

Institute for  
Fiscal Studies

# The public finances, the HE sector and social mobility

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Paul Johnson

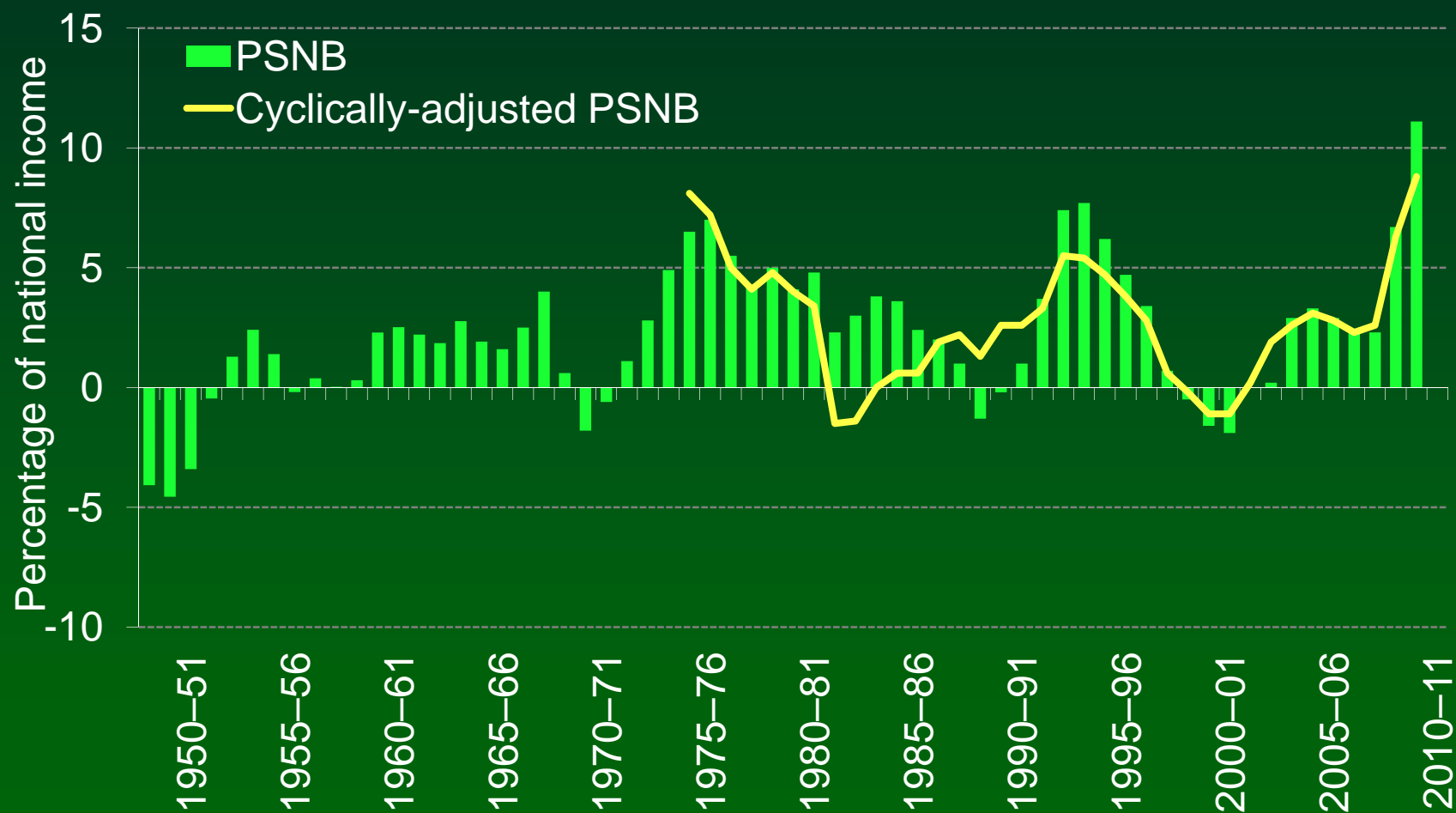
# Outline

- The public finances
- And the changing shape of public spending
- The HE reforms
- Social mobility

# The public finances

- The deficit reached its highest level since the war

## Deficit hit a post WW2 peak



Source: IFS calculations; HM Treasury; Office for Budget Responsibility.

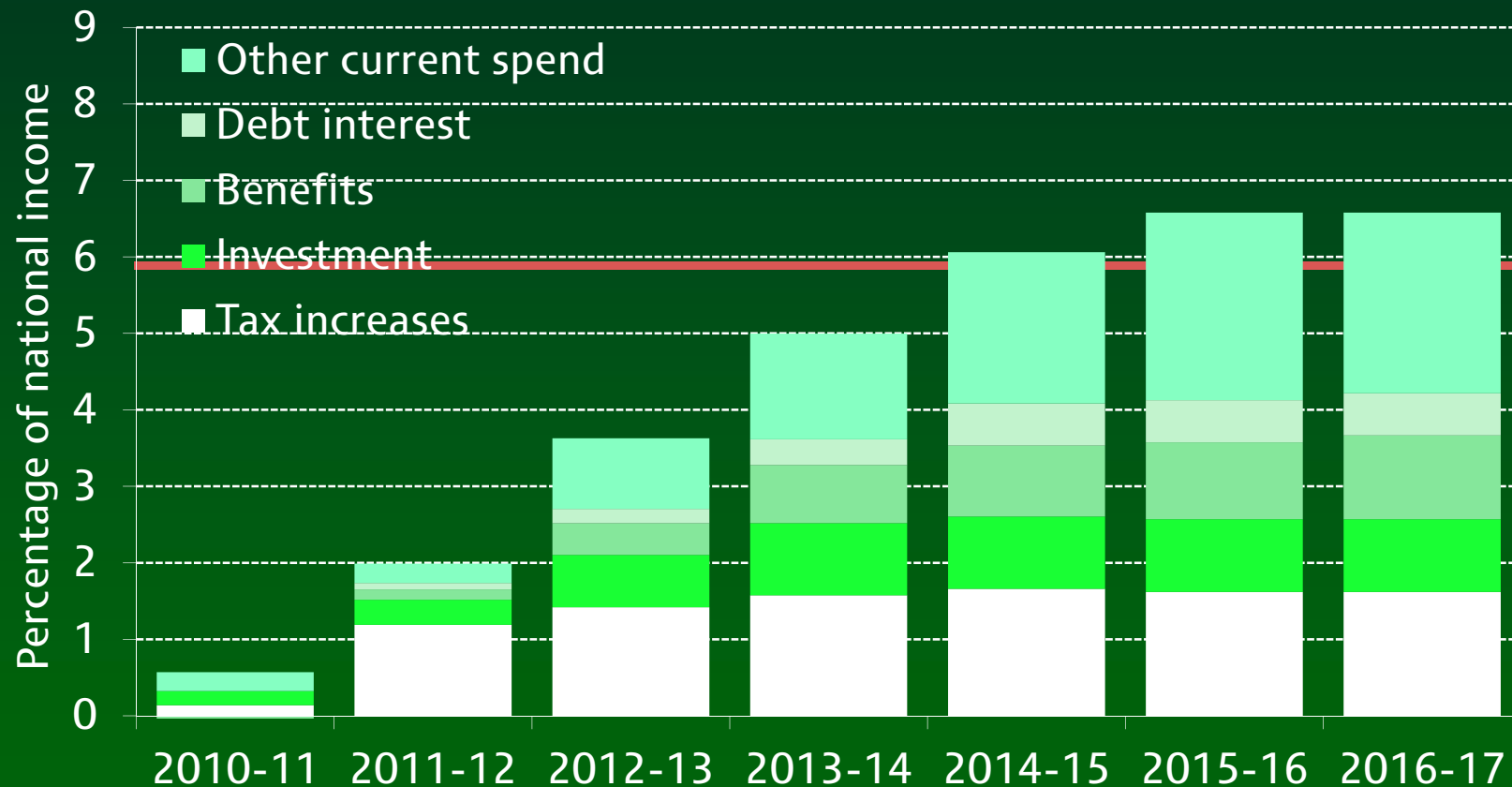


# The public finances

- The deficit reached its highest level since the war
- The structural deficit now thought to be £114 billion
  - Trend GDP in 2016 forecast to be 13% below where it would have been had pre-2008 trend continued
- Response is a huge fiscal tightening

