



**20 October 2010**

**Graduate taxes are a better funding mechanism than tuition fees**

**New research model supports a tax system which would be of greater benefit to individuals, academic institutions, and society**

Graduate taxes are a better mechanism than tuition fees for funding higher education because they reduce risk for students, and offer an incentive for universities to improve teaching and facilities, suggests new research from Cass Business School and the University of Cologne.

Tom McKenzie, Research Fellow at Cass, and Dirk Sliwka, Professor at the University of Cologne, examined ways of funding higher education, comparing upfront tuition fees with a proportional graduate tax on future income and found that the graduate tax was more favourable as it transfers volatility in future income from risk-averse students to the state.

The research paper, *Universities as stakeholders in their students' careers*, suggests that if a graduate tax scheme was adopted, revenues should flow directly to the institution of the alumnus as this would increase the incentive for universities to improve the quality of education. This is because universities would stand to profit from boosting their students' earnings potential and to lose out if they did not add value. They would effectively become stakeholders in their graduates' careers. In addition, a graduate tax would allow more people to attend university as the most successful graduates at the top end of the income spectrum would subsidise university places for others, something that does not happen with flat tuition fees.

The academics concluded the following:

1. The fixed tuition fee provides higher work incentives for graduates
2. Graduate taxes provide better incentives for universities to invest in their students' human capital than do fixed tuition fees
3. These incentives are even stronger when each university receives the tax revenues directly from its own former students
4. By replacing tuition fees with a graduate tax, enrolment can be increased without violating the state's budget constraint
5. If the state maximises student well-being it will implement the graduate tax
6. Most students prefer the graduate tax, but high ability students prefer the upfront fee

McKenzie and Sliwka found that risk-averse students preferred the graduate tax as future income is volatile and the state assumes part of this risk through the tax. However, since students differ in their abilities, those of high calibre are likely to prefer an upfront fee as they expect to pay more tax than their less able counterparts later on. But due to the insurance effect of their education, a student with an average ability still prefers the graduate tax.

Tom McKenzie, Research Fellow at Cass Business School commented: "The current debate has focused on equity issues surrounding the ability to pay for higher education but not on how this education might be changed for the better. A tax paid back to the graduate's alma mater would not only offer an affordable alternative to fees; it would also encourage universities to invest in teaching quality and help their students into employment upon graduation."

**- ENDS -**

**For further information please contact Nicole Haroutunian,  
[Nicole.haroutunian@city.ac.uk](mailto:Nicole.haroutunian@city.ac.uk), 0207 040 5210**

## **About Cass Business School**

**Cass Business School**, City University, London, delivers innovative, relevant and forward-looking education, training, consultancy and research. Located in the heart of one of the world's leading financial centres, Cass is the business school for the City of London.

Our MBA, specialist Masters and undergraduate degrees have a global reputation for excellence, and the School supports nearly 100 PhD students. Cass offers the widest portfolio of specialist Masters programmes in Europe and our Executive MBA is ranked 21<sup>st</sup> in the world by the *Financial Times*.

Cass has the largest faculties of Finance and Actuarial Science and Insurance in Europe. It is ranked in the top 10 UK business schools for business, management and finance research and 90% of the research output is internationally significant.

Cass is a place where students, academics, industry experts, business leaders and policy makers can enrich each other's thinking. For further information visit: [www.cass.city.ac.uk](http://www.cass.city.ac.uk)