Abstract

In higher education pure credit market funding leads to underinvestment, while income-contingent student loans funding tends to produce overinvestment in education. We analyze whether a market structure in which both funding schemes coexist and compete against each other might restore efficiency of the educational investment process. In the absence of government intervention, we find that funding competition does not rectify this investment inefficiency nor it will improve pooling of individual income risks. However, a policy which allows the two funding schemes to compete and which, at the same time, restricts access to higher education can achieve investment efficiency and improve risks pooling. We find that the equilibrium with funding competition and restricted participation yields the highest level of social welfare.