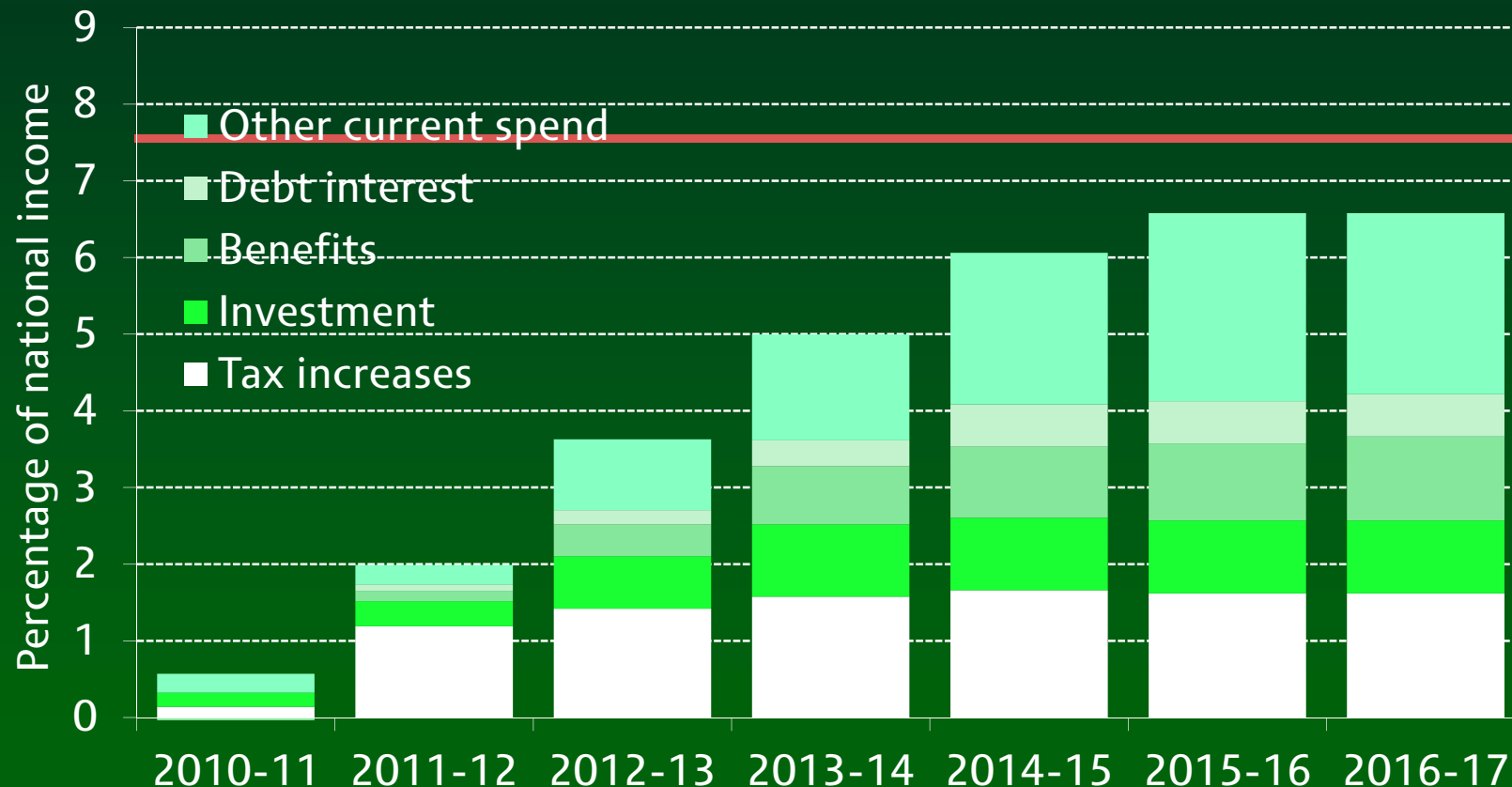
# Fiscal tightening, March 2011

March 2011: £91bn hole in public finances



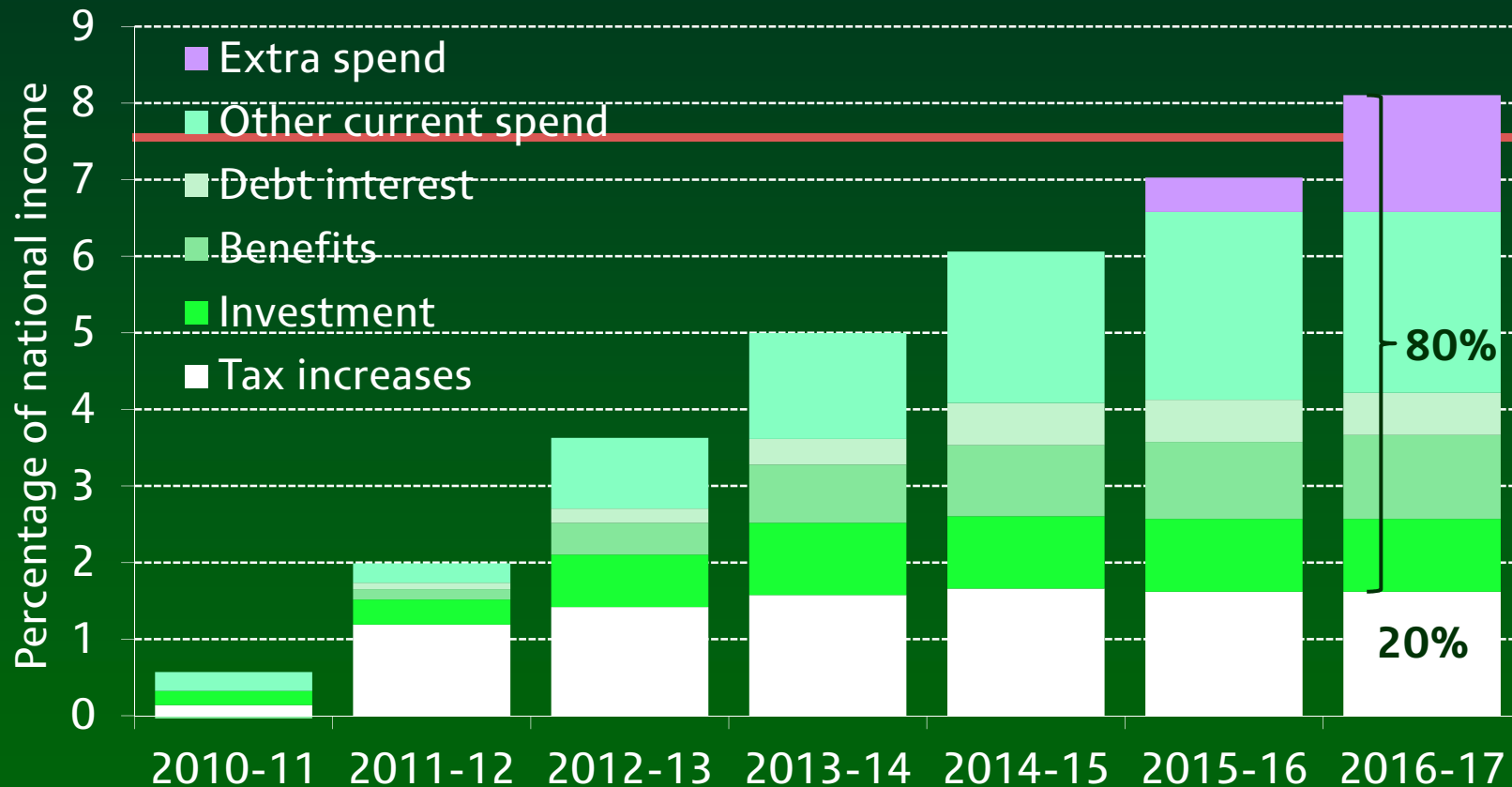
# Fiscal tightening, November 2011: more to do

