The public finances, the HE sector and social mobility

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.

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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

Sources: HM Treasury; Author’s calculations.
Fiscal tightening, November 2011: more to do

Nov 2011: £114bn hole in public finances

Sources: HM Treasury; Author’s calculations.
Fiscal tightening, November 2011: more to do, some more done

Nov 2011: £114bn hole in public finances

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Sources: HM Treasury; Author’s calculations.
On current plans

- Tax rises largely in place
- Dramatic public spending cuts to come
6-year squeeze on public service spending

Note: Figure shows total public spending less spending on welfare benefits and debt interest.
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

International development: 33.4%
Energy and climate change: 15.5%
Work and pensions: 0.9%
NHS (England): -0.2%
Defence: -7.8%
Education: -11.4%
Average DEL cut: -11.7%

DEL = Departmental Expenditure Limits
Notes and sources: see Figure 6.4 of The IFS Green Budget: February 2011.
Some being very big losers

- Average DEL cut
  - Transport: -15.1
  - Culture, media and sport: -21.6
  - Home office: -25.6
  - Justice: -25.8
  - CLG: Local Government: -27.3
  - Business, innovation and skills: -29.0
  - Environment, food and rural affairs: -31.3
  - CLG: Communities: -67.8

Real budget increase 2011–12 to 2014–15

DEL = Departmental Expenditure Limits
Notes and sources: see Figure 6.4 of The IFS Green Budget: February 2011.
Continuing change in the shape of the state

• Actually this doesn’t represent a big change in priorities
No change in ‘priorities’

Notes and sources: see Figure 6 of Crawford and Johnson (2011).
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

- Social protection: 10%
- Personal social services: 3%
- Health: 29%
- Education: 6%
- Transport: 2%
- Defence: 3%
- Public order and safety: 13%
- Gross debt interest: 4%
- Housing: 18%
- TIEEE: 13%
- AFF: 6%
- Other: 1%
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

Notes and sources: see Figures 2.6 & 2.7 of the February 2011 IFS Green Budget.
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.

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 ¼ of graduates will be better off

- Low-earning graduates pay an effective graduate tax
  - Increases in fees → 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

<table>
<thead>
<tr>
<th>Average fee</th>
<th>Loan subsidy (%)</th>
<th>Loan subsidy (£) per graduate</th>
<th>Exchequer cost relative to £7,500 fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>£7,500</td>
<td>28.1%</td>
<td>£9,800</td>
<td>£0</td>
</tr>
<tr>
<td>£8,000</td>
<td>29.0%</td>
<td>£10,510</td>
<td>£258 million</td>
</tr>
<tr>
<td>£8,500</td>
<td>29.8%</td>
<td>£11,240</td>
<td>£525 million</td>
</tr>
<tr>
<td>£9,000</td>
<td>30.6%</td>
<td>£12,000</td>
<td>£802 million</td>
</tr>
</tbody>
</table>

- 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

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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

2002 2003 2004 2005 2006 2007 2008 2009 2010

FSM  Non-FSM  Difference (RH axis)
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