Universities UK

Universities UK briefing

House of Lords debate: The current challenges of higher education funding | Thursday 12 September 2024

Summary of the financial challenges faced by universities

Changes to university funding policy in 2012, with the increase to £9,000 fees, combined with a significant reduction of government funded teaching grants, have led to English universities receiving most of their income from tuition fees rather than government grants. In England, government grants declined by 78% over a decade, while the tuition fee has eroded in value to £5,924 in 2012-13 terms. Fees from domestic and international students now account for over half of the sector's income.

The post-2012 shift in the balance from government grants to fee income means English higher education institutions receive the lowest public investment in the OECD as much of the cost of higher education has been passed on to students. This has occurred alongside a real terms decline in fee income per student. Funding per student in England, from tuition fees and teaching grants, has fallen back to levels last experienced prior to the 2012 increase in fees, with inflation and government cuts wiping out increases in funding. **2015/16 was when funding for domestic teaching, through fees and government grants, last met the cost of providing it - also known as the teaching unit of resource.** If the unit of resource had kept pace with inflation it would worth the equivalent of £12,723 per student in today's prices.

Analysis published by PwC, commissioned by UUK, demonstrated that the financial sustainability of the higher education sector is vulnerable to several risks, including above-expected increases in expenditure by universities partially driven by staff costs, and decreases in international student numbers.

The most recent OfS report on the financial sustainability of the sector indicates the situation has become even more challenging, with 40% of providers expected to be in deficit in 2023–24. This is based on provider projections which have historically been highly optimistic. The data shows all parts of the sector, from small specialist universities to large research-intensive institutions, are experiencing the strain.

Financial sustainability in the devolved nations

Arrangements for higher education teaching funding differ in each nation of the UK. While this briefing primarily focuses on England, challenges with financial sustainability exist throughout the UK:

- Welsh universities have had fees capped at a lower level than English institutions until 2024.
- Over the last decade, funding per student in Scotland has declined by over £2,500.
- In Northern Ireland funding per student has lagged behind England by over £1,000 each year.

Financial sustainability of university research

There is also a structural issue in university research funding, which risks seeing the UK's world class capabilities and competitive advantages being eroded. Despite recent increases in investment, the current system relies on a disproportionate and growing cross-subsidy from universities to make research viable which, given the financial deterioration of universities, has produced a huge gap in funding. Every £1 of public R&D spending stimulates £1.96 to £2.34 of private spending. However, despite increased investment in R&D at the 2021 Spending Review, in 2022–23, UK universities incurred a £5.3 billion deficit on their research activities. **We need an ambitious and long-term approach from the government to funding university research.**

Broadly speaking, the university research funding system is built on two pillars: Strategic Institutional Funding, such as Quality-Related (QR) research funding (and devolved nation equivalents) which is allocated based on the quality of each university's research, and project-based grant funding which is allocated by UK Research and Innovation (UKRI) based on competitive bidding. In recent years, both QR funding and project-based funding have declined for universities.

Since 2010-11, QR funding and devolved nation equivalents has decreased in real terms by 16% in the UK as a whole, and even more so across the devolved nations (-14.8% for England, -19.4% for Scotland, -20.6% for Wales and -40.3% for Northern Ireland). QR funding is critical as it allows universities to make strategic research and innovation investments into equipment, research space, skilled technicians, software, and skills. It also enables strategic choices on what project-specific grant funding to bid for.

In the current system, project-specific grant funding allocated by UKRI is meant to cover up to 80% of the full economic cost (fEC) of research, (with the remainder intended to be covered by other funding available). However, rates of recovery are below this and are worsening. In 2022–23, only 69.3% of total research costs were recovered, resulting in universities subsidising research from other, increasingly overstretched income streams, mainly international student fee income. This model is not fit for purpose and will continue to widen the financial sustainability gap.

What risks are universities facing?

Analysis from PwC shows that universities are expecting to rely more on fee income from international students in the coming years. Many universities are assuming numbers of UK undergraduates will also increase. Universities are also assuming that annual growth in their spending will fall to approximately 3 - 3.5%, significantly below recent trend and income growth projections. If this 'base case' scenario does not happen, PwC's sensitivity analysis of potential future scenarios shows that there are significant risks to the financial sustainability of individual universities and the sector as a whole.

