HEPI DEBATE PAPER 39

Undergraduate fees revisited

By Tim Leunig

hepi

About the author

Tim Leunig is a multiple international prize-winning economist. In his decade as a senior UK government official, he served as Education Adviser to the Prime Minister (Rishi Sunak), Economic Adviser to two Chancellors of the Exchequer (Sajid Javid and Rishi Sunak), Chief Analyst, Chief Scientific Adviser and Senior Policy Adviser at the Department for Education, as well as working in three other Whitehall departments.

He invented Britain's first ever jobs furlough scheme, the National Funding Formula for England's schools and Progress 8, the method by which our secondary schools are evaluated.

He has taught at the London School of Economics for 25 years, and has held visiting Professorships at universities in the US and continental Europe.

HEPI Debate Papers are designed to stimulate informed conversations about topical issues. They do not represent a fixed HEPI position.

Executive Summary

This HEPI Report considers the recent history of student finance in England, including the limitations of the current fees and loans system, before proposing a 10-point plan for fixing some current weaknesses.

Together, the policies proposed would enable every student who is capable of going to university to do so, supported by maintenance grants as well as loans, while also ensuring better funded higher education institutions that are more able to equip graduates for the rest of their lives.

While graduates would still be expected to repay the costs of their higher education, their debts would never rise – not even in cash terms. All this can be delivered without burdening the state with any extra costs, indeed by accelerating repayments the proposals make it easier for governments to achieve five-year fiscal rules.

The core features are:

1. A 20-year, rather than 40-year, repayment term on student loans.
2. No increase, even in nominal terms, of the amount owed.
3. A minimum student loan repayment of £10 a week after graduation.
4. An additional repayment of 3% of income between the income tax and student loan repayment thresholds.
5. Letting graduates reduce their pension contributions in order to make higher student loan repayments more affordable.
6. Reintroduction of an interest rate supplement for graduates earning over £40,000 a year, set at a maximum of 4% for those earning over £60,000.
7. A new 1% National Insurance surcharge for employers that recruit graduates.
8. New maintenance grants for students with parental incomes up to £65,000, with full grants of around £11,000 for those with household incomes below £25,000.
9. Provision of maintenance loans for all students not receiving a full grant, provided their parents' income is below £100,000 a year.
10. Additional teaching grant averaging £2,000 per student.

As a result, universities will be better funded for teaching and students will receive more maintenance support. Students from the poorest backgrounds will no longer graduate with the biggest debts and no one will see their student loan debt rise year after year. Graduates will typically be free of their student debts by their early 40s, with any outstanding loans written off after 20 years. Meanwhile, employers will have access to a better skilled workforce.

This package would also reset relations between government – for whom the proposals are less costly than now – the higher education sector and students.

History

Student finance has evolved over the years. Following the 1960 Anderson Report, the 1962 Education Act required local authorities to pay students' tuition fees and maintenance on a means-tested basis. Richer parents were expected, but not legally required, to make up the difference.

The 1963 Robbins' Report did not rule out a move to loans in future, and Robbins himself saw that as sensible and inevitable.[1] Shirley Williams, Minister for higher education, proposed the idea in the late 1960s, but it was not taken forward either by the Labour Government or by Margaret Thatcher as Education Secretary in the early 1970s.

Labour were back in power by the mid-1970s, but rather than following Williams's recommendation, free tuition became universal, along with some maintenance support. This was the first time that fee-free university education was available to all.

By 1988, the Government formally floated the idea of loans: 'top-up loans to supplement grants are one way, among others, of bringing in new finance to help students and relieve pressure on their parents'. These maintenance loans began in the 1990/91 academic year. They were repaid as a fixed amount each month, typically over five years, albeit with repayments only from those earning above a minimum income threshold.

John Major's Government commissioned Ron Dearing to review higher education funding towards the end of their time in office. In response to the Dearing report – although not in line with it – the New Labour Government's 1998 Higher Education Act created £1,000 up-front means-tested fees for students from affluent backgrounds. Maintenance grants were abolished in favour of larger loans. Repayments were income contingent.

The year 2006 saw the introduction of variable fees, of up to £3,000 for full-time undergraduate courses in England (and Northern Ireland, with Wales following in 2007), but these no longer needed to be paid up front. Maintenance grants had already returned, and were increased in 2006. The Government also agreed to write-off any outstanding loans after 25 years.

The Labour Government commissioned John Browne to review higher education funding. He reported in October 2010, after the Conservative-

Liberal Democrat Coalition Government entered office. In response, that Government allowed universities to raise fees and £9,000 fees became the norm.[2] Repayments continued to be income contingent, with the repayment period extended to 30 years. A higher rate of interest was charged to those graduates with higher incomes, and interest was added to the amount borrowed while the student was studying.

In 2016, the Conservative Government abolished maintenance grants, replacing them entirely with loans. This saved the Exchequer money in the short run, but at the cost of adding to both student debt and loan forgiveness at the end of the repayment period.

