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Fair, Progressive and Good Value?

Summary

On 3 November, Coalition Ministers responded to the Browne Review's[1] proposals for the future funding of universities in England. In summary, their response:

- endorses the Browne view that public investment in teaching funding is a 'subsidy' rather than an investment
- proposes that funding from the majority of undergraduate courses should be withdrawn completely by 2014 with a £2.9bn annual reduction in spending on higher education
- assumes that for full-time students entering university from the 2012 academic year, universities will offset the reduction in teaching funding by charging fees up to a maximum fee 'cap' of £9,000 per annum
- proposes amendments to the student support and graduate contribution system by extending fee loans to part-time students who study at 33% of a full-time course, adds a real rate of interest of up to 3% on loans of graduates earning more than £21,000 and proposes that fee and maintenance loans for both full-time and part-time students should be repaid by graduates from 2015/16 at 9% of earnings over £21,000 until loans are repaid, or for a maximum of 30 years

This Report examines the Coalition's reforms and assesses the extent to which Government Ministers' claims that their proposals offer a more progressive system and better value for taxpayers, can be substantiated. In addition, the Report examines the likely impact of the proposals on social mobility - a key objective of the Coalition Agreement for higher education agreed by the Conservative and Liberal-Democrat Parties.

On the basis of the economic modelling of their impact, we conclude that in their current form, the proposals are likely to impact adversely on social mobility and participation, will lead to 60-65% of graduates being worse-off than under the current system with the greatest impact on middle income earners and further, that they are unlikely to provide good value for taxpayers.

Those graduates earning over the £21,000 threshold face a triple whammy of higher fee debt, real interest rates and a longer repayment period. For many middle income graduates this is likely to see them paying much more for their degree compared to the current system. A male graduate from a middle income household (£42,000 per annum) on median earnings aged 25 (£23,000 in today's money terms) can be expected to be worse-off by between £15,000 and £20,000 under the Coalition's proposals. With a fee of £9,000 this increases £20,000 to £25,000. This graduate could not be considered a high-earner and the earning profile suggest that they could be a primary school teacher.

The Earnings Threshold

[1] Lord Browne of Madingley, former Chief Executive of BP, was appointed to chair the Independent Review of Higher Education and Student Finance in England in November 2009. The Review and its membership were co-commissioned by Lord Peter Mandelson, then Secretary of State for BIS and David Willetts, then Conservatives Universities Spokesperson. It findings were published on 12 October 2010

Coalition Ministers have repeatedly contrasted the £21,000 minimum earnings threshold under the new system with the current repayment threshold of £15,000. On a monthly basis, graduates will undoubtedly pay less towards the balance of their student loan if the repayment threshold stands at £21,000. However, the £21,000 earnings threshold refers to earnings in 2015/16 rather than 2012. This repayment threshold will not be up-rated to take account of inflation between 2012 and 2015 and will remain in place, without accounting for inflation, until 2020 by which time it will be worth rather less than in today's money

Assuming the same 2.2% inflation and discount rate, the £15,000 threshold, set in 2005, would be equivalent to £16,724 in 2010, £17,468 in 2012 and £19,057 in 2016. In reality, the Coalition's proposals only improve marginally the earnings repayment threshold compared to the current system. If inflation is higher than 2.2% the £21,000 earnings repayment threshold will not offer any real advantages to graduates by 2015/16.

The impact of adding RPI and an interest rate of 3% on higher fee loans

Under the Coalition's proposals, RPI will still be applied to all student loans but once graduate earnings reach £21,000 pa the loans will also attract an additional, tapered interest rate of up to 3%. Under this system:

- The loans of graduates earning below £21,000 pa will be subject to RPI only (a zero real rate of interest)
- The loans of graduates earning between £21,000 pa and £41,000 pa will be subject to a tapered real rate of interest, reaching a maximum of RPI plus 3%.
- The loans of graduates earning more than £41,000 pa will be subject to RPI plus 3%.

