



Universities challenged:

making the new
university system
work for students
and taxpayers

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CENTRE FORUM

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■ Executive summary

The government has announced a new system of university funding.¹ Government grants for teaching will fall, and universities will be allowed to charge higher fees. The government will loan students the money to cover their fees, and the loans only have to be paid back if the former student earns a high enough salary, for long enough. If the student does not earn enough, then the government will write off the debt. The government will also offer maintenance loans to students, on essentially the same basis.

Whether this system works for students, universities and governments is not yet clear. There is an inherent trade-off here: high fees mean universities do well at the expense of students and government, and vice versa. Notice that the financial interests of government and student are aligned: both want low fees. Students want them so that they have to pay back less, governments want them so that they have to write off less debt. This is an optimistic sign, since it means that the government's financial interests are on the side of the consumer, not the producer.

Those who believe in student empowerment, and those who want to limit the cost of universities to the taxpayer therefore want the same thing: a system in which universities are given incentives to be efficient and to maximise value for money in the fees they charge. Both want to see the courses that students want to take, at a price students want to pay, expand at the expense of courses that students do not want to take, at prices they do not want to pay.

At first sight there is competition between universities to help to achieve this, in that would-be students can apply to any university of their choice. But because government restricts the number of students that each university can take, this is not real competition: universities that are not well-liked will still get their students sooner or later.

1 The word 'university' is used here to mean all institutions offering Higher Education courses.

Government must devise a system in which universities and courses that are popular are able to expand. But since the contingent nature of the loans system means that students are subsidised, we need a system that allows individual universities to expand, but which does not allow the sector as a whole to expand indiscriminately.

This paper sets out a method to do this. In essence, government will auction the right to offer places to universities. Universities will bid for those places, with these allocated on the expected loss to government. This gives universities an incentive to offer courses that offer value for money, keeping prices down for students and reducing the cost to taxpayers. Universities that bid for more places than students turn out to want will have to return those places, which will then be re-auctioned to other universities. Thus universities cannot 'trap' students by cornering the market by bidding for excessive places, and universities that are oversubscribed can take more people if they wish to.

■ Introduction

The changing relationship between government, students and university has been the most fraught part of the coalition's legislative agenda so far. The legislation was particularly problematic for Liberal Democrats, whose MPs almost without exception signed the NUS pledge which read "I pledge to vote against any increase in fees in the next parliament and to pressure the government to introduce a fairer alternative".² But although the Liberal Democrats took most of the flak, there seems little doubt that all members of the government are affected by protests as large as those witnessed in London and elsewhere recently.

At present the government is actively working through exactly how the policy will be implemented. Universities currently have the right to raise fees to £6,000 and in some circumstances to £9,000. We do not yet know the prices that every individual university will wish to charge, or whether they will be allowed to do so. Four groups should care about the level of fees. First, universities, who receive them, and the academics who work in them. Second, students, who have to pay them. Third, taxpayers, since they will end up paying for some students, under the loan system. And fourth, politicians, because the political heat will be greater if almost all universities charge around £9,000 than if these figures are an exception. This paper sets out a system that should lead to lower average fee levels. If these ideas are enacted then the cost to students and taxpayers will be lower, politicians ought to be less hated, and (some) universities less prosperous. Before we set out how the ideas will work, we explain how we came to be where we are today.

The recent legislation dramatically changes the environment in which universities operate. Universities currently receive two streams of funding for teaching undergraduates: from student fees and directly from the government in the form of grants. For students starting in 2012-13 and beyond, universities will generally

2 www.nus.org.uk/Campaigns/Funding-Our-Future/Lib-Dem-MPs-sign-the-pledge

receive all of their income from students, although a limited number of high cost science courses will continue to receive some direct government funding. Fees will clearly rise, and the government has set a cap at £9,000 to stop them rising by amounts that are politically unacceptable. As now, no student will pay up front, with the government providing loans that only have to be repaid if the graduate earns an income in excess of the median income, currently £21,000 a year.

There are good reasons to move the cost of university funding from the general taxpayer to graduates. Graduates are, on average, richer than the general taxpayer, so the move is likely to be progressive. This is particularly true in that graduates who do not earn high salaries will have their debts fully or partially forgiven. The largest group in this category are likely to be women, and in particular women who work part-time after having children. We know too that there is no evidence that earlier moves to increase fees have had any adverse effects on social mobility. The lack of large numbers of students from poorer backgrounds at universities, and particularly at top universities, is primarily because people from such backgrounds achieve lower grades in schools. If we are serious about tackling social mobility, it is to schools, and not universities, that we need to look. The government appears to have listened to this message and has therefore decided to implement a 'pupil premium' that will offer significantly greater levels of funding for those teaching school age students who are in receipt of free school meals.

The government wants students to be in the driving seat, forcing universities to offer good courses at good prices. But there is a real danger that the reforms enacted so far will put universities in the driving seat, and that we will see (almost) all universities charging (almost) all students the full £9,000 very quickly. There are lots of reasons to believe that this is true: universities are collectively oversubscribed, reducing downward pressure on prices. Access conditions – a requirement of higher fees – have historically been easy to fulfil. The media narrative has focused on the £9,000 fee level, to the extent that everyone expects that figure to be common. The government appears to have given universities the right to expropriate students and taxpayers. That is in the interest of no-one except university faculty.

This paper argues that the best way to get universities to offer courses at lower fees is to oblige them to compete with each other to be allowed to offer places. Those who offer good value will be allowed to expand, those that do not will as a result of more popular

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university's expansion contract or even close. New entrants will be strongly encouraged. Once 'overcharging' universities face the genuine threat of closure, they will have a clear incentive to be more efficient, and will stop overcharging. Many universities should be able to offer good quality courses in a wide range of subjects for under £5,000 a year.

The system produced here is not straightforward for government or universities. It will take effort to implement, and that precludes its implementation for students beginning in academic year 2012-3. Importantly the system is straightforward for students, for whom there should be no discernible change – except that fees will be lower for many. And, as importantly, this system creates good incentives for universities to offer courses that students want to do, at prices that they – and the taxpayers who are underwriting them – are happy with.

■ A very short history of university fees and student loans

Following the publication of the Conservative commissioned Dearing Report in 1997, the Labour government introduced uniform university fees in 1998, means tested against parental income. Students were eligible for loans to pay these fees, with repayments contingent on earning more than a threshold, initially £10,000. The rate of interest was set equal to the rate of inflation, so that the debt did not increase in “real” terms. Those who earned insufficient amounts saw their debts written off after 25 years. Fees were initially set at £1,000 per year, rising with inflation. Different arrangements applied in Scotland.

In 2003 universities were allowed to raise fees, up to a maximum of £3,000 per year, irrespective of parental income. Loans were again available on essentially the same basis, now with a minimum income level for repayments of £15,000. All universities charge the full amount permitted in law.

Following the Labour commissioned Browne Report, the Conservative-Liberal Democrat coalition government has announced that universities will be able to charge up to £6,000, or £9,000 subject to meeting access criteria agreed with the university access body OFFA, with contingent loans again available to students. Repayments would begin when a former student’s income exceeded £21,000, which would itself be indexed to median earnings. The interest rate would be inflation initially, rising to inflation plus up to 3% after repayments begin, with the exact rate dependent on the earnings of the person repaying the debt.³ In addition, students will generally be eligible for maintenance loans of £3,750 a year, to be recovered through the same repayment plan.⁴ Outstanding debts

3 The real interest rate is 0% for those earning £21,000, rising to 3% for those earning £41,000 or more.

4 Students from the poorest backgrounds will also be eligible for a maintenance grant, and students from moderately poor backgrounds will be eligible for a larger maintenance loan.