The 2024 reforms

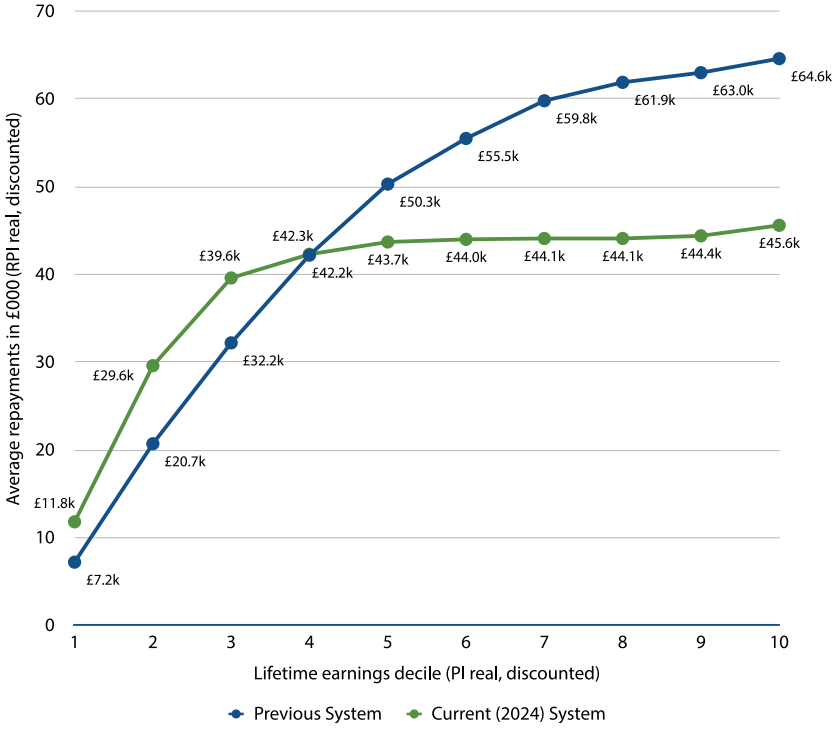
Student finance was reformed once more for those starting their degrees in 2023. The payment threshold was lowered from £27,295 to £25,000; the repayment period was increased from 30 to 40 years, and the interest rate premiums both for high earners and while studying were abolished.

The combination of owing less initially (because of the abolition of interest while studying), a rise in monthly repayments (caused by lowering the repayment threshold) and a 10-year extension of the repayment period means that more people will repay in full. Despite this, the IFS calculate that these changes actually increase the cost to taxpayers.[3] The abolition of the interest rate premium during study means that those who repay in full repay less in total. In addition, the ending of the high earner interest rate supplement means that the highest earners pay pack less in total, as they are not asked to pay an interest rate supplement. The biggest winners from this change are generally men, who disproportionately paid this charge. Men overpaid by £2.5 billion under the old scheme, but underpay by £0.2 billion under the new arrangements. In contrast women – for whom the obligation to pay for 40 years is much more likely to matter – underpaid by £1.3 billion under the old system and £2 billion under the new. The Government gave away £3.3 billion of taxpayers' money, 80% of it to men and disproportionately to the highest earning men.

The 2023 changes were correspondingly regressive within the graduate population. Graduates in the bottom three deciles of the graduate earnings

distribution were made worse off, those in decile four were unaffected and those on average incomes and above gained. The biggest gainers were graduates in the top two deciles, who were asked to pay back around £20,000 less over their lifetimes. Since the new system requires more money from taxpayers, other losers include non-graduates and graduates still paying under earlier repayment systems. Those losses are in addition to the figures in Figure 1.

Figure 1 Repayments by lifetime earnings decile (RPI real, discounted)



Why we need change

The 2012 system should have worked. It provided universities with a considerable boost to their incomes. It did not burden any student with any

form of conventional debt. They were free to pursue careers that interested them, with debts written off if those careers were not sufficiently well-paid or simply did not work out. Indeed, graduates were not required to work at all. Unlike those on conventional benefits, no benefit officer from the Department for Work and Pensions would be on their back, pointing out warehouse jobs or urging them to increase their hours so that they would be less of a burden on the state.

In some ways the system has worked. Young people are more likely to go to university than ever before, and this is particularly true for young people from poorer backgrounds. The prospect of debt has not deterred people from getting a university degree. Indeed, it has helped – the new student finance system allowed the 2010 to 2015 Conservative-Liberal Democrat Coalition Government to abolish student number caps, allowing a big increase in the number of students, particularly from poorer backgrounds. The current system has improved social mobility and raised economic growth. We are both a more prosperous and a fairer society because of the tough and unpopular choices that the Coalition Government took.

For all that, the current system has not worked. Student fees have risen only a token amount in the last decade or so, meaning that real fees have fallen massively. Quite a number of universities appear to be close to the edge financially. Significant redundancies and perhaps outright collapse are on the cards: the Government has reached the point where public money is being spent on consultants to cope with that outcome.[4]

Despite the real terms fall in student fees since 2012, we do not see students celebrating at getting better and better value degrees: the level of dissatisfaction remains high.[5] Graduates do not like the sometimes apparently ever-rising amount of debt that they owe, even though any unpaid debt will be written off in the end. The highly progressive nature of the loan repayment system – with no repayments for those earning £25,000 or less – means the amount outstanding will often rise for years, and in some cases for every year until the debt is written off. This is particularly true for graduates from poorer backgrounds, who have access to larger maintenance loans. Because they owe more initially, their repayments are less likely to cover the interest accruing each year, so the amount outstanding continues to rise. This is also more likely to be true for women, who earn less per hour

and are more likely to work fewer hours, making it again more likely that their repayments will fail to cover the interest accruing.

Nor is the system working well for government. The system is unpopular with students, unpopular with the general public and costly to taxpayers. Universities are very reliant on overseas students to remain afloat. Opinion polling is clear that the public do not want government to spend more money on universities, or for fees to rise. Public First found that universities ranked last but one of 16 different ways to increase government spending. Similarly, when presented with a range of 20 education policies, only supervised teeth brushing was less popular with the public than a £500 rise in university fees.[6]

The loans system also generates a superficially plausible anti-university narrative. The number of students who do not repay their loans in full allows those who oppose universities to argue that this is somehow proof that university is not worth it, that we should reduce the number of students and perhaps the number of universities as well. This anti-human capital narrative is catching hold, particularly on the political right. This agenda is dangerous both for UK growth, and for social mobility.

Finally, the university system is still monolithic. There is no competition in fee levels – unlike for graduate degrees. Universities overwhelmingly offer three-year degrees, predominantly in a single subject, with no early exit routes. It remains hard to change universities or to do a module at another university.

