Student Funding Panel

An analysis of the design, impact and options for reform of the student fees and loans system in England

CONTENTS

FOREWORD

Higher education transforms lives and provides the highly-skilled work force needed by employers to thrive and for the UK to compete globally. By 2022 it is projected that the UK economy will require around 2 million additional jobs in occupations requiring higher-level skills.

For higher education participation to expand to meet these needs the question of how it can be funded in an equitable, sustainable and affordable way comes very much to the fore. Public policy and debates about student funding over the last two decades have grappled with this challenge, particularly the appropriate balance between the public and private contribution to the costs of study and the extent to which this should reflect the balance of benefits to individuals, government and society as a whole.

The changes to student funding introduced in England in 2012 represent the most radical seen in the last two decades. A largely grant-based system was replaced by a substantially loan-based system, underwritten by the government, with a more targeted use of the remaining public grant for teaching. This was also combined with measures intended to protect participation of the most under-represented groups. The reforms also aimed to introduce more market-based elements into the provision of undergraduate education in England and encourage competition and investment in the student experience.

These reforms took place within the context of significant fiscal challenges facing the UK, resulting in severe fiscal austerity and significant cuts to direct public funding for higher education. The implementation of alternative means of funding for undergraduate teaching of UK and EU students allowed the government to largely mitigate what would have been the significant impact of these cuts on universities.

The changes have been controversial and have attracted significant public debate, particularly in relation to the impact on students and the longer-term costs and sustainability of the system. It is in this context that the Student Funding Panel was established to consider the impact and design of the student funding system. To inform their work the panel undertook comprehensive evidence gathering – from a wide range of individuals, including students, and organisations – and analysis of the impact and effectiveness of the reforms, examining the impact on students, institutions and the government.

Although the overall message from the panel's work is that these reforms are still embedding, some reassuring messages emerged from the evidence gathered. There was no indication that the student funding reforms have deterred young, full-time students from applying to university, and applications continue to rise. Importantly it is significant that applications from all socio-economic groups have continued to increase steadily following the changes. Institutions have also adapted and responded to the reforms, increasing investment in the student experience, with student satisfaction continuing to be reported as consistently high.

Despite this, there are a number of emerging challenges. As the report highlights, a key impact of the changes has been to replace the short-term certainty of grant-based funding with the long-term uncertainty of loan-based funding. It is this uncertainty in the longer term cost of higher education which in many ways has become a focus for recent debates about the funding system. The report shows it is unhelpful to focus only on the long terms costs to government through the Resource Accounting and Budgeting (RAB) charge, not least because of the complexities, assumptions and uncertainties built in to the calculation. This often overlooks broader policy goals including the impact that higher skilled individuals can have in boosting overall productivity and labour market growth in the future.

Nonetheless the panel recognises the importance of longer term sustainability and proposes a number of options for bringing down the long term costs of the system, and detailed analysis and assessment of proposed options for doing this are considered in the report.

Another important issue identified by the panel is the level of financial support for students' living costs. Evidence collected from students suggests that they are more concerned about the level of maintenance support they receive while studying than they are about the long-term debt arising from the increase in student loans.

The sharp decline in part-time and mature student entrants to higher education also remains a cause for concern and the report sets out certain measures that can help address this.

The panel's report also highlights a number of pressures and challenges to be faced by institutions themselves over the next five years, including whether the current funding system is able to address the real terms reduction in income from public grants for teaching. A sustainable funding system for institutions will be essential if they are to meet the challenge of continuing to invest in a world class teaching and student experience.

Getting future decisions on the design of the student funding system in England right is crucial. The system connects learners, universities, taxpayers, policy-makers, and wider societal and economic interests. In considering the design of the student funding system however, the panel noted the compromises and trade-offs that result from any changes and the importance of ensuring a balance, of sometimes competing, interests of students, graduates, taxpayers, government, and universities.

This report presents a wealth of evidence to support policy development and inform decision making.

EXECUTIVE SUMMARY

Introduction

- This report sets out the findings of the independent Student Funding Panel, established by Universities UK in 2014. The purpose of the panel was to analyse the impact of the reforms to funding for undergraduate students in England introduced in 2012–13, identify any major issues, and assess the options for reforming the system in the future. The impact was analysed for the three major stakeholder groups: students; government; and universities.
- Getting the design of the student funding system right is a critical component of public policy. The system connects important policy goals in relation to skills development, economic growth, social mobility, and individual opportunities. In the current period of fiscal austerity, it is more important than ever to ensure that public funding is being targeted as efficiently and effectively as possible, and that there is an appropriate balance of incentives for all parties in the system. It is also important to make sure that whatever system is put in place is financially sustainable, and has durability over the long term without the need for frequent change or upheaval.
- The changes to student funding policy in England, which were introduced in 2012–13, were the most radical for decades. A substantially grant-based system was replaced by a substantially loan-based system, with more targeted use of the remaining grant for teaching. At the same time, changes were introduced to the wider regulatory environment to encourage greater competition between institutions, and to place the interests of students more squarely at the centre of the system. These were in line with trends taking place in other areas of public policy in the UK, and continued a process of marketisation of higher education that had been in train for some time (albeit significantly accelerating it).
- The reforms attracted a great deal of debate and discussion. One of the effects of the changes, as the Institute of Fiscal Studies (IFS) has pointed out, has been to replace the short-term certainty of grant-based funding with the long-term uncertainty of loan-based funding, given the difference in public accounting approaches. This has in itself led to a lot of debate over whether the current system is financially sustainable. Other concerns that have been raised publicly include: whether the higher fee would deter students from applying for university (particularly those from low-income backgrounds); the potential impact of long-term debt on graduates; the impact on certain subject areas (especially, but not exclusively, the arts and humanities); and that the system may inhibit innovation in learning and teaching delivery.
- In analysing the impact and assessing the options for reform, it is important to bear in mind that there is no single right answer to the issues raised: all of the solutions involve compromises and trade-offs of some kind. The Student Funding Panel used a number of principles to guide its thinking throughout the course of its work, and these are as follows:
- The student funding system in England should:
  1. be capable of providing a world-class learning experience for all students
  2. be progressive, and should encourage participation in higher education of students from currently under-represented groups
  3. encourage entrance to higher education for all students who have the qualifications and ability to succeed
  4. recognise that higher education is both a public and a private good, and should be funded accordingly – striking a balance between individual and taxpayer contributions
  5. be flexible, and capable of adapting to changing fiscal, social, and economic circumstances in the future

6. be affordable for:
   - students
   - graduates
   - government
7. foster innovation and efficiency in university provision and operation
8. provide stable and sustainable funding for teaching and learning in universities

The funding context

- The student funding reforms were conceived and implemented during a period of severe fiscal austerity in the UK. Following the election in 2010, the coalition government prioritised reduction of the deficit in public funding (which at that point stood at £153 billion) over all other policy considerations, one consequence of which was significant reductions in the cash funding available to government departments each year. Funding for the NHS, schools, and overseas aid was protected from these cuts, meaning that a greater contribution towards deficit reduction fell on the spending departments outside these areas including the Department for Business Innovation and Skills (BIS). The BIS budget was cut by just under 30% between 2010 and 2015. Funding for science and research was ring-fenced within this budget, with the result that most of the burden of cuts fell on the teaching grant.
- The outlook for public spending for the period following the 2015 general election looks no less severe. IFS analysis of spending plans as laid out by the Conservative party prior to the 2015 general election, suggest that unprotected departments (which include BIS) would face further cuts in spending of 17.9%[1]. From 2019–20 onwards, however, public spending is forecast to grown in line with GDP growth. This means that there is a further period of fiscal constraint lasting at least 4-5 years to go through before spending can increase. This will therefore continue to affect the context for decision-making in relation to higher education funding (as with all other areas).
- Higher education had experienced a period of 'unsustainable growth' during the 1990s – resulting in the erosion of the unit of resource per student by around two-thirds between 1989 and 1998. This trend was arrested from 1999 onwards through the combination of increased capital grants, and the increase in variable tuition fees. However, the cuts to public funding following the spending review in 2010, including substantial cuts to capital funding for teaching, have resulted in a reduction in the unit of resource for the first time since 1998-99. While this has been partially offset by the increase in fees, evidence suggests that income for the sector per FTE is only now at the same level as in 2009–10.

The impact of the student funding reforms

The impact of the reforms on students

- There is no evidence to suggest that the student funding reforms have deterred students from applying to university. This is true across all socio-economic groups: and indeed, there has been a slight closing of the gap between the highest and the lowest participation groups in terms of university applications. Numbers of applications for entry in 2015 were at their highest ever level.
- However, there has been a sharp decline in part-time and mature student entrants to higher education. Numbers of mature student entrants have since recovered to some extent, but part-time student numbers have not. The decline in part-time students may be attributed to a number of factors, including wider economic circumstances, withdrawal of public funding for continuing professional development, and risk-aversion on the part of the working population during a recession. However, it is also likely that changes to the student fee and loan regime for part-time students has contributed to the fall-off in numbers. Although this report does not provide a detailed exploration of all of the factors involved in the recent decline in part-time undergraduate provision suggestions received by the panel - in response to its call for evidence- for changes to the student funding system that may help to mitigate this trend are provided in chapter 3.

1 IFS (2015) Post-election Austerity: Parties' Plans Compared

- As a result of the reforms, and of wider changes in the regulatory environment, students have become increasingly concerned about the value for money they receive from their undergraduate education. This is reflected in concerns about contact hours and teaching time, for example, and also in access to teaching and learning facilities, resources, and academic support.
- Current evidence suggests that students are more concerned about the level of maintenance support they receive while studying than they are about the long-term debt arising from the increase in student loans. Responses to a survey carried out by the Student Funding Panel showed that 58% of students were worried about living costs, while 42% were worried about fee levels. Graduates will undoubtedly be faced with higher overall debts under the current system than under the old (pre-2012-13) system. However the repayment terms in the post-reform system mean that it is more progressive overall than the previous one, with lower earners likely to pay back less overall under the current system than they would have done under the old one.

The impact of the reforms on government

- The reforms to the student funding system introduced in 2012–13 significantly altered the impact of expenditure on higher education on the public accounts. However, estimating the long-run impact of the reforms on government finances is uncertain, given the way the system has been designed, and the need to make assumptions about a number of key parameters (such as the government cost of borrowing, future labour market conditions, and graduate repayment behaviour).
- There has been a particular focus since 2010 on estimates of the Resource Account Budget (or RAB) charge, which is an estimate of the net present value of the future subsidy required for the loan system. The subsidy comprises two elements: subsidy of the interest rate; and an estimate of the amount of loan outlay that won't be repaid. The RAB charge was initially estimated to be around 30% when the new system was introduced. This estimate has gradually increased since then, and is now put at somewhere around 45%. This suggests that the new system may cost the government more in future in terms of public subsidy than it had originally estimated.
- However, it is unhelpful to focus only on the RAB charge as a measure of the cost of the system. It is a complex calculation which is by its nature very uncertain and is sensitive to changes in very long-term assumptions including graduate earnings and government costs of borrowing up to thirty years in the future. Of greater importance are the factors in the economy which drive the calculation of the RAB charge. For example, what needs to be monitored more closely is the assumption that more, better-skilled graduates in the economy will boost overall productivity and labour market growth in the future, and that there will continue to be strong demand for graduates in the economy. These are among the policy aims that the reformed system is trying to achieve, and if it is successful it will lead to a higher, not lower, flow of student loan repayments.
- As part of the package of reforms, the government now also needs to target the remaining grant funding for teaching more efficiently than previously, due to the cuts to this area of spending. There is a need to prioritise spending more rigorously, to direct public funding to areas of market failure, and provide clearer evidence on the return on investment of specific streams of funding. The historic link between funding and regulation has now also been broken, leaving a gap that needs to be filled by a refreshed regulatory architecture as soon as possible.

The impact of the reforms on universities

- The university sector in England has had to cope with a significant shift in its income streams as a result of the reforms of 2012–13. Reliance on grant funding for teaching has been replaced by reliance on loan funding instead. In addition, there are more demands made on this stream of funding, including increased expenditure on widening access and financial aid, the need to invest in learning and teaching infrastructure in response to increased expectations and demands from students, and investing in staff in order to maintain high-quality provision. In particular, universities have had to compensate for significant cuts in capital funding by generating surpluses for investment from their operating income, including income from fees.

- The sector has demonstrated that it has been able to adapt positively to the current student funding system. However, the sector faces a number of challenges over the next five years including whether the current funding system is able to address the real terms reduction in income from grants for teaching and tuition fees. The Higher Education Funding Council England (HEFCE) has noted that forecasts for lower surpluses, shrinking liquidity and increased borrowings suggest that universities in England are now consuming their cash reserves to sustain themselves, signalling a trajectory that is not sustainable in the long term.
- The reforms have also had a non-financial impact on universities. They have allowed for increased investment in widening participation and financial aid and have facilitated greater focus on teaching quality and employability outcomes. Although increased innovation in teaching and learning delivery is occurring, it is currently not clear what role the reforms have had in fostering activity in this area.

The impact of the reforms on the devolved administrations

- Increasing differentiation in fee arrangements following the reforms in England, have had an impact on the flow of students and funding across the devolved administrations and from other parts of the European Union. Evidence suggests that where fees have increased (e.g. for Scottish and Northern Irish students studying in England) students are less likely to apply to study in England. In comparison students from Wales, who receive government support to make up the increase in fees, are more likely to apply to institutions in England following the reforms.
- Changes in the funding regime in England have had an impact on the funding for higher education institutions and government expenditure in other part of the United Kingdom. In Scotland the increased income available from higher fees paid by students from England has led to income from this source playing a more integral role in the Scottish higher education funding system. In Wales, where the Welsh government provides a fee subsidy for Welsh students studying in England, an increasing amount of government funding for higher education is being spent on institutions in England following the reforms. Any further changes in student funding policy in England are therefore likely to impact on higher education funding in the devolved administrations.

Options for reforming the student funding system

- The Student Funding Panel looked at a number of options for reforming the student funding system[2]. Each option had the aim of reducing the long-run cost to government of the loan system, with one in particular (the Labour Party proposal) seeking also to reduce significantly the future debt burden for graduates. However, it should be noted that reducing the long term cost to government through reductions to the RAB charge does not by itself release cash in the present to allow for increased spending on higher education. Any increase in the annual cash budget for higher education following a reduction in long term costs, would still need to be agreed by the Treasury through the spending review process. Recent changes in the treatment of student loans in departmental budgets however, mean that increases in the RAB charge above planned levels does now impact on other areas of departmental spending. It is therefore important to consider options for reducing the RAB charge to planned levels to avoid cuts to other areas of departmental spending.
- The five options the Panel reviewed were:
  1. Modifying the parameters in the current system
  2. Freezing all the thresholds at their current level
  3. Making repayments on total income once above the earnings threshold
  4. A 'pseudo' graduate tax
  5. The Labour Party proposal
- In the view of the Student Funding Panel, it is too early to assess the full impact and effectiveness of the changes to the student funding system introduced in 2012–13, and there is therefore no need for a major change in policy direction or design at the current time. The system needs time to 'bed down' and work properly, and then can be fully assessed in more detail.

2 The data modelling and analysis of these options was carried out by the Institute for Fiscal Studies, for which the Student Funding Panel would like to acknowledge its support and record its thanks.

- However, if concern about the long-run costs to government of the loan subsidy increases in the short term, then some modifications to the system could be made. Of the options analysed, the preferred of the panel is the threshold freeze model where the lower and upper income thresholds for repayment are frozen in nominal terms for a period, meaning their real value declines with inflation. The scenario modelled in this report sees both thresholds frozen for a period of seven years (from 2016 to 2023)[3] by which point the lower threshold meets the real value of the threshold under the previous (pre-2012) system. All other parameters remain the same. The advantages of this option are:
  - It reduces the estimated RAB charge from around 43% to around 30%.
  - It increases the future value of repayments.
  - It reduces the future borrowing requirement for Government to support the system.
  - It adapts the current system to the prevailing labour market conditions.
  - It retains the strongly progressive features of the current system.
  - It is straightforward to communicate to students, graduates, and other stakeholders, in that it does not require a significant change in policy direction or design.
- In addition, recommendations are also made to improve funding for maintenance support. Suggested options for improvements in funding for maintenance support and for part-time students, submitted to the panels call for evidence, include; linking changing levels of support to increases in accommodations costs; ensuring equity in maintenance support between full-time and part-time students; potentially restoring some funding for students studying equivalent or lower qualifications (ELQ) on a targeted basis; lowering the study intensity for loan eligibility; and providing more incentives to encourage employer funding.

Finally, the panel looked at a number of longer-term options for reforming the student funding system. These included: tying university funding more closely to the earnings of their graduates; and privatising the provision of loan funding. While there may be future opportunities to revisit some of the assumptions underpinning the current system, none of the longer-term options analysed was thought to be sufficiently well-developed to be capable of being implemented at present (if at all).

3 This time period is used for illustrative modeling purposes, and could of course be changed. See the main body of the report for details.

Conclusions and recommendations

The panel recognises that getting the design of the student funding system in England right is crucial. The system connects learners, universities, taxpayers, policy-makers, and wider societal and economic interests. Designed effectively and efficiently, it can support critical policy goals in relation to skills growth and social mobility (among others).

In looking at the design of the current student funding system and options for reform the panel felt that it was also important to balance a number of sometimes competing interests – those of students, graduates, taxpayers, government, and universities. More often than not these are aligned, but there are often compromises that need to be made, especially during the current period of fiscal austerity, which is likely to last at least for the period of the current parliament.

While there are undoubtedly difficult challenges ahead, the first three years of operation of the system could be said to have been broadly successful, with institutions adjusting to the changed financial environment, demand for student places remaining strong, real progress being made in widening participation to university and the reforms enabling government to pursue a policy of expanding entry to university.

Against this background, and in light of the detailed and comprehensive analysis carried out in the course of its work, the main findings of the Student Funding Panel are as follows:

- The current system of student funding in England is broadly fit for purpose, does not require wholesale reform, and needs to be given time to work.
- Prospective and current student understanding of the system needs to be improved, and the description and communication of the system need to be clarified and simplified.
- Some of the parameters in the student loan repayment system may need to be modified over the medium term. The panel recognised that all options for changing repayment parameters involve trade-offs and compromises. However, the panel believed that freezing the repayment threshold in the current system for a specified period of time was most likely to achieve the optimal balance of outcomes for students, graduates, government and universities.
- Funding for maintenance support needs to be improved: in terms both of quantity and targeting.
- Loan recovery mechanisms need to be improved and options for improving student loan collection should be analysed and implemented as a priority.

INTRODUCTION

The period since 2010 has witnessed some of the most wide-ranging changes to the student funding system in England for decades. During this time, the system has shifted from being substantially grant-based to substantially loan-based. At the same time, significant changes have been made to regulation and the public accounting of funding for teaching undergraduate students in England. Taken together, these policies fundamentally altered the relationships between the main actors in the system: students, graduates, taxpayers, and universities.

Public and political interest in student funding has never been higher. The policy changes have attracted a great deal of comment, analysis, and opinion. Five years on, this report is an attempt to draw together some of this analysis, set out as clearly as possible what has worked and what has not, and assess some of the most recent options which have been put forward for reforming the system in the future.

Getting the design of the student funding system right is crucial for a number of reasons. Firstly, it ensures that students can continue to benefit from a world-class teaching and learning experience. Secondly, it ensures that the public funding that is devoted to this area is being used efficiently and effectively. Thirdly, it can promote opportunities for increased participation in higher education, benefitting individuals and the economy as a whole. Fourthly, it can achieve a fair balance of funding contributions from all the respective beneficiaries of higher education. Last of all, it can ensure that universities continue to receive the funding they need to sustain investment and preserve their world-class provision.

The student funding reforms took place against a backdrop of substantial political and economic change. The incoming coalition government in 2010 prioritised reduction of the UK's public funding deficit over all other policy considerations. The deficit at that point stood at £153 billion, having been exposed as a result of the financial crisis of 2008. In an attempt to address this the coalition put in place a number of measures, including significant cuts to public funding across all major spending departments (except health, schools and overseas aid, which were ring-fenced and protected). At the time, the government's overarching policy was to eliminate the structural current deficit by 2014–15 and to meet 80% of its deficit-reduction target through public spending cuts, and 20% through increases in taxation. In reality, due to a deterioration in economic growth and tax revenues between 2010 and 2012, the ratio was more like 89% spending cuts and 11% tax rises, with borrowing estimated to have been £100 billion higher than initially forecast, resulting in an extension of fiscal consolidation measures into the next parliament.

Against this background a number of decisions affecting public funding for higher education in England were taken in short order over the summer of 2010. The first of these was to protect public funding for science and research, which was ring-fenced in cash terms. The second was the process by which reforms to student funding were introduced at the same time as cuts of just under 30% were made to funding for the Department of Business, Industry, and Skills (BIS), which hosts the higher education budget. This cut related to the cash available to spend each year (the Departmental Expenditure Limit, or DEL). Additional cuts were made to capital funding. The implementation of alternative means of funding for undergraduate teaching of UK and EU students allowed the government to largely mitigate what would have been the significant impact of these cuts on universities.

In the months leading up to the general election of 2010, a cross-party review of student funding in England was set up by the then-Secretary of State, Lord Mandelson. The review was chaired by Lord Browne, and reported its findings in October 2010[4]. The government drew heavily on this report in making its policy recommendations on student funding later in 2010, but did not accept its findings wholesale.

Instead, the coalition's reforms of student funding (proposed in the second half of 2010 for implementation at the start of academic year 2012–13) comprised the following elements for full-time students:

- Grant funding for teaching provided through the Higher Education Funding Council for England (HEFCE) would be cut by £3 billion (a 64% decrease) over four years.
- The remaining grant funding would be targeted at high-cost subjects (in HEFCE funding bands A, B, and C), and at funding to support widening participation (the Student Opportunity Fund).
- The upper limit on tuition fees that could be charged by universities was raised to £9,000 per student, per course, across all institutions and all courses.
- Institutions wishing to charge up to £9,000 were required to complete an access agreement, setting out the measures they would take to widen access, and have this approved by the Office for Fair Access (OFFA).
- Institutions that did not want to complete an access agreement, did not want to charge the higher fee, or had their access agreement rejected by OFFA, would be able to charge a maximum fee of £6,000 per student, per course[5].
- The funding to support undergraduate education would continue to be provided directly to universities by the government, up to the full value of the fee charged each year. However, instead of being paid in the form of a grant, the funding would be repaid by graduates in the form of an income-contingent loan on the following terms:
  - Repayments would begin once graduates had reached an earnings threshold of £21,000 per year.
  - At that point, repayments would be made at the rate of 9% of income above £21,000.
  - A real rate of interest would be applied to loans for graduates earning above £21,000, at a tapered rate up to a maximum of RPI plus 3%. Graduates earning above £41,000 would be charged the maximum real rate of interest rate of RPI plus 3%.
  - If the loan is not been paid off after 30 years, the government will write it off.

The following elements were introduced for part-time students:

- A cap on tuition fees at £6,750 per student.
- Tuition fee loans worth up to £6,750 a year were made available to students enrolling at a publicly-funded institution. In order to be eligible, the student had to be:
  - following a course with a specified qualification aim
  - aiming for a qualification that is not at an equivalent or lower level than one already held
  - studying at a minimum 25% intensity of an equivalent full-time student
- Loan repayment terms the same as those for full-time students.

An overarching aim of the reforms was to introduce more market-based elements into the provision of undergraduate education in England designed to encourage competition, improve services, and drive down costs. To support this the government also introduced a number of policy interventions to alter the regulatory environment intending to protect the collective interests of students, improve information provision, and deregulate the system to encourage new providers to enter.

One of the effects of these changes to the system – as the Institute for Fiscal Studies has observed – has been to trade a reduction in the immediate cash requirement to fund higher education for increased uncertainty over the long-run costs of the system. The short-term certain cost of grant funding has been replaced substantially by income-contingent loan funding, the cost of which to government is more difficult to predict. Although the overall cost to government is less clear however, it is not necessarily the case that this makes the funding system inherently unstable.

4 Browne (2010) Securing a sustainable future for higher education: An independent review of higher Education funding & student finance.
5 In practice, none of the access agreements put forward were rejected.

Overall – and within their own terms – we could say that the reforms to the student funding system have been successful. They contributed to the targeted reduction in the BIS DEL, while maintaining essential income to the higher education sector. Following a fall-off in 2012–13 (due, largely, to a substantial decrease in deferrals), demand for student places has remained very high and numbers of entrants to higher education from under-represented groups has increased.

Nonetheless, a number of groups and commentators have expressed concerns over the impact of the reforms. Many of these worries have centred on the size of the Resource Accounting and Budgeting charge (or RAB charge), which is a measure used to estimate the long-run cost to government of the student loan write-off and interest rate subsidy. The government's original estimate of this figure was 32%, but since then the figure has gradually been revised upwards and for 2014–15 was estimated to be around 45%[6]. Other non-government organisations have also provided current estimates of the long-run cost of student loans to government, one of the most reliable of which is from the IFS which states that loan subsidies are currently around 43%[7]. Although these estimates differ-primarily due to differences in the data used in each model, assumptions made regarding loan take-up, and the way in which earnings and employment interactions are modelled[8]-the IFS approach allows for changes to the student loan system to be modelled and assessed and is therefore used in the assessment of options for reform in this report. While the RAB figure is undoubtedly useful, it does not necessarily warrant the attention that has been paid to it in policy debates, not least because of the complexities and assumptions built in to the calculation of the charge. Other aspects of the reforms are arguably at least as important.

Another more significant concern is over the impact of the system changes on demand from part-time and mature students, which has reduced significantly. The number of part-time entrants fell by 46% between 2010–11 and 2013–14. There are a number of potential factors driving this, including external labour market conditions and reductions in public funding for continuing professional development more widely. However, it is likely that changes to the student funding system have played a part in this development, as universities increased fee levels in response to the removal of teaching grants for part-time students and in anticipation of increased uptake of a more generous loan package by students that did not materialise.

Some of the other concerns with the impact of the reforms that have been expressed publicly by commentators and interest groups include the following:

- **The long-run level of debt incurred by graduates will inhibit their future economic choices**, including the likelihood that graduates will undertake postgraduate study and putting increasing financial pressure on what will already be a hard-pressed generation.
- **The system does not encourage diversity in teaching and learning** through incentivising the provision of full-time, three or four year degrees over other forms of education.
- **The system has not acted as a driver for innovation in the delivery of teaching and learning.** Although an under-evaluated issue, the evidence presented to the Student Funding Panel suggests that changes to the funding system have done little to incentivise further developments in this area. Nevertheless, it was recognised that there has been an increase in online content for courses (including MOOCs), greater use of blended learning and significant investments in teaching facilities since 2011, but it was unclear if this was due to the reforms or other drivers of change (for example, technological) . It was the view of the panel that more needed to be done to understand the role the current funding system could play in driving innovation in teaching and learning.
- **There is too much focus on the economic utility of a degree** and not enough attention paid to the value of higher education for its own sake or as a public good. This is evidenced, for example, in the increased focus on employability outcomes as a marker of value for money for degree study.
- **The reforms under-value the contribution of arts and humanities subjects** by concentrating the remaining teaching grant subsidy on Science, Technology, Engineering and Mathematics (STEM) and other high-cost subjects (including some creative arts and design courses). However, it is also the case that per-student income for band D subjects (principally classroom-based subjects) has increased as a result of the reforms, not fallen. Between 2010–11 and 2012–13 teaching funding rates (including funding from teaching grants, tuition fees and capital grants) for these subjects are estimated to have increased by 36% in real terms.

6 Office for Budget Responsibility (2014) Fiscal sustainability report
7 IFS (2014) Estimating the public cost of student loans
8 A detailed explanation of the difference between government and IFS estimates of the long run cost of student loans is available in annex A.2 of the 2014 IFS report 'Estimating the public cost of student loans'.

It was against this background of complexity and uncertainty that the Student Funding Panel was established. Comprising seven vice-chancellors and four independent external experts, its overall aim was to analyse the impact of the reforms and assess potential options for future reform. Details of the membership and terms of reference of the Panel are included in the annexes.

This report is the result of that work and is structured broadly as follows: firstly, the funding context in which the changes occurred and any future reforms would take place is considered; secondly, the impact of the reforms on the key stakeholder groups is assessed (these being students, government, and universities); finally, a number of options for future reform of the student funding system are analysed, and their impact and merits assessed. While the panel is putting no single recommendation for reform forward, the findings contained in the report represent a balanced and comprehensive assessment of the most common proposals currently under discussion.

