  - No cost to them if student drops-out or fails or doesn't pay back loan
  - Universities will go to the max price to show they are high quality

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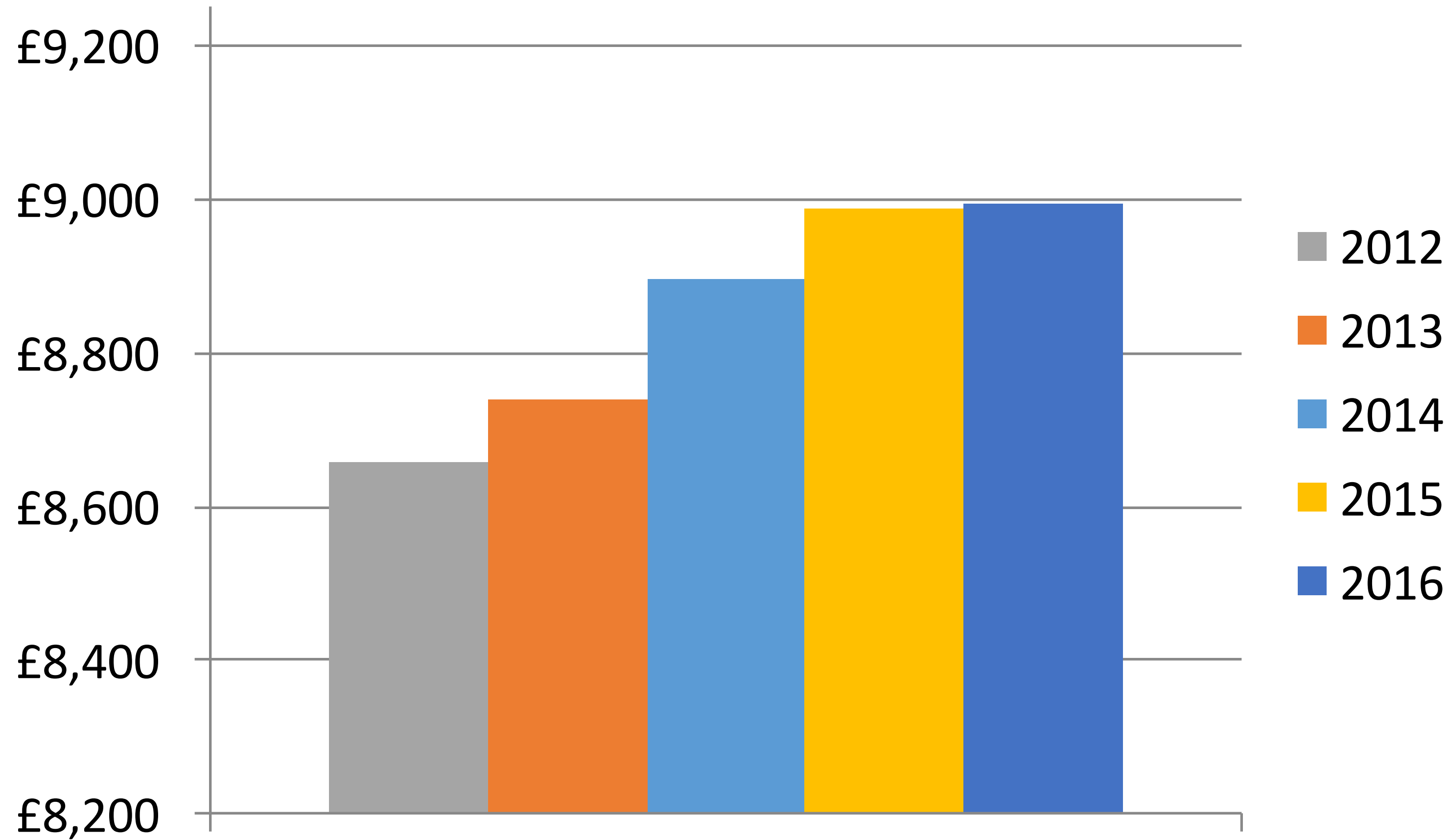
What happened to fees from 2012?



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In 2017 allowed to increase fees by RPI – What happened?

