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Higher Education Funding

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Outline

- Reasons for state intervention in higher education
- Overview of higher education funding policy
- Current higher education system
- Analysis of higher education reforms
  - financial impact of reforms on students, graduates, the taxpayer and universities
- Potential implications for access to higher education

Reasons for state intervention in HE

Why might the market alone lead to inefficient outcomes?

1. Credit market failure
2. Risk and uncertainty
3. Externalities
4. Information problems

1. Credit market failure

- HE requires cash for fees and living expenses
- With perfect credit markets, borrow now and repay from future income
- But credit markets are not perfect due to information asymmetry, risk and uncertainty
- Lack of collateral to secure debt against
- Asymmetric information: borrower has more information than lender
- Lender exposed to adverse selection / moral hazard
- Higher interest rates or credit rationing
- Inefficiently small amount of borrowing and investment

2. Risk and uncertainty

- Student may be reluctant to borrow
  - Debt aversion
  - Perceived risk of failing the degree
  - Uncertain returns to a degree: positive on average but high variance
  - Might need high risk premium to make the investment worthwhile

3. Externalities

- Education may create benefits to society over and above those that accrue to the individual
  - Total return to education = private return + social return
- Average private return to HE vs. non-HE is roughly 25–27% for women, 18–21% for men (OECD)
- Social returns much more difficult to quantify
- Do individuals incorporate *social* return to education in weighing up costs and benefits?

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4. Information problems

- To make rational decisions, individuals must be perfectly informed about
  - Nature of product (e.g. university quality, HE experience)
  - Prices (e.g. fees, living costs, foregone earnings)
  - Future (e.g. earnings, debt repayments)

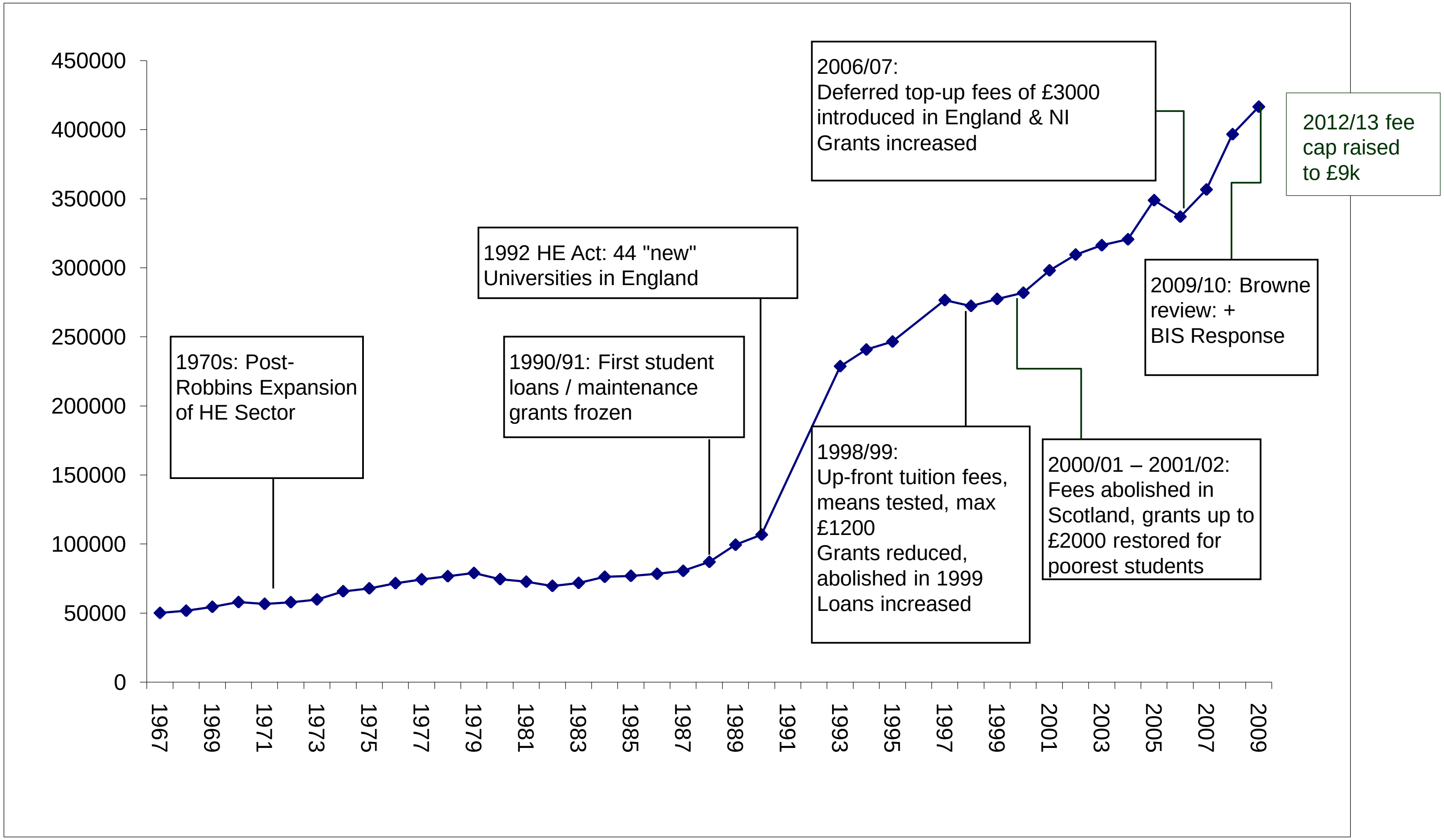
- Imperfect information may lead to under-consumption
  - Particularly among lower socio-economic groups

Efficiency

- All of these arguments can justify state interventions and subsidies on efficiency grounds
  - But do not justify full subsidy given large private returns to HE