The 2023 reforms have done nothing to improve any of these problems. The changes were structurally minor, with one exception – the lengthening of the repayment period to 40 years. This overwhelmingly affects women, as most men have repaid their loan in fewer years. This change is unlikely to be successful – older graduate women as a group are fairly responsive to tax rates. The mortgage has gone, the kids are gone – why work when you lose a particularly high proportion of your income in tax, national insurance and loan repayments? We know we have a problem of people in their 50s choosing to drop out of the labour market – these changes make that problem worse.

Aims and principles of reform

The proposals in this report are based on the following aims and principles.

Neutral for the taxpayer

The system should be revenue neutral for taxpayers. Of course there is an argument for taxpayer subsidy. I gain, you gain, we all gain from a better educated population. This is true directly, because higher earners pay more taxes and receive fewer benefits. That means the rest of us can pay less in tax, or have better public services. It is also true indirectly, in that better educated people are more likely to found new firms, and expand existing ones, increasing wages and raising tax income from other people and organisations.

Against this, there are two reasons to support a fiscally neutral position. The first is the harsh reality – and we have just learned how harsh that reality is – that there is no money left. Britain does not want to pay more in tax, in part because the tax burden, although low by European standards, is at an all-time high. If the higher education sector wants to propose an alternative to the current system that the government will take seriously, that proposal cannot increase the deficit, or taxes on non-graduates.

All formal, quantitative fiscal rules risk distorting policy choices, and it should not be necessary to show that a proposal conforms to the particular rules, if the underlying fiscal effect is sound. In this case, however, the proposed changes are helpful in meeting the current fiscal rules, because they accelerate the period of repayment. In cash-flow terms, therefore, they are helpful to the government.

University open to all

It is absolutely imperative that access to university is available to all. Above all, this is a moral argument. An individual's opportunity to go to university should not be constrained by the circumstances of their birth and their upbringing, or at very least we should not exacerbate the effects of those circumstances through the student finance system. This is also good economics: sending the brightest and best to university, irrespective of their backgrounds, is a pro-growth policy. This principle means that the loan system must, in the main at least, be an income-contingent system.

Social insurance

Those two principles mean that it is inevitable that the state will lose money on some students, since some graduates will not get a job that allows them to pay back their loans in full. An inevitable corollary of the first two principles is that the student finance system must be a form of social insurance: if some graduates underpay, some graduates must overpay. So be it. It is already and inevitably the case that the affluent overpay for everything funded by the state through general taxation. Ultimately the rich have to pay the taxes because the poor have too little money to pay their share. That is simple reality, and it is reasonable to apply the same logic to university funding.

Do not be nasty to graduates for no good reason

The current system saddles many graduates with a debt that rises significantly for 40 years. Those rises are almost always a fiction, of course, since the debt will be forgiven at the end. It is self-evidently absurd to impose a depressing rise in debt year after year. We should not seek to make so many people miserable for such little gain – graduate after graduate tell me that they never open correspondence from the Student Loans Company for this reason. They know the sum owed does not matter, but they still do not want to see it in black and white.

More money for universities

Some universities are now teetering on the edge of bankruptcy. We need a system that allows universities to be able to survive and prosper and offer a decent education without having to rely on cross subsidy from overseas students. That is not to argue that we should reduce the number of overseas students, but rather to state that a university system that absolutely requires cross subsidy from this source to be able to teach students adequately is not properly thought through.

A 10-point plan

The vision thing

Imagine a world in which every student who is capable of going to university is able to do so, with maintenance grants and loans available to ensure that access is a reality. Imagine too that universities are better funded than they are now, able to offer high-quality education that equips graduates for life. Those graduates will go on to repay debts, debts that

never rise even in nominal terms, over 20 years. Imagine all that without burdening the state with any additional expense.

10 points

The first element of the plan is a much shorter repayment period – just 20 years. Heading off for university believing – even if wrongly in many cases – that you will be paying back your student loan for 40 years is absurd. Even a mortgage is typically only 25 years. Nor, as we shall see, is a 40-year term necessary to meet our target of fiscal neutrality. A 20-year period is shorter than the old 25-year period and shorter than the 30-year term applying to the majority of current student debt, and much shorter than the absurd 40-year system imposed on the most recent graduates.

The second element is a 'no rise' clause. This means what it says: the debt will never rise, even in nominal terms. If you repay nothing – while you are still on the course, or for any other reason – the amount you owe stays the same with the interest for that year written off. If your repayments are less than the interest after you graduate, the difference is written off.

The third element is a small, non-income contingent element to the loan system. Specifically, all graduates should have to repay £10 a week, come what may. This makes the system much more financially stable. Like all figures in this report, the £10 would rise each year in line with inflation.

The fourth element is an additional student loan charge of 3% for earnings between the income tax threshold and the current student loan repayment threshold. Again, this makes the system much more financially secure. This adds about £1 a day to repayments for those earning above £25,000 – and less for those who earn a lower amount.

The fifth element is that graduates should be able to reduce their pension contributions while they are repaying their student loan debt. This means that graduates can choose to reduce or eliminate the additional financial burden caused by the non-income contingent element, and by the new additional income related element. Pensioner poverty is a problem, but it is much rarer among graduates. Graduates who choose to take advantage of this option will have time to make additional pension contributions as appropriate after paying back their student loans – not least because their student loan repayment period will be only 20 years. Reducing

contributions is straightforward. In defined contribution pension schemes, less money in directly translates to a smaller pension pot. In defined benefit pension schemes the reduction would lead the worker to be treated as akin to a part-timer, pro rata to their contributions. If, for example, they reduce their employee contribution such that their total contribution rate falls by a tenth, they would be treated as equivalent to someone working 0.9 full-time equivalent – they pay 90% in, and they accrue 90% of the benefit.

The sixth element is a return to the interest rate premium for the highest earning graduates. The proposal is for no premium – that is, the debt will rise by inflation only – for those earning up to £40,000 a year. There will be an additional 4% premium for those earning £60,000 or more, with a pro-rata rate between these two income levels.[7] This is what is meant by a social insurance system.

