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Paying for Higher Education: Are Top-Up Fees Fair?<sup>1</sup>

**By/Par**

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**ABSTRACT**

This paper considers four institutional models for funding higher education in the light of principles of fairness and meritocracy, with particular reference to the debate in the UK over 'top-up fees'. It concludes that, under certain plausible but unproven assumptions, the model the UK government has adopted is fairer and more meritocratic than alternatives, including, surprisingly, the Graduate Tax.

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## **1. FOUR MODELS**

Consider four models for paying for higher education:

- 1) Wholly state-funded provision (*Full Funding*): Universities are paid for entirely by the state, so are free at the point of delivery. Admission is selective, and students pay their way through college with a mix of parental support, part-time work, and loans.
- 2) Means-tested funded provision (*Means-Tested Funding*): students pay the full cost of their tuition as well as for their upkeep, out of a mix of parental support, part-time work, and loans. Students from low-income backgrounds have a sliding-scale subsidy, which pays, for those from the very lowest income backgrounds, the whole of their tuition fees and a significant part of their living costs.
- 3) Graduate-tax funded provision (*Graduate Tax*): universities are free at the point of delivery, but graduates pay a premium on their income tax returns to fund future provision, so that universities are not paid for out of the general fund. Students universally receive spartan, but adequate, maintenance grants to cover their living costs.
- 4) Unfunded provision (*No-Funding*): students pay the full cost of their tuition as well as for their upkeep, out of a mix of parental support, part-time work, and loans

## **2. FULL-FUNDING VERSUS MEANS-TESTING AND GRADUATE TAX.**

The UK system of paying for higher education is a hybrid of Full Funding and Means Tested Funding: students pay for their upkeep themselves, and pay part of the cost of tuition (currently LS1,125). The recent adoption of so-called ‘top-up’ fees, whereby universities will be permitted to charge as much as LS 3,000 represents a shift closer to Means-Tested Funding, though students will still pay much less than the real cost of their tuition.

Which of the above models is the fairest? The UK government ministers insisted that the move further away from Full Funding toward Means-Tested Funding was motivated by fairness. The idea is this: it is unfair for everyone to get a subsidy that not everybody needs equally. Why should middle class children have their higher education subsidized when their parents can well afford, and most working class children will be ineligible for, or will choose not to take up, the subsidy? In effect, the government wants to make funding for college a means-tested benefit. Under the old arrangements students from low-income families were exempt from tuition fees; under the new arrangements they will be, effectively, exempt from fees at the Universities which charge the top-up fees, and will actually receive, in addition, a small living-expenses grant at any universities not charging the top-up fees.<sup>2</sup>

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<sup>2</sup> This is not how the arrangements have been described formally, but it is how they will work out.

In the public debate within the UK, Means-Tested Funding and Graduate Tax have been distinguished by the government on practical, but not principled, grounds. A broad consensus holds that higher education is under-funded; the universities want money sooner rather than later; and the Treasury wants to avoid current account deficit. The graduate tax proposal would yield resources only after the next entering cohort graduated, and even then significant revenues would emerge only once that cohort was earning larger salaries. However, there could be, in principle, a fairness issue too. Graduate tax proposals are typically sensitive only to the prospective incomes of the graduates; not to their classes of origin. The government does not regard higher education as a basic entitlement, but as a privilege for which people may legitimately be charged. They regard it as unfair that the needy and the wealthy should pay the same amount for goods to which there is no entitlement, and regard differential charging as, in principle, fair. If it is unfair to expect students from low income families to pay as much for their university education as students from wealthier families, Means-Tested Funding could be superior to Graduate Tax, which charges them the same amount. Graduate Tax could, of course, be supplemented by a means-tested grant to students from low-income backgrounds.

