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Universities need to have a stake in their graduates. Without it, we risk entrenching mediocrity

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Theresa May's Conservative deputy Damian Green has talked about starting a "national conversation" on the future of university tuition fees. Who can blame him? Jeremy Corbyn's manifesto commitment to scrap them is widely credited with helping boost 18-24 year old voter turnout in the general election from 43pc to 68pc, with the vast majority voting Labour.

The problem, well known to Conservatives, is that the Left wing critique of the current student loan system is almost entirely wrong. A "conversation" predicated on their terms will end with disastrously bad policy change.

Annual tuition fees are currently capped at £9,250 per year and paid upfront by the Government, with graduates repaying at 9pc of any income earned above £21,000. The interest rate on any debt accumulated is RPI+3pc whilst studying and then varies between RPI and RPI+3pc depending on earnings.

With the abolition of maintenance grants, also replaced with loans, the average student "debt" on graduation is now above £50,000, with any outstanding amount owed written off after 30 years of repayment. Myths about such a regime of upfront support and graduate repayment are legion. It is still regularly and widely stated, for example, that this framework deters students from poorer backgrounds from applying, leads to less support for them, leaves universities under-resourced and drowns graduates in debt. Yet none of these claims appear to be true.

The proportion of 18-year-olds eligible for free school meals going to university has near-doubled from 12.2pc to 22.5pc in the past 11 years. Overall, the increase in tuition fees reduced lifetime repayments for those in the bottom third of the graduate earnings distribution, whilst increasing the contribution of graduates overall, according to the Institute for Fiscal Studies.

Meanwhile, universities' incomes have risen too since tuition fees were tripled. Even the total amount of notional debt individual graduates owe, though scary sounding, is largely irrelevant for many, given the repayment amount given is capped at a time-limited fixed proportion of income. In fact, as many as 77.4pc of graduates will have some debt written off.

But there are more nuanced critiques to be made about the status quo. The current system comes with significant risks to the public finances, for example, with the level of taxpayer support strongly affected by uncertain earnings growth. The high interest rates charged mean that future graduates with high expected earnings might even be able to borrow from other sources more cheaply, leaving taxpayers exposed to a greater share of the total costs of what become arbitrary subsidies for those whose debts are written off.

But perhaps the most important problem is that the system does not give the universities themselves a stake in their graduates' futures, and so encourages free-riding in terms of real value added.

Two years ago Peter Ainsworth, the economist, estimated that up to a third of graduates are still in jobs that could be done by non-graduates five years after graduation. The current system encourages universities to load up on student numbers to earn income but per se does little to ensure the experience itself adds value.

If we really are going to have a national conversation about tuition fees, we should drop talk of turning back the clock, and instead think about a funding model which aligns the incentives of universities, students and taxpayers to provide good long-term outcomes for graduates. One such method was proposed by Milton Friedman, and would entail scrapping student loans entirely and replacing them with market-based graduate levies. This would see government taken out of the equation altogether.

Universities would individually or collectively offer contracts to their students, who would agree to pay the university they attended a given percentage of their earnings after graduation. That percentage could vary by course or institution, as could the length of repayment. As such, it would remain like a graduate tax, but with the revenue going to the institution of the alumni and not the Government. Essentially, the university would have an equity stake in the graduate premium of its ex-students.

This would have several major advantages over the current framework. Universities would have a much stronger interest in the long-term outcomes of their graduates, providing strong incentives for both high-quality teaching and the development of a lifetime relationship with them, including careers advice and support.

They would also have an incentive not to over-supply trendy or popular courses, since an over-supply of graduates would diminish the earning premium. Given most of the benefit of higher education accrues to graduates, it is entirely appropriate that they pay for a substantial proportion of the education they receive.

But a system which fails to link revenues to successful outcomes risks entrenching mediocrity and encouraging universities to provide worthless courses for the sake of income. This is the real problem with the current student loans approach but, sadly, few seem to be talking about it.

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