The seventh element is a 1% employers' National Insurance surcharge for graduates. It is time to accept that employers benefit from a better educated workforce. They too should play a part in covering the costs. In the medium term it is most likely this cost to employers will manifest itself in the form of lower gross wages, roughly to the extent of the additional cost. Critically, however, firms can allocate this cost more widely – including to graduates who did not pay for their education. In all probability the author will be slightly worse off from this proposal. So be it. It will also at the margin lead employers to think whether they can use non-graduate workers. That is a good incentive: non-graduates are more likely to be unemployed, so a small financial incentive to employ more non-graduates would be a good pro-growth measure for society as a whole.

The eighth element is the re-creation of maintenance grants. Student work is not always easy to find, particularly if you study away from home and cannot offer an employer continuity of service. These grants would be means tested but would not be restricted to the poorest. Those whose parents earn up to £25,000 would get a full grant, those whose parents earn up to around £65,000 a partial grant.[8] The cost is covered by part of the rise in employers' National Insurance.

The ninth element is a maintenance loan system that offers support to those from middle income backgrounds. Loans would be available to those whose parents earn between £25,000 and £100,000. Those from the richest

backgrounds would not receive maintenance support from the state. Those students would, as was once the case, be expected to rely on their parents for support.

The tenth element is a £2,000 per student rise in university funding, funded directly by government, rather than by increased fees. The costs will be covered from the remainder of the employer National Insurance charge. A variety of different ways to administer that uplift will be described later.

Costings

Vote of thanks

The Institute for Fiscal Studies (IFS) have produced an excellent student finance calculator for England, which is used to cost the proposals in this report.[9] The production of that calculator was funded by the Nuffield Foundation. The author is grateful to both organisations, neither of which has any responsibility for the ideas included here. Anyone interested in proposing changes to the student finance system would be well-advised to use this calculator.

Understanding the fiscal estimates

The fiscal effects of each measure are not independent. The fiscal benefit of the £10 a week flat-rate charge, for example, is lower if the duration of the loan is 20 years, rather than 40 years. In this section, the fiscal impacts are correct given the order in which they are presented. They cannot therefore be taken as correct if any previous change has been rejected by the reader. Thus because the effect of the £10 charge is calculated after the effect of shortening the repayment period, the fiscal effect is lower. Were the £10 charge to be imposed while keeping the current 40-year repayment period the fiscal effect would be larger than the number given here.

We divide the proposals into three sections. The first section are changes that can be modelled clearly and unambiguously, and which affect students directly. The second section includes changes that are harder to model simultaneously, while the third and shortest section contains those ideas that are genuinely hard to model financially.

Costings 1

A maximum loan repayment period of 20 years

Shortening the loan period for 40 years to 20 years is obviously costly.[10] The 40-year period sees 82% of borrowers pay back their loan in full (95% for men, 72% for women). Shortening this to 20 years reduces the overall percentage to 45% (61% men, 33% women). The cost rises from £2.2 billion to £7.1 billion, a rise of £4.8 billion.[11]

A £10 a week compulsory charge

The IFS calculator does not permit a fixed element.[12] The £10 a week compulsory charge is modelled as a 100% charge on income between £0 and £520 a year. This method will understate how much revenue this will raise, since it will not capture repayments from people with no earnings. On that basis, a £10 charge over 20 years improves the fiscal position by £2.1 billion, giving an overall cost to taxpayers of £5 billion for the loan scheme. Overall, 56% of people will repay their loans in full (71% men, 44% women).

A 3% charge between the income tax threshold and the current repayment threshold

This change also raises revenue – about £1 billion.[13] That in turn increases the proportion who will repay their debts in full to 63%, consisting of 78% of men and 51% of women.

A higher interest rate for the very richest

This proposal is to add additional interest to the loans of those who earn more than £40,000.[14] This would start at 0%, rising steadily as incomes rise up to a rate of 4% for those who earn more than £60,000.[15]

This raises £1.8 billion. Overall the system now loses £2.3 billion, just £23 million more a year than our current system. Remember too that our estimate of the effect of the £10 weekly flat rate element understates the yield, since it was applied only to people with earnings. In all probability this first set of proposals are revenue positive for taxpayers.

A no rise clause

This report proposes a 'no rise' debt cap. That means what it says on the tin – a student borrowing to cover the cost of three years fees at £9,250 a year will graduate with £27,750 worth of debt, rather than having inflation added twice to the first year's fees, and once to the second year's fees. The

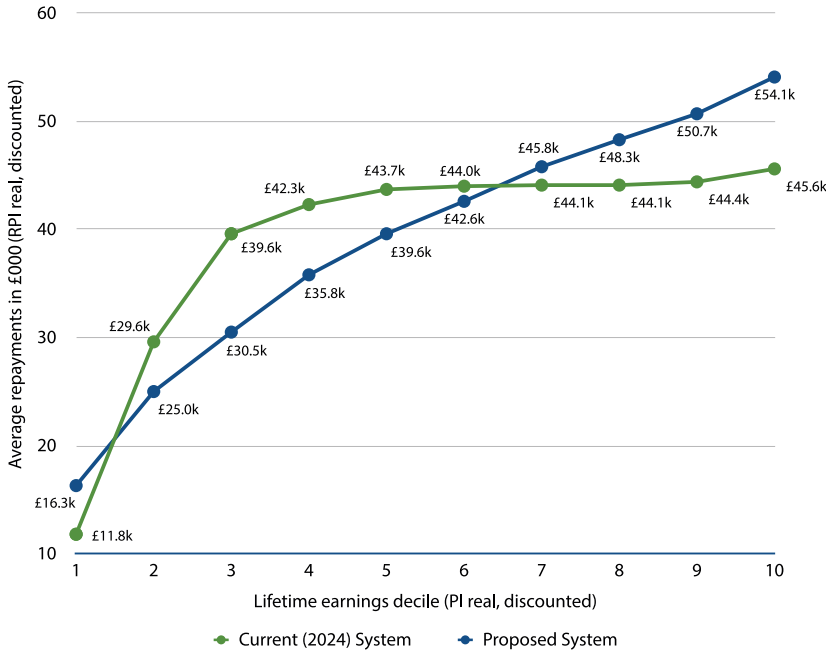
IFS calculator does not allow a 'no rise' debt cap to be modelled explicitly. The financial benefit to the student and the financial cost to government of this proposal is equivalent to a reduction in fees of around £200 a year, assuming inflation to be a little over 2% a year. The IFS calculator shows that if fees are £200 a year lower, the Government is £50 million worse off over the long run, given the other changes above.

