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Fair, Progressive and Good Value?

An assessment of the impact of the Coalition Government's proposals for the reform of Higher Education funding in England on graduates, the taxpayer and social mobility

A million+ Report

London Economics

November 2010

Introduction

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- proposes that funding from the majority of undergraduate courses should be withdrawn completely by 2014 with a £2.9bn annual reduction in spending on higher education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

Coalition Ministers have also stated that:

- fees of over £6,000 per annum will be subject to an institution agreeing an Access Agreement with OFFA[2] with the detail and operation of agreements subject to further consultation

- a National Scholarship Scheme of up to £150m per annum will be available by 2014/15, with the requirement that universities will have to participate in the NSS if they wish to levy fees in excess of £6,000 with details again subject to consultation but with the possibility that the NSS may be linked with the pupil premium[3] raising questions about how it might be accessed by mature students

- a Higher Education White Paper will be published in 2011 to promote the entry into the market of more private providers, clarify the future management of student numbers and propose amendments to the role of the Higher Education Funding Council for England (Hefce)

- changes to statutory instruments to amend the current fee cap and aspects of the graduate contribution system will be tabled for a vote in Parliament in December 2010

The Coalition's proposals represent a fundamental reform to the funding of higher education in England. They will have far-reaching effects on students, graduates and taxpayers as well as for universities. However, the Government intends to debate the proposed changes before the Christmas parliamentary recess and in advance of the publication of the Higher Education White Paper.

[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
[2] The Office of Fair Access established under the 2004 HE Act.
[3] Parliamentary Answer Rt Hon David Willetts MP 26 November 2010

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.

Section 1 - Are the proposals more progressive for graduates?

The Government has made much of its claim that the proposed repayment scheme for graduates is more progressive than the current system. Under the proposed reforms, the minimum earnings threshold for repayment amongst students entering higher education from 2012 will increase from £15,000 to £21,000 so that graduates will pay repay 9% of their annual income above £21,000. All graduates will therefore pay less towards the balance of their loan **per month** than they would if the £15,000 threshold was maintained. However, they will do so for longer because the repayment period will be extended from 25 to 30 years and because fee loans will be much larger. Depending on earnings, loans will also be subject to a real interest rate in addition to RPI.

The Government claims that in combination, these measures are progressive because a quarter of graduates – those with the lowest lifetime earnings – will pay less under the new system[4]. Ministers are choosing their words carefully: paying less per month than at present is not in itself the test of a more progressive graduate repayment system. Progressivity can only be assessed in terms of the 'all-in' cost of the reforms to students and graduates. Section 1 investigates these issues in more detail.

The earnings threshold

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.

Modelling undertaken by BIS[5] makes it clear that the £21,000 earnings threshold refers to earnings in 2015/16 rather than 2012. The repayment threshold will not be up-rated to take account of inflation between 2012 and 2015 and in fact 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 a discount rate of 2.2%, £21,000 in 2015/16 is the equivalent of £18,500 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.

RPI and interest rates

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[4] In House of Commons on 3 November the Secretary of State, Rt Hon Vince Cable MP asserted that 30% of graduates would pay less based on an IFS analysis which was subsequently withdrawn.
http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm101012/debtext/101012-0001.htm#10101248000003

[5] The Department of Business, Innovation and Skills

Under the present system, the Government subsidises the cost of student loans. For students who took out loans after 1998, interest accrual on the balance of the debt is linked to inflation as expressed through the Retail Price Index (RPI) or the Bank of England base rate plus 1% (whichever is lower) for 25 years or until the loan is paid off. The value of the amount paid back is therefore the same in real terms as the value of the amount borrowed.

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[6]. 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 Tables 1 and 2 illustrate how, irrespective of earnings, zero-rate interest might accrue depending on the balance of the loan and the value of RPI. This is unlikely to seem like a zero real interest rate, particularly to low earners. 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, explored in greater detail in Section 2, 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 (£7000 fees)[7]

Household Income	Student Debt	RPI = 1%	RPI = 2%	RPI = 3%	RPI = 4%	RPI = 5%
£25,000	**£32,625**	£326	£653	£979	£1,305	£1,631
£42,600	**£37,500**	£375	£750	£1,125	£1,500	£1,875
£62,125	**£31,725**	£317	£635	£952	£1,269	£1,586

Table 2: Impact of RPI in year following graduation (£9000 fees)

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

Ministers have argued that other countries also charge a positive real rate of interest. This is true – with one crucial difference. Countries like the Netherlands have much lower fees (€1,597 per annum in 2009/2010 - equivalent to £1,358 per annum) and Sweden has no fees and a real rate of interest is charged only on maintenance loans.