Nov 2011: £114bn hole in public finances



# Fiscal tightening, November 2011: more to do, some more done

Nov 2011: £114bn hole in public finances

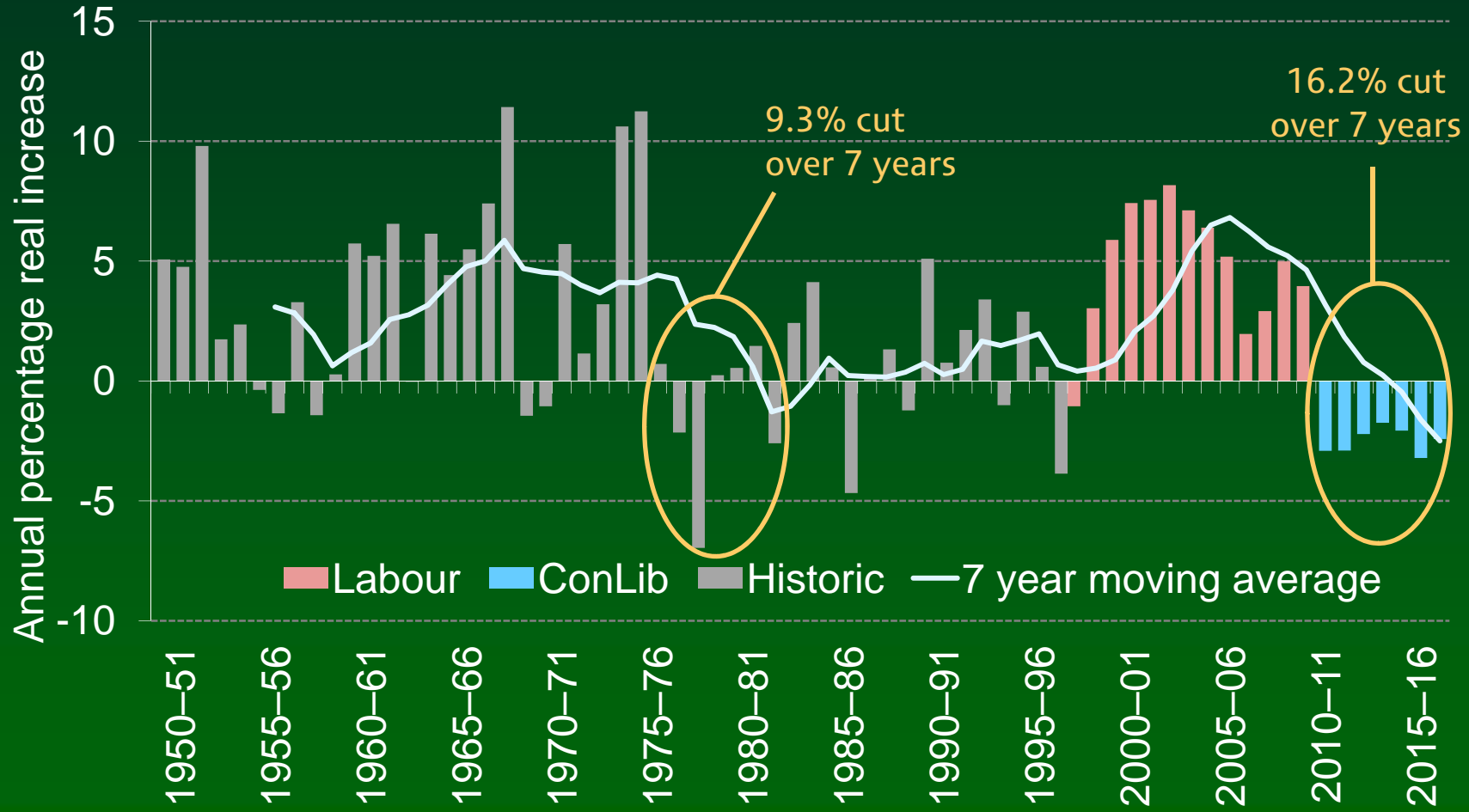




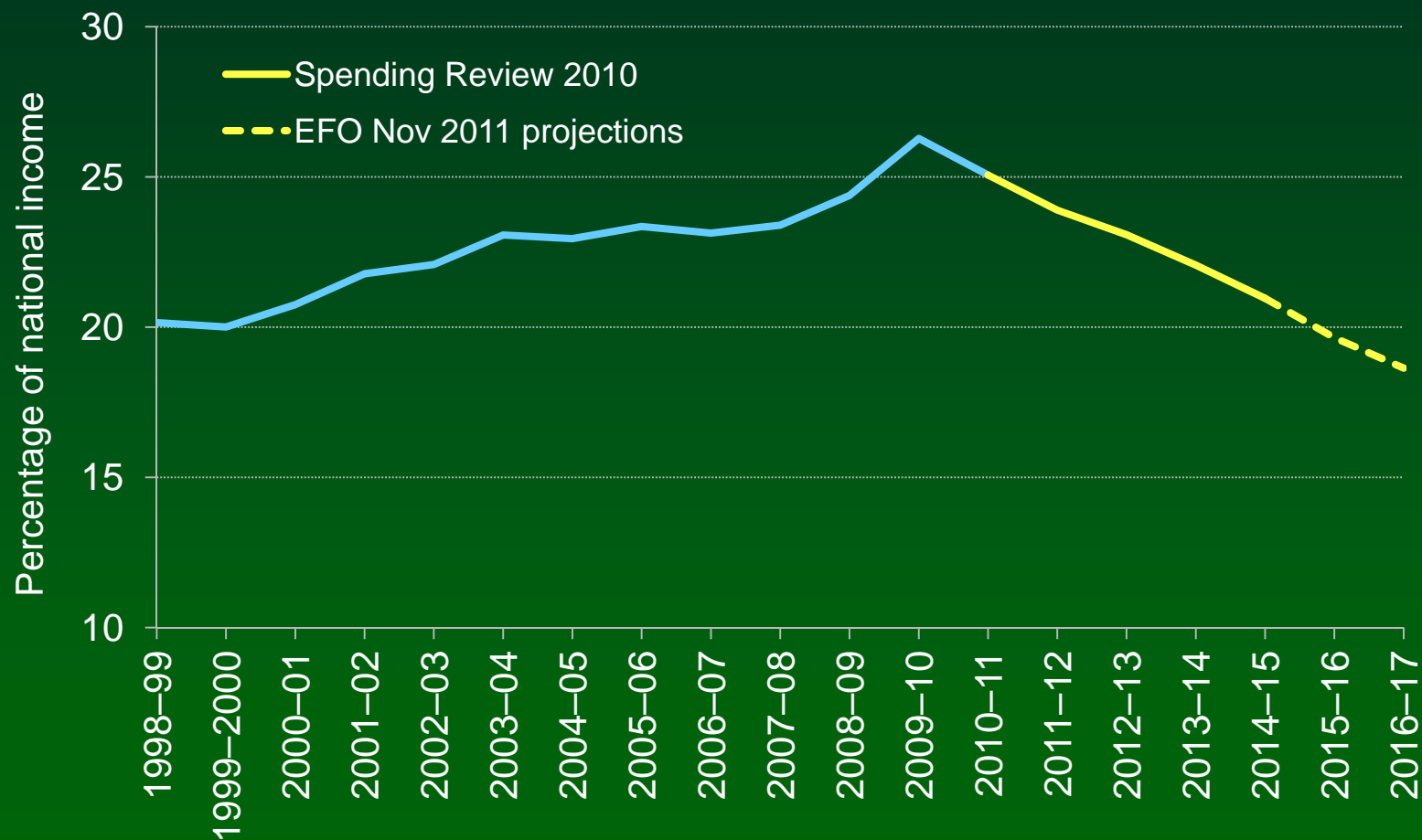
## On current plans

- Tax rises largely in place
- Dramatic public spending cuts to come

7-year  
~~6-year~~ squeeze on public service spending

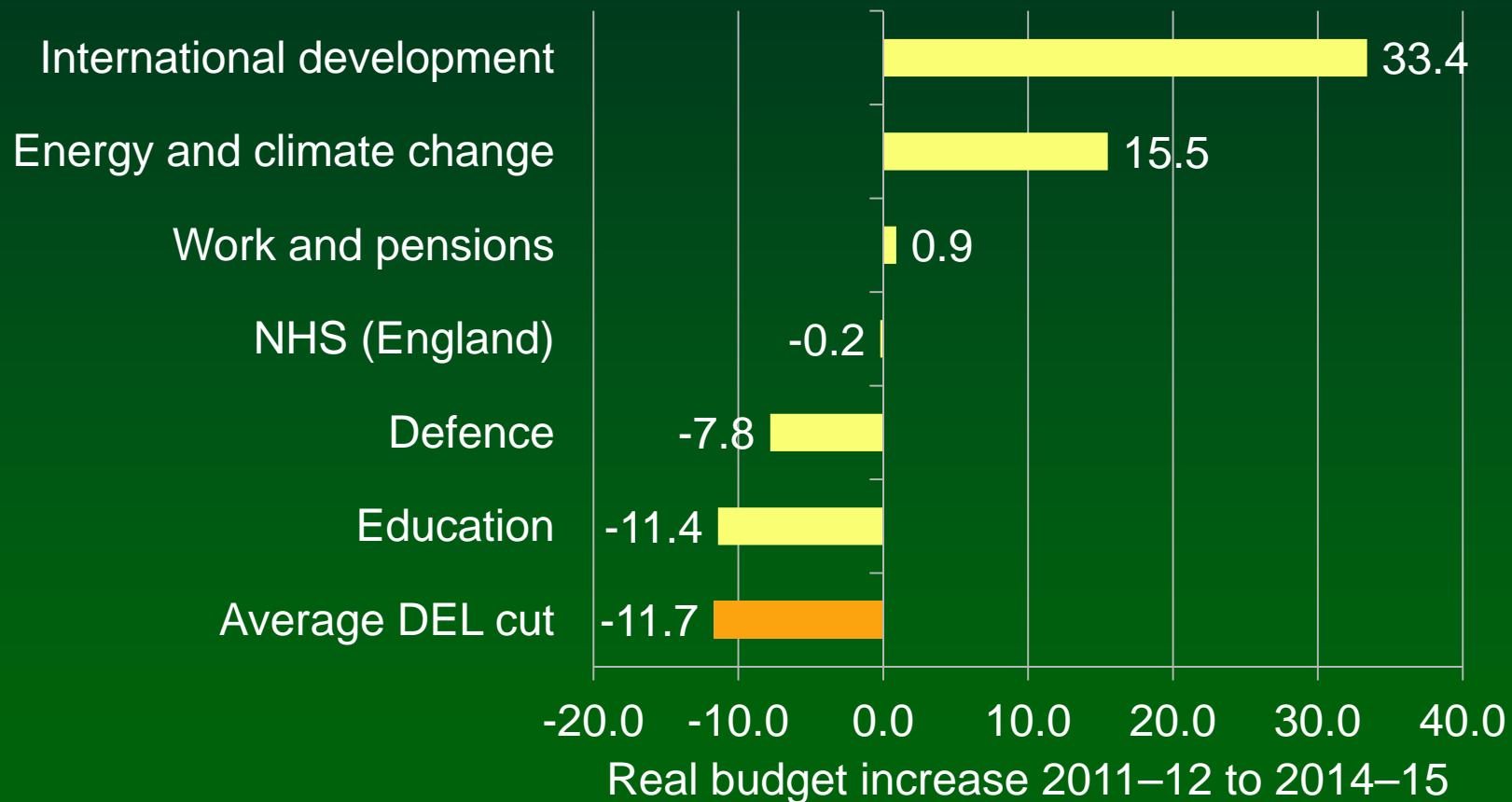


# Returning DELs to pre 2000 levels as a % of GDP

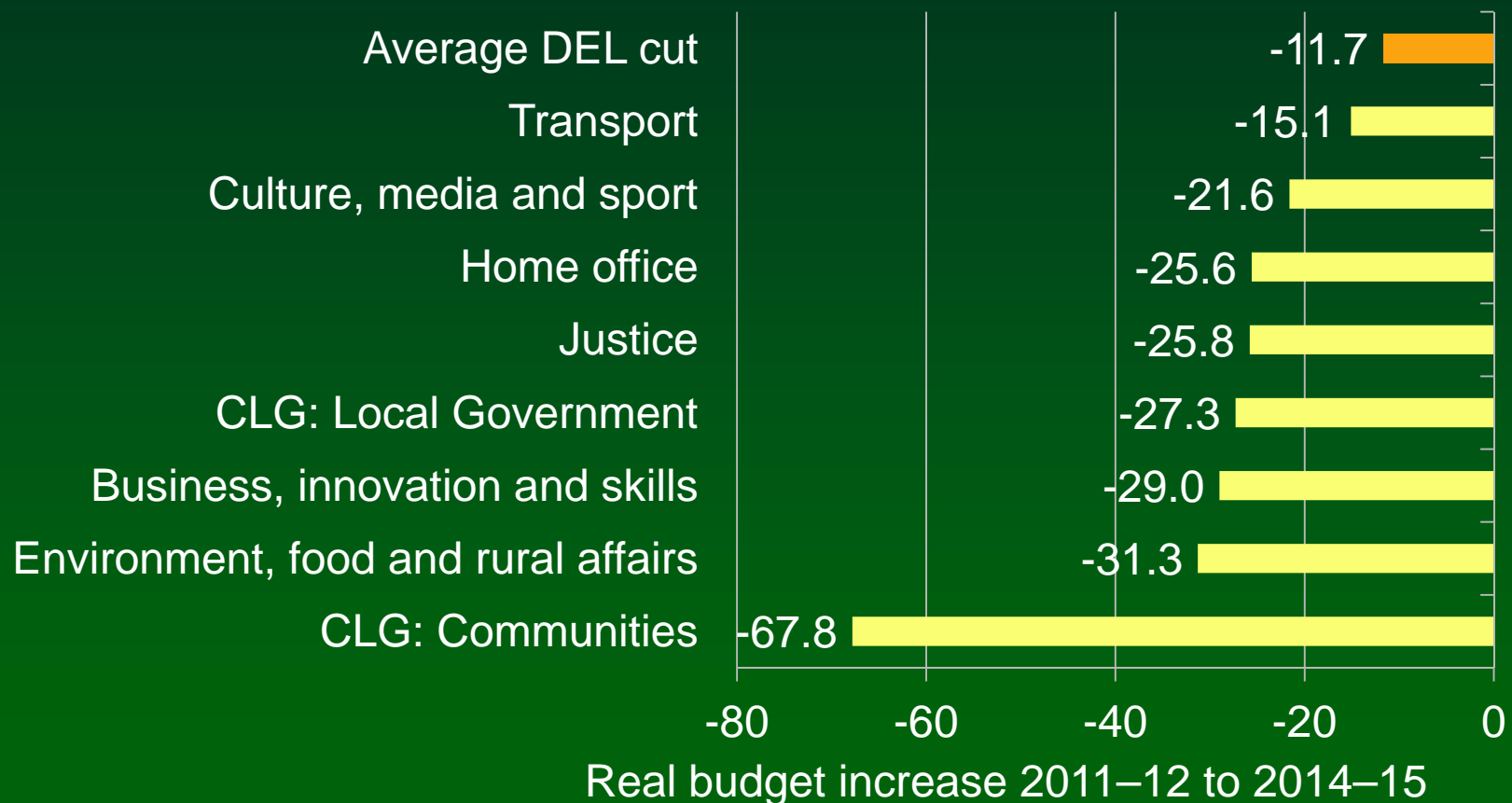


Note: Figure shows Departmental Expenditure Limits (DELs) as a share of national income under current policies, assuming no further changes to Annually Managed Expenditure policies.

