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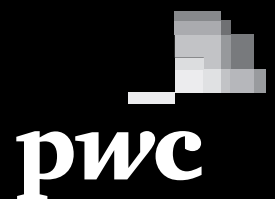


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**Special Edition:
Higher Education**

Whither Scottish Higher
Education?

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This is the second in a series of 'Special Issues' which seeks to publish policy related papers. This second issue highlights issues related to the funding of higher education. We hope this paper stimulates discussion in the policy making communities in Scotland.

Cliff Lockyer
Managing Editor,
Fraser of Allander Economic Commentary
April 2011

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Fraser of Allander Institute
Department of Economics
University of Strathclyde
Sir William Duncan Building
130 Rottenrow
Glasgow G4 0GE

t: +44 (0) 141 548 3958
f: +44 (0) 141 548 5776
e: fraser@strath.ac.uk
w: <http://www.strath.ac.uk/fraser/>

Whither Scottish Higher Education?

Jim Love* (Formerly Professor of Economics and Senior Officer, University of Strathclyde)

Introduction

The last year has seen much discussion across the UK of the funding of Higher Education. Discussion among politicians, media commentators and academics has highlighted two elements: the continuing need to find an approach to the funding of Higher Education which facilitates high, international quality of research, teaching and knowledge exchange activities; and the continuing durability of familiar and exhaustive arguments about sources of contributions to funding. Against a long-standing background of governmental financial support for the UK HE sector, policy-makers are choosing elements from a well-established menu of options about sources of funding, and, as evident in policies on tuition fees, those choices may vary in different parts of the UK. The recent past has also seen, in contrast to the approach taken by Dearing some fifteen years ago, a series of partial approaches to the issue of HE funding: debate on RAE/REF exercises and the associated funding regime takes place almost separately from the discussion of funding education which tends to concentrate on fees and graduate contributions.

Contributions to HE funding

Conventionally, government in the UK contributes to the funding of HE. This is, in part, to ensure supplies of graduates in particular disciplines such as medicine and teaching. In part, public funding reflects a view that society benefits from having a well-educated group in terms of behaviours, attitudes and concerns for others. A further element of the rationale is a recognition that access to education and the assumed resulting access to employment helps address problems of social disadvantage. Increasingly also, higher education through its research, knowledge exchange and education activities is seen as having important impacts in terms of employment and income generation, and, indeed, may be important to delivering governments' growth objectives.

Political mantras on the importance of education are reflected in continuing, sizeable commitment of public funds. Such expenditure is under considerable pressure on two fronts. First, public expenditure across the board is being

*While benefitting from the comments of others, the views in this paper are those of the author alone.

reduced to tackle budget deficits. Secondly, as governments prioritise, higher education finds itself further down the pecking order than military expenditure in Afghanistan, Trident renewal, health services and other areas of education. Thus, there are pressures to reduce expenditure, to focus spend on certain types of disciplines at the expense of others and to find or continue, as with tuition fees in England, alternative sources of funding. Increasing taxation generally to pay for services appears to be something that remains beyond the political pale in the UK.

Within the business community there are individuals and companies altruistically supporting HE through donations and endowments, often on the principle of 'giving something back'. Generally, however, business sees higher education as providing a supply of graduates with specific skills and/or with enhanced understanding and learning abilities. Beyond that, most businesses engaging with universities typically do so on a 'something for something' basis, through research/knowledge exchange contracts or specific studentship support for employees or prospective recruits. Welcome though this funding is to universities, it does not address widespread financial pressures.

It is highly unlikely that direct business contributions will help resolve the present difficulties of the HE sector. Businesses probably see themselves as already paying for the 'social good' provided by universities through the existing tax arrangements for companies and their employment of tax-paying graduates.

In terms of contributing to HE funding, the focus has fallen primarily on students and prospective graduates for two reasons. First, the prospect, certainly in the short- to medium-term, is of further tightening of public contributions and relatively limited business support. Secondly, graduates typically earn more on average over their working careers than is the case for non-graduates. The issue has tended then to coalesce into determining the choice of mechanism through which students/graduates contribute.