Given the proposed increase in tuition fees and the higher levels of student debt that will result, the impact of RPI for students who enter higher education in 2012 should not be under-estimated. The Retail Price Index, which measures the average month to month change in the prices of goods and services purchased by households in the United Kingdom, stands at 4.5% as of November 2010[2]. In the last five years it has varied from as low as 1.7% to as high as 6.8%. It is difficult to predict where RPI will lie in 2015/16 (and beyond) but Table 1 illustrates how, irrespective of earnings, zero-rate interest might accrue depending on the balance of the loan and the value of RPI. For those earning more than £21,000 in 2015/16 (and beyond), whose loans will be subject to an additional rate of interest of up to 3%, interest will accrue at an even greater rate. This raises the prospect that many graduates will never pay off their loans even with the extension of the repayment period to 30 years.

Table 1: Impact of RPI in year following graduation

Household Income	Student Debt	RPI = 1%	RPI = 2%	RPI = 3%	RPI = 4%	RPI = 5%
£25,000	**£38,625**	£386	£773	£1,159	£1,545	£1,931
£42,600	**£43,500**	£435	£870	£1,305	£1,740	£2,175
£62,125	**£37,725**	£377	£755	£1,132	£1,509	£1,886

Those students who can afford to pay upfront and those graduates who can pay off early or who do not need to take out the full loan, will be better-off since they will either incur no interest at all or they will incur less interest than others. For many students and graduates, **total** loan repayments will be higher than under the present system and they will pay off their loans for longer. In many more cases, graduates will never repay their loans.

Transparency for students and graduates

The application of an interest rate of **up to 3%** on the loans of graduates earning in excess of £21,000 will add even more administrative complexity to the student loans system. This will exacerbate the problems which already exist in ensuring accurate balance statements and

[2] Office for National Statistics

loan deductions from earnings. It remains unclear whether the student finance system will be able to respond to the challenges that variable interest rates will create

'All-in' costs: Impact of a £7000 fee
To fully assess the progressivity or otherwise of the Coalition's proposals, an assessment needs to be made of what students have to borrow to access university (based on either their parents residual household earnings or their own if they are mature students). This needs to be compared with the repayments that graduates are likely to make according to their earnings i.e. by income decile.

With a fee of £7,000 per annum, approximately 15% of men will pay less than is currently the case as a result of the increased repayment threshold in operation; however approximately 65% of male graduates will pay between £10,000 and £15,000 more than is currently the case.

Specifically, male graduates will be worse off than the current system once their earnings reach the third income decile (£19,000 per annum salary aged 25 in today's money terms). Male graduates from middle income households (£42,000 per annum) on median earnings aged 25 (£23,000 in today's money terms) can be expected to be worse-off by between £15,000 and £20,000 under these proposals.

With a fee of £7000 per annum approximately 45% of female graduates will pay less under the Coalition's (current) proposals, with the greatest benefits being captured by those women in the 3rd income decile whose earnings now fall below the threshold for repayment. However, these female graduates will never repay their loans in full. Moreover, under a £7,000 average annual fee, 30% of female graduates will end up paying between £10,000 and £15,000 more than is currently the case, with approximately 2% of females from middle income households who go on to earn in the 8th and 9th deciles paying between £15,000 and £20,000 more than is currently the case.

Repayments: Impact of a £7000 fee
With a fee and fee loan of £7,000, a male graduate entering public sector employment (or its equivalent in the private sector) at 21 years of age, earning £26,289 pa aged 25, would repay their outstanding fee and maintenance loans by the age of 42 but that they would pay £11,399 more than is currently the case for their higher education. A man graduating at 30 would not repay until he was 48 years old and would repay £6,173 more than is currently the case.

Under a £7,000 fee, women graduates entering the workforce at 21 in the same profession would pay £6,823 more in today's money but they would never repay and still have a debt of £4,564 at the point of write-off i.e. after 30 years. Women entering the workforce at the age of 30 would pay less for their higher education than at present. However, not only would they never repay, they would still have outstanding debts of more than £21,000 (£21,714) at the end of the 30 year write-off period i.e. when they were 60.