The depth and breadth of the analysis contained in this report is intended to reflect the importance to public policy of getting the design of the student funding system right. As this report makes clear, there is no single right answer when it comes to future reform, only a difficult set of trade-offs that need to be made against a background of continuing fiscal austerity for the foreseeable future.

Principles

The Student Funding Panel agreed a number of principles to guide its thinking in the assessment and design of options for the system in the future. These are as set out below.

The student funding system in England should:

- be capable of providing a world-class learning experience for all students
- be progressive, and encourage participation in higher education of students from currently under-represented groups
- encourage entrance to higher education for all students who have the qualifications and ability to succeed
- recognise that higher education is both a public and private good, and should be funded accordingly – striking a balance between individual and taxpayer contributions
- be flexible and capable of adapting to changing fiscal, social, and economic circumstances in the future
- be affordable for:
  - students
  - graduates
  - government
- foster innovation and efficiency in university provision and operation
- provide stable and sustainable funding for teaching and learning in universities

CHAPTER 1: THE FUNDING CONTEXT

In assessing the impact of recent reforms to student funding on government, students and universities, and options for reforming the loan repayment system, it is useful to consider the funding context in which these changes occurred, and in which any future reforms would take place. This opening section describes the outlook for public finances in the medium-term and provides a summary of the historical funding position of the UK higher education sector prior to the implementation of the 2012 reforms.

Outlook for public finances

In 2008, the UK economy entered a period of recession, reporting six consecutive quarters of negative growth ending in the last quarter of 2009. Government spending, however, continued to significantly exceed revenue. As a result, fiscal policy was adopted to reduce expenditure and therefore the extent of borrowing needed to address the greater gap between income and expenditure.

Following the 2010 election, the newly formed coalition government announced its aim to balance the cyclically-adjusted current budget by 2015–16[9]. Initial plans laid out by the government at the time signalled that this was to be achieved through a period of fiscal tightening, that would see the main measure of fiscal deficit/surplus, public sector net borrowing, decrease from 11% of national income in 2010 to +1.9% in 2015–16[10].

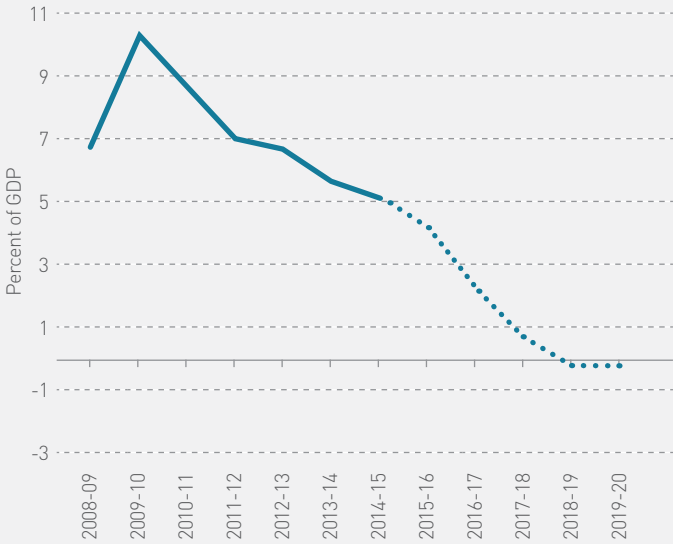
In response to weaker than expected growth in the UK economy, the coalition government extended the period of fiscal tightening firstly to 2017–18 and then to 2019–20. The 2015 general election saw the outgoing coalition replaced with a majority Conservative government. At the time of writing, detailed fiscal plans for the period of the current parliament were not available with the chancellor expected to announce further details at the July 2015 Budget. To provide context on the outlook for public finances this report therefore uses IFS analysis of public spending and taxation plans in the Conservative party manifesto which gives an indication of fiscal plans under the Conservative government up to 2019–20[11].

The Conservatives have outlined their aim to achieve an overall budget surplus and to ensure that debt keeps falling as a proportion of GDP, over the current parliament. In addition they have also stated that they will introduce a new principle of fiscal policy, to be monitored by the OBR, which ensures the government will always run a surplus when the economy is growing[12].

The Conservative party manifesto did not provide explicit figures for the level of borrowing in each year of the current parliament, but figure 1.1 provides an implied trend based on IFS analysis of information in the manifesto for this period. This shows public sector net borrowing falling each year from 4% of GDP in 2015–16, reaching a surplus of 0.2% of GDP in 2018–19 and 2019–20.

9 HMT (2010) Spending review 2010
10 IFS (2015) Green budget: Public Finances under the coalition
11 IFS (2015) Post-election Austerity: Parties' Plans Compared
12 Conservative party manifesto for 2015 general election (https://s3-eu-west-1.amazonaws.com/manifesto2015/ConservativeManifesto2015.pdf)

Figure 1.1: Implied trend for public sector net borrowing according to plans in the Conservative Party manifesto

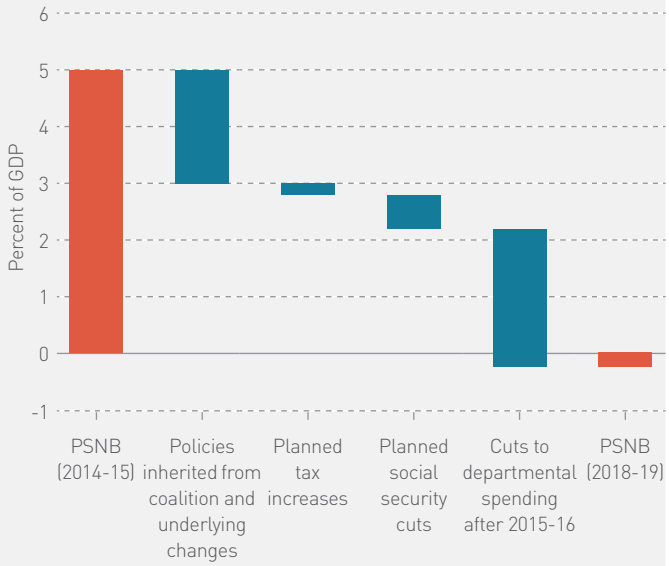


Borrowing profile to date
Implied trend under Conservative Party plans

Sources: Borrowing to date from OBR Economic and fiscal outlook - March 2015

Conservative plans from IFS analysis (http://www.ifs.org.uk/uploads/publications/bns/BN170.pdf, table A.1)

Figure 1.2: Implied composition of deficit reduction according to plans in the Conservative Party manifesto



Source: IFS (http://www.ifs.org.uk/uploads/publications/bns/BN170.pdf) table 7.1

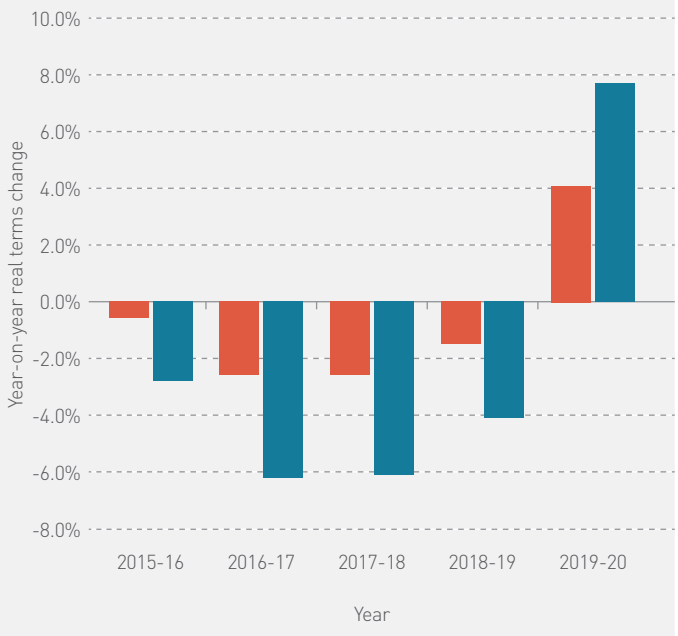
Over the same period, public sector net debt (PSND) is estimated to peak at 80.2% of GDP in 2014–15 around double the pre-recession level, before falling each year to 71.7% of GDP in 2019–20. This means that it will peak one year earlier than forecast and that the peak will be 0.7 percentage points lower than was predicted in the 2014 Autumn Statement.

Around two thirds of the deficit reduction that occurred between 2009–10 and 2014–15 came from cuts in day-to-day spending on public services and administration, with cuts to-date concentrated in unprotected departments outside health, schools and overseas aid, including BIS[13]. Figure 1.2 shows the sources of deficit reduction that it is estimated are to contribute to the forecast movement to surplus in 2018–19 according to plans in the Conservative party manifesto. Around 30% of this change will come from public spending cuts inherited from coalition plans for 2015–16 and 50% from cuts to departmental spending after 2015–16.

IFS analysis of the impact this approach may have on year-on-year changes in departmental spending over the period is shown in figure 1.3. Although the average year-on-year real term change in departmental spending is estimated to be –0.6% between 2016–17 and 2019–20, this includes a sharp acceleration in the pace of real year-on-year cuts of 2.6% in 2016–17 and 2.6% in 2017–18 followed by a 1.5% cut in 2018–19 and a projected increase of 4.1% in 2019–20. The IFS have noted that these plans suggest a £27.5 billion cut to departmental spending from 2015–16 to 2018–19. From 2019–20, after a surplus has been achieved, the Conservatives plan to increase spending in line with growth in GDP.

13 OBR (2015) Economic and Fiscal outlook

Figure 1.3: Implied year-on-year real terms change in departmental expenditure according to plans in Conservative Party manifesto (2015–16 prices)



Departmental expenditure
Spending on unprotected departments

Source: IFS (http://www.ifs.org.uk/uploads/publications/bns/BN170.pdf) tables A6 and A7

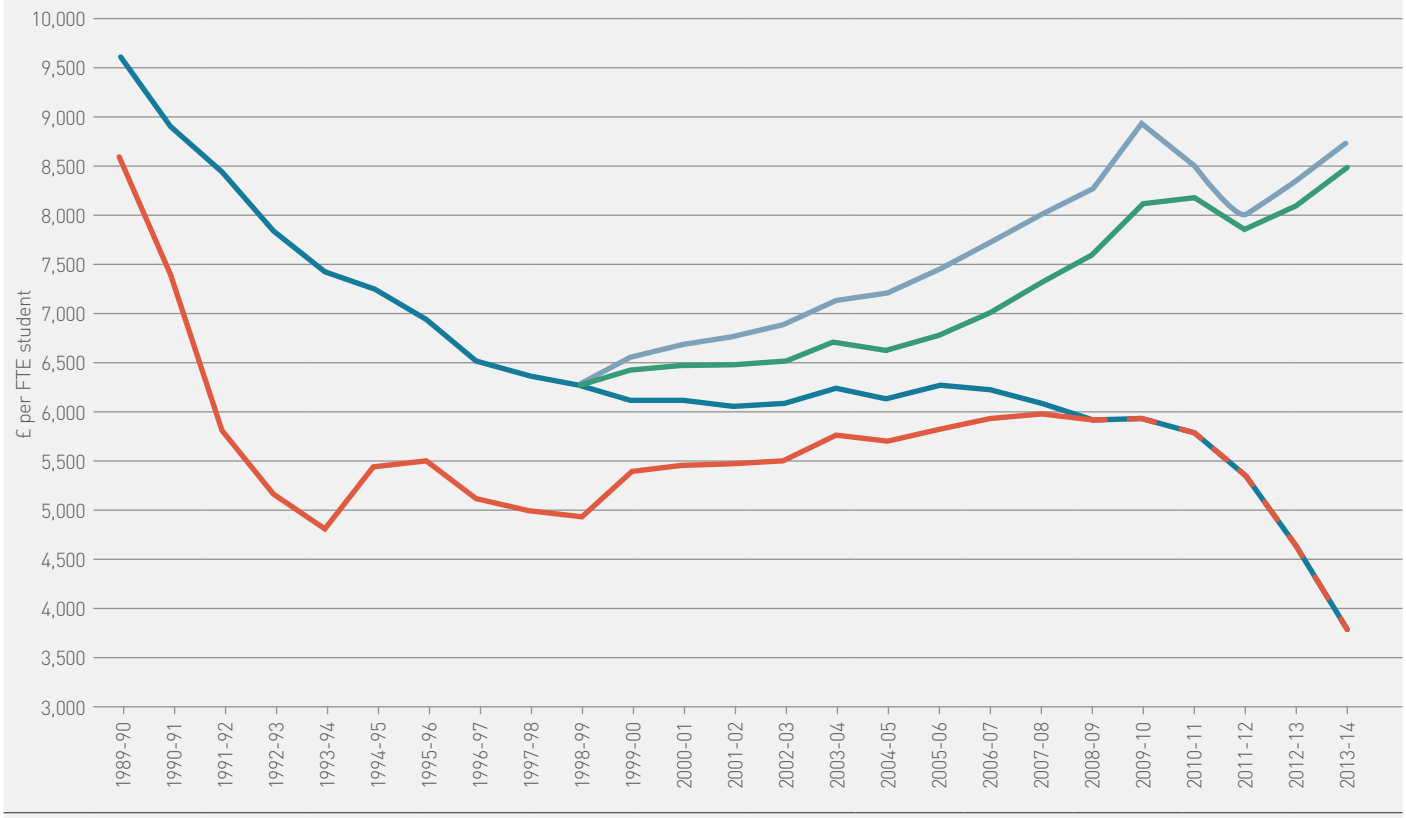
These figures reflect forecast changes in spending across all government departments. However, the Conservatives have pledged to protect funding for the NHS, schools, and overseas aid and have also announced £350 million of additional funding for childcare. This means that a greater contribution towards deficit reduction will fall on spending in departments outside these areas, including higher education, which falls under the Department for Business Innovation and Skills. For these departments, it is estimated that the average year on year real terms change will be -5.5% between 2016–17 and 2018-19. This includes a sharp reduction in spending of 6.2% in 2016–17, 6.1% in 2017–18 followed by a 4.1 cut in 2018-19 and an estimated increase of 7.7% in 2019-20.

Historical funding position for the higher education sector

In addition to the outlook for public finances, it is also useful to place recent changes to higher education funding in the context of the historical funding position of the sector in England.

A useful measure is the 'publically planned unit of funding', representing funding from teaching and research grants, fees (the private regulated fee includes institutional contributions to OFFA access agreements) and capital grants per 'publically planned student FTE'. Figure 1.4 shows how this measure has evolved since 1989–90. Although the trends shown should be interpreted with caution, given the number of assumptions made (see notes to chart), it does allow recent changes to higher education funding in England to be placed in the context of the historical position.

Figure 1.4: Real terms trend in government publicly planned unit of funding (2012-13 prices)[14]



Source: HEFCE[15]

Between 1989–90 and 1997–98, higher education institutions experienced a period of 'unsustainable growth' when the unit of resource declined by just over 30% in real terms. The real value of grant plus fee income reduced from just over £9,500 in 1989–90 to just over £6,250 in 1997–98 (in 2012–13 prices).

This trend reversed from 1999–2000 onwards with the introduction in England of private regulated fees and new capital grants for universities. Over the next 10 years, additional funding provided through the Learning and Teaching Capital Fund in 2004–05, and the increase in variable tuition fees (up to a cap of £3,000) in 2006–07 lead to an increase in the unit of funding of around 40% in real terms between 1998–99 and 2010–11.

The increase in capital grants over this period allowed universities to address a backlog of remedial investment in teaching and learning estimated to be £4.6 billion in 2002 (£5.9 billion in 2012–13 prices), increase investment in estates to accommodate increased student numbers, and improve the suitability of estates.[16]

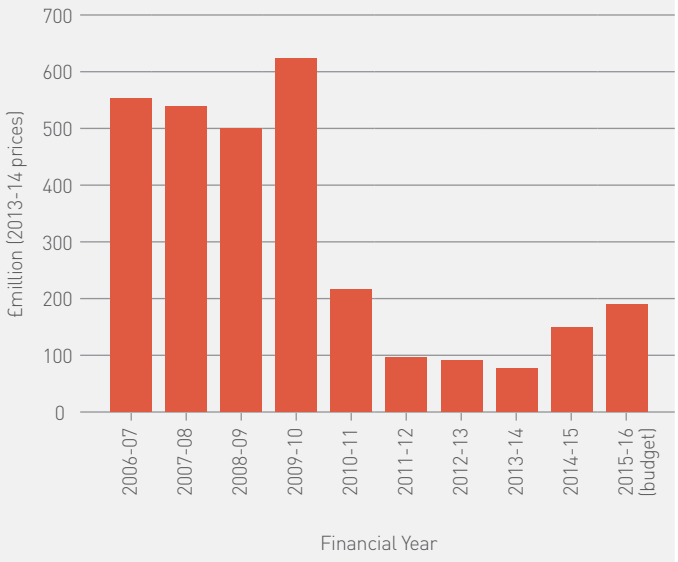
The financial crisis and subsequent reductions in public funding following the 2010 spending review, including significant reductions to capital grants for teaching and learning (figure 1.5), resulted in a reduction in the unit of funding for the first time since 1998–99. Although the recent increase in income from tuition fees has partially offset some of this reduction, the level of income from all sources per FTE has only increased to levels last seen in 2009–10.

14 Grants cover HEFCE recurrent grant (including teaching, research, and innovation), HEFCE capital grant (up to 1996–97 and then shown separately) and TDA grant. 'Public fee' refers to full-time undergraduate fees that are paid directly by government body (usually LEA). This component is phased out over three years after 2006–07. Private regulated fee is the component of fee for which a publicly funded loan is available. From 2012–13, new regime fees, estimated as £8,000 multiplied by 'FT UG planned student numbers' and is phased in over three years. Student numbers are based on HEFCE/ TDA planned FTEs, not actual student FTEs. GDP deflators are based those published by the ONS on 20 December 2013.

15 FSSG (2015) The sustainability of learning and teaching in higher education in England https://www.hefce.ac.uk/media/HEFCE,2014/Content/Funding,and,finance/Financial,sustainability/Pubs/sustain_LT_HE_England_web.pdf

16 HEFCE (2002) Teaching and learning infrastructure in higher education

Figure 1.5: Real terms trend in teaching capital grant, 2006–07 to 2015–16 (2013–14 prices)



Source: HEFCE

In addition to the specific funding changes identified above, over the same period, universities have had to respond to a number of broader changes. These include: greater participation in higher education, which increased from 15% of the population in 1989 to 23% in 1992 and 40% in 2006[17]; provision of support for a far more diverse student population; greater domestic and international competition for students; and increased prevalence of more flexible forms of provision, study modes and learning technologies. The impact of the 2012 reforms on universities is considered in more detail in chapter 3.

17 Wyness (2010) Policy changes in UK higher education funding, 1963–2009

CHAPTER 2: THE IMPACT OF THE STUDENT FUNDING REFORMS

THE IMPACT OF THE REFORMS ON STUDENTS

Overview

This section focuses on the impact of the 2012 reforms specifically on students. In assessing the impact, there will first of all be an evaluation of recent trends in demand for undergraduate study, looking at application numbers as well as data on enrolments. It will then consider the views of current UK and EU undergraduate students themselves on various aspects of their university experience, using evidence gathered for the panel via a series of focus groups and an online survey. Finally, there will be an analysis of how the reforms have affected the size of students' loans, and how much graduates under the new student finance system are expected to repay compared to those under the previous system.

Data published by UCAS suggests that the funding reforms of 2012 have not deterred young full-time students from applying to university, as applications from all socio-economic groups have been increasing steadily. However, numbers of part-time and mature students have declined in recent years. This is due to a number of factors, of which the changes to the student funding system is likely to be one.

A survey and series of focus groups carried out for the panel showed that, despite high levels of satisfaction with their university experience, there is a clear concern among current undergraduate students about whether their financial investment represents 'value for money'. This concern appears to be closely related to subject type and contact hours received as part of their course: the more satisfied a student is with their quantity of teaching time received, the more positive their perception of value for money. Students were also preoccupied with employability, and saw this as a significant factor in evaluating their investment. However, the impact of this will not be known for some time.

The same evidence suggests that current students are more worried about the level of maintenance costs than about long-term debt from student loans, and would like options for increasing funding to meet living costs to be explored. However, this finding needs to be treated with some caution, given the tendency for individuals to give greater weight to losses (and gains) in the present than the future. It is unclear whether current students would be more concerned with loan repayments if they were asked the same question in 10 years' time, and what impact increased levels of overall debt may have on graduate behaviour in the future.

Finally, analysis by the IFS suggests that while a student under the current system will, on average, take out a larger loan than they would have done under the previous system, in terms of loan repayments, the bottom 20% of earners are predicted to pay less back now than would have been the case, had they entered university before the reforms were introduced. This is mainly due to an increase in the repayment threshold.[18]

Impact on university applications and enrolments

Changes in recruitment patterns do not in themselves reveal the factors that have influenced student decision making about university and whether these have changed. Nonetheless, recent application and recruitment trends provide important evidence of the broader impact of the 2012–13 reforms on participation in higher education.

Young, full-time students

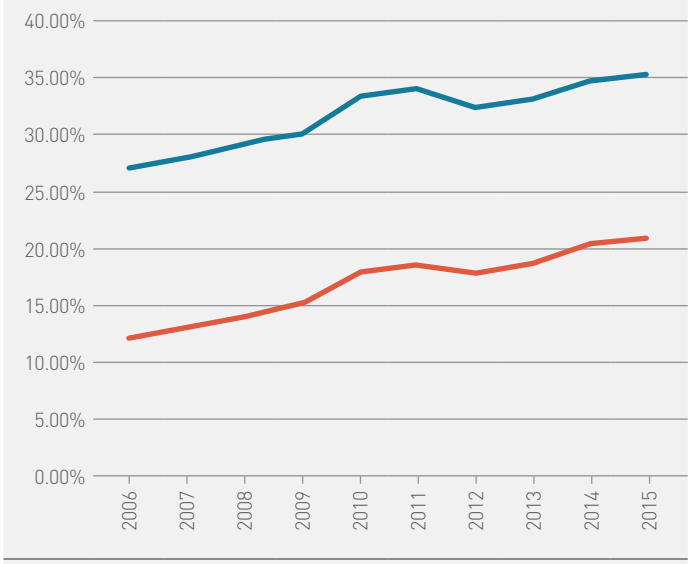
There is no clear evidence to suggest that the funding reforms of 2012 have deterred young, full-time students from applying to university. The percentage of the 18-year-old population in England applying for a place at university by UCAS' annual January deadline was higher in 2015 than it has ever been.

18 Institute for Fiscal Studies (2014) Payback Time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?

A survey commissioned by the Sutton Trust asked 14–18 year-olds whether the increase in university tuition fees in 2012 had influenced their decision to apply to a university in the UK. The responses were: 22% to a great extent; 37% to some extent; 29% it has not influenced my decision at all; 11% were not sure; 1% did not know about the increase.[19] This survey result suggests the introduction of fees did have an impact on many applicants' considerations: however, these results should be viewed alongside applications and recruitment data.

As shown in Figure 2.1, the application rate (number of applicants divided by the estimated base population) among 18-year-olds did decline in 2012, to 32.5%. However, this rate has since increased and, as of the January 2015 UCAS deadline, 35.4% of 18-year-olds applied for a place at university for the coming academic year. Within this, the percentage of 18-year-olds from the most disadvantaged backgrounds (POLAR quintile 1) has followed a similar trend.

Figure 2.1: Application rate for 18 year olds in England by January UCAS deadline

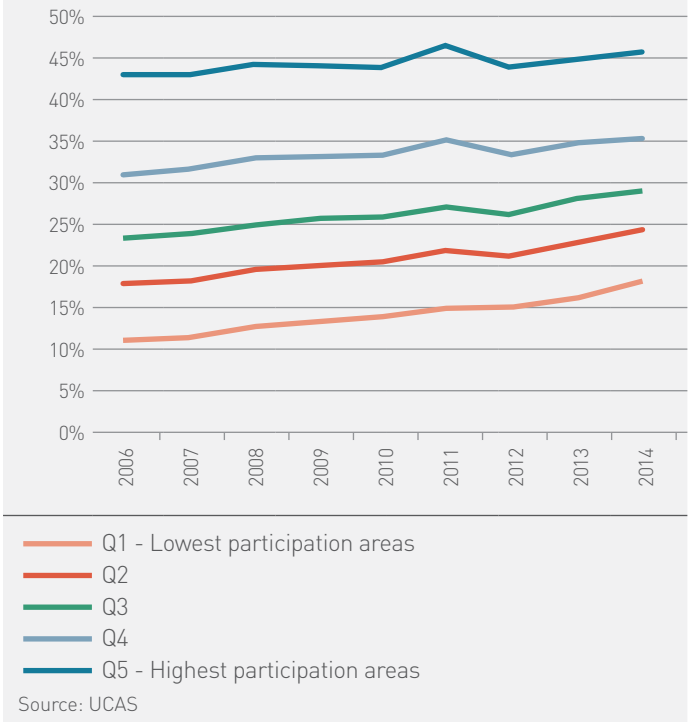


Source: UCAS

While the application rate among students from the most advantaged areas remains higher than that for the most disadvantaged areas (50.6% and 20.4% respectively, as of January 2015), there has been a steady increase in applications across all socio-economic groups since 2012. This suggests that demand for a university education among young, full-time prospective students has not been affected by the funding reforms thus far.

As shown in Figure 2.2, the entry rate (number of acceptances for entry to HE divided by estimated base population) for 18-year-olds in quintile 1 has increased in each year shown, and did not decline even ahead of 2012–13 with the gap between entry rates for advantaged and disadvantaged students continuing to narrow after the reforms.

Figure 2.2: Entry rates for 18-year-olds in England, by POLAR2 (Q5 = advantaged), 2007 to 2014



Source: UCAS

Demand from mature applicants, and those wishing to study part-time, however, has not followed the same trend identified above.

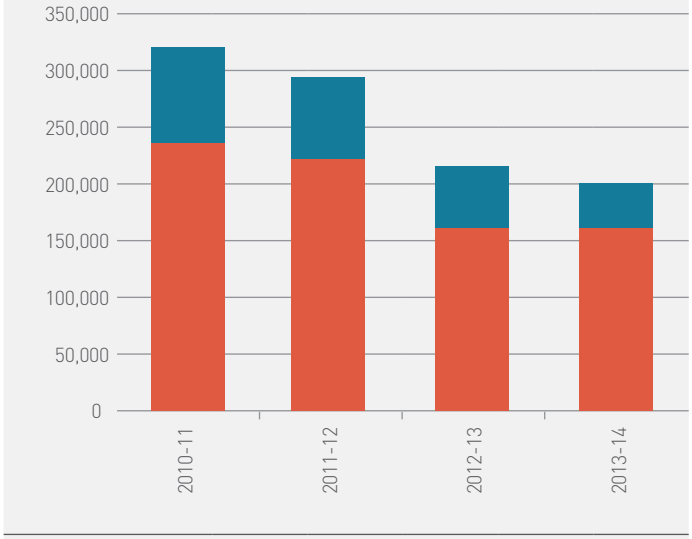
Mature students

In considering the position of mature students (those aged 21 and above), the number of entrants from the UK and EU enrolling onto undergraduate courses in English institutions fell by 37% between 2010–11 and 2013–14, as shown in Figure 2.3. Notably, this decline started before the 2012 reforms were implemented, with overall entrant numbers falling by 8% in 2011–12, the year before fees increased.

However, the most notable year-on-year decline did occur in 2012–13, when entrant numbers fell by 27% year-on-year, from 294,000 to 215,000.

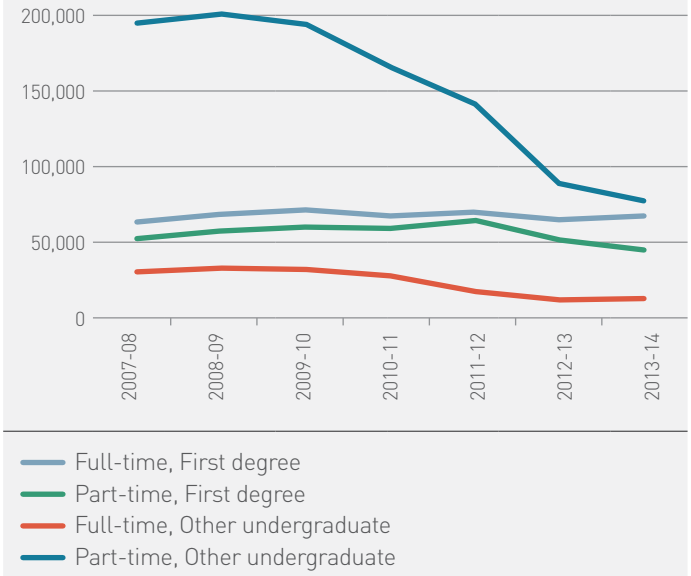
19 NFER Pupil Voice Survey April 2012 for the Sutton Trust.