The no rise clause is perpetual, however. That is harder to cost: we return to this issue later.

Fiscal position – part one

These three revenue raising changes – a £10 flat rate (£2.1 billion), a 3% additional payment on earnings £12,570 to £25,000 (£1 billion) and a higher rate of interest for the highest earnings (£1.8 billion) together raise £4.8 billion.

Figure 2 Repayments by lifetime earnings decile (RPI real, discounted)

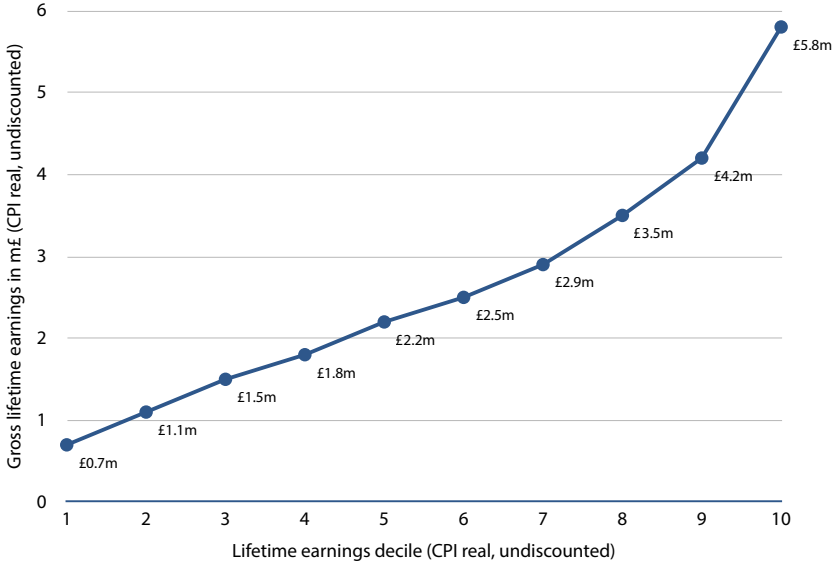


The reduction from 40 years to 20 years costs £4.8 billion, while the 'no rise' clause while studying costs £50 million. The net effect of these five changes combined is to worsen the Government's fiscal position by £73 million a year. This figure should be seen as 'broadly zero', that is, it is within the margin of error for a calculation of this type. Note too that although broadly neutral in net present value terms, the fact that the Government gets the same amount of revenue over 20 years rather than 40 represents a notable improvement in the cash fiscal position, and makes it more likely that the Government will meet its fiscal targets.

These changes are very progressive. With the exception of those in the lowest decile, those in the bottom half of the graduate earnings distribution pay less, while those in the top half pay more.

It is worth emphasising just how much more the top deciles earn. Compared with decile 4, those in decile 9 earn more than twice as much and those in decile 10 more than three times as much. Asking the top two deciles to pay back a maximum of £8,000 more over 20 years is reasonable.

Figure 3 Lifetime earnings by decile (CPI real, undiscounted)



Costings 2

A 1% supplement on employers' National Insurance

The IFS do not explicitly include this as an option.[16] They do, however, allow the option of a graduate tax. We therefore model the fiscal effects of a 1% graduate tax on earnings above £9,100, the starting point for employers' National Insurance.[17] We model the tax as applying for 47 years, that is, broadly speaking taking the graduate to retirement as would be the case for National Insurance.[18] Note that the surcharge would also cover the self-employed: we do not want to increase the National Insurance gap between the employed and the self-employed further than is already the case. The use of income tax as a costing proxy reflects that intention. This surcharge would cover all graduates, including those who did not take out a student loan, irrespective of their employer. This includes public sector employees. Although the Government could choose to compensate such employers for the additional cost, it would be better to ask the pay review bodies to take this cost to employers into account when making their pay recommendations. As we noted above, the most likely effect of an increase in employers' National Insurance is lower gross wages: there is no reason why this should apply only to the private sector.

This funding stream is not tied to the individual employee. That means that the 1% applies throughout their working life, and is paid into a general pot, rather than repaying a specific debt. This raises £10.7 billion per cohort, over their working lifetimes.

Maintenance

In England, there are currently no maintenance grants, no matter how poor your parents may be. Means-tested maintenance loans are available. The amounts vary according to whether you live at home (up to £8,610), away from home outside London (up to £10,277) or away from home inside London (up to £13,328).[19]

The maintenance loans come in two parts. All students may borrow £4,767, irrespective of household income. The highest amounts, given above, are for students whose parents earn less than £25,000. For those whose parents earn between £25,000 and £62,347, access to loans falls by around 15p for each additional £1 in parental income. A student living away from home

whose parents earn £45,000 would be eligible for a maintenance loan of about £7,300 a year, around one third of the adult minimum wage.[20]

This system has three problems.

First, these relatively low sums for maintenance mean that a lot of students have to work during term times. The evidence is clear: more term-time work means that students are more likely to fall behind, get lower marks and fail to graduate.[21]

Secondly, students from the poorest backgrounds graduate with the highest levels of debt, since they are eligible for the largest levels of maintenance loans. That in turn means that they are less likely to repay their debts in full, and more likely to still be making repayments well into their 50s, just because of who their parents are.