[6] Office for National Statistics
[7] Student debt figures are based on maintenance grant and loan parameters **in 10/11 prices** as set out in BIS (2010) The Government Student and Graduate Finance Proposals

Repayment Period
The Coalition's proposed extension of the loan repayment period from 25 to 30 years from 2016 is not dissimilar to the longer loan periods applied elsewhere e.g. Scotland has a 35 year repayment period. However with the exception of the US, fees and fee loans in other countries are much smaller than those envisaged in England after 2012. In some countries no fees are charged and the loans only cover maintenance. The combined effect of the real interest rate and the extension of the loan period will ensure that a greater total of the lending to students and graduates is repaid.

However, those students who can 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 and administrative complexities
The Government's proposals do nothing to address the transparency problems associated with the current student loan repayment scheme. At present when a loan becomes due for repayment, the graduate is sent a statement for the period ending 5 April that year. For PAYE employees, employers calculate and deduct loan repayments based on earnings in that pay period. These are collected by HM Revenue and Customs. At the end of the tax year HMRC advise the Student Loans Company of the repayments that have been made and these repayments are deducted from the outstanding balance.

Yet because the Student Loans Company is only informed of total repayments at the end of the tax year, it may take up to 24 months for the next balance statement to be issued. In the meantime, interest accrues (for students who took out loans after 1998) at either RPI or Bank of England base rate plus 1%, depending on which is lower. Whilst this information is publically available, it is not communicated directly to the payee. At any point in time, the vast majority of graduates do not know how much they owe the Student Loans Company or the rate at which interest is accruing.

The opacity of the current system is far from ideal but 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. This will exacerbate the problems which already exist in ensuring accurate balance statements and 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.

Assessment of 'all in' cost to graduates of proposals
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. So far both BIS and the Institute of Fiscal Studies have concentrated only on the loan repayment system.

The following analysis by London Economics compares the cost to graduates of both a £7,000 fee and a £9,000 fee under the current system with the 'all in' cost under the Coalition's proposals by household income (as this determines grant and loan eligibility) and by graduate income decile (as this determines the level of subsidy on the loan). The analysis has been undertaken for each fee level and for men and women separately and is illustrated in Figures 1-4.

The legend in the Figures shows to what extent the individual that graduates is better or worse off depending on their household income on entry to higher education and their own earnings post graduation. The redder the shading, the greater the additional costs associated with the current proposals, and as such, the worse-off graduates will be compared to the present system. The greener the shading, the better-off graduates will be compared to the present system.

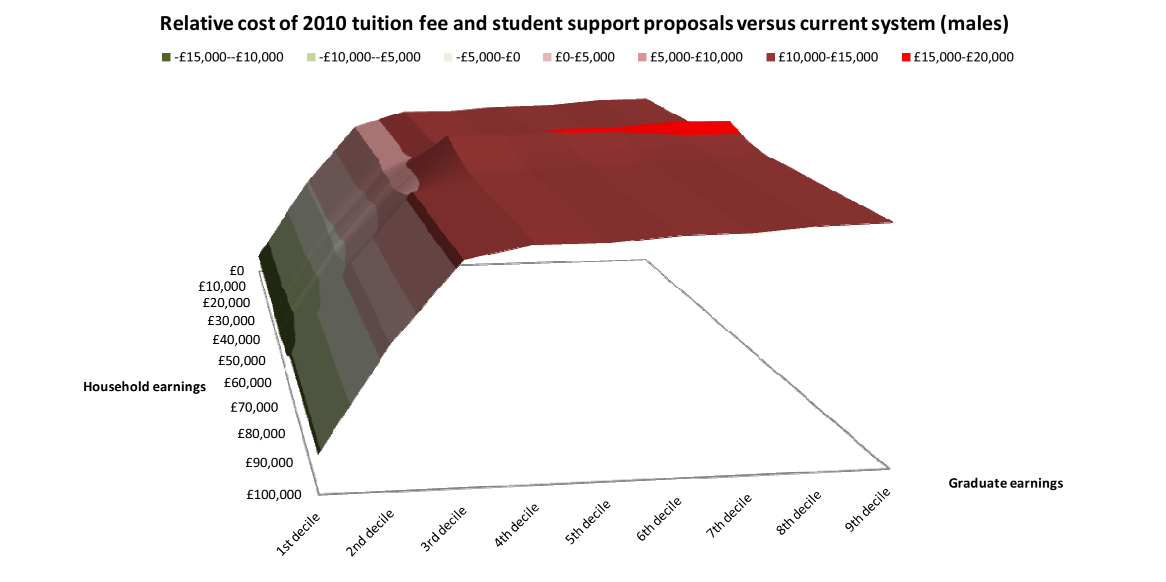
It is evident in all of the Figures that students from middle-income households who go on to earn average or above average earnings are hardest hit under the Coalition's proposals.

