

31 January 2012

Tertiary Education Report: Student allowances: Directions for Budget 2012

Executive summary

This paper provides advice on potential approaches to student allowance savings for Budget 2012. To achieve the priorities outlined in the Vote Tertiary Education Four-year Budget Plan, savings from student financial support of an estimated \$245 million over the four years need to be identified.

We consider that scope exists to improve the value for money of student allowances, especially given large increases in expenditure on allowances (62% since 2007/08), and that loans are now interest-free. International and New Zealand evidence on the relative impact of financial and non-financial barriers to tertiary education lends support to this view, although as the interest-free student loan scheme is both unique to New Zealand and recent, there is no absolutely conclusive evidence.

Student allowances, alongside student loans, provide for wide access to tertiary education and its labour market and wider social benefits. Allowances focus support on students from low income families; and full allowances, including the accommodation benefit, provide more per week to students than a loan. Allowances provide a grant to students, tailored to individual circumstances; for example a student with dependent children or a dependent partner will generally receive a higher level of support than a single student.

The design of student allowances has not been reviewed since student loans became more subsidised, with interest subsidies and interest-free loans, in effect introducing a 'grant' element into the 'loan' scheme. We consider that allowances play an important role, as supplementary support to student loans, for two reasons:

- **To assist people to enter tertiary education** who have very little upfront cash or family resources, and who heavily discount the future benefits of qualifications.
- **To provide additional support for students with higher financial needs**, for example those with dependents.

We have identified two approaches in the short term to make savings and target resources towards need for financial assistance. The Ministry of Education recommends that further work on student allowances for Budget 2012 focus on options within one or both of these. The approaches are:

- **Focus allowances on initial years of study (*preferred*)** to begin to update policy settings for student allowances to reflect wide availability of subsidised student loans. We would undertake further analysis to advise on the impact of this change on priority groups, including beneficiaries.
- **Reduce parental income thresholds (*alternative or additional*)**: to make savings that return the focus of allowances towards students from needy backgrounds (the current maximum level of parental income for a full allowance, at \$55,027, is 30% higher than CPI-adjusted 1992 levels). This is

the approach which would involve the least change to current policy parameters.

Either approach to Budget 2012 would take steps to address the relatively high level of student allowance assistance, and to improve alignment between targeted allowances and widely-available loans. These approaches could provide a platform for more fundamental work on student allowances beyond Budget 2012, but could also be implemented with relatively little change to existing processes for students or agencies.

Either of the recommended options could be phased in over time. Impacts would focus on relatively less needy students, with a lesser impact on access for Māori and Pasifika learners and students from low income families moving into study. Within these options, it would be possible to tailor support specifically to priority groups, including beneficiaries. We will consider these impacts as well as interactions between potential changes to allowances, to student loans, and upcoming welfare reforms, in future advice due in February.

We can see several other potential directions to focus allowances more closely on need and improve the fit between loans and allowances. These are presented in the paper for completeness, and to seek your initial views about future work on allowances. Unlike the directions recommended for Budget 2012, these would represent more fundamental policy change, affecting more students, with greater operational complexity.

Following your feedback, we will develop preferred directions into more detailed options for you to consider in mid-February. We will then draft a Cabinet paper with proposed student support Budget decisions for March 2012.

We recommend you consult the Minister for Social Development on this paper. We have consulted the Ministry of Social Development and the Treasury.

Recommended actions

We recommend that the Minister for Tertiary Education, Skills and Employment:

- a. **note** that we have assessed potential directions against a range of criteria, and that our recommended directions balance effectiveness, savings, impact on different learner groups, and feasibility of implementation in the short and medium term
- b. **indicate** which of the following directions you wish developed into options for Budget 2012 to make savings and target resources towards need for financial assistance:

EITHER

- (i) **focus allowances on initial years of study (preferred):** to begin to update policy settings for student allowances to reflect wide availability of subsidised student loans

AGREE / DISAGREE

AND/OR

- (ii) **reduce parental income thresholds (alternative or additional):** to make savings that return the focus of allowances towards students from needy backgrounds

AGREE / DISAGREE

- c. **indicate** if there are other directions you wish to pursue for Budget 2012

YES/NO

- d. **note** that the paper also identifies more fundamental policy changes which you may wish to pursue for future Budgets, to continue improving targeting of resources
- e. **forward** this report to the Minister for Social Development for her consideration
- f. **note** that we will report back to you in February 2012 with detailed options for the direction(s) you wish to pursue, including impacts and potential mitigations for priority groups, the benefit system and the loan scheme
- g. **note** that following consideration of further advice, a Cabinet paper on the 2012 student support Budget proposals will be developed for March 2012.