- Students starting from September 2017 can be charged up to £9,250
- All but two of the largest 90 universities charging maximum
  - One of those charging £9,246 (as divisible by 8)

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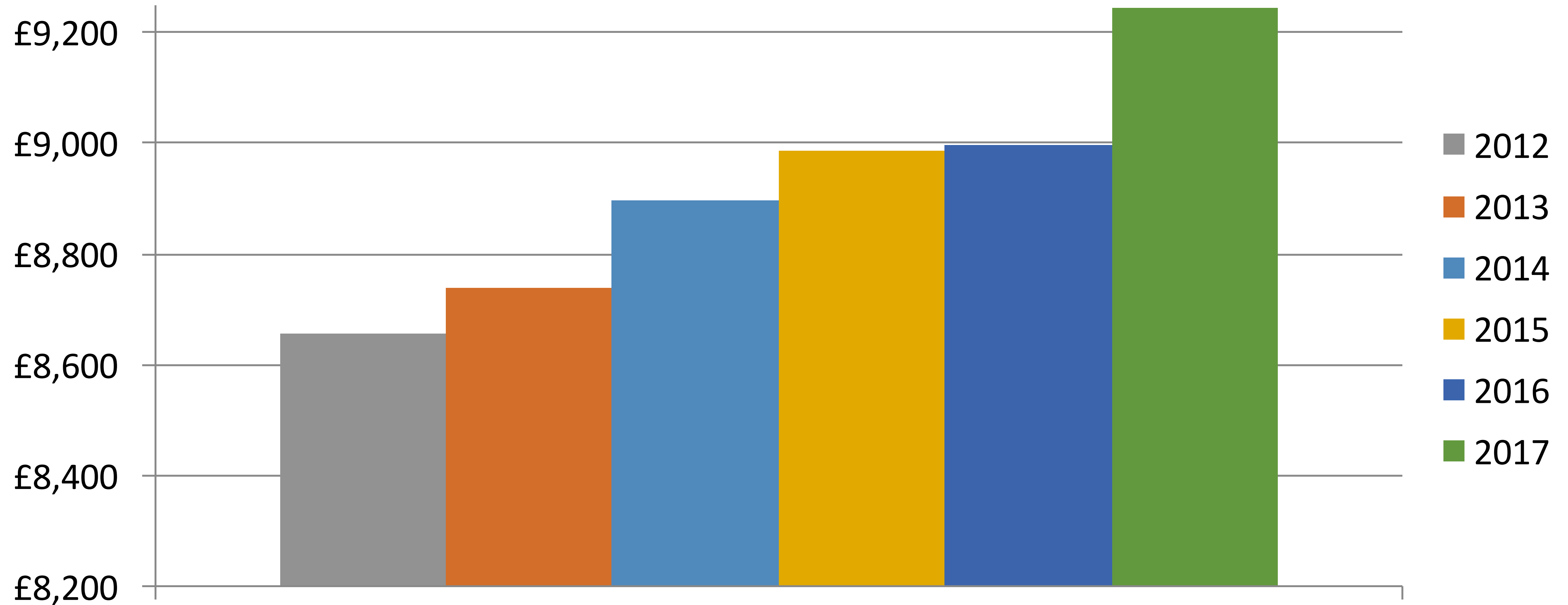
Updated figure:



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Economic Reality

- If graduates don't repay no issue for universities
- All repayment risk borne by government
- If deregulate HE fees with government guaranteed loans need risk sharing between Government and HEI
- If universities don't bare any risks of raising fees they will always charge the maximum fee
    - When fees first went up to a maximum of £3,000 in 2006 and then £9,000 in 2012, almost all universities charged the maximum fee
    - By 2017 it is virtually universal
    - Means lots of universities charging more than the cost of provision (an ethical issue)

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Good economics tells us:

- ICLs are necessary but mean that crucial aspects of standard economics no longer hold

- If HEIs share some of the risk of non-repayment they will charge fees that better reflect true costs and benefits of provision

  - Currently lots of economists working out how to effectively ensure that HEIs have ‘skin in the game’

Easy to say after the event?

- NZ comparable to England because has an ICL loan repayment system (introduced in 1992)
- Initially New Zealand completely deregulated fees (no maximum)
    - Fees soared (by more than 300 %) and costs for government went out of control
    - Student unrest as debts spiralled with high interest rates combined with ICL

Other options for keeping costs under control

- Cap student numbers using grade threshold?
  - Evidence suggests students going to poor schools need lower grade thresholds
- Ensure that choices between academic and vocational routes have access to similar loans
  - Not currently the case so students may be choosing wrong route because of this (cf Australia where get ICLs for vocational courses)

Bad economics example 2: Freeing up access for private providers

- **Reform allows:** private providers to enter the market and charge up to £6,200 per year in fees

- **Pub Economics Logic:** This reform will provide much needed competition in the HE sector and improve choices around provision (part-time provision, fast track provision), break the university stranglehold over degree awarding powers and verification and improve choices and outcomes for students

Some quotes from Jo Johnson – bad economics again

- “We will strip existing universities of the power to act like bouncers, deciding who should and should not be let into the club, will help high quality providers tap unmet demand for different ways of learning.”

