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*The Treasury
View of HE:
Variable
Human Capital
Investment*

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The Treasury View of HE: variable human capital investment¹

If we are concerned about public knowledge and the political economy of its production, then we need to attend to the manner in which the funding of undergraduate study in England was transformed in 2012. Higher tuition fees were licensed by government at publicly funded institutions so that the latter could use fee income to cover large cuts to the direct public funding of tuition. Grants to universities and colleges were cut by roughly £3 bn per year and students pursuing ‘classroom’ subjects, such as politics and economics, are now solely funded by fee income. At the same time, loans to students were extended so that a maximum of £9,000 per year could be borrowed to cover these fees.

This generalised fee-loan regime is more than a temporary austerity measure. Its architect, David Willetts, the former Minister for Universities and Science, wrote in 2013 that ‘unleashing the forces of consumerism is the best single way we’ve got of restoring high academic standards’. Flagging up the course costs to students is meant to make them think more carefully about their university choices and make them demand more when they arrive to study.

But that is only the first step on the transition. The focus of policy has been the transformation of higher education into the private good of training and the positional good of opportunity, where the returns on both are higher earnings. Initiation into the production and dissemination of public knowledge? It does not appear to be a concern of current policy.

Such an anti-vision of higher education - let the market determine what should be offered - unfortunately meshes with a stratified higher education sector which mirrors an increasingly unequal society. This paper outlines the next phase of higher education policy which will exacerbate the erosion of public knowledge from the institutions traditionally most associated with it.

The Coalition government has quietly put in place a series of measures designed to support a new performance metric: repayment of loans by course and institution. It could become the one metric to dominate all others and will be theorised under the rubric of ‘human capital investment’.

The Small Business, Enterprise and Employability Act received Royal Assent at the end of March 2015.

Section Six of the bill is titled ‘Education Evaluation’.² It proposes amendments to existing legislation to allow the co-ordination of data collected by the Higher Education Statistics Agency and HM Revenue & Customs. The Department for Business, Innovation & Skills (BIS) has provided a gloss on the measures.³ Potential applicants to colleges and universities will in future benefit from information on the ‘employability and earnings’ of each institution’s alumni and alumnae. I quote:

¹ This is a companion paper to Andrew McGettigan, ‘The Treasury View of HE: student loans & fiscal control’ PERC e-book etc. What is outlined here as performance is coeval with the kind of data the private sector wants in order to price loan-assets.

² <http://www.legislation.gov.uk/ukpga/2015/26/part/6/enacted>

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/363503/bis-14-1135-sbee-bill-education-evaluation-fact-sheet.pdf

[The measures] will also help to create an incentive and reward structure at universities by distinguishing the universities that are delivering the strongest enterprise ethos and labour market outcomes for their students.

The ‘reward and incentive’ being that applicants could inform themselves about the future earnings of those who followed a particular course and choose where to study accordingly . In its 2015 Manifesto, the Conservative party pledges to ‘require more data to be openly available to potential students so that they can make decisions informed by the career paths of past graduates’.⁴

The Act is the latest move in a new phase of tertiary education policy. In 2012, a new question was added to the annual Labour Force Survey to allow ‘analysis of long-run earnings outcomes from specific institutions’. In July last year, Lord Young’s report for government, *Enterprise for All*, recommended that each course at each institution should have to publish a Future Earnings and Employment Record ‘so that students can assess the full costs and likely benefits of specific courses at specific institutions.’ One section of the report was helpfully titled, ‘What FEER can do’.⁵ In October 2013, David Willetts, then minister for science and universities, expressed his enthusiasm for a new research project funded by the Nuffield Foundation:

Professor Neil Shephard of Harvard University and Professor Anna Vignoles of Cambridge University are currently merging a wealth of data from the Student Loans Company and HM Revenue and Customs which should deliver a significant improvement in the current data on labour market outcomes of *similar courses at different institutions*.⁶ (my emphasis)

