

REPORT

# A CRITICAL PATH

## SECURING THE FUTURE OF HIGHER EDUCATION IN ENGLAND

THE FINAL REPORT OF THE IPPR COMMISSION ON THE FUTURE OF HIGHER EDUCATION



IPPR Commission on  
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## 6. FUNDING THE FUTURE

### 6.1 Weathering the storm: higher education funding in the next parliament

#### **Investing in the future**

This report has set out the case for investing in the nation's people and research base. These are national assets that will drive future growth and help to build a thriving society. High-quality education and research are the foundations on which future prosperity will be built. If they are not protected and nurtured, the productive capacity of the country will be reduced, and we will not get the most out of our economy, society and culture.

The importance of investing in higher education has been recognised by Britain's competitors. They are investing a considerable share of their national resources into expanding high-quality tertiary education and conducting research and development. The UK currently spends 1.3 per cent of GDP on tertiary education, compared to 2.6 per cent in the US, 2.5 per cent in Canada, and 1.9 per cent in Sweden and Denmark (OECD 2012a). This means our competitors are spending nearly twice the proportion of their national wealth on tertiary education that we are. A similar pattern emerges in the field of research and development. The UK spends just 1.8 per cent of GDP on R&D activity, compared to 2.8 per cent in the US and well over 3 per cent in Sweden, Finland, Japan and Korea (OECD 2011b).

These countries have recognised that actively investing in education and research is a good way to secure their future success. Over the long term, Britain should seek to match this level of investment. It will help us to compete with other countries, by raising the productivity of our businesses and public services, as well as making the country a better place to live.

#### **Future spending constraints**

While the nation's long-term goal should be to increase investment in higher education, the next few years will clearly be extremely tough for the government finances. The country is suffering the aftershocks of a profound economic crisis, and the slow pace of economic recovery is placing unprecedented pressure on public spending. As a result, government departments have been asked to make significant spending cuts, and higher education is not immune from this.

In October 2010, the government set out its plan for consolidating the public finances, which saw the majority of departments being asked to make substantial spending cuts. Over the course of this parliament, BIS will see its budget cut by a quarter (see table 6.1). In passing on these cuts, BIS decided that it would give relative protection to further education and apprenticeships, while asking higher education to absorb the lion's share of the spending reductions. The funding allocated specifically to higher education was set to fall from £7.1 billion in 2010/11 to £4.2 billion in 2014/15, a cut of 46 per cent in real terms. This figure excludes government funding for science and research, which is treated separately on the BIS accounts. Recognising the importance of science and research to the economy, the government decided to hold this funding stream constant. It should be noted, however, that the funding for science and research was only held flat in cash terms, which equates to a 9 per cent cut in real terms once inflation has been taken into account.

	2010/11 (£bn)	2011/12 (£bn)	2012/13 (£bn)	2013/14 (£bn)	2014/15 (£bn)	Real cut 2010/11– 2014/15 (%)
Science and research	4.6	4.6	4.6	4.6	4.6	-9
Non-science and research	12.1	11.9	10.8	10.3	9.2	-31
<b>Total BIS budget</b>	<b>16.7</b>	<b>16.5</b>	<b>15.4</b>	<b>14.9</b>	<b>13.8</b>	<b>-25</b>

**Table 6.1**  
The pain so far:  
Spending cuts for  
BIS, 2010/11–  
2014/15

The most obvious result of these spending cuts was the decision to reduce government grants for higher education teaching, and to replace that funding with higher tuition fees for students. In essence, the government shifted some of its current spending commitments onto the next generation of graduates, who will have to repay higher tuition fees once they have completed their studies. As a result of this change, BIS was able to cut its budget while protecting the tuition income flowing to HEIs. The latest grant letter from the government to HEFCE shows that the recurrent grant for teaching will be cut by nearly 50 per cent between 2012/13 and 2014/15, from £3.8 billion to less than £2 billion (BIS 2013b). This income will be replaced by an equivalent rise in tuition fee income.

The government had hoped that by replacing teaching grants with higher tuition fees, HEIs would be able to weather the storm of spending cuts. They assumed that economic growth would have returned over the course of this parliament, meaning that there would be no need for further cuts to the BIS budget. As a result, HEIs would be relatively well protected from the brunt of spending cuts, at least in comparison to other public bodies, such as local authorities, which have witnessed huge upfront cuts in their income.

However, the pace of economic recovery has been much slower than the government predicted, and public spending cuts are therefore going to be extended well into the next parliament. Table 6.2 shows that over the next six years BIS will have to make a *further* cut of £2.2 billion in its budget, assuming the current pace of deficit reduction is maintained. This is the equivalent to an additional real-terms cut of 22.8 per cent. If the government continues to protect science and research spending by holding it flat in cash terms then the rest of the BIS budget will have to bear the brunt of these additional cuts. As a result, our projections show that non-science and research spending is likely to be reduced by nearly one-third. If BIS decides to pass a cut of this size on to higher education, the sector could expect to see its budget cut by £1.16 billion over the course of the next parliament. Even if the government decided to slow down the pace of deficit reduction or raise taxes, it is clear that substantial spending cuts will have to be made in order to put the public finances on a stable footing. There is more pain to come.

**Table 6.2**  
More pain to  
come: Projected  
spending cuts for  
BIS, 2014/15–  
2019/20

	2014/15 (£bn)	2015/16 (£bn)	2016/17 (£bn)	2017/18 (£bn)	2018/19 (£bn)	2019/20 (£bn)	Real cut 2014/15– 2019/20 (%)
Science and research	4.6	4.6	4.6	4.6	4.7	4.8	-5.0
Non-science and research	9.2	8.6	7.7	6.7	6.8	6.8	-31.7
<b>Total BIS budget</b>	<b>13.8</b>	<b>13.2</b>	<b>12.3</b>	<b>11.3</b>	<b>11.4</b>	<b>11.6</b>	<b>-22.8</b>

**Note:** Projections are based on the government's planned departmental expenditure limits to 2017/18, after which they are expected to increase with inflation. The projections assume that the balance of spending between government departments remains the same as at present.

The scale of the government's austerity programme is far larger than is commonly recognised by higher education leaders. BIS will be asked to make a 22.8 per cent cut over the course of the next parliament, in addition to the cuts it has already made. Higher education institutions were relatively well protected from spending cuts over the course of this parliament, as their lost income was replaced by higher tuition fees. With tuition fees already extremely high by international standards, this option will not be available next time around. The sector faces the prospect of profound upfront cuts in income for the first time in over a decade.

### Protecting a national asset

The immediate challenge facing higher education is therefore to navigate its way through another period of deep public spending cuts. It is essential that this is done in a way that does not do lasting damage to one of the nation's most precious assets, and that leaves the sector well placed to flourish in the future. The aim should be to undertake spending cuts in such a way as to protect the long-term productive potential of our economy and society and to put in place strong foundations for future growth. Key to this should be continuing to ring-fence the

science and research budget in cash terms. As chapter 3 set out, higher education research plays a critically important role in innovation and regional economic growth, and it therefore holds the key to national economic recovery. Even holding the science and research budget flat in cash terms means it will have faced a real-terms cut of 8.7 per cent between 2010/11 and 2017/18 – asking it to make a deeper cut still would risk its ability to help drive future innovation and growth.

As well as protecting the science and research budget, there are other areas of spending that should be a priority for BIS. A supply of skills is a key ingredient for economic growth, provided it is matched with innovation and job creation in the private sector. Chapter 3 identified that England faces a particular shortage of intermediate technical skills and argued that this could be lowering productivity in key sectors such as health, manufacturing and the creative industries, as well as hampering efforts to rebalance the economy. Vocational education and training should therefore remain a priority for the department.

Similarly, the government must not row back on its commitment to widening participation. Providing resources for widening participation enables HEIs to fund outreach and retention activities that help to raise participation among young people from poorer families. In chapter 4, we set out how existing resources in this area could be retargeted to create a student premium.

