Nicholas A. Barr

Financing higher education: lessons from the UK debate


You may cite this version as:
Available at: [http://eprints.lse.ac.uk/archive/00000287](http://eprints.lse.ac.uk/archive/00000287)
Available online: June 2005

LSE has developed LSE Research Online so that users may access research output of the School. Copyright © and Moral Rights for the papers on this site are retained by the individual authors and/or other copyright owners. Users may download and/or print one copy of any article(s) in LSE Research Online to facilitate their private study or for non-commercial research. You may not engage in further distribution of the material or use it for any profit-making activities or any commercial gain. You may freely distribute the URL ([http://eprints.lse.ac.uk](http://eprints.lse.ac.uk)) of the LSE Research Online website.

This document is the author's final manuscript version of the journal article, incorporating any revisions agreed during the peer review process. Some differences between this version and the publisher's version remain. You are advised to consult the publisher's version if you wish to cite from it.

[http://eprints.lse.ac.uk](http://eprints.lse.ac.uk)
Contact LSE Research Online at: [Library.Researchonline@lse.ac.uk](mailto:Library.Researchonline@lse.ac.uk)
Financing higher education: Lessons from the UK debate

Nicholas Barr

Professor of Public Economics,
European Institute,
London School of Economics and Political Science,
Houghton Street,
London WC2A 2AE, UK

Tel: +44-20-7955-7482; Fax: +44-20-7955-7546;
Email: N.Barr@lse.ac.uk; http://econ.lse.ac.uk/staff/nb

April 2003

Political Quarterly, forthcoming, June 2003
Financing higher education: Lessons from the UK debate

Nicholas Barr

Though directly an assessment of the 2003 White Paper on higher education in England and Wales, this paper offers analysis and strategic conclusions that apply to all advanced countries. After introductory discussion, successive sections weigh up current arrangements (generally unfavourably), assess the White Paper strategy (generally favourably), and discuss the follow-up actions necessary to ensure that the strategy works. A concluding section stresses political leadership, portrays two contrasting futures, and summarises broader lessons for policy design.

Introductory matters

Higher education in the UK faces three widely-agreed problems: universities are underfunded, students are poor, and the proportion of students from poorer backgrounds has not changed significantly in 40 years. Thus higher education funding puts national economic performance at risk and sells the poor down the river.

There is also agreement about core objectives: strengthening quality and diversity, and promoting access, both for their own sakes and for reasons of national economic performance. Thus the argument is not about what we are trying to do but about how best to do it.

Economic theory offers strong messages for financing higher education.

First, the days of central planning have gone. The case against central planning is not ideological, but rooted in the economics of information. The essence of the argument is that students (in sharp contrast with school children or people with complex medical problems) are well-informed, or potentially well-informed, consumers, and hence better able than planners to make choices which conform with their interests and those of the economy. Though that proposition is robust for many students, there is an important exception: people from poorer backgrounds might not be fully-informed, with major implications for access, discussed below.
On the supply side, central planning, whether it was ever desirable, is no longer feasible. In response to technological change, advanced countries increasingly have mass higher education, meaning more universities, more students and greater diversity of subject matter. Thus the myth of parity of esteem and relative parity of funding is no longer sustainable. In principle, differential funding could be implemented by an omniscient central planner, but the problem is too complex for that to be the sole mechanism: mass higher education requires a funding regime in which institutions can charge differential prices to reflect their different costs and missions.

A second lesson from economic theory is that students should contribute to the cost of their degree. It is true that higher education creates benefits beyond those to the individual – benefits in terms of growth, the transmission of values, and the development of knowledge for its own sake. Thus taxpayer subsidies should remain a permanent part of the landscape. However, students also receive significant private benefits, making it efficient and equitable that they bear some of the costs. This leads to the third set of lessons from economic theory.

Well-designed student loans have core characteristics.