The research cited here has not yet reported, though we are promised some results ‘in the second half of 2015’.⁷ The project is titled ‘Estimating Human Capital of Graduates’ and seeks to assess how the future earnings of ‘similar students’ vary ‘by institution type and subject’:

If different degrees from different institutions result in very different levels of earnings for students with similar pre-university qualifications and from similar socio-economic backgrounds, then this might affect both student choice and policies designed to increase participation and improve social mobility.⁸

That paragraph captures the two angles to this debate: it is not just applicants who want to know what their monetary return on further study might be. Moving beyond consumer choice, the government as lender is becoming increasingly concerned by the size of the subsidy built-in to the student loan scheme as the latter is buffeted by recession, low bank base rates, a troubling graduate labour market and earlier mistakes in the modelling of future repayments.

⁴ op. cit. p. 35.

⁵ Published jointly by Prime Ministers Office & Department of Business Innovation & Skills *Enterprise for all: The relevance of enterprise in education*, 19 June 2014 <https://www.gov.uk/government/publications/enterprise-for-all-the-relevance-of-enterprise-in-education>

⁶ David Willetts, *Robbins Revisited: Bigger & Better Higher Education* Social Market Foundation, October 2013. p. 19

⁷ <http://www.nuffieldfoundation.org/estimating-human-capital-graduates>

⁸ *ibid.*

In England, annual student loan issues are now over £10 bn and are set to continue climbing to about £14 bn by 2018/19. Repayments languish at around £1.5bn. BIS reckons it will only get back the equivalent of 55 per cent of the £10 bn issued each year. 45 per cent is therefore lost as non-repayment. When the new higher maximum tuition fee was voted through in December 2010, it was assumed that the relevant repayment figure would be 70 per cent. Each percentage point of variance is the equivalent of £100 m in lost value (1 per cent of £10 bn). So a drop of fifteen percentage points means BIS is £1.5 bn worse off than expected on a single year's outlay.

There are various methods open to government to manage such shortfalls. But the Treasury is loath to abandon the new funding regime as a low return on a loan is still better than money spent on grants, where no money comes back. What the Treasury wants is information on good institutions.

The 2011 Higher Education White Paper presented undergraduate degrees as a human capital investment that *benefits* the private individual insofar as it enables that individual to boost future earnings. Universities and colleges are then to be judged on how well they provide training that does indeed boost earnings profiles. Such 'value add' would displace current statistical concoctions based on prior attainment and final degree classification. The key device is loans: they go out into the world and the manner in which they are repaid generates information. Graduates then become the bearers of the units of account by which HE performance is set into a system of accountability: 'What level of repayments is this graduate of this course likely to produce over the next 35 years?'

As Willetts had previously argued in 2012, the figures for non-repayment of loans in the departmental accounts, that 45 per cent, is an aggregate for a sector comprising over 100 HEIs, 300 FE colleges offering HE, and 100 private providers 'designated' as eligible for student support. This overall non-repayment figure masks variation in performance by subject (e.g. medicine and law graduates repay more), institution and sex. Willetts has indicated enthusiasm for robust disaggregation of the figures:

I expect that, in the future, as the data accrue, the policy debate will be about the [non-repayment rate] for individual institutions ... *the actual Exchequer risk from lending to students at specific universities.*⁹ (my emphasis)

It is this question of risk that returns us to what is the ur-text for English higher education policy, Milton Friedman's 1955 essay 'The Role for Government in Education'.¹⁰ In the second half of that text, Friedman discusses higher education, in particular professional and vocational education, and offers his understanding of human capital:

[Education is] a form of investment in human capital precisely analogous to investment in machinery, buildings, or other forms of non-human capital. Its function is to raise the economic *productivity* of the human being. If it does so, the individual is rewarded in a free enterprise society by receiving a higher return for his services.