Some commentators have argued that one way to save money would be to cut the proportion of young people going into tertiary education. They believe that more young people should go straight into work after leaving school (see for example Heath 2013). A cursory glance at the labour market shows that this view is misguided. Over the last few decades Britain has witnessed the collapse of its youth labour market, and there are nearly 1 million young people out of work. Sending a greater number of school-leavers into this environment would simply exacerbate the problem and put more strain on the welfare system. When a young person is unemployed for more than a year it has a permanent ‘scarring effect’ on their lifetime earnings, as well as negatively impacting on their health (Bell and Blanchflower 2010). On the other hand, if young people enter tertiary education and training, they are able to improve their prospects of finding a job and leading a healthy life. A government concerned about investing in the next generation would maintain the proportion of young people entering higher education.

There are therefore certain areas of spending – such as research, vocational education and widening participation – that should be priorities for the government over the next few years. Giving relative protection to spending in these areas would help the sector to emerge from a period of fiscal consolidation with its foundations intact, well positioned to flourish in the future.

## Difficult decisions

In return for giving relative protection to some areas of spending, the higher education sector must be prepared to make savings in other ways. Making upfront savings is difficult in higher education because the government has already shifted a large amount of its expenditure into subsidising student loans. This means the state's contribution to tuition is now made several years down the line, when it writes off unpaid student loans and subsidises their interest rate. This was a short-term measure designed to help BIS make spending cuts in this parliament, but the net result is that the department has very little room to make any upfront savings in the next, since most of its costs have been deferred in this way. Changes to the student loan system may save the government money in the long term, but they cannot be used to make spending cuts in the next few years. As a result of this trick to reduce the deficit in the short term, important areas of the BIS budget, such as research and widening participation, have been left very exposed to cuts in the next parliament.

Despite this problem, there are ways to help limit the cost of higher education to the government. These could be implemented in return for giving relative protection to the key areas of spending identified above. At a time of spending cuts, it is fair that both HEIs and students share some of the burden. What follows is a range of options for reform.

### *Holding teaching grants and tuition fees flat in cash terms*

To date, HEIs in aggregate have had their income relatively well protected from spending cuts. It is therefore reasonable to expect them to achieve some short-term efficiencies. By holding the tuition fee cap flat at £9,000, the real value of this fee would decline over time as a result of inflation. For example, if the fee was held at £9,000 until 2017/18, its real-terms value would decline by 9 per cent, meaning it was worth £8,190 in today's prices. This would relieve some of the burden on students and graduates. Similarly, in 2014/15 the government expects to spend approximately £1.96 billion on teaching grants. If these were to be held flat in cash terms until 2017/18, the government could make a 5 per cent saving, worth £104 million.

The way in which institutions can deliver efficiencies will vary depending on their specific context. Institutions could ensure they maximise additional income through their facilities throughout the year. They could also innovate in the way they deliver course content by making use of new technology or experimenting with shorter and more intensive courses.

More savings could come through procurement. After staff, the biggest area of spending for HEIs is on goods and services, which amount to nearly 45 per cent of their total spending. Yet in 2010/11, only 10 per cent of non-staff expenditure was channelled through collaborative procurement arrangements (Petford and Davies 2013). As the Diamond

review (2011) made clear, HEIs could make better use of procurement consortia and manage their suppliers more effectively to drive down costs. Collaboration could also hold the key to reducing costs in other areas. We have already seen the growing use of doctoral training centres, which enable universities to pool their resources to provide opportunities for postgraduate study.

### ***Create £5,000 'fee only' degrees***

As argued in chapter 3, the sector should explore ways of offering more 'low-cost' places to ensure that we can continue to expand opportunity while money is tight. We know that many potential students may wish to study in their local area, live at home, avoid taking on any debt, and combine their studies with paid employment in order to cover living costs.

The government should therefore incentivise the creation of courses that meet the needs of these potential students. It could do this by creating a pool of additional student places which are explicitly designed to be for £5,000 'fee only' courses. Higher education institutions could apply to be given these places, provided the courses meet this criterion. These places would be attractive to institutions that wished to expand their student numbers, or were struggling to fill their full-cost places. These courses would represent a very low cost to the state, as it would not have to pay any maintenance grant, national scholarship programme or maintenance loan subsidy, the amount it has to pay to subsidise fee loans would be reduced. Taken together, this could amount to a long-term saving to the state of over £10,000 per student, compared to the average 'full-cost' place.

### ***Use technology to expand low-cost places***

Technology could provide the key to unlocking low-cost expansion. As argued in chapter 5, one way of expanding opportunity at low cost would be for universities to accredit low-cost online courses, such as those provided through FutureLearn. To start with, the Open University could accredit MOOCs towards its own courses and then towards those of its partners.

### ***Make greater use of employer-sponsored courses***

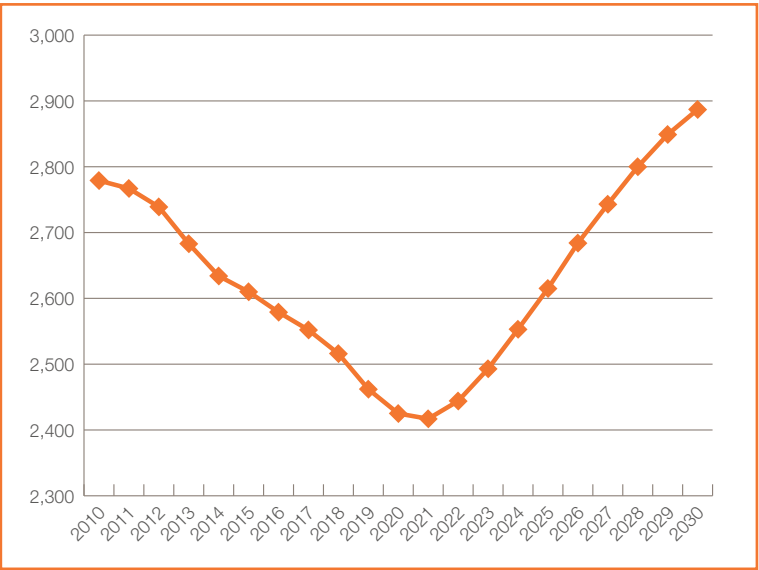
Most commentary on student fees assumes the cost will be shared between the state and the graduate. This ignores the important role that businesses and employers can also play in funding higher education. Employers benefit greatly from higher education, especially where students are studying towards professional certificates that are directly applicable to the workplace. Employers are currently sitting on large cash reserves, which could be invested in training their staff. As we set out in chapter 3, employers could be incentivised to support more employees through higher education by reducing employer national insurance contributions for any employees who are undertaking accredited training.

Students who are currently funded by employers may count towards an institution's number controls if they are not studying on a 'closed course'. There is a danger that students who are currently funded by employers, and therefore represent little or no cost to the state, are taking up places that could be used by others. Higher education institutions should be able to treat these students 'off quota' so that they do not deprive other students of a chance to attend higher education. Any student who has had their tuition and maintenance funded by an employer, and is therefore not drawing on state support, could be exempt from an institution's number controls. This would free up places for others who are currently excluded as a result of the cap on student numbers.

*Bank savings from demographic change*

While the higher education sector must try to expand the number of low-cost places it offers, demographic change is likely to generate some natural savings for the government on full-cost courses over the next six years. As a result of changes in the birth rate, by 2021 there will be 217,000 fewer 18–21-year-olds in England than there are today (see figure 6.1). This could lead to a 4–8 per cent decline in the absolute number of young students in the system, depending on the socioeconomic composition of this group. This means that between 2014/15 and 2020/21 the government will generate a saving of £1.5–3 billion on teaching grants and maintenance grants over a seven-year period.<sup>17</sup>

**Figure 6.1**  
Projected  
demographic  
decline of  
18–21-year-olds  
in England, 2010–  
2030 ('000s)



Source: ONS 2011

<sup>17</sup> We estimate that between 2014/15 and 2020/21 the government will spend approximately £38.2 million on teaching grants and maintenance grants. A 4–8 per cent decline in this budget would lead to a saving of £1.5–3 billion over that time period.



The government should maintain the proportion of 18–21-year-olds entering higher education on a full-time basis, However it should be prepared to see the absolute number of students fall in the short term, before picking up again in 2020. Any expansion in this period must be met from low-cost courses or vocational education, rather than ‘full-cost’ higher education provision.

