Institution: London School of Economics and Political Science

Unit of Assessment: 27: Area Studies

Title of case study: Strengthening higher education finance in Britain and wider Europe

1. Summary of the impact (indicative maximum 100 words)

Research at LSE led by Nicholas Barr made documented contributions to higher education finance in England, Hungary and across the EU. Final impacts of the English reforms between 2008 and 2012 included (a) more resources for universities and student support, (b) more students, and (c) wider participation. The reforms, which affected financial support for over 1 million English-domiciled students in 2011/12, were designed to support economic growth by ensuring a continuing supply of higher level skills and to improve social mobility.

Growing out of earlier UK work, an LSE-led team designed a student loan scheme for Hungary which (a) provided financial support for large numbers of students, (b) involved no additional public spending, and (c) proved robust in the face of the economic crisis.

As a direct result of the success of that scheme, an LSE-led team was invited to produce a feasibility study for an EU-wide student loan facility. The resulting institution, the Erasmus + Loan Guarantee Facility, is intended to foster international student mobility.

2. Underpinning research (indicative maximum 500 words)

KEY RESEARCHERS. Nicholas Barr (Economics Department and European Institute throughout); Iain Crawford (until his death in 2004 Visiting Fellow at the Centre for Educational Research); Jane Falkingham (until 2002, Centre for the Analysis of Social Exclusion); Howard Glennerster (Department of Social Policy throughout). The work in Hungary from 1999-2001 also included Adam Austerfield, a former graduate student at the European Institute with specialist knowledge of Central and Eastern Europe. The team for the EU student loan, led by Nicholas Barr, included Hungarian counterparts from the earlier work in Hungary.

OUTPUTS AND RESEARCH INSIGHTS. In a series of articles and books including [1], [2], [3], Nicholas Barr's exploration of lessons from economic theory for the finance of higher education yielded the following insights: (a) Variable tuition fees improve both efficiency and equity. Since higher education has both social and private benefits, its costs should be shared between taxpayers and the individual beneficiary. Thus higher education should be financed partly by the taxpayer and partly through tuition fees; and, given the increasing scale and diversity of higher education, the research argued for variable fees within a regulated system. However, students (the immediate beneficiary) are credit constrained and so generally cannot afford to pay fees. The research therefore explored other sources of finance, and concluded (b) that the only large-scale and equitable source of private finance is the future earnings of students, i.e. a loan scheme, (c) that an efficient and equitable student loan should have income-contingent repayments (i.e. repayments calculated as *x* per cent of the borrower's subsequent income), and (d) that an interest rate below the government's cost of borrowing is fiscally costly and badly targeted. Falkingham, Glennerster and Barr (1995) [4] simulate different loan designs to show the dramatic improvement in the performance of loans with a positive real interest rate.

These principles underpinned work in England, Hungary and the EU. In Hungary the need for the budget to comply with the Stability and Growth Pact created an additional design constraint, ruling out public finance. But privately-financed loans are problematical because under international statistical rules, if loans include a government guarantee to private lenders, the scheme counts as public spending. Barr [5] was an early exploration into the private finance of student loans. Drawing on that work, the Hungarian design was the first to propose a solution, by combining a cost-of-finance element in the interest rate with a cohort risk premium. That solution was approved by Eurostat. Though privately-financed student loans are not new, the combination of private finance with income-contingent repayments was novel and has attracted considerable interest. The approach was developed further in Barr [3, especially Ch. 14].

3. References to the research (indicative maximum of six references)

1. Barr, N (1993), 'Alternative Funding Resources for Higher Education', *Economic Journal*, Vol.

103, No 418, May 1993, pp. 718-728. http://eprints.lse.ac.uk/280/

2. Nicholas Barr and Iain Crawford (1998), 'The Dearing Report and the Government's Response: A Critique', *The Political Quarterly*, Vol. 69, No. 1, January - March 1998, pp. 72-84. http://eprints.lse.ac.uk/00000283/ DOI: 10.1111/1467-923X.00138
3. Barr, N (2001), *The Welfare State as Piggy Bank: Information, risk, uncertainty and the role of the State*, Oxford and New York: Oxford University Press. http://eprints.lse.ac.uk/1743/
4. Jane Falkingham, Howard Glennerster and Nicholas Barr (1995), 'Education Funding, Equity and the Life Cycle', in Jane Falkingham and John Hills (eds), *The Dynamic of Welfare: The Welfare State and the Life Cycle*, (Hemel Hempstead: Prentice-Hall/Harvester Wheatsheaf, 1995), Ch. 8, pp. 150-66. Available from LSE.
5. Barr, N (1997), 'Student Loans: Towards a New Public/Private Mix', *Public Money and Management*, Vol. 17, No. 3, July-September 1997, pp. 31-40. http://eprints.lse.ac.uk/282/

Evidence of Quality: all Outputs were peer-reviewed and all except 5 submitted to previous RAEs.

4. Details of the impact (indicative maximum 750 words)

IMPACT: ENGLAND. The research in section 2 underpinned policy changes in 2006 leading to final impacts between 2008 and 2012, documented below, and also to reform in 2012.