£7,000 fee

Figure 1 shows that with a fee of £7,000, 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.

Figure 1: Comparison of 2010 fee and student support proposals (£7,000 fee) vs current system (males)

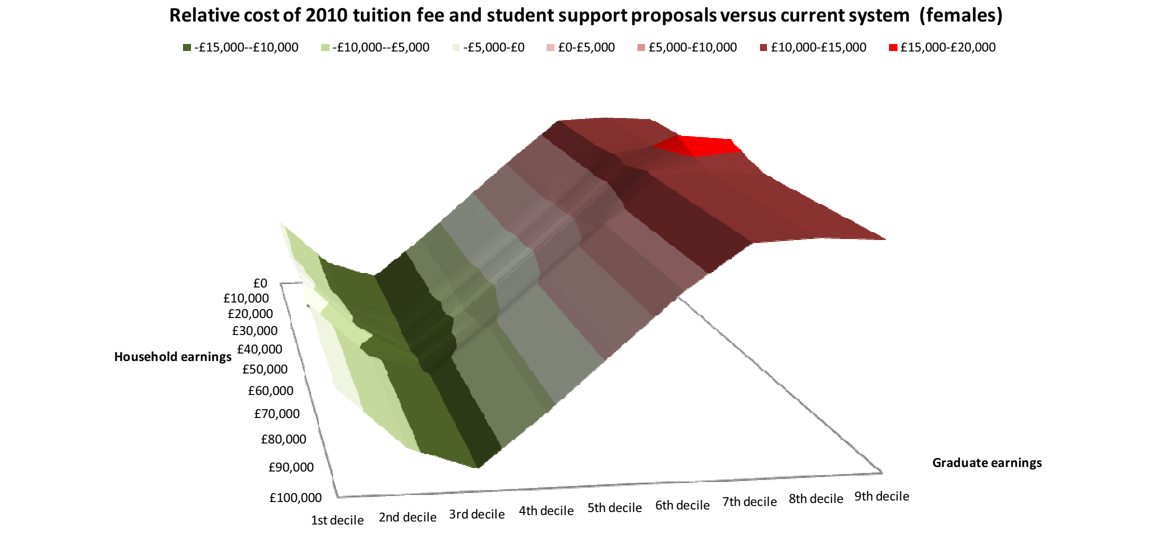


Source: London Economics

Maximum government fee: £7,000; Real rate of interest: Increasing linearly from 0% at £21,000 to 3.0% at £42,000 (2016 prices discounted to 2013/14); Repayment threshold: £21,000 escalating (2016 prices discounted to 2013/14); Interest rate rebate: Yes; Period of repayment: 30 years; Rate of repayment over threshold: 9%; Total Maintenance Loan: £3,875 per annum increasing to £5,500 at £42,600 (HHI) subsequently decreasing to £3,565 per annum at £62,000 (HHI); Total government backed fee Loan: £7,000 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. This is presented in Figure 2.

Figure 2: Comparison of 2010 fee and student support proposals (£7,000 fee) vs current system (females)



