

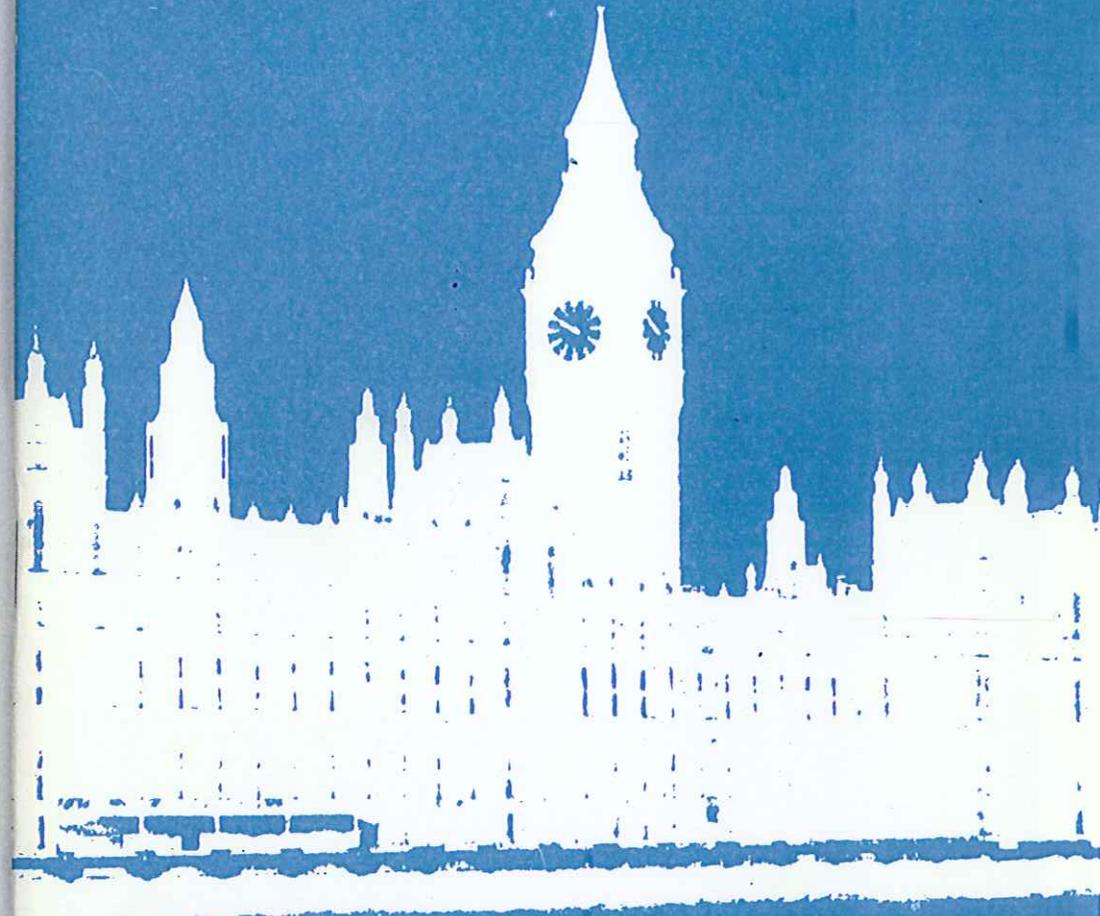


Policy Study No 103

# Nationalised Universities

paradox of the privatisation age

Deepak Lal



CENTRE FOR POLICY STUDIES



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## Introduction

In July 1988 Mr Kenneth Baker, so it seemed, *nationalised* Britain's universities, contravening the principles professed by the Government which he serves. For is not this Government committed to enlarging freedom and developing a free market economy?<sup>1</sup> This is not to deny that there is a powerful case for the state financing of students. Mr Baker may demur that the university clauses in his Great Education Reform Act are no more than a culmination of the steps towards central direction of higher education which began with the institution of the University Grants Commission in 1919. Such central planning has subsequently been advocated by many commissions composed of leaders of the academic community (most notably by the Croham and Jarratt Committees). So Mr Baker can plausibly cloak himself in the pragmatic garb of a traditional Tory who has followed post-war *dirigisme* to its tidy conclusion. But it should be noted that Thatcherism (at least as proclaimed) is based on defending a set of principles whose objective is the demise of socialism, whilst Mr Baker's nationalisation of universities must go beyond the wildest dream of any socialist – if only they could regain power!<sup>2</sup>

Of course, Mr Baker can claim that in principle he is as ardent a Thatcherite as any member of his party, but that as a politician he has to translate these principles into a popular programme by reconciling a number of conflicting political pressures. Amongst these are:

- i) the Government's desire to control public expenditure on higher education, as part of its general programme to reduce the public preemption of national resources;
- ii) its desire not to alienate its middle class constituency which, through the system of mandatory awards and free tuition, at present is entitled to a subsidy from the public at large of virtually the full cost of their progeny's higher education;

1 F.A. Hayek, *The Constitution of Liberty*, Routledge and Paul, London, 1960, for some of the arguments.

2 It was reported in the Press that when Mr Baker visited the USSR his opposite number quipped that whilst Mr Baker was centralising power, he was looking for methods of decentralisation.

- iii) the desire of university academics and Vice-chancellors to maintain the 'parity of esteem' which they have fought for, as a basis of a uniform system with common salary scales and type and structure of courses – so that to the casual observer there is an interchangeability with the 'old' universities of Oxford, Cambridge & London<sup>3</sup>; and,
- iv) their desire to increase access to higher education to a larger proportion of school leavers.

Only a centrally planned higher education system, Mr Baker can claim in his defence, can reconcile the impossible, or at least seem to do so. Any alternative to nationalisation will obviously have to deal with these political realities.

Recently, however, reports have been published in the press that both Mr Baker and the Minister for Higher Education, Mr Robert Jackson, are having second thoughts about their 'nationalisation' of British universities. Commenting on Mr Baker's speech to the Committee of Vice-chancellors at Oxford in October 1988, Michael Prowse in *The Financial Times* parodied the drift of his thinking thus:

I made a ghastly mistake. The provisions on universities in my recently enacted Education Reform Bill will do nothing to increase choice or efficiency. Indeed, I now see that the creation of the Universities Funding Council (UFC) represents strengthening of central planning and bureaucratic direction that is without parallel elsewhere in the economy. I have instructed my civil servants to consider new market-based mechanisms for financing higher education. In the meantime, please accept my apologies for wasting everybody's time.

More recently, Mr Baker is on record extolling the virtues of the market mechanism in higher education in an even more marked fashion. In January 1989 he told a conference that, the diversity and flexibility, so evident across the Atlantic, represents the future towards which we in Britain . . .

3 See J. Carswell: *Government and the Universities in Britain*, Cambridge University Press, 1985, for an excellent discussion of the power of this motive which fuelled the desire for the expansion of higher education in the '60s and '70s, a movement that was largely led by the 'red brick' universities.

will want to move . . . universities will have to go out and market what they have to offer, rather than wait for applications to roll in.<sup>4</sup>

Moreover, Mr Baker has already taken some small steps towards balancing the new mechanism for central planning with a more market-oriented approach toward universities. A scheme for top-up loans – to cover maintenance but not tuition – has been proposed; and it has been made clear that universities will be left free to set tuition fees in excess of the fees element paid by the LEAs.