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would be forgiven 30 years after graduation. As before, students (or their parents) have the right to pay fees directly to the university, up front. At the same time as increasing the amount that universities can charge, the government has reduced the teaching grant that it pays to all universities. In the case of non-laboratory subjects the teaching grant will no longer exist, with an equivalent cut in the grant for laboratory-based subjects.

: Why we need government controls on quantity and prices

The government could allow anyone to go to university, and allow universities to charge any fee that they like, either with or without a cap. But doing either would be very expensive for taxpayers.

The financial case for capping numbers

Students cost the government money either because the government pays for students' tuition upfront, via grants to universities, or because the tuition loan system is income-contingent and many loans will be forgiven in all or part, or because the government uses some combination of the two systems. Controlling the number of students is therefore imperative for public finances under any system of university financing.

The financial case for capping fees

Under the new system fees can rise to up to £9,000 a year. The loans system is income contingent, with students paying back 9% of their income above a £21,000 threshold. As fees rise, students do not pay back more each month, but will pay off their loans for more years. Since any outstanding loans are cancelled after 30 years, it follows that raising fees from (say) £6,000 to £9,000 will not lead to a 50% rise in the amount repaid, unless (at first approximation) the debt from annual fees of £6,000 would have been entirely repaid within 20 years, allowing the debts from £9,000 fees to be repaid in 30.⁵ We can easily imagine a situation in which many graduates would manage to pay off all of a debt if fees are £6,000, but in which relatively few would pay off all of the debt if fees are £9,000. In short, the government's position is leveraged, and when fees rise, the cost to government rises disproportionately.

⁵ The actual numbers are more complex, depending primarily on the rate of income growth of the graduate concerned relative to the rate of growth of median income.

■ The previous system - and why it will not work in the future

The system that has been used up until now has been one of command and control. Universities are given a target number of places to fill each year for each course, and if they under or overshoot that target then their budgets will be cut. Currently universities are fined £3,700 per student over quota. (In some circumstances they are allowed to vary places to a small extent from one year to another, and have considerable flexibility to vary between similar subjects within any given year.) As a result, it is relatively easy for government to control the total number of students, and the total bill.

The number of places at each institution is essentially rolled over from year to year, with institutions able to bid for additional places if they want to form a new department, grow generally, or meet particular initiatives set by government. But there is no competition between universities within any year to any extent.

The number of students who would like to go to university exceeds the number of places made available by the government. We can see this in that the number of applicants exceeds the number who receive offers or attend university. In addition it is plausible that other people would apply to university but are put off by the perception that they will not be offered a place. That demand exceeds supply means that there are few incentives for institutions to cut fees.

All universities currently charge the current maximum in the knowledge that the quota system guarantees them a full set of students. They cannot grow at each others' expense, and demand, at the current price, exceeds supply. At most, they have to be energetic in clearing, but they will get their numbers and their revenue. If the previous system was simply rolled forward, we would expect almost all institutions to charge the maximum £9,000. They would have every incentive to do so, and no incentive not to do so.

■ The role of the Office for Fair Access

The current legislation states that universities may charge more than £6,000 only if they satisfy the Office for Fair Access (OFFA) that they will be successful in widening participation. Universities will not, per se, be assessed for value for money.

The way in which access conditions will be constructed are set out in some detail in a guidance letter from Vince Cable and David Willetts, as the two relevant ministers, to Sir Martin Harris, Director of OFFA. The law requires OFFA to “have regard” for such guidance, and thus this document is important.

The document makes a number of crucial statements. Universities are required to have a credible plan in order to be allowed to raise fees above £6,000: “institutions that wish to charge more than the basic level of graduate contributions [will have] to agree new Access Agreements with you, setting out how they will promote access by under-represented groups and the progress they intend to make.” (para 1.6). Progress will be assessed annually, but within a five year framework.

Universities do not have to prove that their methods deliver greater access, only to persuade OFFA that they will work. Furthermore, once higher fees are in place, OFFA’s powers are relatively limited, or so draconian that it is hard to envisage them being applied. OFFA has three sanctions.⁶ The first is restitution if students have been disadvantaged. This is applicable in a limited range of circumstances, but not applicable if access plans are less successful than expected. Second, OFFA can fine institutions up to £500,000. OFFA has never yet fined anyone, even though “the Government believes that progress over the past few years in securing fair access to the most selective universities has been inadequate” (para 1.4). £500,000 amounts to the extra £3,000 in fees for just 167 students. For a major university with 20,000 students, this is less

6 Ministerial access guidance document para 7.1.

than 1 per cent of the additional fee income per year: a rap on the knuckles rather than a serious deterrent. Third, OFFA can take away an institution's ability to charge more than £6,000. That is, as the guidance document says "the major sanction". It is hard to imagine OFFA doing so for anything other than a wilful and overwhelming breach of the spirit and letter of an access agreement. Such an action would cause cuts in teaching hours, rises in class sizes, abolition of bursaries and so on, making it hard to imagine that OFFA will do this lightly. Because it is hard to imagine, it is correspondingly easy to imagine that universities will all be a bit optimistic about the effectiveness of their access agreements, safe in the knowledge that OFFA is unlikely to place any significant penalty on them.

In addition to the usual access conditions about attracting students from non-traditional backgrounds, OFFA must also now look at the university's record in "retaining students once recruited" (para 3.3). For the first time this gives OFFA considerable power over newer universities, who generally have very good records at attracting students from non-traditional backgrounds, but which sometimes have large numbers of students failing to complete. In 38 of the 119 English Higher Education Institutions more than 15 per cent of their students do not graduate with a degree or transfer to another institution.⁷

But just as the government has benchmarks for the proportion of students from state schools, which are specific to the particular institution, so it also has institution-specific 'benchmark' drop out rates. These benchmark drop out rates are surprisingly high: 37 English HEIs are expected to lose 15 per cent or more of their students. Only 7 institutions have drop out rates 5 per cent or more above their targets. When OFFA makes an institution's drop out rate a formal target, we can be sure that these institutions will make rapid progress in reducing their drop out rates.

It is clearly good for them to want their students to graduate, but we need to be careful. Institutions may be able to predict, at least at the gross statistical level, which students are more likely to drop out. Increased pressure to reduce drop out rates may lead them to be less likely to take all students from these backgrounds. This is, of course, potentially very bad news for access, since it will involve the university avoiding the most marginal groups. And we can all imagine the outcry if the University of Bolton, desperate to hit its retention target, turns out to have, or is perceived to have, accepted

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www.hesa.ac.uk/dox/performanceIndicators/0809/t5_0809.xls

fewer applicants of whichever local ethnic group is most prone to dropping out. For a whole variety of reasons, therefore, the new emphasis on retention is likely to have an effect on permitted fee levels for at most a handful of universities.