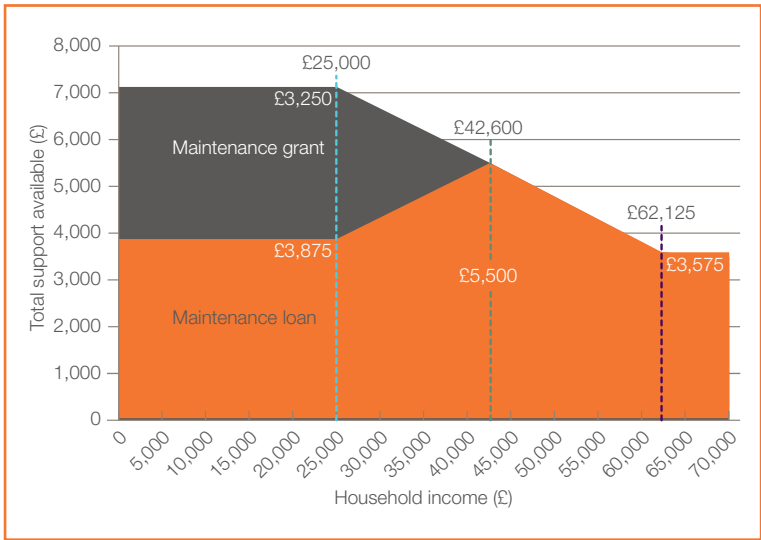
*Reduce the cost of grants to students who live at home*

The government currently offers a range of maintenance support to help full-time students with their living costs. This is the right thing to do, since high upfront living costs could prevent some people from participating in higher education, or could lead to students living in hardship.

However, there is an anomaly in the way this support is currently awarded. Students who live at home are eligible for a lower level of maintenance loan than students who opt to live away from home, since they are likely to incur lower living costs. But this principle does not apply to maintenance grants: students are eligible for the same level of maintenance grant regardless of whether or not they are living at home, despite the same variation in actual living costs. The government could investigate whether a lower level of maintenance grant should be awarded to students who live at home.

*Reduce the cost of maintenance support to the state*

Figure 6.2 shows how maintenance support is delivered through a mixture of grants and subsidised loans, with students from poorer households being eligible for larger grants, while those from wealthier households have to take out more in loans.



Source: BIS 2010

**Figure 6.2**  
Current student support maintenance entitlements, loan/grant split according to income

Both the grants and the loans represent a similar cost to the government, but in different ways. The grants represent an upfront cost to the government averaging £4,212 per full-time student over the course of their degree. The subsidised loans also cost the government, at an average of £4,345 per average full-time student, but the government only incurs this cost later on, once the student has not repaid their full loan. The government could therefore make short-term savings if it reduced the level of maintenance grant and replaced it with a higher maintenance loan. However, this would generate a long-term saving to the Treasury only if it also changed the loan repayment terms to ensure it recouped a larger share of the loan. If the government switched to offering more maintenance loans in place of grants without altering the repayment terms of the loan, it would simply be deferring the cost to fall on future taxpayers.

### **Beyond the storm**

The previous section argued that the higher education sector must be prepared for spending cuts over the next six years. It identified ways in which these cuts could be made without damaging the foundations of future growth and prosperity. These measures, while painful, would enable the sector to emerge from a period of deep fiscal consolidation well placed to grow in the future.

When the country's finances are on a more stable footing, the government will be in a better position to invest in higher education. This will be essential in order to correct for a period of deep spending cuts which, in the case of science and research, will have lasted for nearly a decade. The government should therefore make a long-term commitment to increase real-terms spending on science and research after 2017/18, once the structural deficit has been eliminated. The science and research budget is expected to be £4.6 billion in today's prices in 2017/18. **The Commission recommends that after 2017/18 the government commits to increasing the science and research budget above inflation over a 10-year period.** If the government increased the budget by 1 per cent a year above inflation for 10 years then by 2027/28 the government would be investing £6 billion in science research (or £4.7 billion in today's prices). Nonetheless, even under this scenario, spending on science and research would not recover to today's level until 2024/25.

## **6.2 Creating a sustainable funding system for the future**

While the immediate challenge facing higher education is how to navigate the next round of spending cuts, this must not distract us from the equally important task of creating a funding settlement that will support the sector in the long term. Without a sustainable funding system, we risk storing up costs for future generations and leaving them a poorer Britain.

Soon after winning the general election, the Coalition government announced its plan to reform the higher education funding system. In the face of fierce protest from students and young people, it committed to nearly trebling the cap on tuition fees to £9,000, as well as making changes to the repayment terms of student loans, increasing maintenance support, and reducing government grants for higher education teaching. Lying behind these reforms was a desire to cut public spending and reduce the deficit in the short term, but they were also underpinned by a principled desire to reduce central planning and increase competition in the sector.

According to the government white paper, these reforms were intended to ‘put higher education on a sustainable footing’ (BIS 2011). It argued that the reforms enabled the government to make spending cuts while protecting income for HEIs over the long term and not damaging social mobility. Despite these claims, there are concerns that the current funding system is not well designed to secure the long-term future of higher education (Barr 2012, Thompson and Bekhradnia 2012). This chapter assesses the current funding system and proposes a series of possible reforms.

### Guiding principles

Before making an assessment of the current higher education funding system, it is necessary to set out the principles against which it should be judged. The Commission believes that any funding system should be based on the following principles:

- **It is fair to students across social classes and modes of study.** A funding system must not exclude students based on their ability to pay for tuition, their ability to maintain a basic standard of living, or their chosen mode of study.
- **It is sustainable to the public purse.** A funding system should not defer unnecessary costs on to future governments.
- **It supports institutional autonomy.** A funding system should protect the autonomy of HEIs, where possible keeping them at arm's length from the government.
- **The cost of tuition is shared between graduates and the state.** Given there are both public and private benefits to higher education, the cost should be shared between graduates and the public purse.
- **It does not detract from funding research.** A funding system should not crowd out finance for other key activities in higher education, such as research.
- **It is fair across the generations, when combined with other tax and spend decisions.** A funding system should not place undue burden on a particular generation, when combined with other forms of state support.

- **It pools risk across graduates and HEIs.** A funding system will inevitably generate the risk of low returns on some of the original investment. This risk should be shared across graduates and institutions.
- **It does not unnecessarily restrict the supply of student places.** A funding system should not artificially restrict the number of student places that are available, as this could prevent people from benefitting from access to higher education.

### Strengths of the new funding system

Last September, the first generation of students started higher education under the new student support system. The key features of this system are summarised in the boxed text.

#### Key features of the new student funding system

The most notable aspect of the new funding system is the increase in tuition fees. All HEIs are able to charge a basic fee up to £6,000 for full-time undergraduate courses. If institutions commit to spending additional resources on widening participation, they are able to charge up to £9,000 a year.

Under the previous system, the state provided upfront support for some tuition costs in the form of teaching grants. These have been substantially reduced under the new system, because HEIs are expected to get the majority of their income for teaching through student tuition fees. This has enabled the government to reduce a lot of its upfront expenditure on tuition.

Like the previous system, income contingent loans are available for all full-time home students to cover their tuition fees and to help with living expenses. The government therefore continues to make a considerable outlay on student loans, although it expects to get some of this money back in the form of graduate repayments. Graduates repay their loans through the tax system, being charged 9 per cent of any income earned above £21,000 a year. The government heavily subsidises the interest on student loans and writes off any unpaid debt 30 years after graduation.

See the technical appendix for a more detailed explanation of the student support system.<sup>18</sup>

While it is too early to make a comprehensive assessment of the new system, it is possible to identify its main strengths and weaknesses. By assessing each strength and weakness in turn, it is possible to make a holistic assessment of the system.

18 Available separately, at <http://www.ippr.org/publication/55/10847/a-critical-path-securing-the-future-of-higher-education-in-england>

The main strength of the new system is that it has increased the resources flowing into higher education, enabling institutions to maintain or enhance their level of provision. The majority of HEIs have raised their tuition fees to a level that more than compensates for the loss of government teaching grant. The government had reduced its teaching grant on the expectation that the average tuition fee would be around £7,500. However, the average fee has turned out to be over £8,100, and this may increase further in the coming years as more institutions opt to set their fee at this level. In aggregate terms there has been a small increase in investment in higher education teaching as a result of these reforms.