After examining and rejecting the arguments for central control, this pamphlet proposes a thorough-going new scheme. These recommendations go well beyond the Government's present proposals which offer top-up loans for students' maintenance only; and represent a scheme whereby on the one hand universities can charge full cost fees at their discretion, and on the other the Government provides qualified students with finance (some in the form of grants, some in the form of loans, some in the form of means-tested scholarships) which will cover the entire costs of their higher education.

4 *The Times*, 6 January 1989.

## The planners' hubris

The first question of principle to be asked is what, if any, rôle should the State have in higher education? Here a crucial distinction needs to be made between the State provision and direction of higher education, (or any other level of education for that matter) and the financing of students who for whatever reason may not be able or willing to pay for their education.

J.S. Mill set out the argument clearly in his essay *On Liberty* whilst discussing general (i.e. non-university) education, but it applies with even greater force to higher education,

Unless, indeed when society in general is in so backward a state that it could not or would not provide for itself any proper institutions of education unless the Government undertook the task: then, indeed, the Government may, as the less of two great evils, take upon itself the business of schools and universities, as it may that of joint stock companies, when private enterprise in a shape fitted for undertaking great works of industry, does not exist in the country. But in general, if the country contains a sufficient number of persons qualified to provide education under government auspices, the same persons would be able and willing to give an equally good education on the voluntary principle, under the assurance of remuneration afforded by a law rendering education compulsory, combined with state aid to those unable to defray the expense.<sup>5</sup>

At a time when the Government, by privatising industry, is turning its back on decades of *dirigisme* it is ironic that it should appear to be doing the reverse in respect of universities.

Mr Baker's White Paper *Higher Education – Meeting the Challenge*, argues, however, that there is a place for some overall State direction and planning of higher education, through guidance by quangos such as the Universities Grants Commission (UGC), or its successor the University Funding Council (UFC). This is essentially an argument of social utility,

5 J.S. Mill: *On Liberty*, Everyman's Library, J.M. Dent, London, 1910, p.161.

of which the Government is assumed to be the best judge. Thus the White Paper states:

In higher education itself there is a need to pursue reforms, both in the management and funding of the system and in the monitoring of the quality of its work, so that we can build on areas of excellence in the arts and sciences. But above all *there is an urgent need, in the interests of the nation as a whole, and therefore of universities, polytechnics and colleges themselves, for higher education to take increasing account of the economic requirements of the country.* Meeting the *needs* of the economy is not the sole purpose of higher education; nor can higher education alone achieve what is needed. But this aim, with its implications for the scale and quality of higher education must be vigorously pursued.<sup>6</sup> [emphasis added]

This passage is riddled with intellectual muddles and unsubstantiated assertions. Two are crucial. First consider the assertion about the presumed link between higher education and economic performance (in the italicised passages). This may be part of today's conventional wisdom (due to repeated assertion by journalists and politicians), but the evidence for a direct link between economic performance and education is at best weak and at worst non-existent. Thus Maddison<sup>7</sup> summarised the available historical evidence on the link between education and productivity as follows:

It is sometimes argued that the productivity performance of economies is highly dependent on the state of 'educational capital' embodied in the labour force. The relationship of education to economic performance is obviously a rather subtle matter of both cause and effect, complicated by variations in the quality of education, and by the fact that the rôles of intelligence and education are difficult to disentangle . . . All countries have increased the educational qualifications of their populations significantly since 1950, but the economic significance of

6 *Higher Education – Meeting the Challenge*, Cm. 114, HMSO, April 1987, p.1-2.

7 A. Maddison, *Phases of Capitalist Development*, Oxford University Press, Oxford, 1982, p.110-111.

this is probably no greater than the changes that occurred from 1870 to 1950. In 1976 the average stock of formal education per person in these countries was 9.7 years; in 1950 it was 8.2 years. The evidence available for a few countries suggest that in 1870 the average stock of education per person in these countries was about 3-4 years, with substantial sections of the population illiterate and with very little higher education at all.

It does not seem, therefore, that the postwar acceleration of productivity growth was matched by an acceleration in the growth of educational capital. Similarly, it is clear that the slackening in productivity growth since 1973 is in no way due to a slowing down in the pace of growth of educational capital. Indeed, the evidence available shows more rapid growth in the educational stock in the 1970s than in the 1960s or 1950s.

Second, the idea that specific educational needs of an economy can be specified by an external authority, which universities should seek to meet, reflects the cast of mind of the manpower planner. But the arguments against planning of manpower are the same as those against the planning of output beloved by socialists<sup>8</sup>. Manpower planning assumes that fixed inputs of different skills are required to produce national output: skills produced through fixed inputs of different types of education. In practice, however, opportunities are virtually limitless, except in the very short run, for substituting different skills in producing national output (which moreover does not, as the planners predicate, consist of a set of goods and services produced in some given and fixed proportions). Nor do fixed inputs of schooling yield such definable skills.

Finally, and most important, even if such fixed coefficients did prevail, planners would be able to forecast future 'needs' of different skills only if they were omniscient prophets, and knew the future composition of national output for which these different skills were required. There is no basis whatever for this assumption which underlies all beliefs in central planning. Given our unavoidable ignorance about the composition of future output, a central forecast of educational needs imposed by Mr

8 See D. Lal: *The Poverty of Development Economics*, Hobart Paperback No. 16, Institute of Economic Affairs, London, 1983.

Baker's officials could lead to the nemesis visited upon many developing countries addicted to planning. Thus Indian planners persuaded by utilitarian arguments similar to those advanced in the White Paper, sought to increase the supply of engineers which they deemed essential for India's future economic prosperity. As there is no realistic basis for any central forecasts of future manpower needs, the only effect of this policy was to create a vast pool of unemployed engineers<sup>9</sup>.

9 From recently leaked papers, it appears that it was the Treasury and not the DES which has sought to use manpower planning to determine the demand for higher education. See the report in *The Times* by Sam Kiley 'Rift over the Allocation of Funds', Tuesday 1 November 1988 p.2. It is unclear whether the Treasury believes in manpower planning or is using its professed faith merely as a tactical device to contain public spending on higher education.

## Mr Jackson's justifications

The Higher Education Minister, Mr Robert Jackson, has recently adumbrated a more nebulous interest of the State in higher education. In a talk at Churchill College, Cambridge in March 1988 he defined the Government's interest in higher education in the following terms:

Why does higher education matter? It matters because in modern dynamic, progressive societies and cultures you need to have organised centres for creativity and for criticism – intellectual creativity and criticism...In the knowledge society, there is enormously rapid change...

This is constantly raising the standards of intellectual sophistication that are required to do business, to conduct politics, to manage affairs and so institutions which are dedicated to creativity, to criticism, to keeping abreast with what is happening all around the world, to contributing to it, to taking it forward, are actually of almost primordial importance in modern societies. . . The fact of the matter is that the Government's interest in higher education – while it embraces that concept, the pursuit of knowledge for its own sake – also has a stronger, more dynamic element in it which is this sense of the way in which higher education is important in the functioning of a modern society . . . There is another implication of the Government's vision of higher education as a source of intellectual dynamism in society and that is that the higher education institutions should indeed be intellectually dynamic . . . It isn't so much – because government doesn't have the capacity or the desire to pronounce upon or intervene in it – the content of what is being taught and the research that is being done. Government is concerned – and is quite legitimately concerned – with another set of questions which bear on quality and that is the question of process. We are not concerned about the content of what is done but we do ask questions like "how good are the arrangements in

higher education for making quality decisions about content"?<sup>10</sup>

From this verbatim transcript Mr Jackson goes on to justify the paraphernalia of the planners' ways of control – various monitors of performance, a system of contracts, abolition of tenure etc – which the quangos established before, or under GERBIL, will administer.