Figure 2.3: Mature UK and EU undergraduate student entrants at English higher education institutions, 2010–11 to 2013–14



Source: HESA

Figure 2.4: Trends in UK and EU-domiciled mature undergraduate entrants to higher education institutions in England by mode of study and qualification type, 2007–08 to 2013–14



Source: HESA

When looking at mature entrant numbers there has, historically,been a relatively high concentration of enrolments within the Open University where a continued decline in entrants pulls down the overall figures, even in 2013–14. In 2012–13 and 2013–14, mature entrants to the Open University fell by 25% and a further 26% respectively. Outside of this institution, while it is the case that student numbers fell by around the same percentage in 2012–13 (27%), there was actually a very minor increase in the latest available data (2013–14).

This complex picture therefore suggests that the downward trend in overall numbers is due to a variety of factors, of which the changes to the student funding system is likely to be one. Figure 2.4 shows recent trends in mature entrants to undergraduate courses at a more disaggregated level – by level of study (first degree and other undergraduate courses), and by intensity of study (full-time and part-time). Looking first at full-time, first-degree cohorts, there were more mature students starting a course in 2013–14 than in 2007–08, (although there have been some fluctuations year-on-year). In comparison, the size of the part-time entrant cohort enrolling onto other undergraduate courses has decreased by 61% since 2008–09.

Indicative figures for higher education income from non-credit-bearing courses (any educational course which is not credit bearing and, as such, does not lead to a qualification or institutional credit), which increased by 41% between 2008–09 and 2013–14, suggest that part of the reduction may be due to entrants who previously studied for institutional credit moving to non-credit-bearing courses, which are excluded from statistical returns.[20] There was also a change in government policy requiring nurses to be degree educated from 2013, which affected total numbers in the discipline shifting from other undergraduate courses towards first degrees.

However, the fact that overall numbers of mature entrants decreased most rapidly in 2012–13 suggests that changes to the student funding system are likely to have also affected mature students' decisions to enter higher education.

20 HESA (2015) Income and Expenditure of HE providers

Part-time students

Many mature students study part-time, and the overall number of students studying part-time has followed a similar trend to that of mature students. Evidence is available to explain this decline.

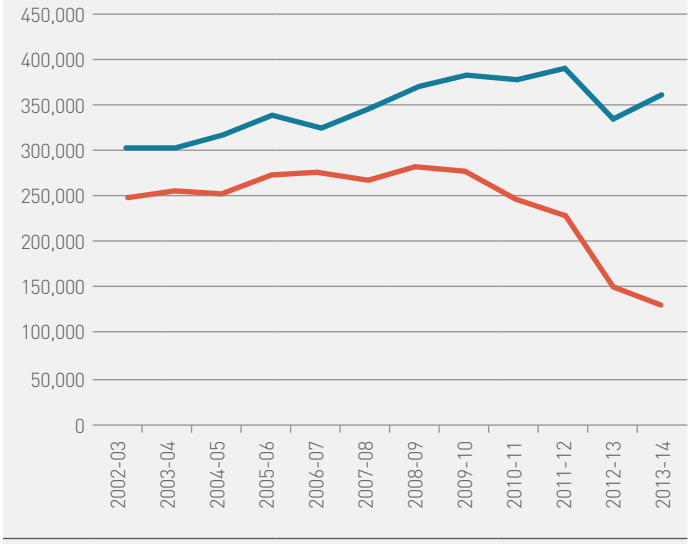
In 2014, Universities UK held interviews with selected institutions to discuss the factors responsible for the recent decline in part-time undergraduate student recruitment. The evidence built upon a 2013 review of part-time provision, as part of which Universities UK conducted a call for evidence on the same issue.[21]

Based on these exercises, the factors identified as influencing students' decisions to study part-time include:

- reforms to undergraduate student funding, including:
  - increased fees following cuts to teaching grants
  - changes in eligibility requirements for tuition fee loans for part-time undergraduate students – this includes the impact of restricting public funding to only those students studying for qualifications that are higher than the one they already hold
- the economic downturn, including increased unemployment and reduced employer funding
- reductions in public funding, including reductions in public sector employment

Figure 2.5 shows that, while the number of first year full-time students rebounded in 2013–14 (after the decline in 2012), the number of part-time entrants has continued to fall in each year since 2008–09, with the most dramatic decline coinciding with implementation of the 2012 reforms to student funding.

Figure 2.5: First year UK and EU-domiciled students on undergraduate courses at English higher education institutions, by mode of study



Source: HESA

A series of institutional interviews suggested that, of the points listed above, the main factor contributing to the decline in part-time undergraduate recruitment has been the changes to undergraduate funding for part-time students in England. This includes changes to the funding of equivalent and lower qualifications (ELQ) from 2008–09, increase in fees in 2012–13 and issues related to eligibility for loans for tuition in 2012–13.

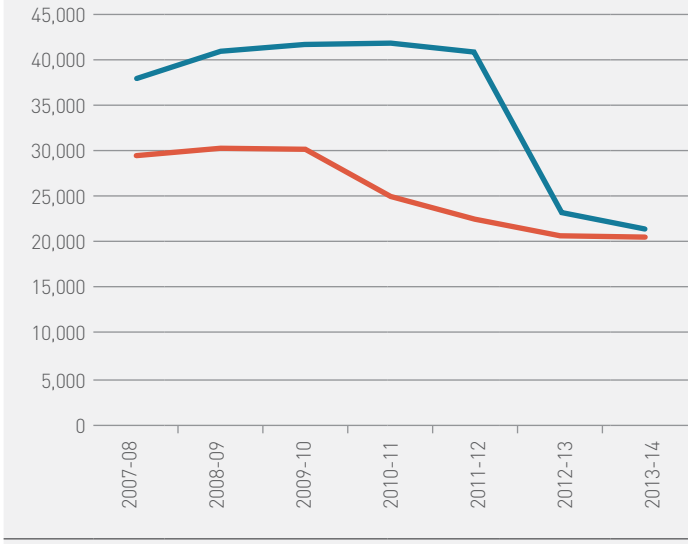
Coinciding with the start of the decline, in 2008–09 the government announced that students aiming for a qualification that is equivalent to or lower than one they already hold would no longer receive public funding (although with certain exemptions). With wider reforms to undergraduate funding in 2012–13, these criteria were then extended to include eligibility for tuition fee loans, in that eligibility was restricted to those students studying for qualifications that are higher than one they already hold.

21 Universities UK (2014) The power of part-time: Review of part-time and mature higher education

In addition, in order to receive funding, part-time students are now required to be studying at an intensity greater than 25% of a full-time qualification, and for a specified qualification aim. Following this, as of 2012–13, no part-time students are eligible to receive maintenance loans and grants. These restrictions on eligibility are likely to have played a key role in affecting demand from potential students wishing to study part-time.

The wider economic climate is also likely to be a significant contributing factor to the decline, as businesses and government faced reductions in the levels of financial resource available to support part-time students. Within the context of an economic downturn and subsequent squeeze on public finances, in 2012–13 the number of entrants being primarily funded by their employer to study on a part-time basis fell by 43% on the previous year. The downward trend in part-time entrants funded by government started earlier, in 2008–09. Between this year and 2013–14, the number of students declined by 32%, as shown in Figure 2.6.

Figure 2.6: UK and EU part-time undergraduate entrants to higher education institutions in England by major source of tuition fee, 2007–08 to 2013–14



Source: HESA

Thus, whereas a variety of factors can explain the continued drop in part-time entrants, there is evidence to suggest that the various reforms to student funding – both in 2012–13 and earlier – have at least, in part, influenced this decline. The combined impact of recent trends is a decline in flexible provision, along with a growth in full-time three-year courses.

The views of current undergraduate students

In order to better understand how current undergraduate students have been affected by the 2012 reforms, the Student Funding Panel collected a wide range of evidence from the student perspective. In addition to information received from a call for evidence and a session at which the National Union of Students informed the panel about impact from the student's point of view, opinions were gathered through an online survey and a series of face-to-face focus groups with students studying at panel member institutions.

In January 2015, Universities UK asked its members to circulate a survey to their current cohort of UK-domiciled undergraduate students, putting to them questions about their views and experiences of the current student fees and loans system in England. Those responding to the survey had started their course since the reforms to the system took effect in 2012–13. A total of 3,240 valid responses were received. More detail on this evidence collection from students can be found in the online paper 'Findings from the Student funding panel survey of students and student focus groups.'

As part of the survey, students were asked:

- why they decided to enter higher education, and whether any alternatives were considered, such as employment or studying abroad
- how satisfied they are with various aspects of their university experience
- whether they felt their university experience represented value for money
- how able they were to meet their living costs while studying
- how concerned they are about their ability to repay their student loan
- a series of questions about their understanding of the student loan system

Key findings from the survey include:

- Over 40% of respondents said they did not consider any alternative options when applying to university.

- There are high levels of satisfaction with universities' facilities for teaching and learning, as well as for a range of other resources and services.
- One in three respondents said they would be prepared to accept small annual increases in tuition fees if their university was faced with a reduction in resources available to sustain its activities.
- There was no overall consensus over whether the university experience represents value for money, but perceptions differ between students in different subject areas.
- Living costs are a concern for the vast majority of students: respondents were more likely to be concerned about meeting their costs of living than about the level of tuition fees.
- Around two-thirds say they are at least 'quite concerned' about their ability to repay their loan.
- 80% are aware that their loan repayments will only commence once their earnings exceed £21,000, although there is generally a lack of understanding about the finer details of the system, such as interest rates on loans.

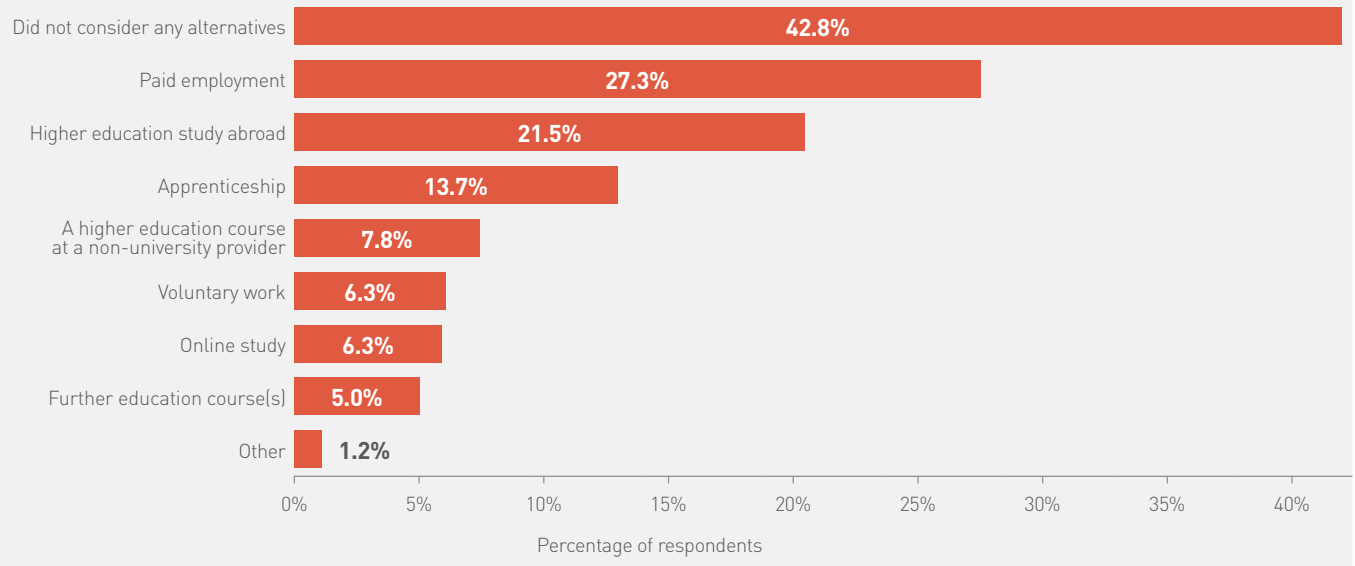
Evidence obtained from the survey was complemented by six student focus group sessions at panel member institutions during January and February 2015. A similar set of questions to those included in the online survey was used across all groups. The key findings of these sessions are detailed within the following sections, to support the results of the survey across three areas. These are the students':

- decision to enter higher education
- experience of university to date and perceptions of value for money
- level of concern about, and understanding of, student finance

The decision to enter higher education

Responses to the survey suggest that, despite the increase in tuition fees in 2012, the decision to enter university was not in question for a large proportion of students. As shown in Figure 2.7, more than four in ten respondents stated that they did not consider any alternative options to entering university. However, around one-quarter of respondents said they had considered paid employment as a possible alternative, and one in five had thought about studying overseas.

Figure 2.7: Alternatives to university considered



Source: Student Funding Panel survey of students

Students participating in the focus groups supported the idea of university being the sole consideration for many. Several students reported a strong influence, and even expectation, among their parents and schools that university is the most appropriate option for them. Outside of these external factors, many students themselves felt that a degree was now the minimum requirement for obtaining a good job, and mature students in particular noted that career progression often required degree-level qualifications.

Other key findings from the focus groups:

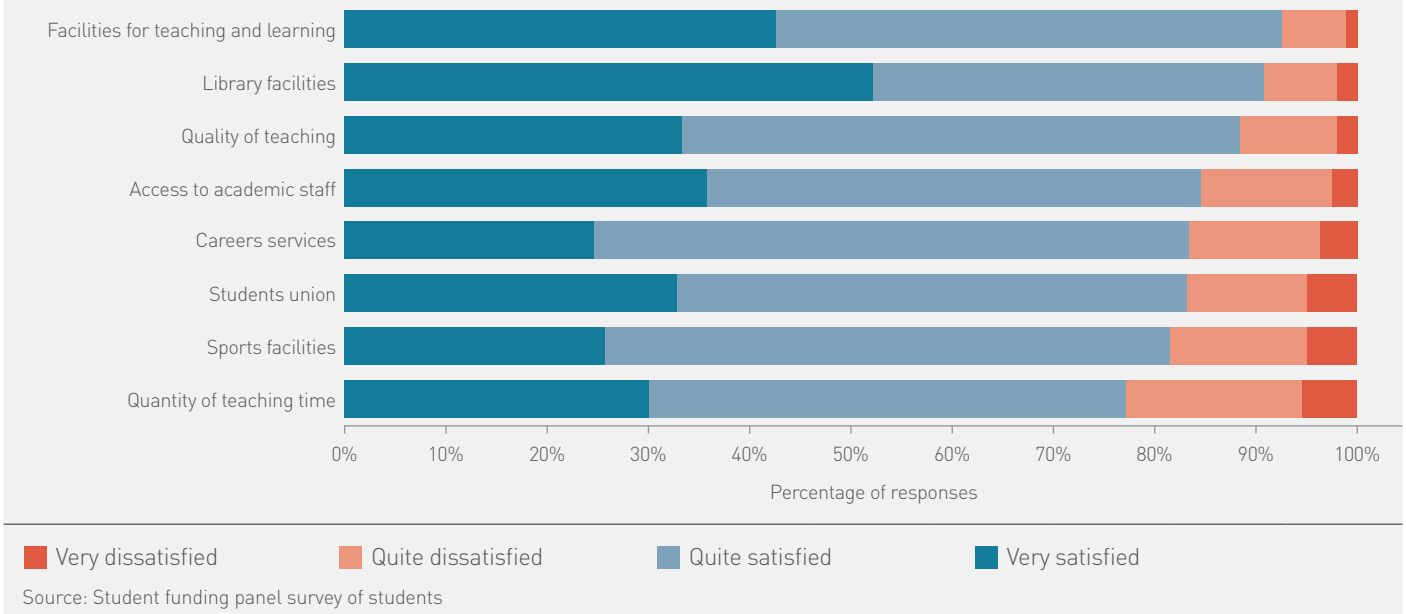
- For the majority of students, the level of tuition fee was not a significant factor in their decision to enter higher education. These students noted that, under the current system, higher education was free at the point of entry, and the income contingent nature of repayment has prevented fees from becoming a deterrent.
- Across all groups, students noted that the level of tuition fee played little or no influence in their decision of where and what to study.
- For the majority of students, considering how they would meet their costs of living played an important role in their decision to enter, particularly for those within universities in and around London.

The experience of university to date and perceptions of value for money

The second section of the survey asked students to reflect on their university experience to date, and whether this experience represented 'value for money'. In light of the recent changes to student funding and increase in tuition fees, it is important to gauge how satisfied current students are with teaching and various services and facilities provided by their institution, and whether they feel that their course has prepared them with the skills necessary to obtain their future career of choice.

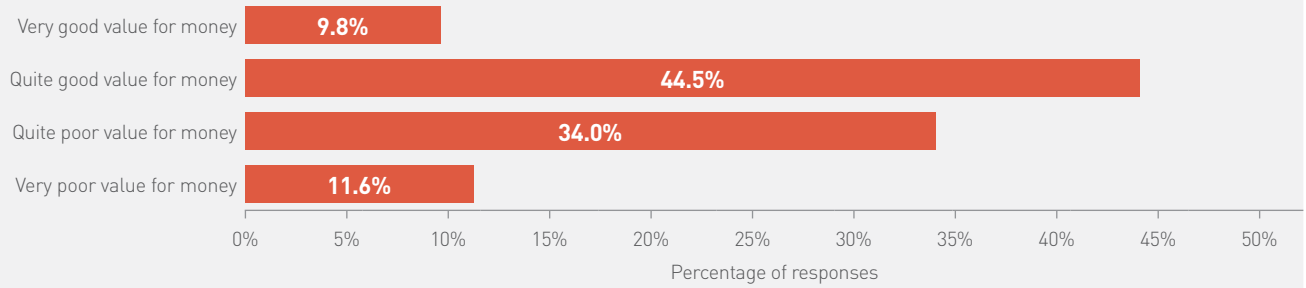
Overall, high levels of satisfaction were reported by students across all areas, particularly for 'facilities for teaching and learning' and 'library facilities', both of which more than 90% of respondents said they quite or very satisfied with. As shown in Figure 2.8, the area where students felt least satisfied overall was with 'quantity of teaching time', where 77% said they were either quite or very satisfied.

Figure 2.8: Levels of satisfaction with various aspects of the university experience



Source: Student funding panel survey of students

Figure 2.9: The extent to which university represents value for money



Source: Student funding panel survey of students

There were some noticeable variations in satisfaction with 'quantity of teaching time' between students in different subject areas. Students enrolled on STEM courses generally expressed higher levels of satisfaction with their quantity of teaching time than those on other courses. Among the most satisfied were those studying veterinary science and agriculture, or medicine and dentistry, with more than 90% of students saying they are 'very or quite satisfied'. At the other end of the scale, the equivalent percentage among those enrolled in historical/philosophical studies was less than 60%.

When asked directly about whether their university experience represents value for money, responses were fairly split overall, with 54% saying that their financial investment in university has so far been very or quite good value for money, and 46% saying it has been very or quite poor. As shown in Figure 2.9, students were most likely to state that their university experience represents 'quite good value for money'.

Focus group discussions highlighted a link between the number of contact hours a student receives and their perception of value for money. In all groups, students were highly aware of variations in 'value for money' across courses, departments and even campuses within their institution. A common comparison was between subjects of study, with many students on classroom-based courses (for example, mathematics) or those with fewer contact hours (such as the arts) questioning why they were paying the same level of fee as those on lab-based degrees that require expensive materials, facilities, and more contact hours.

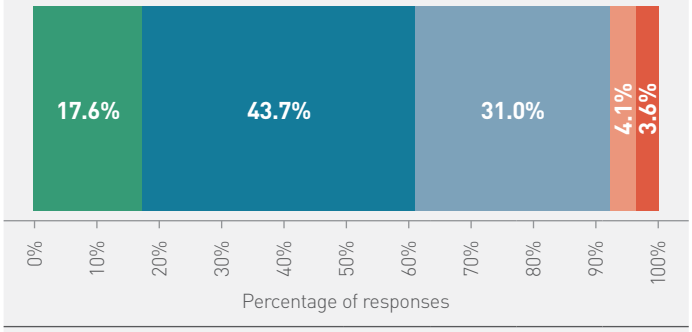
This idea was supported by the online survey results. Perceptions of value for money differed between students in various subject areas. For medicine and dentistry students, 74% said that their degree represents very good or good value, closely followed by those studying subjects allied to medicine and veterinary science/agriculture (both 71%). In comparison, non-STEM students were less likely to rate their experience as representing good value for money.

However, an important qualification needs to be made to the survey findings: many within the focus groups reported that it is impossible to determine value for money without knowing the impact that graduating will have on their employability. These students felt that gaining a good job after completing their course would be a reliable indicator of value for money. The online survey therefore attempted to gauge initial impressions of how university is preparing students for the future by asking the question:

Thinking about your experiences at university to date, to what extent do you feel you have developed skills useful for future employment?

Responding students were most likely to state that their university experience has prepared them with the skills they require 'to a great extent'. As shown in Figure 2.10, just under 4% of respondents believe that their course has not prepared them in this way at all. Adding to this, several respondents to the panel's call for evidence reported that the funding reforms had prompted an increased interest in the employability of graduates from applicants, as well as in developing students' employability skills.

Figure 2.10: The extent to which university has so far developed students' skills useful for future employment



Source: Student funding panel survey of students

Therefore, whilst it might be too early for the current cohort of students to determine whether their course represents value for money, in terms of a key indicator – employment outcomes – most feel that university is preparing them with the skills needed to get the job they want.

It is also not completely clear to what extent the level of fees affects perceptions of value for money. Results from the HEPI-HEA Student Experience Survey 2014 showed that students studying in Scotland (where Scottish and other EU nationals pay no fees) were far more likely than those elsewhere in the UK to say that their course represents value for money – around 70% compared to around 40% in England. However, results were only marginally more positive in Northern Ireland, where students mostly pay £3,685 per year. HEPI concluded that the bigger impact on value for money perceptions might come from having any fees at all, rather than the difference between £3,685 and £9,000.[22]

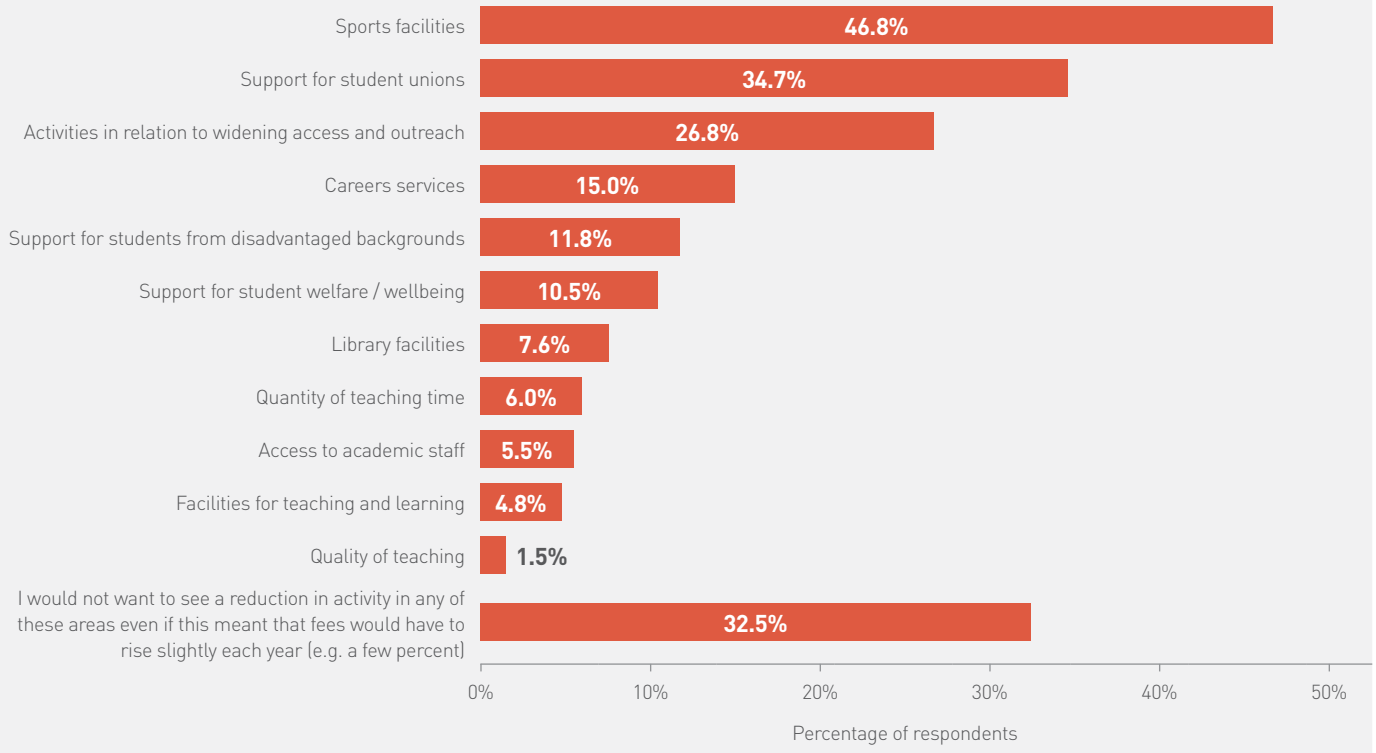
Other key findings from the focus groups:

- Some students felt that they were receiving poor value for money in comparison to those paying lower fees on the previous funding system. There was an expectation that, with higher fees, students should receive better service from both academic and non-academic aspects of their time at university. One group of students were conscious that their institution had invested in improvements using income from fees, but that they were unlikely to benefit from these as they would graduate before it was finished.
- It was widely felt that more information was needed on how income from fees contributed to university finances and how income was being spent on teaching.
- In addition to contact hours, value for money was also linked with: access to staff; the ability to provide the university with feedback; availability of careers advice and support, and high-standard facilities (both academic and non-academic).
- Themes identified as potential enhancements to value for money included: increased engagement with staff; improved quality of buildings and facilities; provision of internships and placements, and greater investment in affordable student accommodation.

Finally, within this section, the online survey asked students where a university's investment in activities should be reduced, should they be faced with an increasingly challenging financial climate. As shown in Figure 2.11, most of the respondents selected one or more activities that could be reduced in such a scenario. However, one in three students said that, should universities be faced with reduced resources, they would be prepared to see tuition fees rise slightly each year in order to protect the institution's current levels of activity.

22 Higher Education Policy Institute and The Higher Education Academy (2014) The HPI-HES Student Academic Experience Survey 2014

Figure 2.11: Areas where activity could be scaled down, should universities have reduced resources available



Source: Student funding panel survey of students

This suggests that many students are more concerned with their university being able to continue operating at current resourcing levels rather than the tuition fees increasing slightly above £9,000.

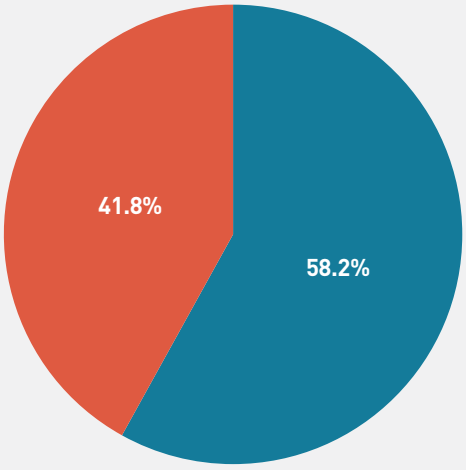
Student finance

The final area of focus within the evidence-gathering exercises was on whether students feel concerned about repaying their loans, meeting their living costs, and how much they know about the student finance system.

Perhaps unsurprisingly, students were likely to express at least some level of concern about meeting their living costs whilst studying as well as their ability to repay their student loan after graduating, with 79% and 63% being at least 'quite concerned' respectively.

When faced with the choice of which concerns students the most: living costs encountered during your course or the level of tuition fee for your course, it was living costs that came out as the greater worry, as shown in Figure 2.12. In total, 58% stated that living costs are of greater concern than the level of fees.

Figure 2.12: What respondents said is the greater concern: living costs or tuition fees



Source: Student funding panel survey of students

It therefore seems that, at face value, current students are more worried about the level of maintenance costs than about long-term debt from student loans. However, this finding may need to be treated with some caution, given the tendency for individuals to give greater weight to losses (and gains) in the present than the future. It is unclear whether the current students would be more concerned with loan repayments if they were asked the same question in 10 years' time, and what impact increased levels of overall debt may have on graduate behaviour in the future. Nonetheless, options for increasing funding for living costs need to be explored.