Second, the new system continues to provide financial support for students who would otherwise be unable to meet the cost of tuition. The use of income-contingent loans is a good way to overcome this barrier, as it enables students to borrow money that they have to repay only later in life, once they can afford to do so. This helps to remove the constraints on students from poorer families participating in higher education. Early indications suggest that full-time students from poorer families have not been disproportionately affected by the rise in tuition fees (UCAS 2012).

Third, it maintains institutional autonomy over funding. Institutions receive a large swathe of their income in the form of tuition fees, and are therefore not tied to the Treasury for their funding. This protects them from short-term political interference or changing spending priorities, allowing them to make decisions that are in their own long-term interests.

Fourth, the new system is based on a clear principle that the cost of higher education should be shared between the state and the student. The student contributes in the form of tuition and maintenance fees, which are repaid through the student loan system. The state contributes by providing some upfront teaching grant to HEIs, heavily subsidising student loans, and providing funds for widening participation. The point at which these contributions are made varies across the lifetime of the loan – some are upfront contributions by the government, while others are deferred. The exact share of the cost that is born by each student varies according to their earnings later in life. Some well-paid graduates will end up paying the entire cost of their tuition, while many others will not. The modelling presented in section 6.3 below suggests that when all the different payments and subsidies are taken into account, the whole cohort of graduates will collectively contribute 21.5 per cent of the total cost of higher education tuition, with the state making up the rest.

### **Ten weaknesses of the new funding system**

As well as having strengths, the new funding system has a number of weaknesses. These weaknesses are not well understood in public debate, but they could have very serious consequences for the future of our higher education system.

The first weakness is that the new funding system has not delivered sufficient numbers of part-time and mature students. Chapters 3 and 4 have outlined why it is important to provide opportunities for people to access higher education throughout their adult life. This is especially important at a time of economic restructuring, as people need to be able to retrain to adapt to the new economic climate. Part-time study is also a useful vehicle for upskilling the workforce in key areas such as health and early years. It is, therefore, extremely concerning that the introduction of the new tuition fee regime appears to have precipitated a 40 per cent decline in part-time students, with many students unable to access loans and seemingly put-off by the high upfront cost of a degree.<sup>19</sup>

A second concern is that the student loan system may not be sustainable for the government finances in the long term. The government is making a huge outlay on student loans, which it is able to avoid counting towards the deficit because it expects to receive the money back in the form of graduate repayments. The only long-term cost to the government is deemed to be the amount that it expects to write off in the form of unpaid loans or interest rate subsidies – this is known as the ‘RAB charge’. The government first estimated that the RAB charge on the new loan system would be 30 per cent – in essence it predicted that it would have to write off 30 per cent of the total value of loans. However, it has subsequently had to increase this estimate to 34 per cent, and the modelling we present below suggests that in reality it is more likely to be around 39 per cent. The government has therefore underestimated the amount the taxpayer will have to pay to subsidise student loans.<sup>20</sup> This problem will remain hidden until the loan repayments from this cohort of students start to come in to the Treasury over the next 30 years. At that point, the government will have to cover the shortfall in loan repayments. This means that future taxpayers could have to pick up the bill for the unexpected cost of today’s student support system. This has led some commentators to describe the new system as akin to a ‘dodgy private finance initiative’, where the government spends money now but stores up the costs for future taxpayers in the form of unpaid loans (Barr 2012). While the low cost of government borrowing on the gilts market may help to mitigate the worst effects of this problem in the short term (Shepherd 2013), it is clear that the high RAB charge is storing up longer-term problems for the government and preventing BIS from issuing more student loans.

Third, in a related point, the generous subsidy for student loans is placing undue pressure on other areas of public spending. The government has decided to provide the vast majority of its support for higher education tuition in the form of loan subsidies. These subsidies do not provide an

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<sup>19</sup> See section 4.2 for a detailed discussion of the decline in part-time study.

<sup>20</sup> For a detailed explanation of why the government’s estimated RAB charge is too low, see the technical appendix, available separately (see note 18).

immediate benefit for students – rather, they help to relieve the cost on graduates later in life when they are employed. The government has therefore opted to invest its resources in helping out graduates with their loan repayments. This could be deemed a questionable use of resources at a time when the government has made cuts to more direct forms of support for young people, such as the education maintenance allowance, Aim Higher and higher education teaching grants.

A fourth concern is that the new student support scheme could place more pressure on the BIS budget in the next few years. If the government realises that it has underestimated the long-term cost of the student loan system to the Treasury then it will be forced to increase the RAB charge. Our modelling suggests it will have to increase the RAB charge from 34 to over 39 per cent. In order to compensate for this increased long-term cost, the Treasury will require BIS to make an equivalent saving in its current expenditure. A higher RAB charge will therefore add more pressure on BIS to cut essential current spending in the short term, in areas such as science and research.

Fifth, the design of the student loan system means the government will have to ration the number of student places available in the system. As we have argued in chapters 3 and 4, it is important both to provide a supply of high-skilled people for the economy and to open up places for students from disadvantaged backgrounds. Rationing the number of places available in higher education would be detrimental to both these aims. It is particularly harmful to students from disadvantaged backgrounds, who are more likely to be crowded out from higher education if there is a shortage of places. In theory, a well-designed student loan system could help to create more places in higher education, by providing additional resources for the sector to expand (Barr 2012). This was the logic behind the introduction of tuition fees under the previous government: they were additional to government expenditure and therefore enabled more places to be created and more people to benefit from higher education. However, the new system adopts a different logic – it has simply used tuition fees to replace government spending. Given the state subsidises student loans so heavily, it has not been prepared to issue more loans. We have already seen attempts to restrict the number of students in the system through the reform of institutional number controls.

Sixth, the student loan system may exacerbate problems with fair access to postgraduate study. As the number of people taking undergraduate degrees has increased, so the value of having a postgraduate qualification has increased in terms of ‘standing out’ in the labour market. Taught master’s courses are becoming an increasingly important gateway for entry to certain professions. However there is limited state support for people to enrol on these courses, which leaves many graduate students having to take out a private bank loan or rely

on family support. Even before the introduction of the new funding system there were concerns that students from less-advantaged families were unable to access master's courses. These concerns have been exacerbated following the introduction of the new funding system, prompting fears that students who take on such large amounts of debt as undergraduates will be put off postgraduate study.

Seventh, the new funding system may exacerbate problems of student hardship. There are signs that the value of maintenance support for students has not kept pace with rising living costs in recent years. The NUS has provided evidence of students struggling to make ends meet, with an associated impact on their studies and increased likelihood of dropping out (NUS 2012b). This is partly the result of excessive accommodation costs at some institutions, but the design of the student loan system could make things worse. Given the government has committed to providing a generous subsidy for student loans, it will prove very expensive to increase the size of maintenance loans. The government will not be prepared to do so, for fear that it will place more pressure on the public purse in the form of loan subsidies. This could prevent maintenance loans from keeping pace with rising living costs, forcing more students to live in hardship.

Eighth, the new funding system has not achieved its stated aim of increasing price competition in higher education. The government had expected that institutions would charge different levels of tuition fee, helping to create a market of different courses for students to choose between, with an average fee of around £7,500, once fee waivers had been taken into account. However, few incentives were put in place to encourage this. As a result, being keen to protect their income and prestigious reputations, most HEIs have charged the maximum they are allowed to, with fees actually averaging around £8,100 net of fee waivers. This is a problem because it means there are few low-cost courses available for those who may need to pay their fees upfront, such as part-time students. It also puts more pressure on the student support system, as the government has to issue and subsidise larger loans than it expected.

Ninth, the way government support is delivered in the new system is very opaque. By increasing tuition fees, the government has generated feelings of hostility among the student body, with many people convinced that the state no longer provides any support for higher education at all. Students will therefore increasingly behave as if higher education is a private good, and there is a danger that families will no longer 'buy in' to the principle of higher education as a publicly provided service. In reality, the government does provide support for higher education – but it does this by subsidising loans, in a way which is not transparent to the general public.