- Income-contingent repayments, i.e. repayments calculated as \( x\% \) of the borrower's subsequent earnings, collected alongside income tax, are essential. They protect access because the loan has built-in insurance against inability to repay; and because repayments are collected alongside income tax, they also protect the borrower from the risk of making an unsecured loan. Income-contingent repayments have a profound effect that is insufficiently understood by politicians and the public.

- Loans should be large enough to cover all fees and living costs, resolving student poverty and promoting access by making higher education free at the point of use.

- Loans should attract an interest rate broadly equal to the government's cost of borrowing. The huge problems caused by interest subsidies are discussed below.

Where things stood before the White Paper: a wedding and four funerals

This section assesses current arrangements. The lesson other countries could usefully follow is the introduction in 1998 of loans with income-contingent repayments.\(^3\) Having campaigned with Iain Crawford for many years for that result, I warmly welcome the move.
The bad news is that that is all the good news. The current system has four strategic flaws, offering lessons to other countries of policies to avoid or to phase out: central planning continues; the system is complex; loans are too small; and loans attract an interest subsidy.

**Problem 1:** central planning continues in three guises. Tuition fees (£1125 in 2003-4 in England and Wales) are centrally determined for UK and EU students. There is also control of student numbers. Not the least of the resulting anomalies is that universities which recruit too many students may be penalised. In good Communist tradition, the central planner determines both price and quantity. In the same tradition, control is heavily bureaucratic. Assuring teaching quality is a worthwhile activity, but the procedures during the latter part of the 1990s involved vast amounts of paperwork; they also bore another hallmark of central planning – a counterproductive one-size-fits-all process.

**Problem 2:** the system of student support is vastly complicated, with major ill-effects: nobody can understand the system; it is a nightmare to administer; and complexity, *per se*, impedes access.

**Problem 3:** loans are too small. The full loan (£4000 outside London in 2003-4) does not cover all living costs; not all students get the full loan; and there is no loan to cover fees. Thus students are poor, forcing them to rely on their parents, to use expensive credit card debt, and/or to spend long hours earning money. These factors all impede access.

**Problem 4:** loans attract an interest subsidy. Under the present system, the interest rate on student loans is equal to the inflation rate, i.e. a zero real rate of interest. This is policy design of such cleverness that it achieves not a single desirable objective.

- The subsidy is enormously expensive, currently around £800 million per year.
- It impedes quality. Student support, being politically salient, crowds out the funding of universities.
- It impedes access. Loans are expensive, therefore rationed and therefore too small.
- It is deeply regressive, the main beneficiaries being successful professionals in mid career.
The last point bears explanation. Interest subsidies do not help students (graduates make repayments, not students). They help low-earning graduates only slightly, since unpaid debt is eventually forgiven. They do not help high-earning graduates early in their careers—with income-contingent loans, monthly repayments depend only on earnings; thus interest rates have no effect on monthly repayments, but only on the duration of the loan. Thus the major beneficiaries are successful professionals in mid career, whose loan repayments are switched off earlier because of the subsidy than would otherwise be the case.

What should the government do? Iain Crawford and I have long advocated a strategy with three legs.\(^4\)

**Leg 1**: variable fees bring in additional resources to improve quality. Students should be helped to pay the charges as described below. Of central importance, charges should be deferred: thus graduates make repayments, not students.

Thinking on fees is often muddled. Many people agree that higher education is a right, but it does not follow that it must always be free; food, equally, is a right, yet nobody demonstrates outside shops or restaurants. Another confusion is between social elitism, which is abhorrent, and intellectual elitism, which is both necessary and desirable. There is nothing inequitable about intellectually elite institutions. The access imperative is a system in which the brightest students are able to study at the most intellectually demanding institutions irrespective of their socioeconomic background.