⁹ David Willetts, 'We cannot be certain about every step. But the journey will be worthwhile', *Times Higher Education*, 26 May 2011, www.timeshighereducation.co.uk/story.asp?storycode=416257

¹⁰ Milton Friedman 'Role For Government in Education' (1955)

<http://www.edchoice.org/The-Friedmans/The-Friedmans-on-School-Choice/The-Role-of-Government-in-Education-%281995%29.aspx>

There is a role for government to provide loans to individuals for such study because capital market imperfections render such loans expensive or impossible to secure without collateral.¹¹ Existing imperfections in the capital market tend to restrict the more expensive vocational and professional training to individuals whose parents or benefactors can finance the training required. They make such individuals a "non-competing" group *sheltered from competition by the unavailability of the necessary capital to many individuals*, among whom must be large numbers with equal ability. The result is to perpetuate inequalities in wealth and status.¹² (my emphasis)

The problem from a national perspective is therefore 'underinvestment' and inequity (a lack of social mobility). Government intervention is justified if there are too few graduates or if graduates only come from the privileged classes. In the same essay, Friedman sketches a precursor to the income-contingent repayment loan underpinning English tuition fee policy. He proposes that the government 'buy a share in an individual's earning prospects'. That is to say, the government 'advances [the student] the funds needed to finance his training on condition that he agree to pay the lender a specified fraction of his future earnings' [sic].¹³

As England has transitioned towards Friedman's idea over the last twenty years (add the current policy to write-off outstanding balances thirty-one years after graduation and you have ICR loans), we have reached a hybrid loan-voucher scheme with a large subsidy provided by government (that 45 per cent of estimated non-repayment again). Friedman was explicit - a loan scheme should be self-financing and individuals should 'bear the costs of investing in themselves'. That said, he goes on to argue that money should follow the individual in either form, as loan or voucher, rather than being paid to institutions:

The subsidisation of institutions rather than of people has led to an indiscriminate subsidization of whatever activities it is appropriate for such institutions to undertake, rather than of activities it is appropriate for the state to subsidise. The problem is not primarily that we are spending too little money ... but that we are getting so little per dollar spent.¹⁴

And here is the rub. The growing and unexpectedly large subsidy built into the current iteration of fee-loan regime points to that same problem: the government is not getting the maximum from borrowers or from universities (which are using tuition fees to subsidise other

¹¹ What is often missed - for example, by Foucault - is that the family in Gary Becker's work is reconceived as a Coasian intergenerational *firm* making investment decisions. Social mobility is then accordingly calibrated so that no individual should be hamstrung by the decisions of their parents and antecedents. Socioeconomic Status (SES) is therefore a counter-concept to 'class'. In a society with high social mobility, SES can always be revised by good investment decisions - there is no systematic disadvantage - and the situation is competitive. But the role for government is to ensure that the human capital markets are functional and so inherited advantage is minimised. Long-run inequality is not determined by 'class' if access to capital is not constrained. (Even better if the market allows children to borrow as individuals rather than families on their behalf). This gives some content to Thatcher's 'there are individuals and there are families' and reveals the self-conception of David Willetts's *The Pinch* - where demographic cohorts, 'generations' is a third factor introduced to the analysis. We need to attend to *familia aëconomica* rather than *homo aëconomicus*.

Michel Foucault *The Birth of BioPolitics: Lectures at the Collège de France 1978-1979* edited by Michel Senellart [2004] & translated by Graham Burchell, Palgrave MacMillan 2008. pp. 215 ff.

David Willetts, *The Pinch: How the Baby Boomers Stole their Children's Future - And Why They Should Give It Back* Atlantic Books, 2010

¹² op. cit.

¹³ ibid.