Dr. Andrea Schöllmann
Group Manager, Tertiary Education
Ministry of Education

NOTED / APPROVED

Hon Steven Joyce
Minister for Tertiary Education, Skills and Employment

_____/_____/_____

Tertiary Education Report: Student allowances: Directions for Budget 2012

Purpose of report

- 1 This paper recommends you consider two potential directions for student allowances in Budget 2012 to make savings and begin targeting resources more to need for financial assistance. It also provides approaches that could be considered for longer-term policy work. It seeks your feedback on which directions you wish to see developed into options for Budget 2012.

Background

- 2 To improve tertiary education outcomes with no additional funding over the next three years, it is necessary to continue to reprioritise new expenditure from lower priority areas and ongoing efficiency gains, and seek to target expenditure more effectively within tertiary education to drive performance.
- 3 The draft Four-year Budget Plan, submitted to you on 27 January 2012 (METIS 645370), proposes saving a net total of \$245 million over four years from student support, for reprioritisation within tertiary education. A key choice for Ministers will be the relative focus on savings from student loans versus savings from allowances.
- 4 There is scope to tighten student loan policy settings further, to continue to improve the long-term affordability of the Scheme and achieve savings for reprioritisation. However, as you have already removed a significant amount of low value lending, the implications of further change for access to tertiary education will need to be carefully considered.
- 5 In contrast, student allowance policy settings have not been comprehensively reviewed since the introduction of the current allowances system in 1989. In particular, allowance settings have not altered to take account of the higher subsidies in interest-free student loans. Also, if a student is not eligible for an allowance, loans remain an option for most. Therefore there may be scope for improving the value for money of student allowances without significantly reducing access to tertiary education.
- 6 There have been significant increases in student allowance recipients and expenditure in recent years (METIS 622539 refers). In particular:
 - a Government expenditure on student allowances has increased from \$385 million in 2007/2008 to \$620 million in 2010/11: a 62% increase.
 - b Over 95,000 students received an allowance in 2010, up by 50% since 2004. Numbers are forecast to reduce slightly in out-years due to flattening numbers of school leavers and economic recovery.
 - c Allowances begin to abate at parental income of \$55,027, and are still available up to parental income of \$89,156. Thresholds are adjusted annually for CPI, but additional increases in the 2000s also expanded eligibility significantly: if CPI increases had continued, without policy change, the threshold would have been \$42,049 in 2011 dollars.
 - d The average annual allowance was \$5,500 in 2000/01 and is expected to rise to \$6,800 in 2011/12, then continue to grow with annual CPI adjustment.

- 7 Student allowances were introduced in an environment of low tertiary participation and low or no fees. Government introduced allowances with an objective to increase participation for those whose low family income was a barrier to participation. Low family incomes and debt aversion (reluctance to borrow to fund tertiary study) are commonly seen as barriers to tertiary education participation that necessitate allowances. However, international evidence suggests that low family income may not be the only, or even the main, barrier to tertiary education. This evidence is discussed in paragraphs 8 to 13 below.