Full-Funding is used by most mature democracies for primary and secondary education. Why should Higher Education be treated differently from primary and secondary education in the first place? Like primary and secondary education higher education is implicated in the production of public goods; and the fact that schooling produces public goods typically plays a central role in justifying funding of primary education.<sup>3</sup>

But higher education is different in three important ways. First, we think that there is an age of majority at which it is appropriate to hold people accountable for their major life decisions, and, arbitrary as it is, 18 is the age that most industrial democracies have designated. It is only partially arbitrary - almost everybody would agree that 30 would be too high, and 7 too low, and for good reasons. Second, higher education is not compulsory but voluntary. It is expensive, and is not something that everyone would gain from in their late teens and early 20s (even if they would later), so it would be extremely inefficient to make it compulsory. Third, the monetary return to higher education flows largely to the individual receiving the education, whereas, in most conventional analyses, a much greater proportion of the return to primary and secondary education constitutes a public benefit. Because the person undergoing higher education is the primary beneficiary, and because it is reasonable to hold him accountable for his behavior, it is unreasonable to ask others to pay for it, especially if those others are not getting a benefit. Given the desirability of people bearing the costs of their own choices, why should we not reject all of 1-3 and adopt No-Funding instead?

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<sup>3</sup> I dispute that the fact that it produces a public good should play a central role in justifying funding compulsory education in *School Choice and Social Justice* (Oxford: Oxford University Press, 2000), chapter 2.

### **3. THE CASE AGAINST NO-FUNDING.**

Why, in other words, should anyone enjoy the benefits of higher education without paying the full costs? Because a second imperative also motivates the government. The ideal of meritocracy – that talent and effort should be rewarded with success, but social class background should, itself, not be a predictor of success – demands that participation in higher education be roughly proportionate to the numbers in the cohort from all social classes. Higher education makes an important contribution to success, as measured in terms of lifetime expected incomes, and access to interesting jobs. The precise amount of the wage premium attached to a degree is unclear: what is clear is that it is substantial. A recent OECD report claims a premium of 17% (exceptionally high for OECD countries)<sup>4</sup>, taking into account foregone earnings, costs of tuition, and tax rates; and a Labour Force Survey study shows graduates aged between 20 and 24 earning (gross) 25% more than those with A-level (and equivalent) qualifications<sup>5</sup>. Even if we assumed as low as a 10% all-things-considered premium, that is a substantial benefit, especially when combined with the relatively more interesting and autonomous jobs that are available to the HE graduate<sup>6</sup>.

These gross figures obscure considerable differences among kinds of degree, and also among institutions. The premium is higher for science than for arts graduates, and may be higher for graduates of elite than for graduates of low-prestige institutions. And variation itself varies over time and across countries. Whatever the premium, it is worth noting that it is an artifice of the design of tax-transfer policy. As one would expect, the OECD estimates that HE has much a lower monetary benefit in those countries with more progressive tax-transfer policies. It is also an artifice of the private costs of higher education; if students had to pay the full cost of their tuition, that would make some inroads into the net monetary benefit. In principle it should be possible to design a tax-transfer regime in which the income-maximiser was indifferent to, or even averse to, higher education, although no participants in the UK debate have proposed this. But the meritocratic case against 4 would evaporate in such a regime.

Higher education has, of course, expanded massively in the UK over the past two decades, but the proportions of participants from different social class backgrounds has remained more or less constant, and participation is dramatically greater among children from high social class origins. The 1997 Report of the National Committee of Inquiry into Higher Education reports that whereas in 1940 8.4% of the 18+ cohort from social classes I, II, and III<sub>n</sub> participated, only 1.5% from social classes III<sub>m</sub>, IV, and V participated. In 1950 the

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<sup>4</sup> OECD, *Education at a Glance 2002*, Chapter A : The output of educational institutions and the impact of learning.

<sup>5</sup> *Graduate Market Trends*, Spring 2001.