Other key findings from the focus groups:

- Across all groups, students felt that the current student funding system did not provide them with the necessary levels of support to meet their costs of living. Within this, the majority of concerns related to accommodation costs.
- The majority of students across groups – particularly those who had researched the repayment system in detail – were not overly concerned about the prospect of repaying loans. These students felt that the more immediate concern after graduation was repaying debt that they had accumulated during their time at university (for example, in the form of overdrafts or credit card debt).
- A smaller number of students felt concerned that they did not adequately understand how the repayment system would work and the impact it may have on their earnings, including their ability to borrow money in the future (e.g. for a mortgage). This was partially supported by findings in the online survey, which showed that, whilst 80% of students could correctly identify the loan repayment threshold as being £21,000, most did not know what percentage of their earnings above this threshold would be repaid, nor what interest rates applied to their loans.

Impact on graduate repayments

This final section focuses on how the switch to the current system of student finance has affected the size of graduates' loans and the levels of repayments they will need to make compared to those who entered university in 2011–12. Firstly, Table 2.1 compares the maximum levels of tuition fee and maintenance loans available under the final year of the old system and first year of the current system. Between years, there was an increase in the available maintenance loans as well as in the maximum level of tuition fees charged by institutions.

Table 2.1: Loans and student support under the old and new systems

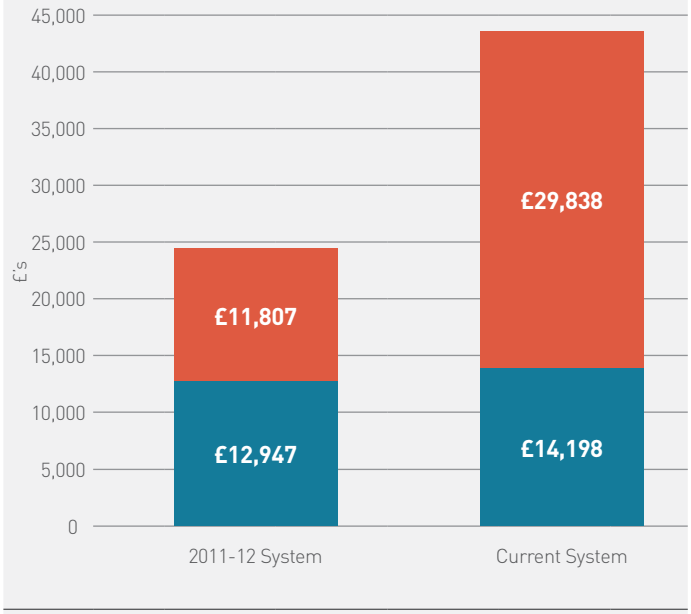
Factor	2011–12 system	2012–13 system
Maximum tuition fee loan	£3,375	£9,000
Maximum maintenance loan, outside London	£4,950	£5,500
Maximum maintenance grant	£2,906	£3,250

Source: IFS

Analysis carried out by the IFS suggests that students under different systems are to be faced with very different levels of debt at graduation. On average, an undergraduate student who started university in 2011–12 can expect to graduate with an overall loan of less than £25,000 (in 2014 prices). This compares with the 2012–13 cohort that is expected to have an overall loan of around £44,000. As shown in Figure 2.13, it is predominantly fee debt that has contributed to this increase.[23]

23 Institute for Fiscal Studies (2014) Payback Time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?

Figure 2.13: Average real student debt at graduation under the old and new systems (in 2014 prices)



Note: These figures apply to young full-time English-domiciled students studying at the 90 largest universities in England. It is assumed that all students take out the full fee and maintenance loans to which they are entitled and that there is no 'dropout' from university.

Source: IFS

Students under the current system also face different repayment levels and accrue different levels of interest on their loans compared to those who entered university in 2011–12. Table 2.2 compares the accumulation of debt under both systems, based on interest rates applied on loans both during study and after graduation, as well as the applicable salary repayment thresholds.

Table 2.2: Accumulation and repayment of student loans under the old and new systems:

Factor	2011–12 system	2012–13 system
Real interest rate during study	RPI +0%	RPI +3%
Real interest rate after graduation	RPI +0%	RPI + 0-3%, depending on income
Repayment threshold	£15,795 (in 2012)	£21,000 (in 2016)
Repayment rate	9%	9%
Repayment period	25 years	30 years

Source: IFS

The IFS has noted that the above changes have made the system more generous for students in some respects and less generous in others. On the one hand, the income threshold above which loans start to be repaid has been increased, but on the other, differences in interest rates applied to loans after graduation mean that 45% of graduates will repay more than they borrowed in real terms under the new system.

The increased repayment threshold means that all students graduating under the new system pay less per month than those under the old system. For thresholds in 2015–16 a graduate earning £30,000 a year before tax would pay £94 a month under the old system compared to £67 a month under the current one[24].

An increased level of debt means that most students graduating under the current system are likely to be faced with higher total repayments than their counterparts graduating under the previous system. Before the reforms, graduates were, on average, expected to repay around £15,000 in net present value terms[25]. This compares to more than £22,500 under the current system (in discounted 2014 prices).

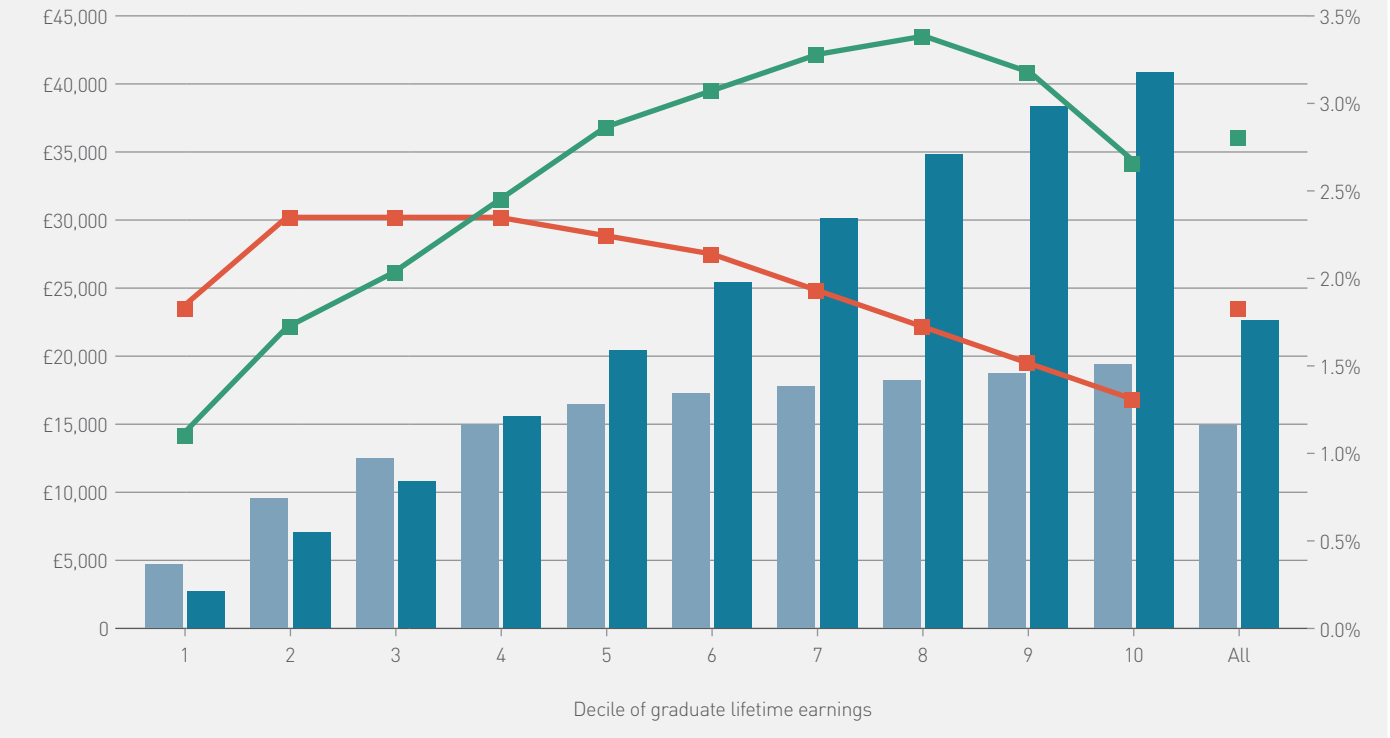
24 http://www.studentloanrepayment.co.uk/
25 Institute for Fiscal Studies (2014) Payback Time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?

However, IFS analysis also suggests that the current system will affect students differently depending on their future earnings profile. Figure 2.14 compares how much graduates under both systems are expected to repay over their lifetimes, by their level of lifetime earnings. The lowest 30% of earners are actually forecast to repay less in monetary terms under the current system than they were under the previous system. In this sense, the current system could be deemed to be progressive: by increasing the threshold before which repayments commence, the lowest earners are protected from the longer period of repayment overall, paying back a lower proportion of their lifetime earnings than they would have under the previous system.

In comparison, the highest earning graduates are expected to repay substantially more under the current system than those under the previous one. The highest 10% of earners could actually end up paying more than double under the current system than what they would have repaid under the old system, both in monetary terms and as a percentage of their lifetime earnings. The profile of total real repayments as a share of lifetime earnings reflects the fact that, under the current system, it is graduates in the top 20% of lifetime earnings which are most likely to pay back their loans in full before the write off period of 30 years.

As a whole, a lower proportion of graduates will now repay their full loan amount: under the old system 49% of graduates would have repaid in full by age 40, compared with just 5% under the current system.

Figure 2.14: Net present value of total real repayments and as a share of real NPV lifetime earnings across distribution of graduate lifetime earnings (in discounted current prices)



Note: The % figures represent the average total repayments in real NPV terms in each decile as a percentage of the average lifetime earnings (also in real NPV terms) in that decile. These figures apply to young full-time English-domiciled students studying at the 90 largest universities in England. It is assumed that all students take out the full loans to which they are entitled, that there is no 'dropout' from university, that graduates repay according to the repayment schedule and that they have low unearned income.
Source: IFS

Therefore, while on average the reforms to student finance will lead to graduates being faced with higher levels of debt and loan repayments than they would have under the previous system, this by no means applies to all graduates.

At present, there is insufficient evidence available on the extent to which increases in undergraduate tuition fees in 2012–13 have influenced students' attitudes to postgraduate study, or any changes in their aversion to debt. One study focussing on undergraduates of the pre-2012 system is HEFCE's *Intentions after Graduation Survey* (2014), which compared final year undergraduates' intentions with their actual destinations six months after graduating.[26] This analysis showed that 61% of students who said they were unlikely to study at postgraduate level believed course fees were a deterring factor. The same analysis also suggests that, of those students stating an early intention to pursue postgraduate study, certain groups were less likely to go on and actually enrol than others, including: students from BME backgrounds; students with disabilities; mature students, and those from less advantaged backgrounds.

From this evidence, HEFCE concludes that some groups of students are more likely to experience barriers into further study than others. The 2013 survey of undergraduates showed that, of those who were either not sure about, unlikely to enter or definitely not going to enter postgraduate study, 33% said 'fear of debt' was one of the factors putting them off.[27]

HEFCE's *Intentions survey* for 2015 will target the first group of students paying £9,000 a year, and the results of this will offer some indication of the impact of the undergraduate reforms on demand for postgraduate study.

THE IMPACT OF THE REFORMS ON GOVERNMENT

The reforms to the student funding system introduced in 2012–13 significantly altered the impact of expenditure on higher education on the public accounts. While these changes have been discussed and debated at considerable length in the policy, political and media domains, they are not widely understood. This means that there is still confusion about the potential impact of any reforms on the public accounts, and on the future availability of funding for higher education in England.

Assessing the impact of the reforms on government is, nevertheless, complex. The various streams of funding which support undergraduate education impact differently on the public accounts. In addition, estimating the long-term impact of the reforms on government finances is uncertain, given the way the system has been designed and the need to make assumptions about a number of key parameters (such as the government cost of borrowing, future labour market conditions, and graduate repayment behaviour). All of these assumptions are contestable, and changes can affect estimates of the long-term costs to various degrees (as set out below).

The student funding system in England comprises two broad elements, each of which needs to be looked at separately to assess the overall impact of the reforms on government. These are: student loans, and grant funding.

Student loans

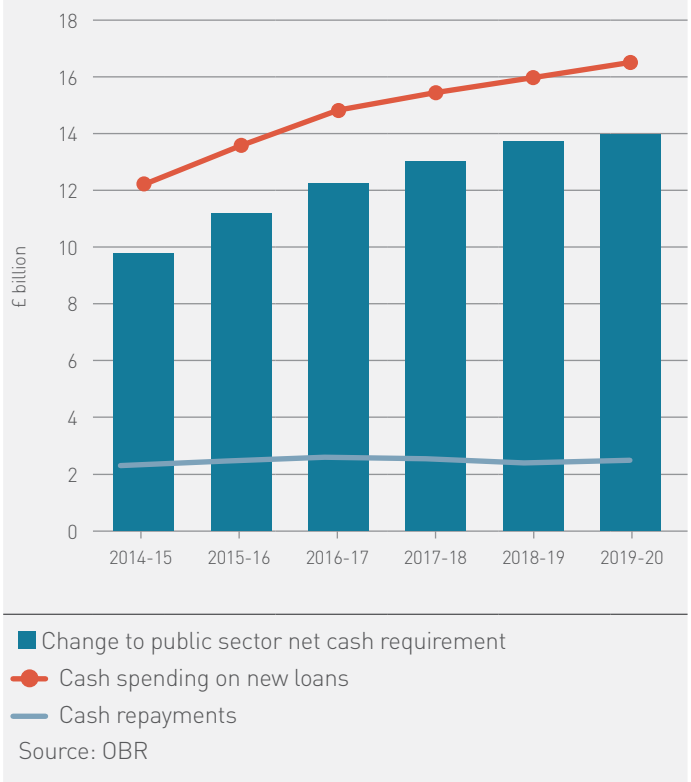
The way in which student loans impact on the government accounts – and particularly on BIS's budget – was set out in the UUK report The Funding Challenge for Universities, published in 2013[28]. In summary, there are two principal components to the long-term cost to government arising from student loans:

26 HEFCE (2014) Intentions After Graduation Survey 2014: Summary
27 HEFCE (2013) Intentions After Graduation Survey 2013: Initial findings
28 Universities UK (2013) The funding challenge for universities

- **Costs associated with issuing loans and repayment of principal:** In accounting terms the cash flows associated with the issuance of loans and their repayment effect the government's cash position and are recorded as Annual Managed Expenditure (AME). This is expenditure which is unpredictable or not easily controlled by departments, and includes items such as welfare tax credits or public sector pensions. This expenditure influences the government's cash flow through the public sector net cash requirement (PSNCR) and in turn, affects changes in public sector net debt (PSND), but importantly does not count towards the government's level of borrowing as it is classed as a financial transaction. This is a significant feature of the current student funding system, as it allows the government to continue funding higher education adequately while simultaneously allowing them to achieve its policy aim of deficit reduction.
- **Costs associated with the loan subsidy:** This comprises two separate elements: the interest rate subsidy and the estimated cost of loans that cannot be recovered. In contrast to the long run cost of outlay on loans, this component is accounted for as resource funding in the BIS DEL in the form of the RAB charge, but is a non-cash item (described technically as an 'impairment' on the BIS budget). Therefore, it does not impact directly on the cash available to spend each year on higher education, but serves instead as an estimate of the net present value of the student loan outlay that the government estimates it will not recover.

The Office of Budget Responsibility has estimated the impact of student loans on the PSNCR each year. As shown in figure 2.15, the net increase in the PSNCR as a result of higher student loans is estimated to be £13.95 billion by 2019–20.

Figure 2.15: Impact of student loans on public sector net cash requirement



Source: OBR

It is assumed that government will continue to fund its overall debt through the sale of gilts in future (as it does now), and that provided the UK is able to maintain its strong credit rating (currently AAA[29]), this does not present a difficulty in fiscal terms.

The calculation and impact of the RAB charge, however, is more fraught and contentious. In their report from 2014 titled *Estimating the Public Cost of Student Loans*[30], the IFS identified seven factors that contribute to uncertainty around the calculation of the RAB charge. These are:

1. The assumed future growth rate of earnings.
2. The level of earnings in the present (that is, the threshold at which loan payments will be triggered by the first cohort of graduates under the new system).
3. The level of take-up of student loans.
4. Graduate repayment behaviour.
5. The number of students.
6. The level of fees.
7. The government's own cost of borrowing (built into the current system as an assumption of 2.2%).

29 Standard and Poor's (March 2015) Sovereign risk indicators
30 IFS (2014) Estimating the public cost of student loans

Each of these factors is subject to change, and it will be some time before data becomes available to accurately assess the full impact on the level of government subsidy required to support the student loan system.

It should also be noted, as the IFS point out that these uncertainties also apply to the calculation of the loan subsidy under the previous (pre-2012) system[31]. So, in comparing estimates of the long-run cost of the current system, it is important to bear in mind that anything that increases this estimate would also increase the baseline against which it was being compared. For that reason, it is not accurate to say that there is a point at which the subsidy in the new system is such that it becomes more expensive overall than the old system, since the cost of both systems will have increased.

The RAB charge still serves a useful function as a means of comparing estimates of the long-run costs of the system in the present (including comparing the potential impact of reform options). It also helps to maintain fiscal discipline by serving as a reminder that at some point in the future a real subsidy will crystallise in cash terms. However, of arguably more importance in public policy terms are the factors that drive the calculation of the RAB charge, since these provide a greater insight both into the effectiveness of the system and the impact which is being felt in the wider economy. For example, estimates of the RAB charge are sensitive to assumptions about future graduate earnings, employment outcomes, and labour market conditions.

If graduate earnings increase on average, the majority of graduates find employment and more graduate-level jobs are created in future, then student loan repayments will be healthy. If any of those factors stagnate, then the government subsidy for the system will need to be higher. What is significant here – and what needs to be monitored closely – is the assumption that more, higher-skilled graduates in the economy will boost overall productivity and labour market growth in the future, and that there will continue to be strong demand for graduates in the economy. This is the broader policy goal that the system is seeking to achieve, which will in turn have significant economic and social benefit for the UK, and it should attract far greater scrutiny than the level of the RAB charge.

Notwithstanding this, estimates of the RAB charge have increased gradually since the new system was introduced. The starting assumption made by government was that it would be around 30%. After a while it was increased to 34%. In its 2013 report titled A Critical Path: Securing the Future of Higher Education in England, the IPPR estimated the RAB charge to be 39%[32]. The most recent estimate from the IFS puts the figure at 43%[33], while the latest figure from BIS puts the estimate for post-2012 loans at 46%. This means that, all other factors being equal, the cost of subsidising the student loan system in future will be higher than originally anticipated.

A key factor driving the increase in the estimate is the earnings threshold at which repayments begin, which is currently set at £21,000. As a result of the recession, overall wage growth has been more sluggish than anticipated, with the result that it is estimated to take longer for graduates to reach this threshold, and thus to begin repaying their loans. If labour market conditions begin to improve, then estimates of the RAB charge will begin to decrease (although, as discussed in the section on options for reform, later in this report, this is by no means the only factor which could reduce the RAB charge).

Grant funding

The second component of public support for undergraduate education in England is grant funding. This is counted as part of the government's annual cash outlay (through BIS in relation to higher education), and does have an impact on the deficit. The government's stated policy in 2010 was to 'prioritise reduction of the deficit over all other aims', which meant that departmental expenditure limits for all non-protected departments (that is, those outside health, schools, and overseas aid) were subject to major cuts.

31 IFS (2014) The idea of a single tipping point for the RAB charge is misleading
32 IPPR (2013) A critical path: Securing the future of higher education in England
33 IFS (2014) Estimating the public cost of student loans

The grant for BIS was cut by around 27% over the life of the spending period since 2010, translating into a reduction in total HEFCE allocations (including research, teaching, and capital) of 45% between 2010–11 and 2015–16. Given that grant funding for research was protected in cash terms in the form of the science and research ring-fence, all of the funding cuts fell on the other part of the higher education budget. This residual funding was used to cover three main areas (with some additional funding attributed to administration costs): 1. maintenance grants for students from low-income backgrounds (demand-led); 2. support for high-cost, and strategically important subjects (chiefly, but not exclusively STEM subjects); 3. the Student Opportunity Fund, to support widening participation activities undertaken by institutions.

There are a number of consequences for government of this policy decision:

- **There is a need to prioritise grant spending more rigorously.** In any era, decisions about the allocation of public resources should be rigorous and evidence-based. However, this is particularly the case when resources are scarce, as they are currently (and likely to remain so). Decisions to prioritise particular areas of spending are much more demanding now, with difficult trade-offs needing to be made between policy areas of equal importance. This applies, for instance, to support for particular subject areas (for example, high-cost, or strategically-important), particular policy aims (widening participation, support for part-time students), and different missions (teaching and learning, innovation and growth, research).
- **Maintenance grant funding has not kept pace with inflation.** Expenditure on maintenance grants is one of largest components of the remaining BIS RDEL (Resource Departmental Expenditure Limit which represents day to day spending on public services), accounting for 38% of the higher education resource budget and 12% of total BIS resource spending in 2013–14. Since 2012–13 the maximum maintenance grant available to students has increased by a factor that is less than inflation, putting a constraint on the funding available to students for direct maintenance support. Evidence gathered by the Student Funding Panel suggests that this is a major concern for students, with the result that there is increasing concern about the ability of students to meet their day-to-day living expenses.
- **Cost estimates for the increased higher education participation are highly sensitive to the characteristics of any additional students.** The expansion of undergraduate student numbers in recent years has led to an increase in recruitment of students from non-traditional backgrounds. This means that each additional student recruited into the system is more likely than the average student to qualify for maintenance support, increasing the pressure on the cash needed to support students in the long run.
- **Public funding needs to be directed to areas of market failure.** Compared to the previous funding system, the basic structure of the current system comprises more market-based features through the increase in the fee cap and relaxation of controls on student numbers, combined with targeted public funding support for areas where there would otherwise be market failure. Defining such areas however is difficult and contentious, and it is not always straightforward to collect the required evidence to support identification of specific areas of market failure. Defining areas which may require intervention relies on a clear statement of policy aims at government level, such that prioritization decisions can be taken, and may also require new approaches in the collection of evidence from agencies and institutions.
- **The historic link between regulation and funding has been broken.** in the past, the funding council has been able to enforce regulation through applying financial sanctions to institutions, and/or creating financial incentives to encourage particular policy aims. This applied, for example, to the control of overall student numbers. The cuts to the HEFCE teaching grant are leading to an increasing decoupling of funding and regulation, and the gap has yet to be filled by a refresh of the overall regulation architecture.

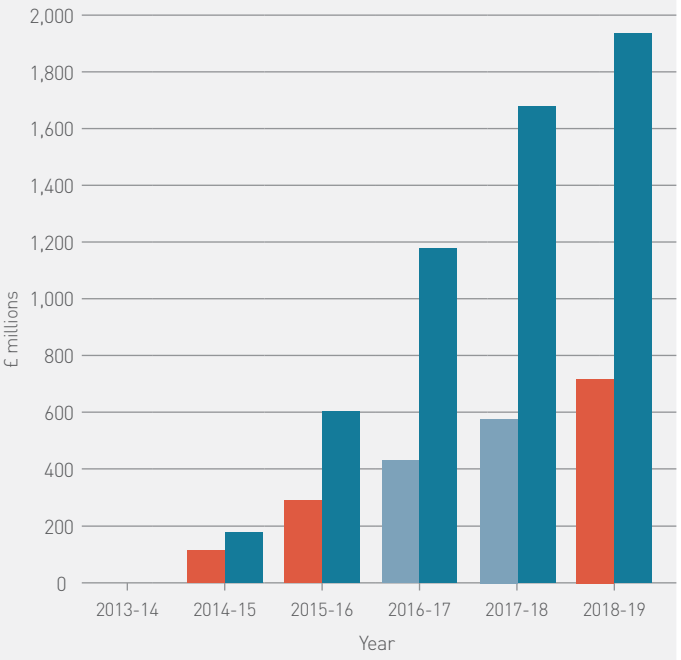
Required changes, identified by the Universities UK regulation task and finish group, include measures to strengthen student protection in the event of an institution failing and a new lead regulator to provide effective leadership and strategic oversight of the regulatory system[34]. These changes need to happen as a matter of urgency to ensure the student funding system continues to meet the interests of students and other constituencies, is fit for purpose in the longer term, and can help promote and maintain the high quality and international reputation of the higher education sector.

The combined impact of changes in student loans and teaching grants have resulted in a reduced government expenditure per higher education student, which decreased by 8.9% in real terms between 2009–10 and 2013–14[35], while maintaining the level of teaching funding for universities.

Student numbers

One final area of impact of the reforms on government relates to control of undergraduate student numbers. In the Autumn Statement 2013, the government announced that it would significantly increase the cap on student numbers in England in 2014–15, with complete deregulation of the system in 2015–16. The estimated costs and cash requirements to support this policy are shown in figure 2.16.

Figure 2.16: Estimated change in grant and loan outlay as a result of removal of student number controls



HEFCE and maintenance grants (incl Barnett consequential)

Costs for teaching and maintenance grants 'continue to build in 2016-17 and 2017-18' actual increases not confirmed

Outlay on loans

Source: HMT

Increasing opportunity and expanding the country's higher-level skills base is important with all the available evidence suggesting that the country will need more, not fewer, graduates in the future, in order to remain competitive in the global knowledge economy[36].

While the detail of the funding required remains to be worked out, it is worth noting that this policy is unlikely to have been affordable under the previous, grant-based system. It is only by moving to a substantially loan-based system and effectively leveraging the strength of the government's balance sheet, that constraints on the recruitment of students have been able to be relaxed. This is in the long-term interest of both individual students and the country as a whole.

34 Universities UK (2015) Quality, equity, sustainability: the future of higher education regulation
35 BIS (2014) Funding per student in higher education
36 BIS (2013) The relationship between graduates and economic growth across countries

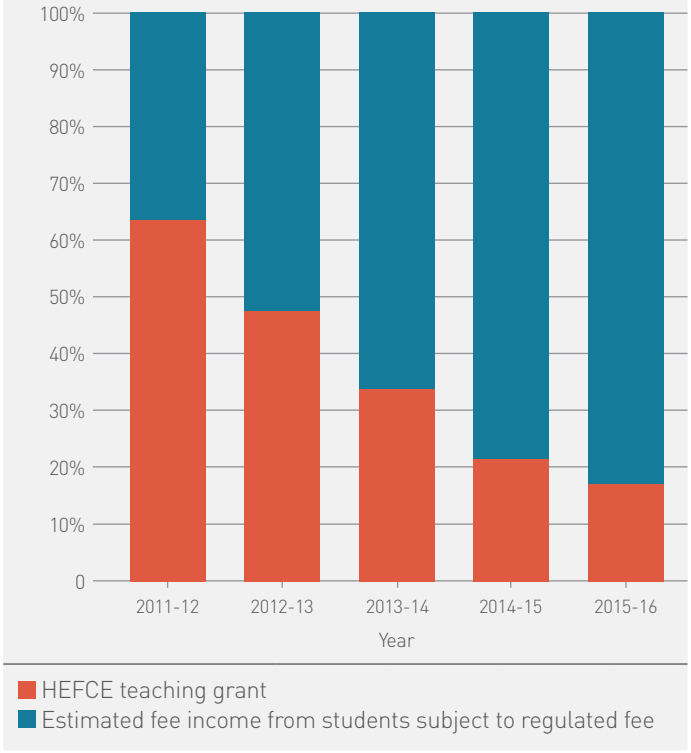
THE IMPACT OF THE REFORMS ON UNIVERSITIES

This section of the report considers the impact of reforms on universities, in particular whether the current student fees and loan system in England allows and encourages universities to support high quality teaching and deliver an outstanding – and financially sustainable – learning experience for students.

Funding trends

As described in chapter 1, a key characteristic of the 2012 reforms to student funding was a significant reduction in the level of teaching funding that universities received from government grants and an increase in the level of funding from tuition fees which were raised from £3,375 to £9,000 (in 2012 prices). Figure 2.17 shows that since the implementation of the new funding system, the proportion of teaching income the sector receives from grants has decreased from 66% in 2011–12 to an estimated 17% in 2015–16. At an aggregate level, therefore, under the current system, universities are more reliant on income from tuition fees in the funding of undergraduate teaching.