**Leg 2**: adequate and universal income-contingent loans. The loan should be large enough to cover fees and realistic living costs and should be available to all students. This package eliminates upfront fees (the Student Loans Company would send fee payments directly to the university), making higher education free at the point of use, as in Scotland. It ends student poverty. It eliminates parental contributions. It is easy to understand. It is vastly simpler to administer than current arrangements. And, as discussed below, the package is equivalent to restoring grants.
Leg 3: active measures to promote access. There are two causes of exclusion: financial poverty and information poverty. Any strategy to promote access must address both. Grants are vital; so are financial incentives to universities to widen participation; and so are extra resources to provide intellectual support at university for access students to make sure that, once they arrive, they get the support necessary to make the transition. Action to inform school children and raise their aspirations is equally critical. The saddest impediment to access is someone who has never even thought of going to university. Action needs to start young. A final set of measures to promote access, discussed below, helps low earners after they leave university.

The White Paper strategy

The content of the White Paper is wide-ranging. Discussion here is limited to the funding proposals.

The term 'top-up fees' conflates three separate questions: should fees be the same at all universities or different; should students pay fees upfront or deferred; and should universities receive fees upfront or deferred? The White Paper answers all three questions correctly. From 2006 fees will no longer be fixed, but variable between 0 and £3000. However, there will no longer be an upfront charge, since fees will be fully covered by a loan. Universities, however, will receive the fee income upfront.

The White Paper seeks to promote access directly in at least three ways. It brings back a grant of at least £1000 per year. Fee remission continues, as at present: people from poor backgrounds will not pay the first £1125 of any tuition charge, and some students might be exempt from the entire £3000 charge. Finally, a new Office for Fair Access (OFFA) will ensure that universities charging fees above £1100 have well-designed plans to widen access and carry those plans out.

Student support continues essentially as at present. The maximum maintenance loan remains broadly unchanged, and entitlement continues to be income tested, i.e. parental contributions continue. Loans attract a zero real rate of interest, i.e. interest subsidies continue. The income threshold at which loan repayments start will be raised from its current level of £10,000 to £15,000 in 2005.
Research funding will be more focussed, not least to protect the UK research base, to which the White Paper has an explicit commitment.

Public spending is set to increase significantly over the next three years.

Seen through the eyes of lurid press coverage, the proposals look horrible – high fees, large debts. That view is thoroughly misleading. The White Paper strategy has two elements: it (a) redistributes from better-off to worse off, and (b) ends communism, i.e. brings in genuine competition.

Strategy element 1: redistribution from better-off to worse-off. The underlying principle is that those who can afford to pay more do so, releasing resources to improve quality and promote access. Economic theory is particularly useful to explain what is going on. The White Paper proposes two sets of actions (see Figure 1):

- A price increase, raising the average tuition fee from \( p_0 \) to \( p_1 \). This leads to a movement along the demand curve from \( a \) to \( b \). Taken alone, this action obviously reduces demand and harms access. However (a) the fees are deferred for everyone, and (b), there are also:
  - Targeted transfers to groups for whom access is fragile. This moves their demand curve outward, increasing their demand to \( c \).

Thus the strategy is deeply progressive. It shifts resources from today's best-off (who lose some of their fee subsidies) to today's worst-off (who receive a grant) and tomorrow's worst-off (who, with income-contingent repayments, do not repay their loan in full).

[Figure 1 about here]

Three sets of supporting arguments are important. First, the main disparity in participation occurs when people leave school at 16. Of those with A levels good enough to go to university, 90 per cent do so, with little socioeconomic variation. Thus spending to improve GCSE scores does more for access than subsidising fees for people who would have gone to university anyway.
Second, other ways of paying for higher education are unfair. A graduate tax (i.e. an additional x pence on income tax until retirement, or for a fixed period such as 25 years), is unfair because repayments are unrelated to the cost of a person's degree.

Flat fees, i.e. the same fee at all universities, are unfair for two reasons. It is unfair if a student at Banbury University pays the same fee as one at Oxford. Secondly, as Iain Crawford and I predicted – not least in our earlier article in *Political Quarterly* – flat fees discriminate against British students.