OFFA does not have a reputation for being particularly aggressive. The Higher Education Policy Institute's Thompson and Bekhradnia note that "no university has yet failed to satisfy OFFA, and there is no reason to expect any to do so in future". Les Ebdon, head of the Million+ university group, was blunter, saying that access requirements were "about as useful as an ashtray on a motorbike".⁸ NUS President Aaron Porter has said that "Offa has always been a weak and toothless regulator".⁹

A system in which OFFA is the only thing that stands in the way of universities charging £9,000 seems unlikely to prevent many universities from charging the new maximum fee.

8 S Baker, Times Higher Education, 16 Dec 2010.

9 R Attwood, Times Higher Education, 7 December 2010.

■ The universities' case for higher fees

All universities can be expected to argue that they cannot offer a proper university education for £6,000. Given that a fee of £6,000 represents less than the current fee and teaching grant, this case is easy to make. Universities will have to charge around £7,000 to replace the loss of the government teaching grant, and for this reason it is likely that all universities will want to charge at least this amount. In addition, many universities have seen cuts in other funding streams, including grants for capital spending, and for research. Many will see the implicit deal with government as being one in which government cuts a range of sources of state finance for universities, and universities replace that money with higher student fees.

Universities are likely to claim that they need fees that are significantly higher than either £6,000 or £7,000 to provide the standards that they will state that their students seek. Les Ebdon has stated publically that all English Higher Education Institutions will charge £9,000 within two years.¹⁰ Sir Peter Scott, vice-chancellor of Kingston University, concurs saying that “universities will charge the maximum”, arguing that they “need the money”.¹¹ Although personally unconvinced of the need for uniformly high fees, Professor David Eastwood, vice-chancellor of Birmingham, former Higher Education Funding Council for England (HEFCE) chief executive and a member of the Browne Review panel sees the proposed system as squeezing institutions like a “toothpaste tube” with fees rising towards £9,000.¹² He argued that average fees would be higher under the government’s system than would have been the case had the government followed the Browne Review’s recommendation.

10 S Baker, Times Higher Education, 16 Dec 2010.

11 P Scott, Times Higher Education, 16 Dec 2010.

12 S Baker, Time Higher Education, 17 Feb 2011.

Here Vice-Chancellors have two advantages. First, the media narrative has concentrated on the idea that fees will soon be £9,000, and that graduates will soon be more than £30,000 in debt. Indeed, NUS President Aaron Porter went further, writing about “Student debt: the £40k question”.¹³ Although raising the spectre of very high fees may have made for better headlines in the battle against the new fee regime, it also makes it easier for institutions to raise fees to this level, since this is now the default figure in the debate. Second, anger at high fees is very much directed against the government, rather than at universities, meaning that universities are likely to be able to deflect criticism towards the government if and when they seek to raise fees to £9,000. This also means that universities have an incentive to raise fees very quickly – if they do it now it is more credible that they can blame the government whereas if they keep fees low initially and raise them over the next few years they are more likely to receive the blame for the increases.

Universities are also likely to claim that students favour what they will characterise as a high-fees, high-quality equilibrium. Thompson and Bekhradnia argue that US evidence shows that students perceive price as evidence of quality. In this context there is very little pressure to reduce prices, and all universities will want to charge as high prices as possible. Obviously this has limits but there is no reason to think that the limit will be less than £9,000 a year. The BBC reports Professor Julia King, vice-chancellor of Aston University, as saying that student representatives at her university’s council argued that fees needed to be £9,000 or they would object that the university was planning to spend less on them than was being spent on students by other universities.¹⁴ The students have got their wish: Aston has announced fees of £9,000.

Will student pressure lead to lower fees?

Students and the NUS have been highly vocal in opposing fees at a national level. We might therefore think that these groups will be equally effective at opposing fees at local level, particularly as students actually have to pay the costs of the higher fees. There are, however, reasons to think that this pressure will be relatively muted.

We have already seen comments suggesting that students will be willing to pay higher fees in order for their university to be perceived as being of higher quality. This is reinforced by Sir Peter Scott’s

13 www.channel4.com/news/student-debt-the-40k-question-for-lord-browne

14 www.bbc.co.uk/news/education-12435602

comment that the difference between (say) £7,000 and £9,000 is too small to change student behaviour, given that they do not have to pay the money back upfront.¹⁵ Thompson and Bekhradnia go further, arguing that since many students will not be paying back all of their loans, there is no additional cost to many of them of going to a university charging £9,000 rather than one charging £6,000. As a result their expectation is that “the great majority of students will be charged the maximum fee within a few years.” For these reasons student pressure is unlikely to be effective in lowering fees.

Even when students want to pay less and universities are prepared to charge less, the best outcome for these two groups will be for universities to charge a higher fee and remit the money back to students in the form of scholarships and the like. Students who prefer lower debts can pay off some of the debt immediately, those who prefer to have a maintenance grant can keep the money and repay it – or not – later in their lives. The government is aware that this will prove costly to the taxpayer.¹⁶ But although “poorly targeted” recycling of fees to grants is prohibited, “bursaries and scholarships that are well targeted” are allowed, since “Targeted bursaries are an entirely legitimate way for an institution to pursue fair access” (para 5.7). Rather plaintively it notes that when such financial assistance is to be given “we hope you will encourage the use of financial waivers” (para 5.5). The NUS expects universities “to tempt students in with ‘cashback’ deals masquerading as bursaries in the access agreement.”¹⁷

More generally the NUS ‘Briefing on the fee setting process at Universities’, sent by their Director of Campaigns and Strategy and their Political Officer, notes that “simply campaigning for a low fee might not generate the results you require (especially inside the Russell and 1994 Group)”. The document is remarkably sanguine about the prospect of higher fees, arguing that the new system has created “vastly increased numbers of graduates that will never pay the loan off”, and for whom the fee issue is not, therefore, the be-all and end-all issue. The NUS advice focuses as much on “what do students get for their (increased) fees?” In this context neither individual students, nor the NUS, can be relied upon to create effective downward pressure on prices and costs.

15 P Scott, Times Higher Education, 16 Dec 2010.

16 Ministerial access guidance document, para 5.4.

17 www.nusconnect.org.uk/asset/News/6010/Briefing_Note_University_Fee_Setting_Discussions1.pdf

■ What is government going to do?

The government cannot rely on access conditions and student pressure to ensure that £6,000 rather than £9,000 is the new norm. Professor Claire Callender, Birkbeck's Professor of Higher Education Policy, correctly remarked to the Times Higher that the government has "no serious mechanism" for controlling fee levels.¹⁸ David Palfreyman, Director of the Oxford Centre for Higher Education Policy Studies, concurs, arguing that the government is "now panicking as they have got very little in the way of levers to stop everybody jumping on the £8,500 or £9,000 bandwagon".¹⁹ In addition to the OFFA guidance, and pressure from students, the government has three additional mechanisms which it hopes will induce universities to offer better value for money.