## With an uneven spread between departments



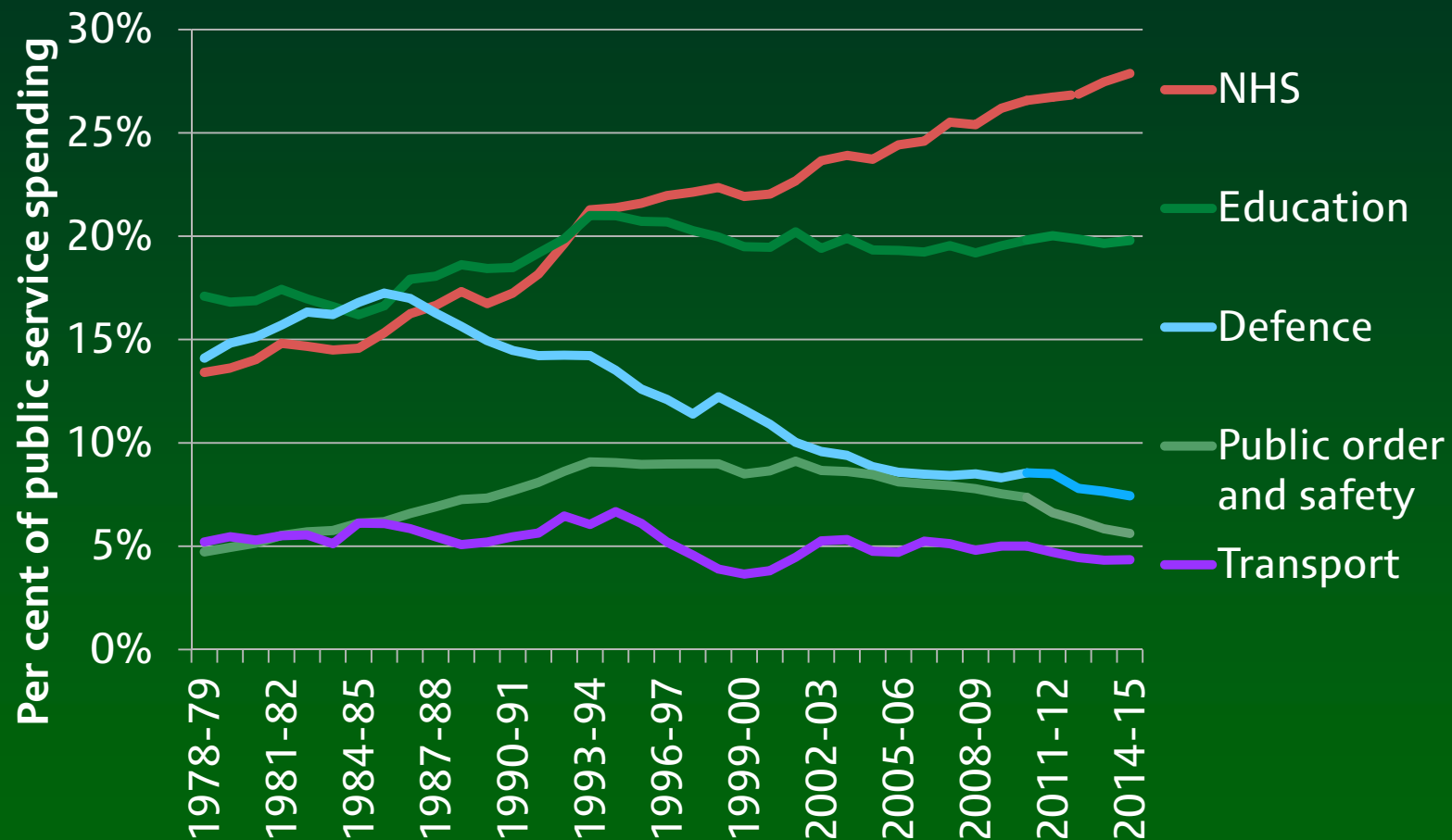
## Some being very big losers



## Continuing change in the shape of the state

- Actually this doesn't represent a big change in priorities

## No change in 'priorities'

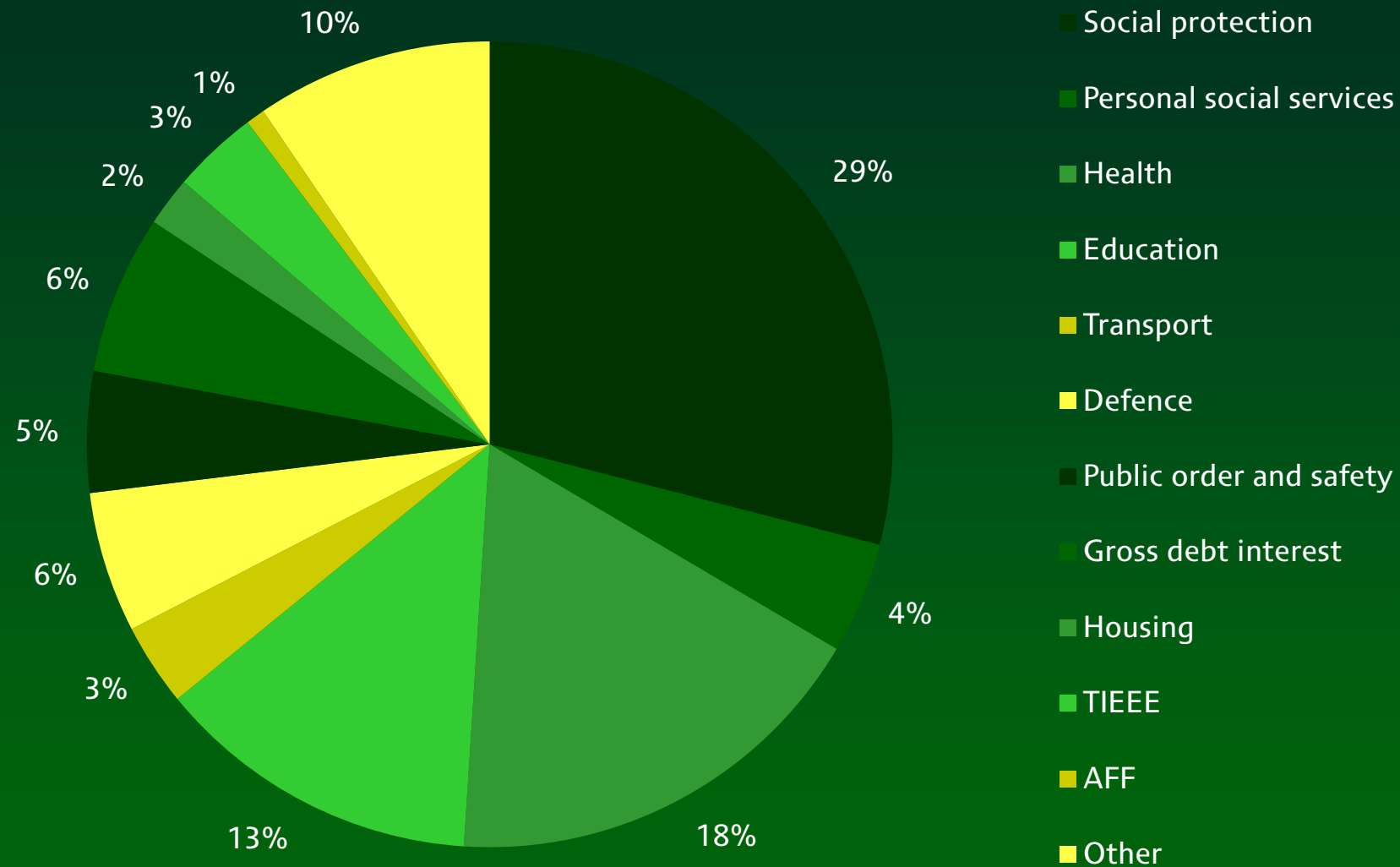


## Continuing change in the shape of the state

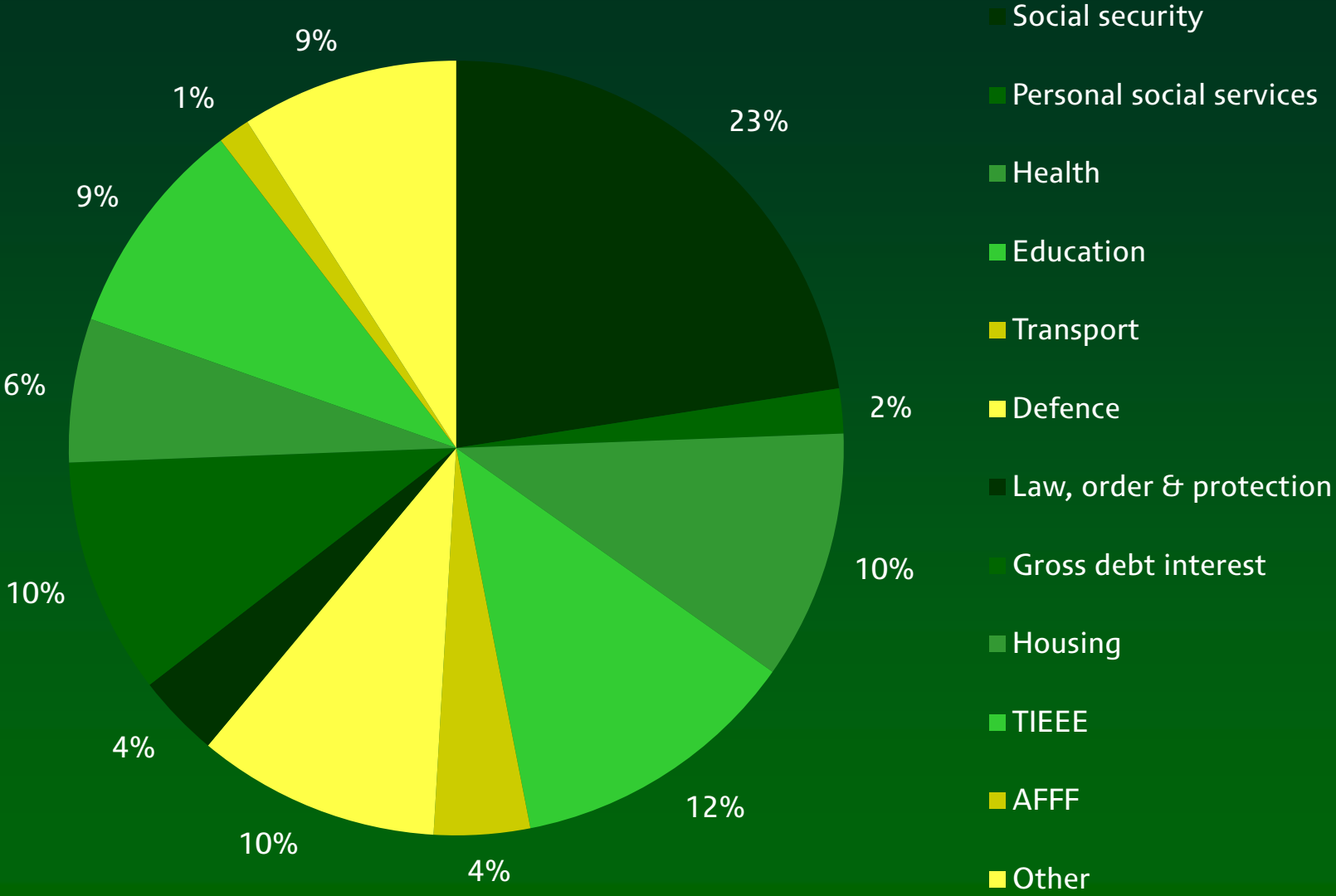
- Actually this doesn't represent a big change in priorities
- Health, social protection and education account for two thirds of public spending
- Up from less than half in 1979
- Increase results from health and social protection
  - Education has merely maintained its share
- Defence, housing and support for business and industry have taken the strain