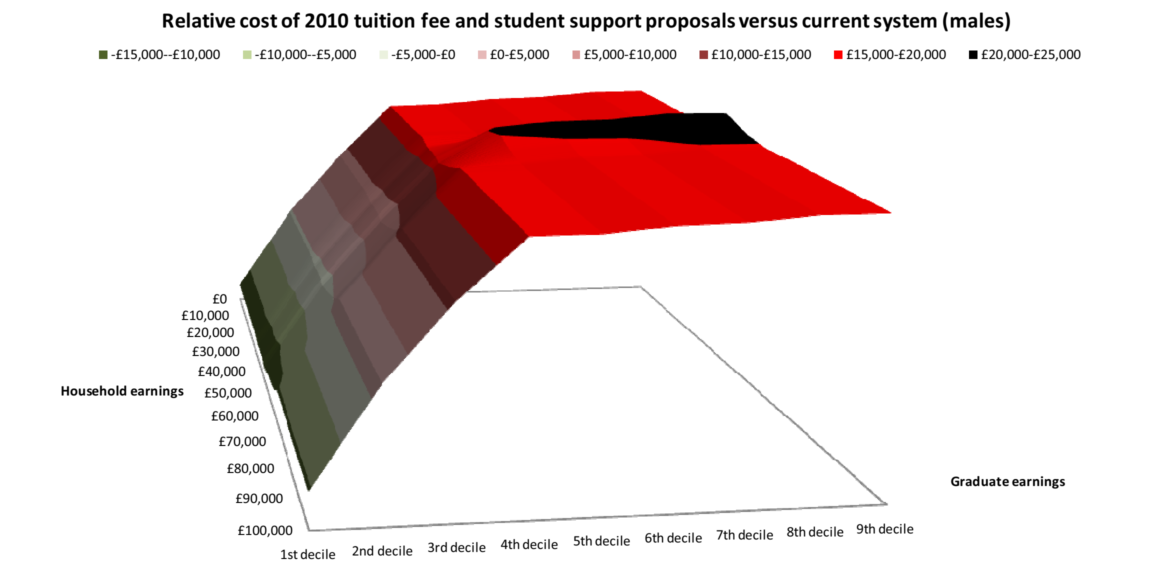
Source: London Economics

Maximum government fee: £7,000; Real rate of interest: Increasing linearly from 0% at £21,000 to 3.0% at £42,000 (2016 prices discounted to 2013/14); Repayment threshold: £21,000 escalating (2016 prices discounted to 2013/14); Interest rate rebate: Yes; Period of repayment: 30 years; Rate of repayment over threshold: 9%; Total Maintenance Loan: £3,875 per annum increasing to £5,500 at £42,600 (HHI) subsequently decreasing to £3,565 per annum at £62,000 (HHI); Total government backed fee Loan: £7,000 per annum

£9,000 fee

The impact of a £9,000 per annum fee on students is illustrated in Figures 3 and 4. The analysis is conceptually equivalent, though clearly the increasing tuition fee increases the expected cost under the proposals relative to the current system of fees and student support. As before, graduates from middle income households who go on to achieve average or average earnings post graduation can now expect to pay in excess of £20,000 more for their degrees than is currently the case.

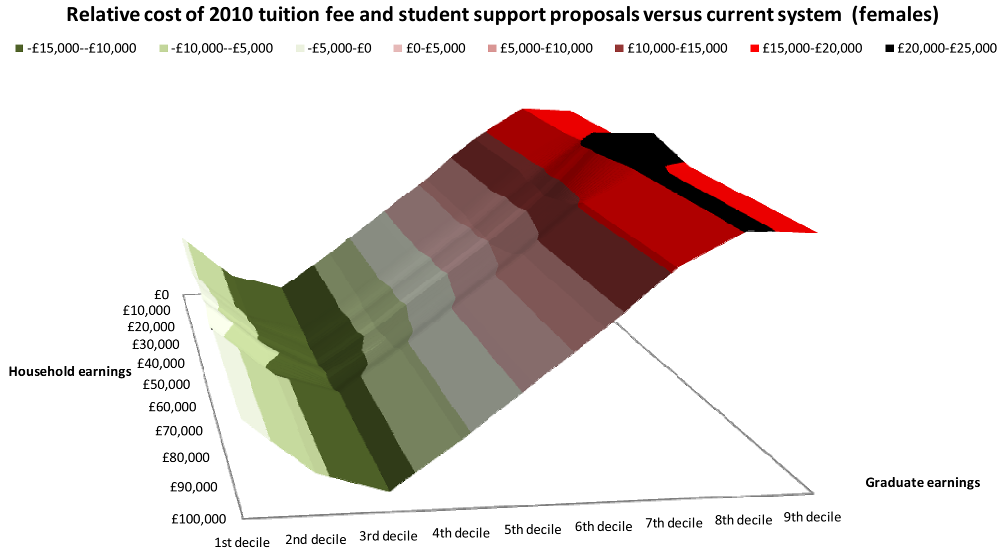
Figure 3: Comparison of 2010 fee and student support proposals (£9,000 fee) vs current system (males)



Source: London Economics

Maximum government fee: £7,000; Real rate of interest: Increasing linearly from 0% at £21,000 to 3.0% at £42,000 (2016 prices discounted to 2013/14); Repayment threshold: £21,000 escalating (2016 prices discounted to 2013/14); Interest rate rebate: Yes; Period of repayment: 30 years; Rate of repayment over threshold: 9%; Total Maintenance Loan: £3,875 per annum increasing to 2£5,500 at £42,600 (HHI) subsequently decreasing to £3,565 per annum at £62,000 (HHI); Total government backed fee Loan: £7,000 per annum