All-in costs: Impact of a £9000 fee
With a fee of £9000 per annum, graduates from middle income households who go on to achieve average or average earnings post graduation can expect to pay in excess of £20,000 more for their degrees than is currently the case.

Repayments: Impact of a £9000 fee
Male graduates entering public sector professional employment (or the equivalent in the private sector) at age 21, would repay their loans at the age of 44 but incur additional costs of almost £16,000 (£15,999) compared to the current system. Men entering the same workforce at the age of 30 would pay off by the age of 49 but would make additional payments of over £10,000 more (£10,198) towards the cost of their higher education compared to the present system.

In comparison, women entering the same workforce at age 21, would never repay but would still have debts of almost £12,000 (£11,975) at the end of the 30 year loan period in spite of the fact that they had paid £6,686 more towards their university studies than under the current system. Women entering higher education later, graduating at 30 and entering the same profession, would repay less than at present towards their higher education but they would still have debts of £28,685 after 30 years when the loan was written-off at the age of 60.

Rather than the Government's proposals being more progressive, 60-65% of graduates will be worse-off than under the current system with those on middle income paying much more for their degree than under the current system.

Treasury accounting: costs to the taxpayer under-estimated

Treasury accounting procedures allow fee loans to be accounted for in a different way to the direct funding of universities through the Hefce teaching grant and only the write-off costs of the loans will appear on the Treasury books. The Treasury appears to be unconcerned about the fact that the Government will have to borrow to fund a much larger student loan book - and equally unconcerned about the implications for future taxpayers of this 'lifetime cost' approach which will inevitably mean large write-off costs at the end of the loan period. While the proposals assist the Government in demonstrating that the deficit has been cut, they will be of little benefit to taxpayers and graduates in the long run.

Over-estimates by BIS of graduate repayments mean that the long-term cost to the taxpayer of higher fee loans has been underestimated. Rather than the current 27.5p in the pound, write-off costs are likely to be at least 36p in the pound on a fee of £7,000. Write-off costs are likely to be almost 40p in the pound on a fee of £9,000 although other estimates suggest that this could rise to 50p in the pound[3].

Impact on Treasury if enrolments fall

A conservative estimate of the responsiveness of enrolment to increased costs based on the assumption that a 100% increase in cost reduces enrolment by 5%, would mean that under a £7000 tuition fee, 23,248 fewer students may enrol and result in an Exchequer indirect loss of £1.914 billion per annum. This compares to the £2.03 billion net saving from replacing Hefce teaching funding with increased tuition fees and loans.

Using the same assumption, under a £9000 tuition fee, 34,782 fewer students may enrol resulting in an Exchequer indirect loss of £2.864 billion per annum. This compares to the £1.44 billion net saving from replacing Hefce teaching funding with increased tuition fees and loans.

Higher Transaction Costs

Implementation of the proposals will incur higher administrative and transaction costs and will be less economically efficient than the current system which combines a partnership approach of direct taxpayer investment in teaching and a graduate contribution related to a maximum annual tuition fee of £3290 in 2010/11.

Taxpayers likely to be worse-off in the long-run

The Coalition's proposals are based on an accounting device which allows the Treasury to reduce the deficit on paper. In practice taxpayers will pick-up the costs of borrowing to fund a much higher loan book and in the long-run will have to meet much higher write-off costs than under the present system. In these circumstances, it is difficult to see how the proposals provide a long-term sustainable framework for the funding of higher education and universities in England and taxpayers are likely to be worse-off compared to the current system.