- “In the 1820s, UCL – now a pillar of academic excellence – was dismissed as ‘a Cockney University’. ”

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Economic Reality

- May allow some high quality providers to enter market, but they could have done that before
- Experience from Australia, New Zealand and the US tells us that this will end up costing the government lots of money and with little or no benefit to students as regulation of this 'free market' is very difficult
  - Especially with government guaranteed student loans

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US for-profit sector

- For-profit enrolment surged during the weak job market of the 2008 recession
  - College appealing alternative but state tax revenue decreases meant unable to fund increased demand
  - Increase in government generosity saw enrolments with private providers rise
  - Growth rates jumped 21.5 percent from 2007 to 2008 alone

- Good news story?

No!

- Millions of students have left for-profit colleges with few skills but major debts, their financial lives ruined (as don’t have income contingent loans).

- Defaults in US system concentrated in for-profits and community colleges but largest increase is in for-profits sector

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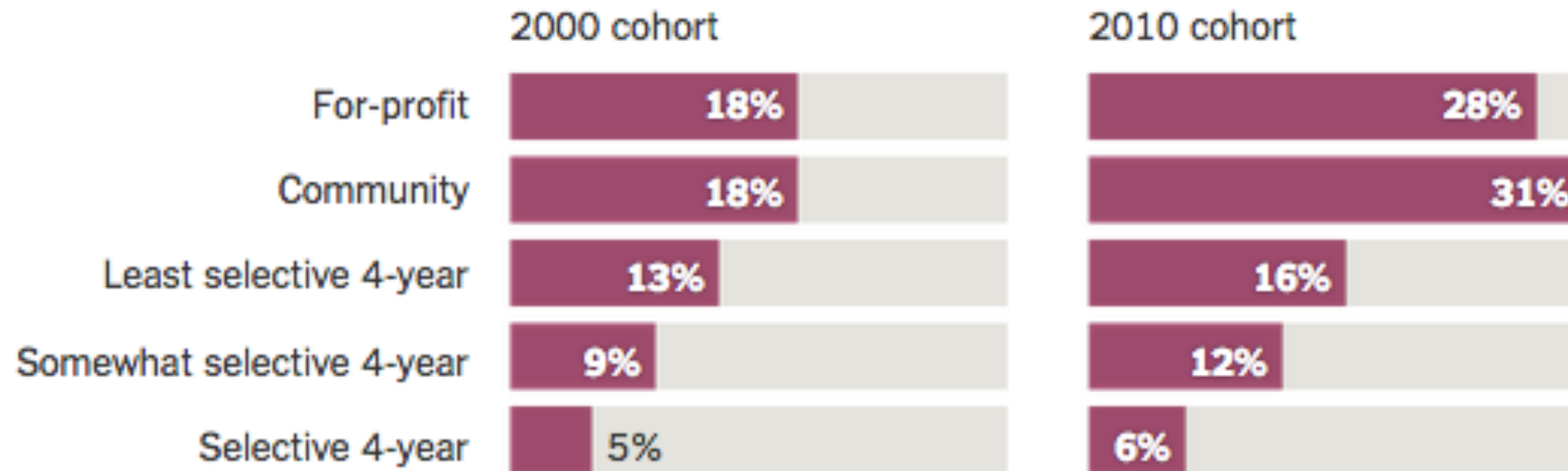
Defaults Lowest at Elite and 4-Year Colleges



Source: Analysis of National Student Loan Data System by Looney and Yannelis (2015)

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NZ again

- In the early 1990s the NZ National government also introduced uncapped places and unfettered private provider student access to government loans.

- This was done for vaguely similar reasons advocated by Jo Johnson: widening access to higher education, giving greater choice to students and responding to the need for more graduates in the knowledge economy.

- Again, perhaps unsurprisingly, participation rates soared, fees soared and expenses blew out and concerns grew over graduate and course quality.

- Led to unrest and complete wind back of policy including re-introduction of caps

Other changes that should be considered using good Economics

1) Real interest rate too high and hence regressive for graduates (better design possible)

2) Abolition of grants based on bad economics and saves government very little money

3) HEFCE funding not logical – reforms in 2012 mean no subsidy for Humanities and Arts
   - Externalities only for Sciences/Engineering/Medicine?
   - Of course indirect subsidy for students of Arts/Humanities via loan subsidy but no direct subsidy for Universities

4) Poor information on value of undertaking different degrees, subjects and/or attending different institutions
   - Students not making decisions with full information
   - New data should help here (LEO)

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Beware of simple economics being used in a complex HE world .

- Capital market failures mean most countries have government sponsored debt
  - Sound economic reasons for this
- This means very difficult to have price and provider competition in HE market
  - Most recent reforms likely to be very expensive for taxpayer and provide poor outcomes for students
- Need to go beyond 'pub' economics to design effective HE policy

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Thank you