First, the government is permitting new entrants. Existing postgraduate training firms such as BPP have so far been most prominent here. These are firms who – quite rightly – believe that they can offer courses that students will find attractive. Their entry into the market has the ability – at the margins at least – to introduce competition, but it seems unlikely that they will offer sufficient scale, or a sufficient range of subjects, to really alter the dynamics of the higher education marketplace. To be really effective the government needs scale. Here the most promising suggestion, championed by David Willetts, is that students could study at further education colleges for degrees constructed by, and perhaps marked by, University of London academics. The University of London already offers a distance learning international degree, and the idea is that this would be taught locally within further education colleges by staff trained to teach it. Modern universities do not like this idea at all, with Professor Les Ebdon, chair of the Million+ group saying: "Employers do not want people who just sit exams, but people with the graduate attributes and higher-level skills developed at

18 R Attwood, Times Higher Education, 17 February 2010.

19 S Baker, Times Higher Education, 17 February 2010.

university.” This criticism misses the point: the government’s plan is not for distance learning, but for learning in FE colleges. Schools could also offer at least some degree courses: Methwold School in Thetford is about to offer degree programmes in business studies under the University of London umbrella. Local MP Elizabeth Truss has described this as “very exciting”.²⁰ At present such courses are not eligible for loans under the student loan scheme. By selectively allowing FE colleges to offer places with student loans, the government can effectively target and challenge universities that it thinks offer poor value for money.

The second card that government seems likely to play is to try to introduce cost pressures by creating a ‘core-margin’ model. In this model universities get a guaranteed core number of students, but are expected to compete at the margin. The ratio of core to margin is obviously important, with the greater the margin, the more likely it is that universities will have to respond. At present it seems likely that the government will settle on a core-margin ratio of 90:10.²¹ It seems unlikely that this ratio will create any meaningful downward pressure on prices. Let us imagine that a university plans to charge £9,000, but is concerned that it will not fill all of its marginal places. Even if it thinks it will fill no marginal places at £9,000 it will still not reduce fees below £8,100, since filling 90 per cent of places at £9,000 leads to higher revenues than filling 100 per cent of places at any price lower than £8,100. In fact this over-estimates the incentive to cut fees, since additional students do increase costs, even if the university already has a full set of buildings and so on. If the marginal cost of a student is £3000, and the margin is 10 per cent, then the lowest equilibrium price is £8,400. Second, the university may get additional students even at £9,000. If the university thinks that it will fill half the margin places at £9,000, and that a margin student costs £3,000, it will never offer a price of less than £8,700.²² Whatever the exact numbers, it is clear from this example that the core-margin model will not generate significant downwards pressures on costs.²³

Finally, the government retains the threat of further legislation. The Ministerial Guidance letter states that “It is, of course, not within your [OFFA’s] legal powers to impose any quota for how many

20 S Baker, Times Higher Education, 28 October 2010.

21 C Cook, FT, 8 February 2010.

22 $0.95 * 9,000 - 0.05 * 3,000 = 1 * 8,700 - 0.1 * 3,000 = 8,400$

23 Although the margin will do little to create downward pressure on costs, it is useful in that expanding popular courses means more students are able to do the courses that they want to do.

institutions charge what level of graduate contribution". It argues that this "is consistent with our policy of an autonomous higher education sector, where institutions take their own decisions." There is, of course, a 'but' coming – "But if the sector as a whole appeared to be clustering their charges at the upper end of what is legally possible, and thereby increasing the pressure on public funds, we will have to reconsider what powers are available, including changes to legislation, to ensure that there is differentiation in charges".²⁴ At some level this statement does not need to be made: governments always have the right to change the law. But the very fact that ministers have included this statement suggests that they are not convinced that the system that they have put in place will be successful in keeping fees reasonable. They add "We intend to keep this under very close review for 2012/13", holding out the possibility that even if universities and OFFA are successful in constructing access agreements that lead OFFA to allow a lot of universities to raise fees towards the £9,000 level this summer, government may legislate to overrule those agreements, and enforce lower fee levels.

We can already see some intimations of this, with evidence of informal government pressure on institutions. It is understood that HEFCE has been putting pressure on some universities not to move to £9,000, at least for this year.²⁵ What is not clear is whether this is a short term strategy, while the fees issue is particularly politically salient, or a longer term strategy. It is easy to believe that it might be moderately successful for a year or two, but it is hard to think that it can be effective beyond that.

24 Ministerial access guidance document, para 1.7.

25 S Baker, Times Higher Education, 17 February 2010, and personal communications.

■ Other approaches that have only limited potential

The Browne Review looked into the effect of raising student fees on government finances. It wanted to 'tax' universities that charged more than £6,000 so that higher fees would have no effect on government finances, since the tax on universities would cover the additional losses that would accrue from increasing the amount of loans that would need to be forgiven. This would mean that government would have no financial reason to care about the level of student fees – although obviously it would have a political concern. This system did not appeal to universities or government. Universities were concerned as to how the government was going to price the tax on them, and both government and universities were concerned that taxing universities simply looked odd. To withdraw teaching grants was one thing, but for government to take a chunk of the tuition fees as well seemed to be impossible to justify. Finally, governments were concerned that the tax rates would be such that there would be virtually no point in any university charging more than the £6,000 figure, at which point the idea of a market in education would disappear.

Nicholas Barr and Neil Shephard proposed a scheme which had many similarities to the Browne Review proposals.²⁶ Their scheme sees the recreation of the teaching grant, set at £1,500, which would be paid in full for fees of up to £4,500, and then withdrawn at a rate of 60 per cent, that is, for every £1 that fees rose, the university would lose 60p of teaching grant (section 6-19). This would clearly reduce the incentive to raise fees above £4,500, since raising fees from £4,500 to £7,000 would result in the university gaining only £1,000 of extra net revenue. Nevertheless, the incentive to reduce fees comes at a direct financial cost to the government, since the

government is required to recreate the teaching grant. Around half of this cost is offset by the government not having to cover missed loan repayments in future, but the other half represents genuine additional expenditure.²⁷ This is not likely to appeal to the government in current economic circumstances, and to some extent represents a direct reversal of the recent thrust of government changes in this area.

In addition, Barr and Shephard argue that universities that raise fees beyond £7,000 would have to cover the additional losses from the additional loans themselves, broadly in the manner of Browne, using actuarially calculated university specific loss factors.²⁸ This means that the government would have no financial reasons to be concerned about fee levels above this point. Since universities would have to give a portion of the additional fees back to the government, this reduces their incentive to raise fees beyond £7,000. Again, however, the politics of the government apparently taxing students up front to go to university, in case they do not pay the money back later, is likely to prove troublesome.

An alternative would be to operate from the ‘top down’. Under this proposal the government would authorise a certain number of places, with students with the best grades having the first right. Effectively there would be a minimum pre-university qualification – if you have it (or better) you can go to university, if you don’t you can’t. At first sight this seems very appealing. The current government is keen on a “British Bac” at 16, a core set of subjects that would allow students to go further in education. Having a clear entry criterion for university would appear to fit into this model.

There are two good reasons why this model is not, in fact, at all appealing. First, it is not easy to rank students. To most people it is apparent that a 3As student should be ranked above a 3Bs student, but many universities disagree. The Russell Group, which represents 20 leading universities, has just published a paper saying exactly this.²⁹ They have listed eight “facilitating” subjects, and note that “If you decide not to choose some of the facilitating subjects at advanced level, many degrees at competitive universities will not be open to you”. This sentence is highlighted in a double exclamation box, meaning that it “is VERY important” (emphasis in the original).

27 Calibrated from N Shephard ‘Tuition fee-based philanthropy and the state’, Mimeo, Table 1.

28 *ibid*, sections 26-29.