<sup>6</sup> Jeff Borland, Peter Dawkins, David Johnson, and Ross Williams, *Returns to Investment in Higher Education: Report to the Vice Chancellor, the University of Melbourne* estimate the return to HE in Australia as AU\$300,000 (earnings over a working lifetime) and \$90,000 (net monetary benefit).

percentages are 18.5 and 2.7; in 1960 26.7 and 3.6, and so on till 1995 when the figures are 45% and 15.1%. The report explains:

As Halsey (1980; 1993) points out, whenever the [HE] sector expands – from 1963 or from 1987 – the fastest rates of growth go to the lower socio-economic groups, but the absolute incremental growth goes to the higher socio-economic groups. The effect is to maintain nearly constant ratios of participation between higher and lower socio-economic groups, by volume, at approximately 75:25 for the pre-1992 universities and 68:32 for the 1992 universities. These ratios have remained broadly unchanged over a long period.<sup>7</sup>

If we believed that talent correlated well with social class of origin there would be no particular meritocratic case for trying to encourage more equal participation by social class of origin, since meritocracy requires rewarding talent, rather than intrinsically requiring compensation for disadvantage. But there is no reason to think that differences in talent correspond well to differences in social class of origin, so the state should take measures to remove barriers to working class participation, and the way to do this is by reducing the upfront costs either on a means tested or universalistic basis.<sup>8</sup> The concern for meritocracy thus supports 1-3 over No-Funding, while the concern for fairness supports Means-Testing and Graduate Tax over Full Funding.

In the previous paragraph I took talent to be the marker of merit. But meritocracy is the view that talent and effort should be rewarded, not just talent. Why, then, isn't the lower preference working class 18-year olds display for taking up higher education properly understood as lower effort? If it were, then it would not constitute a concern for the meritocrat, and the meritocratic case against No-Funding would evaporate.

The meritocrat cannot simply define effort as preference, though. Whether the differential preference constitutes differential effort depends on the explanation for the differential preference. While the empirical literature on socio-economic class and uptake of educational opportunities is unanimous on the finding that correlates socio-economic class of origin with uptake, the explanations of this finding fall into three broad categories:

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<sup>7</sup> *Report of the National Committee*, hosted at <http://www.leeds.ac.uk/educol/ncihe/> Report 6, p 2, at [http://www.leeds.ac.uk/educol/ncihe/r6\\_039.htm](http://www.leeds.ac.uk/educol/ncihe/r6_039.htm)

<sup>8</sup> There are reasons to think that talent (defined, say, as IQ) might not be distributed evenly across classes. Peter Saunders argues that open labor markets and assortative mating combine over time to produce an IQ difference between classes (see, Peter Saunders, 'Might Britain be a Meritocracy?', *Sociology*, 1995, 29: 23-41; for a convincing response see Gordon Marshall and Adam Swift, 'Merit and mobility: A Reply to Peter Saunders', *Sociology* (1996) 30, 375-386.). Even if there were differences in IQ across classes, they would have to be large before the differential participation in Higher Education could be attributable to them.

- i) explanations which appeal to structural barriers to participation (such as the hidden curriculum, discriminatory behaviour by teachers in school, lower quality of schooling for working class children etc).
- ii) explanations which appeal to the pathologies of class, such as the absence of aspirational differences between middle-class and working class cultures, or that working class children (and their parents) are more risk averse with respect to taking on debt.
- iii) explanations which claim that similarly talented motivated children rationally respond differently to the opportunities presented by the educational system because their background conditions give those opportunities a different character. Gordon Marshall et. al. explain as follows:

Because of the dissimilar opportunities and constraints facing children from working-class and middle-class backgrounds, they (and their parents) are involved in different calculations of the possible costs and benefits of particular educational strategies.... From this point of view, aspirations (say) to attend university on the part of working class children are rather more ambitious than would be those same desires when expressed by their middle class peers, and also involve increased risks implied by the attempt to travel a greater social distance.<sup>9</sup>

If, for example, a working class and a middle class child both place a premium on not slipping down the social scale, the middle class child has to attend University, whereas the working class child does not. I'll give another, more detailed, example shortly.