Figure 2.17: Change in balance income from teaching grants and tuition fees, 2011–12 to 2015–16



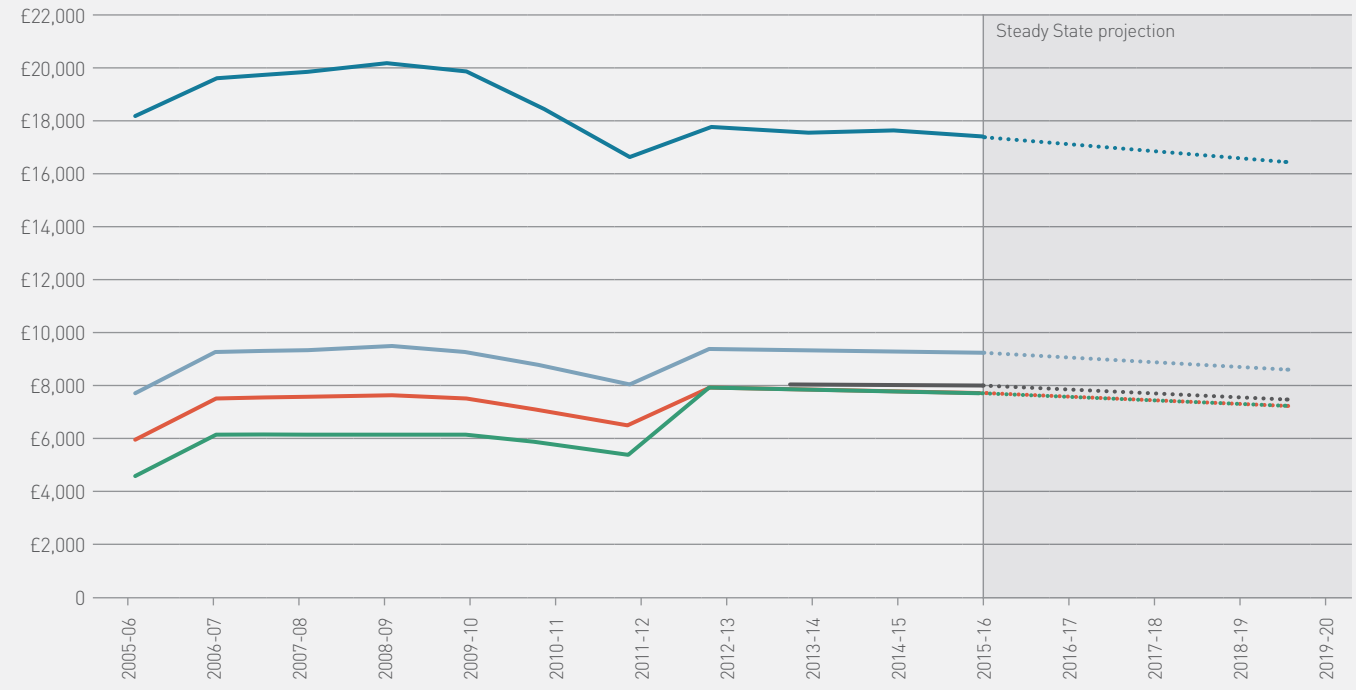
The reforms have also resulted in changes in the level of resource available to universities for teaching. Analysis by the IFS has suggested that between 2011–12 and 2012–13 funds available to universities for teaching across the whole of a degree increased from an average of £22,143 per student for those entering in 2011–12 to £28,250 per student under the current system – equivalent to an increase in funding of around 28%[37]. It is important to note however that this excludes changes in some sources of income for teaching, primarily public funding in the form of capital grants which decreased by 85% between 2009-10 and 2012-13 (see figure 1.5).

37 Institute for Fiscal Studies (2014) Estimating the public cost of student loans, IFS Report R94

An alternative measure of the change in resource available to universities for undergraduate teaching is shown in figure 2.18. This reflects the resources that universities may receive for each new entrant in the form of mainstream teaching grants from government, income from tuition fees (net of institutional expenditure on bursaries and scholarships and activities to support widening participation as part of access agreements with OFFA) and capital grants from government for teaching[38]. This is intended to give an indication of the core funds received by universities for teaching UK and EU full-time undergraduates, excluding items such as research (which are included in the unit of funding chart shown in figure 1.4), and illustrates different rates of funding for different subjects.

Universities also receive grant funding for teaching that is allocated according to student and course characteristics. For 2015–16 this funding amounts to £625 million or 6% of teaching income that the higher education sector is estimated to receive in that year. These allocations are an important element of the funding system and account for additional costs that a university may face due to certain student and course characteristics (e.g. higher costs for courses in London, additional costs of recruiting and supporting students from disadvantaged backgrounds). Funding from these sources have not been included in figure 2.18 as the amount received by individual universities varies depending on their student intake, and they also support part-time undergraduate and postgraduate taught provision, as well as the costs of full-time undergraduate education.

Figure 2.18: Typical rate of teaching funding (mainstream teaching grants, tuition fees and capital grants) for full-time undergraduate entrants in England, in 2012–13 prices



Band A Clinical subjects **Band B** labarotory based subjects **Band C** Intermediate cost subjects
Band D Classroom based subjects **Band C1** Subjects outside bands A & B where costs exceed £7,500

Source: Universities UK analysis of HEFCE and OFFA data

38 These reflect allocations through HEFCEs teaching capital investment fund. In recent years the government has also provided additional teaching capital funding for STEM subjects which amounted to £200 million in 2015-16 and was allocated to universities through a competitive bidding exercise.

As described in chapter 1, in the period prior to 2005–06 the sector had experienced a significant reduction in the historic level of funding per student. Figure 2.18 shows that following the introduction of variable fees in 2006–07, the rate of funding for teaching received by institutions from mainstream teaching grants, tuition fees and capital grants increased in real terms across all bands. Following the 2010 comprehensive spending review and government cuts to teaching grants and capital funding, the level of resource available for teaching decreased with funding for laboratory based subjects (price band B) decreasing by 15% in real terms between 2009–10 and 2011–12. Across all subjects the level of teaching funding per student in 2011–12 represented a decrease compared to levels seen in 2006–07. The reforms in 2012–13 saw the rate of teaching funding for new students across all subjects increase in real terms compared to 2011-12.

The projected trend from 2014–15 onwards assumes that the fee cap is maintained at £9,000 in cash terms with fee levels consistent across subjects[39], student numbers remain at 2013–14 levels and, for the period to 2018–19, public funding is frozen in cash terms (thereafter increasing in cash terms by the average annual increase in GDP between 1994 and 2013, 2.2%)[40]. This results in a reduction in the funding rate in real terms across all subjects.

As noted above the IFS have estimated that resources to universities for teaching increased by 28% between 2011–12 and 2012–13, and applying the funding rates per new entrant in figure 2.18 to student numbers across subjects gives a similar figure of 27% over the same period. However it is important to note that this excludes the significant decline in funding prior to 2011–12 as a result of cuts to capital and teaching grants. If for example, funding rates are applied to student numbers for 2008–09 and 2015–16, the real term change in resource available for teaching is closer to a 5.2% increase. This is likely to decrease further as the cap on tuition fees leads to income from this source being eroded by inflation in the future.

Although at an aggregate level there has been an increase in the level of resource for teaching, changes in teaching income experienced by individual universities will depend on a number of factors, including: patterns of student recruitment, balance of subject provision, level of tuition fee, expenditure on access agreements, and student retention rates. Figure 2.19 shows the real terms change in income for undergraduate teaching (including income from tuition fees and teaching grants for full-time students, but excluding capital grants) against the change in full time UK and EU domiciled undergraduates between 2009–10 and 2013–14. This demonstrates the significant variation in funding and student recruitment outcomes across the sector over the period. In its report on the sustainability of learning and teaching in higher education in England, the Financial Sustainability and Strategy Group (FSSG) identified the increased volatility and competition resulting from the 2012 reforms as a significant change for higher education institutions following the reforms[41].

Universities have also delivered significant efficiency savings, estimated to amount to £1.1 billion between 2011–12 and 2013–14[42], which have enabled the sector to support investment in capacity, capital and the student experience, despite substantial cuts to capital grants.

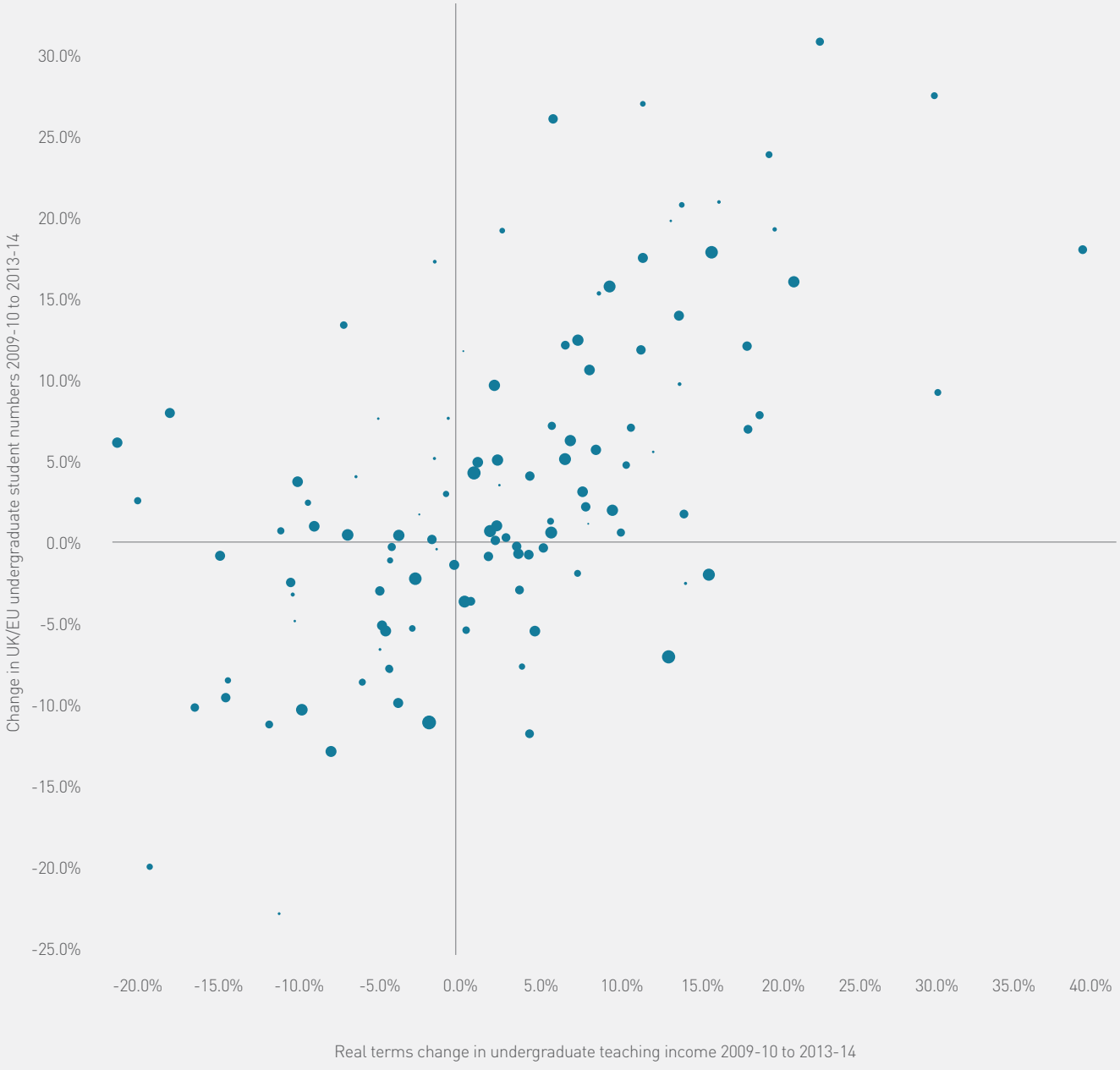
Financial health of the sector

In addition to changes in the way that institutions receive funding for teaching and the level of resource available, higher education institutions are also experiencing a number of other challenges to their long-term financial sustainability, including increased competition both at home and abroad, significant cuts to capital grants, increased liabilities for pensions and the impact of changes in government policy in relation to immigration and research funding. This section examines the extent to which the reforms have helped institutions respond to these challenges.

Across institutions in England, teaching accounts for approximately 50% of all long-term costs. Table 2.3 shows the proportion of income that institutions receive by activity against the full economic cost of that activity (based on Transparent Approach to Costing (TRAC) data[43]). Full economic costs refer to long-term costs that institutions face including those related to staff, equipment, support and facilities (such as libraries and information and technology systems), replacement costs of an institution's infrastructure and full costs of sustaining activities, including investment in infrastructure and future productive capacity.

39 Indicative evidence from Unistats data suggests that there may be some variation in fee levels by subject
40 Analysis of fiscal targets of the main political parties by the IFS suggests that some level of further cuts are likely to be necessary following the 2015 election (IFS (2015) Post-election Austerity: Parties' Plans Compared)
41 FSSG (2015) The Sustainability of learning and teaching in higher education in England
42 HEFCE (2015) Financial health of the higher education sector: Financial results and TRAC outcomes 2013-14
43 HEFCE (2015) History of TRAC http://www.hefce.ac.uk/funding/finsustain/trac/history/

Figure 2.19: Changes in home and other EU full-time undergraduate recruitment and real term change in recurrent teaching grant and tuition fee income, 2009–10 to 2013–14



FT UG UK/EU students (full person equivalent) 2013-14

150 5,000 10,000 15,000 20,000 23,845

Source: HESA

Table 2.3: Full economic costing (FEC) recovery by institution activity					
FEC recovery (income as % of costs)	**2006–07**	**2010–11**	**2011–12**	**2012–13**	**2013-14**
Publicly funded teaching	96.9%	102.3%	100.9%	100.7%	102.1%
Non-publicly funded teaching	130.1%	131.0%	132.0%	133.0%	136.6%
Total activity	93.7%	97.8%	97.8%	96.5%	96.5%
Source: HEFCE					

Table 2.3 shows that, despite the increase in fees in 2012–13, the sector reported a marginal surplus of 2.1% on publicly funded teaching activity, which broadly covers undergraduate teaching of home students, and that this figure was broadly in line with the level of surplus achieved prior to the reforms.

Expenditure on staffing and infrastructure form the two largest costs of teaching – making up 60% and 15% of institutional costs respectively – and the recent reforms to funding in England have seen universities face additional operational costs (associated with the market and the raised expectations of students)[44].

Universities have identified a number of areas of teaching that have seen increased investment following the reforms, these include:

- **Improvements in teaching and learning facilities:** More than 90% of institutions have reported improvements to teaching buildings and spaces[45], with 61% of those institutions planning to increase expenditure in capital in the next 12 months focussing on teaching facilities.[46]
- **Investment in staff:** 75% of universities reported increased support to students from academic staff (such as greater availability of informal drop-ins), approximately 50% reported increased contact hours with academic staff and/or increased small-group teaching arrangements for undergraduates, and around 40% reported improvements to class sizes.[47]
- **Improved support for students:** including scholarships and bursaries, outreach, mentoring and subsidising student residential and course costs.

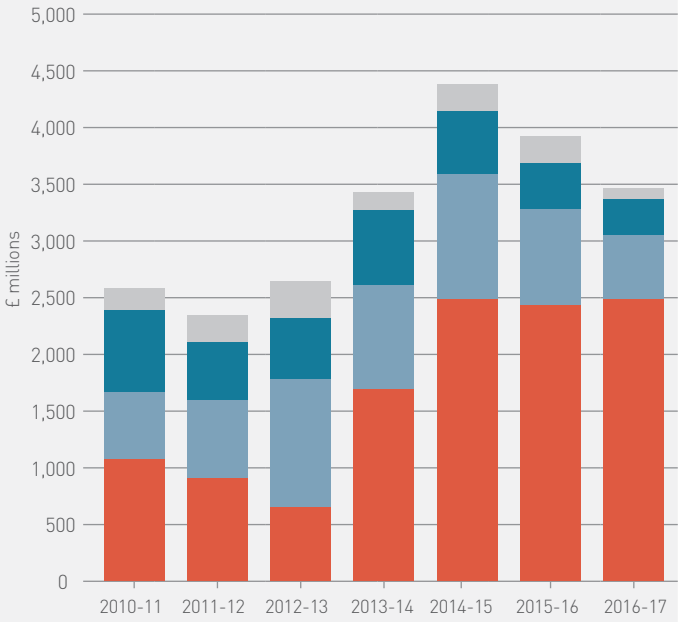
As a result of the continuing impact of historical underfunding trends outlined in chapter 1, it is estimated that by 2013 the sector still required £3.3 billion of investment in order to upgrade parts of its estate to a 'sound and operationally safe condition'[48].

This does not take into account additional investment to improve and add to current infrastructure that may be required to address increased student expectations or increased student numbers following removal of student number controls if the quality of the student experience is to be maintained and improved. The need for institutions to respond to these drivers is clearly reflected in sector projections for capital spending following the reforms. Figure 2.20 shows the most recent figures for actual and forecast capital expenditure by higher education institutions in England up to 2016–17[49], and suggests that despite the significant reduction in public grants for capital funding in recent years the sector is forecasting an increase in capital expenditure from an average level of £2.5 billion between 2010–11 and 2012–13, to just under £3.5 billion in 2013–14 and £4.5 billion in 2014–15.

Importantly, the way in which the sector will need to fund this increased expenditure is also changing with the proportion of capital expenditure to be financed by internal cash resources expected to rise from 10% in 2009–10 to around 70% by 2016–17.

44 FSSG (2015) The Sustainability of learning and teaching in higher education in England
45 ibid
46 Deloitte (2014) The higher education finance directors survey 2014: The prudence paradox http://www.deloitte.com/view/en_GB/uk/industries/government-public-sector/education/higher-education-finance-directors-survey/index.htm
47 BIS (2014) Research paper no. 169: Improving the student learning experience – a national assessment.
48 HEFCE (2015) Financial health of the higher education sector: Financial results and TRAC outcomes 2013-14
49 HEFCE (2014) Financial health of the higher education sector: 2013-14 to 2016-17 forecasts

Figure 2.20: Funding breakdown of capital expenditure (2010-11 to 2012-13 actual, 2013-14 to 2016-17 forecasts)



Receipts from sale of tangible assets
Deferred capital grants received
Mortgages and loans acquired
Net capital to be financed from internal cash

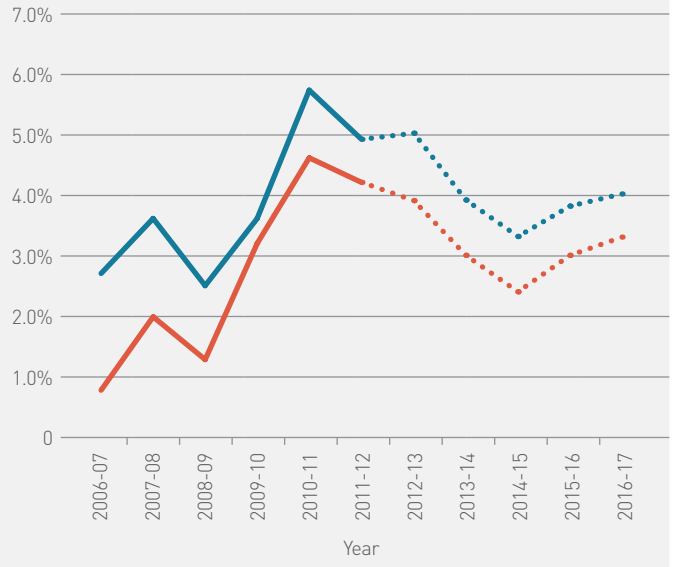
Source: HEFCE

This change in the way that institutions fund capital investment is highlighted in a 2014 UUK / HEFCE survey of institutions which asked about the importance of funding sources for capital investment (both teaching and research). This found that the internal cash generated from surpluses was viewed as either moderately, very or extremely important[50] for investment in new buildings and facilities by 74% of institutions, by 93% for upgrading or repurposing of existing infrastructure, and 96% for maintenance of existing infrastructure. Around 48% of institutions said that bank loans were important for investment of new buildings and to a lesser extent for upgrading or repurposing of existing infrastructure (24%).

The generation of cash reserves from surpluses have therefore become increasingly important to the financial sustainability of institutions. In its recent assessment of the sustainability of teaching learning at higher education institutions in England[51], the FSSG highlighted the importance of surpluses in the current higher education environment, noting that universities were becoming increasingly self-reliant in the financing of their own working and investment capital. This requires the generation of cash for these purposes, in order to manage greater uncertainty, volatility and risk.

Despite the increasing importance of generating a margin between income and expenditure, the sector's operating surplus is expected to fall from 4.6% in 2010–11 to 2.4% in 2014–15. Variations in surpluses across the sector also suggest that a reliance on internal cash resources to fund capital investment may not be possible for all institutions. The impact of the fixed fee cap and the rising costs of delivery, are also placing increased pressure on surpluses following the reforms. Sector forecasts for operating surpluses over the period 2013–14 to 2016–17, range from 2.4% to 3.4% of total income, suggesting that even small changes in income or expenditure could have a material impact on financial performance of the sector.

Figure 2.21: Operating and historical cost surpluses 2006–07 to 2016–17



Historic cost surplus (actual)
Historic cost surplus (Forecast)
Operating surplus (actual)
Operating surplus (forecast)

Sources: HEFCE, HESA

50 The survey defined 'Not at all important' = less than 5% of investment, 'Slightly important' = between around 5% and 20%, 'Moderately important' = between around 20% and 35%, 'Very important' = between around 35% and 50%, 'Extremely important' = more than 50%

51 FSSG (2015) The Sustainability of learning and teaching in higher education in England

In assessing whether the current level of surplus reported by the sector is adequate it is important to consider the long-term costs that institutions face. Table 2.4 provides a comparison of the actual level of surplus achieved by the sector against the level required to cover long-term costs including universities' needs for financing and investment, as well as changes in the value of infrastructure costs over time. These figures show that for 2013–14, the higher education sector required a surplus of £1.95 billion – or 7.6% of total income – to cover its long-term costs across all areas of activity. This compares to an actual surplus of around £1.1 billion or 4.2% of income, leading to a 'sustainability deficit' of £883 million, and represents an increase from the figure of £726 million reported in 2011–12 and £870 million in 2012–13. This evidence suggests that the current level of income to the sector is not enough to finance all of its activities and investments in the medium-term, and that at an aggregate level, the sector is not generating the necessary level of surplus to ensure long-term sustainability[52].

Table 2.4: Summary of TRAC data 2011–12 to 2013–14

	2011-12	2012-13	2013-14
Target sustainability surplus to cover long run costs (full economic costs) as % of total income	£1, 761M 7.6%	£1, 876M 7.7%	£1, 947M 7.6%
Actual surplus* as % of total income	£1,036M 4.5%	£1,007M 4.1%	£1,064M 4.2%
Sustainability gap as % of total income	(£726M) (3.1%)	(£870M) (3.6%)	(£883M) (3.5%)

Source: HEFCE

* This figure is different from the surplus reported in the annual financial statements because of adjustments in respect of joint ventures, minority interests and endowments in the TRAC returns.

In addition to the financing of capital investment from net internal cash, in light of significant cuts to public capital funding, the sector has also borrowed an additional £501 million to help fund capital investment, resulting in total sector borrowing increasing to 26.3% of total income – or £6.7 billion – at the end of July 2014. Borrowing is projected to rise further to a high of 28.9% of total income by the end of 2015–16, which is likely to increase the cost of interest payments to £444 million, compared to £367 million in 2012–13 placing further pressure on cash reserves in the future.

The sector requires strong liquidity, in order to manage increased pressure on cash reserves and increased volatility of the new funding system. By the end of July 2014 net liquidity of the sector increased by £285 million to £7.7 billion, producing a net cash position in the sector of £1.0 billion. This is relatively small compared with an overall income of £25.6 billion and is lower than the net cash position reported in 2012–13, which was £1.2 billion.

In addition to the challenge of funding capital expenditure under the current student funding system, responses to the student funding panel call for evidence also identified a number of other areas where universities face challenges to their long-term financial sustainability.

1. **Changes in pension reporting:** from 2015–16, institutions will be required to use the financial reporting standard FRS102, which requires recognition of liabilities relating to deficit recovery plans for multi-employer pension schemes on balance sheets. The latest interim valuation of the Universities Superannuation Scheme indicates that the deficits are likely to be significant (as of the 31 March 2014, indicative figures show that the USS scheme was £13 billion in deficit), and that a deficit recovery plan is required. A study of the impact of these changes found that, across four pilot institutions, the new liability reduced retained earnings by 20%[53]. For one institution the impact of the new liability was close to 40% of existing retained earnings, suggesting that this could present a significant adjustment for some institutions.

52 HEFCE (2015) Financial health of the higher education sector: Financial results and TRAC outcomes 2013-14
53 BUFDG (2013) New UK GAAP and FE/HE SORP: The Pilot Conversion Summary Report

2. **Erosion of income from fees:** Under the current system of funding, there is no scope for institutions that have already reached the £9,000 cap to increase fees for full-time undergraduate students from the UK or EU. With no increase in the cap, its value will be eroded by inflation to £8,000 by 2019–20, and to £7,500 net of expenditure on access agreements (2012–13 prices). It should be noted that increases in institutional costs are likely to differ from standard measures of inflation. The higher education pay and prices index previously produced by Universities UK showed that on average between 2000 and 2010, the increase in institutional non-pay related costs were 1.3 percentage points above the increase in RPIX. With the erosion of the tuition fee cap, English institutions' ability to invest in new infrastructure and improvements in teaching will be further constrained.
3. **Impact of immigration reforms:** government reforms to immigration have led to increased uncertainty in recruitment of non-EU students. Figures for 2013–14 indicate that total overseas student numbers were 2.9% lower than projected; indicating growth was not as strong as expected. With income from international students' tuition fees accounting for 12.7% (£3.9 billion) of all income to the sector in 2013–14[54], slower growth could have a material impact on the ability of institutions to generate surpluses required for increased capital investment and financial sustainability.

The sector has demonstrated that it has been able to adapt positively to the current student funding system, particularly in light of significant reductions to public funding for teaching capital. However, the challenges facing the sector over the next five years and the lack of potential sources of additional income from grants for teaching or tuition fees, suggest that the current trajectory may not be sustainable in the long-term.

HEFCE has noted that forecasts for lower surpluses, shrinking liquidity and increased borrowings suggest that universities in England are now consuming their cash reserves to sustain themselves, signalling a trajectory that is not sustainable in the long-term. Without increased surpluses and continued government support, there is a risk that the sector will be unable to deliver the scale of investment required to meet student demands, build capacity and ensure that the sector can remain internationally competitive'[55].

Non-financial impact of the reforms

This section considers the non-financial impact that reforms to student funding have had on universities across a range of areas. This includes the extent to which the reformed system allows and encourages universities to widen access and improve participation in higher education, improve teaching quality and the employability of students, develop innovations in teaching, and support flexible forms of provision.

Widening participation

The reforms have resulted in a significant increase in funding for widening participation, with a total of £1.08 billion allocated in 2014–15 from funding council grants and institutional funding, representing an increase of 33% compared to 2011–12. This is despite a reduction in the student opportunity funding allocated by HEFCE (from £405 million in 2011–12 to £366 million in 2014–15) and the government's decision to reduce its allocation for the national scholarship programme (NSP) from £150 million to £50 million in 2014–15.

Over the same period, institutions have absorbed reductions in public funding in order to maintain and increase activity to widen access. This includes reductions to the Access to Learning Fund (which stood at £37 million in 2013–14, before being absorbed into mainstream HEFCE funding), AimHigher (funding ceased in July 2011, with £252m invested between 2008–09 and 2010–11), and cuts that have been announced for the Disabled Students' Allowance (estimated reduction of 70% of the £125 million allocated in 2011–12[56]).

A literature review of research into widening participation to higher education[57] found that the increasingly competitive environment following reforms impacted on more collaborative approaches that have been shown to be more effective in widening participation. This was reflected in responses to the panel's call for evidence, which noted the key role that activity universities were undertaking as part of their OFFA access agreements had played in encouraging collaborative activity across the sector, particularly in the context of increased competition.

54 HESA Finance Plus 2013-14
55 HEFCE (2015) Financial health of the higher education sector: Financial results and TRAC outcomes 2013-14
56 'Grant cuts will hurt disabled students' http://www.agent4change.net/inclusion/inclusion/2216-grant-cuts-will-hurt-disabled-students-bata-warning.html
57 HEFCE (2013) Literature review of research into widening participation to HE http://www.hefce.ac.uk/media/hefce/content/pubs/indirreports/2013/literaturereviewofwptohe/Executive%20summary.pdf

Research into widening participation to higher education by HEFCE[58] also noted that uncertainty over future funding for widening participation, in addition to changing institutional priorities, made it increasingly difficult for institutions to plan initiatives in the medium term. Other research has noted that 'whilst the processes of marketisation may lead to investment in high-class facilities, it may also deflect resources from widening participation activities'[59].