29 russellgroup.org/Informed%20Choices%20final.pdf

Ranking students becomes even harder when we take into account the myriad of qualifications that are used by students – particularly mature students – as a route to university. The UCAS tariff guide lists 48 different qualifications.³⁰ These include relatively conventional well-known qualifications, such as A-levels, Scottish Highers and the International Baccalaureate, as well as much less common qualifications. Although UCAS have decided that an ASDAN community volunteering certificate is worth more than a pass in Riding stage 3 from the British Horse Society, but less than a pass in the Diploma in Fashion Retail, and has worked out what all three mean in terms of A-levels, it is not clear that the government would be willing to make these particular equivalences critical in deciding who should go to university.

The second issue with controlling costs by restricting the number of people is that it does nothing to increase cost pressures for individual courses. If we simply limit the total number of students, and let the 'best' students enter first, and continue 'down' the list until all the places are allocated we will create virtually no cost pressure on universities, particularly on those at the top who would be in essence guaranteed their students come what may. The 'best' universities would see themselves as monopoly providers for the best students, and price accordingly. Once the best students had filled the best universities, the next best universities would see themselves as monopoly providers for the next best students, and price accordingly, and so on, all the way down the line. Price pressures in such a system would be very weak.

■ A better system

We need a system which forces universities to compete for support from both the parties that will be paying them – the student and the government. Introducing competition will also increase pressure on universities to provide the things that students want – teachers who can teach, courses that are well-constructed and interesting, careers services that are effective. Finally, allowing popular courses to expand directly increases well-being in that more students are on the courses that they want to be on. And as every faculty member in every university knows, teaching students who want to take the course is better than teaching those who are there under sufferance.

As we shall see in more detail below, the interests of the students and government are partially aligned. Both have an interest in seeing low fees rather than high fees. But their interests are not completely aligned, because every pound that a student pays back is a pound that the government does not have to cover. Since the interests of the two groups are only partially aligned, the proposal is inevitably complex. But it is important to realise that the complexity applies to government and universities, and not to students. This is important: government and universities can cope with complexity, and complexity at this level will not prevent the scheme from working effectively. What is important is that the choices facing students are simple, and closely match the current system. This is critical for the system to be responsive to student demands, and for the system to match students with places effectively.

The system proposed here will create significant downwards pressure on university fees, at all levels. It does not set out simply to constrain fees from rising above £6,000, but rather to ensure that all students are offered courses that offer value for money. As a result, this scheme is good for students and good for government, both in terms of government finances and in terms of government popularity. For these reasons government should explore the implications of this proposal in more detail.

Understanding value for money

Since the loans to students are income contingent, the cost to government clearly rises if the fees are higher, as more money is being loaned and thus might not be repaid. But as we noted earlier, the cost to the taxpayer rises disproportionately as the fees rise, because of the nature of the income contingent loans. As an example, someone earning £10,000 above the threshold consistently over their working life would repay their student loan so long as the tuition fee was not more than £5,250 a year (assuming that they took out a maintenance loan as well). So if this person attends a university that charges more than £5,250, the government will end up paying off all of the additional fee.³¹ Therefore the government has a general interest in lower fees.

The government's preference for lower fees is not, however, uniform across all students or all courses. It is likely that some universities, or some courses, generate high returns to their students that in turn means that government will end up bearing less of the cost in these cases. Government can be more relaxed about the level of fees in these cases. In contrast, government needs to be much more concerned about fees when students attend universities whose graduates have poor employment records, or when they are studying courses that are known to predict low levels of earnings.

Finally, we know that individual students will have characteristics that affect their likely earnings later in life. Although there are exceptions, a student with three As at A-level, for example, has a 30 per cent chance of getting a first class degree, whereas someone with three Ds has only a 5 per cent chance, with knock on effects for likely earnings.³² Again, the government should be much more concerned about the fees paid by the three Ds student who is less likely to get a strong degree result than with the fees paid by the three As candidate.

We also know that women earn less over their lifetimes than men, both because they earn less per hour, and because they are more likely to work part time, and more likely to have career breaks. The likelihood that government will be required to pay off their student debt is therefore greater. But while it is legitimate for government

31 This figures assume that the person is in work continuously for 30 years. Time out, whether as a gap year or to gain further qualifications, or because of unemployment, would require a higher average salary in order to pay off the debt. As an order of magnitude, one year out of the labour market requires a further £500 in income above the threshold in the remaining 29 years.

32 www.suttontrust.com/research/use-of-an-aptitude-test-in-university-entrance/1sat-report-final.pdf

to be particularly concerned about the cost of degrees for people with limited previous educational success, it is not legitimate for government to distinguish between students according to gender, or between courses according to whether they attract disproportionately men or women. It would be simply unacceptable for the government to allow universities that attracted more men to charge higher fees because men pay back more of their university loans on average. The same is true for ethnicity.

The government can accurately calibrate each of these factors using data from the student loan company. The student loan company records give graduates' repayment records until the student loan has been fully paid off. Since repayments are linked to earnings, the government therefore knows the earnings of every graduate, month by month, from graduation until the loan is finally paid off. In addition, Student Loan Company (SLC) records include the student's university and course, and can be linked via UCAS records to their A-level or other pre-university academic attainment. Although the lower level of fees in the past means that many student records do not extend as far into careers as we would like for this purpose – because the records stop when the debt is paid off – there will be sufficient data for us to have a very good sense of the typical income and repayment patterns of graduates who have done different courses, at different universities, and come from different backgrounds.³³

It is therefore possible for government to construct a table which records the likely loss to the government for each course at each university, with different levels of fees. This would be on the basis of a 'standardised student', a composite that is typical for the student body as a whole; an average of men and women, different ethnic groups, different socio-economic backgrounds, and different forms of schooling.

Table 1 (below) is a hypothetical table for the returns to students studying different courses. For this example, students are divided into two categories: those with strong A-level grades; and those with weaker A-level grades, with the former earning higher incomes later in life.³⁴ Universities offer degrees in 'X' and 'Y', with

33 Publishing this information would also make it more likely that the government will achieve a good price when it sells off student loan debt, as it will be easier for market participants to understand the extent to which graduates are likely to repay.

34 UCAS publish a tariff that recognises 47 other qualifications as being potentially valid qualifications for universities to consider in lieu of A-levels. The phrase "A-levels" should be considered short hand for "All relevant qualifications used by universities to judge student attainment prior to admission". See footnote 30 for more details

students who studied X earning more than those who studied Y. Although the numbers in Table 1 are hypothetical, they have been calibrated so that total non-repayments average 30 per cent, in line with government and other expectations. The figures should, therefore, be seen as plausible, taken as a whole, with the precise assumptions used given in the notes to the table.

To understand how the table works, let us take the case of a high grades student, studying X at a university charging £1,000. The total loan will total £14,250, made up of £1,000 for fees and £3,750 for maintenance per year. There is a 10 per cent chance that the student will repay nothing, creating a loss of £1,425 per student. In addition, there is a 25 per cent chance that the former student will earn between £1,000 and £15,000 above the repayment threshold. Since the fees are low, most of this group will still be able to repay their debt, so the additional loss is only £513 per student. The total loss is therefore £1,938, the figure given in Table 1.

Table 1: Losses born by the government per student

Annual fee level	High grades student studying X	High grades student studying Y or low grades student studying X	Low grades student studying Y
£1000	1938	2906	4359
£2000	2505	3758	5636
£3000	3128	4691	7037
£4000	3805	5708	8561
£5000	4538	6806	10209
£6000	5325	7988	11981
£7000	6168	9251	13877
£8000	7068	10601	15902
£9000	8025	12038	18056

Notes:

All figures rounded to the nearest £.