Figure 4: Comparison of 2010 fee and student support proposals (£9,000 fee) vs current system (females)



Source: London Economics

Maximum government fee: £7,000; Real rate of interest: Increasing linearly from 0% at £21,000 to 3.0% at £42,000 (2016 prices discounted to 2013/14); Repayment threshold: £21,000 escalating (2016 prices discounted to 2013/14); Interest rate rebate: Yes; Period of repayment: 30 years; Rate of repayment over threshold: 9%; Total Maintenance Loan: £3,875 per annum increasing to £5,500 at £42,600 (HHI) subsequently decreasing to £3,565 per annum at £62,000 (HHI); Total government backed fee Loan: £7,000 per annum

Graduate repayment profiles

The impact of higher fees loans on graduate repayment profiles is shown in the following tables – again calculated for fee loans of both £7,000 and £9,000 per annum.

Table 2 shows that 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 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 but 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.

Table 2: Graduate repayment proliles by characteristic - £7,000 tuition fee and tuition fee loan				
Name of profile	**Public Sector Profession al**	**Public Sector Professional**	**Late graduate**	**Late graduate**
Full-time / part-time	FT	FT	FT	FT
Length of degree	3	3	3	3
Gender	M	F	M	F
Age of graduation	21	21	30	30
Annual salary age 25 (30)	£26,289/ £40,387	£24,979/ £34,871	£0 / £37,966	£0/£31,242
Debt upon graduation	£33,516	£33,516	£33,516	£33,516
Outstanding debt at point of write-off	0	£4,564	0	£21,714
Age when/ if balance paid off	42	Never	48	Never
RAB charge (size of subsidy)	15.4%	28.7%	25.7%	66.3%
Proposed cost of HE (HHI=£43,000)	£15,258	£10,300	£11,418	-£3,719
Current cost of Higher Education (HHI=£43,000)	£3,859	£3,477	£5,245	£4,098
Additional cost of Higher education	**£11,399**	**£6,823**	**£6,173**	**-£7,817**

Source: London Economics

Maximum government fee: £7,000; Real rate of interest: Increasing linearly from 0% at £21,000 to 3.0% at £42,000 (2016 prices discounted to 2013/14); Repayment threshold: £21,000 escalating (2016 prices discounted to 2013/14); Interest rate rebate: Yes; Period of repayment: 30 years; Rate of repayment over threshold: 9%; Total Maintenance Loan: £3,875 per annum increasing to £5,500 at £42,600 (HHI) subsequently decreasing to £3,565 per annum at £62,000 (HHI); Total government backed fee Loan: £7,000 per annum

Table 3 illustrates the impact of a £9,000 pa tuition 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 and 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.

Table 3: Student repayment proliles by characteristic - £9,000 tuition fee and tuiition fee loan				
Name of profile	**Public Sector Profession al**	**Public Sector Professional**	**Late graduate**	**Late graduate**
Full-time / part-time	FT	FT	FT	FT
Length of degree	3	3	3	3
Gender	M	F	M	F
Age of graduation	21	21	30	30
Annual salary age 25 (30)	£26,289/ £40,387	£24,979/ £34,871	£0 / £37,966	0/£31,242
Debt upon graduation	£39,516	£39,516	£39,516	£39,516
Outstanding debt at point of write-off	0	£11,975	0	£28,685
Age when/ if balance paid off	44	Never	49	Never
RAB charge (size of subsidy)	16.5%	38.9%	26.7%	70.7%
Proposed cost of HE (HHI=£42,000)	£19,858	£10,163	£15,443	-£3,601
Current cost of Higher Education (HHI=£42,000)	£3,859	£3,477	£5,245	£4,098
Additional cost of Higher education	**£15,999**	**£6,686**	**£10,198**	**-£7,699**

Source: London Economics

Maximum government fee: £7,000; Real rate of interest: Increasing linearly from 0% at £21,000 to 3.0% at £42,000 (2016 prices discounted to 2013/14); Repayment threshold: £21,000 escalating (2016 prices discounted to 2013/14); Interest rate rebate: Yes; Period of repayment: 30 years; Rate of repayment over threshold: 9%; Total Maintenance Loan: £3,875 per annum increasing to £5,500 at £42,600 (HHI) subsequently decreasing to £3,565 per annum at £62,000 (HHI); Total government backed fee Loan: £7,000 per annum

Conclusions

Once the correct assumptions in respect of the earnings repayment threshold and male and female participation and the 'all-in' costs of the proposals are taken into account rather than monthly repayments, million+ and London Economics have concluded that, rather than the Government's proposals being more progressive, approximately 60-65% of graduates will be worse off than under the current system with those on middle incomes hit particularly hard often paying hugely more for their degree than under the current system.