# Public spending in 2010-11



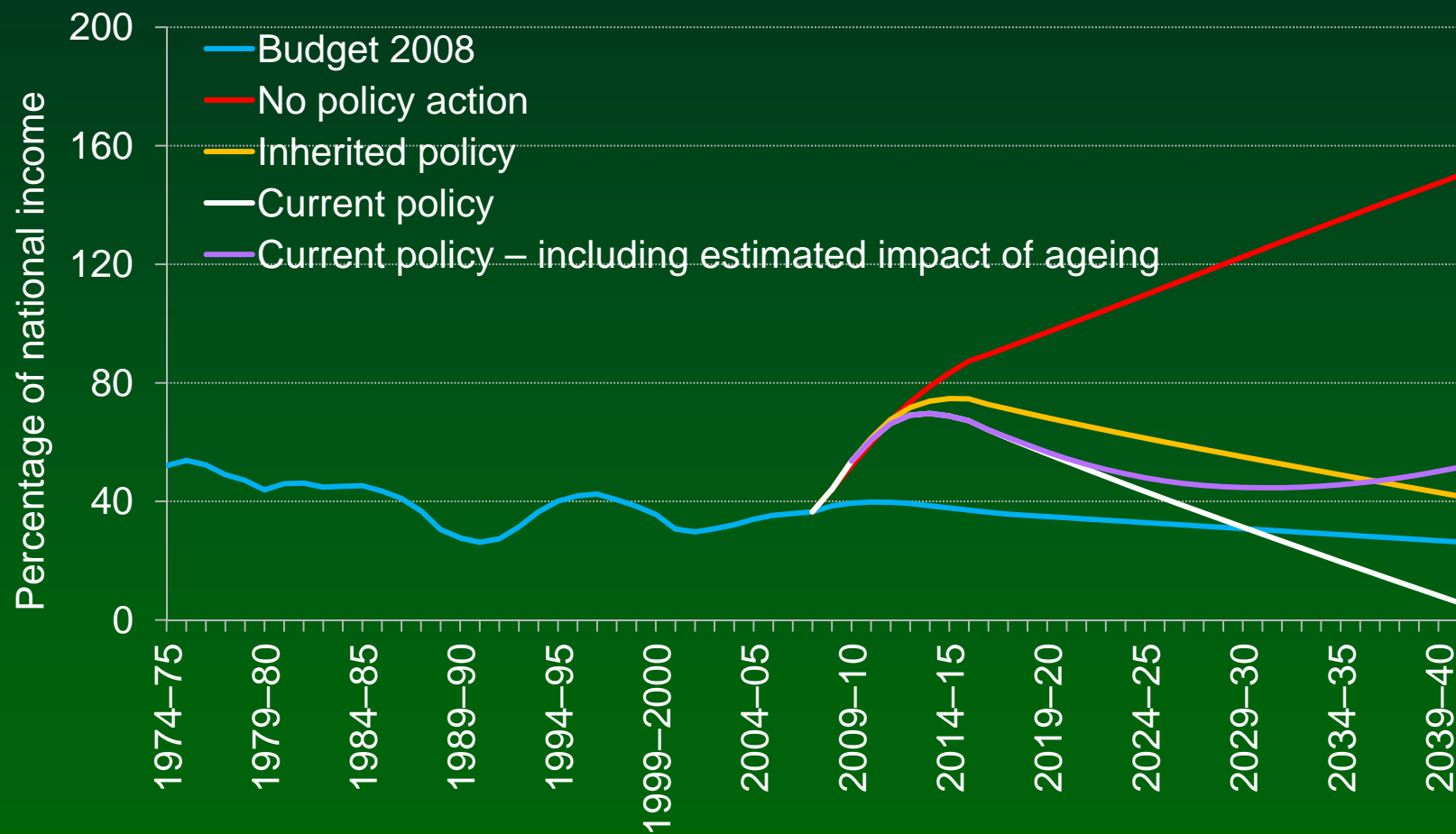
# Public spending in 1978-79



# Demographic pressures going forward

- Mean that even the current austerity programme won't set us on a path to long term sustainability

## Debt not back to pre-crisis levels for a generation



## Going forward state is set to change further

- OBR projections by 2060:
  - Pension spending to rise from 5.5 to 7.9% of GDP
  - Health spending to rise from 7.4 to 9.8% just due to ageing. And likely to rise faster
- So a minimum of £80 billion tax increases and spending cuts to find
  - And pressures on e.g. motoring taxes likely to increase that

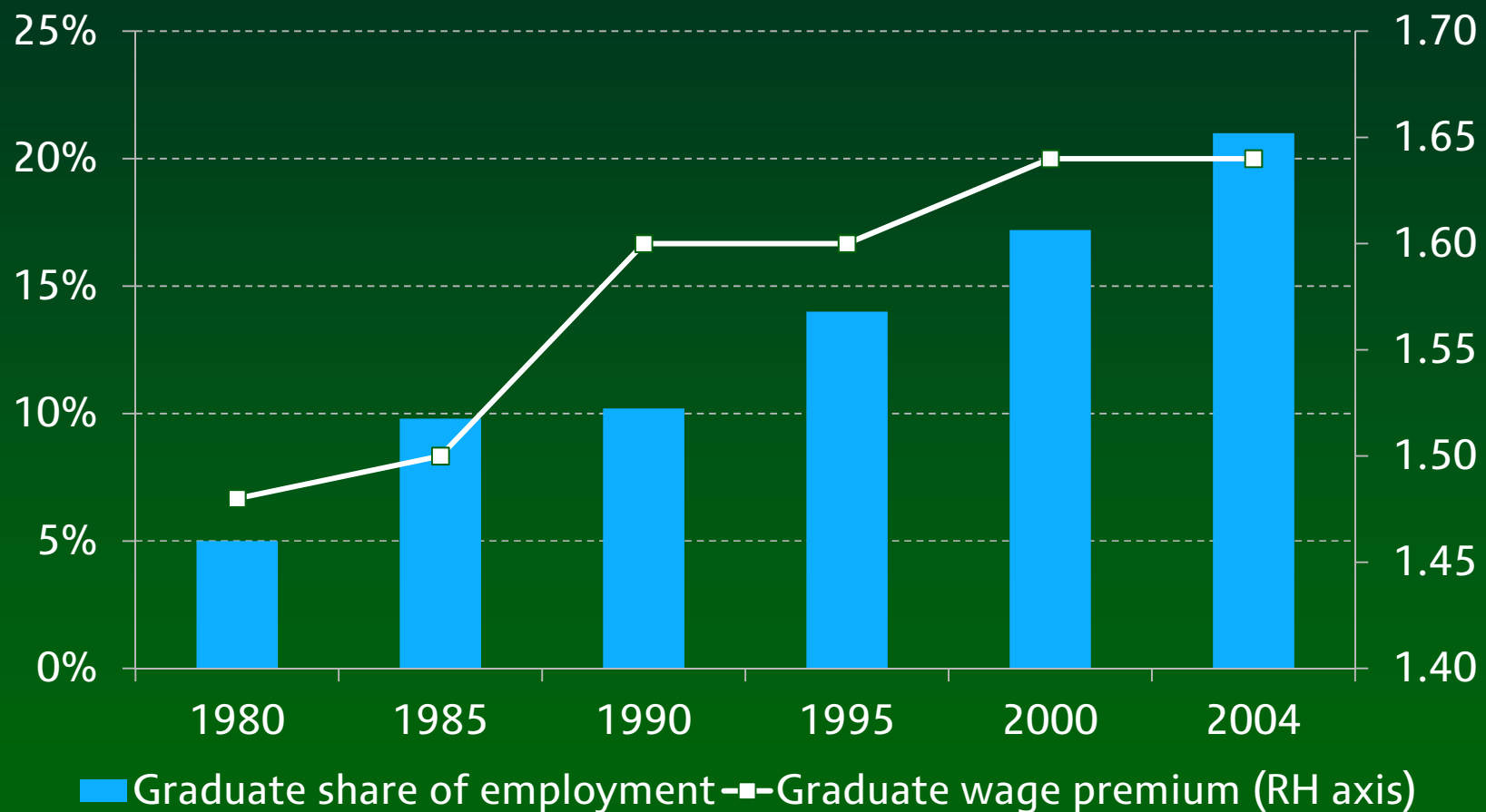
## With the result that

- If state remains same size health and pensions alone could account for more than a half of non-interest spending by 2060
- Unless
  - Total spending increases
  - Other spending falls even more sharply
  - Health spending is reformed and reined in

## Context for HE spending

- Continuing short term pressure from slow growth and deficit reduction
- In longer term the pressure from health and pensions will squeeze all other spending
- Of course spending on research remains important component of *long term* growth policy
- And maintenance of graduate premium in face of huge expansion in numbers

# More young people are graduating from university, yet the wage premium remains high



Source: Machin, S. & S. McNally (2007), *Tertiary Education Systems and Labour Markets*, report to the OECD for the Thematic Review of Tertiary Education, available at: <http://www.oecd.org/dataoecd/55/31/38006954.pdf>.



# Government response to the Browne Review

## 1. Fees

- “Soft cap” of £6,000, absolute cap of £9,000

## 2. Support

- Means-tested maintenance loans
- Tighter maintenance grants (relative to Browne)
- Scholarships

## 3. Repayment

- Increase repayment threshold to £18,500 (as in Browne)
- Lengthen write-off point to 30 years (as in Browne)
- Tapered interest rates
  - 0% real if earn less than £18,500, 3% real if earn at least £36,800