¹⁴ ibid.

activities like research). One might blame universities that set fees for classroom subjects at the same rate as lab-based subjects, that blanket £9 000 per annum, or loan funding offered for subjects that do nothing to boost graduate productivity. Either way, it points to the issue of mis-investment rather than underinvestment. Indeed, given the statistics on graduates filling posts that do not require graduate qualifications, from the human capital theory perspective, one might even use the language of overinvestment in HE. It is not clear to many whether the problems of the graduate labour market are recessionary, structural, secular or a combination of all three.¹⁵

Belief in the generic value of a degree and its centrality to the neo-endogenous growth theory of the nineties is on the wane. There is now a cross-party consensus growing around the need to boost tech skills, through Degree Apprenticeships and Labour's idea of a new 'dual track' system.¹⁶ The latter term was chosen to deflect any suggestion of a return to the pre-1993 binary system of HE but in March, Vince Cable went so far as to lament the abolition of Polytechnics at an Association of Colleges event.

Human capital theory addresses this question - the risk of undesired subsidy and mis-investment - through Gary Becker's redefinition of moral hazard: 'Children can default on the market debt contracted for them by working less energetically or by entering occupations with lower earnings and higher psychic income.'¹⁷

In a different register, ministers have been looking back to Lionel Robbins's 1963 Higher Education report for inspiring slogan that launched a key phase of expansion: 'higher education should be offered to anyone who can benefit'. What needs underscoring is the definition of 'benefit' is being transformed by what in *The Great University Gamble* I called 'financialisation'.¹⁸ Benefit now walks forward redefined in monetary terms as creditworthiness - of institutions and individuals. 'If this student with these qualifications from this background does this course, how much should we lend them towards fees? Is this an institution that does provide training that increases graduate earnings?' In September 2012, Willetts outlined the dream:

Imagine that in the future we discover that the RAB charge [non-repayment rate] for a Bristol graduate was 10 per cent. Maybe some other university ... we are only going to get 60 per cent back. Going beyond that it becomes an interesting

¹⁵ 'Over the 10 years 1993 to 2003, average graduate earnings grew by an average 0.9% per year in real terms. Given the decline in real earnings associated with the recent financial crisis and recession, average graduate earnings actually declined over the period 1993 to 2012 – equivalent to an average 0.2% decline per year over the 19 years. The real growth in average graduate earnings in recent decades has therefore been lower than the 1.1% a year real average earnings growth assumed by the OBR for the long run. However, this lack of growth in average earnings *might be due to changes in the composition of graduates*: as more individuals obtain degrees, the average quality of degrees may have declined.' (my emphasis)

Claire Crawford, Rowena Crawford & Wenchao Jin *Estimating the Public Cost of Student Loans* Institute for Fiscal Studies, April 2014. p. 34, fn. 37.

¹⁶ Liam Byrne 'Over the weeks to come we'll have more to say about reform and our ambition to build a British "dual track" system, creating for the first time a big, wide vocational, professional and technical path to degree level skills for students who want to earn while they learn ...'

<http://www.timeshighereducation.co.uk/comment/opinion/liam-byrne-why-fees-should-be-6k/2018816.article>

¹⁷ Gary Becker *Human Capital: a theoretical and empirical analysis with special reference to education* (3rd edition) University of Chicago Press, 1993. location 4244 on Kindle edition

¹⁸ Andrew McGettigan *The Great University Gamble: money, markets and the future of higher education* (Pluto, 2013)

question, to what extent you can incentivise universities to lower their own RAB charges.¹⁹

On the down-side, the easiest way for universities to ‘lower their own non-repayment rates’ is to reduce fees or alter the balance of subjects and places they offer. For the government as lender, removing access to the loans - ‘dedesignation’ - would represent a significant sanction against institutions, though the threat of any withdrawal will be stronger than the execution.

In the first instance however, the evaluation data sought by that series of measures I outlined earlier only needs to be good enough to justify two tiers of maximum fee. A normal maximum and a higher one for high-cost subjects at ‘successful’ institutions. To mimic the vice-chancellors at the elite end of things: ‘We are losing money on our high-cost subjects but our graduates are good for higher borrowing, so give us dispensation to set a tuition fee above the current maximum.’ Friedman rejected the idea of a flat offer to all applicants:

... the [repayment demanded] should in principle vary from individual to individual in accordance with any differences in expected earning capacity that can be predicted in advance--the problem is similar to that of varying life insurance premia among groups that have different life expectancy.