Tax funding has at least three problems. First, it does not work – access has barely improved in 40 years. Second, it will not happen: higher education will always lose out to the NHS, nursery education and school education. Third, it should not happen. Higher education confers a benefit on society as a whole, and to that extent should continue to receive tax funding. Beyond that, however, tax funding is deeply regressive. If the money comes from general taxation, the taxes of the hospital porter pay for the degree of the old Etonian. If it is unfair for graduates to pay more of the cost, as the proponents of tax funding argue, it is even more unfair to ask non-graduate taxpayers to do so.

The counter-argument is to make taxation more progressive. Suppose the government raised £5 billion that way. The question that proponents of tax funding must then answer is: why should that money be spent on the best and the brightest who will disproportionately go on to become the richest, rather than on nursery education, vocational education, action to improve the staying on rate post-16, and more generous grants?

A third set of supporting arguments notes that the proposals can be viewed from very different perspectives than their portrayal in the press. The White Paper can be regarded as restoring universal grants. Higher education is largely free at the point of use: the Student Loans Company squirts money into the student's bank account to cover her living costs and into the university's bank account to cover her tuition fees. The graduate subsequently makes income-contingent repayments, which differ from income tax in only two ways: they do not go on for ever, and they are paid only by people who have been to university and benefited financially from their degree. In short, income-contingent loans are logically equivalent to a grant financed by an income-related graduate contribution.
Another perspective is to think of student loans as extending social insurance. We pay national insurance contributions now so as to get our pension later, i.e. we redistribute to ourself over our life cycle. Student loans are exactly the same – students receive a 'pension' now for their university education, repaid through their own subsequent contributions.

Core argument 1: in conclusion, deferred variable fees are equitable.

- They resolve the serious inequities of tax funding, a graduate tax or flat fees.
- Those who can afford to pay a larger contribution do so, where 'can afford' refers to their income after graduation, i.e. to outcomes.
- The system protects access in two ways: students face no upfront charges; and graduates repay only if their earnings warrant.
- As illustrated in Figure 1, the system actively promotes access because it frees resources to increase the staying-on rate post-16 and to restore grants, thereby focusing resources on those who need help most, rather than spending wastefully and regressively on blanket subsidies.

Strategy element 2: the end of communism. Completely separately, variable fees shift the balance of power from the central planner and producers to students and employers by (a) giving universities an independent source of income and (b) strengthening competition.

Core argument 2: variable fees make funding open ended. If fees are set by government, rising fee income can be offset by falling taxpayer contributions. Thus government controls the total volume of resources going into higher education – funding is closed-ended. Australia is a graphic example: government introduced centrally-set fees in 1989 to address a funding crisis; the system is now back in crisis. Equally, and also predicted in our earlier article, the introduction of fees in the UK has not netted any extra money. A graduate tax has the same problem: government controls the volume of resources going into higher education, and universities compete in a zero sum game. With variable fees, universities have an independent income source. The central planner no longer determines the funding envelope.
Core argument 3: variable fees introduce competition. My support for competition is not ideological. Competition does not always improve outcomes. Most particularly, it is beneficial only where consumers and producers are well-informed. This, it was argued earlier, is the case for universities, but not for school education. Thus competition in higher education matters greatly, empowering the choices of students, and indirectly also employers. The change in the balance of power is fundamental to creating a diversified system fit for purpose in a technological age. This is not an argument for law-of-the-jungle competition. Government has an important continuing role, but as regulator and setter of incentives, not as central planner.

The resulting changes will be significant. The days are gone when higher education was based on a unitary model of 3 or 4 years of full-time academic study in institutions devoted to teaching and fundamental research. Diversity today has many dimensions:

- Period of study: it should be possible to study part-time, staying in one's current job. Equally, accelerated study should be possible, e.g. studying over the summer to complete a degree in 2 years, reducing living costs and facilitating earlier return to work.

- Level of degree: there should be a seamless line of progression from sub-degree study to undergraduate and postgraduate degrees.