Past and current HE funding policy

UK higher education finance policy



Source: HESA

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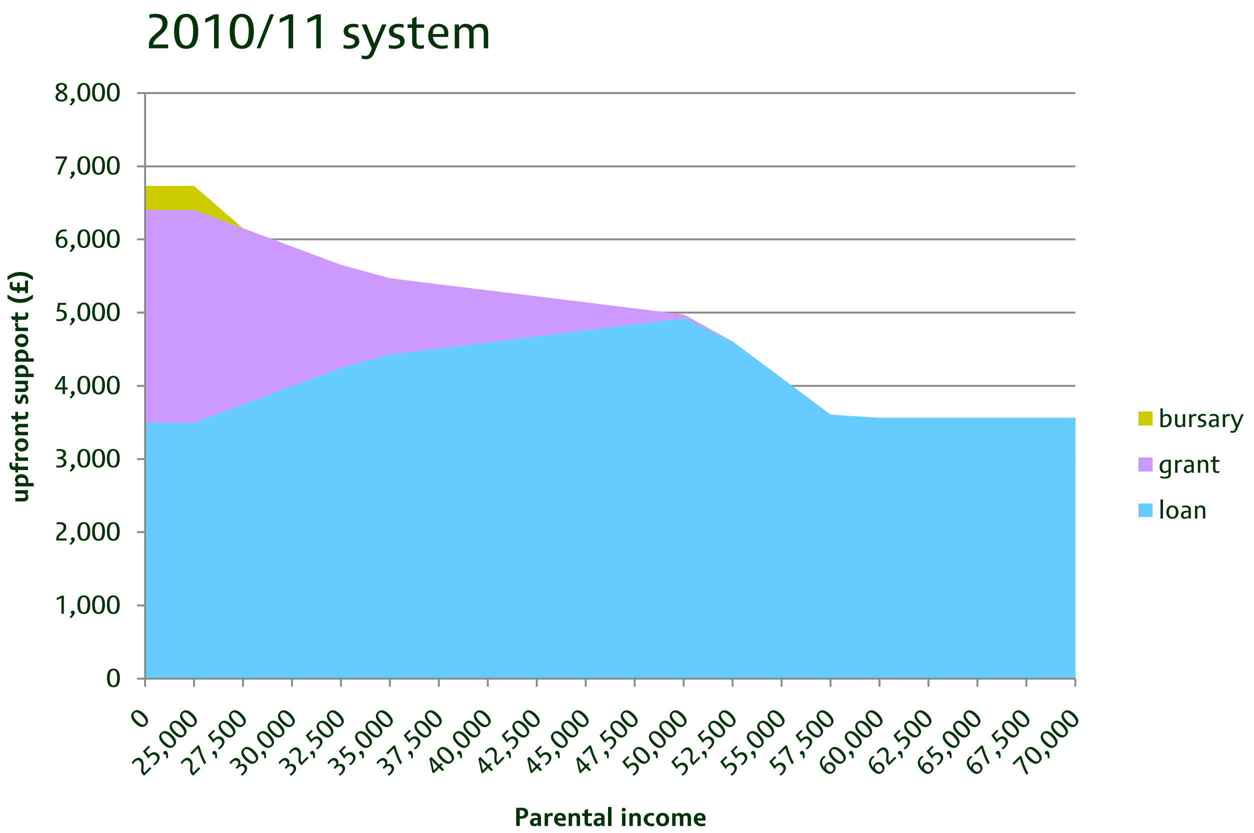
Current system: costs to students, the taxpayer and graduates

Current system (academic year 2010/11)

1. **Fees**
   - £3,290 per year, deferred
2. **Support**
   - Maintenance loan – max £4,950, deferred
   - Maintenance grant – max £2,906 (parental income<£25k)
   - Bursaries
3. **Repayment**
   - Repayment at 9% of earnings above £15,000
   - Zero real interest rate
   - 25 year write-off period

Under the current system of upfront support, maintenance loans depend on parental income