Results are for a “standardised student”, as defined in the text.

The table uses the following assumptions.

All students take out a maintenance loan of £3,750 per year.

10% of students with high grades studying X repay nothing. A further 25 per cent of such students earn between £1,000 and £15000 above the repayment threshold, and therefore may only partially repay their debts.

The non- and partial-repayment figures rise by 50 per cent for students with low grades or for students studying Y, and thus by 125 per cent for students with low grades studying Y.

In contrast, a student with relatively low grades, studying Y at a university charging £6,000 a year means much higher losses for the government. The total debt incurred is £29,250. The government will lose 22.5 per cent of this from those who do not repay at all, plus a further £5,400 per student because 22.5 per cent of students make only partial repayments, for a total loss per student of £11,981.

When we look at the table we can see that it contains diagonal lines of similar figures running from the bottom left to the top right. The cost to the government of sending a previously high attaining student to study X at a university charging £8,000 per year is £7,068. This is almost the same cost as sending a student with weaker A-levels to study X at a university charging £5,000 (£6,806) and about the same as sending a student with weaker A-levels to study Y at a university charging £3,000 (£7,037). From the point of view of the government, all of these outcomes offer similar value. Positions to the north west of this line offer better value (smaller figures), and positions to the south east offer worse value (larger figures).

Table 1 can be used by the government to assess the value for money offered by different universities for different courses, and different students. Of course, the returns to a degree as a whole, and the returns to individual courses can and will change over time. Nevertheless, it is highly likely that the income trajectories that we can derive from student loan company data for the past 30 years will give us a strong indication of the likely losses that government will have to bear for different categories of students, taken as a whole. It is the best way to proceed.

Table 1 is illustrative, but an analysis based on real data will demonstrate that the returns to courses and universities will vary, perhaps dramatically. The government agrees that the returns to universities vary, which is why it is so keen to enable “more people from disadvantaged backgrounds” not only “to enter higher education” but to ensure that they end up at “the most selective higher education institutions” so that they can “subsequently gain employment in the professions and other rewarding, well paid occupations”.³⁵

35 Ministerial access guidance document, para 2.1.

What about access?

Government is right to care about access. The university that you attend can be hugely important for your life chances. The most important way to increase access to universities as a whole, and to top universities in particular, is to ensure that more pupils from state schools achieve high grades at A-level. The pupil premium is likely to prove more effective than OFFA in the long term. Nevertheless, there are two things that the government can do. First, it should continue with the OFFA regime, requiring any university charging more than a certain amount to undertake activities that are likely to increase access, and to be held accountable for the success of those activities. Second, government can explicitly skew the results of Table 1 to support entrants from non-traditional backgrounds. It could say, for example, that students on free school meals will be assessed for Table 1 as though they had 20% more UCAS points. Thus the loss on a (say) CCC student on free school meals would be defined as the same as a non-free school meals student with BBB. This would make it easier for universities to take students from backgrounds characterised by lower school attainment.

Universities would bid for the right to offer places

The government would publish a more finely grained version of Table 1, based on its understanding of standardised students' labour market performance by university, course and A-level results.³⁶ The likely performance of new courses would be evaluated in the light of similar courses offered elsewhere, and the likely performance of new providers would be based on the experience of other new entrants in the last 30 years. The government would also set an indicative number of places that it expects to offer.³⁷ The government would make one eighth of the total places available to universities to bid for. Universities would, via sealed bid, request n places, in subject X , for students who have UCAS grades z , at a fee p . Thus LSE might bid for 200 economics places, all at 4As, at a fee of £8,000. Another university might bid for 100 economics places, at an average of grade CCC, at £4,000.

36 i.e. standardised for gender, race, socio-economic characteristics, but varying by university, course and A-level results.

37 Excluding the Open University there are 162 English universities with HEU students, admitting a little under 600k students each year in total.

The government would then look at Table 1 and work out the cost to government of each bid. It would then accept the best value bids, up to the number of places available in the first round of the auction. This process would be immediate. The government would publish a list of the accepted bids, and hold the next round of the auction until all of the places have been allocated.

The role of new entrants into the higher education sector

We know from experience of other sectors in the economy that new entrants are often critical in increasing levels of effective competition. British Airways European operations have responded well to the challenge of low cost airlines, but it was the existence of low cost airlines that led BA, for example, to scrap the ‘Saturday night stay’ rule, whereby a Saturday night stay used to be a pre-requisite for a cheap fare. Interestingly that rule remains for long haul flights, where low cost airlines are not an important feature of the market.

For these reasons it is critical that new entrants are allowed to enter the market. As of now, HEFCE needs to approve such entrants, but the government should be very clear that new entrants are very welcome. New entrants can be for-profit or not-for-profit. All Further Education Colleges should be cleared as entrants provided that they have an existing Higher Education partner to ensure standards. Schools should also be given this right. In addition, groups such as BPP who have demonstrated an ability to deliver post-graduate training would also be approved.

If the government wanted to use this scheme for students who will apply to university next academic year it would need to move very quickly, and it is probably not a realistic option. A more informal system is probably the only option for this year. In subsequent years clearly there will be sufficient time for the process to work effectively.

Universities would not be allowed to bid for everything. First, if they want to bid for more than 120 per cent of current entry levels, they would have to demonstrate to HEFCE that they had the capacity to teach significantly more students. New entrants would also have to satisfy HEFCE that they could enter the sector effectively. Second, if universities bid for places that students later turn out not to want, they will have to pay a charge of £100 per place to the government,

when that place is not taken. This will act as a deterrent to wishful thinking on the part of universities as to the students that they might attract. There is a sense in which this 'restocking charge' mirrors the incentives in the private sector: if Ford over-estimate demand for the new Focus, they have to pay a charge in that production lines will not run to full capacity. They therefore have an incentive to accurately predict demand. The restocking charge creates a similar incentive for universities.

Universities would be allowed to resubmit early unsuccessful bids in later rounds, or to adjust their bids from round to round. If the final fees are lower than the government expects, then the government would then be able to increase the number of places available, at its discretion.

How would new courses and new universities be assessed?

If an existing universities wish to offer new courses, the 'Table 1 cost' will be assessed by reference to similar courses. If we find that physics graduates and economics graduates have similar income trajectories across the sector as a whole, and a university that offers physics decides to offer economics for the first time, the 'Table 1 cost' for that economics course would be the same as for their physics course. Universities wanting to create new courses would therefore know where they stand.

The expansion of new universities over the past thirty years has given us enough evidence of their graduates' effectiveness in the labour market, so it will be straightforward to construct Table 1 estimates for new entrants to the sector. These would take into account the subjects offered, and the pre-entry qualifications of their students.

After all the rounds have been completed, universities would be able but not required to average their awarded places. This means that if a university has won the right to offer places at £6,000 and at £4,000 in the same subject they could average the two fee levels. They would also be able to vire places across subjects with the same economic return categories – thus if economics and law both have the same returns to government, a university with the right to offer both at a particular price can vire offers in one to the other.

The exception – inevitably – would be across the divide between science and non-science. The government wants science places

protected, and therefore universities cannot vires places out of science subjects. Equally, science subjects receive additional funding from the government, and therefore universities cannot vires places into scientific disciplines. The same is true for medicine.