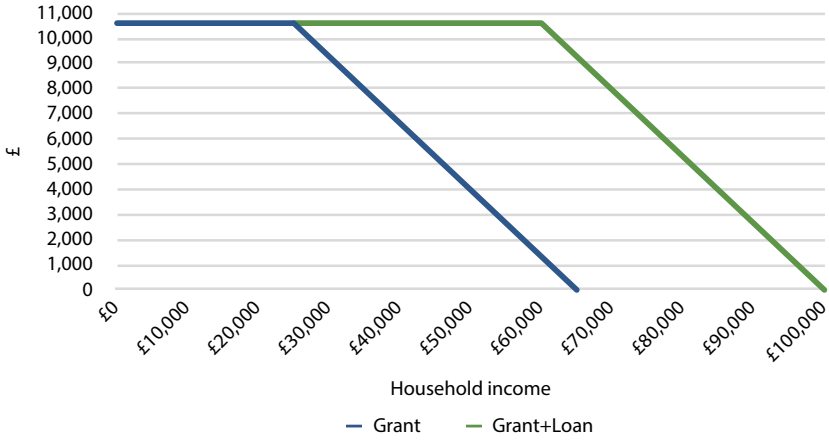
Thirdly, more generally, a proportion of the maintenance loans are never repaid. Without maintenance loans, students would repay 95% of their debts.[22] In contrast a sixth of maintenance loans are not repaid, raising the overall losses on the system to 10%.

This report proposes an increase in maintenance support of around £400 for all types of student. The new rates would be £10,600 for those who study away from home outside London, £13,800 for those studying away from home in London and £9,000 for those studying at home.[23]

This support would be a grant rather than a loan for those whose parents earn up to £25,000. This figure, like all those that follow in this section, would vary according to the number of children in the household. The grant would fall as parental income rises, and would be zero for those whose parents earn £65,000 or more.[24]

Those whose parents earn above £25,000 and less than £100,000 would also be eligible for a maintenance loan. The maximum combined maintenance grant and loan would be equal to the grant levels set out above. Those whose parents earn between £25,000 and £60,000 would receive the full amount as a combination of grant and loan.[25] Those whose parents earn more would be able to borrow less, with those whose parents earn over £100,000 ineligible for a maintenance loan. The result can be seen below, for students living away from home outside of London. Similar graphs apply to other groups.

Figure 4 Maintenance support



This package radically changes the position of most students. Those whose parents earn £25,000 or less will receive a grant not a loan, and the total support will be more than now. The poorest will not – unlike now – graduate with more debt than the richest.

For those students whose parents earn up to £65,000 the position is unambiguously better. They will receive more money than now, and some of it is a grant. A student whose parents earn £45,000 a year, living away from home outside London, can currently borrow £7,497 as a loan each year. Under this proposal they will receive £5,300 as a grant and be eligible for a loan of £5,300 as well. They therefore have around £3,100 more to live on and accrue about £2,200 less debt each year.

Those students whose parents earn between £65,000 and £82,000 are also better off, in that although they will not be eligible for grants, they will be eligible for larger loans than is now the case. Someone with parents earning £65,000 will be eligible for a loan of £9,275, almost double the current level of support. Someone whose parents earn £80,000 will be able to borrow a little over £500 more a year.

For those whose parents earn over £80,000 a year, the position is reversed. They will be able to borrow less money for maintenance than now, and

those whose parents earn more than £100,000 will not be eligible for a maintenance loan at all. This is a return to the position that was historically common, namely that the wealthiest parents are expected to support their children's living expenses.

The judgement is that parents with a household income above £100,000 – the top sixth of the income distribution – would rather pay to support their children, than to pay more in tax to cover the later write-offs of student loans.[26]

Together this maintenance package costs £6.9 billion.

Improving university finances

This report proposes a £2,000 rise in the unit of resource. This costs £2.9 billion.[27] There are many, many ways to allocate this money. This report proposes three alternatives, but they are not the only three, and no judgement is made as to the most appropriate one.

The first approach is simply to recreate a £2,000 teaching grant for all courses, at all universities. The second approach is to be more subject specific. Some subjects could be selected for higher uplifts, because the government believes that the current system of cross subject subsidy is unhelpful, or because it believes that some subjects are more important strategically or especially vulnerable. The third approach would be an asymmetry by institution. The government could push this money into research rather than teaching support. It could do so either by increasing the quantum of funding linked to the Research Excellence Framework, or for responsive mode competitions. Alternatively, it could move towards Full Economic Costing, whereby the government funds more of each funded research project, thereby expecting a university to reduce their cross subsidies from other sources of income. There are advantages and disadvantages to all three approaches and deciding between them is for another report. For now, it is sufficient to note that this report proposes a rise in university funding of £2.9 billion and is neutral to how that money is distributed.

In addition, the significant rise in the amount of maintenance funding available to almost all students means that universities could and should be allowed to repurpose most of their bursary funds towards improving

standards. This currently runs just shy of £400 million, allowing for say a £300 million reduction.[28] Together with the direct grants this means an increase in *de facto* university funding of £3.2 billion.

Fiscal position – part two

The combination of the National Insurance surcharge, the maintenance package and the additional directly funded support for universities yields a notable improvement in the government position – around £800 million. This more than outweighs the £73 million worsening in the government position from the first set of changes. Our best guess is an overall improvement in the fiscal position of £711 million. The rise in National Insurance would be immediate. The rise in maintenance support and university finance would apply to new students, so there is a short-term fiscal windfall for the Government, in that in the first year only one-third of the expenditure is needed and in the second year two thirds, as some students will be on the previous regime. This is a windfall of £10.7 billion. Politics might require the Government to offer the higher levels of maintenance to existing students. Doing so reduces the windfall to £3.8 billion. This is a genuine windfall and obviously helps the fiscal position.