Section 2 - Do the proposals provide better value for the taxpayer?

The Coalition Government's proposed reforms to the higher education system in England have been justified on the basis of the state of the public finances and the need to reduce the structural deficit. Specifically, the Government proposes to withdraw at least £2.9bn of public investment in higher education per annum by 2014/15 on the basis that this will reduce public sector borrowing requirements and the deficit. The substitution of student and graduate funding for public investment in higher education teaching means that the size of the student loan book will increase substantially. The Government will have to continue to borrow to fund student loans to cover the higher fees that universities will be forced to levy and also, to fund the additional fee income which will be paid to universities via the Student Loans Company . This section investigates whether the Government's proposed reforms are likely to represent better value for the taxpayer than the current system of higher education funding.

Accounting Mechanisms

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. In simple terms, as new student loans are issued, the Government makes a provision for non-repayment. This is referred to as the resource cost or RAB charge on the loan. For example, if the Government lends students and graduates £3bn in loans but the estimate is that the Government will only recover 72.5p in the pound back after the 30 year loan period, the resource cost/ provision is £0.825 billion.

The RAB charge on the current loan system currently stands at 27.5% and results in an annual resource cost of £1.229 billion per cohort of students. Under a £7000 fee, London Economics have estimated that the RAB charge will increase to 36.1% and will result in a resource cost of £2.610 billion per student cohort. Under a £9,000 fee, the RAB charge is expected to increase to 39.4% with an associated resource cost of £3.277 billion per cohort.

Although a provision for these costs is made by BIS in the current financial year, the actual impact of the interest rate subsidy and loan write-off only impacts on the government deficit at the point when the subsidy or write-off takes place. For the first cohort to study under the new funding system, any subsidy or write-off will take place in 2046.

As such, 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.

Flawed Modelling

This is not the end of the story. One of the most concerning issues arising from the Government's proposals is that they appear to be modelled on flawed and incomplete assumptions. For instance, BIS has modelled repayment patterns based on equal participation in higher education by men and women. However, official statistics and the House of Commons library confirm that men and women currently make-up 45% and 55% of the student cohort respectively. This 10 percentage point gender difference means that there is substantial inaccuracy in the BIS modelling. London Economics estimate that this error alone will cost the Government approximately £132m more per annum assuming a £9,000 per annum fee.

The BIS modelling assumption that graduates enter the workforce at 21 or 22 years of age is also problematic in that it takes little account of the current age profile of 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[8]. 82.2% of part time first degree undergraduates were aged over 21 and in total 25.6% of all first degree undergraduates were aged over 21.

Over-estimates by BIS of graduate repayments mean that the long-term cost to the taxpayer of higher fee loans has been underestimated. As outlined above, 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 will rise further if, as many expect, fees have to be higher than £7,000 in order to offset the fact that the majority of undergraduate courses will receive no public investment after 2012. 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[9].

These higher write-off costs will also make it much more difficult for the Government to get a reasonable return on its planned sale of the student loan-book in 2015. As a result, the write-off costs could, in effect, be even higher.

Lost returns from 'lost' graduates

In addition to the direct costs and benefits to the Exchequer there are also significant indirect effects if a large number of students no longer enter higher education as a result of higher fee levels. The approximate lifetime benefit to the Exchequer from the provision of undergraduate degrees to men stands at approximately £106,000 and £63,000 for women (as a result of enhanced taxation receipts, National Insurance and VAT payments). Given the current proportion of men and women in a graduate cohort, this averages at just over £82000 in today's money terms.

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.

Transaction costs

The removal of direct funding of higher education also has the effect of increasing transaction costs. Instead of universities receiving taxpayer funding directly, taxpayers will fund the Student Loan Company to lend students significantly more than at present. The taxpayer also has to fund the SLC so that it can pay fee income to universities in the academic year when the fee is levied. Because universities will be almost wholly dependent for teaching funding on a transfer of funds from the SLC rather than Hefce, the SLC will have to pay fee income much earlier than under the present system otherwise universities will receive no funding for undergraduate teaching for the first 6 months of the academic year. Finally, the taxpayer will have to fund a much higher student loan book for up to 30 years. The transfer of resources required by 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.

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

[9] 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*

Barnet consequentials
The Browne Review's proposals and the Government's response, on the face of it, only impact on universities in England. However, 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.

Conclusions
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.