Impact on Scotland, Wales and Northern Ireland: the Barnet consequentials

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[3] Hepi estimates that the RAB Charge on a £9000 per annum fee loan plus maintenance loan could be 50p in the pound - see *The Government's proposals for higher education funding and student finance*

Ministers have acknowledged that the withdrawal of investment in teaching funding from universities in England will also impact adversely through the Barnet consequentials on funding settlements in Scotland, Wales and Northern Ireland. These settlements will be adjusted downwards to take account of the removal of teaching funding in England. As a result, the Government's plans have much wider consequences for higher education in the UK as whole as well as for all taxpayers in the future.

Empowering the student?
Both Lord Browne and Coalition Ministers have characterised the proposed changes to the system as 'funding following the student' and the new system as 'empowering the student'. However, unless they are wealthy enough to pay upfront, the reality is that students who want to enter university from 2012 will need to borrow the full cost of their university tuition as well as maintenance from the state.

Level of Loans
Even in its own modelling, BIS assumes that the average tuition fee required to offset the withdrawal of public investment in teaching will be £7,200 pa for new entrants in 2012/13[4]. In reality, the loss of taxpayer funded investment means that fees are likely to be significantly higher.

- A student from a household earning £25,000 who borrows to pay for tuition fees of £9,000 pa and borrows £3,875 pa (on top of an annual maintenance grant of £3,250) will graduate with a debt of £38,625
- A student from a household earning £42,600 who borrows to pay for tuition fees of £9,000 per annum and the full £5,500 annual maintenance loan will graduate with a debt of £43,500.
- A student from a household earning £62,125 who borrows to pay for tuition fees of £9,000 per annum and the maximum £3,575 annual maintenance loan that they are eligible for will graduate with a debt of £37,725.

Impact on Mature Students
In 2008/09, 8.7% of first degree undergraduate students were aged 22-25, 8.8% were 26-35 and 8.1% were over 36 years old[5]. No assessment has been undertaken by BIS of the deterrent effects or the impact on the participation of mature students of the requirement to take out loans of up to £40,000 with a repayment period which will extend to the end of some graduates working lives and possibly into retirement.

Older students are not evenly distributed across institutions. The majority of students in modern universities enter university in their early twenties or when they are older and they are often from widening participation backgrounds. As a result, any deterrent effects on students will have a greater impact on some universities and is likely to impact adversely on social mobility.

Questions about Part-time Students
The Government's proposals include extending fee (but not maintenance) loans from 2012 to part-time students who study at 33% of a full-time course. However, this must be balanced against the much higher pro-rata fee levels which part-time students are likely to be charged.

In 2008-09, 82.2% (168,705) of part-time first degree undergraduates were aged over 21. As mature students, higher fee levels and fee loans may be challenging if part-time students have other financial and caring responsibilities. These commitments may also make studying consistently at 33% of a full-time course more difficult. As a result, the impact on participation of extending fee loans to part-time students is unpredictable. Modern universities which support part-time and flexible study may still find that they are disadvantaged in terms of fee income compared to those which admit mainly younger 18-21 year old full-time students.

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[4] BIS modelling of graduate repayments 3 November 2010

[5] million+ analysis of Equality Challenge Unit (2010) Equality in higher education: Statistical report 2010

No Equality Impact Assessment

The Government has also been silent on other equality indicators including those related to disability, ethnicity and religion. Almost 47% of all UK domiciled black students and almost 30% of all Asian students are educated in just 27 modern universities[6]. It is well-known that for cultural and religious reasons some students are less inclined to access loans including those which attract interest but as yet no equality impact assessment of the proposals has been published.

Definition of Social Mobility

Social mobility is a cornerstone of the Coalition Agreement on higher education. However, there is a real risk that the Coalition is seeking to define social mobility in higher education in very limited terms. Ministers have suggested that the number of students progressing to Oxford from disadvantaged backgrounds and who have previously been in receipt of free school meals, is a measure of social mobility. Social mobility is more properly assessed by reviewing the extent to which participation in higher education enables graduates to enter employment and professions associated with higher socio-economic occupations and earnings compared with their socio-economic backgrounds when they entered university as students.