Whatever the mechanism, however, there are reservations. Students/graduates, even if they accept that they typically earn more on average than others, may feel that they contribute more to general taxation in absolute and proportionate terms and are critical in creating income and employment for others. As with business, they may argue that they are making their contribution through existing taxation arrangements and that asking graduates to repay part of any graduate income premium is unjust. There is also a strong sentiment that it is 'unfair' to burden new graduates with debt at the start of their post-university careers: the corollary to this view is that other taxpayers, regardless of whether they or their families participate in HE, should carry the tax burden.

In addition, there are concerns about access to HE for disadvantaged groups. For prospective students from disadvantaged areas, often with no direct family experience

of universities, the prospect of adding additional future contributions to 'pay' for taking a degree programme to the likely maintenance costs may well affect adversely the level of participation. This compounds the difficulty that for many students in disadvantaged areas the likelihood of obtaining the grades necessary for entry to the most popular or 'prized' courses is not high.

Over the past twenty years or so efforts have been made to ensure that socially and economically disadvantaged groups should be given greater opportunities to participate in HE. While increasing in absolute terms with the expansion of HE places, the participation of disadvantaged groups has not grown markedly in proportionate terms. HE remains dominated by 'middle class' groups, who may, on balance, enjoy a subsidy from public support.

Governments' contracts with universities and students

In terms of their contract with universities, governments have a considerable degree of monopsony power. The process of their determining numbers of places and setting levels of government support for student places is well-established, and their prioritising of disciplines is already biting. Governments also tend to go beyond contracting with the universities to support a given number of student places, eg by controlling the number of EU students in aggregate. Thus, even if a number of EU undergraduate students, whether from the UK or elsewhere, are prepared to pay full fees and maintain themselves, such numbers are counted against student target numbers.

In contrast to controls on intakes and potential fee income, governments recognise that universities are autonomous institutions when taking decisions on the deployment of resources which fairly frequently in the present financial climate involves measures having to be taken to remedy budget shortfalls, eg by reducing academic and professional services staffing costs, often with attendant reductions in programmes offered, and/or by cancelling or postponing capital expenditure.

At polar extremes, governments' 'contract' with students might (not) extend to providing full (any) support, whether for fees or maintenance, with students having to pay no (all) maintenance costs, no (all) balance of any fee cost on prioritised courses and no (full) fee costs for other courses. In practice, however, UK governments have engaged in providing support for students and the political issue for governments is that of determining where to pitch support on the spectrum between these extremes which might be acceptable to students and the wider electorate and which might maintain levels of fee income and student numbers to help sustain the universities.

On the assumption that government and business are not in a position to provide a solution to maintaining and, even less likely, to enhancing the resources available to universities, attention has devolved on to students/graduates, whatever

their concerns, and on to the choices available for arranging their contributions.

Features of student/graduate contributions

Whether in the form of loans, up-front tuition fees or post-graduation tax schemes, there are recurrent features of the contributions which may be made by those participating directly in HE:

- (1) (re)payments are usually deferred until after graduation and are made on the basis of income from employment;
- (2) (re) payments are not directly related to course costs;
- (3) there are threshold income levels before (re)payments begin and, in the case of loans, these thresholds trigger real interest rate levels;
- (4) outstanding (re)payments are typically written off after some specified time period; and
- (5) students frequently have access to loans for maintenance, which may be means-tested against parental income.

The exact form of these features varies with the specific scheme adopted; and these features are to be seen, for example, in the particular outcomes of the Browne Report for tuition fees in England from 2012.

The Scottish context

Within the Scottish context, there has been a fairly wide political consensus in favour of having a world-class HE sector and against seeing a (partial) funding solution through tuition fees of the English model. Equally, until recently, there was a clear reticence among politicians, in the run up to the Holyrood elections in May, to explain how they will ensure support for Scottish universities to enhance performance and resolve any funding gap that may emerge relative to English universities or other major international competitors over the next few years. One feature of the funding debate changed at the beginning of March when, perhaps driven by an element of bidding for electoral support, political parties began to disavow the need for graduate contributions. Universities find themselves trying to deal with considerable funding reductions this year and prospective reductions over coming sessions while facing considerable uncertainty over the shape and levels of future contributions to their income streams.