Finally, there is a wider concern that the new funding system is not fair across the generations when seen in the context of other tax and spending decisions. Young people have borne the brunt of the government's spending cuts, including cuts to the educational maintenance allowance, Aim Higher, careers advice, the future jobs fund, and sixth form and further education funding. This all comes on top of being asked to take out larger loans to cover higher tuition fees, (although it is important to note that these loans only represent a cost to graduates once they are in employment later in life). In contrast to this, the government has protected universal benefits for pensioners, helped secure pension incomes, and eased the tax burden on the highest earners in society.

In summary, the government was faced with the difficult task of making spending cuts in higher education. It reformed the student support arrangements in a way that reduced the deficit, maintained funding for HEIs, encouraged the sector to be more responsive to student demands, and rebalanced the contribution made by graduates and taxpayers. Despite these benefits, the fact the reforms were designed around a short-term need to cut the deficit will create problems in the long term. These long-term problems are substantial and outweigh any short-term gains. The current funding system is not sustainable and needs to be reformed. The next section sets out some options for doing so.

## 6.3 Options for reform

The new student support system has a number of serious flaws, which together prevent it from meeting the principles, as set out above, that we believe should guide policymaking in this area. It will be necessary to rectify these flaws in the medium term, in order to put the sector on a fair and secure financial footing. The Commission has modelled five options for reforming the undergraduate loan system and two options for reforming the funding of postgraduate study.<sup>21</sup> All of these reforms are designed to maintain the flow of resources into higher education at their current level, while rectifying some of the problems with the present system. It is important to note that each of these options has strengths and weaknesses of its own. These are set out clearly, in order to cast light on the trade-offs that are involved.

The modelling presented below is based on the latest available data, and is therefore an accurate reflection of recent trends in higher education. It examines the resource flows between the exchequer, students/graduates and HEIs, including both part-time and full-time undergraduate students in England. The model incorporates all elements of the student support system, including maintenance grants, maintenance loans, tuition fees, tuition fee loans, HEFCE teaching

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<sup>21</sup> The modelling was conducted by London Economics. For a detailed explanation of the methodology see the technical appendix, available separately (see note 18).

grants, the national scholarship programme and access agreement expenditure. It uses lifetime earnings profiles from the Labour Force Survey to predict the labour market outcomes of graduates, and therefore their repayment profiles on student loans. The results of the model are all presented in net present value terms.

## The current funding system (baseline)

### What has been modelled?

The baseline for all our modelling was the 2012/13 funding system. We have constructed the baseline using the latest available data. This shows the funding system for the cohort of students starting in the 2012/13 academic year – that is, under the Coalition government’s new student support system.

### Why has this been modelled?

The baseline has been included to enable easy comparison with the reforms presented later in this chapter.

### What is the balance of contribution between the state and graduate?

The table below shows the aggregate flow of resources between three key actors in the higher education system: students/graduates, HEIs, and the state/exchequer. This shows the total contribution, or gain, that each of these groups makes over the entire funding period – from the point when this cohort of students start out in higher education to the point at which their loan repayment period has ended 33 years later. It therefore enables us to take an overview of which group is contributing what amount to higher education. The table shows that over the entire repayment period, the cohort of students starting higher education in 2012/13 are expected to contribute around £1,624 million while the state contributes £5,953 million. This means that graduates, in aggregate, contribute 21.5 per cent of the entire cost of student support, with the state contributing the rest.

**Table 6.3**  
Resource flows:  
2012/13 baseline  
scenario

		To		
From	Students/grads	Students/grads	Institutions	Exchequer
	Students/grads	NA	£7,262m	(£5,638m)
	Institutions	(£7,262m)	NA	(£315m)
	Exchequer	£5,638m	£315m	NA
	Total	(£1,624m)	£7,577m	(£5,953m)

### How does the state make its contribution?

Under this system, the state makes the majority of its contribution to higher education by subsidising student loans for full-time students. It contributes approximately £4.2 billion in this way, with the remainder of its contribution made up by maintenance grants, teaching grants and the national scholarship programme.

### What is the expected non-repayment on loans (RAB charge)?

The cost of student loans to the government is very high – it expects to lose 39.4 per cent of the total value of loans that it issues.

### Which graduates bear the greatest share of the cost?

Because student loans are repaid on an income-contingent basis, high-earning graduates are more likely to repay the full cost of their loan. In fact, due to the interest rate charged, they may pay back slightly more than they borrowed, while the lowest-earning graduates pay back a smaller proportion of their loan.

The table below shows the expected repayment of graduates at different points on the earnings distribution, based on their average lifetime earnings. The 10th percentile represents low earners (those individuals who are at the 10 per cent mark on the income distribution), and the 90th percentile represents high earners (at the 90 per cent mark); the 50th percentile represents the ‘average’ graduate. A negative RAB indicates that the graduate repays more than the face value of their original loan. For further details see the technical appendix, available separately (see note 18).

	RAB charge	Outstanding amount	Age of repayment
39.4%			
<b>Males, full-time</b>			
10th percentile	90.3%	£35,477	Never
20th percentile	59.9%	£23,740	Never
30th percentile	32.7%	£11,607	Never
40th percentile	11.3%	£286	Never
50th percentile	7.4%	£0	49
60th percentile	4.6%	£0	46
70th percentile	1.5%	£0	44
80th percentile	-1.3%	£0	41
90th percentile	-4.2%	£0	38
Average	22.5%	£7,901	46.9
<b>Females, full-time</b>			
10th percentile	100.0%	£38,696	Never
20th percentile	99.4%	£38,524	Never
30th percentile	94.7%	£37,121	Never
40th percentile	77.3%	£31,967	Never
50th percentile	58.5%	£25,486	Never
60th percentile	39.1%	£18,045	Never
70th percentile	16.0%	£7,548	Never
80th percentile	0.5%	£11	51
90th percentile	-1.9%	£0	46
Average	53.7%	£21,933	50.4

**Table 6.4**  
Expected repayment schedule:  
2012/13 baseline scenario

## Scenario 1: Adjust loan repayments by raising the top rate of interest

### What has been modelled?

Graduates earning over £41,000 currently pay 3 per cent real inflation. This scenario has modelled the impact of raising the top rate of interest to 4.5 per cent above RPI.

### Why has this been modelled?

The government heavily subsidises the student loan book. While this helps to reduce the burden of loan repayments for graduates, it is expensive to the Treasury. This forces the government to cap student numbers and puts pressure on other spending commitments. Some commentators have suggested the government should try and recoup a larger share of the loans it issues, in order to free up resources to, for example, expand the number of places available in the system (Barr 2012).

### What is the balance of contribution between the state and graduate?

The table below shows that by raising the top rate of interest, the aggregate contribution of graduates increases by £679 million, while the state saves the equivalent amount over the lifetime of the loan. This means that by the end of the repayment period, the graduate cohort will have contributed approximately 30 per cent of the total cost, with the state picking up the rest.

**Table 6.5**  
Resource flows:  
Raising top rate  
of interest to 4.5  
per cent

		To		
		Students/grads	Institutions	Exchequer
From	Students/grads	NA	£7,262m	(£4,958m)
	Institutions	(£7,262m)	NA	(£315m)
	Exchequer	£4,958m	£315m	NA
	Total	(£2,303m)	£7,577m	(£5,273m)
	Change from 2012/13 baseline	(£679m)	£0m	(£679m)

### How does the state make its contribution?

Under this scenario, the state continues to make the same upfront investment in maintenance grants, teaching grants and the national scholarship programme as it does under the current system. However, it has reduced the amount it subsidises student loans, generating a long-term saving of £679 million.

### What is the expected non-repayment on loans (RAB charge)?

Under this scenario the cost of student loans to the government is reduced – it expects to lose 33.3 per cent of the total value of loans that it issues.

### Which graduates bear the greatest share of the cost?

Under this scenario, high-earning graduates would contribute a greater share of the total cost than at present. Graduates on low incomes would repay the same amount as they do under the current system.