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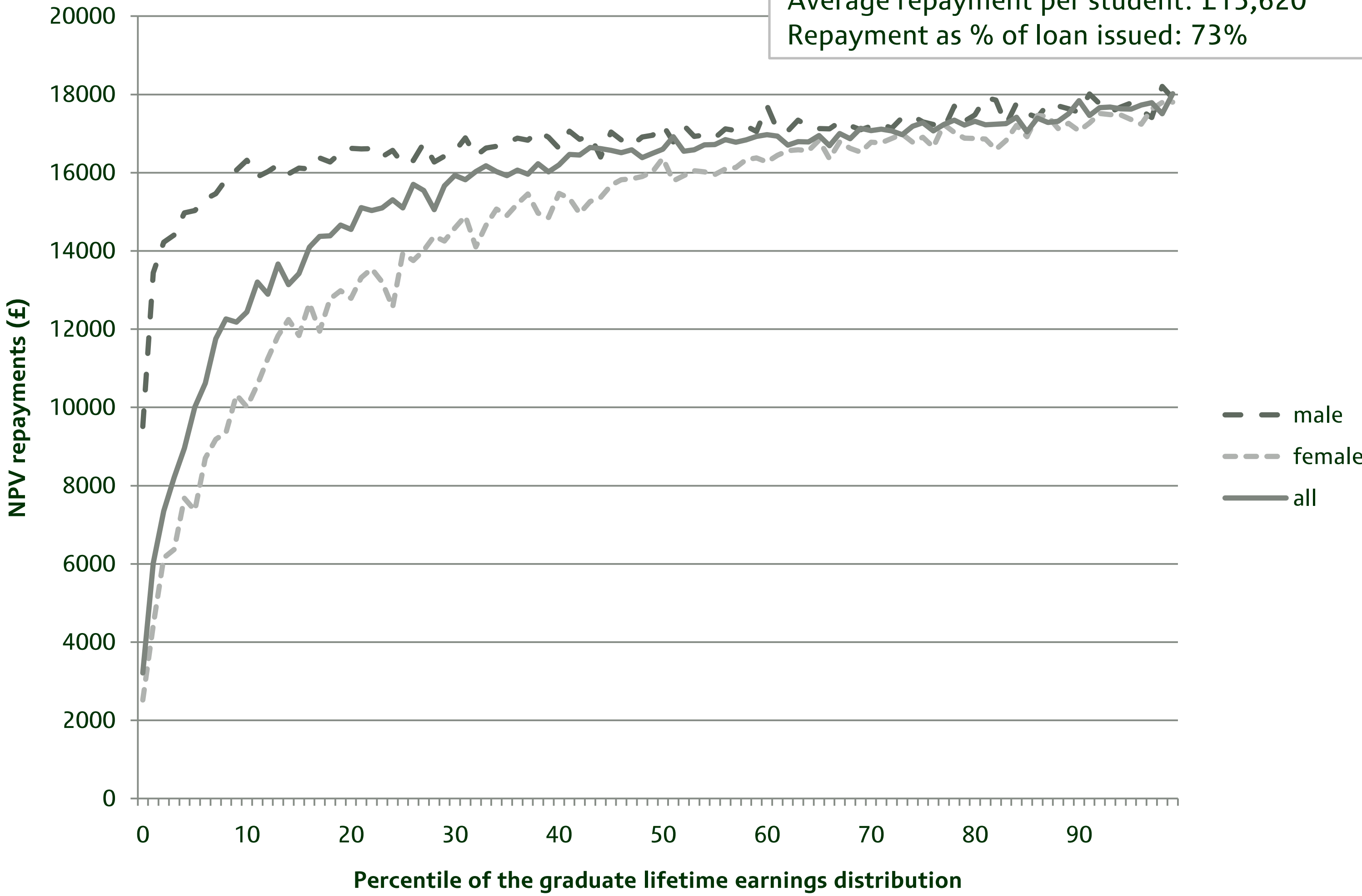
The current system: net present value of repayments

Average loan per student: £21,300
Average repayment per student: £15,620
Repayment as % of loan issued: 73%



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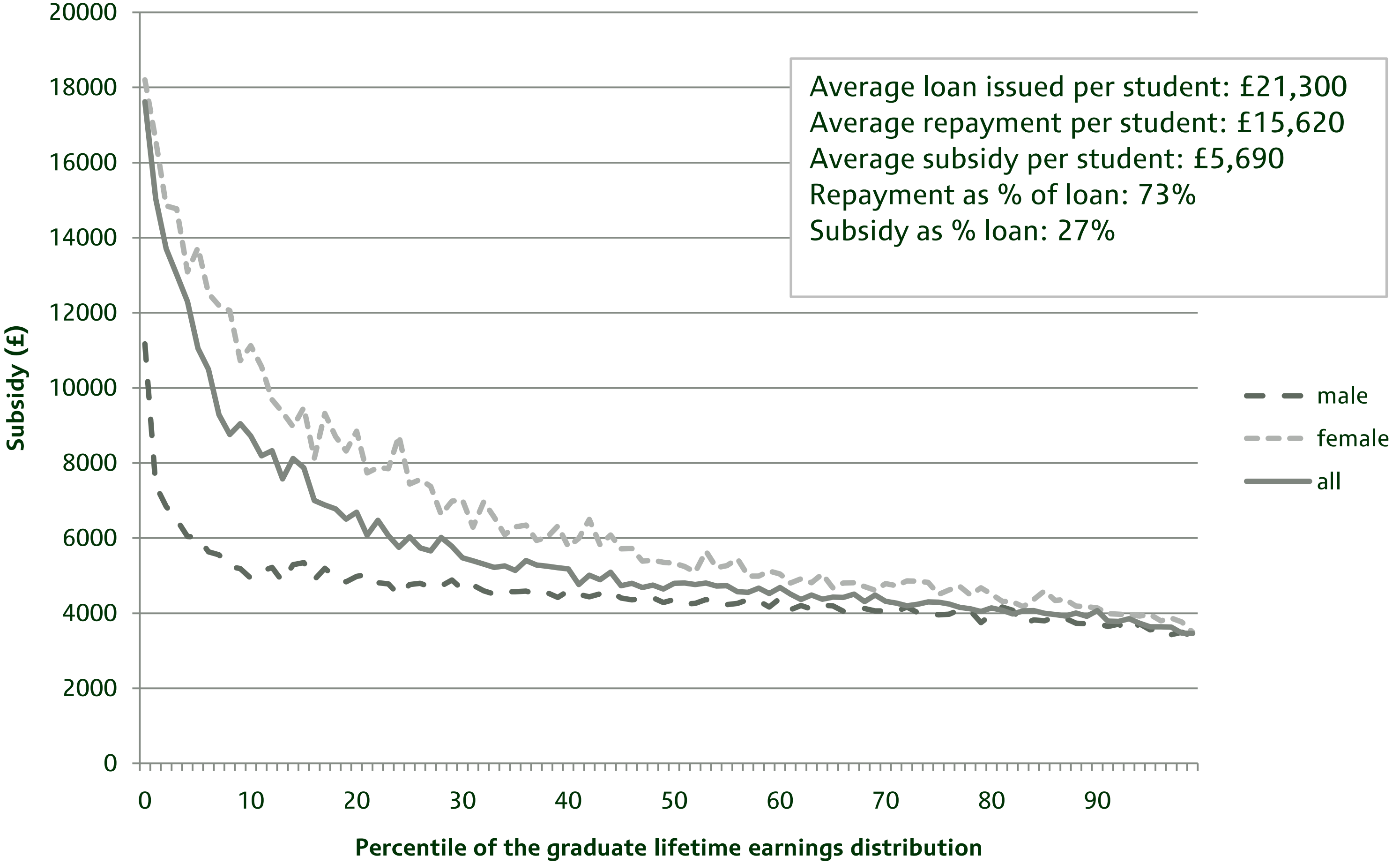
The current system: Government subsidy