- Coverage: degrees can and should cover increasingly diverse areas.

- Type of training: degrees can offer academic training, vocational training, or both. This is nothing new – medical degrees are high-quality vocational training.

- Type of research: research can be fundamental, or applied, or assisting local economic development. All are important; all are properly part of higher education.

The potential benefits from competition are large, but so are the resulting changes, creating political opposition. The supply side response is predictable. The White Paper strategy has profound implications for the management of universities. The elite universities – like Poland and Hungary in 1990 – welcome the new freedoms, but some institutions are unenthusiastic, seeing the new arrangements as more a threat than an opportunity. The demand-side response is also understandable. Students, like the Poles in 1990, see prices rising, but not yet the resulting benefits. Once the changes are in place, students should
greatly prefer the new system, which transforms their power by giving universities strong incentives to give them such things as accelerated courses and part-time options.

Making the strategy work

The previous section argued that the White Paper strategy promotes access by transferring resources from better-off to worse-off people, and promotes competition, and hence diversity. This section considers what needs to be done to ensure that the strategy is translated into action, discussing in turn actions to promote access, policy to ensure that central planning stays dead, and matters for future consideration.

Promoting access. If the White paper is to succeed in widening access, action is needed (1) to publicise what income-contingent loans mean, and (2) to improve further the student support package.

It is vital to increase public understanding of income-contingent loans. One of the roots of current problems is that David Blunkett responded to the Dearing Report in July 1997, at a time when the Inland Revenue had not yet agreed to collect repayments (which was not decided until November 1997), forgoing a golden opportunity to explain why the new loan scheme was dramatically better than the old one. Partly because of that timing problem, the government has been woeful in publicising income contingency; and the absence of such publicity has created a vacuum filled by a misplaced obsession with headline debt figures, fanned by lurid newspaper articles.

Income-contingency changes everything.

- Repayments are like income tax: people with low earnings make low repayments or no repayments; and repayments instantly and automatically track changes in a person's pay packet.
- A larger loan has no effect on monthly repayments, only on duration; thus
- Higher fees do not affect monthly repayments, and
- Larger maintenance loans do not affect monthly repayments; equally
- A higher interest rate does not affect monthly repayments.
Ministers should stop talking about debt, and instead concentrate on key messages:

- It is a payroll deduction, not debt.
- Students get their higher education free – it is graduates who make repayments, and then only to meet part of the costs and only if their earnings warrant.
- If it is unfair to ask graduates to pay more of the cost (as the proponents of tax funding argue), it is even more unfair to ask non-graduate taxpayers to do so.

Nor should the size of the debt be exaggerated. A £20,000 loan seems large because people (and newspapers) focus on the stock of debt, rather than the flow of repayments. Yet we mostly think about expenditure in flow terms, so that cumulative totals seem shocking. On plausible assumptions over a 40-year career a current graduate will pay (in cash terms) about £850,000 in income tax and national insurance contributions, and will spend about £½ million on food. As an alternative comparator, it is possible to repay £10,000 of student debt in 10 years by giving up a smoking habit of 20 cigarettes a day. Quite rightly, no student or parent loses sleep over a career tax debt of approaching £1 million, because he/she looks at such figures through the other end of the telescope – i.e. in terms of monthly, income-related repayments rather than as cumulative totals. Student debt – given income-contingent repayments – is the same. It is not like a bank overdraft or credit card bill, but a payroll deduction alongside income tax and national insurance contributions.

A second set of actions to promote access is to improve the student support package, to ensure the outward shift of the demand curve in Figure 1. The full grant should be higher. As discussed earlier, students from poor backgrounds may be less well-informed and hence debt averse. Thus grants are an essential element in promoting access.

The maintenance loan should also be higher. Because the current loan does not cover realistic living costs, many students face a combination of poverty, heavy and expensive credit card/overdraft debt, and excessive hours in part-time work. Debt aversion arises in part because student loans and credit-card debt become conflated in people's minds.