**Table 6.6**  
Expected  
repayment  
schedule: Raising  
top rate of  
interest to 4.5 per  
cent

	RAB charge	Outstanding amount	Age of repayment
<b>33.3%</b>			
<b>Males, full-time</b>			
10th percentile	90.3%	£36,830	Never
20th percentile	59.9%	£29,582	Never
30th percentile	32.7%	£21,738	Never
40th percentile	10.2%	£12,037	Never
50th percentile	-9.8%	£349	Never
60th percentile	-12.8%	£0	49
70th percentile	-15.6%	£0	46
80th percentile	-18.2%	£0	43
90th percentile	-20.2%	£0	40
Average	12.9%	£11,171	48
<b>Females, full-time</b>			
10th percentile	100.0%	£38,697	Never
20th percentile	99.4%	£38,622	Never
30th percentile	94.7%	£37,933	Never
40th percentile	77.3%	£35,595	Never
50th percentile	58.5%	£32,458	Never
60th percentile	39.1%	£28,863	Never
70th percentile	16.0%	£22,806	Never
80th percentile	-8.1%	£11,270	Never
90th percentile	-22.6%	£0	49
Average	50.5%	£27,361	51

### What are the main strengths of this scenario?

- It reduces the cost of student loans to the government and brings the RAB charge down to below the government's current estimate. This means the loan system will not be storing up unexpected problems for the future.
- The RAB charge is lower, which means the government could issue more loans in order to expand places in higher education. However, the RAB charge is only slightly lower than the government's current estimate so there would not be room for a large expansion.
- The cost of making the loan system sustainable is borne by graduates earning over £41,000. It does not have a negative impact on low-earning graduates.

### What are the main disadvantages of this scenario?

- It increases the share of the cost borne by graduates. If the state chose not to reinvest the savings in higher education, it would represent a withdrawal of state support for higher education over the long term.

- Some graduates will pay back more than they borrowed. The highest earners will overpay their loan by around 20 per cent. This could be seen as a disadvantage if the intention is for graduates to simply pay the ‘sticker price’ of a degree programme. It could also mean the ONS refuses to classify the funding system as a ‘loan’, since the level of overpayment by some graduates is so high.
- Charging a high real rate of interest increases the likelihood that wealthy graduates will opt to repay their debt as a lump sum, in order to avoid having to pay the interest. This means the Treasury would not benefit from increased repayments for this group.

### **Are there other ways the government could recoup a larger share of the loans it issues?**

- Raising the top rate of interest is not the only way the government can recoup a larger share of the loans it issues. The government could save a similar amount of money (£666 million) by lowering the threshold at which graduates start to repay their loans from £21,000 to £18,000. Another option would be to extend the loan repayment period from 30 to 40 years, although this would save a slightly smaller sum of £518 million.
- In contrast to raising the top rate of interest, these options would increase the burden on lower-paid graduates. It would mean that lower-paid graduates would repay a larger share of their loans than at present. This is a disadvantage that would have to be traded off against the disadvantages of raising the top rate of interest outlined above.

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## **Scenario 2: Lower the tuition fee to £6,000**

### **What has been modelled?**

This scenario models the impact of lowering the maximum tuition fee to £6,000, with the government reintroducing an upfront teaching grant to compensate HEIs for the loss of income.

### **Why has this been modelled?**

Some commentators have called for tuition fees to be lowered and for the state to reintroduce more upfront funding for tuition. This is based on the belief that the state should make a larger upfront contribution to higher education in recognition of the public benefits that higher education provides (see for example the Campaign for the Public University 2012).<sup>22</sup>

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<sup>22</sup> The Labour party has also called for the tuition fee to be lowered to £6,000; however, it recommends that this is funded through a mixture of changing the loan repayment system (so that high-earning graduates pay a higher interest rate and repay their loans for longer) and obtaining additional funds from corporation tax. This is not the scenario that has been modelled here.

**What is the balance of contribution between the state and graduate?**

The table below shows that by lowering the tuition fee to £6,000, the aggregate contribution of graduates falls by £637 million, while the state increases its expenditure by an equivalent amount over the lifetime of the loan (as the exchequer compensates universities for the loss of fees through additional HEFCE teaching funding). This means that by the end of the repayment period, the graduate cohort will have contributed 13 per cent of the total cost, with the state picking up the rest.

From	To		
	Students/grads	Institutions	Exchequer
Students/grads	NA	£5,591m	(£4,604m)
Institutions	(£5,591m)	NA	(£1,986m)
Exchequer	£4,604m	£1,986m	NA
Total	(£987m)	£7,577m	(£6,590m)
Change from 2012/13 baseline	£637m	£0m	(£638m)

**Table 6.7**  
Resource flows:  
£6,000 tuition fee  
with additional  
teaching grant

**How does the state make its contribution?**

Under this scenario, the state makes a larger share of its investment in the form of upfront teaching grants for HEIs – it will provide £1.99 billion in this way. Meanwhile, it will save £1.01 billion on the cost of subsidising student loans, as the overall size of the loan is smaller.

**What is the expected non-repayment on loans (RAB charge)?**

Under this scenario, the repayment terms of the student loan have not been altered, which means the state is continuing to provide a large subsidy. However, because the overall loan is small, graduates are more likely to repay it. The cost of student loans to the government is therefore reduced slightly – it expects to lose 36.4 per cent of the total value of loans that it issues.

**Which graduates bear the greatest share of the cost?**

Because the loan repayment system has not been changed, there is little impact on which graduates bear the greatest share of the cost (see table 6.8, over).

**What are the main strengths of this scenario?**

- The headline tuition fee for students is reduced, which may increase demand for higher education, especially in part-time study. It will also reduce the perception that all students contribute the full cost of their degree, and lower the overall stock of debt that students have to take on.
- The government funds a greater share of teaching in the form of upfront grants. This reduces the burden on future governments, by not deferring a large cost in the form of loan subsidies.

- The overall balance of expenditure is shifted away from the graduate and onto the state. For some commentators, this is a fair reflection of the public benefits of higher education.

### What are the main weaknesses of this scenario?

- There is a high upfront cost to the government, as it would need to immediately increase teaching grants for HEIs. Under this scenario, the Treasury would have to fund an additional £1.67 billion in HEFCE teaching grants. This would be the upfront annual cost of lowering tuition fees to £6,000 (although the overall cost of this policy to the government would be less than that in the long term, as it would make savings in the future as a result of the reduced cost of student loans).
- Over the entire time period, this policy would cost the government an additional £638 million, which some commentators would argue could be spent on other things.

**Table 6.8**  
Expected  
repayment  
schedule: £6,000  
tuition fee  
with additional  
teaching grant

	RAB charge	Outstanding amount	Age of repayment
	<b>36.4%</b>		
<b>Males, full-time</b>			
10th percentile	88.1%	£27,734	Never
20th percentile	50.7%	£14,122	Never
30th percentile	17.7%	£250	Never
40th percentile	12.0%	£0	48
50th percentile	8.5%	£0	46
60th percentile	5.7%	£0	43
70th percentile	2.6%	£0	41
80th percentile	-0.3%	£0	39
90th percentile	-3.3%	£0	36
Average	20.2%	£4,678	45
<b>Females, full-time</b>			
10th percentile	100.0%	£31,467	Never
20th percentile	99.2%	£31,260	Never
30th percentile	93.5%	£29,587	Never
40th percentile	72.1%	£23,350	Never
50th percentile	48.9%	£15,529	Never
60th percentile	25.1%	£6,483	Never
70th percentile	6.7%	£3	51
80th percentile	2.1%	£0	47
90th percentile	-0.6%	£0	42
Average	49.7%	£15,298	50



## Scenario 3: How a £6,000 tuition fee could be funded by changes to the terms of student loans

### What has been modelled?

Lowering the tuition fee to £6,000 would mean the government had to increase its spending on teaching grants for HEIs. This scenario models whether this could be funded by changing the terms of student loans in order to make the system cost-neutral to the Treasury.

### Why has it been modelled?

The previous scenario assumed that the cost of lowering the maximum tuition fee to £6,000 would have to be paid for from the public purse. However, it is also possible to fund a lower tuition fee by altering the repayment terms of the student loan. Essentially, the government could generate savings by making the loan subsidy less generous to graduates and then use these savings to increase teaching grants and reduce tuition fees. This would succeed in bringing down the headline fee but, in aggregate, graduates would contribute the same proportion of the total cost as under the current system – they would just do it in a different way.