The questions, however, arise: even if we accept Mr Jackson's argument that the Government has some general interest in maintaining the 'intellectual dynamism' and hence the quality of universities: (a) is there any reason to believe that the present quality of British higher education is suspect? (b) even if it were, are the Government's proposed remedies – through central direction – likely to be efficacious?

In his eloquent pamphlet *Diamonds into Glass*<sup>11</sup> Professor Elie Kedourie has answered 'no' to both questions. Neither the current quality of British higher education, nor the management of their resources by universities is reprehensible. At least the Government has produced no evidence which could support these charges.

The belief in the efficacy of *dirigiste* monitoring of the 'quality' of higher education is built on sand. True, just as the Government may legitimately have some general concern about the quality of industrial management on which the economic prospects of the country may depend, it will also have a general concern about the quality of education. But this Government (quite rightly) does not seek to monitor and direct the performance of industrial enterprises through a central plan as is common in Communist countries, or through management contracts with some public quango. It believes that such industrial planning is both infeasible and destructive of efficiency and liberty. So why does Mr Jackson believe that his Government can monitor and improve the quality of higher education through central planning? At least in the industrial sector one natural

10 From a transcript of an unscripted talk by Robert Jackson: 'Policy Funding for Higher Education', 17-18 March, Churchill College, Cambridge, distributed as Appendix 2. to R. Marris 'How to Measure Performance Genuinely', paper for LSE Suntory - Toyota Conference on 'Funding and Management of British Higher Education', 20 Sept 1988.

11 Centre for Policy Studies, London, 1988.

measure of performance – profitability – does exist. No such unequivocal performance indicator is available for higher education, whose inputs and outputs are erratic and ephemeral.

Moreover, as the history of Soviet planning shows us, most attempts to use non-market indicators of performance lead to a system of incentives which systematically subvert the very objectives for which they were instituted. Thus measuring performance by the percentage of 'good' degrees which students obtain in relation to a measure of their A level grades on entry (a so-called value added measure of teaching performance), merely produces 'grade inflation' – a process which can be seen at work in the pressures to 'perform' associated with the 80s' cuts in funding of higher education.

The ludicrous (were it were not so deadly serious), proposal by the Universities Grants Commission to measure research performance by what they call 'bibliometric techniques', which in effect measure how many times a particular work has been cited, will lead to a further incentive 'to publish or be damned', to a marked increase in the citation of oneself and of one's friends, but not of one's opponents; whilst both those whose ideas become so well-known that no one bothers to cite them, and those who are 'sleepers' with ideas well ahead of their time would fail miserably on their bibliometric indices. To cite just two examples of the latter from my own field, economics, Frank Ramsey – a brilliant mathematical economist – wrote two papers which were virtually forgotten by the profession for about three decades, but subsequently became the precursors of a fruitful and voluminous literature on the theories of optimal growth and optimal taxation. The second is the case of John Muth, whose 1961 paper on 'rational expectations' was rediscovered after nearly a decade, and has formed the basis of the so-called 'new classical' macroeconomics whose powerful intellectual artillery has fought the post-war Keynesian consensus<sup>12</sup>. Under Mr Jackson's new regime, on the basis of their bibliometric indices

12 According to the Social Science Citation Index which begins in 1966 Muth's paper published in 1961 had the following number of citations: 1966-5; 1967-3; 1968-2; 1969-2; 1970-4; 1971-2; 1972-9; 1973-10; 1974-10; 1975-20; 1976-33; 1977-41; 1978-47; 1979-44; 1980-71; 1981-56; 1982-74. As Donald McKloskey, from whose book *The Rhetoric of Economics*, University of Wisconsin Press, 1985 (p.87) these figures are taken, notes on this 'sleeper': "There was a tiny flash and long afterwards a boom".

## Questions of subsidy

both Ramsey and Muth would no doubt (having had their tenure abolished) have been asked to seek their fortunes outside the university. As politicians, perhaps?

The essential point about academic services is that it is not easy, perhaps not possible, to monitor them. The knowledge on which judgements of performance need to be based are necessarily local, personal and subjective. That is why most great universities have relied on internal moral codes, and on the pressure of a collegiate environment to ensure that quality is maintained and shirking eschewed. This collegiality, the only means of maintaining the 'intellectual dynamism' that Mr Jackson seeks to foster, is necessarily threatened by the bureaucratic apparatus that will be born, with colleagues here becoming the administrative arm of Mr Bakers's quangos, there becoming fearful of non-conformity due to the abolition of tenure. His proposed means are likely to lead to the exact opposite of what they aim to achieve.

But perhaps most of these quasi-utilitarian arguments being advanced by Mr Jackson and Mr Baker are some kind of camouflage. One charitable interpretation is that they are trying to justify central planning, desired not for its own sake but as a means of reconciling the irreconcilable: that is, on the one hand honouring the commitments to reducing public expenditure, on the other adhering at least in appearance to the Robbins principle that all qualified school leavers are entitled to a publicly funded place at a university. We examine this dilemma more fully below (p. 35). At the level of principles, however, no valid argument for the State direction of higher education exists. This leaves the question of the State *financing* of students in higher education, its justification and level.

The major justification for a state subsidy to students in higher education concerns equity and equality of opportunity, together with some general cultural advantages of encouraging scholarly activities that would not attract private funds, but form an essential part of a civilised society.

As higher education is clearly one determinant of the lifetime income of an individual, limiting access to it to those with the ability to pay tuition fees would put the poor at a disadvantage – as well as perpetuate existing income inequalities. If all students, however, could borrow against their prospective future incomes, those who were unable to pay for their higher education out of their own or their families' current income could fund it. But as individual returns from this investment in higher education are highly risky, and students (particularly if they are poor) unlikely to be able to provide adequate collateral, private banks may well not wish to offer such loans. This so-called 'imperfection' of capital markets means that individuals cannot borrow to fund 'human capital formation', and underlies government proposals to provide loans or loan guarantees to help students finance their education.

Now under the current system of financing students, British students admitted to a university are in effect fully subsidised by the taxpayer. This public subsidy (which is over and above that implicit in removing the inefficiency in the market for 'human capital formation') is a pure transfer payment from general taxpayers to the students fortunate enough to gain a university place. As such it is a politically determined entitlement, and cannot properly be provided with an economic rationale. (But see a qualification discussed below in Chapter 7). The nature and extent of this subsidy is concealed by the peculiar history of the subsidisation of British university students and it is this non-transparency – whatever its political merits – which has led to much muddle about the proper role and extent of State financing of students in higher education.

In effect the subsidy to students (and one must emphasise that this is what current arrangements amount to, even though

Ministers and journalists talk incorrectly of a subsidy to universities) is provided through the block grants made by the University Grants Committee to the universities, the nominal fees (of about £700 per annum) and the means-tested but mandatory maintenance grants paid for by the local authorities. The cost per university student of the first two components of this subsidy which correspond to the full tuition costs (at constant 1986-87 prices) are given in Table 1 (which also shows what percentage of these come in the form of UGC direct block grants).

Two points need to be noted about these figures. First, compared with tuition fees in most universities in the United States, these 'full cost equivalent' tuition fees are highly competitive. Second, as nearly 22 percent of university students come from fee-paying independent schools where parents have been paying similar sums for secondary education, this cost per student of a university education cannot be regarded as excessively high.