The continuing interest subsidy, however, makes larger maintenance loans costly. One way out is as follows. Suppose realistic living costs outside London are £6000. The government should offer all students a second maintenance loan of £X, where £X is the...
amount that brings a student's total maintenance package to £6000, at a stroke eliminating student poverty and abolishing compulsory parental contributions. Similar loans should be offered to postgraduates. The interest rate on the second loan should equal the government's cost of borrowing.

The political difficulties of such a move should not be exaggerated. Students would welcome both the improvement in their standard of living and the fact that they could borrow the extra money at the government's borrowing rate rather than the credit card rate.

*Ensuring communism stays dead.* The second leg of the White Paper strategy is a more competitive environment for higher education. Ensuring that the policy intent takes place requires (1) consideration of the fees cap and (2) a sustained real funding increase over the medium term.

The fees cap 'will apply throughout the life of the next Parliament, and it will rise annually in line with inflation so that it keeps its real value' (White Paper, para. 7.31).

The cap needs to be high enough (a) to pay the best universities the rate for the job and (b) to bring in competition, and low enough (c) to ensure that the White Paper proposals are politically sustainable and (d) to give universities time to put in place management suitable for a competitive environment.

Given these criteria, the initial cap of £3000 is probably right. However, its duration – the life of the next Parliament – is too long. If the cap is too low for too long, a critical bulk of universities will charge the maximum, approximating a system of flat fees. The result will be to reintroduce closed-ended funding and thus to restore central planning by the back door.

It is equally necessary to ensure a sustained increase in university income. In the medium term, more resources will come through variable fees. However, clawback by the Treasury over the next 10 years (as in Australia) would put quality at risk. From 2006, students will face higher fees. If the quality of their university experience fails to match those higher fees, the new arrangements could come under political threat. Adequate tax funding during the initial phase is therefore essential.
Matters for future consideration: reducing the interest subsidy. As with the fees cap, it is important to introduce reforms that are politically sustainable. Even so, it is worth another look at the interest subsidy, since its cost considerably dilutes the redistributive power of the proposals, putting at risk the pro-access leg of the White Paper strategy.

As discussed earlier, the blanket interest subsidy achieves not a single desirable objective. The White Paper proposals aggravate matters by increasing the cost of the subsidy. First, loans will be larger, to cover tuition fees, increasing the cost of the interest subsidy proportionately to increased loan outgoings. In addition, the repayment threshold will be increased from £10,000 to £15,000, the effect of which is to increase the cost of the subsidy disproportionately. The combined effect of the two changes could easily increase the cost of the subsidy to £1.2 billion per year.\footnote{11}

As explained earlier, that expenditure is targeted with exquisite accuracy on exactly the wrong people at exactly the wrong time. The resources could and should be used instead to finance a series of pro-poor policies.

- There should be more assistance for poor students at university, including (a) a larger grant, (b) raising the income threshold below which people qualify for a grant, and (c) offering ‘super grants’ covering all costs, to some students in their first year.
- There should also be better support for the generality of students, including (d) increasing the full maintenance loan, and (e) abolishing the income test; all students are eligible for a full loan, thus abolishing compulsory parental contributions.
- More generous assistance for people with low incomes after graduation should include (f) freezing the real value of debt for people with low income (i.e. a targeted subsidy), covering low-income workers and people who are unemployed, (g) giving a similar subsidy to people taking career breaks to care for young children or elderly dependants (even better, government could signal its support for such activities by writing off 5 per cent of outstanding debt for each year of caring activities), (h) writing off (say) 10 per cent of the debt of nurses in the NHS and teachers in the state education system for each year of service, and (i) restoring debt forgiveness after 25 years, thus offering protection to people with low lifetime earnings. In present-value terms the cost of giving up repayments in later years is small.
The Department for Education and Skills argues that such mechanisms are complex and expensive to administer. Neither argument stands up. The correct argument is the opposite: eliminating the blanket interest subsidy makes it possible to eliminate the income test for loans, thus significantly reducing administrative costs.