### Possible changes to the loan system

We have modelled four possible ways that the government could reform the loan repayment system, in order to generate sufficient savings to make the move to £6,000 tuition fees ‘cost neutral’ to the Treasury over the long term. Each of the following reforms, on their own, would be sufficient to achieve this goal:

1. **Charge a real interest rate of 4.6 per cent for all graduates earning over £41,000.** Under the current system, graduates earning over £41,000 are charged a real rate of interest on their student loan of 3 per cent – the government could raise this to 4.6 per cent.
2. **Charge a flat real interest rate of 3.13 per cent for all graduates earning over £21,000.** Under the current system, real interest rates are tapered between 0–3 per cent depending on a graduate’s earnings – the government could charge a real interest rate of 3.13 per cent on all graduates earning more than £21,000.
3. **Uprate the repayment threshold by 1.1 per cent per annum.** The repayment threshold is currently set at £21,000, which will be uprated by 2 per cent per year (in line with earnings). The government could uprate this threshold below inflation, at 1.1 per cent. This would mean a greater proportion of lower-earning graduates repaid more of their loan.
4. **Bring down the level at which graduates start to repay their loans to £17,120.** Rather than uprating the threshold more slowly (as outlined above), the government could simply bring down the repayment threshold to £17,120 and continue to uprate it with earnings as planned.

Each of these changes would enable the government to reduce tuition fees to £6,000 in a way that was cost-neutral to the Treasury. However, they would have different impacts on graduates, depending on their earnings. Increasing interest rates would mean that high-earning graduates would contribute a greater share of the cost than they do at present, however there is a danger that they would opt to repay their loans as a lump sum in order to avoid paying this interest. Lowering the repayment threshold would mean that graduates with lower incomes would contribute a greater share of the cost than they do now.

**What are the strengths of this scenario?**

- It enables the government to lower headline tuition fees, without putting any additional long-term pressure on the public purse.
- By lowering the tuition fee at the same time as lowering the RAB charge, the government would be able to issue more loans and expand places in higher education.

**What are the weaknesses of this scenario?**

- While this scenario would be fiscally neutral for the Treasury over the long term, there would be an upfront cost to the government. This arises from the fact the government would have to increase its contribution on teaching grants immediately but it wouldn't generate savings from its reform of the loan system until several years down the line. The Treasury would therefore have to fund an additional £1.67 billion in HEFCE teaching grants in the first few years of the scheme before it started to generate higher returns on the loan book.

**Scenario 4: Funding tuition through a mixture of student loans and means-tested family contributions**

**What has been modelled?**

This scenario models replacing some of the burden of student loans with a means-tested upfront family contribution. It assumes that the average tuition fee remains at £8,303, but students from well-off families will have to pay some of this in the form of an upfront contribution (and will therefore not be entitled to a full fee loan), while students from less well-off families can continue to access a higher level of loan to cover their fees. The balance of loans and upfront fees for households with different levels of income is set out below.

**Table 6.9**  
Fee/loan split:  
£6,000 tuition fee,  
with additional  
upfront means  
tested fee

Household income	Upfront contribution	Average tuition fee loan
£0–£25,000	£0	£8,303
£25,001–£42,600	£643	£7,660
£42,601–£70,000	£1,473	£6,830
£70,001+	£2,303	£6,000

Why has this been modelled?

One of the criticisms of the current system is that it stores up costs for future generations. By introducing a means tested upfront tuition fee, the cost of higher education would be shared between the graduate and their family. Meanwhile, families who can't afford the fee would not be prevented from accessing higher education, because they would be eligible for income contingent loans.

The purpose of the loan system would be more about ‘social targeting’ – removing a barrier for people who don’t have access to resources – than simple ‘cost sharing’ (Ziderman 2013). For young students, this reform would introduce an element of intergenerational transfer, with both the parents and the graduate contributing to the overall cost of tuition.

What is the balance of contribution between the state and graduate?

The table below shows that the aggregate contribution of graduates and their families increases by £486 million, while the state reduces its contribution by an equivalent amount over the lifetime of the loan. This means that by the end of the repayment period, the graduate and their family will have contributed 28 per cent of the total cost of tuition, with the state picking up the rest.

From	To		
	Students/grads	Institutions	Exchequer
Students/grads	NA	£7262m	(£5,152m)
Institutions	(£7262m)	NA	(£315m)
Exchequer	£5152m	£315m	NA
Total	(£2,110m)	£7,577m	(£5,467m)
Change from 2012/13 baseline	(£486m)	£0m	£486m

**Table 6.10**  
Resource flows:  
£6,000 tuition fee,  
with additional  
upfront means  
tested fee

How does the state make its contribution?

Under this scenario, the state continues to make a larger share of its investment in the form of subsidising student loans – it will provide £3.68 billion in this way. It will provide the same amount of teaching grant as at present. However, it will save £486 million from the fact that a portion of the tuition costs are being paid upfront, rather than all of this amount being channelled through the loan system.

What is the expected non-repayment on loans (RAB charge)?

Under this scenario, the repayment terms of the student loan have not been altered, which means the state is continuing to provide a large subsidy. The RAB charge therefore remains high, at 38 per cent, although the overall value of loans is smaller than at present.

### **Which graduates bear the greatest share of the cost?**

Because the loan repayment system has not been changed, there is little impact on which graduates bear the greatest share of the cost.

### **What are the main strengths of this scenario?**

- It removes some of the burden of student loans from the state and shifts the cost onto more well-off families.
- It shares the cost of tuition across the generations, with families being asked to contribute some of the upfront cost on a means-tested basis.
- It could free up resources for the state to spend on other areas of higher education.

### **What are the main weaknesses of this scenario?**

- The state continues to heavily subsidise the loan repayments of graduates, meaning it expects 38 per cent of loans to go unpaid. Some commentators have argued that there are more effective ways for the state to make its contribution to higher education.
- Means testing is expensive to administer and there is a high risk of people evading the upfront fee, for example by not declaring their full household income.
- There may be a high cost for families who have more than one person at university. In Ireland, the number of dependent children is factored into means-testing – something similar might be required here.

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## **Scenario 5: A graduate tax**

### **What has been modelled?**

This scenario models the impact of abolishing tuition fees and loans and introducing a higher rate of tax for graduates instead. This rate of tax would be an additional 1.96 per cent on all taxable income above £10,000 for a period of 40 years. For the purpose of this model, the maintenance system has not been altered – we assume that it will continue to be funded through a grant and loan.

### **Why has this been modelled?**

A large number of organisations in the higher education sector, including the NUS, have proposed introducing a graduate tax. They argue that it is more efficient, more progressive and fairer to students, as they avoid taking out a loan.

### **What is the balance of contribution between the state and graduate?**

For the purpose of this model, we have calculated the level a graduate tax would have to be set at in order to replicate the resource flows under the current system. A 1.96 per cent tax would ensure that the balance of contribution between the state and graduate remains unchanged at its current level.

### **How does the state make its contribution?**

Under this scenario, HEIs would receive all of their teaching income directly from the exchequer. Some of this income would have been provided through the graduate tax, while some of it would represent additional funding by the state (which is no longer having to subsidise fee loans and can channel these funds into teaching grants).

### **What is the expected non-repayment on loans (RAB charge)?**

As there are no tuition fee loans under this scenario, there is no RAB charge for them. The state would continue to subsidise maintenance loans – it would expect to write off 29 per cent of the value of the loans it issues.

### **Which graduates bear the greatest share of the cost?**

A graduate tax is one of the most progressive forms of repayment system, since high-earning graduates will continue to pay the tax for 40 years, meaning they will contribute a greater share of the total cost than under the current system (when their contribution stops once they have repaid their loan). Under a graduate tax, graduates with an income between £10,000 and £21,000 will make a small contribution, whereas at present they are exempt from repaying their loans.