Costings 3

No rise clause while working

This report noted earlier that it is not possible to use the IFS Calculator to cost a 'no rise clause' after graduation. We can, however, make some estimates by using examples of plausible trajectories.

The first example is a student from a poor background who graduates after three years. They will have been eligible for a full maintenance grant, and will only have borrowed to cover their tuition fees. The no rise clause means they graduate with a debt of £27,750. Assuming inflation is 2%, the interest on their debt will be £555. The £10 a week flat rate means that even if they have no job, their debt would rise in any case by just £35. The cost to taxpayers of the no rise clause would therefore also be £35 – a trivial amount.

Now consider a student living away from home whose household income was £65,000. This student will graduate with the largest possible amount of debt, because they will be eligible for a maintenance loan of £11,000. If their parents earned less, their debt would be lower because

part of that loan would be a grant. If their parents earned more, their debt would be lower because they would be eligible for a smaller or no maintenance loan. They will graduate – assuming they take the maximum maintenance loan – with a debt of £60,750. If they have no income the interest on their debt would be £1,215, and they will repay only £520, a £695 write off. This is a relatively extreme case. The write off would, however, be zero so long as they earn £28,588 a year. This sum is typical for a starting graduate employee, but relatively low for someone who is embedded in their career. For most graduates in full-time employment the cost to the Exchequer of the 'no rise' clause will be zero and for the remainder it will be low. Even at minimum wage, the cost of the rule is only £402 a year.[29]

The most extreme case will be medical students, who rack up many years of student debt, and have no income to repay it for some time. Society should, however, accept that it is absurd that would-be medics see their debts spiral both from additional study, and from interest payments thereon. That the no rise clause is of special value to medical students and junior doctors should not be seen as a downside.

This rule will mainly affect those whose parents' income is around £65,000, and who take time out or work part-time, perhaps because they have small children. This group of people – overwhelmingly women – are, however, the group most likely to not repay all of their student loans. This is particularly true for a 20-year system with a stronger element of individual overpayment and underpayment. The in-year cost, therefore, is likely to be matched by a reduction in the amount written off at the end of their repayment period.

In short, there will be – by definition – a cost to the 'no rise' clause after graduation, but it is likely to be small, that is, in the millions, rather than in the billions. It seems likely that it will be covered by our estimated surplus of more than £400 million.

There are two small further changes that the government could make that would raise revenue, but in a way that is currently hard to quantify. The first change is to end the practice of four-year undergraduate degrees, with a very few exceptions (such as languages and medical degrees). The way the loan system works is that, *de facto*, a graduate repays none of

the fourth year of their degree, unless and until they repay the first three years in full, including any maintenance debt. This means that the losses for the fourth year far outweigh those for the first three years. Although not widespread, a four-year undergraduate degree is a costly anomaly for the taxpayer.

Similarly, and more commonly, some universities allow students to stay on for another year to convert their undergraduate to a Master's degree as part of what is known as an integrated Master's degree. When the student takes this option, their additional year is eligible for another year of funding on the undergraduate loan scheme. This is considerably more costly to the taxpayer than if an additional year is funded via the Master's Loan scheme, because the latter requires students to repay both loans simultaneously.

Requiring such students to fund their additional year via the postgraduate loans scheme would save the taxpayer money. It would also encourage choice and intellectual diversity. It is somewhat odd that a Durham undergraduate will in effect receive a government subsidy to undertake a Master's at Durham than at Cambridge. Government should not subsidise anti-competitive practices in this way. Better that students make a choice of where to study on a level playing field, not one that has been distorted by the Government's student loan scheme.

Finally, government should integrate fees and maintenance loan funding as is the case for the postgraduate loan scheme. Any student attending a university with a lower fee could borrow the difference as an additional loan towards their maintenance costs. It is often said that students equate price with quality, and therefore no university will undercut another. This is not true at graduate level, however, where prices vary dramatically by course and university. The current undergraduate loan system unhelpfully discourages price competition. The additional funding for universities makes it more likely that some will choose to cut fees. More generally, the coming fall in the number of 18-year olds may make universities more willing to cut fees, as demand falls, and the government should encourage that approach. Insofar as not every student would borrow the difference in fees as additional maintenance, this would reduce the cost to taxpayers.

Discussion

Taken together, these proposals represent a significant evolution of our system of funding undergraduate degrees. The proposals retain much of what is good about the system. Universities will continue to be free to offer courses in the subjects they want to teach, and admit those students they wish to admit. There is no return to number controls in this report. Students will continue to pay fees, but the terms on which they borrow will be different. Everyone will pay something back, no matter how low their income, and the richest graduates will pay back substantially more – as was the case until recently.

Almost all students will be able to see their debts fall year on year, and no student will see the amount they owe rise under any circumstances. Monthly payments will rise, but the duration of repayments will fall sharply, from 40 years to 20 years. In addition, graduates will be able to choose to make lower pension contributions to help clear their student loans and prevent any short-term reduction in their standard of living.

Students will have much more maintenance support available, and the majority of that support will be as grants, not loans. For most people, going to university will be much much easier, and the need for part-time work will be somewhat reduced. The richest parents will, however, have to fund their children's maintenance in full.

No proposals of this scale can avoid downsides. This report argues, for example, that all graduates should pay £10 a week, no matter their income. The money would be collected via a change in the personal allowance for anyone employed or self-employed. For those without earnings, the payments would be made by direct debit.

There are two groups of people with no income. The first are individuals in affluent households, who choose not to work. Society should have no qualms about adding £520 to the bills of such households. The second are those whose households have a low income. Society does, of course, need to be careful in how we treat those in poverty. That said, there are many circumstances that we do not correct for via the benefits system. Those who need a car because they live in a rural area get no additional funding, nor do those who smoke, or have a pet. Those who have to find

£10 a week because they went to university will be expected to do so come what may. This cost is far lower than any of the three items listed above, and in general graduates have more options in the labour market than non-graduates.