Applicants would apply to universities

At the start of the academic year in which students apply, universities would collectively hold the right to make offers equal to the total number of students that the government is willing to fund. Universities could charge up to the price agreed with the government. They would issue prospectuses, and make information available to students just as they do at present. They would be required to state what is actually offered, in terms of teaching, and – as importantly – output measures, such as whether students are satisfied with courses, employment prospects, and income trajectories.

Under the current system, students then apply for places, based on actual or predicted results.

As in the current system, universities assess those applications, and make offers to the students that they would like to take. There would, however, be three types of offer. The first and most common type of offer would be when a university has a confirmed place that it wishes to offer it to the applicant.

Second, there would be transfer offers. Here the university is saying that it would like to take the student, but that they have already offered all of their places to other applicants. A transfer offer means that if the applicant holds an offer from another university, it can transfer that offer to the second university, subject to the transfer not adding to government expenditure. This is very important: until now, we have been concerned with forcing universities to respond to government. Here we make them respond to applicants as well.

Imagine a student has an offer from Bath, but would rather go to Bristol. Unfortunately Bristol has no places left, but would like to take the candidate. Bristol wishes that it had bid for an additional place in the earlier auction. Although it cannot bid for an additional place at this point, it can gain an additional place at the expense of Bath, if the student prefers Bristol to Bath, and if there is no effect on government finance. If the expected cost to the government is the same or lower at Bristol than at Bath, given the fees charged and the projected income trajectories, then the process is straightforward: the student's preference means that the place transfers from

Bath to Bristol. If going to Bristol increases the predicted loss for the government, then the student can only move if Bristol covers the difference (for example, by remitting the relevant sum to the government).

Third, there will be waiting list offers. Here the university is saying that it would like to take the person, and will give them the place if and when it gains more places later. As we shall see, there is good reason to think that more places will become available when A-level results become known. The waiting list offers would give the student a rank on the waiting list, so that students know where they stand.

As in the current system, students then choose between the offers, or reject all of them. Students have also gained the right to transfer an offer from one place to another, so long as the place that they wish to go to accepts them, and so long as the transfer does not increase the cost to the taxpayer. In addition, students can be more confident about rejecting offers in the proposed system because as we will see, more places will become available later in the year. There would be no insurance offer.

After universities have made their offers, and students accepted or declined their offers, some universities will have spare places. They will have bid for, and received, more places than they can fill with relevant quality applicants. They will have to return their places to HEFCE immediately, paying the appropriate level of restocking charge. These returns would be public. This would happen in early March.

These places would then be re-auctioned. Universities who have waiting lists will bid for these places, in order to be able to offer them to their waiting list. The knowledge that the university can bid for more places like this will give students greater confidence to accept a waiting list place from their first choice rather than accept an offer that they like less from another university. This in turn forces universities to be more responsive to student demand, in all dimensions – price, quality, and so on.

Universities with waiting lists will not be the only bidders. Some universities will have received offers in the first round, but discovered that students thought that other offers were preferable, and therefore have had to return their places to the government. But universities are high fixed cost organisations, and those with too few students at this stage are likely to rebid, more aggressively, in order to stave off collapse. This group will therefore have to

offer students a better deal to survive. For example, a university that previously won the right to offer courses at £7,000 to students with 3Cs at A-level that finds fewer takers than expected will have to cede those places back to the government. It can then bid for places, but clearly it will have to offer students a better deal. As such, there is within-year pressure on universities who do not offer students a desirable package to cut their fees.

Universities with waiting lists, and those with insufficient students, would bid for the places. The government would again seek value for money, allocating places according to the likely cost to government. The winners would again offer places to students, and students would again accept or decline. Declined places would again be returned, and would be allocated after the results are known.

By the Easter preceding the A-level exams, therefore, the vast majority of students will have received and accepted an offer from a university, just as at present.

When the results come out

Universities would then confirm or deny the place. Note that since the agreement with the government specified the A-level points, the university cannot confirm a place unless the student has the grades that the university has agreed with government. The agreement with government is based on the average of students taking the course, and so a 'BBB' university can admit a BBC student if one of their other students achieved ABB, and so on, so long as the overall average is BBB. There is no requirement to admit a BBC student just because another has achieved ABB: that is for the university to decide.

Since not everyone gets their grades, and since not all shortfalls will be compensated for by outperformance, universities cannot confirm all of their places. Those places will be returned to the government, and the appropriate restocking charge will be paid. These returned places, along with any outstanding places that have been declined by students prior to exams, will then be offered to universities. These places will then again be auctioned to achieve value for money. To make the system particularly responsive to students, universities will at this point have to show evidence of student demand. The actual number of places released at this point will reflect the government's position – if universities have charged less than expected, the government can fund more places with

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the same budget. Equally, if the labour market is poor, or for any other reason, government may decide to fund more places using additional money.

Finally, all universities can expand to any extent, at any time, if they pay government a fee equal to the Table 1 losses for their course. This is costless to the government, and should therefore be permitted.

⚡ What would the effects be?

This system creates good incentives. It creates an incentive for universities to offer attractive courses that students want to study. Universities that do this will attract more students, and better students. This will allow them to expand, or charge higher fees (along the equilibrium diagonal) or some combination of the two. Universities that are not popular will have to cut fees to attract students. Allowing entry makes this much more likely, and therefore increases the incentives for all universities to be responsive to students.

Second, it creates an incentive for universities to care about the employment trajectory of their students. Too often employers complain that students are not 'work-ready', and too often students complain that careers services are not effective. A university that is good at placing its students into work will do well in this system, because lower losses to government means that the university is able to expand or to increase its fees.

Third, it creates good incentives for universities to raise scholarship revenue. A university that can pay its 'Table 1' fee to the government can expand as much as it likes. This is particularly easy for top universities, whose Table 1 figures are relatively small. This is a good fundraising proposition: a donation of the loss to government is sufficient to increase access to the university, meaning that donors can increase the number of people who get the opportunity that they had, for a relatively limited sum.

Finally, we have very good incentives for universities to think hard about cutting costs in order to cut fees. This paper is primarily about the incentives, and not about the methods by which universities can cut costs. CentreForum is currently undertaking further work that will look in detail about what universities can do to be more cost effective. Nevertheless, it is important to sketch out some basic information that demonstrates that it is plausible to imagine that large cost savings are possible.