Recent evidence on student finance

- 8 We have drawn on a range of recent research on student finance, locally and from the United Kingdom, Canada, Australia and other countries. There are limitations in this evidence, specifically from a New Zealand context. Little research has been undertaken on the impact of student allowances in New Zealand, particularly since the introduction of interest-free student loans or in the context of the recent recession. Research findings do not necessarily apply to the New Zealand context, because nearly all other international student loan schemes charge some form of interest, and not all are income contingent.
- 9 The existence and extent of debt aversion among potential students is debated in the international literature. A number of international researchers conclude that there is weak evidence for widespread debt aversion, and that there is not a strong link with socio-economic status. Recent behavioural research has also found that students' stated fear of debt does not correlate well with actual borrowing behaviour. Reluctance to borrow for tertiary education has also been linked with low numeracy and the perception of low returns from tertiary education. This suggests a need for better information for students and families.
- 10 The available New Zealand research suggests that debt has little impact on the attitudes of young people towards tertiary study, and that socio-economic status, particularly financial circumstances, is not significant.¹ This research has largely been conducted with university students, and so may not reflect the attitudes of those studying at lower levels.
- 11 Student loan borrowing increased following the introduction of interest-free loans, suggesting that students are more comfortable using interest-free loans. For example, in 2010, 74% of eligible students borrowed from the Loan Scheme, compared with 61% in 2005, the year before interest-free loans were introduced. A recent Inland Revenue study found that for students with a loan, borrowing to fund tertiary education has become normalised.²
- 12 Ministry of Education research published in 2008 looked at the educational achievement of student support recipients who studied full-time during the years 1999-2001. The research found that full-time students who received either a student allowance or a student loan achieved better in tertiary education, controlling for other factors, than students who received no student support. There was very little difference in completion between students who received both loans and allowances (a relatively large group) and those who received

¹ Zhang, J. and Kemp, S. (2009) *The relationships between student debt and motivation, happiness, and academic achievement*, *New Zealand Journal of Psychology*, 38(2), 24-39; Haultain, S., Kemp, S. and Chernyshenko, O.S. (2010) *The structure of attitudes to student debt* *Journal of Economic Psychology*, 31(3), 322-330; Kemp, S., Horwood, J. and Fergusson, D. (2006) *Student loan debt in a New Zealand cohort study* *New Zealand Journal of Educational Studies*, 41, 273-291.

² 'Attitudes of Student Loan Borrowers Living in New Zealand and Overseas research report' IRD 2011/154

loans only (also a large group), controlling for prior qualifications, ethnicity, and study type.³ Socio-economic status was not included specifically, however prior qualifications, ethnicity, and study type provide proxies to some extent.

- 13 The international and New Zealand evidence above needs to be treated with some caution, but it suggests that given interest-free loans, allowances could be more tightly targeted to need, without significantly affecting overall tertiary participation and completion. This would free up resources to be reprioritised within the tertiary education system. Specific groups may be affected more significantly, including those identified as priority learners. These impacts are discussed below.

Role of student allowances in Māori and Pasifika participation and achievement

- 14 Currently young Māori and Pasifika people are much less likely to engage in the tertiary education system,⁴ to complete qualifications and to progress to higher levels of study than the total population. Educational underachievement results in underutilisation of talent, lower productivity and wider social and economic costs. We will provide advice by 3 February on the effectiveness of wider tertiary policy settings in lifting system performance for Māori and Pasifika learners.
- 15 Student loans and allowances address financial barriers to study, primarily supporting access and participation objectives. Existing support from loans and allowances is likely to provide an important support for existing participation, especially for Māori and Pasifika from low-income families. However, our research indicates it is unlikely that further improvements in participation or achievement would result from increases in financial support. For example, student loan uptake by Māori and Pasifika is in proportion to enrolment by these groups in tertiary education. On average, Māori and Pasifika borrowers have lower loan balances, which are likely to be linked to studying short sub-degree courses. Some Māori or Pasifika learners may be reluctant to borrow for tertiary study, but the limited New Zealand evidence relating to ethnicity and reluctance to borrow for tertiary study does not suggest a strong systemic link.
- 16 We will provide advice on the potential impact of proposed student allowance directions on Māori and Pasifika in February, as part of advice on more detailed options.
- 17 Māori and Pasifika who do not achieve in tertiary education often also face more significant non-financial barriers to tertiary education, such as low prior attainment, and lack of family familiarity with tertiary education. Current funding settings provide only limited incentives for tertiary education organisations to select or support learners who may require targeted recruitment strategies, tailored learning environments, or additional academic or pastoral care. Our initial analysis is that improving these incentives is likely to provide greater overall improvements in outcomes for Māori and Pasifika learners than maintaining or increasing funding for student support.