The control numbers system operated by the Scottish Funding Council also has a seemingly political dimension. While the EU requires that Scottish universities are only paid home fees, as set by the SFC, for EU students (other than from England and Wales), financial penalties are imposed by the SFC on universities if home and EU undergraduate student numbers jointly exceed the control numbers set by the SFC. This seems to reflect political concerns that any excess numbers of students paying the full fee costs might be seen as 'buying' access to HE and

that this option is probably not available to students from disadvantaged backgrounds. There is, however, no restriction on non-EU students, whatever their socio-economic background, paying their own fees to participate in Scottish HE. Nor is there any sense of how higher EU student enrolment might further disadvantage home students from particular backgrounds for whom the most direct issue is their participation relative to more affluent home student groups.

Where to now?

For some time the focus of debate has been on how much and in which way students should contribute to HE costs. Given government positions on deficit reduction, on prioritisation of public expenditure and on income taxation, combined with limited business support, the debate has been pushed in that direction. The Browne Report exemplifies this approach, and makes no serious attempt to reconsider more fully the relationship between government and the universities. Even if only the issue of possible student contributions is discussed, there is a need to examine again the nature of the 'contract' between government and the universities.

Student/graduate contributions

In Scotland the tuition fees option has been excluded politically. Even were it not, and recent political pronouncements in Scotland notwithstanding, an income-contingent contribution from students after graduation is a sounder approach. It helps shift concern about what is to be paid away from the time at which application is being made and away from the need for prospective students and their families to arrange funding not only for maintenance but also for fees. This is likely to be more important to families in the less affluent parts of the community and for whom supporting a family member through a university course is a considerable challenge. An income-based charge does represent an additional tax burden on graduates, but with income thresholds before any payment is made and with graduates as a group earning more than others there is an inherent fairness.

A further element of social 'fairness' could also be added if means-tested maintenance grant payments were made by government to students whose parental income falls below certain levels and/or for students attending schools or colleges in certain post code districts. Such a scheme could also recognise the number of students in a low-income household participating in HE. In principle, all students might be treated in the same manner as independent adults without parental means-testing, but such an approach to maintenance means all students having to have recourse to loans and does not help tackle effectively issues of access and participation.

A post-graduation contribution scheme (and a means-tested maintenance grant system) would require up-front capitalisation of the future stream of graduate tax payments. This could be done by government or, at least in principle,

by the banking sector. There would also require to be a clear sense of the ambition government has for universities and how public funding contributes to that. Government in Scotland would have to decide whether or not Scottish universities should be competing with the best in North America and increasingly China. The next step is then to determine whether such world-class standing can be supported by funding at the levels which English universities may have once the Browne Report proposals reach steady state or whether more (or less) will be required if quality and performance levels are set against English or global competitors. By comparing the 'desired' level with current actual levels, it is then possible to start looking at the scale and feasibility of the income-contingent contribution that can be made by graduates.

Such an approach might result in a funding gap between the 'desired' level and the funding that can be supported by the feasible contribution to universities' funding from the taxation of graduates. This might then trigger rethinking of the level of ambition for all or for some of Scotland's universities, and/or the whole set of arrangements around university funding including undergraduate education.

Universities will have a view on the 'desired' funding level and, from a university perspective, there may be a potential concern that governments might undertake the process from the opposite direction, and for understandable political reasons. The attraction to politicians might well be to identify the politically feasible and saleable level of graduate contribution and to declare that level as being sufficient to ensure world-class standing for the Scottish HE system, funding levels elsewhere notwithstanding. This approach might generate funding similar to Browne steady-state levels in England. If, however, it does not, because the political driver is to minimise as far as possible the additional taxation payable by graduates, the Scottish system may find itself at considerable disadvantage even within a UK rather than a global horizon in attempts to attract quality staff and to provide high-quality infrastructure.

Where the political preference is for a zero level of graduate contribution, this needs to be accompanied by a clear statement of: (i) what government is prepared to contribute from the public purse; (ii) why government believes that contribution is sufficient to maintain or improve the Scottish sector's world standing; and (iii) particularly in an era of public expenditure restraint and reduction, which other publicly-funded services are to be affected in order to support higher education.