Which of these kinds of explanation is correct may matter for the meritocrat. The first explanation suggests strongly that there is something wrong (from the meritocrat's point of view) with the unequal uptake of higher education, because the fundamental causes of the unequal uptake are socially constructed barriers to participation. The latter two explanations, though, are more interesting.<sup>10</sup>

Consider the second. Sometimes this claim has a cultural dimension – it is claimed that working class people are more risk averse when it comes to debt. But, if that were the right story, there might be a case against accommodating this aversion. As I said earlier, we think that, at some point, people should be held accountable for the preferences on which they act. Consider Thor and Olaf, who are from the same social backgrounds and have the same level of talent. The prospect of debt makes Olaf uneasy, so he would rather enter the workforce at age 18 and earn an immediate wage than enter university and incur a substantial debt, even though on that course of action his expected pay-off is better overall. Thor is unperturbed by

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<sup>9</sup> Gordon Marshall, Adam Swift, and Stephen Roberts, *Against the Odds?: Social Class and Social Injustice in Industrial Societies* (Oxford University Press, 1998), p. 140-141.

<sup>10</sup> For a much more sophisticated and extensive discussion of the significance of meritocracy in these debates see Gordon Marshall, Adam Swift and Stephen Roberts, *Against the Odds*, chapter 7. See also chapters 2, 4, and 8 for extensive and valuable discussions of social mobility, meritocracy, and educational opportunities.

debt. They are, essentially, acting on different preferences with regard to debt, and if we think they should be held accountable for the preferences they act on we shall say that there is no reason based in their interests to arrange things to make it more likely that Olaf will enter higher education.

This case is easy, because Thor and Olaf have been, *ex hypothesi*, subject to similar forms of social conditioning. Now suppose, instead, that the explanation of this difference is cultural because, for example, Thor's parents have free-and-easy attitude toward money whereas Olaf's parents belong to a religious community of practice that frowns on debt and the accumulation of worldly goods. Still, I don't see that this constitutes a reason for the state to attempt to make them more equally likely to take up higher education (for example, by giving both of them grants, and thus subsidizing Thor, who thereby enjoys something like a consumer's rent). We can think of Olaf's aversion to debt as relevantly like an expensive preference, or, slightly differently, as revealing a lack of effort.<sup>11</sup> On the former interpretation the principle of meritocracy might be overridden by a principle of personal responsibility that demands that people be held accountable for the fundamental structure of their preferences. On the latter interpretation Olaf simply displays less merit than Thor.

If the aversion of working class 18 years olds is relevantly like the aversion of Olaf, then meritocracy fails to support 1)-3) over No Funding. There are, of course, reasons for doubting the validity of the analogy with religion; whereas the religious preferences are part of a whole system of belief governing somebody's life, the preferences generated by unjust class differences might be thought of as adaptive and contingent. But there is no need to make this argument, or invoke the first kind of explanation, in order to restore the meritocratic case for inducing greater working class up-take. The very possibility of the third explanation supports the case. The following example illustrates why.

Consider Bob and Terry, who both enjoy the opportunity of entering a lottery. They can both choose between these two lotteries:

*Lottery 1:* a 50% chance of getting an inflation-adjusted income of \$20k, and a 50% chance of getting an inflation-adjusted income of \$21k

*Lottery 2:* a 50% chance of getting an inflation-adjusted income of \$15k, and a 50% chance of getting an inflated-adjusted income of \$30k.

Suppose that Terry and Bob have exactly the same talents, inclination to work hard, and, crucially exactly the same fundamental preference structure - they both want to maximize their income subject to the constraint that they want to guarantee an income of \$20k if possible.

Suppose that the only difference between Terry and Bob is that Terry's parents have no resources, whereas Bob's can guarantee him an inflation-adjusted income of \$5k.

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<sup>11</sup> Not a lack of effort all-things-considered, but a lack of effort to develop and exercise his earning capacity. In the example he turns his effort, instead, to pleasing God.

Then, Terry will choose lottery 1, but Bob will choose lottery 2. Bob can expect to be better off than John, even without his parents giving him anything (his expected income is \$22.5k; John's is \$20.5k). Suppose they both lose their chosen lottery - then they are equally well off over the course of their lives, (although Bob's parents have kicked in lots of money). But let's just suppose that the final outcome is that both 'win' the lottery they've chosen (this will happen 25% of the time) - then over a 30 year working career, Bob will earn \$270k more than John, *without his parents ever giving him a penny*.