What is, unfortunately, extravagant is the Robbins principle, which in effect laid down that anyone qualified to go to a university has to be provided with a university education at public expense. In liberal terms this 'Robbins principle' is indefensible. For example Hayek, considering State subsidisation of education (over and above that required to remove the imperfection in the capital market already discussed), noted that:

The situation is somewhat different, however, when the costs of a higher education are not likely to result in a corresponding increase in the price at which the services of the better-trained may be sold to other individuals... but where the aim is the further dispersion and increase in knowledge throughout the community at large. The benefits that a community receives from its scientists and scholars cannot be measured by the price at which these men can sell particular services, since much of their contribution becomes freely available to all. There is, therefore, a strong case for assisting at least some of those who show promise and inclination for the pursuit of such studies. It is different matter, however, to assume that all who are intellectually capable of acquiring a higher education have a claim to it. That it is in the general

interest to enable all the specially intelligent to become learned is by no means evident or that all of them would materially profit by such an advanced education, or even that such an education should be restricted to those who have an unquestionable capacity for it and be made the normal or perhaps the exclusive path to higher positions<sup>13</sup>.

The open ended commitment of public expenditure which the Robbins principle entails is equally indefensible. It is not surprising that at least since the early 1970s<sup>14</sup>, due to the unavoidable exigencies of public finance, the Robbins principle has in practice been repudiated by Governments of both major political parties. Given the temper of the times no future Government would attempt to implement it. Yet it is still invoked, at least rhetorically<sup>15</sup>, by part of the higher education establishment. Perhaps this is not surprising since the maintenance of any semblance of consistency between Robbins and requirements of fiscal prudence dictates – does it not? – that creeping central planning of higher education under the aegis of the UGC and the officials of the DES, of which Mr Baker's full scale 'nationalisation' of universities is the latest sorry chapter. All those who revel in their current and prospective roles as the Platonic Guardians of Higher Education, have sought to cover themselves with the mantle of Robbins whenever their ambitions have been questioned. Their statements should be seen for what they are – self-interested smokescreens. Worse, though, by continuing to uphold Robbins even when in practice he has been repudiated, the evolution of a political consensus on alternative methods of financing students in higher education, which would in effect increase the access to higher education that Robbins sought, has been put back by some two decades<sup>16</sup>.

13 Hayek, op. cit. p.383.

14 See Carswell, op. cit. p.132 and following.

15 Most recently by Sir Peter Swynnerton Dyer, the last chairman of the UGC and the chief executive of the new UFC.

16 Thus writing in 1964, Lord Robbins said "I have little doubt that, as time goes on and the advantages of higher education are more generally perceived and the burdens of financing its expansion are more severely felt, there may easily come a change in public attitudes such that the equitable arguments for a considerable replacement of grants by loans will become practically relevant", in his *The University in the Modern World*, Macmillan, 1966, p.30.

To conclude; whilst there is a case for State subsidisation of student finances, there is none for State direction, none for the effective nationalisation of universities.

## Full cost fees – and their enemies

How then can British universities be denationalised? The answer is simple. Every university should state that from next October it will charge full cost fees to all its students – just as they already charge their growing number of overseas students (for whom the fees currently recommended by the CVCP are £4,300 a year for arts, £5,700 for science and £10,500 for medical courses). This measure would remove anomalies such as the cheap education provided to students from the EEC (who only pay home student fees) but not to those from the rest of the world. How these fees are financed by students (either home or overseas) should not be the universities' concern. If their current places are filled – and why should they not be, given the excess demand at the aggregate level for British university places? – their income would be no less (and possibly greater) than under the dispensation of funds through the UFC. As their income would thus arise directly from the services they provide, the UFC could then be abolished.

Since no legal obstacles prevent the universities determining their own fees (a principle which Mr Baker has recently endorsed), they could take this action unilaterally. But unfortunately (starting as one does from a situation wherein the Government has a stranglehold over university finance through the deceptive means of granting home students a State subsidy through the UGC's block grants) the action would have to be taken collectively by a majority of the universities. Otherwise each university would face the well-known prisoner's dilemma if it acted unilaterally and charged full cost fees. If none of the other universities followed suit, the one which unilaterally raised fees and eschewed UFC funding could see its better home students melt away to other universities which offered *free* places.

Would universities agree to raise fees collectively? From the accounts of the recent meeting of the Committee of Vice-chancellors and Principals which considered a watered-down version of such a scheme, they were split. It was difficult to discern the logic of those who opposed the move to full cost fees.

Such a move, however, will clearly not be in the interest

of the planners – the UGC, its successor body the UFC, the DES, the CVCP, all of which derive their existence and power from a *dirigiste* concept of higher education. As regards the UGC (and now the UFC), it has never supported the raising of tuition fees to their real cost – despite the Robbins recommendation that there should be some increase in them to foster the autonomy of the universities. As Carswell noted<sup>17</sup>, the UGC disliked any substantial increase in fee income to the universities which would diminish the power of the UGC to control and dictate to them. Small wonder that Sir Peter Swinnerton Dyer, the last chairman of the UGC and new chief executive of the UFC should feel such alarm at the heretical (from his mandarin viewpoint) market-oriented views of his new chairman Lord Chilvers<sup>18</sup>. Similarly, despite their demurrals and flotation of fresh schemes for more market based methods of financing universities (on which see below) Mr Baker, Mr Jackson and their officials at the DES are not likely to relish the full implications of such a change.

This leaves one interest group, the academics. It is in the interest of the providers of the services – university teachers – that they charge, and in turn get paid, the market value of their services – unless of course under the current system they are obtaining more than the market would pay. But it is a sad fact that the hold of non-market ideas is so strong in academia that university teachers have failed to press for the obvious reform, which, according to the Government's own professed principles, would patently be in their self-interest. The Association of University Teachers which should surely serve the real interest of its members, seems to be more interested in its anti-market ideology, arising from its dubious affiliation with the TUC and the Labour Party. Should it not, in that case, remind itself of those ringing words from one of the founders of its faith that by embracing a system of higher education based on full cost fees, it is arguing for a fair market price for the services of its members, and by advocating such a cause academics 'have nothing to lose but their chains. They have a world to win'<sup>19</sup>?

But, although the *dirigisme* of the UGC and DES may be

17 Carswell, op. cit. p.113.

18 See the report in *The Times Higher Educational Supplement*, 28 October 1988 p.11.

19 Karl Marx: *Communist Manifesto*.

discounted, it is worth considering further why many academics are suspicious of the privatisation of universities entailed by charging full cost fees. Even though in the initial post-privatisation years, it might not be hard for universities to devise a collective agreement to charge nearly uniform full cost fees, and implicitly to accept the current quotas for home students imposed by the UGC, over time we could expect that, depending upon the relative demand and supply, fees would differ by subject and university. If, as is desirable on economic grounds, academics are paid their market price, there would also be different remuneration of academics in different disciplines and universities. Also, as a result of market pressures and the decisions taken by this university and that, courses and departments would be restructured, with some disciplines expanding and others contracting in different universities. This differentiation is likely to be opposed by those who support the 'parity of esteem' supposed to exist between academics, all on a common national salary scale, and universities – all offering a similar breadth of subjects.

Of course, this 'parity of esteem' is a fiction. Esteem, especially amongst academics, has to be earned. It cannot be ascribed or legislated. The present system with its nationally uniform pricing of inputs and outputs, leads (as any economist would expect) to various non-price methods of adjusting demand to supply. In each subject and overall, depending in part upon their history, there is a pecking order of universities and departments in terms of earned esteem. With no financial differences in reward, academics and students want to belong to the 'better' universities. But without the ability to use differential financial rewards to attract academics (and, after a lag, students) from the more esteemed universities, the less esteemed are fixed in their position in the league table, in which their only satisfaction is the dog-in-the-manger one of seeing that their colleagues in the more esteemed establishments at least receive the same pay and perquisites as they do!