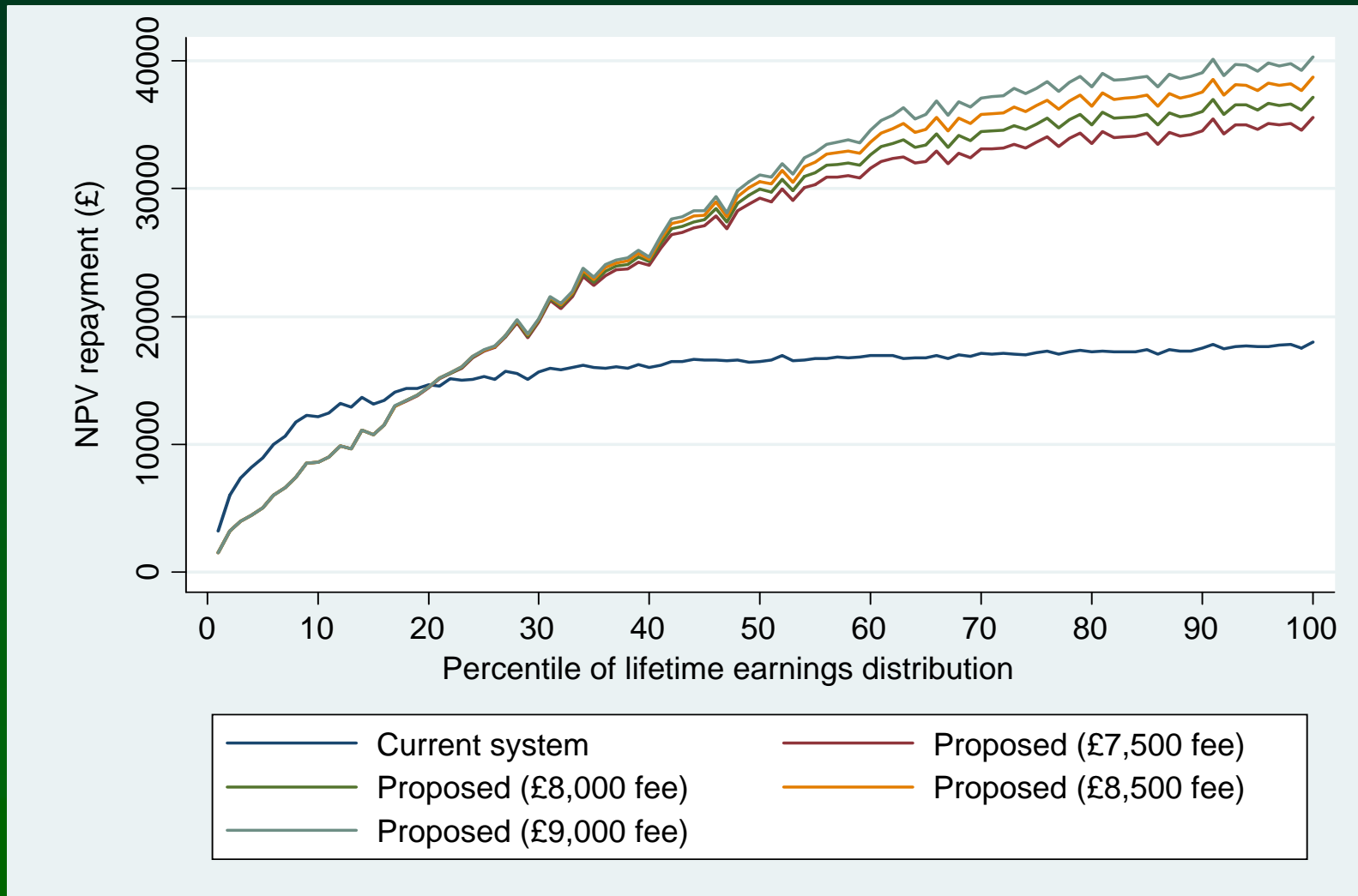
# Overall

- On average graduates are worse off
  - But repayment schedule highly progressive
  - Poorest  $\frac{1}{4}$  of graduates will be better off
- Low-earning graduates pay an effective graduate tax
  - Increases in fees  $\rightarrow$  increase amount of debt written off
- University teaching grant to be cut by around 80%
  - Universities lose roughly £3,300 per student per year (on average) in HEFCE funding
  - To compensate for this, need to charge £7,000 fees or more

## Implications of higher than expected fees

- Government proposals costed assuming average fee of £7,500
- If fees are set higher:
- Winners: universities (more fee income)
- Losers: graduates (more repayments) and taxpayer (more write-off)
  - If fees are £9,000 instead of £7,500, only half of extra money lent out is repaid – other half is written off
- Students unaffected (until they become graduates)

# Higher fees lead to high earners paying more but little effect on lifetime low earners



## And higher fees are costly for public finances

Average fee	Loan subsidy (%)	Loan subsidy (£) per graduate	Exchequer cost relative to £7,500 fee
£7,500	28.1%	£9,800	£0
£8,000	29.0%	£10,510	£258 million
£8,500	29.8%	£11,240	£525 million
£9,000	30.6%	£12,000	£802 million

- If fees were £9,000 across the board, taxpayer saving would be 40% lower than Government expected

## Progressive nature of repayment means

- Low earning graduates pay back less than they borrow
- Incentive for HEIs to charge high fees to students whose repayments are largely unaffected
  - Straight transfer from taxpayer to university
- Ideally you'd levy an institution specific fee based on future earnings of graduates
- Basic difficulty created by mismatch between “price” and “cost”
- Response – inevitable complexity and regulation

## Effects on competition may be less than hoped

- Mismatch between price and cost will blunt effects
- As will excess demand for places
- In a market with imperfect information and high value of reputation price could be seen to signal quality

## Summary

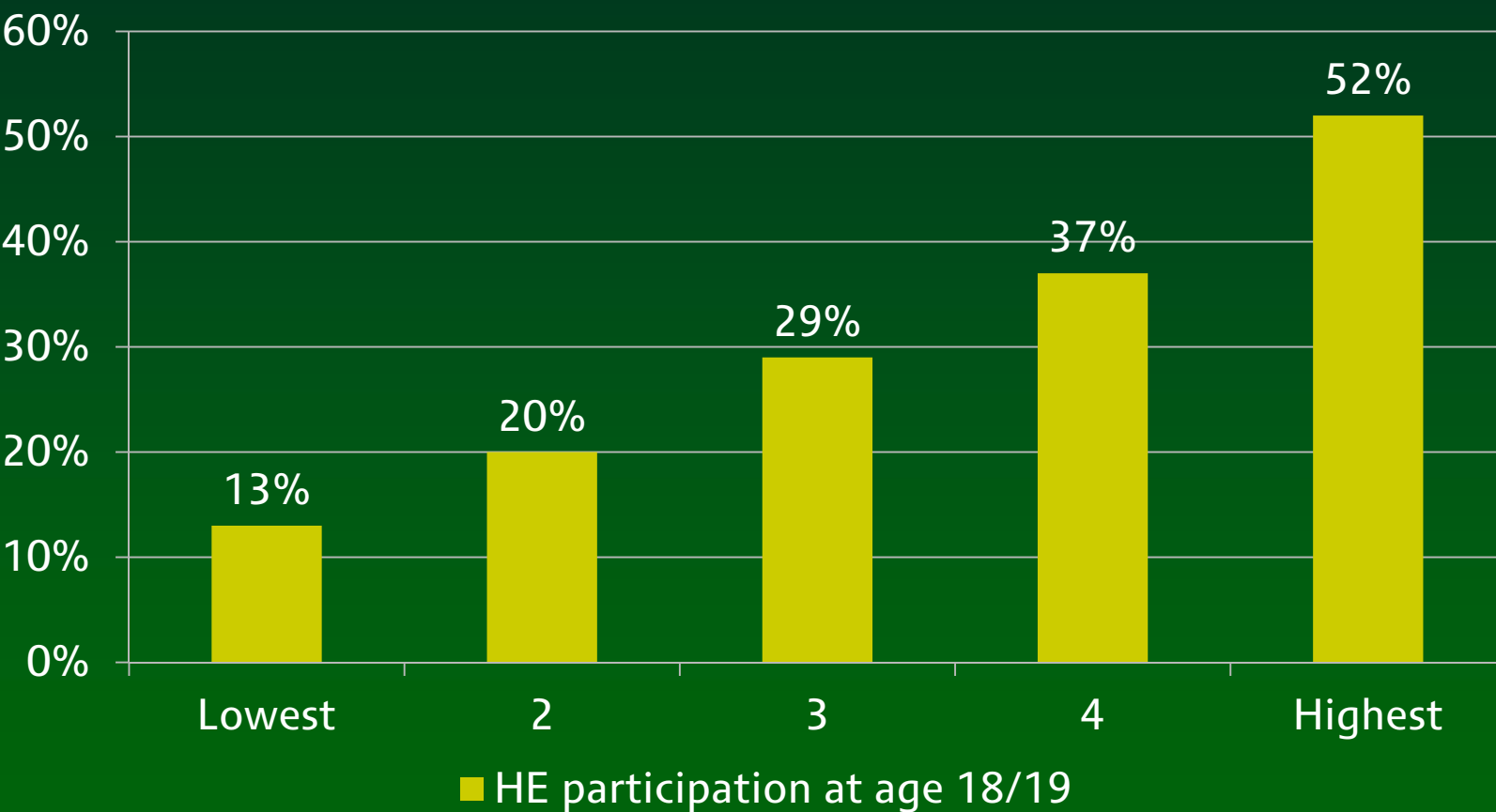
- Government was major 'winner' of Browne recommendations and its own proposals
  - Universities also benefited slightly
- Graduates were major 'losers' (on average)
  - Even more so with higher than expected fees
  - But lowest earnings graduates pay less and are immune to higher fees
- Higher than expected fees transfer an additional benefit from Government and graduates to universities
  - This split is about 50:50



## What about social mobility?

- Obvious concerns that higher fees will affect participation decisions
- We start from a world of very different levels of HE participation by social background

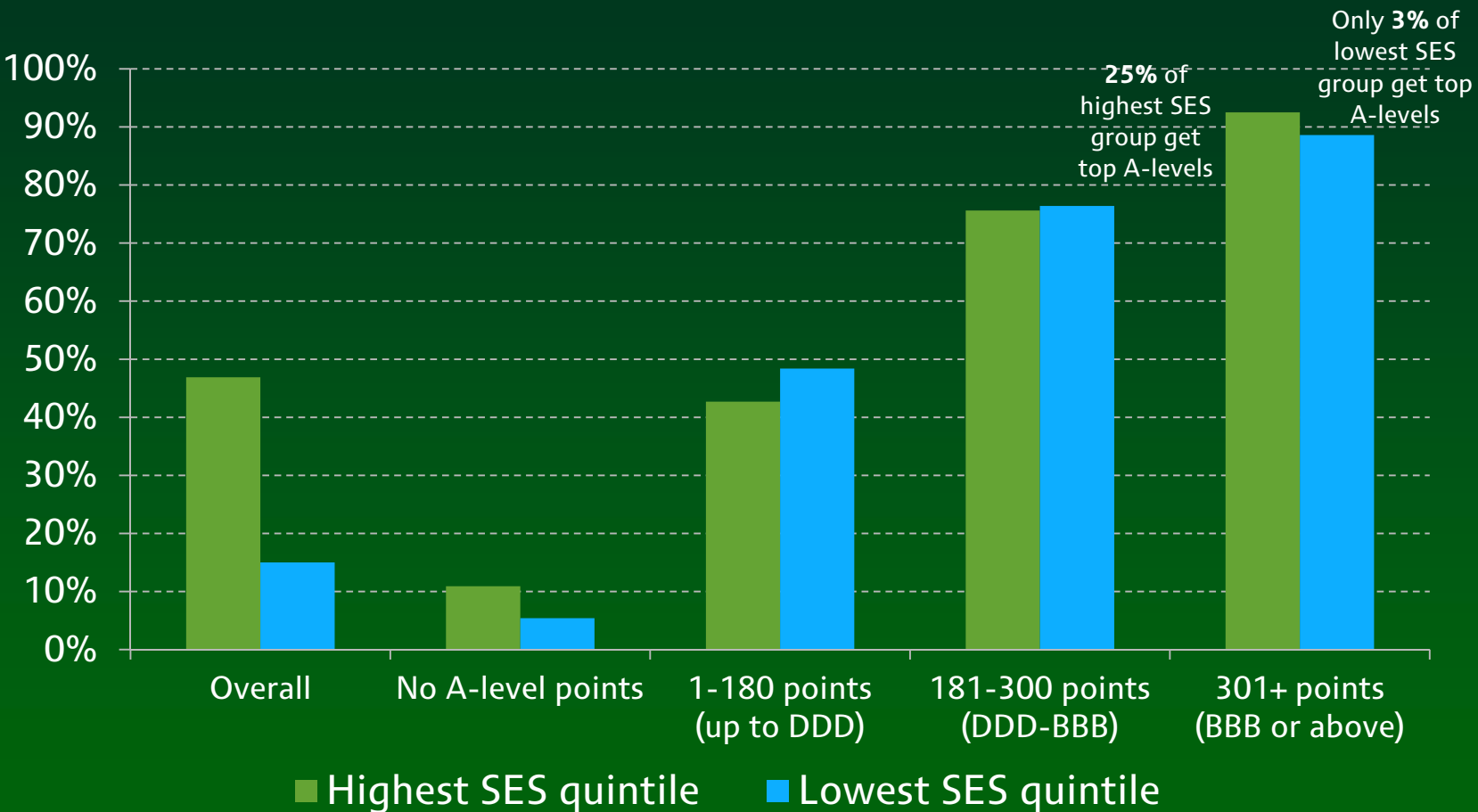
## Strong relationship between family background and HE participation