A number of responses to the panel's call for evidence suggested that institutional investment in initiatives to widen participation, over and above requirements by OFFA, were under pressure, due to volatility in tuition fee income and the need for institutions to produce larger surpluses.

A number of institutions acknowledged that the current system allows for investment in widening participation activities, but expressed concerns that this is becoming increasingly difficult as funding pressures increase. It was noted that any increase in funding following the reforms was only just beginning to replace the loss of funding from schemes that had been cut (such as AimHigher and Connexions, the National Careers Service). Continuing uncertainty surrounding student opportunity funding was also highlighted, with universities noting that this made it difficult to plan for long-term initiatives, including collaborative activity.

Pressures on the funding of initiatives to widen participation have also resulted in a greater focus on evaluation of impact. OFFA has noted that institutional access agreements provided for 2015–16 have seen increased consideration of evidence on the impact of spending including sector-wide and institution-specific research[60] (including research by OFFA which suggests that institutional expenditure on bursaries has no impact on retention rates or application behaviour of disadvantaged students). Increased use of an evidence-based approach on the impact of widening participation initiatives has resulted in expenditure moving away from fee waivers and towards support for access, student success and progression activity, with 84.6% of institutions now including progression spend in their access agreements.

In responses to the panel's call for evidence, a number of universities felt that further consideration needs to be given to how effectively the large sums involved in supporting widening access and participation are addressing the real problems of under-representation of certain groups.

Teaching quality

Although the UK higher education sector has an international reputation for high quality, a key difficulty in determining the impact of reforms on the student experience in relation to teaching quality is the lack of appropriate measures to allow comparisons over time and across institutions. All universities in England are subject to periodic review by the Quality Assurance Agency for Higher Education. This provides assurances that necessary thresholds for quality and standards are in place, but does not provide an appropriate set of measures to determine changes in teaching quality over the period of reforms.

Although no explicit evidence was provided to the panel's call for evidence (which demonstrated a link between the new funding regime and improvements in the quality of teaching), it was noted that the effect of the funding system – together with increased national and international competition and increased visibility of the NSS and league tables – had arguably led to an acceleration of enhancements already being implemented across the sector. These developments had also encouraged universities to target resources towards initiatives which added value to the student experience (as opposed to other priorities).

A number of universities noted that continued high levels of satisfaction reported by the National Student Survey – combined with the fact that it was relatively rare for the QAA to identify causes for concern in institutional academic standards and quality – suggested that teaching quality remained high across the sector. However, it was felt that it would be difficult for the sector to maintain this excellence if the unit of resource continued to be eroded in real terms.

Employability

The majority of views expressed to the call for evidence felt that the current system encouraged institutions to fund and pursue improvements in employability, including greater collaboration between employers and universities.

58 Ibid
59 Stephenson et al (2014) Pedagogic stratification and the shifting landscape of higher education' https://www.heacademy.ac.uk/sites/default/files/resources/PedStrat_Finalreport.pdf
60 OFFA (2014) Access agreements for 2015-16: key statistics and analysis

Many respondents pointed out that increased competition in the recruitment of students and the use of employability measures in league tables were key drivers in improving the student experience in relation to employability. It was felt that employability formed an important component of the institutional offer, and was essential if institutions were to remain competitive. The organisations that dealt directly with students during the application process also noted that students and their sponsors were attaching greater importance to employability than under the previous funding system.

Innovations in teaching

Innovations in teaching potentially cover a great breadth of activity, including: adoption of technological change; changes in the way that students and staff interact; increased course flexibility; and new investment in infrastructure, facilities and equipment[61]. Definitions of improvements to teaching can also vary according to the different perspectives and expectations of students and institutions.[62]

Recent developments in innovative teaching have included introducing students to new types of generic skills and experiences (for instance, those related to employment, volunteering, and entrepreneurialism), development of distance and blended learning styles of teaching, greater availability of massive open online courses (MOOCS), and increased use of technology as an integral part of the teaching and learning experience[63].

A common response to the panel's call for evidence was that it was still too soon to understand the impact of reforms to student funding on activity in this area and the role that the new funding system can play in encouraging innovations in teaching and learning. It was felt that there were some signs that activity in this area was being encouraged in response to increased marketization. The increased focus on student experience was felt to have led to some improvements and innovations, but respondents noted that volatility of the current system had resulted in some institutions taking a more risk-averse approach, preferring to focus on changes that deliver improvements and innovations in measures related to NSS scores such as feedback and assessment rather than wider innovations in teaching and learning delivery.

Universities felt that although the current system allowed them to be strategic in developing innovations in digital learning, this would be severely constrained in the future without changes to the fees and loans system, particularly in relation to the fee cap and support for STEM subjects. Some universities also noted that the increasing focus on students as consumers works against universities, using income to fund longer-term initiatives on curriculum innovation, as this yields dividends for future students but is of less relevance to those currently studying.

Flexible study

As noted in chapter 2, part-time study has seen recruitment decline by 46% between 2010–11 and 2013–14, with the reduction focused principally on non-Bachelors undergraduate courses (including institutional credits, and certificates and diplomas of higher education).

The reforms have presented significant challenges to institutions that continue to offer part-time provision, with institutions reporting that increases in fees (in order to maintain quality following the loss of grant funding), and greater price sensitivity on the part of mature students, have led to a drop in demand for part-time provision. Where little public funding is available (for example, for students wishing to study short courses and modules), institutions were responding to reductions in demand by reconsidering their offers[64].

A number of respondents to the call for evidence felt that one of the key outcomes of the current funding system was the increasing dominance of the traditional three year full-time degree, which had resulted in fewer options being available to potential students wishing to participate in higher education. It was felt that much of the debate surrounding the implementation of the current system had been skewed towards full-time study for a first degree, and much less attention has been paid to the wider range of qualifications that universities offer.

61 Leadership foundation for Higher education (2013) Changing the learning Landscape
62 BIS (2014) Improving the Student Learning Experience – a national assessment
63 FSSG (2015) The Sustainability of learning and teaching in higher education in England
64 UUK (2014) Trends in undergraduate recruitment

THE IMPACT OF THE REFORMS ON THE DEVOLVED ADMINISTRATIONS

Differing fee arrangements across the UK for different groups of students have had an impact on the flow of students and funding across the devolved administrations and from other parts of the European Union. Table 2.5 shows the change in full-time and part-time undergraduate entrants by country of UK institution and domicile of student, between 2010–11 and 2013–14. The greatest proportional reductions (20% or more) in undergraduate entrants over this period were seen for other European Union students to institutions in Wales and Northern Ireland, for students from Scotland to institutions in England, and students from England to institutions in England (as a result of the reduction in part-time numbers described in Chapter 2).

In response to the call for evidence, UCAS provided information on recent trends in application rates (proportion of the population applying for entry into higher education) for full-time undergraduate provision across the UK. This highlighted that:

- the changing pattern of application rates from Scotland to England is consistent with changes in behaviour due to a variation in fees, with application rates falling for Scottish applicants to English institutions and increasing for Scottish applicants to institutions in Scotland
- following the reforms in England and Wales, application rates of Welsh students to England increased
- following the reforms in England, application rates from Northern Irish students to English institutions fell, while correspondingly, application rates to institutions in Northern Ireland had increased
- future changes to funding policy that result in further differentiation in fees would be expected to generate behavioural changes in recruitment across the UK along the same lines

Table 2.5: Change in full-time and part-time undergraduate entrants between 2010–11 and 2013–14 by country of institution and domicile of student

		Domicile of student				
		England	Scotland	Wales	Northern Ireland	Other European Union
Country of institution	England	-21% -119,205	-23.5% -2,880	-10.9% -1,342	-20.7% -1,275	-21% -5,695
	Scotland	7.7% 345	-7.9% -3,704	9.7% 15	-6.6% -75	6.2% 290
	Wales	-1% -115	-18.3% -20	-4.1% -1,120	-3% -5	-21.3% -635
	Northern Ireland	50.2% 130	0% 0	-46.2% -5	5.9% 840	-59% -735

Source: HESA

Note: Colours reflect groups of proportional change (dark blue highest increase, dark orange largest decrease)

Comparison of funding levels across the UK

In its analysis of potential funding differences between the higher education sectors in England and Scotland, the joint Scottish government/Universities Scotland technical group estimated that by 2014–15 an annual funding gap of £263 million may develop (assuming an average English fee of £8,000 that increased by inflation).[65] Other estimates have found that, assuming an average fee of £7,200 and cuts to teaching grants as outlined by BIS in 2010, funding per FTE in England would increase to £8,700 by 2014–15 compared with £7,200 in Scotland (assuming no change to funding policy in Scotland).[66]

Responses to the call for evidence also noted the increasing importance of fee income from English students for some institutions in Scotland, with income from this source playing a more integral role in the Scottish higher education funding system. A number of respondents felt that further changes in student funding policy in England were likely to impact on the recruitment and decision-making of rest-of-UK students who might be considering study in Scotland.

Although institutions in Wales receive up to £9,000 in tuition fees, with fees above £3,575 paid for by the Welsh government, a comparison of grant funding allocated by HEFCE to allocations received by Welsh institutions suggests that a funding gap is developing. When scaled using the Barnett Formula, £224 million of grant funding is allocated to institutions in England compared to £157 million in Wales.[67]

Responses to the call for evidence also noted concerns related to the increased subsidy provided by the Welsh government, in response to the increase in fees in England, particularly around the amount of funding that is being spent on tuition fees for institutions in England contributing to a funding gap between England and Wales. It has been estimated that the removal of student number controls in England could potentially result in additional costs for the Welsh government of up to £7 million in fee grant payments, £5 million in tuition fee loans and £9 million in further support costs for Welsh students studying in England.[68]

SUMMARY OF THE IMPACT OF THE REFORMS

The full impact of the student funding reforms in England will not be known for some time, particularly the long-term effects on public finances. However, there are a number of points that can be drawn from the evidence available to date:

- There is no evidence that the funding reforms of 2012 have deterred young, full-time students from applying to university. Numbers of applications from all socio-economic groups have been increasing steadily.
- Numbers of part-time and mature students have, however, declined. This may be due to a range of factors, of which changes to the student funding system is one.
- The structure of the reformed student funding system means that there is greater uncertainty over the long-run costs to government. These will be influenced by such factors as: graduate employment outcomes, future labour market conditions, graduate repayment behaviour, and wider economic factors which affect the cost of living.
- While the RAB charge is a useful means of comparing estimates of the long-term costs of the system in the present, and also of comparing different options for reform, it is misleading to focus on this as the most significant indicator of the impact of the reforms. This is due both to the uncertainty surrounding the calculation and the treatment of the RAB charge in the public accounts. Of much greater significance in policy terms are the factors that drive the estimates of the RAB charge, since they now drive the costs of the system.
- The 2012 reforms have increased income to universities in aggregate. This has compensated for reductions in funding from other sources (for example, capital funding for teaching), and the need to cope with increased capacity. It is also a continuation of the policy of restoring funding to universities following the historic decline in the period leading up to the late 1990s. However, there are indications that the sector is not achieving the level of surplus required to cover all of its long term costs and this gap has increased following the reforms.

65 Report of the Scottish government – Universities Scotland technical group on higher education (2011) http://www.scotland.gov.uk/Resource/Doc/82254/0114163.pdf
66 Dearden et al (2012) Higher Education Finance in the UK
67 Universities Wales (2014) Welsh Government draft budget proposals for 2015-16: A Response by Higher Education Wales
68 Ibid

CHAPTER 3: OPTIONS FOR REFORMING THE STUDENT FUNDING SYSTEM

This section looks at a number of options for reforming the student funding system. These were selected by the panel following consideration of proposals submitted through the panels call for evidence. Following on from evidence of the impact of the current system on students, the government and universities, the aims for these options in broad terms were:

- the reduction of potential long-term costs of the student funding system to government
- to ensure that all students who have the ability to benefit from a university education can do so
- to support social mobility
- to maintain the existing world-class level of university teaching and learning and ensure it is sustainable

All of the options selected therefore maintain a system that is free at the point of entry for students who are qualified and able to benefit from a university education and provide the same level of funding to universities for teaching. Further options for increasing maintenance support to students for the costs of living and supporting part-time provision are provided in the later sections.

The analysis in this section considers the impact of each option for reform on the long term cost to government and future graduate repayment and debt, and is drawn from modelling and analysis carried out for the Student Funding Panel by the Institute for Fiscal Studies. Before looking in detail at the options, it is worth bearing in mind what the aims of reducing the long-term costs are, and how this might translate into releasing resources that could be used to support other priority policy areas within higher education.

The options that follow are all assessed predominantly by comparing their impact on long-term loan subsidy (and thus taxpayer contribution), as measured by changes in the RAB charge. They are also assessed in terms of their impact on graduate repayment behaviour – namely, which graduates within the overall future earnings distribution are likely to contribute most to reducing costs in the long-run.

Reducing the RAB charge by itself does not, however, directly lead to the release of resources to divert to other areas of higher education expenditure. This is due to the factors outlined in previous sections: the RAB charge is a non-cash item in the BIS budget that is used to estimate in net present value terms the long-term cost of subsidising the student loan system. It falls outside the Office of National Statistics' definition of public sector current budget (PSCB), and does not impact the fiscal aggregates. It is also a ring-fenced item within the BIS budget, and transfers out of the ring-fence are not permitted without the approval of Treasury[69].

If changes are made which reduce estimates of the RAB charge over the long term, then any increase in the cash elements of the BIS Resource Departmental Expenditure Limit would still need to be negotiated with Treasury as part of the spending round discussions. Conversely, if the RAB was to increase over time, then the impact on the cash elements of the BIS RDEL would also need to be negotiated with Treasury (in this scenario with the expectation that they would need to be reduced to accommodate a higher RAB charge). However, following recent changes in the treatment of student loans in BIS departmental budgets (HMT Consolidated budgeting guidance in July 2014) there is now a mechanism for dealing with changes in the RAB above a target figure set by HMT. In summary this means that HMT sets a target RAB for BIS (currently 36%) which sits as a non-cash impairment in the BIS RDEL. Any excess RAB charge over this is applied to the BIS RAME and charged back to BIS RDEL over the next thirty years potentially impacting on other areas of departmental spending. There is therefore now a more immediate incentive for BIS to reduce the RAB charge closer to levels agreed with the Treasury. However it is important to note that, as the IFS has pointed out[70], the focus of attention in future needs to divert from a fixation on the RAB charge, to the overall need for continued investment in the higher education sector in England, from all sources.

69 Universities UK (2013) The funding challenge for universities
70 IFS (2015) There's more to higher education funding than the RAB charge

Nevertheless, significantly reducing the RAB charge does allow scope for negotiating an increase in RDEL in BIS that could be used for other purposes. This report does not go into detail in assessing what these options are, but high-priority candidates for increased grant funding include:

- *Increased maintenance support for students:* Feedback collected by the panel, directly from students, suggests that current levels of support available for maintenance are not adequate to meet student needs.
- *more financial support for part-time and/or mature students (either directly, or in the form of grants to institutions):* Evidence collected by the panel suggests that the decline in part-time provision is due to a number of factors including the funding reforms, the economic downturn and reductions in public funding. However, greater financial support for part-time provision could be considered to help address some of these issues.
- *more support for high-cost subjects, to maintain the quality of the overall teaching infrastructure:* Chapter 2 showed that even though the reforms had led to an increase in the resource available for teaching, the potential lack of any further increase in income from tuition fees or grant may lead to further pressure on the funding for high cost subjects in the future.
- *maintain funding to support widening participation through the Student Opportunity Fund (or its future equivalent):* Evidence collected by the panel has suggested that the reforms have not had a significant impact on the recruitment of young students from disadvantaged backgrounds. Use of any additional funding to maintain support for activity that is currently taking place in support of widening participation could also be considered

This list is not exhaustive, and the options are not mutually exclusive.

REFORM OF THE STUDENT LOAN REPAYMENT SYSTEM

Bearing the above points in mind, this section looks at five options for making changes to the student funding system in England. These are:

1. modifying the parameters in the current system
2. freezing all the thresholds at their current level
3. making repayments on total income once above the earnings threshold
4. a 'pseudo' graduate tax
5. the Labour Party proposal

Options 1–4 are primarily concerned with reducing the long-term cost to taxpayers, while option 5 is mainly concerned with reducing the cost to graduates.

The baseline position

In the current system, students are entitled to take out loans to cover the full value of their tuition fees, as well as a contribution towards their living costs (the value of which depends on their family income and whether they study inside or outside London). They do not have to make repayments until after they graduate, and only then once their income rises above a certain threshold. They must continue making repayments until their loan is fully repaid, or until the end of the repayment period, whichever comes first.

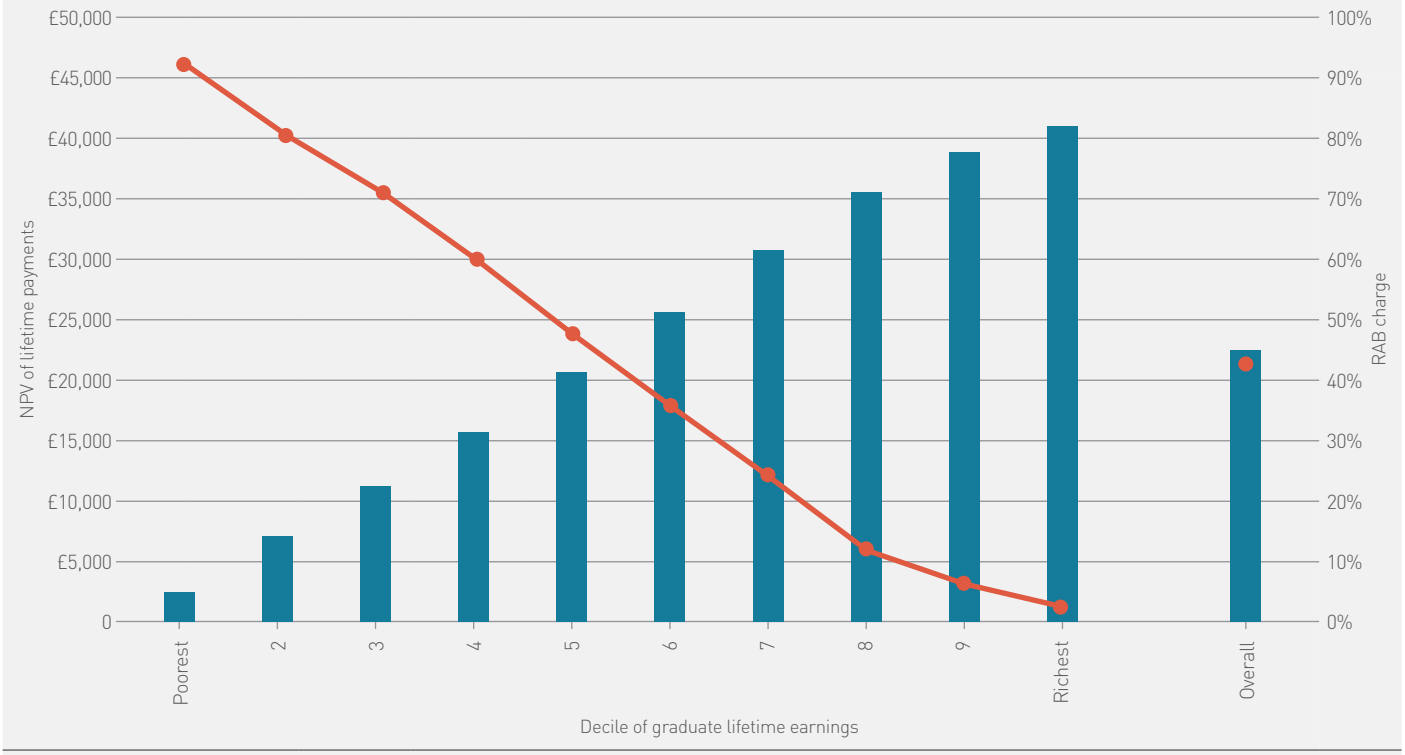
The key features of the current undergraduate loan system are as follows:

- Students can borrow the full value of their tuition fees each year (up to a cap of £9,000 per year) and a maximum of £7,675 per year in maintenance loans (if they live away from home in London). They face a real interest rate of 3% while they are studying, i.e. their debt increases in value whilst they are at university. This means that a student on a three-year course being charged the maximum tuition fees and receiving the maximum maintenance loan will leave university with debt of £51,500.

- Individuals do not have to make repayments until after they graduate, and only then once their income reaches £21,000 a year (in 2016 prices). Once their income crosses this lower income threshold, they must repay 9% of their income above the threshold, so, someone with an income of £22,000 per year would have to repay £90 in that year (9% of £1,000), while someone earning £31,000 per year would have to repay £900 in that year (9% of £10,000). This lower income threshold is assumed to increase in line with average earnings from 2016 onwards.
- Once they have left university, graduates face a real interest rate of 0% if their income is less than the lower income threshold and 3% if their income is above an upper income threshold (currently set at £41,000, and assumed to increase in line with average earnings). The interest rate charged increases linearly in between (for instance, someone with income of £31,000 faces a real interest rate of 1.5%).
- Any outstanding debt that remains at the end of the repayment period (30 years after graduation) is written off.

In their modelling, the IFS uses the government's preferred real discount rate of 2.2%, and discount all future payments (both from and to the government) back to 2012 (the time at which the decision to 'invest' in the 2012 cohort of students was made).

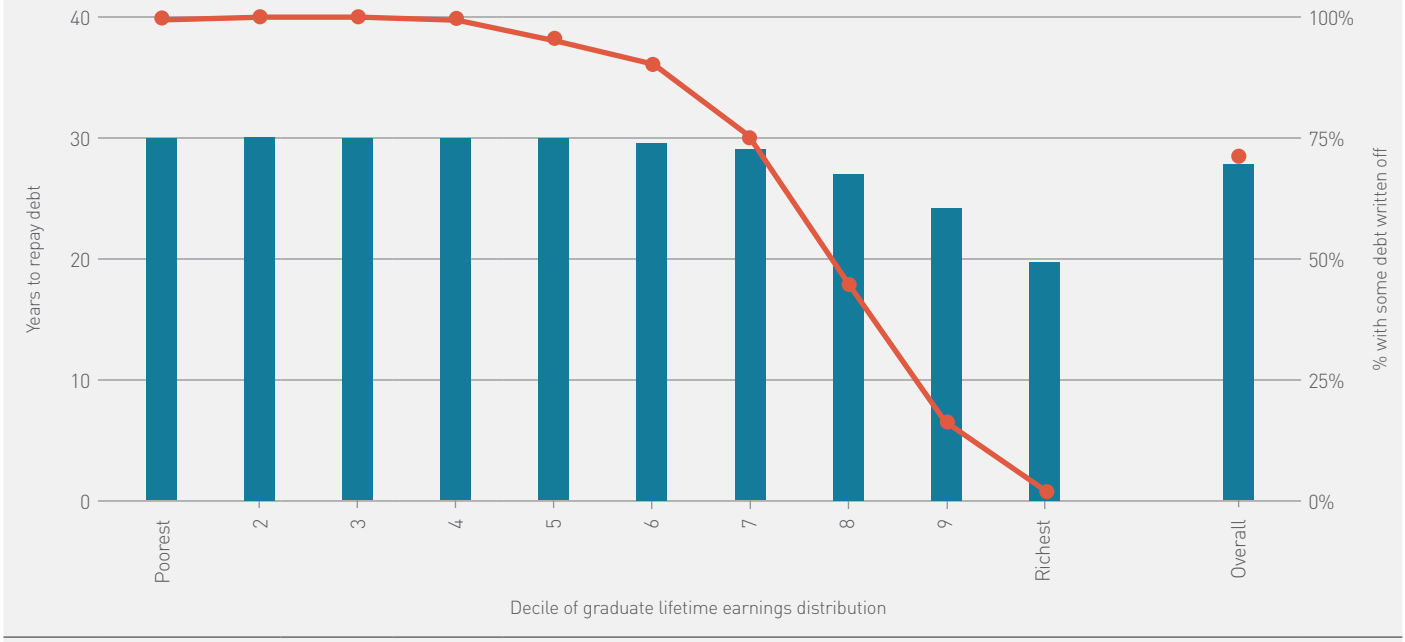
Figure 3.1: Net present value of repayments and RAB charge, by decile of graduate lifetime earnings distribution: default 2012 system (2014 prices)



Source: IFS

Note: 'NPV of lifetime repayments' is the value of expected future graduate repayments in today's money (i.e. in 2014 prices, discounted using a discount rate equal to the government's assumed cost of borrowing (RPI+2.2%)). Assumes all graduates take out the maximum loan to which they are entitled, repay following their repayment schedule and have no unearned income.

Figure 3.2: Average years to repay and percentage with debt written off by decile of graduate lifetime earnings: default 2012 system



Source: IFS

Figures 3.1 and 3.2 reproduce similar figures in Crawford, Crawford and Jin (2014) and Crawford and Jin (2014).[71] They show that, on the basis of current estimates of future graduate earnings growth – using the government's preferred discount rate, and under the assumption that the existing loan parameters remain in place for the entire repayment period – it is estimated that graduates will, on average, repay around £23,000 in NPV terms over their lifetime, over an average of 28 years. But this still means that over 70% of graduates are likely to have some debt written off at the end of the repayment period.

These write-offs, together with the fact that the average interest rate charged to graduates is less than the assumed cost of government borrowing (the discount rate), give a long-term cost to government of issuing student loans of around 43p per £1 (equivalent to a RAB charge of 43%), under the assumptions outlined above. This means that the loan subsidy is expected to be around £17,400 per student. This is an uncertain cost whose true value will not be known for decades to come. However, the current estimate of this figure can be added to the certain up-front costs of teaching and maintenance grants (of around £7,100 per student) to give an approximate estimate of the total taxpayer contribution to the funding of undergraduate higher education per student. Using the government's preferred discount rate and the OBR's forecasts of future graduate earnings growth, IFS estimates suggest that this figure will be around £24,500 per student for the 2012 cohort. For a cohort of around 300,000 undergraduate students, this amounts to an estimated government contribution of around £7.3 billion per cohort.[72] (Assuming constant group size, this can also be thought of as the total cost per year.)

Figures 3.1 and 3.2 also show how these figures vary across the distribution of lifetime earnings. All graduates are split into 10 equally-sized groups (deciles) on the basis of their earnings over the 30-year repayment period (referred to as 'lifetime' earnings as a shorthand in what follows). The 10% of graduates with the lowest lifetime earnings repay, on average, less than £3,000 in NPV terms: almost none repay their loans in full and so most are liable for repayments for the full 30 years. They have an average RAB charge of 93%. The 10% of graduates with the highest lifetime earnings, on the other hand, are highly likely to repay their loans in full: they repay over £40,000, on average, in NPV terms and only 2% have some debt written off.

71 There are small differences in estimates as a result of updated student number estimates.

72 Note that a cohort size of 300,000 students is assumed here, which was the size of the 2012 cohort (the focus of this report) and makes our total public cost figures consistent with those in Crawford, Crawford and Jin (2014). Figures for different cohort sizes can be calculated by multiplying up the per-student figures.

The current system of student loans is therefore highly progressive: it is estimated that the highest-earning graduates are highly likely to repay their loans in full, while the government subsidises an increasing proportion of each £1 that it lends to graduates with lower lifetime earnings. The progressivity of the system has significant implications for the distributional consequences of reforms that might seek to reduce the government subsidy inherent in the student loan system.

Modifying the existing loan parameters

The current student funding system contains a number of parameters that could each be modified (either singly, or in combination) to reduce the long-term cost[73]. Changes to the loan repayment parameters could be introduced as part of an overall package of higher education funding reforms.

Table 3.1 below sets out the principal loan system parameters, the options for modification, and the likely impact of any changes.

From this it can be seen that there are a number of changes that could be made to reduce the long-run cost of the subsidy to government, while allowing the system to remain progressive overall and ensuring higher education remains free to students at the point of entry, and maintaining income to universities to support expansion and high-quality teaching and learning. The modification with the largest impact is reducing the earnings threshold at which repayments begin (currently set at £21,000). For example, reducing the threshold to £18,000 in 2016 and uprating it annually by average earnings every year thereafter reduces the RAB charge by 6.4 percentage points, from 43.3% to 36.9%. Holding the threshold at its current level in 2016 and then uprating it by 2% a year reduces the RAB charge further – from 43.3% to 31.1% (A full analysis of the relative impact of all the possible changes set out above is available in the relevant IFS report[74]).