³ Ministry of Education (2008) *Educational Achievements of Student Support Recipients*. Note that the small group who received an allowance only (and did not borrow from the loan scheme) had a significantly higher likelihood of completion than students who received both loans and allowances, or loans only. However, this finding must be treated with caution, as the number of 'allowance only' recipients is very small, and these students are not necessarily representative (as they include students on academic scholarships who did not need to borrow). This is despite the research being conducted while allowances, but not loans, had a performance requirement.

⁴ After adjustment for school attainment, Māori and Pasifika learners are still less likely to progress directly from school to higher-level tertiary education.

Interface between student loans and allowances

- 18 Loans and allowances are designed to interact, with many students currently receiving both. Many allowance recipients borrow either fees or course-related costs. The abated allowance income threshold means that not all allowance recipients receive a full allowance, and under current policy settings they can top up to the loan living cost maximum of \$169.51 per week.
- 19 Around 85% of all 2010 allowance recipients also borrowed from the student loan scheme for fees, living costs or course-related costs, with 36% using the loan scheme to supplement their partial allowance. As a result of this, any reductions in allowance spending will increase loan spending, although with a lower cost to government as 55 cents in every dollar lent is eventually repaid. We intend to assume that allowance recipients will borrow loan living costs if their allowance is reduced or removed.
- 20 Unlike the flat rate received through the living cost component of the loan scheme, allowance recipients can receive more money per week based on individual circumstances. For example, an eligible single student aged under 24 and living away from home would be likely to receive \$167.88 per week, a single person with children would receive \$288.47 per week, and most who live away from home also receive an accommodation benefit of up to \$40 per week. Allowance rates are indexed to inflation and adjusted each April.

Interface with welfare system

- 21 Student allowances have been designed to interface with the benefit system as well as with student loans. The current system aims to avoid any disincentives for people to move into study from benefit, and also aims to avoid creating disincentives for young people leaving school with low or no qualifications to go on to benefit. The main way this is done is to align the maximum rates of student allowances with the maximum relevant benefit rates. It is not possible to receive a benefit and an allowance at the same time. Despite the rates being aligned, detailed settings such as abatement and differences in accommodation and other supplementary support (which are more generous on benefit than on student allowance) can provide a disincentive for some, particularly sole parents, to leave a benefit and move into the student support system.
- 22 The Welfare Working Group (WWG) recommended a long-term investment-based approach to improving outcomes from welfare benefits and services. An investment approach will require changes to the way beneficiaries are supported to study and is likely to identify a group of beneficiaries for whom higher-level tertiary study (level 4 or above) is the best way to achieve better outcomes and reduce their long-term liability. Cabinet has directed MSD to develop a proposal for a number of bursaries to provide extra support with the costs of entering higher-level tertiary study. [2]
- 23 A significant minority of people move from a benefit to an allowance each year. In 2007, 3,148 people moved from a benefit to an allowance or partial allowance

(5.5% of all allowance recipients); in 2010 7,644 people moved (8%).⁶ For some young people leaving school, the choice of whether to enter tertiary education may be influenced by the availability of an allowance. Reducing student allowance access could increase the proportion of this group who move onto a benefit.

- 24 Any changes to student allowances need to be understood in the broader context of the potential impact on the benefit system and the welfare reform work. Once we understand the directions you wish to pursue regarding allowances, we will provide you with advice regarding the scale of impact on the benefit system.

