Intelligence MEMOS

From: Charles M. Beach and Frank Milne

To: Canada's Ministries of Colleges and Universities

Date: December 16, 2019

Re: **Financial Risks of Growing Post-Secondary Reliance on Foreign Students**

The numbers of foreign students at universities and colleges in Canada have risen dramatically in recent years, which raises major potential financial risks for the post-secondary education sector in this country.

Canada's international post-secondary student population has grown from 60,000 in 2000 to 220,000 in 2016 and more than 300,000 last year. This is being driven by rapid increases in average living standards and the number of middle-class families in countries such as China and India who seek a good internationally recognized education for their offspring.

For schools that face declining real-dollar government revenues per student, this is an opportunity, especially given their wide discretion in setting foreign-student fees. Foreign bachelor-level students pay on average about 3.5 times the domestic tuition, and in some cases as much as seven times.

In Ontario, where a 10 percent tuition cut has been imposed, taking out an estimated $380 million from overall operating revenues, the incentive to attract more foreign students only grows.

Foreign students offer many benefits. Domestic students get a broader understanding of the outside world, and foreign students' entrepreneurial talent can help energize the Canadian economy. They help make up for a declining natural birthrate and rapid aging of the Canadian population. And they can provide a cross-subsidization of domestic students' education, help enhance a university's research profile, and subsidize growth of university infrastructure and hence the potential benefits of economies of scale offered by new technology.

But there are also potential risks that could ultimately hurt schools and impose a cost on Canadian taxpayers through a range of unintended consequences. Australia and the United Kingdom are further down this road in the burgeoning reliance of their universities on foreign students as a critical revenue stream, and we can learn from their experiences and concerns. About 13 percent of university students in Canada are international students, while in Australia and the U.K. the number is 25 percent, and rises above 40 percent at several Australian universities.

This exposes post-secondary schools to substantial risks from sudden external funding shocks such as a possible rise in the Canadian dollar, slower growth or a recession in foreign economies, or a foreign government's disagreement with some aspect of Canadian foreign policy. Saudi Arabia, for instance, said last year that it would withdraw virtually all 6,000 or so of its students at universities in Canada because of a Canadian Foreign Affairs tweet about human rights.

One aspect of the foreign student inflow to Canada is its concentration in just two countries. About 30 percent of foreign students come from India and 25 percent China. The latter government has already cut off Canadian exports of soybeans and canola, presumably for political reasons. Just imagine the financial shock if they followed the example of Saudi Arabia? Indeed, the University of Illinois, has taken out a $60-million insurance policy against "a significant drop in tuition fee revenue from Chinese students." The university's annual premium on this policy could provide the basis of a market valuation of this one risk alone. Hence, a just-announced federal policy to help diversify foreign students recruited to Canadian universities across a broader range of source countries makes good sense.

A second aspect of concern is the concentration of foreign students in a limited number of disciplines. In Canada, 27 percent of foreign university students are enrolled in management and public administration programs and 19 percent in architecture, engineering and related technologies. In Australia, about half of all international students are registered in commerce-related studies. That means the risk exposure is concentrated in these key disciplines or faculties. A recent Australian study calls this funding risk exposure a "precarious state" and a recent study of the U.K. system calls it "unstable."

Key to attracting foreign students are international rankings of schools on the Internet. Such rankings rely heavily on international faculty research profiles and the attractiveness of a school's website. This creates a strong incentive for schools to invest heavily in research activity and in attractive infrastructure (new buildings and facilities), especially in the areas of foreign-student concentration. But what happens if the schools' expectations are not met? The rapid growth of Chinese students, for example, appears to have slowed (in Canada) or indeed plateaued (in Australia) as China rapidly develops its own education system. Overinvestment based on faulty expectations can lead to severe financial woes.

This raises a real moral hazard problem. Would a government be willing to allow such a university or college to fold, or would taxpayers have to pick up (at least some of) the bill for bailing them out? Are some Canadian schools just too big to fail?

Charles M. Beach is Professor Emeritus at Queen's University and Frank Milne is BMO Professor of Economics and Finance at Queen's University.

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