Table 3.1: Impact of changes to principal loan system parameters

Parameter	Action	Impact on graduates	Impact on government	Impact on HEIs
Repayment threshold (currently £21k)	Reduce Uprate by RPI or another deflator (currently uprated annually by avg. earnings)	Graduates in middle 80% of earnings distribution see their repayments increase the most Small effect on high or low earners	Reduces RAB charge	None
Repayment rate (currently 9% on earnings over threshold)	Increase	High earners pay off debts faster V high earners reduce overall debt Reduces loan subsidy for low earners	Reduces per-student level of loan subsidy Savings dependant on new level of repayment rate	None
Interest rate (currently RPI + 3% while studying; variable after)	Various: Reduce or increase while studying Reduce or increase post-graduation	Increases loan subsidy if reduced while studying Reduces loan subsidy if increased post-graduation	Increases RAB charge if reduced while studying Reduces RAB charge if increase post-graduation	None
Loan write-off period (currently 30 yrs.)	Increase to 35 years	Reduces loan subsidy for middle-earning graduates (they pay more)	Reduces RAB charge	None

Source: IFS

73 This differs from the option to freeze all the thresholds at once, modelled below, in that it examines the impact of changing one or more parameters at a time.
74 IFS (2014) Estimating the public cost of student loans

Improving loan collection mechanisms

Another method of reducing the long run cost of the student loan system to government is to ensure that the collection process is as effective as possible. Following the National Audit Office assessment of student loan repayments[75] the government implemented a number of changes including updating the model used to estimate student loan repayments, review and revision of targets for loan collection and greater transparency in repayment rates.

Further improvements however could be made to collection of loans from graduates who move overseas. Currently, student loan repayments are collected by the HMRC through the P.A.Y.E tax system for UK-domiciled graduates. Those living outside the UK for more than three months have to complete an annual Overseas Income Assessment form containing their current employment details, so that the Student Loans Company can assess what repayments should be made. Repayments are affected by the earnings threshold set for specific destination countries. While this is in principle the most efficient option, steps could be taken to improve the overall effectiveness of loan collection, learning lessons from the private sector. More advanced techniques for tracking graduates could be introduced, together with methods of reminders and notification. Options for improving student loan recovery mechanisms should be analysed and implemented as a priority.

Freezing the thresholds in the current system

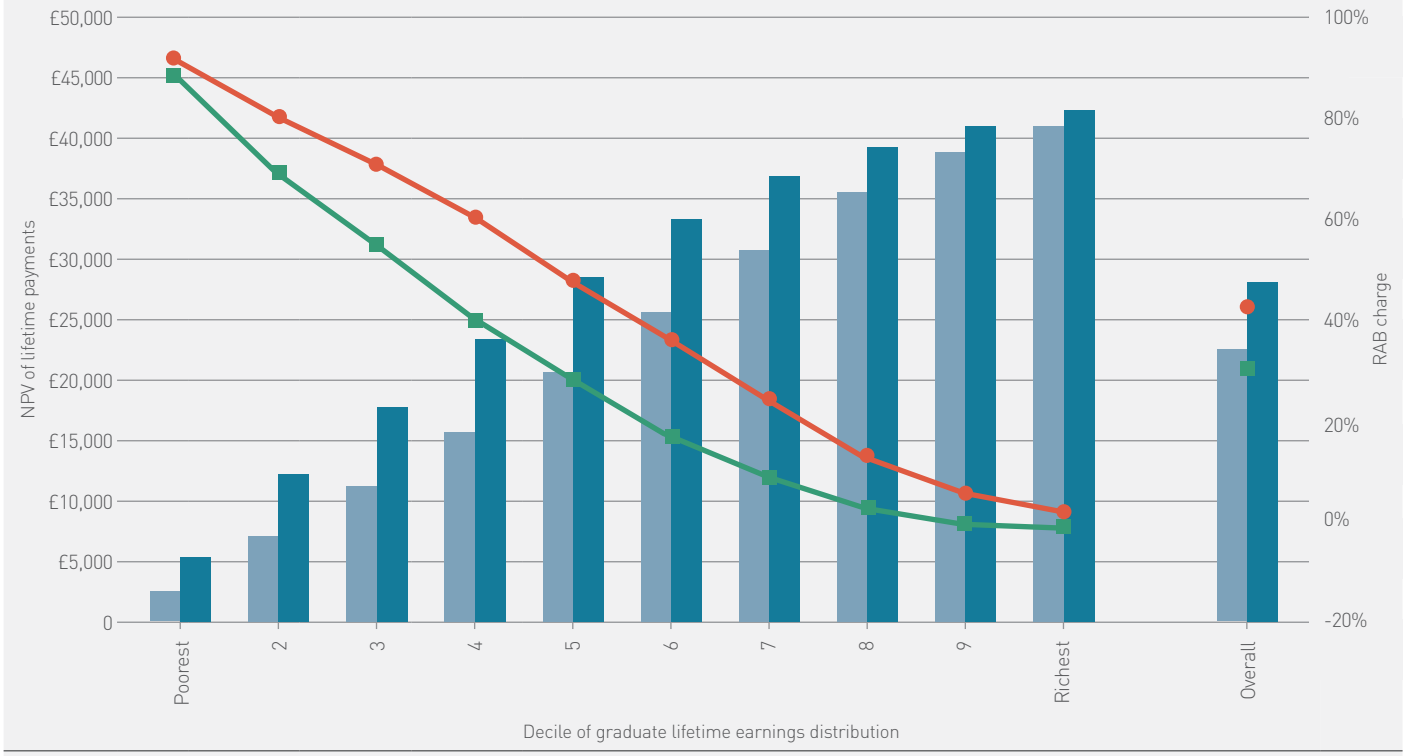
The key features of this system as modelled by the IFS are as follows:

- The lower and upper income thresholds are frozen in nominal terms for a period, meaning their real value declines with inflation. In the scenario modelled, they are frozen until the point at which the lower income threshold meets the real value of the lower income threshold under the previous (2011) system, which was £15,000 in 2011. Assuming this threshold would have been uprated in line with inflation (RPI), it would have risen to £21,000 in nominal terms in 2023. Both the lower and upper income thresholds are therefore frozen for a period of seven years (as the first year of repayments for the 2012 cohort is 2016). After seven years, the thresholds are assumed to rise in line with inflation (RPI) rather than average earnings growth.
- All else is the same as the default system.

Figures 3.3 and 3.4 illustrate the overall and distributional implications of this policy, and how they compare with the default system (introduced in 2012). In each figure, the light blue bars and red lines represent the estimated position under the existing system, and the dark blue bars and green lines represent the estimated position after the reform.

75 NAO (2013) Student loan repayments

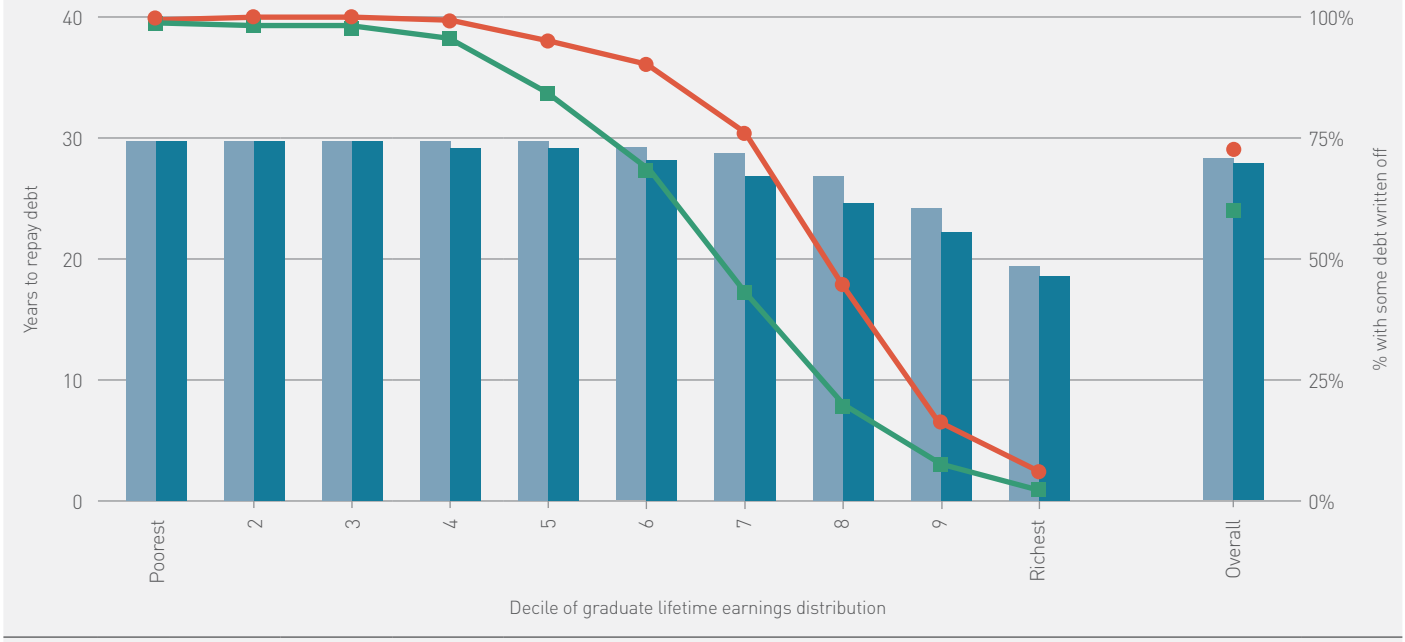
Figure 3.3: Net present value of repayments and RAB charge, by decile of graduate lifetime earnings distribution: default 2012 system versus threshold freeze



Source: IFS

Note: 'NPV of lifetime repayments' is the value of expected future graduate repayments in today's money (i.e. in 2014 prices, discounted using a discount rate equal to the government's assumed cost of borrowing (RPI+2.2%)). Assumes all graduates take out the maximum loan to which they are entitled, repay following their repayment schedule and have no unearned income.

Figure 3.4: Average years to repay and percentage with debt written off by decile of graduate lifetime earnings: default 2012 system versus threshold freeze



Years to repay – default (LH axis) Years to repay – threshold freeze (LH axis)
% with debt write-off – default (RH axis) % with debt write-off – threshold freeze (RH axis)

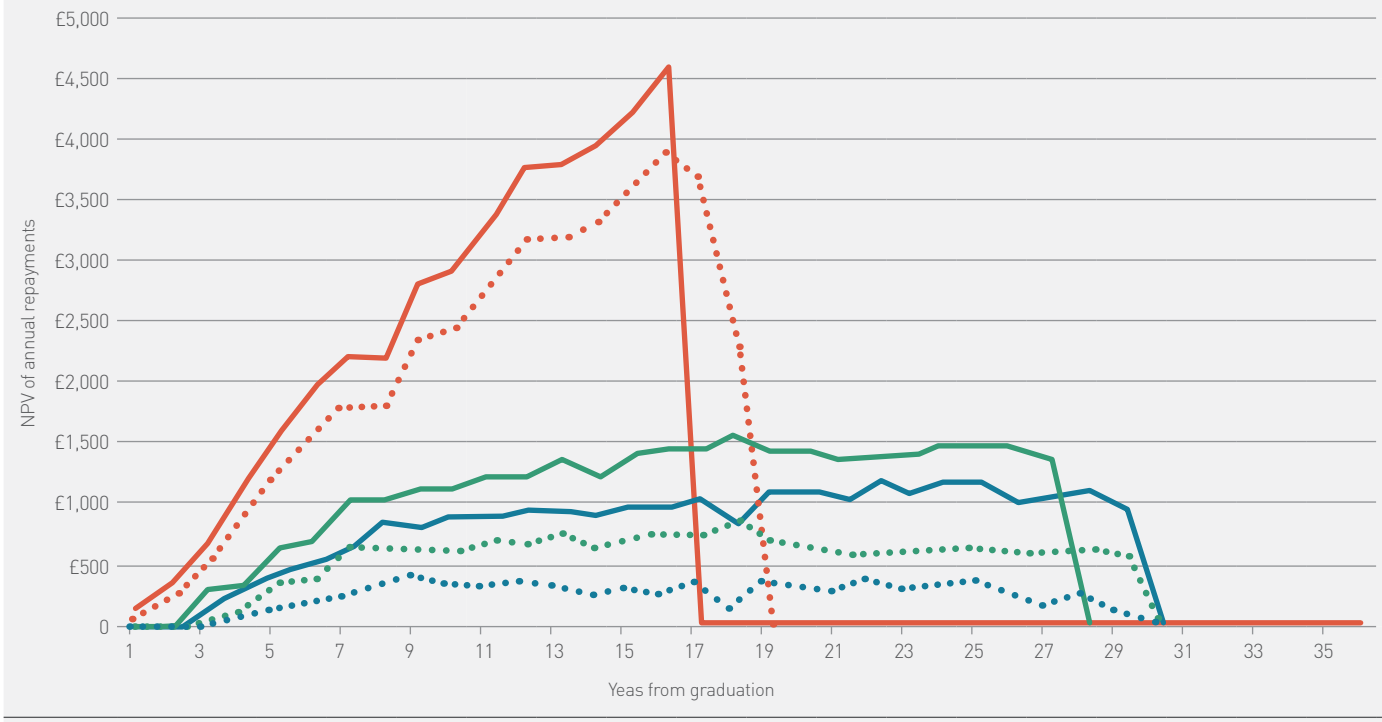
Source: IFS

Using the Treasury's preferred discount rate and the OBR's forecasts for graduate earnings growth, and assuming the loan system remains otherwise unchanged throughout the repayment period, IFS estimates suggest that graduate repayments would increase by around £5,000, on average, in NPV terms were this proposal to be enacted. The RAB charge would fall to around 30% (compared with around 43% under the existing system). Moreover, it is estimated that around 62% of graduates would not repay their loans in full (compared with 72% under the 2012 system). From a public finance perspective, this reform would increase the rate at which public debt declines over time, as the value of the repayments collected each year would rise. There would also be less outstanding debt to write off at the end of the repayment period, thus future borrowing would rise by less than under the 2012 system.

Middle-income graduates would be hit hardest by this reform. Graduates on low incomes (between the old and new lower income thresholds) who would previously not have been liable for repayments will now have to repay 9% of their income above the new lower threshold, but this is still a relatively small amount. Graduates earning above £21,000 will have to make repayments on an increasingly large slice of their income, and more higher-income graduates will now face a higher interest rate, as the threshold above which the highest interest rate (of RPI+3%) is charged falls. Higher-income graduates are also affected by these reforms, but for a shorter period, as they repay their loans more quickly.

Figure 3.5 provides further insight into these distributional implications, showing expected average annual repayments for individuals at different parts of the earnings distribution: specifically, for individuals earning at the median of graduate lifetime earnings, as well as at the 25th and 99th percentiles.

Figure 3.5: Net present value of annual repayments: default versus threshold freeze



Source: IFS

The dotted lines represent the profile of annual repayments under the default 2012 system, while the solid lines represent the profile under the proposed reform, in which the income thresholds are frozen in nominal terms for seven years and then increase in line with inflation rather than earnings.

The increase in total lifetime repayments is represented by the difference between the area under the solid line and the area under the dashed lines. All graduates experience an increase in annual repayments under the proposed new system, but the absolute and relative increase compared to the default system is largest for lower-earners. For example, 28 years after graduating from university, it is estimated that those earning at the 25th percentile of graduate lifetime earnings would be making annual repayments of over £1,100 in NPV terms, on average, under the proposed new system: about four times as much as they would be paying under the default 2012 system.

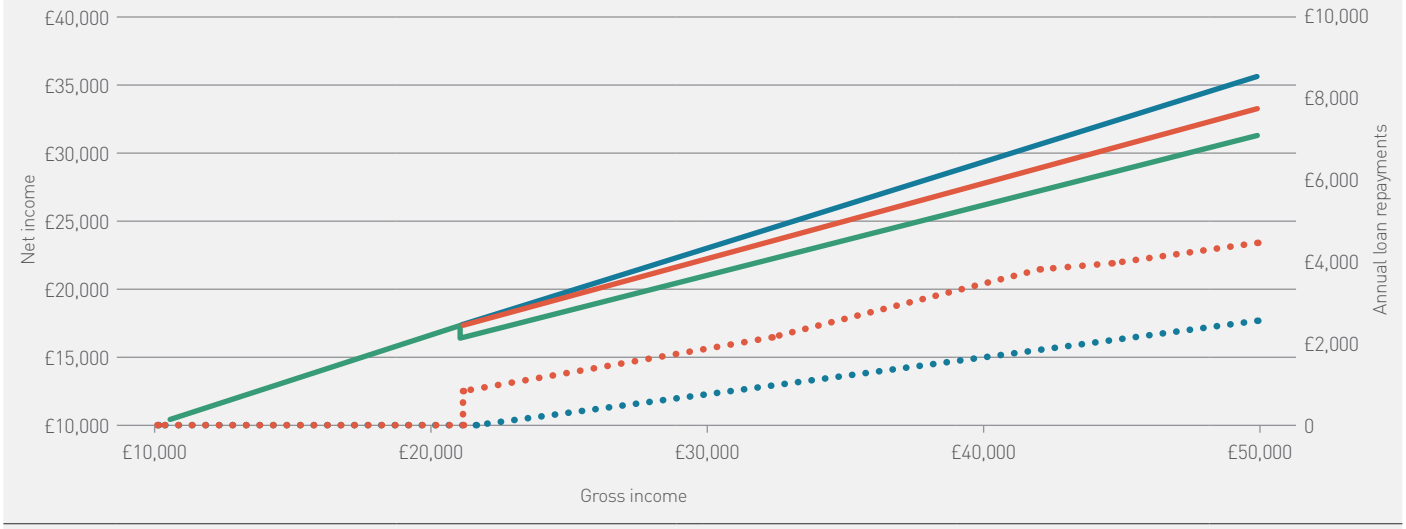
Looking across the whole repayment period, Figures 3.3 and 3.4 show that graduates in the seventh decile of lifetime earnings would, on average, make repayments for an additional two years under the proposed new system, with total repayments increasing by around £6,400 in NPV terms. IFS also estimates that the percentage of graduates in this decile who repay their loan in full would more than double, from around 25% to nearly 60%.

Making repayments on total income once the earnings threshold is reached

The key features of this system as modelled by the IFS are as follows:

- Individuals now pay a percentage of total income if they earn above the lower income threshold. The percentage increases on a sliding scale from 4% of all income at the lower income threshold to 9% of all income at and above the upper income threshold. (These thresholds are uprated in line with average earnings, as planned under the 2012 system.) This is similar in some respects to the HELP system of undergraduate and postgraduate loans proposed by University Alliance (2014).
- All else is the same as the default system.

Figure 3.6: Net income and student loan repayments under different repayment schedules



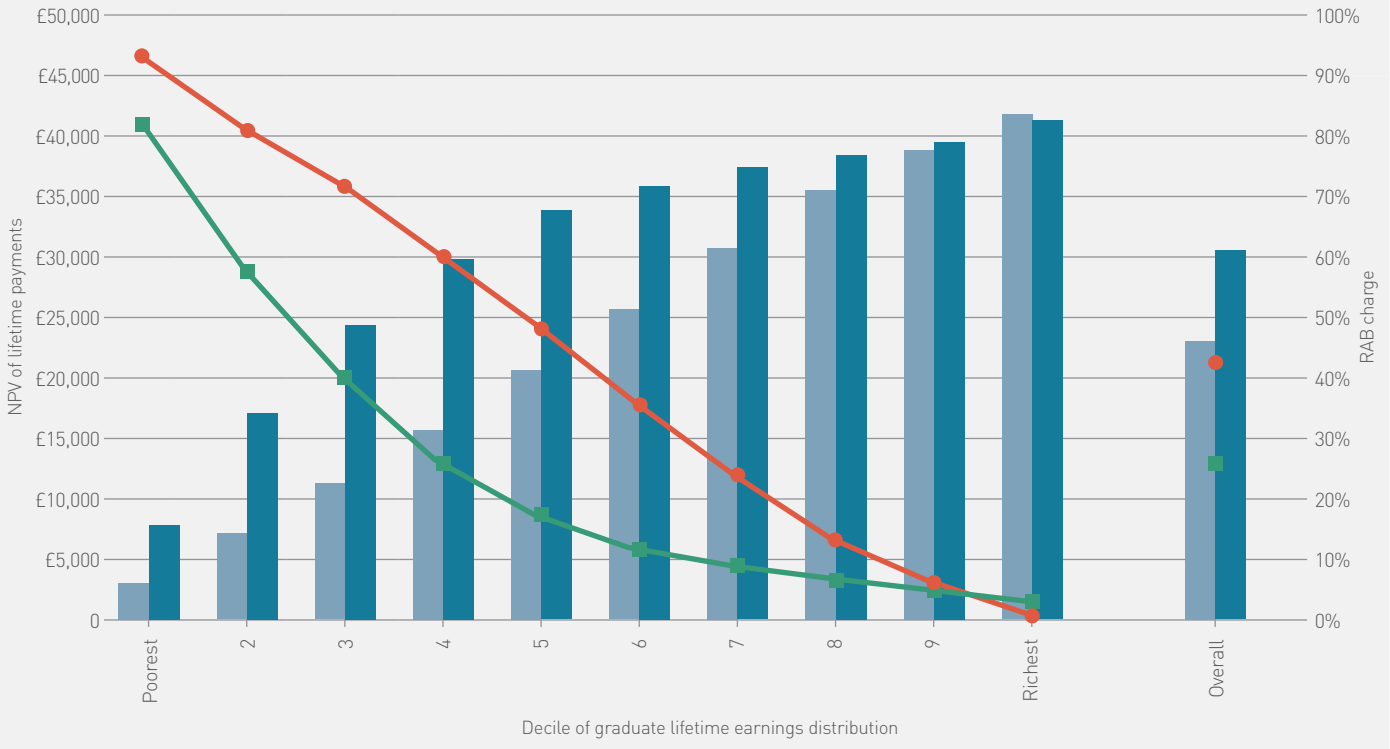
Source: IFS

Figure 3.6 illustrates the relationship between gross income and net income (left-hand axis) and loan repayments (right-hand axis) under the default and potential new system. The solid blue line shows income after income tax and National Insurance (NI) contributions have been paid. The solid red line shows income after tax, NI and student loan repayments under the default 2012 system have been made, and the dotted blue line illustrates the amount of loan repayments that are made for a given level of gross income, rising at a rate of 9% on income above the lower income threshold (£21,000).

The solid green line shows income after tax, NI and student loan repayments under the 2012 system have been paid under the proposed new system, and the dotted red line illustrates loan repayments under the proposed system, jumping up at £21,000 and rising at a more rapid rate as income increases. As Figure 3.6 clearly shows, repaying a percentage of total income once income rises above a threshold introduces a 'cliff edge' at the lower income threshold of £21,000. This is because if an individual earns £20,999, they make no student loan repayments, whereas if their income rises by £1 to £21,000, they would now be liable for student loan repayments of £840 (4% of £21,000). (In comparison, under the current system, individuals would make no student loan repayments if their income was £21,000, they would repay 9p (9% of £1) if they had income of £21,001, they would repay 18p (9% of £2) if they had income of £21,002, and so on.)

There is a growing academic literature on the extent to which people respond to such 'cliff edges' by 'bunching' below the threshold: in this case, organising their affairs to ensure that their income does not rise above £21,000 per year. A paper relating to the income-contingent student loan repayment system in Australia (Chapman and Leigh, 2008) – in which repayments are due on the basis of total income once income rises above a threshold – finds some evidence of bunching below their threshold, but that the economic impact of that bunching was very small (although it should be noted that the discontinuity in income induced by their system occurs at a lower income level, and is somewhat smaller than the 'cliff edge' that would be introduced here).

Figure 3.7: Net present value of repayments and RAB charge, by decile of graduate lifetime earnings: default 2012 system versus total income system

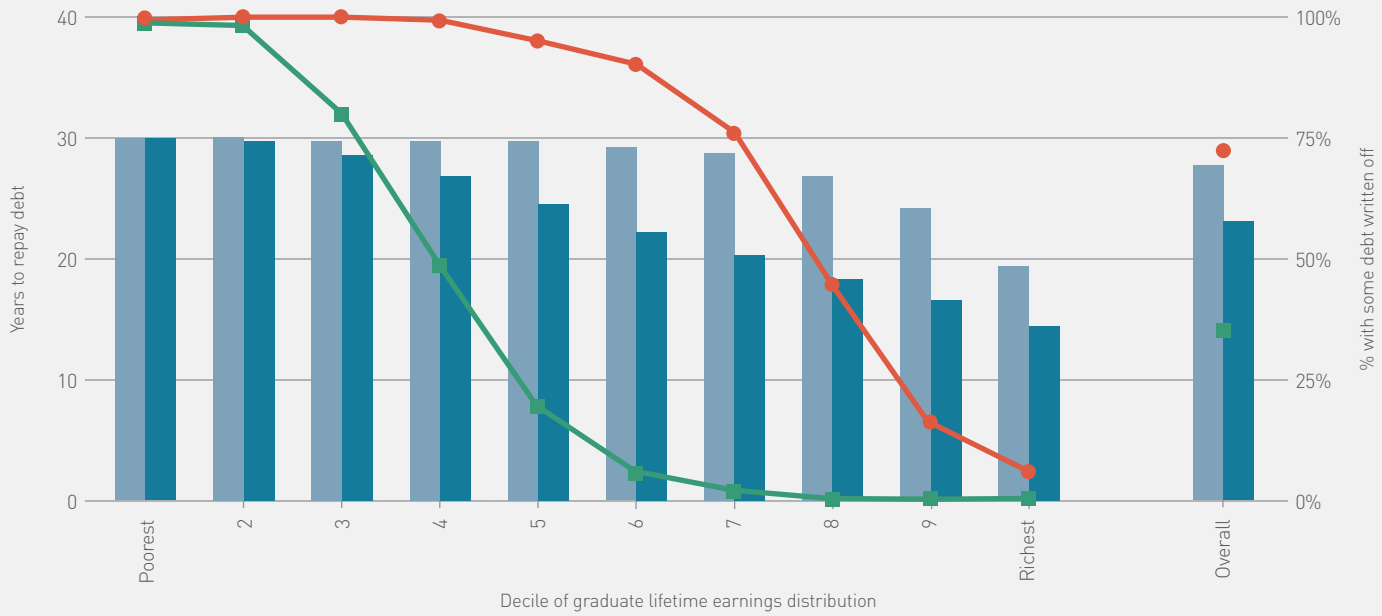


Source: IFS

Figures 3.7 and 3.8 illustrate the financial implications of the total income proposal for graduates and the government. Average repayments would increase by more under this system than under the proposal to freeze and then uprate the income thresholds more slowly (described above), with NPV repayments increasing by over £7,200, on average, compared with the 2012 system, and the RAB charge almost halving from 43% to 25%. The percentage of graduates who would not repay their loans in full is also estimated to fall dramatically, approximately halving from 72% under the default system to around 36% under the proposed new system.

Figures 3.7 and 3.8 illustrate that it is again lower-to-middle income graduates who are estimated to make the largest additional repayments. In contrast to the threshold freeze proposal, the highest-income graduates would actually see their repayments fall in this scenario, as they would repay their loans more quickly, and hence would be less likely to face higher interest rates, and for a shorter time. In fact, the additional repayments made by the 10% of graduates with the lowest incomes would be higher, on average, than those made by the highest-earning 30% of graduates.