Governments' contract with universities

For the reasons listed earlier, governments provide support to universities. While universities, and faculties and schools within universities, vary in the proportions of their income derived from public support for undergraduate programmes, there is unlikely to be any widespread advocacy among universities for removing that support. There may be a need,

however, to review the nature of the relationships between government and the universities.

Governments are, in effect, purchasing given numbers of student places from a set of autonomous HE providers. As indicated earlier, however, the role of government extends beyond this 'purchase' of student places to imposing control numbers on Scottish and EU student places. In addition to setting student numbers, governments' monopsony power embraces setting the fee levels at which places are purchased in broad discipline bands. The broad-brush nature of the fee levels and the issue of whether they reflect institutions' costs in supplying places have been debated inconclusively for some time.

Fees set for a broad group of disciplines are the same for all Scottish universities and there is no effective differentiation for differences in programme quality across institutions. A blanket approach to pricing for any discipline also, of course, fails to take account of a central element in programme quality, namely the linkage between research quality and teaching. Quality differences are frequently attested to in the accreditations awarded (or not awarded) by academic peer groups and professional bodies.

Governments undertake their own exercises in quality assurance through the Enhancement-Led Institutional Review (ELIR) process. These exercises, apart from the resource commitment required of the universities, again reflect the exercise of control in that their scope extends beyond the programmes on which governments purchase places and set fees, whether these other programmes are delivered locally or internationally. Adverse ELIR outcomes might have serious reputational impacts and, *in extremis*, governments could remove funded places and potentially threaten the financial viability of institutions. The extension of ELIR beyond the programmes supported by government, is predicated presumably on a view that, for example, a programme delivered badly might impact on the reputation of the Scottish HE sector as a whole.

Quality issues and reputation are, of course, vital to universities. Equally it is essential that government, on behalf of taxpayers, has confidence in the quality of the programmes on which there are publicly-funded students. It is reasonable to ask, however, whether the extension of the ELIR process beyond government-supported places is overly intrusive and whether it is sufficiently helpful to universities to warrant its continuation in its present form. Universities are jealous of their reputations and have internal systems, along with external academic and professional accreditations and external examiner systems, which are designed to ensure standards. ELIR may pick up some 'aberrations' in the very large portfolio of non-government-supported programmes offered by Scottish universities but there must be doubts over whether, given the sensitivity of educational markets to quality and reputation, ELIR adds much to the adjustment/correction process.

The continuing exercise of controls over the university sector contrasts with governments' declarations, at both UK and Scottish levels, of the wish to decentralise decision-making to local levels, whether in fields such as health or local government.

Whither controls and funding?

The issue of controls is relevant to the debate on future HE funding. Accepting fee levels as they are in view of the downward pressure on government budgets, there are steps governments could take to enable income generation by the universities. These steps would require a 'culture' shift by governments away from controls and regulation to seeing the relationship with universities as being much more contractual in nature. Governments could restrict themselves to being in a contract with universities to purchase given numbers of student places. Equally, of course, universities, as autonomous institutions, should be able to decide whether they wish to take student numbers and fee levels as offered by government.

Removal of control numbers and the associated clawback arrangements would allow universities to offer places on programmes to home or EU students currently denied access, provided they satisfy entry requirements. On equity and compliance grounds, not least EU requirements, additional students could be charged fees as paid by government. This might not generate much income in the short-run but would start to rebalance the relationship between governments and universities, and opens up the possibility of universities developing another channel for income growth as has been done with international (non-EU) students and graduate entrants to undergraduate courses.

Access issues might be addressed by government deciding that certain minimum proportions of the places it purchases are to be reserved for students from disadvantaged backgrounds. The allocation of these reserved places to universities could reflect institutions' relative success in attracting such students over, say, the past five years. This could also be seen as being reinforced if there were a means-tested maintenance grant scheme.

A difficulty with such positive discrimination is that, as referred to earlier, students from disadvantaged groups often find it difficult to compete on entry standards and, consequently, there may be a risk of diminishing the quality of entry standards as measured by Highers and other qualifications. There is a potential trade-off here which politicians could helpfully take an explicit and public view on.