The combination of the £10 a week and the 3% additional repayment on incomes below £25,000 will increase repayments by up to £900 a year. This is not trivial, which is why this report also argues that graduates should be allowed to reduce their pension contributions. This report neither recommends that individuals take that opportunity, nor counsels against it – it would be for each graduate to decide what to do in the light of their circumstances and expected future circumstances.

Of course there is a chance that by allowing graduates to pay less into their pensions now, we force them onto benefits in retirement at great cost to the taxpayer. That seems unlikely, however. Pensioner poverty has fallen a lot, and the higher state pension, higher graduate incomes and auto-enrolment means that it is hard to imagine many graduates being either poor or meaningfully more reliant on the state in retirement as a result of this proposal.

The proposals in this report will unambiguously make it easier for students to study. In the vast majority of cases they will have more money to hand, and the government will be much clearer with richer parents how much they are expected to pay to support their children – as was the case in the 1980s. That makes it more likely that students will be able to reduce the amount of paid work they do. We know this improves grades and increases graduation rates. That therefore also increases national income.

Conclusion

The time has come to accept that the 2012 student finance system has not worked. Students do not like it. Graduates do not like it. Universities do not like it.

This report argues that we can build on the best bits of the current system, while remedying those that do not work. We can have a system whereby students are better supported while at university, where debts never rise and where all student loans are repaid or forgiven within 20 years.

Graduates will repay more each month, but will be able to cover that additional cost – or even all of their student loan – from their pension contributions.

Universities will see their incomes rise markedly, and the increase in student support means that they will be able to redirect some of their bursary funds towards teaching excellence.

Finally, employers need to be part of the system, with a 1% employers' National Insurance supplement.

This package would reset relations between government – for whom the proposals are less costly than now – the sector and students.

Endnotes

1 Nicholas Hillman, 'From Grants for All to Loans for All: Undergraduate Finance from the Implementation of the Anderson Report (1962) to the Implementation of the Browne Report (2012)', *Contemporary British History*, Volume 27, Issue 3, 2013, pp.249-270, DOI: 10.1080/13619462.2013.783418

2 The University of Buckingham and The Open University are exceptions.

3 https://ifs.org.uk/student-finance-calculator

4 https://www.bbc.co.uk/news/articles/cpd9mgk028lo and https://www.delta-esourcing.com/delta/respondToList.html?accessCode=8F22W4EAR7

5 Jonathan Neves, Rose Stephenson and Josh Freeman, HEPI / Advance HE *2024 Student Academic Experience Survey,* June 2024, p.15 https://www.hepi.ac.uk/wp-content/uploads/2024/06/SAES-2024.pdf

6 Will Yates, 'Public First Education Polling', 12 June 2024 https://www.publicfirst.co.uk/public-first-education-polling.html

7 The choice of £60,000 is constrained by the IFS finance calculator not permitting higher values.

8 As now, the figures would be slightly different for those studying in London or at home.

9 https://ifs.org.uk/student-finance-calculator

10 In the IFS calculator we select 'loan repayments' and set the 'loan term' to 20 years.

11 Figures may not sum due to rounding.

12 In the IFS calculator we select 'loan repayments', '2: Payment rate varies with earnings', and then £0 (100%), £520 (0%), £25,000 (9%).

13 In the IFS calculator we select 'loan repayments', '2: Payment rate varies with earnings', and then £0 (100%), £520 (0%), £12,570 (3%), £25,000 (9%).

14 In the IFS calculator we select 'loan repayments', set 'Maximum interest rate above RPI (in %)' to 4% and then set 'Interest rate thresholds (in £)' to £40,000 and £60,000 on the slider.

15 The IFS does not estimate the effect of raising the latter threshold above £60,000.

16 For this, we reset the IFS calculator back to the original values, choose 'loan repayments', 'graduate tax' and then set a minimum threshold of £9,100, a rate of 1% and a duration of 47 years.

17 https://www.gov.uk/government/publications/rates-and-allowances-national-insurance-contributions/rates-and-allowances-national-insurance-contributions

18 https://assets.publishing.service.gov.uk/media/5a7f02e640f0b62305b84929/spa-timetable.pdf

19 https://www.gov.uk/student-finance/new-fulltime-students. There are different amounts for long courses, students over 60 and those on a year abroad. Additional support is available for students with children, disabilities and adult financial dependents.

20 https://www.savethestudent.org/student-finance/maintenance-loans.html#amount

21 https://www.journals.uchicago.edu/doi/10.1086/719995

22 Derived from the IFS student finance calculator.

23 The IFS calculator requires these numbers to be in round £100s, hence the rise for each group is not exactly the same.

24 £73,000 if studying away from home in London, £61,000 if living at home.

25 Again, £73,000 if studying away from home in London, £61,000 if living at home.

26 https://ifs.org.uk/tools_and_resources/where_do_you_fit_in. £100,000 income, 2 adults, 2 teenage children, council tax £3,000.

27 The IFS calculator records 498,000 students, each costed on the basis of a three-year degree.

28 https://www.hesa.ac.uk/data-and-analysis/finances/table-15

29 £11.44, based on 37.5 hour working week.

Tim Leunig lays out the shortcomings of the current higher education funding model in England and proposes a 10-point action plan to fix the system for the benefit of students, institutions and the nation.

HEPI was established in 2002 to influence the higher education debate with evidence.
We are UK-wide, independent and non-partisan.
September 2024 ISBN 978-1-915744-32-6
Higher Education Policy Institute
99 Banbury Road, Oxford OX2 6JX
www.hepi.ac.uk

Printed by BCQ, Buckingham
Typesetting: Steve Billington, www.jarmanassociates.co.uk