The key issue is that there is no cultural element explaining the different choices that Bob and Terry make here. They have the same fundamental level of risk aversion, face the same choice of lotteries, but choose different lotteries because they have access to different supplementary resources, which difference they are neither responsible for nor do they embrace. Unlike Olaf, who reflectively endorses the religious values that underpin his choice, and welcomes being held accountable for the choice, Terry sees the lack of parental resources as a drawback, correction for which would not be a slur on his character or values.

At least in so far as the different choices that similarly talented working class and middle class children make with respect to the uptake of higher education reflect similarities between choices with respect to higher education and the two lotteries described above, there is a reason to correct for those choices, if meritocracy is an important value. Meritocracy seeks similar levels of uptake for higher education across the social classes. If reliance on loans is a barrier to this, it should be mitigated. So No-Funding should be rejected.

#### **4. MEANS-TESTING VERSUS GRADUATE TAX.**

Where have we got to? The meritocracy argument counts against No-Funding. But the meritocracy and fairness argument point in different directions. Fairness counts against Full Funding; but what if Full Funding were the only system on which the barriers to working class participation could be overcome? Which of 1)-3) best implements meritocracy depends on the facts, and here the facts could be different against different economic and cultural backgrounds. But it is worth mentioning that there is no qualitative difference between debt incurred for tuition and debt incurred for living expenses. So if aversion to debt is a major barrier to participation for working class students, restoring an adequate maintenance grant for those students is a priority. The new legislation leaves working class students in roughly the same position as they were before, with the exception of those (probably few) who will attend non-top-up charging universities, who will be a little better off.<sup>12</sup>

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<sup>12</sup> There will probably be few such students attending non-top-up universities, because there will probably be few non top-up Universities. Of the few that remain, most will, in fact, be post-1992 Universities, which tend to have higher proportions of lower socio-economic class origin students.

Suppose that meritocracy is indifferent between Full-Funding, Means-Testing, and Graduate Tax. The government has justified moving from Full-Funding toward Means Testing on fairness grounds, and it seems right that other things being equal fairness counts against Full Funding. What about the choice between Means Testing and Graduate Tax? Does fairness comment on that choice?

I think it does. The graduate tax, effectively, charges working class and middle class students the same amount for the education they receive. Although Graduate Tax may overcome the debt aversion problem as well as, if not better than, Means-Testing, working class and middle class students face the same long-run costs. And, if it is unfair to subsidize them equally upfront when the middle class students have less need of the subsidy, it should be unfair to charge them equally after the fact. A means-tested tuition and maintenance grant, other things being equal, seems preferable to the graduate tax.

One might counter that the graduate tax is more progressive because, although it does not distinguish between students on the basis of class of origin, it does distinguish between those who benefit more and those who benefit less from higher education. Different degrees, and different universities, add differently to our earning capacity, and those whose university education adds more to their earning power will pay, over time, more, than those who do not enjoy as great a benefit.

But this argument is problematic in various ways. While there is a powerful case for high earners to pay higher taxes, it is not clear why we should single out a particular source of extra earning power for extra taxation. Some people gain enormously from their secondary schooling; others from the networks their parents can plug them into; others simply from being very talented. Whichever of these the high earning power comes from the case for taxing earnings is just as strong.<sup>13</sup> Why should those for whom higher education is the key variable be expected to pay more than what it cost, if those for whom secondary schooling is the key variable should not be expected to pay more for that?

