Nicholas Barr July 15th, 2025

Financing universities – is there a way out of the maze?

Universities are in a financial pickle. Home fees are not enough to cover the cost of teaching home students, while the number of foreign students and the fees they are charged cannot rise much further. To add to that, the Government is now proposing a 6 per cent levy on tuition fees from foreign students in order to fund other education and skills programmes. ***Nicholas Barr*** *argues that the only way out of this financial dead end for universities is for the Government to recoup more money from student loans than it currently does.*

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After 14 years of public spending cuts between 2010 and 2024 (aka austerity), high borrowing after the 2008 financial crisis and pandemic, and low economic growth, the UK economy is in a pickle. The idea behind the spending cuts was to allow tax cuts that – it was argued – would spur growth, a policy that hasn't worked, as I have previously pointed out.

> *Fee income has not kept pace with inflation – teaching home students is a loss-making activity.*

Higher education is also in a pickle. Following reforms in 2012, universities pay for teaching primarily from tuition fees, with additional taxpayer support only for expensive subjects like science, engineering and medicine. Universities can charge what they like for overseas students and postgraduate degrees, but the maximum fee for UK undergraduates was set at £9,000 per year in 2012 and has been largely frozen since then. As a result, fee income has not kept pace with inflation – teaching home students is a loss-making activity. Universities UK estimate that the current shortfall is £1.4 bn per year. The resulting effects include redundancies and worries that many universities are on the brink of bankruptcy.

The Government's levy proposal

The government has proposed a levy (currently suggested at 6 per cent) on the income from the tuition fees of overseas students, with the proceeds (estimated at £620 million) to be reinvested in education and skills.

The proposal does nothing – repeat, nothing – to improve the finances of universities.

- If the income is used within higher education the levy robs Peter to pay Paul.
- If used outside higher education the levy removes £620 million from already-stressed budgets.

And since overseas fee income subsidises the teaching of home students, the levy would reduce resources for teaching home students.

Universities might try to respond by charging even higher fees to foreign students, but fees are already high and the scope for increases has already been largely exploited.

Or universities could seek to recruit more overseas students. That approach is problematical. First, it may not succeed because of increasingly-burdensome visa requirements. If successful, second, extra recruitment risks crowding out UK students. Third, the risk is that increased recruitment comes largely from countries where applicants are less price sensitive such as China, putting universities at risk from geopolitical turbulence.

Other possible ways forward

So, what to do? Below I outline potential sources of university income, mainly to show that they are, at best, only partial solutions.

Taxpayers. For multiple reasons, the costs of higher education should be shared between taxpayers and the beneficiary. The removal of taxpayer support for most subjects from 2012 was (diplomatically put) bad economics. Across the OECD about two-thirds of spending on higher education is public; the equivalent UK figure is 25 per cent, even lower than the USA (35 per cent).

More taxpayer support, though the right answer, is currently a pipe dream. Taxes could be increased, but they are already high by historical standards; and universities face competing demands from the NHS, nursery education, crumbling schools, population ageing, etc.

Tuition fees. Universities can be financed from higher fees for home students. But fees are already high-with considerable political resistance to further increases. Higher fees could potentially be paid from:

- Family resources: parental/grand-parental contributions do nothing to promote access and do not improve university finances unless the fees cap is raise.
- A student's earnings while a student. but time spent earning competes with study time and leisure activities, and, again, do nothing to improve university finances unless the fees cap is raised.
- A student's future earnings, i.e. student loans. As discussed below this route could offer a partial way forward.
- Employers: the option of an increase in employer national insurance contributions was grabbed for other purposes. With voluntary contributions, the incentive is for employers to free-ride on training financed by their competitors. Again, the potential gain should not be over-estimated.

Research grants and contracts: in principle these are not relevant to the finance of teaching, and in any case much research funding fails to cover full costs.

University commercial activities include consulting and entrepreneurial activities such as exploiting intellectual property rights; both can improve finance, but only at some universities, and will not raise transformative sums.

Philanthropy can be useful, but produces significant resources only for very few institutions.

Loans taken out by universities can smooth capital costs but are a bad way to finance deficits in running costs; and (surprise) loans have to be repaid.

What then?

When the economy improves some teaching grant should be restored. But for the moment the best shot is to improve the performance of student loans.

Repayments on student loans are a fraction of a graduate's subsequent income until they have repaid the loan, or until any outstanding balance is forgiven after 40 years (or less for loans taken out in earlier years). This system – income-contingent loans – is designed to make a loss on people with low lifetime earnings. Such losses are well-targeted social policy spending.

But the loss on student loans is larger than is necessary for that purpose. In 2024-25:

- The Student Loans Company lent £8.3 bn to undergraduates;
- Of every £100 of loan about 68 per cent is projected to be repaid, i.e. the loss (the so-called RAB charge) is 32 per cent, i.e. about £2.7bn.

If the loss could be reduced from 32 per cent to 20 per cent the resulting saving would be nearly £1bn per year.

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Why does this matter? Until reform in 2019 the government exploited a loophole in the way student loans entered the public accounts, as I explain here. Put colloquially, loans were accounted in “funny money”, so that improved loan performance produced saving only in funny money which could not be used in the same way as “real” money. Reform in 2019 fixed the problem, thus savings from improved loan performance can now be diverted to other uses.

Internationally the best government-run income-contingent loan schemes projected a loss of 11-12 per cent. This is probably unrealistic in the UK given current economic turbulence, but reducing losses from 32 per cent to 20 per cent (*a*) would be better policy design and (*b*) would free around £1bn for additional taxpayer support for teaching, a significant contribution to the current estimated shortfall.

There are various levers for improving loan performance, notably adjusting (*a*) the level of income at which repayments start, (*b*) the repayment rate as a percentage of earnings and (*c*) the interest rate paid by borrowers. A separate type of approach is through risk-sharing with universities, discussed here.

Higher education is an important part of the government’s growth agenda – and of students’ life chances. I recognise that the proposal would face political headwinds but seems about the only way to release substantial resources given the current fiscal position.

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