Comparisons with 2006 of Limited Value

Coalition Ministers have likened their proposals to those in the 2004 Higher Education Act on the basis that the latter also introduced a near three-fold increase in fees from 2006. There are a number of key differences between the reforms proposed for 2012 and those introduced from 2006 and as a result, the comparison is of very limited value. In particular, 2006 fee income was additional to, and not a substitute for, public investment in teaching.

Impact of Increase in Price

In economic terms, an increase in price would normally be assumed to weaken demand. Even with the potential for an overhang in demand resulting from record applications and record numbers of people failing to secure a place at university in 2009, 2010 and 2011[7], it would be surprising if the reforms did not impact on participation. The impact of the proposed reforms on participation amongst those from lower socio-economic groups and those seeking to enter university in their early twenties or as mature students (those over 25 in the official statistics) has not been modelled by the Government.

Deterrent Effect of higher fees on those from Disadvantaged Backgrounds

An Ipsos MORI survey found that fee increases had a much greater deterrent effect amongst 11-16 year old from more disadvantaged backgrounds[8]. Irrespective of the graduate repayment system, higher fees and higher levels of debt are likely to deter students from lower socio-economic backgrounds – who already leave university with the greatest amount of debt[9].

Widening Participation Premium and Aimhigher

The Government has made no firm commitment to protect the 'Widening Participation' premium paid to institutions in recognition of the higher costs associated with teaching students from disadvantaged backgrounds. Ministers have also announced that the £78m per annum funding for AimHigher, a national programme to widen participation in higher education by raising the aspirations and developing the abilities of young people from under-

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[6] million+ analysis of Equality Challenge Unit (2010) Equality in higher education: Statistical report 2010

[7] UCAS 'End of Cycle' figures for 2009 are available at www.ucas.com/about_us/media_enquiries/media_releases/2010/210110 and 'End of Cycle' figures for 2010 can be found at www.ucas.com/about_us/media_enquiries/media_releases/2010/161110. In 2010 unplaced applicants were up by one third and over 200,000 missed out on a place at university this year. Over the last six years the acceptance rate for applicants has fallen from 78% to 69%. There is a strong possibility of record numbers of 'reappliers' in 2011 - there were nearly 60,000 in 2010. It is also possible that there will be a surge in applications as applicants try to secure a place before the new fees and funding system is introduced in 2012. In 2005 there was a surge in applications ahead of the introduction of higher fees in 2006.

[8] Ipsos MORI (2010) Young People's Omnibus 2010: A research study among 11-16 year old on behalf of the Sutton Trust

[9] HECSU (2010) Futuretrack Stage 3 Working Paper 3. The impact of paid and unpaid work and of student debt on experience of higher education

represented communities, will cease from April 2011 even though the all-age careers service will not have been established by this date. There is a real risk that not only will some potential students discount the option of university but also that there will not be the institutional support to encourage them to think again.

Eligibility and operation of the National Scholarship Scheme
The eligibility criteria for the National Scholarship Scheme are not yet agreed but the £150 million available by 2014/15 is just £7 million more than that made available for the Aimhigher programme when it was first established and is substantially less than the current value of Widening Participation funding. Many widening participation students do not progress to university from school or college. As a result, eligibility criteria linked with school age have the potential to disadvantage mature students and those who progress to university from widening participation backgrounds in their early twenties.

Impact on Social Mobility
There is undoubtedly a real risk that participation in higher education and in particular participation by those from lower socio-economic groups and mature students will be undermined as a result of the significantly higher fee levels that will be required from 2012. Ministers would run less risk of damaging participation and would be more likely to achieve their goals of improving social mobility if they moderated their proposals to withdraw 80% of teaching funding.

The Alternative
The restoration of more teaching funding would provide the taxpayer investment that universities require to deliver lower fee increases. It would ease the problems associated with creating a more progressive graduate repayment system and is also likely to be perceived by both students and their families as being fairer than the Coalition's current proposals.

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