First, universities can be more efficient at the margins. In particular, universities should be better at joining together to gain economies of scale in back office functions, and via collective purchasing. Policy Exchange has recently published a paper that sets out a range of ideas along these lines, and the changes that government needs to make to facilitate them.³⁸ They demonstrate that the Higher Education sector is lagging behind the Further Education sector in this area, and that considerable savings are possible. The government, however, turns out to be obstructing this sort of effective joint working, in that universities are exempt from VAT for services that they provide themselves, but are liable for VAT if they procure services jointly. Different parts of the NHS are allowed to work together without becoming liable for VAT, and as Massey suggests, government should clearly ensure a level playing field in the university sector as well. Nevertheless, we should be aware that savings such as these are likely to be relatively minor relative to university budgets. Massey quotes with approval that UCL are saving £250,000 a year by using Microsoft's free email service. But while £250,000 is worth having, it equates to under 0.04 per cent of UCL expenditure.³⁹

The most effective way of cutting costs is likely to be a reconsideration of the role of the academic. At present it is assumed that all academics will both teach and do research, although this is already being changed at the margin with the growth of both research only 'research fellows', and teaching only 'teaching fellows'. But the expansion of universities has been driven by an increase in student numbers, with the expansion of research being a rather accidental corollary. It is not clear whether, as a nation, we either want or need more research, and nor is it clear that all of the expansion has led to research of particularly high standards. There are currently 181,000 academics at UK universities, and yet only 52,000 were submitted for the most recent Research Assessment exercise.⁴⁰ Thus there are more than 125,000 academics whose research output was not felt to be sufficiently impressive by their employers as to warrant even entering them into the assessment exercise. In some cases there are good reasons – faculty at the very start of their careers, for example, and in others universities entered only their best people. But still, the failure of UK universities to enter more than 2 in 3 academics

38 www.policyexchange.org.uk/images/publications/pdfs/Higher_Education_Austerity_2.pdf

39 Based on Higher Education Statistics Agency statistics.

40 www.hesa.ac.uk/index.php?option=com_content&task=view&id=1898&Itemid=239 and www.rae.ac.uk/results/outstore/Main%20table%20of%202008%20RAE%20results.xls

suggests that there are large numbers of academics who are not producing research of any serious quality.

We can see this when we look at the concentration of work that is judged to be “world-leading in terms of originality, significance and rigour” – the highest category in the UK Research assessment exercise. The Research Assessment Exercise showed that the top four UK universities alone account for a quarter of Britain’s world-leading research, and the top 14 for more than a half. In contrast the bottom half of institutions account for less than 3% of our world-leading research. Only 50 of the 158 institutions have more than 100 academics whose work was judged to be internationally excellent across all disciplines combined. No wonder Lord Willis, formerly chair of the House of Commons select committee on Science and Technology, has called for the rationalisation of university research to around 30 universities.⁴¹ The harsh reality is that many academics in many universities are either producing no research or research of a mundane quality. Their principal role is to teach, and their contracts could be structured accordingly.

In this context it is worth stating that all academics with good research ideas should always be able to apply to research councils for research funding. Research councils fund academics at full economic cost, including the cost of buying them out of teaching. Being on a contract that is oriented around teaching should not preclude any academic with a plausible research idea from applying for funding that will allow them to undertake that research.

Teaching at a university is not identical to teaching in a school. At least for upper level undergraduate courses we need faculty who are aware of what is going on in research. But while we need them to be able to understand and explain current research, we do not need them to undertake it. The concept of ‘research aware’ as well as ‘research led’ teaching is an important one. For many introductory courses even that is not required: teaching introductory economics does not require one to be at the forefront of either economic theory or applied economics.

A brief comparison of universities and private schools shows just how low fees could be, and perhaps should be. It is not clear whether university teaching should be more or less costly per hour of tuition than school teaching. On the one hand, university faculty generally have PhDs, and we might expect them to need more time to keep up with the literature, even if they do not contribute to it. This would

41 Lord Willis, Times Higher Education, 24 March 2010.

imply that students can expect to pay more per hour. Against that, universities have the potential for considerable economies of scale. Lectures can contain hundreds of students, which hugely reduces the costs incurred per hour of student tuition. In addition, many classes are given by graduate students and other ad hoc associated members of staff, often on relatively low wages, or paid by the hour. These factors would imply that universities should charge less per hour.

As an illustration, we will assume that a teaching oriented university could have fees that equate to the same cost per hour of tuition as currently charged in good private schools. Private schools exist in a competitive sector, in which well-informed parents care about both costs and quality. It is reasonable to assume that the fees charged in public schools represent the market cost of provision. Charging the same per hour does not, of course, imply that annual fees will be the same, since contact hours in universities are much lower than in schools. Many students on humanities courses are in classes or lectures for 8 hours a week, and for 20 weeks of the year, perhaps with additional revision. St Paul's Girls' School charges £23.50 per hour of tuition, while Bradford Grammar School charges £14.20. The biggest part of this difference is likely to be the additional costs of operating in London. At these rates, and assuming 200 hours of tuition per year, a university student would pay £4,700 and £2,840 in fees respectively per year.

Many in the university sector will no doubt say that these figures are impossible, but they are not. The new BPP University is charging fees of £3,225 for the BSc in Business Studies. Universities typically charge British students under £4,500 for taught masters subjects (see appendix). Professor Malcolm Gillies, Vice Chancellor of London Metropolitan University has stated that the rush to high fees shows that "there has not been a really serious attempt to see how you might reduce costs in the interests of affordability for the student." London Met plans to charge less than £6,000.⁴² In this context it is sensible to imagine that a majority of courses at a majority of UK universities would cost less than £4,000, even with the abolition of government teaching grants, with significant numbers of courses costing considerably less. There is no reason, after all, to think that BPP is the lowest cost provider, especially as it uses central London campuses. In addition, many existing universities already own their sites, and have buildings that have been constructed and paid for. They should be able to produce good quality courses for less than the rate charged by BPP. But they will only do so if they have a real incentive to do so.

42 'The Week in Higher Education', Times Higher Education, 24 March 2010.

■ Conclusion

This paper has set out how the government can introduce effective competition in the university sector. There are very good reasons for it to do so. Competition will increase the extent to which students can study the courses that interest them, and to which they are well-suited. It will increase the pressure on universities to raise the quality of their courses, in order to attract students. And above all, it will create incentives for universities to think seriously about their costs, and to deliver courses that offer good value to both students and taxpayers. Finally, of course, if this summer sees large numbers of university courses offered with prices of £4,000 or lower, the political narrative concerning university fees will change. That, as well as the considerable savings on public expenditure, is important to government.

■ Appendix

Typical MSc and MA fees charged to UK and EU students

University	Fee
Anglia Ruskin	£4,200
Bangor	£3,466
Bath	£4,400
Birmingham	£4,650
Bradford	£4,160
Brighton	£4,086
Bristol	£3,950
Brunel	£4,400
Cambridge	£3,770
Cardiff	£3,466
Durham	£4,770
Essex	£3,750
Exeter	£4,600
Glamorgan	£3,440
Glyndwr	£3,492
Hull	£3,732
Imperial	£3,732
Keele	£3,440
Kent	£3,950
King's College London	£3,750
Kingston	£4,850
Lancaster	£4,170
Leeds	£4,200
Leicester	£4,345
Lincoln	£3,694
Liverpool	£3,446
London South Bank	£4,190
Loughborough	£4,250
LSE	£10,272

Manchester	£5,000
Newcastle	£4,350
Nottingham	£4,480
Nottingham Trent	£4,000
Oxford	£3,466
Oxford Brookes	£4,470
Plymouth	£4,150
Portsmouth	£3,466
Queen Mary University of London	£4,900
Reading	£4,200
Roehampton	£4,200
Royal Holloway	£3,480
Salford	£4,400
Sheffield	£4,600
Sheffield Hallam	£3,600
SOAS	£7,000
Southampton	£3,446
Sunderland	£4,050
Surrey	£4,800
Sussex	£4,700
Swansea	£3,440
University College London	£4,865
University of East Anglia	£3,446
University of Wales Trinity Saint David	£3,441
Warwick	£6,080
Wolverhampton	£4,065
York	£4,200
Average	£4,266

Note: These are the standard fees, or, where there is no standard fee, the fee charged for a large number of courses.

Source: University websites.