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The Browne Review (The Independent Review of Higher Education Funding and Student Finance)

Lord Browne asked to examine 3 issues:

- widening university participation
- affordability of higher education for students and the taxpayer
- how to simplify the current system of support
- Given the current economic circumstances: how to ensure the financial sustainability of the system

The Browne Review recommendations

1. **Fees**
   - Remove the fee cap, but universities must compensate the government for cost of non-repayment
2. **Support**
   - Universal maintenance loan
3. **Repayment**
   - 2.2% interest rate
   - Increase repayment threshold to £21k
   - Lengthen write-off period to 30 years

The Governments' response to the Browne Review

1. **Fees**
    - Fee cap of £9,000
    - "soft cap" of £6,000 (widening participation)
2. **Support**
    - Means-tested maintenance loans
    - Tighter maintenance grants
    - Scholarship for students who qualify for free school meals
3. **Repayment**
    - Tapered interest rates
        - 0% if earn less than £21,000 3% if earn >=£41,000
    - Increase repayment threshold to £21k (and uprate with earnings)

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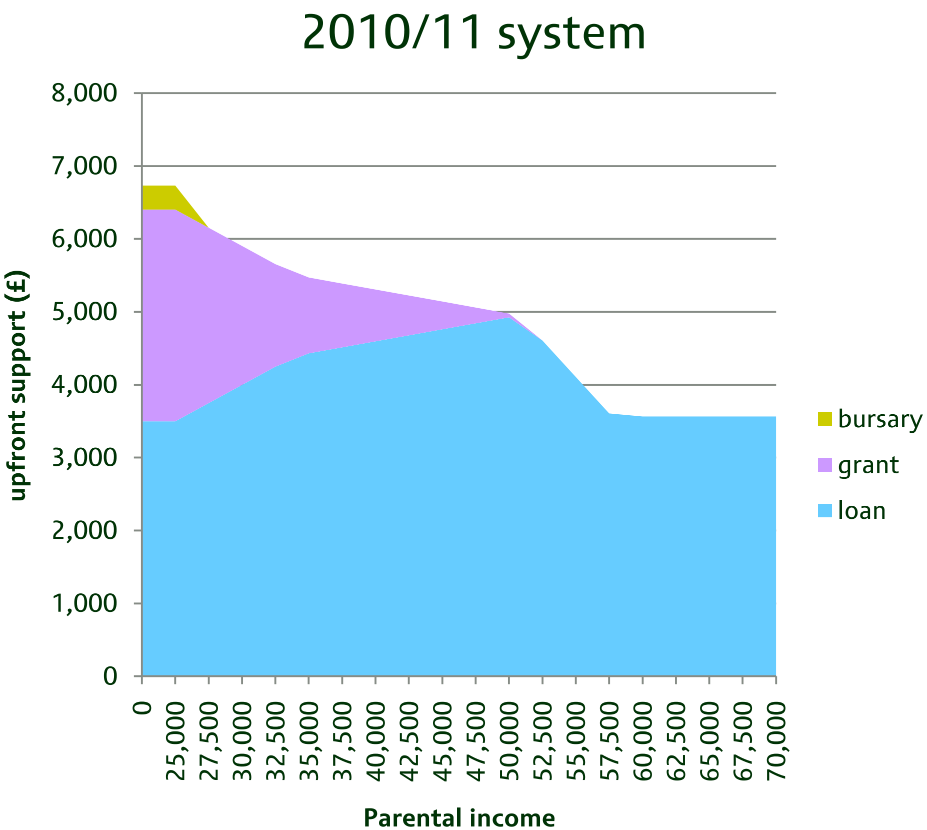
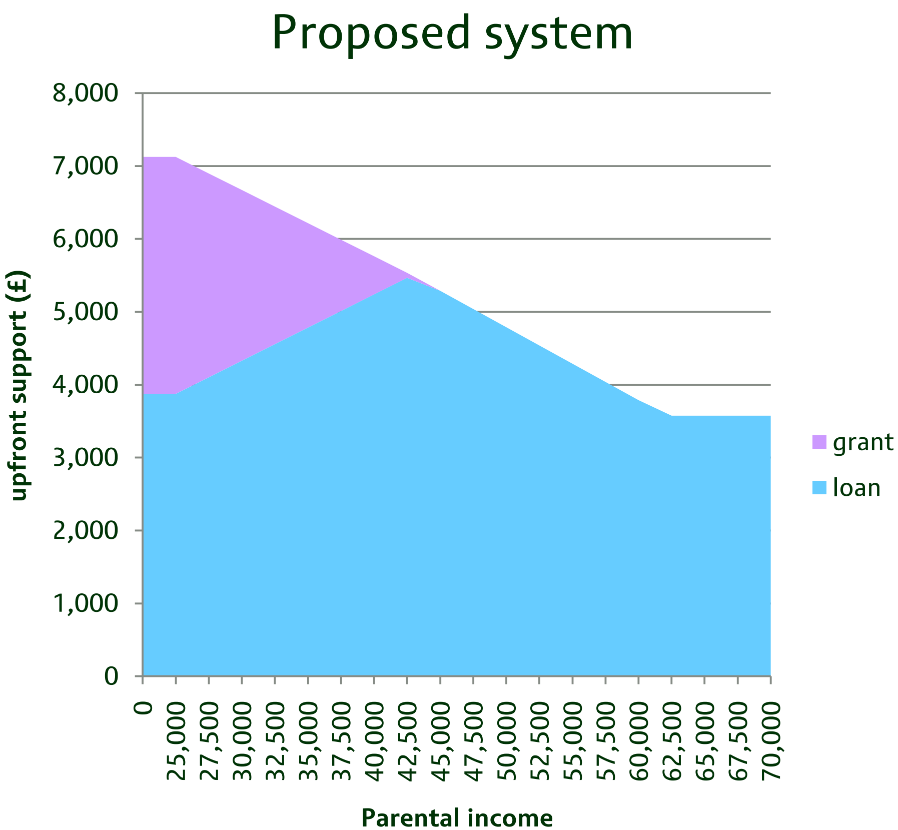
Impact of the proposed reforms