Both taxpayers and graduates would be better off in the long and short-term if the Government invested more resources in teaching funding rather than transferring all the risk to students, graduates and future taxpayers in the form of much higher fee loans and write-off costs. If teaching funding was reduced by around £2.1bn pa rather than £2.9bn (still a substantial decrease in the deficit) fees of less than £6,000 would be the likely outcome. This would be fairer for students and graduates and would provide better value for the taxpayer.

Section 3 - What are the implications for participation and social mobility?

The Browne Review entered new territory in describing the public funding of teaching as a subsidy rather than an investment. The Government's acceptance of this approach signals a major shift in ideology as well as policy. Effectively, from 2012 public investment will be removed from most higher education courses and responsibility for the future funding of university teaching will be transferred to the individual. As outlined previously, the cap on tuition fees will be raised to £6,000 – or up to £9,000 in 'exceptional circumstances' – to allow universities to offset the shortfall in funding that will result from the reduction of the annual teaching grant from £3.5bn to just £700m.

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.

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[10]. In reality, the loss of taxpayer funded investment means that fees are likely to be significantly higher.
For students entering higher education in 2012, universities will receive no public funding for so-called classroom and studio-based subjects which fall into Hefce subject bands D and C. STEM subjects or SIVS[11] or other capital-intensive courses e.g. art and design,

[10] BIS modelling of graduate repayments 3 November 2010
[11] SIVS – Strategically Important and Vulnerable Subjects

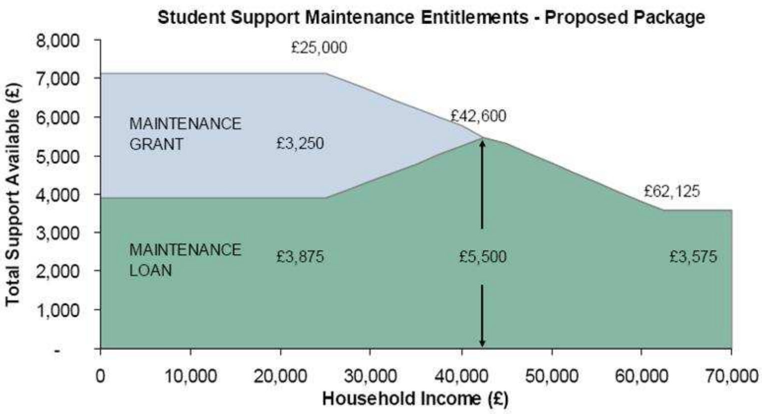
which currently fall into Hefce subject band B[12] will be funded *less* the average of Bands C and D. With 80% of students studying band D and C subjects, many universities will lose nearly all their teaching grant.

Undergraduate teaching funding is not the only funding at risk. The Government has yet to clarify the future of allowances paid to London institutions in recognition of the additional costs incurred in the capital or confirm whether there will be additional funding for the widening participation premium paid to universities which teach students from non-traditional backgrounds. The funding currently provided as a contribution to the costs of postgraduate taught courses also remains in doubt.

All of these allowances are currently part of the teaching grant which the Government is seeking to reduce by £2.9bn pa by 2014/15. Cuts in capital funding will also require universities to pay more of the costs of capital projects out of income. All of these factors contribute to many universities estimating that, unless more teaching funding is made available, they will have to almost treble the fee price to £8,000 to £9,000 pa to offset the shortfall. This means that students may well have to take out fee loans of up to £27,000 for a three year course.

In addition to fee loans, maintenance loans – widely acknowledged as insufficient to cover living costs – will be required by many students. Under the Government's proposals, both maintenance grants and maintenance loans will be means-tested based on residual household income[13]. The maximum maintenance grant will be £3,250 pa for students who are studying away from home and outside of London and who are from households where earnings are less than £25,000. These students will also be eligible for a loan of £3,875 per annum. As household income increases above £25,000 the total amount of support available to students will decrease: the value of maintenance grants will taper down and no maintenance grants will be available for students from households where earnings are above £42,600; whilst the maximum value of maintenance loans will taper up to £5,500 as household income increases to £42,600 and then taper down to a standard loan of £3,575 for those with households with incomes of £62,125 and above. This is illustrated in Figure 5.

Figure 5: BIS Maintenance and Fee Parameters in 10/11 prices[14]



Source: BIS

The proposals raise the very real prospect that full time students will leave universities with loans of more than £35,000 at the end of a three year course. For those contemplating entering higher education from 2012 and beyond, these are significant sums. For instance:

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[12] Subjects are grouped into bands ranging from Band A (medical) to Band D. Universities receive teaching grant from Hefce according to the number of students studying in each band. Band A attracts the most funding and Band D the least funding. 80% of students study subjects which fall into the Bands C and D but Band C includes some high cost subjects e.g. computer science.
[13] BIS (2010) The Government Student and Graduate Finance Proposals
[14] BIS (2010) The Government Student and Graduate Finance Proposals

- 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.