Whether fee levels set by government will sustain universities in a competitive global environment and permit universities to deliver on social and growth objectives is a moot point. In the international arena Scotland does reasonably well in league table terms. Both in league tables and in the development of reputation and regard, research plays a crucial role.

Research is mostly undertaken by individuals who deliver teaching programmes, and physical infrastructure is frequently used for both teaching and research, as well as for knowledge exchange which builds from these activities. While monitoring exercises seek to identify the proportions of time spent on different activities and, thus, the associated costs, the resulting estimates are broad-brush in nature and do not capture the fluidity and integration of movement across academic roles. Seeking to tackle the costs and funding of teaching and research largely in isolation from one another produces two partial snapshots with no guarantee of their addition resolving the big issue of public provision for those direct and indirect economic and social benefits the community derives from HE.

Given the often indirect and delayed links between many different types of research and the impacts on society, it is difficult to determine monetary values for research. At present public funding for research is directed to Scottish universities through administered values placed on performance in RAE/REF exercises by the SFC on behalf of government and through competitive application to the UK Research Councils. In addition, in Scotland SFC operates a Horizon Fund for academic initiatives which is taken as a general top-slice from monies allocated by government for higher education and then distributed by the SFC for particular purposes including research. The nature of the funding regime for research might also form part of any reconsideration of the nature of the contractual relationship between government and HE.

The principal agencies operating between government and the universities in Scotland are the SFC and Universities Scotland. If a holistic approach is being taken in terms of coverage of academic activities and if the nature of the contract and control relationships is being rethought, especially when decentralisation of decision-making is much discussed, it would be prudent also to examine the remits and operational dimensions of these two bodies to judge their fitness for purpose in a new environment.

Any such successor review to Dearing (The National Committee of Inquiry into Higher Education, 1997) and Cubie (The Independent Committee of Inquiry into Student Finance, 1999) might also look at issues such as the role of higher education provision in Further Education and the relationships with university programmes. A feature of review processes is that they can be lengthy and, particularly for University managers, staff and students, any delay may be unwelcome. Urgency should not be confused, however, with importance. A pragmatic, interim solution might be: (i) to have the higher education sector and the post-May Holyrood Government engage immediately in renewed debate about the adequacy of the funding settlement for the period until the end of academic session 2012/13; and (ii) to set a deadline for final reporting by a review in mid-2012 with outcomes to be implemented in session 2013/14.

Observations

Discussion here has focussed on a number of issues and not on the arithmetic of university funding. In looking at future contributions to funding it is important to have a two-stage process which begins by establishing clear principles and relationships before moving to the funding numbers and their rationale. Doing otherwise runs the risk of having principles and relationships submerged from the start in a debate dominated by issues of who pays what and when.

The main observations drawn here are:

- (i) there is a need to examine the nature of the relationship between government and universities and the associated funding and contractual matters;
- (ii) such examination should embrace research, knowledge exchange and education and not seek to take a partial view which concentrates on students' contributions to the funding of teaching programmes;
- (iii) as part of the consideration of the relationships between government and HE there should be an examination of the extant control and agency functions in the system and the nature of a more clearly contractual relationship;
- (iv) any changes in the system need to be assessed in terms of their implications for the quality of outcomes;
- (v) it seems inevitable that in time students contributing to the costs of higher education will be a feature of the Scottish system as in England and many other countries;
- (vi) given such inevitability, contributions from income after graduation rather than up-front tuition fees seem to provide a way forward, subject to the kind of arrangements set out above.
- (vii) consideration should be given to means-tested maintenance grants as a mechanism to support access, and to be funded through the increased contribution funding made by graduate.

Universities are resilient institutions. Now, fifteen or so years on from Dearing and Cubie, seems an opportune time to review the whole relationship between higher education and government. Not doing so might result in increasingly difficult times for institutions seeking to operate in a highly competitive global market. It might help focus the attention of both universities and governments to contemplate the consequences for growth and social welfare were Scottish higher education to see future erosion of its capacities to deliver quality education, research and knowledge exchange.

Contact details:

e: james.love4@ntlworld.com
t: 0141 959 8903