1. Students
2. Graduates
3. The Taxpayer
4. Universities

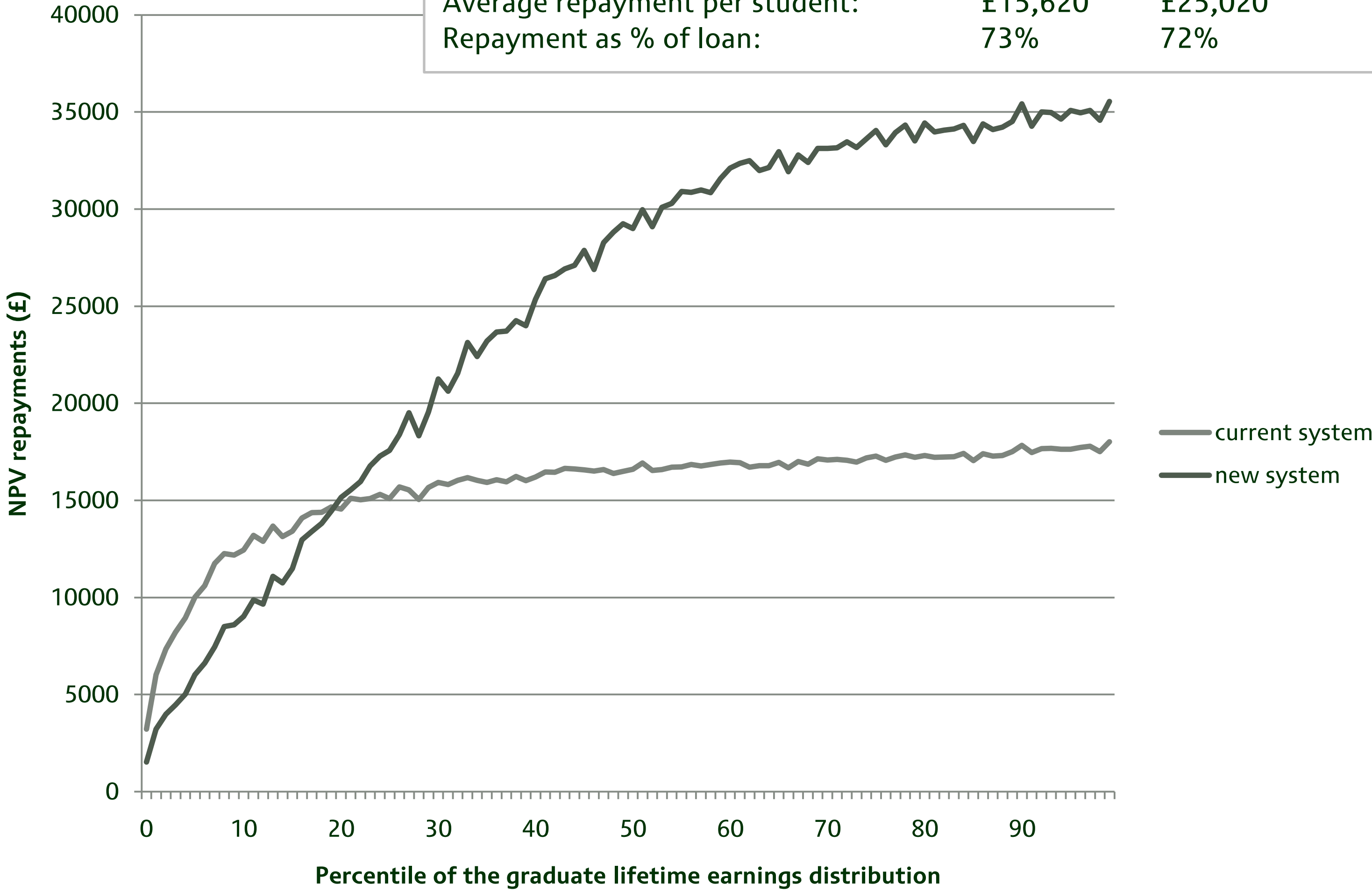
Students are better off under the new system, in terms of up-front support





Graduates: 78% are worse off, though the system is progressive

System:	2010/11	proposed
Average loan per student:	£21,300	£34,800
Average repayment per student:	£15,620	£25,020
Repayment as % of loan:	73%	72%