## Understandable fears and misgivings

It is important to tackle the fear that a system based on market principles might entail the relative decline (and in some cases demise) of departments and universities for which there is a lack of demand at full cost pricing.

First, it should be noted that cuts and closures are already taking place. The difference is that they depend on the judgements of the UGC made at the centre, with the inevitable politicisation that this entails. A market based system of structural adjustment, on the other hand, would provide better signals of the different demands for different subjects; and, if the academics concerned wished to do so, they could take suitable countervailing action (on their salaries, student numbers etc) rather than being subject to the *fiat* of a committee.

Second, nothing in the evolution of a market based system would prevent a university from keeping this or that less popular subject, by cross-subsidising it from part of the revenues obtained for the more popular subjects.

Thus, the net effects of such a system of higher education should in the long run be no worse, from the viewpoint of the self-interest of academics, than the current politicised system – especially since once the universities charge full cost fees and admit any one suitably qualified and able to pay them, they will no longer be limited to filling only the arbitrarily determined quotas laid down by the UGC: quotas based more on the exigencies of public finance than the true demand for higher education at its full cost price.

But as inevitably the market solution will lead to short run distributional effects amongst universities and academics – with gainers and losers – it is unlikely that, however much privatisation is in their long term interest, they will press for it. Even though in principle universities could, if they chose, readily escape, in practice public action might be required to ‘force them to be free’!

Finally, there is an assortment of other misgivings that

some may have about a fully privatised university system. Would the universities be able to fund their future capital needs and research activities out of the income they derive from full cost fees? Or would there still be some need for direct grants from the Government either through the UFC or the DES? It might be tempting for universities to base their fees to students on the costs of teaching alone, hoping that the research side of academic activity would continue to be financed by the Government. But this would be a thin edge of a big wedge which might undermine their newly found independence.

If universities really believe their public rhetoric that academic research and teaching are inseparable activities, it does not make sense to cost these separately and charge students for only a part of their total costs. To quote Hayek again:

On the highest level the dissemination of knowledge by instruction becomes inseparable from the advance of knowledge by research. The introduction to these problems which are on the boundaries of knowledge can be given only by men whose main occupation is research<sup>20</sup>.

The teaching that university students receive from scholars is assumed to be informed by research. The two functions must be inextricably entwined if universities are not to be mere ‘vocational’ machines.

Nevertheless it is impossible to argue that all British universities should aim to have a uniform balance between teaching and research. The planned system involves subjective judgments in the setting-up of fair standards for this balance, and imposes arbitrary standards in classifying some universities as primarily research based and others as mainly teaching institutions. By contrast it is one of the strengths of a market based system that it would allow diversity between universities, and hence in their relative costs and fees, to evolve in response to decentralised decisions by consumers and producers of their services.

Should universities under a new system be granted complete freedom to set their fees – if necessary differentiated by subject? The case for allowing them such autonomy may seem to be compromised by the following considerations. First, there

<sup>20</sup> *Constitution of Liberty*, op. cit. p.388.

are certain subjects where the costs per student include the costs of very expensive laboratories and equipment. If the fees for these subjects are based on their unit costs, they would be much higher than for many arts based subjects. Would these high fees not discourage students from studying the very subjects that the Government and the public believes – however erroneously – are essential for economic growth? Similarly, there may be some subjects of cultural importance which for whatever reason may not be able to attract many students, so that since a minimum infrastructure is required in terms of staff and services, their cost per student may also be above average. Universities might be tempted therefore to discriminate against such high cost subjects.

Three points need to be made against these arguments for denying universities the autonomy to charge whatever fees they choose.

- i) it would be open to universities to charge uniform fees for all subjects, and then cross-subsidise the high unit cost subjects from the revenues obtained on low unit cost ones in the general academic interest of maintaining the breadth of subjects vital to a good university.
- ii) even if differential fees are charged it would be open to the public or charitable bodies who demand graduates in some subjects – e.g. physics school teachers and dons – to bear part of the costs of their education by for instance repaying the loans on behalf of the high fee payers. This would be preferable to a planning system whereby the Government attempts to forecast the 'desired' number of these graduates, and finances a fixed quota in particular universities.
- iii) to the extent that graduates – engineers for example – are hired by industry, their relatively higher cost of production should in part be borne by the industry concerned, either through raising the salaries paid to these graduates or else by taking over the repayment of part of their loans.

The case therefore does not stand up for separating the 'normal' teaching and research costs of different universities, nor for prescribing any uniformity of fees charged by subject or university. Nevertheless, there would still be special, new

emerging areas of expensive research in the sciences for which universities might not be able to pay out of their regular fee income. Public money in support of such ventures should be channelled through the research councils.

## Setting up the scheme

Government action is needed to underwrite its proper interest in financing students, once the current route via UGC block grants has been blocked, and universities become financially independent through charging full cost fees. Observing the principles for state action in higher education sketched earlier, the ideal system is not far to seek. On grounds of economic efficiency, there should first be some system of public loans or publicly guaranteed loans which overcomes the inevitable imperfection of private capital markets, by enabling students to borrow against their increased earnings in prospect from their higher education.

Secondly, one must take account of the 'externalities' associated with higher education (of the sort adumbrated by Hayek in the passage quoted above). As these essentially comprise some subsidy to the education of scientists, academics, doctors etc, whose services are demanded by public institutions including the Government, the simplest solution would be to write off part of the higher education loans of those who joined the public services or the universities and stayed in these professions for some minimum period.

On grounds of equity the Government might wish to encourage and subsidise clever poorer students. The principle of means testing already applies to existing maintenance grants, and could easily be applied in giving means-tested scholarships, or vouchers to cover the full cost of a university education, to such students who gain university entrance.

These are the strictly economic subsidies, and their ideal form as described above is based on the sound principle put forward by welfare economists, that subsidies should aim directly at remedying specific distortions.

This leaves, however, the political entitlements to public subsidy of many students which are part of the present system of funding higher education. Being political, it is not, perhaps, for an economist to pronounce on their desirability. What can be said is that many of these entitlements accrue to the off-spring of the Government's supporters, who, as Sir Keith Joseph's

unhappy attempts at introducing vouchers showed, will not balk at exerting political pressure to prevent their erosion.

For this reason a politically feasible privatisation of the universities might be effected in the following phases:

- i) The Government announces that from next year the universities are to charge full cost fees to their home students at the same rate as to overseas students.
- ii) The UGC/UFC block grant is abolished.
- iii) The Government gives bursaries equivalent to the full cost fees, to each and every home student who has been already allocated a place at university for the next few years by the UGC.

In effect the situation of the universities and their students, and the size of public expenditure, would be exactly as at present – but there are three important differences.

- i) the quango UFC could be abolished.
- ii) the principle, essential for their privatisation, that universities must derive their income from fees for the services they provide would be established.
- iii) the way would be open to evolve a market based system of higher education in any one of a number of possible ways that may be desired on political grounds.

This last point deserves some elaboration. The Government could announce that after the first few years – the transition – when student numbers and the full cost fees would correspond to the presently agreed plans for home student quotas and the implicit cost per home student (shown in Table I), universities would thereafter be free to charge whatever fees they thought fit, to negotiate with their staff on its remuneration and terms of service in whatever way they thought fit, and could dispose of their capital assets – whose legal title should be passed on to the universities – as they saw fit. The State in turn would finance students, their number and the form of subsidy being along a number of possible lines, the choice of which could become part of the political debate (with the proviso that the State subsidy to students could not be open-ended, and would be subject to limits and political control, just as other forms of public expenditure). As universities could charge different fees for

different courses, the Government would of course still be able to exercise influence over the universities and the courses chosen by the students it was financing – because these would affect the total amount of public expenditure. Given that it fixed its commitment in advance, it would have a choice between financing fewer students on more expensive courses, or more students on less expensive courses.