### **What are the strengths of this scenario?**

- A graduate tax is a very progressive form of payment, with high earners shouldering more of the burden, while those in low-paid jobs do not accumulate debt.
- A graduate tax avoids the need for students to take on high levels of debt and removes the need for tuition fees.
- Funding could still follow the student, providing healthy competition between institutions and putting student choices at the heart of the system.

### **What are the weaknesses of this approach?**

- While the government outlay on a graduate tax is very similar to the outlay on student loans, it is treated in a different way in the government accounts. When the government borrows money to issue in the form of student loans, it is able to treat this as an asset that doesn't count against the deficit (because it expects to get a lot of the money back). However, if it was to borrow money to fund higher education teaching grants, it would have to score this against the deficit – regardless of the fact it expected to get a lot of money back in the form of graduate tax. Due to these accounting rules, introducing a graduate tax could add an additional £7.26 billion to the deficit, even though the government is not actually borrowing or spending any more money than it does under the current system. Opinion among experts is divided as to whether these accounting rules could be changed by the Treasury.

- There is a danger that the government could change the amount of funding it gives to institutions or the way it allocates those funds. It therefore leaves institutions more exposed to short-term political decisions and, potentially, with less autonomy.
- There is a small danger that more people could avoid paying the graduate tax than the student loan. For example, if a graduate had a period working overseas, they could avoid paying tax for the years they are abroad, whereas under the current system their loan would still be accumulating over this period.

## Scenario 6: A postgraduate loan system

### What has been modelled?

An income-contingent loan system for postgraduate students would see all students studying a taught masters course as eligible to borrow £10,000 to cover the cost of their tuition fees. Graduates would repay this at 9 per cent on any earnings between £15,000 and £21,000 (all other features of the loan system, such as write-off period and interest rates, would be the same as the undergraduate loan). The loan would be available to full-time and part-time students, and there would be no maintenance support available.

### Why has this been modelled?

A number of commentators have expressed concern that students from less well-off homes cannot access finance to fund postgraduate study. This prevents them from gaining qualifications that are increasingly important for access to some professions (see chapter 4). The postgraduate loan system that we have modelled here was first proposed by Leunig (2011).

### What is the balance of contribution between the state and graduate?

At present, the state makes a small direct contribution to taught postgraduate courses (we have estimated that it contributes around £103 million in teaching grants). Under a postgraduate loan system, the state would also contribute around £41 million in subsidising loans. Overall, therefore, the state will contribute about 15 per cent of the total cost.

**Table 6.11**  
Resource flows:  
Postgraduate  
loan system

		To		
From	St'ts/grads/fams	St'ts/grads/fams	Institutions	Exchequer
	Institutions	NA	£905m	(£44m)
	Exchequer	(£905m)	NA	(£103m)
	Total	£44m	£103m	NA
		(£861m)	£1,009m	(£148m)

How does the state make its contribution?

The state continues to make a contribution in the form of teaching grants – this remains unchanged from the current system. By introducing a loan system on top of this, the state would increase its long-term contribution, because it would also subsidise the loan repayments.

What is the expected non-repayment on loans (RAB charge)?

Because graduates would repay their loans on income between £15,000 and £21,000, the state can expect to get most of the loan value back: the estimated RAB charge is approximately 6.9 per cent. The long-term additional cost to the government of introducing a postgraduate loan scheme is £41 million.

Which graduates bear the greatest share of the cost?

Because loan repayments are made on earnings between £15,000 and £21,000, the vast majority of graduates will repay the full cost of their loan. However, because high earners are charged higher rates of interest, the repayment system is still progressive, with high earners contributing the greatest share of the cost.

Table 6.12  
Expected  
repayment  
schedule:  
Postgraduate  
loan system

	RAB charge	Outstanding amount	Age of repayment
6.9%			
Males, full-time			
10th percentile	16.1%	£0	44
20th percentile	11.1%	£0	43
30th percentile	8.4%	£0	43
40th percentile	5.0%	£0	44
50th percentile	2.6%	£0	44
60th percentile	0.2%	£0	44
70th percentile	-2.3%	£0	45
80th percentile	-3.7%	£0	45
90th percentile	-8.3%	£0	46
Average	3.2%	£0	44
Females, full-time			
10th percentile	45.7%	£2,069	Never
20th percentile	22.5%	£0	48
30th percentile	16.1%	£0	45
40th percentile	12.0%	£0	44
50th percentile	7.2%	£0	45
60th percentile	3.2%	£0	46
70th percentile	-1.3%	£0	47
80th percentile	-5.8%	£0	48
90th percentile	-8.0%	£0	48
Average	10.2%	£230	45

### **What are the main strengths of this scenario?**

- This scenario removes the financial constraints on students who wish to study for a postgraduate qualification. It therefore removes one of the major barriers that prevent less well-off students from studying for a masters degree.
- This scenario is very cost-effective for the government. Graduates continue to contribute the lion's share of the overall cost of postgraduate study (as they do at present).

### **What are the main disadvantages of this scenario?**

- The overall cost to the government of introducing a postgraduate loan is very low. However, the government would have to borrow money in order to fund the loans. This would add around £646 million to public sector net debt, but it would not count towards the deficit.
- The government may need to regulate the number of students receiving postgraduate loans. Without this, an expansion of student numbers could make the loan system more expensive to the government.
- The government may need to regulate fees for postgraduate courses, in order to prevent universities inflating the cost of their courses in response to the increased supply of finance for students.
- This scenario would prevent the government making some other changes to the undergraduate loan system (for example the government would be unable to lower the threshold on undergraduate loans).
- There are unknown effects on the behaviour of employers. Some employers who currently support students to take masters courses (such as the NHS) may stop offering support if they believe graduate students can take out a loan instead.
- There are a large number of EU students who would be eligible for fee loans. The exchequer would need to take a careful view on the likelihood of loan repayment.

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## **Scenario 7: A postgraduate tax**

### **What has been modelled?**

We have calculated how the government could fund taught masters courses through a 'postgraduate tax'. This would be an additional 1.29 per cent on all income above £10,000, which would be levied for 40 years after graduation.

### **Why has this been modelled?**

If the government decided to introduce a graduate tax for undergraduate study, it may want to address the problems of access to postgraduate education in the same way.



### **What is the balance of contribution between the state and graduate?**

The balance of contribution between the state and the graduate would be similar to scenario 6 (postgraduate loans). The state would contribute £146 million, while graduates would contribute £863 million.

### **How does the state make its contribution?**

While institutions would receive the same income for taught masters students, they would receive this in the form of a grant from the exchequer. The exchequer, in turn, would receive income in the form of a postgraduate tax.

### **Which graduates bear the greatest share of the cost?**

Because graduates contribute through the tax system, this is a very progressive form of repayment. High-earning graduates will continue to make a contribution for most of their working life, relieving some of the burden on lower-paid graduates.

### **What are the main strengths of this scenario?**

The strengths and weaknesses of this scenario are very similar to introducing a tax for undergraduate study. Namely:

- A postgraduate tax removes the financial constraints that students face when trying to access postgraduate study.
- A postgraduate tax is a very progressive form of payment, with high earners shouldering more of the burden, while those in low-paid jobs do not accumulate debt.
- A postgraduate tax avoids the need for students to take on high levels of private debt and removes the need for upfront tuition fees.
- Funding could still follow the student, providing healthy competition between institutions and putting student choices at the heart of the system.

### **What are the weaknesses of this approach?**

- As with the graduate tax, there is a danger that the government's initial outlay on postgraduate study would have to be scored as current expenditure – even though it expects to get a lot of this money back through the tax system. It is therefore treated differently on the government accounts from a postgraduate loan system, even though the overall outlay and cost of both systems is identical in the long run. Due to these accounting rules, introducing a postgraduate tax could add an additional £904 million to the deficit. As noted above, opinion among experts is divided as to whether these accounting rules could be changed by the Treasury.
- There is a danger that the government could change the amount of funding it gives to institutions or the way it allocates those funds. It therefore leaves institutions more exposed to short-term political decisions and, potentially, with less autonomy.

- There is a small danger that more people could avoid paying the postgraduate tax than the student loan. For example if a graduate had a period working overseas, they could avoid paying tax for the years they are abroad, whereas under the current system their loan would still be accumulating over this period.