Mature students
The Government's proposals rely on modelling which assumes that graduates enter the workforce at 21/22 years of age. This takes little account of the current age profile of students. As previously identified, 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[15]. In total, 25.6% of all first degree undergraduates were aged over 21.

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 participaton 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.

Part-time students
The Government's proposals include a very welcome measure for part-time students. Under the current system part-time undergraduate students are excluded from the student fee and maintenance loans system and are forced to pay fees up front. The introduction of variable fees in 2006 had a significant negative impact on part-time enrolments which are only now returning to 2006/07 levels. 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 will now 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. Some part time students will remain ineligible for fee loans and others may be unwilling to take out loans because of other commitments. As a result, the impact on participation of extending fee loans to part-time students is unpredictable and 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.

Social Mobility
Social mobility is a cornerstone of the Coalition Agreement on higher education. However, there is also a real risk that the Coalition seeks to define social mobility in higher education in very limited terms. Ministers have suggested that the number of students progressing to

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

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. In this respect, official statistics[16] confirm that the contribution of modern universities to both widening participation and social mobility is outstanding and is on a scale and scope that should be both valued and promoted.

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[17], it would be surprising if the reforms did not impact on participation. The likely 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) is of particular concern and has not been modelled by the Government.

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. 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.

After variable fees were introduced in 2006, demand for university places initially fell but subsequently recovered. However it is important to note that in addition to raising the cap on tuition fees, the 2006 reforms removed the need for full-time students to pay fees upfront; uprated the earnings repayment threshold from £10,000 pa to £15,000 pa and reintroduced maintenance grants and maintenance loans with loans attracting RPI but charged at a nil interest rate thereafter. Demand was also influenced by the increase in the number of 18 year olds in the period and by the recession and rising unemployment. Research by the IFS for BIS has illustrated that the **combination** of increased fees and student support had little impact on full-time enrolment; however, the impact of an increase in fees (holding other factors constant) was estimated to have a negative impact on enrolment (and increase in fee by £1,000 was estimated to have a 4.4 percentage point reduction in enrolment).

More recently, an Ipsos MORI survey of 2,700 11-16 year olds in the first half of 2010 found that the prospect of even low level increases in tuition fees had significant deterrent effect on participation amongst young people. Amongst those questioned who said they were likely to go to university under the current fee system, one in six (17%) said they were unlikely to go if tuition fees increased to £5,000 and almost half (46%) if fees increased to £10,000 a year[18]. It is well-known that students with less family and financial support are more debt and risk averse and the Ipsos MORI survey found that fee increases had a much

[16] Social Mobility: Universities Changing Lives pub million+ March 2009
[17] 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.
[18] Ipsos MORI (2010) Young People's Omnibus 2010: A research study among 11-16 year old on behalf of the Sutton Trust

greater deterrent effect amongst 11-16 year old from more disadvantaged backgrounds[19]. 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[20].

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[21]. Over a third of all UK domiciled students from black, Asian and minority ethnic backgrounds study in these institutions, whilst just 16% study in Russell Group institutions and less than 10% in 94 Group institutions[22]. It is well-known that for cultural and religious reasons some students are less inclined to access loans including those which attract interest.

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-represented communities, will cease from April 2011 even though the all-age careers service will not have been established by this date. The Coalition's proposed reforms are being introduced over a much more rapid timescale than in 2006[23] and will apply to students who have already commenced study for A-levels and other Level 3 qualifications in the 2010/11 academic year. As a result, 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.

It should also be noted that the eligibility criteria for the National Scholarship Scheme are not yet agreed but that 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 premium. In addition, 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. Universities which are already the most successful in widening participation may once again find that they are disadvantaged if the requirements of the NSS either debar them from participating or if they end up having to pay out proportionately more income to support NSS students than other institutions.

Conclusions

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 restoration of more teaching funding would provide the taxpayer investment which universities require to deliver lower fee increases. It would ease the problems associated with creating a more progressive graduate repayment system and is

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

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

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

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

[23] By April 2004, the fee cap and graduate repayment scheme had been voted through the House of Commons although not the House of Lords. Universities, students, their advisers and the Student Loan Company had more than two academic years to prepare for the 2006 reforms.

also likely to be perceived by both students and their families as being fairer than the Coalition's current proposals.

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