The first step in freeing the universities could therefore be taken almost immediately, by a single change in the form of financing universities, and with no change in the current level of entitlements to students or in public expenditure. The raising of tuition fees to full cost fees (equivalent to the average current public expenditure per student – excluding maintenance grants – in each university) and the substitution of student vouchers or bursaries to the home students (whose numbers and admission standards would be identical with current UGC plans) would replace the existing UGC block grants and nominal tuition fees paid by local authorities; and effectively denationalise universities at a stroke.

It might be argued that this change would be purely cosmetic as the universities, at least during the transition to alternative systems of financing university students would still depend financially upon the number of home students they were allotted by the Government. True, but the change in the environment in which university decision-making takes place would be important. This can be illustrated by considering other goods which are mainly purchased by the Government – for instance many items of defence hardware. The current and prospective system of university management can be compared to a single nationalised organisation consisting of all the firms which provide say ordnance, ships, planes etc for the Government. In fact, however, the Government recognises that even if it is the major consumer for the output of such defence industries, keeping them in private hands yields the usual efficiency gains. The same gains would accrue from privatising universities even if the Government were the sole purchaser of *their* output.

But of course, it is only because of the conflict between the current practice of making mandatory awards to any student who gains a university place, and the legitimate desire to control

public expenditure, that the Government through the UGC has put quotas on the so-called full time equivalent (FTE) number of home students any institution can admit. Thus there are no restrictions on the number of high fee paying overseas students that universities can admit; but home students, often of even higher academic calibre, and many of whom might be able and willing to finance their education, are turned away from British universities. This anomaly would disappear as soon as all students were charged the same full cost fees (though, of course, all fees would not remain identical in a fully liberalised system). At the margin, those home students who failed to get one of the fixed number of vouchers (equivalent in number to the existing UGC/FTE quotas) would still have the option of obtaining a British higher education from their own means. In this way the discrimination against home students, which is a natural and scandalous concomitant of the present planned system, would be removed.

The question naturally arises, how in this first stage of reform the fixed number of quotas and bursaries will be distributed. If the necessary political support for denationalisation of universities is to be obtained from those who have come to expect free higher education as an entitlement, the full cost vouchers or bursaries must go to those who would have obtained mandatory awards in the current system. As at this stage each university already has a quota of home students allocated by subject, vouchers for the full cost fees to the students it would admit under its quota could be given to the universities to be handed to them. Any additional students admitted, whether home or from overseas would have to be financed from private means.

## Privatised universities: the final form

The next stage of reform which must allow for the distribution of state-subsidised students between universities and subjects to be determined by consumer demand rather than by government planners – as is the case for overseas students – could take many different forms, ultimately depending on the manner and extent of state-subsidisation of students.

Whilst the simple act of charging full cost fees for all students would lead to the immediate privatisation of universities, such a scheme is unlikely to be initiated by the Government unless a credible and politically viable scheme of student financing of fees is also in place.

Assuming realistically that the overall public expenditure on higher education remains static in real terms, and given the average real full tuition cost per student in British universities, (see Table I) the Government has to decide

- i) whether it will continue to provide a completely free university education to roughly the existing number of students in British universities, or whether it will provide an average subsidy less than the full cost fees to a larger number of students;
- ii) on what basis it will choose between different students who are to be subsidised; and
- iii) what form the subsidy should take.

Several proposals have recently been aired dealing with these issues.<sup>21</sup> The fundamental choice must be based on an understanding of what are the ultimate objectives of public subsidisation of higher education. And this must surely be to create a system of funding higher education whereby,

- i) on grounds of efficiency students who make rational, individual decisions on the expected costs and benefits of

21 See for instance: J. Barnes and N. Barr: 'Strategies for Higher Education', paper at LSE SuntoryToyota conference, op. cit. 10.

an investment in their higher education are able to implement them by being able to borrow against their expected increase in lifetime income.

ii) on grounds of equity and equality of opportunity, public subsidies may be granted to students who come from poor backgrounds who may be deterred from taking the risk involved in investing in their higher education by borrowing.<sup>22</sup>

iii) there must be a remedy for possible under-investment in types of education which determine the supply of various professions – school teachers, academics, doctors – whose private rewards may be less than their social worth (at least in nationalised systems of education and health such as the British).

In addition there could be a case for at least some public grant to be paid to all university students. For example, the Government has proposed top-up loans towards maintenance, though *not* tuition. The investment of the student will consist not only of the full cost fees but also of alternative earnings foregone during the period of education.<sup>23</sup> His return is the incremental earnings made possible. But part of this increase is taxed by the Government, or (putting it differently) part of the 'benefits' from higher education accrue to the public at large in terms of these tax revenues. It is as if the public at large had an equity stake in its graduates, its dividend being these 'extra' tax revenues. If students financed themselves solely from loans the public at large would be receiving a 'dividend' without having paid anything for the equity it implicitly owned in its graduates. There would therefore be a case for some part of the costs of the student's education to be paid for out of public funds as a

22 In economist's jargon they may be highly risk-averse. This may not matter in itself, as different degrees of risk-aversion are like differences in tastes. But if because of this, highly risk-averse children from poorer backgrounds do not enter higher education the 'cycle' of deprivation which may be a social concern could be perpetuated.

23 We assume that the student would have to maintain him or herself in any case even if they did not go to university, so this element in the 'costs' of the two alternatives nets out.

grant.<sup>24</sup> Taking up the last point first, we have made some crude calculations detailed in Appendix 1, of the level of the grant which would yield a tax based rate of return of 10 percent to the general public, on the basis of estimates of rates of return on higher education in Britain. It is of the order of £2800 at 1986-87 prices or about 60% of the average full tuition cost of a university student of about £5000 in that year (see Table I).

This leaves the balance of 40% of the full cost of tuition. Even amongst people with diverse ideological persuasions, a consensus is emerging that there needs to be some form of government guaranteed loan scheme at least partially to finance university students. There are problems. The Government may worry about the incidence of default, and the borrower may worry that the income increase in the expectation of which the loan was taken out may not materialise.

In this context, the recent, much-discussed proposal by Barnes and Barr is worth considering: state loans to students with income-related repayments made through a surcharge on the national income contributions of the graduates. This has two advantages. First, as most graduates will be earning, have a NIC number, and be making normal NIC payments, a graduate NIC surcharge should be easy to collect, and hence avoid the problem of loan default that has plagued the US educational loan programme. Second, as the annual repayments are based on a NIC surcharge they are clearly linked to the incomes of the graduates, with relatively low earners paying less than high earners. It is important that the repayments should be finite, ending when the loan and accumulated interest are paid off; and not involving any redistributive element of post-graduation income-related subsidy or taxation. Earnings should not determine how much is repaid on a loan, as has been suggested

24 It may be objected that on a similar line of argument, given the existence of a capital gains tax, there is a case for the public subsidisation of shares and stocks, as the general public benefits through the tax on the capital gains on these equities. This argument, of course, shows why the capital gains tax is a bad tax, and is an argument against it, and not against the proposal in the text. For even on grounds of ideal taxation, there would be a place for an income tax – with some progressivity – to fund essential public goods such as defence and the legal system. With such an income tax, the above argument for some grant element in student financing would hold.

for instance in the failed Democratic presidential candidate Michael Dukakis's proposal of a Student Tuition and Repayment System (STARS). The argument against any such redistributive system is based on the incentive it would create for loans to be used mainly by students who expected to earn relatively little – whilst those who expected to earn highly would have to pay back a lot, and might not wish to participate in the scheme<sup>25</sup>.

