

Research brief

Higher Education Funding Reforms in England: the Distributional Effects and the Shifting Balance of Costs

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Introduction

The extensive debate over the financing of higher education (HE) has led to a renewed interest in lifetime earnings differences between graduates and non-graduates. Moreover, any assessment of the distributional impact of the government's proposed reforms to HE funding, which includes the extension of income contingent, subsidised loans, designed to allow graduates to pay for increased (variable) fees, requires information about the lifetime earnings paths of graduates. This paper makes use of new simulations of lifetime earnings profiles to highlight how graduate lifetime earnings differ from non-graduates', and to set out what the effects of the new system of HE funding in England introduced in 2006, and a number of variants, would be on the lifetime incomes of different graduates.

Key Findings / Recommendations

- The analysis indicates that the funding reforms will result in an increase in transfers from graduates and taxpayers, to both the funding of universities and student support.
- Compared to the previous system the authors find that lower earning graduates and those from lower parental income backgrounds will be better off, despite the increase in tuition fees; the opposite is the case for higher earners and for those from the higher end of the parental income distribution.
- The findings suggest that the income-contingent nature of loans under the new system (whereby loans are written off after 25 years and are only repaid when the graduate is earning over a certain amount) does serve to provide some insurance against potential low realised returns from HE for graduates.
- The authors undertake simulations to examine the differential impact by gender and income. These indicate that, for women, student loans represent a government subsidy of around 60% of the face value of the loan for the lowest lifetime-earners, to around 15% for the highest earners (with the average across all women at around 25%). For men the range of taxpayer subsidy is narrower, at around 27% for the lowest earners and 12% for the highest earners (with the average subsidy at around 17%).

- The number of years taken to repay is also decreasing in lifetime earnings, ranging from 25 years for the lowest earners (at which point all outstanding debt will be paid off) to between 10 to 15 years for the highest earners. For women the average time for repayment will be around 17 years, whilst for men it will be around 13 years.
- Around 21% of women can expect to have some debt written off, with their repayment capped at the 25 year cut-off, whilst this is the case only for around 2% of graduate men.

Methodology

In this paper the authors use a copula approach to model the dependence in wages between ages, whilst they also allow for a stochastic component to employment, by including entries and exits from the labour market in their simulations. The earnings simulations are based on data from the UK Labour Force Survey (LFS) covering the period spanning 1993 through 2003, whilst the simulated employment paths and re-entry earnings ranks are based on mobility patterns observed in the British Household Panel Survey (BHPS) between 1991 and 2004 inclusive.

Other Findings

The authors also considered the effect on graduate incomes of a number of possible future reforms. The hypothetical scenarios that they considered involved the imposition of a real interest rate of 2.5% on loans, with different assumptions about the treatment of accumulated interest above the level of repayment due in any given year. The implied savings from this reform for the exchequer, and costs to the graduate would be highest for men in the 2nd to 4th deciles of the male lifetime earnings distribution, and for women at the 6th and 7th deciles of the female earnings distribution.

By contrast measures such as freezing the loan repayment threshold in nominal terms, or allowing discounts for early repayment would tend to cost low-earning graduates the most. The authors also highlighted the implications of raising the existing fee cap above £3,000, with the cost of higher tuition increasingly expensive to the taxpayer as fees are raised.

Conclusions and Implications

In this paper the authors have analysed in detail what different Higher Education (HE) funding policies mean for graduates across the lifetime earnings distribution. In particular, they have used simulations of lifetime earnings for graduates to analyse the cost of paying for higher education under different HE funding schemes. They have found that implications of each of the HE reforms considered vary very widely between high, middle, and low earners. These findings therefore highlight the importance of uncovering the full distributional impact of these reforms.

Additional Information

Further information about this research can be obtained from Dominic Rice, DIUS, N4, Moorfoot, Sheffield S1 4PQ.

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