The 2006 reforms introduced variable tuition fees, extended the system of income-contingent loans to cover fees, and reinforced policies to widen participation through intervention earlier in the system. Those reforms contributed to final impacts during the assessment period in several ways.

More resources for universities: between 2007-8 and 2011-12, tuition fee income at English universities from home and EU undergraduates increased by 53%, from £2.65 billion to £4.05 billion (HESA data). Taxpayer support for teaching remained broadly constant; thus the income from fees was a net addition to university resources.

Increased student support: the reforms increased the value of maintenance loans, extended loans to cover fees and re-introduced student grants. Between 2007/8 and 2011/12 the number of awards of financial support to English-domiciled students rose by nearly 20%, from 836,000 students to over 1 million; spending on student loans rose by 50%, from £3.97 billion to £6 billion, and on grants by 57%, from £1 billion to £1.57 billion [A, Tables 2a, 2b; B, Table 2].

More students: increased resources facilitated expansion of the system. The number of new English-domiciled entrants between 17 and 30 years old into higher education rose by 16%, from 294,000 in 2007/08 to 342,000 in 2011/12, [C, Table 1].

Wider participation: the reforms were associated with an increase in applications from people in the most disadvantaged areas, from 13.8% of the cohort in 2008 to 18.4% in 2012, an increase of 33% [D, Fig. 6 and underlying data]. Given the range of surrounding reforms (e.g. the Literacy and Numeracy Hours, Education Maintenance Allowances and AimHigher), the evidence does not allow a claim that the reforms led causally to improved participation, but supports the claim that they were part of a strategically-designed package which was consistent with wider participation.

Reforms in 2012 included raising the interest rate on student loans. By reducing the fiscal cost of loans, this reform is a fundamental element in a strategy to expand student numbers and thus to increase investment in skills; increased numbers also particularly benefit students from disadvantaged backgrounds. The final impacts will emerge in the coming years.

LINKS BETWEEN RESEARCH AND IMPACT. Activities directed at influencing policy included invited evidence to the Education Select Committee [E] and newspaper articles [F]. Nicholas Barr was described by the *Financial Times* (30 June 2011) as 'the most influential thinker in this area'. His influence was acknowledged by Tony Blair when Prime Minister [G], including 'thanks and appreciation for the outstanding contribution you made to the debate on our higher education reforms. The maturity of the debate … owed a great deal to your media presentations, and all the painstaking work on which they were based.' The contribution to the interest rate element in loan design was acknowledged in a letter from Dr Vincent Cable, Secretary of State for Business, Innovation and Skills to the editor of the *Financial Times* (5 July 2011), stating that '[Martin] Wolf rightly praises Prof Nick Barr's ideas, which have influenced our thinking. For example we are, as he recommends, introducing a real interest rate on student loans … to reduce the costs to the exchequer' [H]. In further corroboration, a House of Commons Library publication [I, p. 12] acknowledged that 'Professor Nicholas Barr has argued for some time that the interest rate subsidy is both inefficient and unfair'.

IMPACT: HUNGARY. As a result of earlier policy work in the UK based on [2], an LSE team was invited to assist in the design and implementation of a student loan in Hungary (see source J). Prior to the loan scheme there was no general system of student support in Hungary. The loan facility was therefore popular, because it gave students an option they did not have before. The scheme has universal access (i.e. all students are entitled to a loan, and the size of the loan is not income tested), and all students face the same loan conditions. The crucial elements in the underpinning research described in section 2 were (a) the importance of income-contingent repayments, (b) the need for loans to avoid interest subsidies and (c) ensuring that the loan scheme was classified as private. The resulting scheme has all these features. The interest rate has three elements: the cost of finance, a cohort risk premium, and an element to cover administrative costs (Berlinger 2009: K). The cost-of-finance element and cohort risk premium mean that the loan system breaks even and thus does not require a substantial government guarantee. The latter is the essential feature which allows the loan to be classified as private, a core objective, since at the time of its introduction Hungary faced a binding requirement to comply with the Stability and Growth Pact as a pre-condition for EU accession.

The final impact – better student support, facilitating investment in human capital – is shown by the history of the scheme. In 2008 the maximum size of the loan was increased, and it became possible to use loans to pay tuition fees directly to universities. In 2010 the European Investment Bank agreed a new credit line of EUR 140 million, a market test of the scheme's financial and operational stability in the face of the economic crisis. In 2011, the scheme's tenth year, the flow of repayments matched loan outgoings, i.e. the system became self-financing on a year-by-year basis [L, pp. 46 and 50].

As indicators of significance, between 2008 and 2012, 64,000 students took out loans totalling 61 billion Forints (approximately EUR 210 million) [L, p. 46). By 2012, the scheme had made cumulative loans of 247 billion Forints (approximately EUR 850 million, or 0.85% of GDP) to a total of 331,000 students [L, p. 46], an average take-up rate of about 25 per cent.