It is hard to imagine an answer to this question, furthermore, that justified taxing only those people who get a monetary benefit from higher education. Higher education yields three key kinds of private benefit to the student. One is increased earning power. A second is access to interesting and (non-monetarily) rewarding employment. Sometimes these two correlate (high paid jobs are often intrinsically rewarding), but sometimes graduates trade off higher income against greater interestingness. The third is the intrinsic value of the education they receive - the enjoyment of spending several years of their youth among interesting and lively young people engaged in intrinsically valuable learning activities. For some consumers of higher education (indeed for most of those reading this essay) this third benefit is the most important: the lasting benefit of an enriched intellectual life. It is hard to see what principled justification there could be for charging extra to those people for whom higher education

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<sup>13</sup> We may have good reasons to want to tax some sources of unequal earning power differentially; for example, when increased earning power is a consequence of the responsible exertion of effort in developing one's own talents. It might be very difficult for a taxing authority to target those sources, though.

increases their earning capacity, but not those for whom it provides access to more intrinsically rewarding job opportunities and leisure time.

Even if a justification could be provided for singling out higher education as a source of increased earning capacity for taxation, and for singling out enhanced earning capacity from the other benefits of higher education, the graduate tax does not, in fact, tax the increased earning power higher education yields. It fails to do this in two ways. First, it is far too rough-grained to capture the exact contribution higher education has made to any individuals' earning power. Compare Damon Albarn (of Blur) and Noel Gallagher (of Oasis). The graduate tax would tax Albarn but not Gallagher (since Albarn has a university degree and Gallagher does not) although Albarn's high income is entirely unrelated to his successful completion of a degree. We can imagine, by contrast, a pop star whose high earning is entirely a consequence of his having attended college, because it is there that he met the more creative members of the band he joins. The graduate tax does not distinguish between him and Albarn. In other words, it fails to target the actual contribution higher education makes to earnings.

The second way that the graduate tax fails to target earning power is that *earnings*, not *earning power*, are the object of taxation. Earnings, and therefore the taxes paid under the graduate tax, are a function of earning power and the choices the individual makes. Someone might, as a result of attending university, have dramatically increased earning power but choose to take low paid jobs, perhaps because they are more interesting or because they make for a more leisurely lifestyle, or because they are more socially valuable. But these people, at least for the first few years of their working life, enjoy not just the non-monetary benefits of higher education but also the crucial benefit of the security provided by enhanced earning capacity (they know that they can make a great deal of money if they want or need to). The graduate tax taxes earnings, not earning capacity. The relevant benefit that higher education brings is not enhanced earnings, but enhanced earning capacity, for which earnings are not a great proxy.

These considerations suggest that the government, on moral grounds if not technical grounds, is moving in the right direction.<sup>14</sup>

## **5. ONE ADVANTAGE OF THE GRADUATE TAX.**

I'd like to conclude with a comment about why the Graduate Tax might be preferable to Means-Testing on grounds that have little to do with fairness or meritocracy. All 8 years of my own higher education were funded (the first 3 by the State, the rest by the University where I did my PhD.) But almost all of my teaching has been carried out in institutions where students pay their own living expenses and contribute a significant sum to their tuition

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<sup>14</sup> For a powerful technical argument for the graduate tax against 2), and extensive debate and discussion, see Daniel Davies's entry on [www.crookedtimber.org](http://www.crookedtimber.org) at <http://www.crookedtimber.org/archives/001208.html>

expenses. The difference in the relationship between the teacher and the student when the student is paying a significant part of their tuition is striking. The fully-subsidized student is much less liable to act like a consumer, and much more likely to act like a student. This changes the teacher-student relationship; because the teacher can teach what is genuinely valuable and interesting within her field of study, rather than needing to cater to the interests and tastes of the student. The student who is enjoying a free higher education is more likely to explore the 'irrelevant'; more likely to study intellectually serious subjects like economics and philosophy than vocational subjects like business studies; more likely to find herself drawn in directions that help her to flourish as a person. My conjecture is that the key difference is whether they perceive themselves as having to maximize their income soon after college, which large loans pressure them to do. Other things being equal, the experience of higher education will be more rewarding for the student if the student experiences it as costless. I do not want to judge whether this consideration has sufficient weight to override fairness considerations. But it certainly does not override meritocracy considerations. If the college experience becomes more valuable, that makes it all the more important that access to it should not be restricted to the already-advantaged.