Assumes average fee of £7,500 per year

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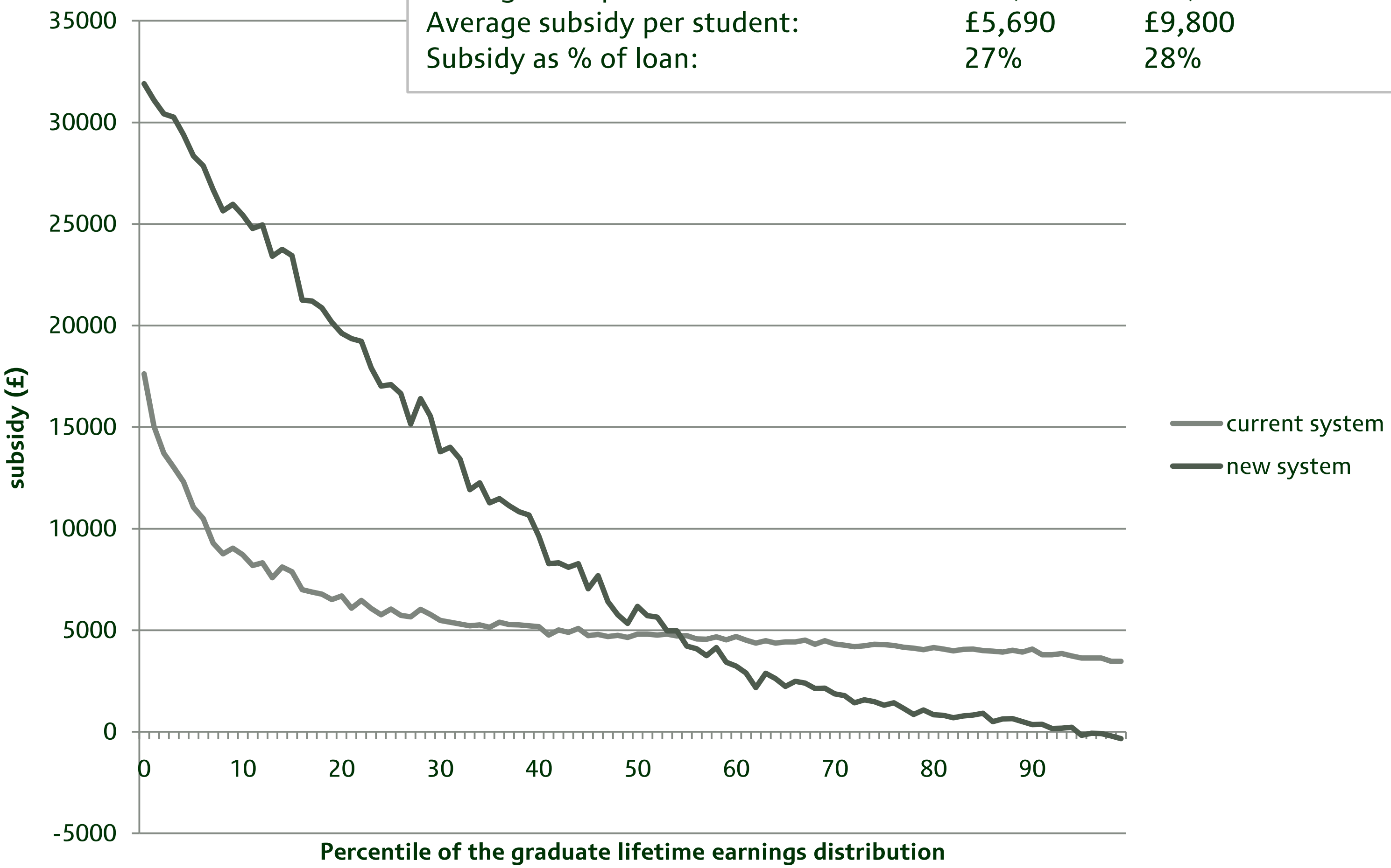
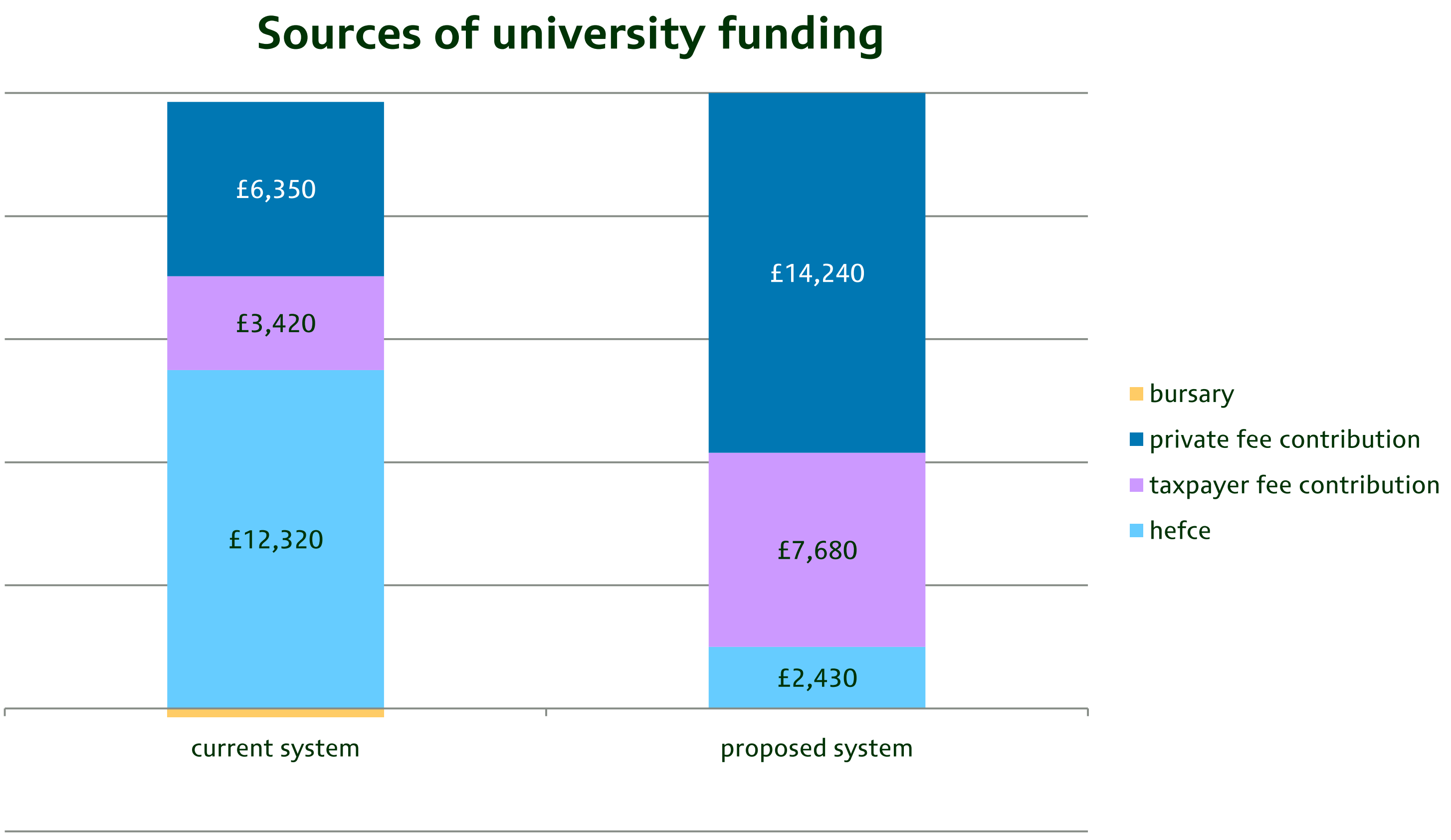
The cost to the taxpayer has increased