Again, the political difficulty of such moves should not be overstated. The Netherlands and Sweden charge a positive real rate, a matter that is taken for granted in those countries. A higher interest rate does not add a penny to a student's monthly repayments, nor affect the headline debt figure. And a commitment by government to spend the resulting extra resources on the targeted interventions just described would make it difficult for the National Union of Students to argue against the move without laying themselves open to charges of fighting to protect middle-class perks using access as a fig leaf.

Conclusion: two futures

The White Paper aims to do two fundamentally important things.

- To shift resources from today's well-off to today's and tomorrow's worst off. Those who can afford to pay more do so, releasing resources for targeted transfers.
- To end communism. Variable fees create competition, shifting the balance of power from the central planner and producers to consumers.

Will the strategy succeed? The answer depends on the political will to follow through, in particular to:

- Improve information about the deal for students. The single most important and immediate task for government is to create understanding that repayments are not debt, but a payroll deduction.
- Reduce the interest subsidy to release resources for the access strategy.
- Relax the fees cap over time to ensure that the end of communism is irreversible.

Outcome 1: Failure to take off: a political downward spiral. The story is of:

- Failure to convince students and their parents that this is not a case of heavy debt; political ructions continue. Hence
Inability to reduce the interest subsidy, hence insufficient resources to promote access and continuing rationing of loans by the Treasury, further aggravating the politics of higher education finance, and hence

• Inability to raise the fees cap, restoring communism and its companion, underfunding.

As a result, in five years time we will be back in crisis, as in the incomplete reforms of 1997. But this time would be a final farewell to world class universities.

**Outcome 2: Take off: a virtuous political spiral.** With political leadership, the beneficial outcomes are self-reinforcing.

• Publicity and education get student debt from the overdraft bit of people's brain to the payroll deduction bit.

• In a calmer political environment, it is possible to reduce the interest subsidy, freeing a large volume of perversely-targeted resources for the many pro-poor, pro-access policies outlined earlier, further improving the politics of reform, hence,

• The fees cap can be raised in stages, bringing in the benefits of competition and increasing resources for universities.

The result is a vibrant, diverse and responsive system of higher education, at its best world-class, with strongly progressive funding matching the brightest students with the best universities irrespective of their socioeconomic background.

The strategic lessons for other countries are clear. With mass tertiary education:

• Variable fees are essential for quality and diversity.

• In the interests of access, however, fee charges should be deferred through a loan entitlement.

• Loans should have income-contingent repayments, and should attract an interest rate broadly equal to the government’s cost of borrowing.
Acknowledgements

This paper draws on Iain Crawford's and my 15-year collaboration, on assistance from Colin Ward and his team at the Student Loans Company on factual matters and administrative feasibility, and on work by the three of us advising the Hungarian government. A fuller version of this paper is published as Nicholas Barr, ‘Financing Higher Education in the UK: The 2003 White Paper’, memorandum to the Education and Skills Committee's inquiry into the White Paper ‘The Future of Higher Education’, HCxxx, TSO, 2003, pp. yy-zz (henceforth Barr, 2003), downloadable from http://econ.lse.ac.uk/staff/nb.

Notes


3 Australia and New Zealand already have such a system; for discussion of higher education finance in other countries, see Barr, 2001, op. cit., Ch. 13.


5 See Polly Toynbee, 'Help toddlers, and then let students pay their own way', Guardian, 22 January 2003.


8 Ibid., p. 78.

9 For assessment of the Dearing Report and the government’s response, see Barr and Crawford, op. cit.

10 Students and parents have legitimate worries, but mostly exaggerated or misplaced – see Barr, 2003, op. cit., paras 121-130.

11 Ibid. paras 104-120 for fuller discussion.

12 Ibid., paras. 107-119.
Figure 1: The White Paper's twofold strategy to promote access