Whatever payments mechanism is used (and the use of the NIC system is the chief novelty of the Barnes-Barr<sup>26</sup> scheme), the essential point is that, on grounds of economic efficiency, some form of government guaranteed loans is justifiable as part of the financing of university students.

Might the servicing of such loans be considered too onerous by prospective students from poor backgrounds? It should be noted that in the current system only about 8% of university students are from social classes 4 and 5. The way to subserve the second principle of equality of opportunity is to use part of the current public expenditure on higher education to give means-tested scholarships.

As regards the final reason for public action in higher education – the encouragement of this discipline and that for social reasons, or 'externalities' – the simplest solution would be for the Government to 'pay back' the loans of students who enter the relevant 'professions'. As most of these – school teachers, doctors – are part of the public sector, the extent of this 'subsidy' will be directly related to the 'hires' in these professions by the public sector. So it should not lead to any open-ended commitment to public subsidisation.

In Appendix 2, we sketch the mechanism of an illustrative scheme which whilst keeping annual public expenditure on higher education constant in real terms, provides a mixture of government grants and loans, with poorer students receiving

25 See G.S. Becker: 'Why the candidates are missing the point on college costs', *Business Week*, 14 November, 1988.

26 The Barnes-Barr proposal is also more open-ended, as given their redistributive predilections they at times suggest using their repayments scheme as a redistributive device. Also, as has been pointed out most recently by the Institute of Fiscal Studies, NICs are a bad tax. It would be preferable to eliminate them. The income tax system, despite the Inland Revenue's resistance, could be used as the repayment mechanism.

completely free subsidised education. It could work as follows. With universities privatised and charging full cost fees (assumed on average to be the same in real terms as at present) the Government's fixed annual expenditure – currently given as block grant by the UGC, and tuition fees as part of mandatory grants by local authorities – is handed to a Universities Student Finance Committee (a suitable change in the role of the UFC which would be redundant). This committee would give out full cost scholarships to poor students, and to the remainder, 60% of the full cost fees as a grant and the rest as a real interest free loan to be repaid over 20 years. Assuming that between 10-20 percent of the loans are not repaid either because they are defaulted on or because they are forgiven (for graduates employed in the public sector, or whose incomes are too low), and that annual full cost fees are £5000 per annum, the self-financing scheme would allow an expansion in students (over current numbers) financed by the agency of 4-5% every 5 years, with 10-20 percent of the students receiving full scholarships and the remainder paying back only £25 a month.

As the table to the Appendix shows, if the period of repayment were lowered to 10 years, for the same monthly repayment of £25 by graduates who received loans, the higher education system could be expanded at the same rate of 4-5%, even if the grant-loan mix was changed to 80% grant and 20% loans.

Such a self-financing loan scheme which provided increased access and completely free tuition to poor students, without any increase in public expenditure, and with only a modest monthly repayment burden on graduates, would seem to meet all the irreconcilable pressures on Mr Baker and Mr Jackson which we outlined at the start.

Although such a scheme might describe the ideal final system of financing students in higher education, it is unlikely that it could be legislated overnight, if for no other reason than the cry from those politically vocal groups who would protest against interference with their current entitlements. Why pay even £25 a month if you can manage to pay nothing? The transitional phase, therefore, could follow the lines adopted for other politically determined entitlements: namely, keeping their nominal value constant, but letting their real value erode as even

low inflation takes its toll. This seems to be Mr Baker's – correct – policy in introducing student loans to 'top up' current maintenance grants, whose value is to be frozen. Similarly, whilst introducing a supplementary loan scheme for tuition costs, the Government could also freeze the value and number of scholarships to cover full cost fees at the current numbers of students agreed by the UGC (except for poor students who gain admission to a university on some minimum grades in their A levels).

How should these scholarships be distributed? Given the political need to satisfy expectations based on existing entitlements, they will probably have to be rationed on the basis of A level performance. (This seems to be similar to the scheme being floated by Mr Jackson.) Over time, the extra nominal public funds available after deduction of the fixed nominal charge on these politically determined scholarships, should be used both to provide the full subsidies to poor students, and also to subsidise the loans of those who enter the professions with 'externalities'. Thus, gradually, we would move towards the 'ideal' system of financing students in higher education, with the rational balance between grants and loans in student financing discussed above.

As far as the universities are concerned, however, they would have been privatised at the first stage of these proposed reforms. As soon as they start charging full cost fees, their financial independence would be established, together with the principle that they charge and earn a market price for the services they provide. Thus, irrespective of the means the Government eventually adopts to finance university students, it can immediately free the universities by abolishing the UFC and its block grants, to be replaced by full cost fees and by handing over the control of their existing capital assets to the universities. If Mr Baker fails to adopt one of these feasible methods of denationalisation, the suspicion must be that, for all his protestations, he wishes to remain the Commissar of Higher Education.

## Conclusion

No good case for the recent 'nationalisation' of universities exists. The proposed direction of higher education will neither subserve the Government's cherished principles in other fields, nor the vague and unjustified – generalised – concern which some of its agents express about the quality of British higher education. The paradox of a Government which seeks to privatise in effect nationalising universities is explicable only in the light of the conflicting political pressures it faces. We have sought to show better methods than nationalisation, which the Government rightly abhors, to reconcile these pressures.

Now, although there is no case for government *planning* of universities a case does exist on grounds of economic efficiency and equity for some State *financing* of university students, through a mixture of loans, grants and means-tested scholarships. Whatever the appearances, the present system of State financing does give public subsidy of the full cost of students' higher education to themselves – not to universities. Excluding maintenance grants, this average subsidy comes to about £5,000 a year: a sum which represents the full cost fees per student which would yield universities an income equivalent to that which they now receive through the block grants, politically determined, from the UGC (or now the UFC).

The simplest way to privatise universities would be to make them charge these full cost fees to all their students, thus removing the unjust discrimination against applicants of British nationality, whose numbers are rationed by the exigencies of public finance.

Once universities obtain their income from full cost fees the UFC can and should be abolished. Instead a University Students' Funding Council would distribute the loans, grants and means-tested scholarships which are the proper concern of government – the number of students supported and the mix of different forms of financing being decided by the political process. We have given some calculations which illustrate how (even with the annual public expenditure in higher education remaining constant in real terms, and with poor students receiving completely free university education whilst the rest enjoy a mixture of grants and loans) numbers of home students

could be expanded by 4 to 5% a year. Thus, preservation of the Robbins principle which has in practice been rejected by both political parties, would be reconciled with the inevitable pressures to contain public expenditure. It must be noted that the cost to the students for receiving the loan would be no more than £25 a month, in real terms, spread over 10 years.

The paper argues that one of the principal interest groups who would oppose such 'privatisation' from universities, the academics, can only stand to gain from universities charging the full market cost of their services to the students. Fears of structural readjustment, and of a market based system of rewards are shown to be unfounded, especially when compared to the arbitrary and politically-determined processes of today. The opposition of the CVCP and the UFC to privatisation is perfectly comprehensible: it reflects a reluctance to lay down their tasks as the Platonic Guardians of Higher Education. This opposition can be eliminated by their abolition. More difficult to counter will be the antagonism of those students and their parents who have received, or can expect to receive, a large subsidy from other taxpayers. Here, tactics similar to those which the Government has adopted to erode the real value of other politically sensitive but economically unjustifiable entitlements could be used.