System:	2010/11	proposed
Average loan per student:	£21,300	£34,800
Average subsidy per student:	£5,690	£9,800
Subsidy as % of loan:	27%	28%



Assumes average fee of £7,500 per year

Public funding has been cut, but universities have access to more private finance



Assumes average fee of £7,500 per year

Balance of contributions to higher education

	Current system	Proposed (7.5k fee)	change
taxpayer	-£22,290	-£16,750	+£5,540
graduates	-£15,620	-£25,020	-£9,400
universities	+£21,780	+£24,340	+£2,570
students	+£16,130	+£17,420	+£1,290

Figures per student totals for a three year course

This table shows that the new system (with a £7.5k fee) will:
• save the taxpayer £5,540 per student (from reductions in HEFCE grant, net of increased fee and loan subsidy)
• *cost* graduates £9,400 per student (from increased fee and maintenance loan repayments)
• *benefit* universities by £2,570 per student (from additional fee income net of reduced HEFCE income and scholarships)
•*benefit* students by £1,290 per student (from increased grants, loans and scholarships)

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How will the increase in fees impact student participation?

Research by Dearden, Fitzsimons & Wyness (2010): estimate effects of tuition fees , loans and grants on higher education participation **using funding reforms of past 20 years**

UK higher education finance system 1992 – 2007

- Variation in fees , loans and grants over time
  - Upfront fees of £1200 introduced in 1998
  - Deferred fees of £3000 introduced in 2006
  - Student maintenance grants reduced then abolished in 1999, re-introduced in 2004 and extended in 2006
  - Maintenance loans increasing every year
- Variation in fees, loans and grants by parental income level – means testing

Results of modelling – grants, loans and fees impact participation in different ways

- A £1000 increase in fees results in a 3.3 percentage point *fall* in participation

- A £1000 increase in grants results in a 1.9 percentage point *increase* in participation

- A £1000 increase in loans results in a 1.9 percentage point *increase* in participation

Source: Labour Force Survey, £2006

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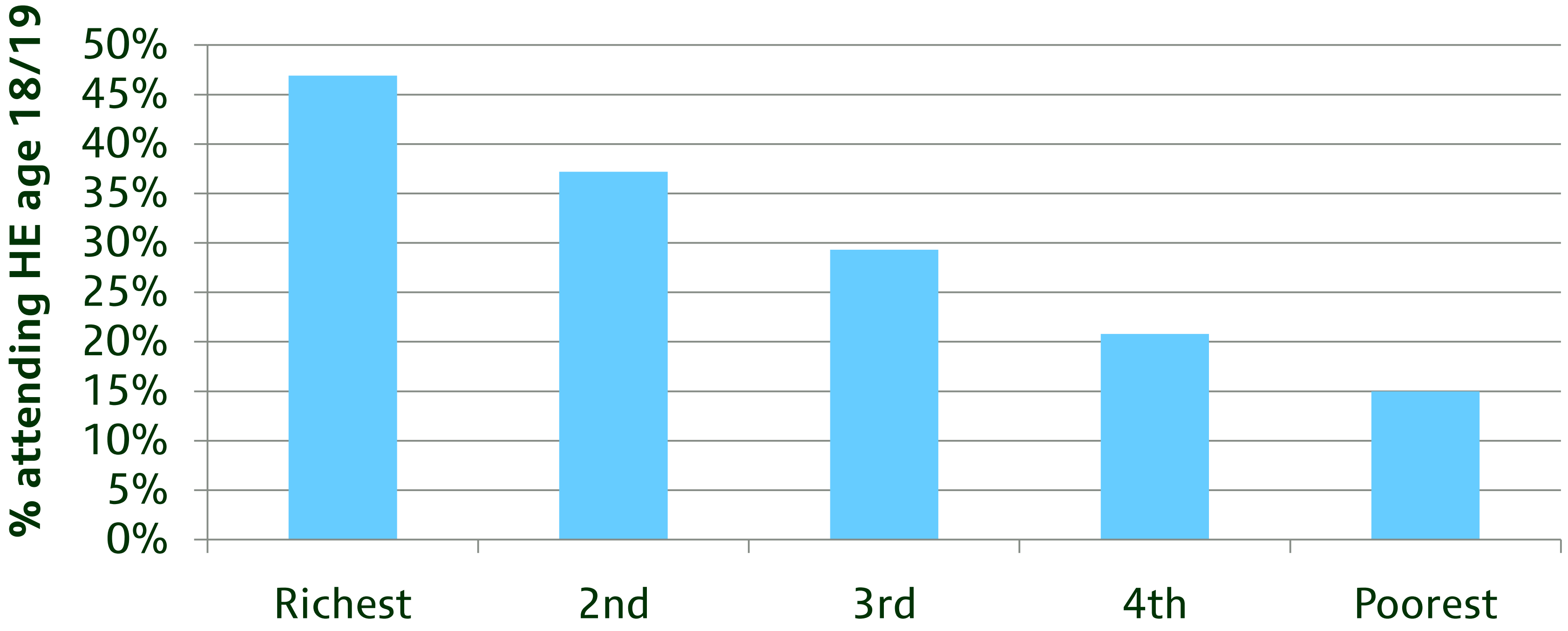
How will the increase in fees impact student participation?