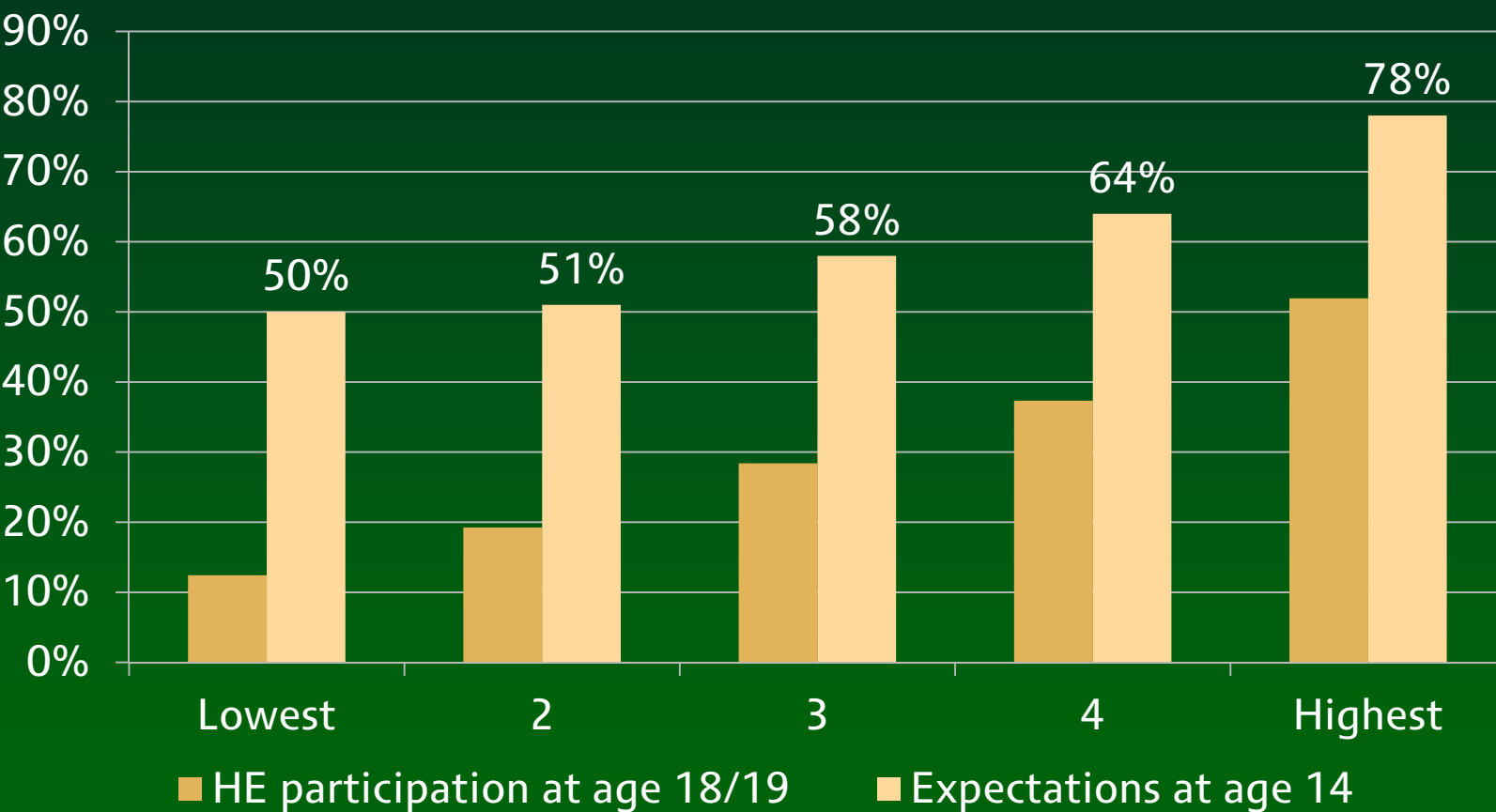
## What about social mobility?

- Obvious concerns that higher fees will affect participation decisions
- We start from a world of very different levels of HE participation by social background
- Though limited evidence on effects of previous changes
- And difference is almost entirely driven by prior achievement

# Instead they are almost entirely explained by differences in prior attainment



## And not, it seems, by a dearth of aspirations

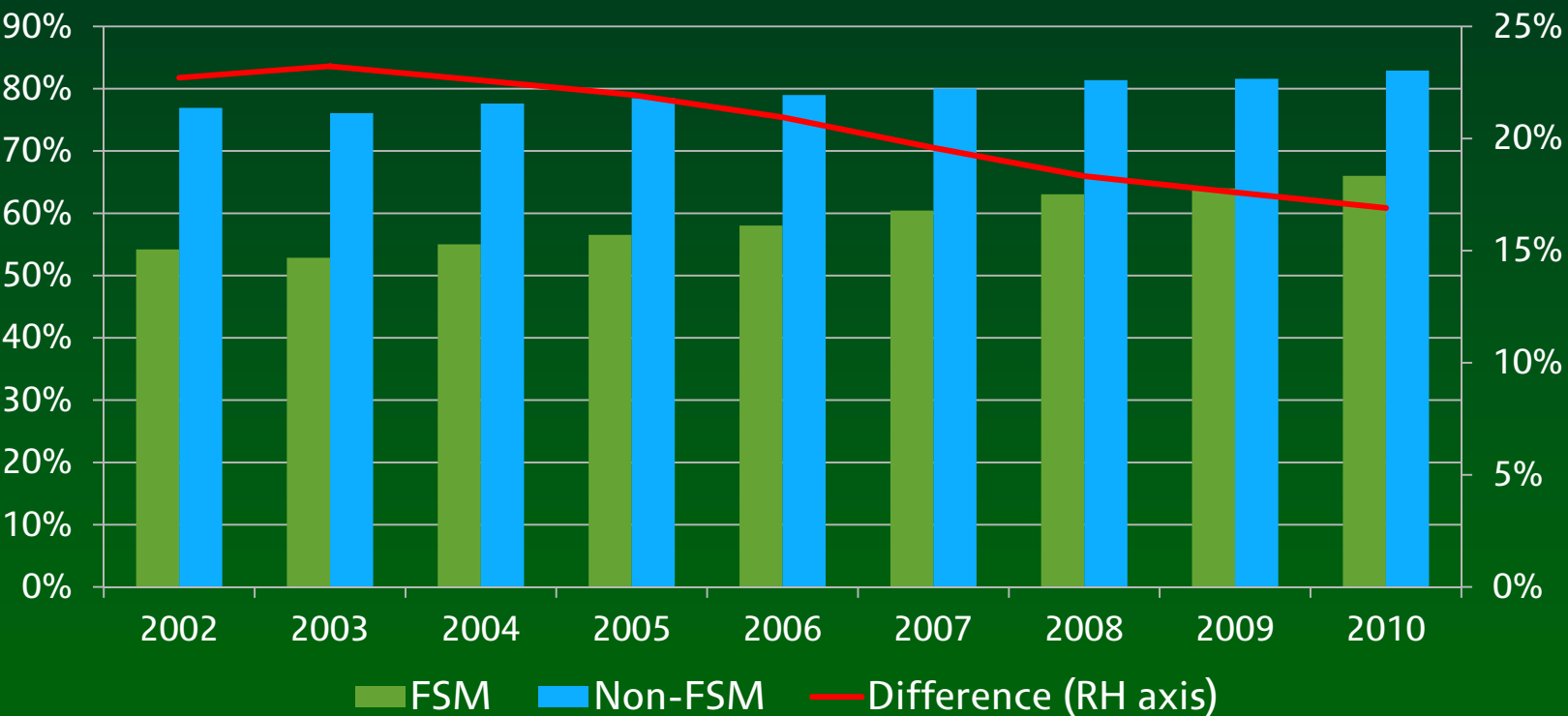


## Debate about social mobility is confused

- Government has said it wants to focus on *relative* mobility
  - Particularly hard to affect in a highly unequal country
- And lots of evidence that even as lower social groups do better in absolute terms, the better off stay ahead