Their analysis shows that a significant proportion of UUK's members are vulnerable to reductions in international student numbers, increased expenditure, and reduction in the growth rate of domestic undergraduate students.

Although PwC's analysis considers these sensitivities individually, it is possible that they could happen at once as part of a "perfect storm". For example, if international student numbers decreased and expenditure also increased, universities would face even more pressure.

All sizes and types of higher education providers – including research-intensive, teaching-intensive, and specialist and creative institutions – would be affected by the sensitivities modelled.

Could these sensitivities happen?

The risks identified in PwC's analysis, based on forecasts submitted for 2022/23, are not just hypothetical. In many cases, we are already starting to see their impact, especially in terms of international student recruitment. Some examples of how risks could become reality include:

International student recruitment

After almost a decade of stagnation, the UK experienced a period of significant growth in international students between 2019 and 2022, driven by a combination of government policy and the openness of the UK immediately following the pandemic. The number of international students in UK higher education reached an all-time high of 758,855 in the academic year 2022/23, however has since declined as both political and market factors changed, and the attractiveness of the UK as a study destination has fallen. There has now been a significant market correction, with previous analysis from UUK suggesting international student numbers were down 0.4% year-on-year in September 2023, and down 44.0% in January 2024. Home Office data shows that in the year ending June 2024, the number of study visas granted to main applicants was down 13.2% compared to the previous year, while the number of study visas granted at Masters' level in the year ending June 2024 was down 17.1% on the previous year.

Universities understand that growth in international student numbers must be sustainable, and that the experience for those choosing to study here is truly world-class. This includes ensuring that students have access to appropriate support, services, and accommodation. We recognise that some aspects of the rapid growth of international students in 2019 –2022 severely tested political and public support, however recent policy changes – such as restrictions on dependant visas, increased visa and immigration costs, as well as significant uncertainty around the UK's post-study work offer – have had a significant impact on the attractiveness of the UK as a study destination, as well as the perception of the UK as an open and welcoming country.

Study visas granted to nationals from four of the five top sending markets are in decline year-on-year, suggesting recruitment challenges go beyond only impacting certain markets. In addition, data from Enroly (a third-party platform responsible for onboarding one in every three international students that come to study in the UK) suggest that the average number of deposits paid by applicants intending to enrol in September 2024 is down 28.1% on the previous year, indicating that the 2024/25 academic year will be another challenging year for international student recruitment.

Teachers' Pension Scheme

Universities that are statutorily obliged to be members of the Teachers' Pension Scheme (primarily modern, post-1992 institutions) are now required to pay pension contributions of 29% for 58,000 members of staff (compared to 16.4% in 2019). This is one of the highest employer contributions of any pension across the UK. This is already significantly increasing universities' expenditure, potentially even beyond the 2 percentage points captured under PwC's sensitivity analysis.

Why does it matter?

The UK's performance in higher education and research is exceptional, surpassing our international counterparts. UK universities deliver the highest degree completion rates across the OECD and are recognised as world-class, generating £25.6 billion of export earnings, while broadening the UK's soft power and strengthening global relationships. The UK has the third largest share of the world's academic publications (6.3%) behind only China and the United States, with an even larger share of the world's most highly cited publications (13.4%).

The latest figures show the UK higher education sector's teaching, research and innovation activities had an economic impact of £265 billion. These impacts are felt across the UK. The same report found that the average benefit to the exchequer is £75,000, on each graduate, even after the costs of subsidising their studies are considered because of higher tax and national insurance contributions.

Underfunding will restrict the ability of universities to drive inclusive economic growth and the UK's global competitiveness, as well as provide opportunities to students that are comparable to previous years. Sustained funding that ensures a high-quality student experience and enhances the UK's ability to deliver world-leading research and innovation will rapidly accelerate the positive contributions of universities.

Underfunding will also restrict student opportunity and success. Even with universities' best efforts, a shortfall in funding will inevitably impact on the quality of the student experience. Student to staff ratios have increased from a sector average of 15.5 in 2014–15 to 16.9 in 2021–22.