Variance of this kind would have an additional ‘benefit’ from the free market perspective of the Treasury: so long as there is a significant subsidy beneath the lending then the tuition fee is prevented from fulfilling the signalling function neoclassically associated with price.²⁰ The headline fee does not provide this key function, since you cannot tell how much you are actually likely to repay after graduating. This means that students are prone to ‘moral hazard’ by making choices other than for reasons of productive investment. (Unlike Friedman’s idea of a voucher, the loan subsidy received by any given individual is unpredictable and uncertain.)

If price is to be the single best indicator of quality, reflect future cost and dissuade mis-investment, then the subsidy must be eroded as much as possible. That’s the neoclassical logic. The first step here is the likely freezing of the repayment threshold for the latest loans at £21,000 after 2016. As graduate earnings rise in the following years, ‘fiscal drag’ would generate more repayments and address immediate concerns about the ‘sustainability’ and ‘generosity’ of repayment terms. Graduates though would be paying more than they would have anticipated in 2012.

What I have outlined here, the coming wave of ‘education evaluation’, threatens to supplant traditional understandings of universities as communities advancing public knowledge. Current regulations governing the awarding of degrees aver that standards are maintained and safeguarded only by the critical activity of the academic community within an institution. It will be harder and harder to recall that fact.

¹⁹ David Willetts interview with John Morgan, ‘Wake up to the new world, declares Willetts’ *Times Higher Education* 11 October 2012 <http://www.timeshighereducation.co.uk/421448.article>

²⁰ Note that from a free market perspective, cross-subsidy, whether of subject to subject or teaching to research and vice versa, is a problem for this reason. The government is not anti arts and humanities but is very much exercised by fees set at £9000 rather than close to the presumed ‘cost base’. The preference for free markets also explains why the Treasury decided to remove Student Numbers Controls entirely from universities this coming Autumn: restricting places leads to unmet demand which keeps prices high.

As a conclusion it should be recognised that human capital theory presents itself as a progressive theory in support of social mobility. Human capital investments ‘dominate’ (in the language of economics) ability and would be the preserve of the wealthy without state intervention. What is crucial then is access to the professions, hence the more recent concern with postgraduate loans. New data on the performance of institutions would then help those making investment decisions in a market currently saturated with proxy information and hundreds of rival institutions.

The risk is that academics seeking to resist this further privatisation of knowledge will be cast as vested interests seeking to protect an old, inadequate system lacking in transparency. We will end up on the wrong side of the argument. The difficulty: How to articulate what is threatened? How to defend forms of knowledge which are not subordinate to private returns? Academic freedom and autonomy now face a more pressing, insidious, financialised threat than the traditional bugbear of direct political interference. But all this may prove too abstract for effective resistance.

I have no glib solution to which you might sign up. But when hard times find us, criticism must strike for the root: the root is undergraduate study as a stratified, unequal, positional good dominating future opportunities and outcomes. What might find broader public support is a vision of higher education institutions that are civic and open to lifelong participation, instead of places beholden to the three-year, full-time degree leveraged on loans and aiming to cream off ‘talent’.

What is needed is a recasting of the very structure of undergraduate provision, one in tune with concerted interventions in economic, industrial and labour market policy. This would upset traditional notions of higher education, but it is not clear that they were ever adequate to the mass, not to say, universal, public knowledge envisaged, for example, by Raymond William’s ‘third revolution’:

We speak of a cultural revolution, and we must certainly see the aspiration to extend the active process of learning, with the skills of literacy and other advanced communication, to all people rather than to limited groups, as comparable in importance to the growth of democracy and the rise of scientific industry. This aspiration has been and is being resisted, sometimes openly, sometimes subtly, but as an aim it has been formally acknowledged, almost universally.

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