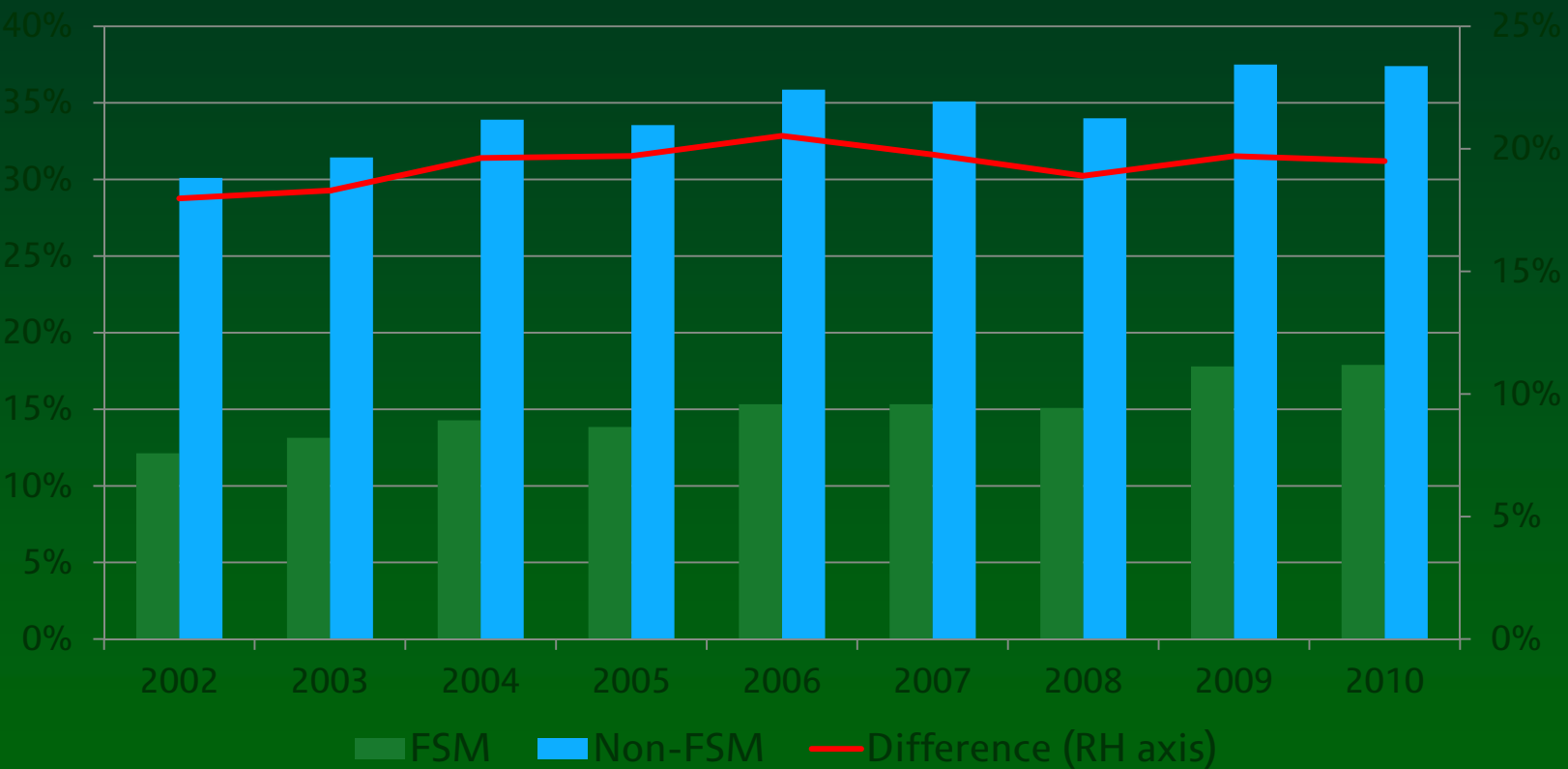
# More FSM pupils are reaching the expected level (Level 4) at age 11

% of pupils reaching the expected level or above in Key Stage 2 maths tests



# But they are not closing the gap at Level 5

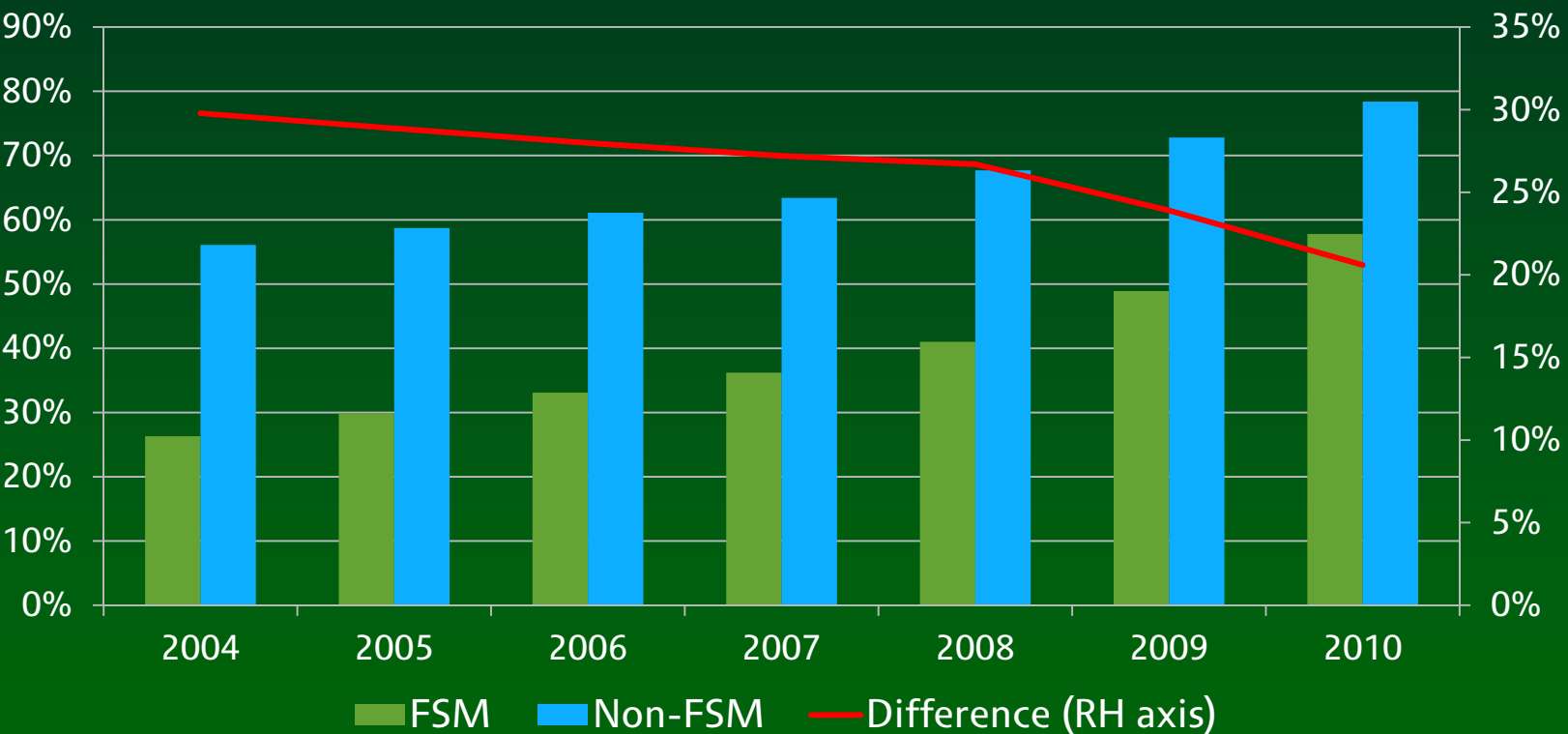
% of pupils achieving Level 5 in Key Stage 2 maths tests





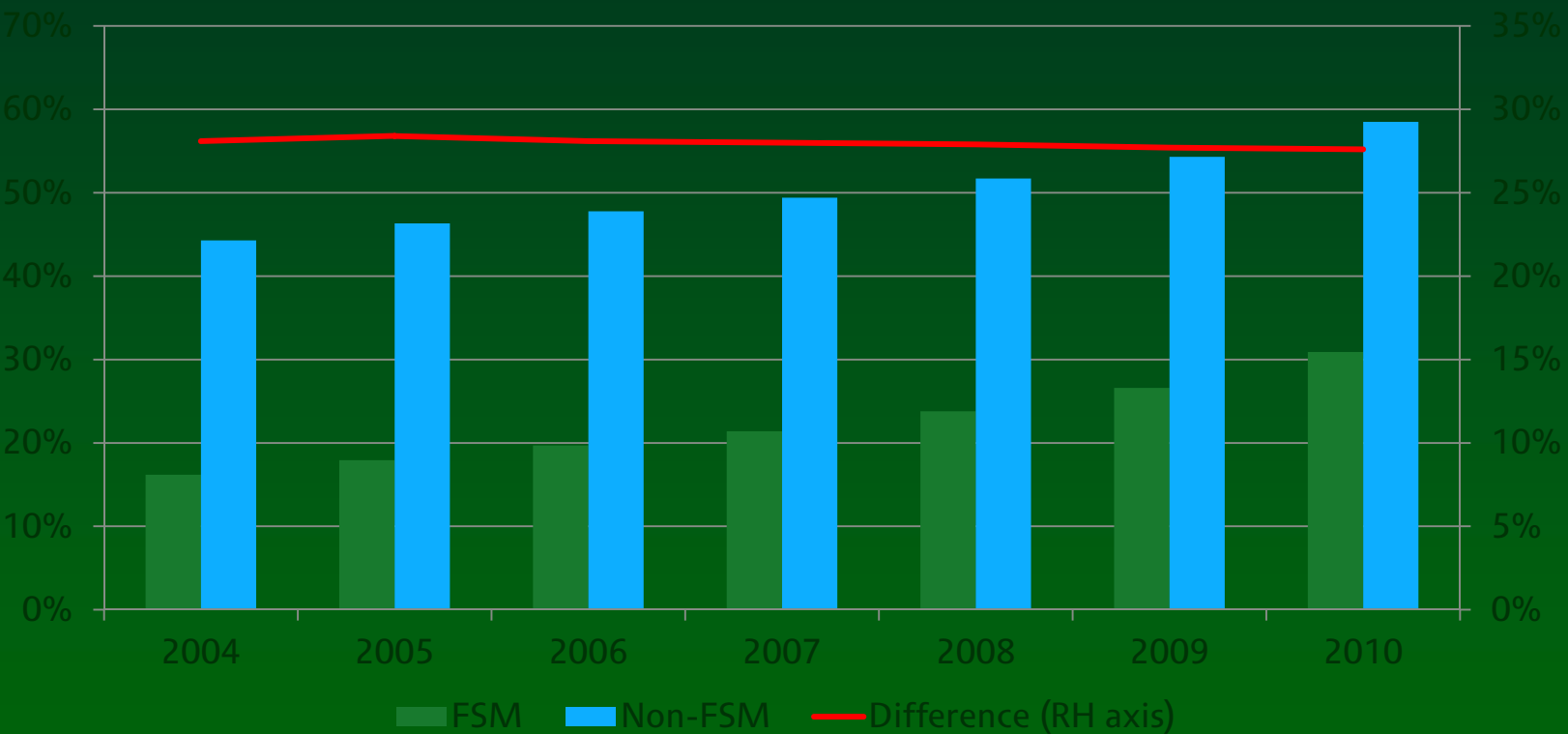
And while GCSE equivalents seem to have helped FSM pupils to close the gap . . .

% pupils getting 5 A\*-C grades in GCSEs and equivalents



# The gap has not closed when measuring GCSEs including English and Maths

% pupils getting 5 A\*-C grades including English and Maths



## Debate about social mobility is confused

- Government has said it wants to focus on *relative* mobility
  - Particularly hard to affect in a highly unequal country
- And lots of evidence that even as lower social groups do better in absolute terms, the better off stay ahead
- Evidence on effectiveness of early intervention often focussed on the very poorest
- Different from role of HE (access to professions, internships etc)
- Non cognitive skills are both (increasingly) important and potentially malleable at older ages

## Conclusions

- Bleak short term outlook for public spending
- And long term also looks worrying
- Reforms to HE could herald wider reforms
  - But illustrate difficulty of market based reforms when, for equity reasons, price not set equal to cost
- These reforms are marginal to overall concerns over social mobility
- But impacting social mobility remains tough