LINKS BETWEEN RESEARCH AND IMPACT. Consulting papers in 1999 [M] were based on the research described in section 2. Public acknowledgement includes an invitation [N] from Csaba Bugar, CEO of the Hungarian Student Loans Companyto Nicholas Barr to give the opening keynote address at the tenth anniversary conference of the loan scheme: 'It is a great pleasure for us to officially invite you to our conference …. Being a … world-renowned expert … and one of the founding fathers of the Hungarian scheme, your participation will make our conference an event of great significance'. Berlinger (2009: K) is explicit that 'The Hungarian model, developed by Nicholas Barr, may be seen as an improved version of the British model' (p. 257).

IMPACT: EU LOAN FACILITY. Noting the success of the Hungarian loan scheme, in 2010 DG-EAC invited an LSE-led team to produce a feasibility study for an EU-wide student loan. The resulting institution, the Erasmus + Loan Guarantee Facility includes EUR 600 million in the EU budget for 2013-2020 (i.e. approximately EUR 85 million per year) to finance a guarantee for an EU-wide student loan for Master's degree students to foster student mobility. That base level of finance will underwrite around EUR 3.6 billion of student loans, i.e. EUR 500 million per year. The scheme was confirmed by the European Parliament in June 2013 [O]. It is too early for final impacts.

LINKS BETWEEN RESEARCH AND IMPACT. The loan facility was presented at a EU Testing Workshop at the EU Commission in January 2011 and is set out in detail in a consulting report [P, published late 2011] by an LSE-led team, based on the research described in section 2.

WHY THE IMPACT MATTERS. Technological advance is driving up the demand for skills. Thus the size and quality of the higher education sector matters for national economic performance; failure to invest in human capital puts national competitiveness at risk. Social mobility is important both as a widely-held value judgement and because Europe cannot afford to waste talent. Thus student loans are an essential ingredient in policies to widen and deepen investment in skills, contribute to social mobility and, if well-designed, foster international mobility of students. The impacts affect the life chances of many young (and less young) people.

5. Sources to corroborate the impact (indicative maximum of 10 references)

All Sources listed below can also be seen at: https://apps.lse.ac.uk/impact/case_study/view/67

A. Student Loans Company (2010), *Statistical First Release: Student Support for Higher Education in England, Academic Year 2009/10*, SLC SFR 06/2009, 25 November 2010. https://apps.lse.ac.uk/impact/download/file/1193

B. Student Loans Company (2012), *Statistical First Release Student Support for Higher Education in England, Academic 2012/13* (Provisional), SLC SFR 05/2012. https://apps.lse.ac.uk/impact/download/file/1194

C. BIS (2013), *Participation rates in higher education: Academic years 2006/2007 – 2011/2012* (Provisional), Department of Business, Innovation and Skills, 24 April 2013. https://apps.lse.ac.uk/impact/download/file/1195

D. UCAS (2013), UK Application rates by country, sex, age and background (2013 Cycle, January deadline), 30 January 2013, http://www.ucas.com/news-events/news/2013/uk-application-rates-country-sex-age-and-background-2013-cycle-january

E. N. Barr (2003), 'Financing higher education in the UK: The 2003 White Paper', House of Commons Education and Skills Committee, *The Future of Higher Education, Fifth Report of Session 2002-03, Volume II,* HC 425-II, London: TSO, pp. Ev 292-309 http://www.publications.parliament.uk/pa/cm200203/cmselect/cmeduski/425/3061250.htm

F. Newspaper articles influencing the 2006 and 2012 reforms https://apps.lse.ac.uk/impact/download/file/1198

G. Letter from Tony Blair, 17 February 2004. This source is confidential.

H. Letter to Editor of the FT: http://www.ft.com/cms/s/0/efe51aa8-a693-11e0-9538-00144feabdc0.html

I. House of Commons Library (2013), *Student Loan statistics*, Standard Note: SN/SG/1079, 3 July 2013, www.parliament.uk/briefing-papers/sn01079.pdf

J. Guardian article: http://www.guardian.co.uk/education/2001/jul/10/internationaleducationnews.students%20;

K. Berlinger, Edina (2009), 'An Efficient Student Loan System: Case Study of Hungary', *Higher Education in Europe*, Vol. 34, No. 2, July 2009, pp. 257-67. https://apps.lse.ac.uk/impact/download/file/1202

L. Diakhitel (2012), *Diakhitel 2012 Annual Report* https://apps.lse.ac.uk/impact/download/file/1203

M. Nicholas Barr and Iain Crawford (1999), 'Student Loans: A Hungarian Proposal: Part 1: Design', Paper for Republic of Hungary: Higher Education Reform Project: Consulting Services for Student Loan Programme, revised May 2000. https://apps.lse.ac.uk/impact/download/file/1204

N. Letter from CEO of the Hungarian Student Loans Company, 7 February 2011. This source is confidential.

O. European Parliament, MEPs strike deal on Erasmus+ programme, http://www.europarl.europa.eu/news/en/news-room/content/20130626IPR14421/html/MEPs-strike-deal-on-Erasmus-programme

P. European Commission, Directorate-General for Education and Culture (2011), Feasibility study on student lending, Final report, Ref: EAC/47/2009, European Commission, Directorate-General for Education and Culture, 2011 http://ec.europa.eu/education/higher-education/doc/lending_en.pdf