Our recommendations could take place immediately, with no effects either on public expenditure or on the present, politically-determined, entitlements of students. But, given today's system of financing it will require either collective action by the universities themselves, or else by the Government. Nevertheless privatisation of Britain's universities remains essential not only for their future but also to resolve the most ironic paradox of the contemporary political scene.

## Appendix I

Estimates of the social and private rates of return to higher education in Britain yield about 9.6% for the private and 8.2% for the 'social' rate of return.<sup>27</sup>

We can use these to work out what would be the level of grant which would yield a tax based equity return on the grant of 10 percent, which was the discount rate usually recommended for evaluating public investments. Assuming that the tax rate ( $t$ ) is 25%, that income foregone is  $Y^F$  per year for 3 years and the income the graduate earns is  $Y^G$  each year (and for simplicity assume this accrues in perpetuity), and that  $Y^G = (1+g)Y^F$ . Also there is free higher education, but the real social costs of tuition ( $T$ ) are £5,000 per annum, then, if  $r^P$  is the private rate of return and  $r^S$  the social rate of return, we have

$$r^P = \frac{(Y^G - Y^F)(1-t)}{3Y^F}$$

$$= \frac{gY^F(1-t)}{3Y^F} = \frac{g(1-t)}{3} \quad (1)$$

$$\text{and } r^S = \frac{(Y^G - Y^F)/3T + 3Y^F}{3Y^F} = \frac{gY^F/3T + 3Y^F}{3Y^F} \quad (2)$$

Inserting  $r^P = 0.096$ ;  $r^S = 0.082$ ;  $t = 0.25$ ;  $T = £5000$   
 we have from (1) that  $g = 0.384$  and  
 from (2)  $Y^F = [0.082 \times 15,000] / [0.384 - 3(0.082)]$   
 $= 1230 / 0.138 = 8913$

If one wants to obtain a tax based equity return ( $e^f$ ) of 10%, then the annual grant  $S$  for 3 years should be (from  $e^f = (Y^G - Y^F)t/3S$ )

$$S = \frac{tgY^F}{3e^f} = \frac{(0.25 \times 0.384 \times 8931)/3}{0.1}$$

$$= £2,852.$$

<sup>27</sup> See G. Psacharopoulos and M. Woodhall: *Education for Development*, Oxford University Press, 1985, p. 56-57.

So roughly  $2852/5000 = 50-60\%$  of the full cost tuition should be paid as a grant. This would then free about 40% of the current higher education budget for subsidising poor students (for the full cost of their fees) and the loans of those recruited into the public sector.

## Appendix 2

Suppose that in constant prices, the full cost fees of students are  $F$  per annum, Degree courses last 3 years.

$F$  — is full cost fee per annum, of which  
 $gF$ — is paid as a grant (bursary) to every student  
 $LF$ — is given as a real interest free loan and  $g + L=1$   
 $N^t$ — is the total number of students in universities in any one year of whom  
 $sN^t$ — are from poor backgrounds and hence get grants for *all* their fees.

Then  $3LF$  — is the outstanding loan that each 'non-poor' student has at the end of their studies. Assume that these loans can be paid back after a grace period of 2 years, and are paid in

$r$  equal instalments (different repayment schedules can easily be worked out).

$E^0$  — is the total public expenditure in the base period, and it is assumed that this remains constant in real terms for ever.

$R^t$  — are the repayments of loans that the Government receives in any year, and that

$d$ — is the default rate on the repayments due on loans in any year either because the loans are written off, or the graduate is on too low an income to repay.

Then in the first five years of the scheme the total number of students remains unchanged at  $N^t$ , of whom  $(1-S) N^t$  are getting a mixture of grants and loans in the proportion of  $gF$ -grant and  $LF$  loan.

At the end of 5 years, repayments on the loans begin. These in each of the next five years, will be

$$R^t = \frac{3LF(1-s)(1-d)N}{r} \quad (t = 5 \text{ to } 10)$$

Assuming that full cost fees in real terms remain unchanged, the extra number of students who can be financed, with the same proportions receiving loans and grants as before in year 5 to 10 are

$$\Delta N^5 = \frac{3LF \times N(1-d)(1-s)}{r} = \frac{3L(1-d)(1-s)N}{r}$$

so between year 5 to 9, the number of students

$$N^t = N + \Delta N^5 \quad t = 5 - 9$$

$$= N[1 + \frac{3L(1-d)(1-s)}{r}]$$

Between years 10 to 15, the expanded numbers will be paying back their loans and hence the student population can be expanded to  $N^t = N + \Delta N^s [1 + \frac{3L(1-d)(1-s)}{r}]$   $t = 10-15$

$$= N.[1 + \frac{3L(1-d)(1-s)}{r}]^2$$

Hence in the next five years the student population can be expanded to  $N^t = N.[1 + \frac{3L(1-d)(1-s)}{r}]^3$   $t = 16 - 20$

Thus assuming no change in the *proportion* of students on full scholarships, the numbers in higher education would grow in each five year period by  $3L(1-d)(1-s)1r$ . per cent *with no increase in public expenditure*.

Table 2 gives alternative rates of growth of the system based on different assumptions of the parameters.

If for instance the repayment period is 10 years, and only 20% of the fee is a loan, the student would pay £25 per month to cover the loan component of 3 years fees at £5000 per annum, and this would allow the higher education system to expand from 4 to 5%, even if default rates are 10 to 20% and the proportion of poor students on full scholarships rises from 10 to 20% of university graduates.

**Table 1**

Year	Govt. Expenditure Per Student £(constant) 1986-1987 prices		New Under graduate Entrants 000's
	UGC Block Grant plus Home Student Fees	UGC block Grant	
1979-80	5,421	4,386.9	74.7
1980-81	5,773	4,671.6	76.4
1981-82	5,589	4,380.1	74.0
1982-83	5,796	5,095.3	71.6
1983-84	5,830	5,147.4	69.2
1984-85	5,790	5,096.2	70.5
1985-86	5,606	4,914.7	70.3
1986-87	5,552	4,855.1	70.7
1987-88	5,753	5,066.9	72.0
1988-89 <sup>1</sup>	5,829	5,145.3	73.6
1989-90 <sup>1</sup>	5,741	5,058.6	75.7
1990-91 <sup>1</sup>	5,621	4,941.7	74.2

1. Planned.

Source: Hansard vol 135, Issues nos. 1453 & 1454, written answers 13.6.88 and 20.6.88 by Mr R. Jackson.

**Table 2**

Growth Rates of Student Numbers for each Quinquennium

		L=0.4		L=0.2	
		s=0.1	s=0.2	s=0.1	s=0.2
r=20	d = .10	4.9	4.3	2.4	2.2
	d = .20	4.3	3.8	2.2	1.9
		Assuming fees Fis £5000 capital repayment per month £25		capital repayment per month £12-50	
r=10	d = .1	9.7	8.6	4.8	4.3
	d = .2	8.7	7.7	4.3	3.8
		capital repayment per month £50		capital repayment per month £25	

The growth rates (:g) given in the boxes are derived from the formula:

$$g = \frac{3L(1-d)(1-s)}{r}$$

L- proportion of fees financed by zero real interest loan

s- proportion of poor students receiving grants for all their fees

r- repayment period of loan in years

d- the default rate on repayments on loans - including loans written off by public employers

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