Problems of underfunding also affect the ability of students to meet their living costs. The current system forces those students domiciled in England that are from lower-income backgrounds, who are typically more debt averse, into taking on higher levels of student loans. Frozen household income thresholds and a failure to adequately uprate the maintenance package with inflation means the average student's maintenance loan now falls £582 short of covering their living costs every month.

What steps are universities taking?

Universities in all four nations of the UK are already making changes to adjust to these pressures – including, in some cases, significant restructuring and transformation programmes. 80% of UUK's members are already undertaking transformation and efficiency programmes across multiple areas. Diminished financial stability for universities has potentially harmful repercussions for students, staff, and the economy. Many universities are currently making similar decisions, such as closing degree courses with low student demand but of national strategic importance, such as modern foreign languages and arts and humanities courses. There is a real risk that certain courses will only be available in a limited number of institutions and will become out of reach to students who cannot travel to study, or who cannot meet highly competitive entry requirements.

How can we secure universities' financial sustainability?

UUK recommends the following actions for universities and government:

Government should support the sector to take **immediate steps** to move to a more solid financial footing through the following actions:

- Increase funding for teaching to meet their real cost through a combination of index-linking fees to inflation and restoring the teaching grant. If the unit of resource had kept pace with inflation it would worth the equivalent of £12,723 per student in today's prices. UUK is not calling for tuition fees to rise to this level. In fact, more and more of the burden is falling on graduates, and the UK is increasingly an outlier within the OECD on this. Our research shows the significant benefits to the Treasury generated by graduates, and we believe it is time for a re-balancing of responsibility for funding to recognise that.

- Ensuring policy stability in relation to international students in order to achieve sustainable managed growth. Specifically, the Graduate route should remain on its current terms for the lifetime of this Parliament.

- Reverse the decline in Quality Related funding for research, which has declined in real terms by nearly 15%.

- Government should work with the universities to deliver a sustainable solution in relation to the significant increase in contributions to the Teachers' Pension Scheme.

- Government and the sector should have a clear plan should a university in England find itself in severe financial distress. Plans to manage the immediate situation and protect the reputation of the higher education sector should be in place, with the support of independent experts, to guide institutions in financial difficulty to find a viable way forward. There are different possible models for such an intervention, but it is crucial to protect students and others who depend on the university, including local public services.

Following steps to stabilise the sector, a more secure foundation will give universities the basis they need to develop more efficient long-term strategies and, in some cases, to transform their business and operating models. This might include greater specialisation, shared services, collaboration to deliver vulnerable subjects, or more agile operating models which allow universities to be more responsive to the specific needs of students, employers and local communities. It may include consolidation of provision across regions or the development of collaborative or group models, but this should be driven by institutional strategy and will not necessarily secure short term financial savings, given that these types of transformations take time and considerable upfront investment. Government could support this sector-led effort through the following actions:

1. A compact with the university sector to deliver sustainable, managed growth in international student recruitment. This should include:

    - a commitment from universities to adopt and fully implement the Agent Quality Framework and Far Admissions Code of Conduct.

- As part of this compact, government should also adopt a more transparent approach when reporting migration trends. This should focus on separating out 'temporary' and 'permanent' migration, measuring 'steady state' net migration over a longer timeframe, such as 3-5 years. Policy should place greater emphasis on numbers granted settlement, known as 'indefinite leave to remain', rather than blunt measures of annual net migration.
- Government and the sector should also jointly invest in efforts to promote the UK in key markets. Government should double their investment in Study UK – on condition that this increase is matched by universities.

2. The removal of VAT on higher education shared services.

3. A Transformation Fund to enable and accelerate changes to universities' operating and business models.

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About Universities UK

At Universities UK, we harness the power of the UK's universities and create the conditions for them to thrive. We are the collective voice of 141 universities in England, Scotland, Wales and Northern Ireland, bringing them together to pursue a common cause: thriving universities, serving society. We aim to ensure our universities can transform the lives of more individuals, drive greater growth and create flourishing places through the knowledge and skills they generate, while being globally competitive centres of research making ground-breaking discoveries. Universities UK acts on behalf of universities, represented by their heads of institution.