Proposed policy approach to allowances

- 25 Student allowances, alongside student loans, provide for wide access to tertiary education and its labour market and wider social benefits. Specifically, these forms of student support encourage students and their families to be able to invest in tertiary education with confidence about the future costs and benefits. In order for the level of support to be sustained over time, it is important that the cost to taxpayers is also predictable, manageable and seen as reasonable.
- 26 Policy changes that increased access to allowances and levels of subsidy for both loans and allowances increased the cost of student support for taxpayers through the 2000s. These also blurred the boundaries between grants and loans, by significantly increasing the subsidy on student loans, now 45 cents in the dollar.
- 27 Allowances have an important role in assisting students to meet their living costs, to supplement more widely-available student loans. We believe this role is:
- a To assist people to enter tertiary education who have very little upfront cash or family resources, and who heavily discount the future benefits of qualifications. The student loan scheme fills this role for many students, but it is unlikely on its own to overcome upfront costs for those with fewest resources. In particular, allowances lower the total cost of tertiary education more explicitly than loans.
 - b To provide additional support for students with higher financial needs, for example those with dependents. Allowances allow for support that is tailored to individual circumstances, currently aligned with benefit levels.
- 28 We have considered the following criteria in assessing potential directions:
- a Effectiveness in targeting need: tertiary education participation and achievement.
 - b Level of savings achieved.
 - c Impact:
 - i. on access for priority groups: Māori and Pasifika, students from low socio-economic backgrounds, people moving from benefit to study, and students with dependents
 - ii. improving alignment with loans, shifting to see allowances as supplementary support to loans: also whether the approach would provide a platform for changes in future Budgets

⁶ Transfers from UB-Hardship Student to student allowance are excluded. A transfer is defined in this indicative measure as having been in receipt of a benefit 30 or fewer days prior to commencing student allowance.

- iii. interaction with possible welfare reform and current benefit settings (although any approach could preserve current entitlements for people leaving benefit to study).
- d Implementation timeframes, complexity and cost: whether the approach can be developed well enough in time for Budget 2012.

Directions for Budget 2012

- 29 We recommend you consider two potential directions for student allowances in Budget 2012 in line with the role for allowances we proposed above.
- 30 The table below assesses these directions. Except for tighter income targeting, all directions would require amendments to the Student Allowances Regulations.
- 31 Both of the proposed directions are relatively simple to implement in the short term and would retain a degree of policy stability, relative to current policy settings. We propose further analysis to advise on the impact of your selected directions on priority groups (including Māori and Pasifika students, young people, beneficiaries, and students with dependents) and on transitions into and through study. Within these options, it would be possible to specifically tailor support to beneficiaries.
- 32 As with options for changes to student loans, a potential trade-off exists between the speed at which changes to allowances can be implemented, and the effectiveness at addressing core problems. For that reason, we also propose three approaches to explore beyond Budget 2012.
- 33 **Focus allowances on initial years of study (recommended).** This would begin to update allowance policy settings to reflect the wide availability of student loans. We recommend you target allowances to the initial years of study (potentially up to 3 years), or first qualification (with an additional allocation for foundation education if a student has not achieved level 3 qualifications), rather than support a student throughout the duration of their study. Students would borrow from the loan scheme for further living costs support up to the 7 EFTS limit on loan borrowing. This approach is supported by evidence that suggests that a student's first year in tertiary education is the most important for ensuring their success.
- 34 This approach would reduce the current 200 week limit on allowance receipt, and would likely remove provisions for Long Programmes, which are mainly postgraduate qualifications, in some cases of over 350 weeks.⁸ This approach would contribute moderate to considerable savings, depending on the number of weeks allowances were limited to. For example, limiting allowance receipt to 120 weeks would have a net positive impact on the operating balance of approximately \$20 million per year, allowing for student loan flow on impacts (although cash savings would be lower than this). Limiting allowances to 80 weeks would have a net positive impact on the operating balance of approximately \$55 million per year. These figures are indicative only.

⁷ Jacques van der Meer, Austina Clark and Chikako van Koten *Establishing Baseline Data: using International Data to Learn More About Completion Factors at One New Zealand University*. Journal of Institutional Research, 2008. Jacques van der Meer *I don't even know what her name is: Considering the challenge of interaction during the first year*. Studies in Learning, Evaluation Innovation and Development, 2009.

⁸ For example, the Master of Dental Surgery or Doctor of Philosophy (PhD) qualifications.