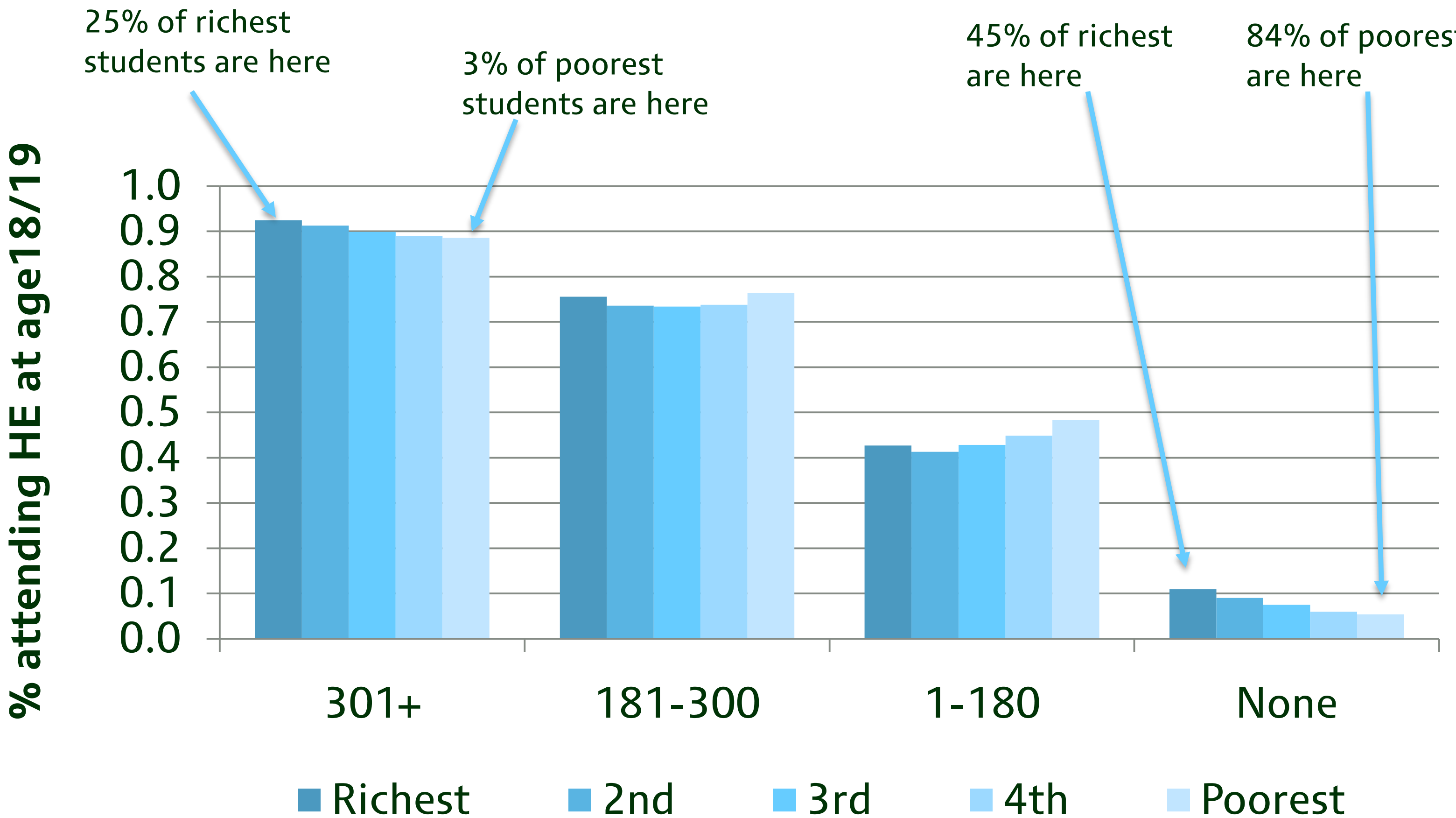
Research by Chowdry et al (2009): understand the determinants of participation in HE

- Well known that students from low-income backgrounds under-represented in university
  - What impact does HE finance have on this?
- How likely are changes to student finance to encourage/discourage entry?

Poorer students are overall less likely to go university than richer students…



… But those with comparable A Level grades to richer students are not



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Conclusions

- Many economic reasons for state intervention in HE provision
  - Though high average private returns to HE
- Current system is expensive to the taxpayer
- New system transfers the cost of HE from the taxpayer to graduates themselves
- New system is progressive
  - lower earning graduates pay less than high earning graduates
  - Low earning graduates pay half as much as they do now, due to increase in repayment threshold
  - High earning graduates pay twice as much as they do now, due to fee increase and interest rate
- Large fee increases and interest rate increases could result in falling participation
  - But barriers to entry for poor students occur earlier in life

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