- 35 Targeting allowances to initial years of study would be a significant policy change for allowances and would therefore carry some risk. This approach would have low operational complexity and cost, depending on the approach to transitions, to foundation education and to students with dependents.
- 36 **Reduce parental income thresholds (alternative or additional).** This would return the focus of student allowances to students from needy backgrounds, reversing changes in the mid-2000s that extended support to students from middle-income families. It would reflect that student loans are widely available, but would not signal a shift in focus for allowances as clearly as the recommended approach. Consequently it would likely have less impact and carry lower risks.
- 37 Having assessed the potential directions against the criteria in the table below, our overall assessment is that the recommended options provide the best balance in the short term between effectiveness, savings, impact on different learner groups, and feasibility of implementation.

Other directions – more fundamental change, recommended for future work

- 38 The table also identifies three further directions which you may wish to consider for future Budgets, to continue improving targeting of limited resources:

[2]

- c **Target allowances solely to low-level qualifications** (which could be partly achieved through focussing on initial years of study, but would also complement wider funding shifts for foundation education).

- 39 These three directions also are in line with the role for allowances proposed at paragraph 27 above, but they require more time to develop so we believe they are more suitable for future Budgets. These directions would represent more fundamental policy change, affecting more students, and would require further analysis.

RELEASED UNDER THE OFFICIAL INFORMATION ACT

Table 1: Overview of directions for student allowances

Direction	How?	Effectiveness of targeting in increasing tertiary participation and achievement	Savings	Impact: access, alignment, fit with possible welfare and loan changes	Implementation complexity and cost
Recommended for Budget 2012					
Focus allowance support on initial years of study	Decrease lifetime allowance limit from 200 weeks. Include removing the Long Programme exemption and/or post-graduate support. [2]	Medium. Some deadweight cost if current broad income thresholds retained.	Medium	Medium. Could particularly affect students doing longer courses/degrees/postgraduate study. Based on allowance recipients between 2004 and 2011, the current average length of allowance receipt is 54 weeks (two years). Consider a transition period.	Medium
Tighter income targeting	Reduce income thresholds. For example target to low income e.g. bottom 25-40%, or reduce to CPI-adjusted original levels (current levels are 30% above these).	Low-Medium. Reported income is not necessarily a good proxy for need. Evidence shows other factors are also significant for tertiary education participation and completion.	Low-high	Low-high depending on degree of threshold reduction. Approximately 50% of allowance recipients are parentally income tested. ⁹	Low
[2]	[2]	[2]	[2]	[2]	[2]
[2]	[2]	[2]	[2]	[2]	[2]
Targeting to lower level qualifications only	Target allowance funding to students studying school-equivalent qualifications ie level one to three study, bridging education. Consider alongside funding changes to foundation education (eg fee-free).	Medium. Some deadweight cost. May have limited impact on achievement, but likely greater impact on participation levels.	High	High impact on current recipients. 60% of current allowance recipients study at degree level and above, and 40% below degree level (25% at certificate level). Overlaps with focus on initial years of study.	Low-medium – consider alongside funding changes for foundation education

⁹ All figures based on 2009 allowance recipients.

Discounted directions

- 40 We have also considered, but do not recommend the following directions:
- a Devolving allowance budgets to tertiary providers. There are a number of risks associated with this direction such as weakening students' influence as consumers, lack of transparency for students, accountability and administrative complexity and the potential for students in similar situations to receive different treatment between providers.
 - b Retaining the current eligibility but cutting the dollar amount per week. This approach would generate few savings as students would most likely borrow the difference from the Loan Scheme. A large number of students receiving a small amount of support would mean expenditure would be spread thinly and therefore be relatively ineffective.

Consultation

- 41 We have consulted the Ministry of Social Development and the Treasury on this advice and reflected their comments in the paper. The recommendations are the view of the Ministry of Education.
- 42 We recommend you consult with the Minister for Social Development, as any changes to allowances will impact on the interface with the benefit system and StudyLink's operations.

Next steps

- 43 Following your feedback on this paper, we will develop potential options from the directions you are interested in, and provide further advice in February. This advice will include impacts on priority groups (including Māori, Pasifika, lower socio-economic groups, beneficiaries and students with dependents) and the effects of interactions with loans and welfare support.
- 44 Decisions on that further advice will inform a draft Cabinet paper on the 2012 Student Support Budget proposals for consideration in March 2012.

RELEASED UNDER THE OFFICIAL INFORMATION ACT