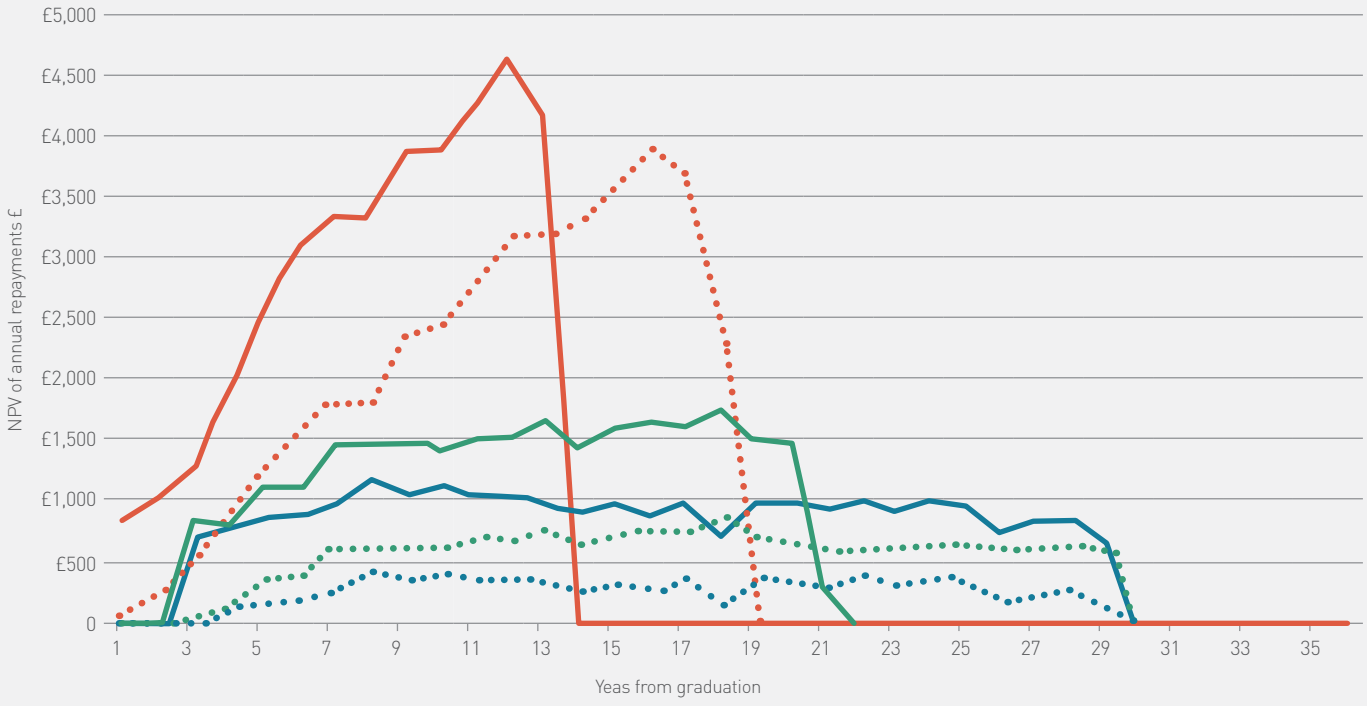
Figure 3.8: Average years to repay and percentage with debt written off by decile of graduate lifetime earnings: default 2012 system versus total income system



Years to repay – default (LH axis) Years to repay – total income system (LH axis)
% with debt write-off – default (RH axis) % with debt write-off – total income system (RH axis)

Source: IFS

Figure 3.9: Net present value of annual repayments: default versus total income system



25th percentile, default 50th percentile, default 99th percentile, default
25th percentile, total income 50th percentile, total income 99th percentile, total income

Source: IFS

This point is illustrated more clearly in Figure 3.9, which shows the different profiles of average annual repayments for individuals at different points of the graduate lifetime earnings distribution under the 2012 system (dashed lines) and the proposed new system in which repayments would be due at a lower rate on all income, once income rises about the lower income threshold. It clearly shows the more rapid profile of repayments for those at the top of the earnings distribution (and indeed for those in the middle). For those at the 25th percentile, by contrast, average annual repayments increase, but not enough to reduce the time over which repayments are paid: their total repayments would thus increase dramatically under this proposal.

Returning to Figures 3.7 and 3.8, they show that graduates in the fourth decile of lifetime earnings are estimated to make the largest additional repayments as a result of this reform, paying nearly £14,000 more, on average, in NPV terms over their lifetime compared with the 2012 system. Meanwhile, those in the sixth decile would see the largest increase in the percentage paying off their loan in full, rising from less than 10% under the 2012 system to more than 90% under the proposed new system.

The public finance implications of this reform would be similar to those described above in relation to the threshold freeze scenario. However, public debt would decline at a faster rate here than under either the default 2012 system or the threshold freeze scenario in the early part of the repayment period, as the value of the repayments collected each year is much higher under this scenario than under either of the other two. This means there would also be less outstanding debt to write off at the end of the repayment period, so future borrowing would rise by less under this proposal than under the threshold freeze scenario (which in turn had lower future borrowing than the 2012 system).

'Pseudo' graduate tax

This reform differs from the two discussed above, since it focuses on trying to secure higher repayments from the highest-income graduates (rather than those on low and middle incomes). The key features of this system are as follows:

- The repayment period is lengthened (from 30 years to 35 years) and individuals continue making repayments until the end of the repayment period, even when they have written off their debt.
- All else is the same as the default system.

This is a 'pseudo' graduate tax because individuals under this system are only expected to repay for 35 years rather than for the rest of their working lives[76]. For modelling purposes, it does not matter whether this is thought of as a loan with a fixed minimum repayment period or a graduate tax. But this choice is highly significant from a public finance perspective.

Money would most likely have to be borrowed in order to finance the up-front expenditure in either case: to lend to students or to give straight to universities. Public debt would therefore increase in both cases. But the implications for borrowing are different. With a loan, borrowing would only increase at the point at which any unpaid debt is written off (at the end of the repayment period). Because the loan subsidy is likely to be lower under this scenario than under the default 2012 system, public debt would decline more rapidly and borrowing would rise by less at the end of the repayment period than under the current system.

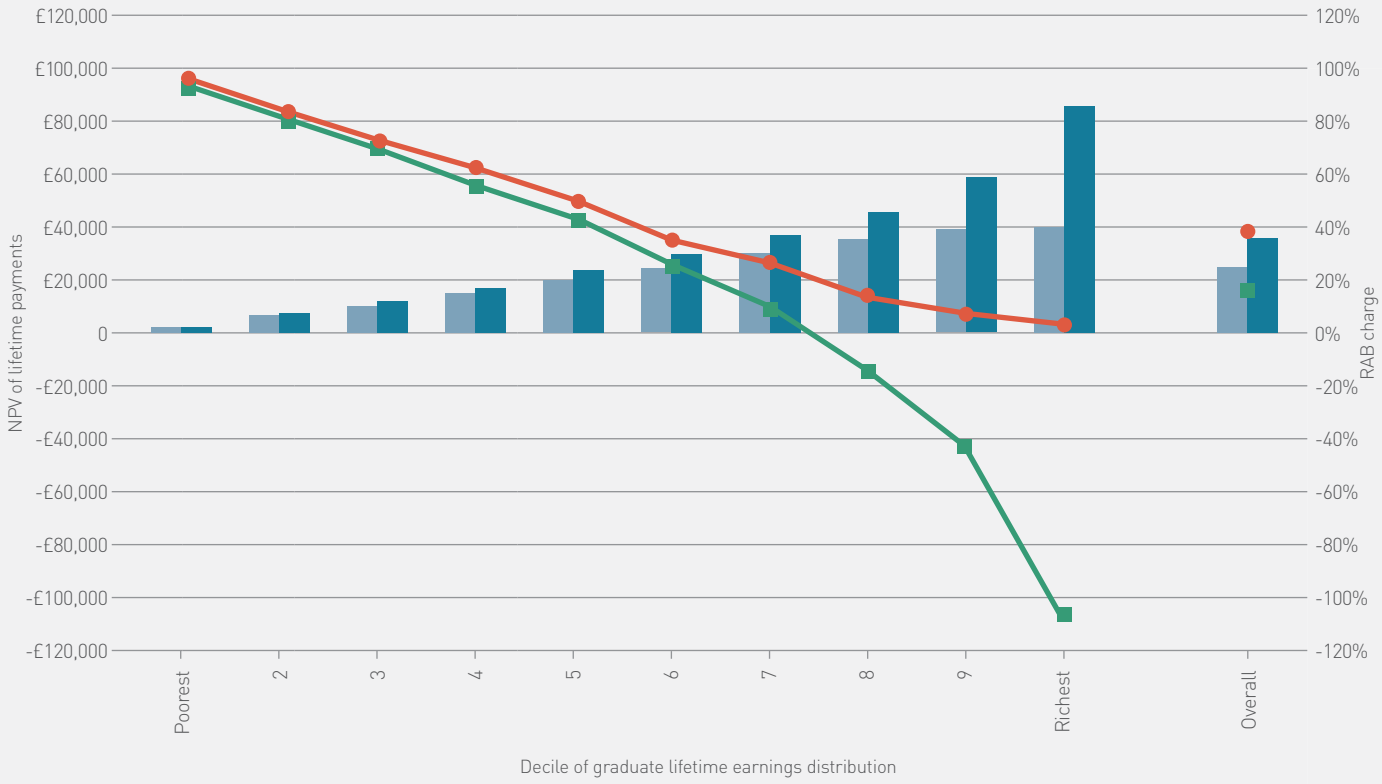
With a graduate tax, however, borrowing would increase at the start of the period. To understand the full implications, we need to be clear which elements of the current system would go and which would stay: if both tuition fee and maintenance loans were replaced by higher teaching grants and maintenance grants (to be recouped in the form of higher tax receipts in future rather than as loan repayments), then the loan system as set out above would effectively be dismantled, and all spending would count towards borrowing in the short run. Over time, as increasing numbers of graduates pay more tax than the up-front costs of their education ('repay their loans' using loan terminology), the system would become partially funded, and up-front borrowing would need to increase by less than the full cost of teaching and maintenance grants. (It would not become fully funded using the parameters we model, however, because even though the RAB charge becomes negative with a lower discount rate, this refers only to repayments on fee and maintenance loans, and would not cover the cost of teaching and maintenance grants.)[77]

In addition, there may be different enforcement issues. For example, it may be difficult to extract graduate tax payments from students who move out of the UK after graduation. It is also likely to matter hugely whether the highest earners are able to opt out of the system (whether through not taking out loans, or by making differential location or labour supply decisions post-graduation, for example).

76 Note that there is a significant question here as to whether the ONS would continue to allow this accounting treatment to be classed as a financial transaction (i.e., a loan) with a 35-year repayment period. This is no by means certain, and the decision would have a major impact on the public finances.

77 It is assumed that existing graduates who attended university under previous systems would not be required to pay a graduate tax. If they were, then it is highly likely that the system would be fully funded from the start.

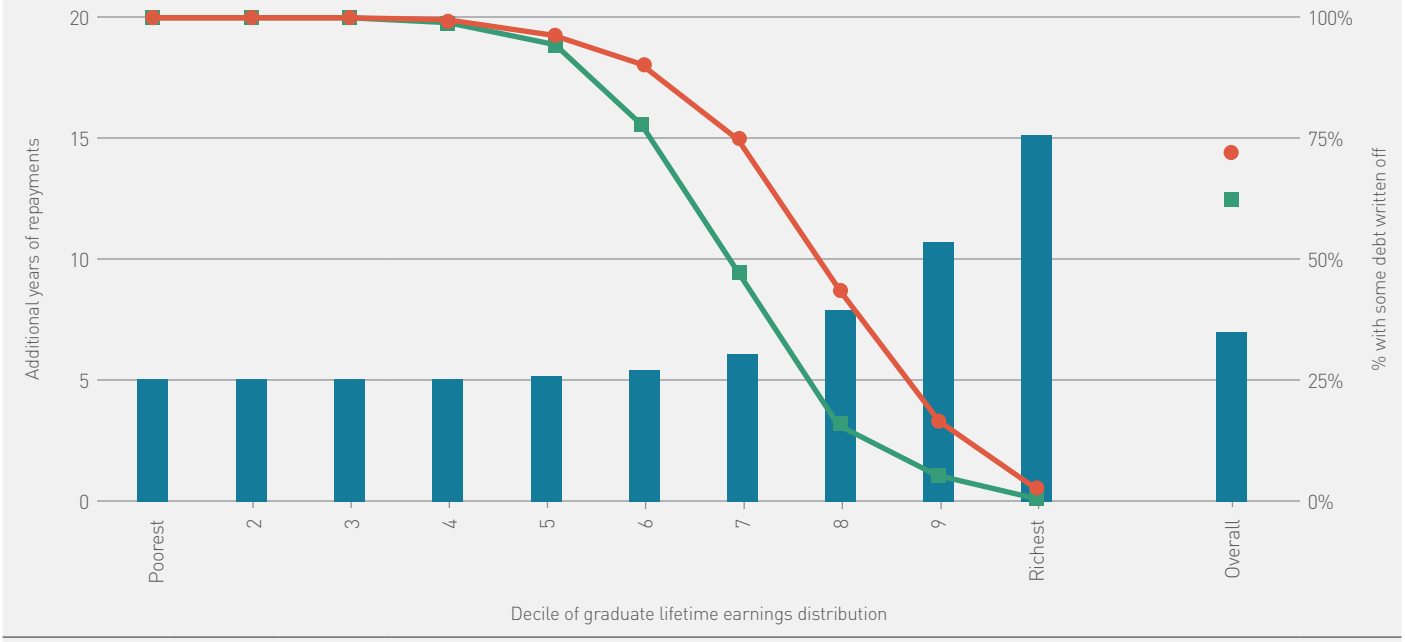
Figure 3.10: Net present value of repayments and RAB charge, by decile of graduate lifetime earnings distribution: default 2012 system versus 'pseudo' graduate tax



NPV repayments default (LH axis) NPV repayments – graduate tax (LH axis)
RAB charge – default (RH axis) RAB charge – graduate tax (RH axis)

Source: IFS

Figure 3.11: Average years to repay and percentage with debt written off by decile of graduate lifetime earnings: default 2012 system versus 'pseudo' graduate tax



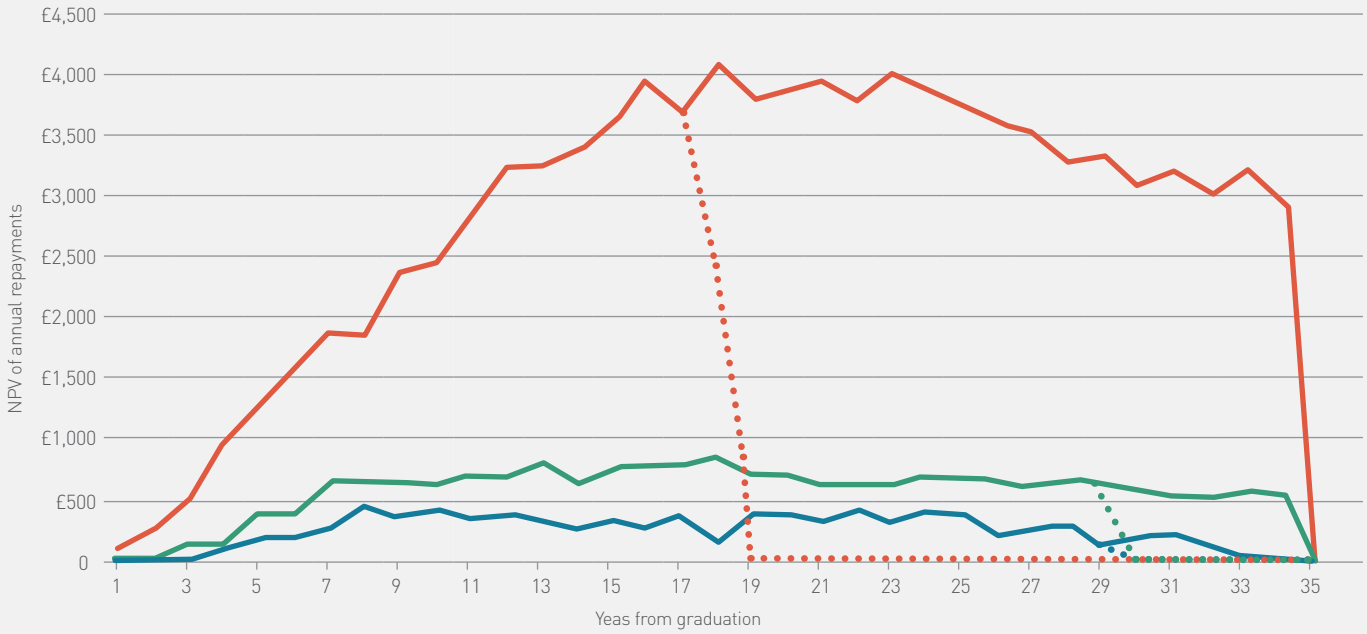
Additional years of repaying (LH axis) % with debt write-off – default (RH axis)
% with debt write-off – graduate tax (RH axis)

Source: IFS

Figures 3.10 and 3.11 show the overall and distributional implications of implementing this pseudo graduate tax for graduates and taxpayers. Average repayments would increase the most under this system compared with either of the previous two reforms: under the standard assumptions used by the IFS regarding discount rates, earnings growth and all other parameters of the system remaining unchanged, it is estimated that repayments would increase by just over £9,500, on average, in NPV terms, with the RAB charge under this proposal falling to 19%, less than half what it is estimated to be under the 2012 system.

Figures 3.10 and 3.11 also make clear that the graduates who would bear the burden of these additional repayments are very different under this system from those in either of the two previous reforms considered. In this case, it is the highest-income graduates – those who would have repaid their loans in full under the 2012 system – who are contributing the most to this reduction in the long-run cost to government. Repayments made by the lowest-earning graduates are similar to those made under the 2012 system, where many are effectively facing a pseudo graduate tax in any case, as they do not repay their loans in full over the 30-year repayment period (and would be unlikely to do so under a 35-year repayment period either).

Figure 3.12: Net present value of annual repayments: default versus 'pseudo' graduate tax



Source: IFS

This point is also shown in Figure 3.12, which shows the profile of annual repayments under the default system (dotted lines) and with proposed pseudo graduate tax system (solid lines) for individuals earning at the 25th, 50th and 99th percentiles of the graduate lifetime earnings distribution. The substantial increase in repayments for those at the top of the earnings distribution is illustrated very clearly, with increases for individuals earning at the 25th and 50th percentiles of the distribution only arising as a result of the increased repayment period of 35 years (compared with 30 years under the default system).

Overall, it is estimated that the highest-earning 10% of graduates would repay more than double what they borrowed in NPV terms under the pseudo graduate tax system: they would end up repaying for an average of 15 years beyond the point at which they would have repaid their loans in full, making their RAB charge –107% (i.e. meaning that the government would effectively make a profit on their loans).

This means that the overall reduction in the long-run cost to government will be highly sensitive to the decisions taken by these high-income individuals. And it highlights one of the trade-offs inherent in making changes to the parameters of the loan system: because the current system is strongly progressive, most reforms either tend to hit lower- to middle-income graduates harder, or they rely heavily on extracting larger repayments from a relatively small number of high-income graduates, whose behaviour may then have a substantial effect on the overall cost of the system.

Labour Party proposal

In the build up to the 2015 general election the Labour Party announced its policy to reduce the cap on undergraduate tuition fees from £9,000 to £6,000 per year. Alongside this reform, it announced an increase in the maximum interest rate incurred on student debt and a rise in average maintenance grants. Specifically, the key features of the system proposed by Labour were as follows:

- The cap on undergraduate tuition fees would fall from £9,000 per year to £6,000 per year, with the lost income that universities would have received from fees replaced by higher teaching grants.
- The maximum interest rate incurred on student debt would increase from RPI+3% under the current system to RPI+4% under the proposed Labour system. Individuals with income below £41,000 per year would face the same interest rate under both systems. Those with income between £41,000 and £47,667 would pay an interest rate between RPI+3% and RPI+4% (on a linear taper) and those earning above £47,667 would pay RPI+4%.
- Maintenance grants would increase from £3,400 to £3,800 per student per year for individuals with parental income below £25,000, and those with parental income between £25,000 and £42,000 would receive smaller increases to their grants.
- All else would be the same as the current system.

Taking into account the fact that not all universities charge the full £9,000 per year, that some students receive fee waivers from their institutions, and that some courses last longer than three years – and assuming that all institutions charge the full £6,000 per year under the new system – the IFS estimates that the policy would reduce debt on graduation from around £44,000 under the current system to £35,000, on average, per student, with teaching grants rising from around £675 to around £3,450 per student per year on average.

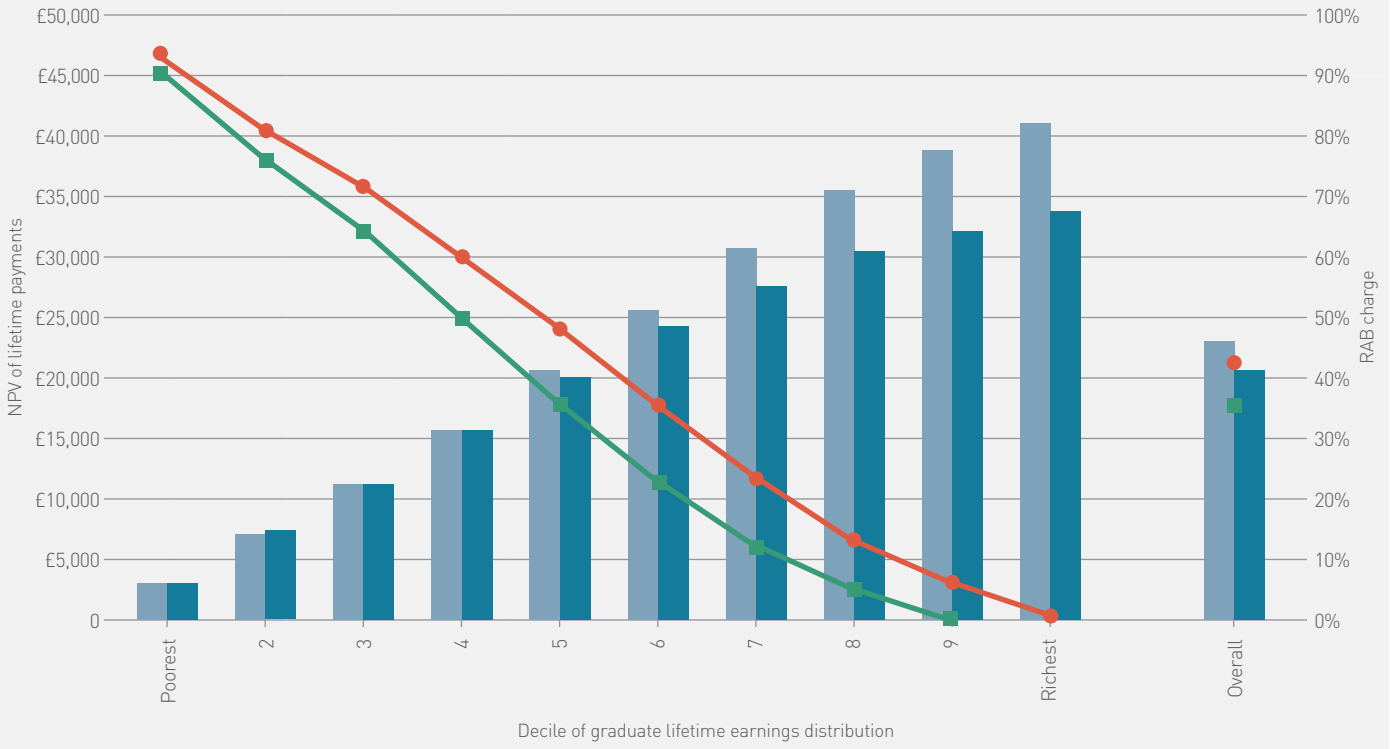
While government spending, in the form of upfront grants and loan subsidy, would rise only slightly as a result of the increase in maintenance grants, there is a shift in the long-term burden of costs from graduates to the taxpayer. This arises because some graduates would be making repayments on the final £3,000 of loans per year under the current system, while under Labour's proposed system the taxpayer would automatically contribute the full amount up front. Graduate repayments are therefore expected to be lower by the average expected value of any repayments made on that last £3,000 per year of loans.

Based on the usual set of assumptions about future graduate earnings growth and the government's cost of borrowing, and assuming there are no changes to the parameters of the loan system over the repayment period, Figure 3.13 shows an estimated fall in average repayments of around £2,400 per graduate under the proposed Labour system compared with the current one. This shows that the average number of years to repay is likely to fall only marginally (by around 18 months, on average), and percentage of graduates with some debt written off would fall from around 72% to around 61%.

The current value of the taxpayer contribution would rise by the same amount as the graduate contribution falls. Taking into account the increase in maintenance grants as well, it is estimated that the total taxpayer contribution to higher education would rise by around £3,000 per graduate under Labour's proposed system.

However, Figures 3.13 and 3.14 show that these reductions in graduate contributions are not spread equally across graduates. It is estimated that, under the current system, the vast majority of the graduates in the lower half of the lifetime earnings distribution – those earning less than £30,700 on average per year – are unlikely to make any repayments on that last £3,000 a year of loans. This means that the proposed change in policy would make virtually no difference to the repayments of these graduates, and the government contribution would rise only if they benefit from the proposed increase in maintenance grants (not shown in the figures).

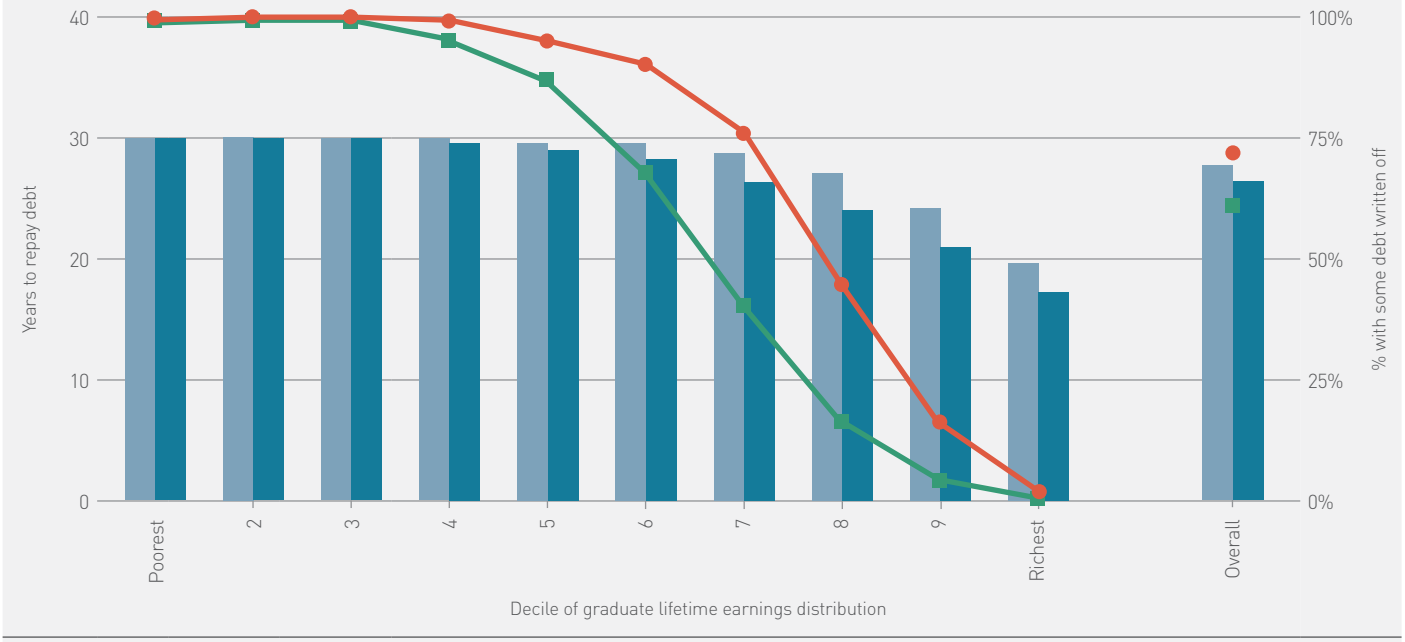
Figure 3.13: Net present value of repayments and RAB charge, by decile of graduate lifetime earnings: default 2012 system versus Labour proposal



NPV repayments – default (LH axis) NPV repayments – Labour (LH axis)
RAB charge – default (RH axis) RAB charge – Labour (RH axis)

Source: IFS

Figure 3.14: Average years to repay and percentage with debt written off by decile of graduate lifetime earnings: default 2012 system versus Labour proposal



Source: IFS

For those in the top 10% of lifetime earnings, however, the IFS estimates that repayments would decline by around £7,500, on average, in today's money. Total repayments would be lower, since these people take out smaller loans to start with, and this would outweigh the effect of the higher interest rate (which would increase the size of the outstanding debt more rapidly for those earning above £41,000 per year). Those in the eighth decile of lifetime earnings would see the biggest reduction in average years of repayment (of around three years, on average), and those in the seventh decile would see the biggest percentage point reduction in the percentage with debt written off, falling from around 75% under the current system to around 40% under Labour's proposed system.

Figure 3.15 provides further insight into these distributional implications, showing the expected average annual repayments for individuals earning at the median, 80th and 99th percentiles of the distribution of graduate earnings. The total saving for graduates is equal to the area between the dotted and solid lines. The graph shows that there would be no difference in expected repayments between the current system and Labour's proposed system for those earning at the median of graduate lifetime earnings. But there would be a clear benefit for those earning at the 80th and 99th percentiles, arising from the fact that the increase in the interest rate they face does not outweigh the smaller loans they take out, meaning that they are subsequently able to clear their debt more quickly. It is estimated that those earning at the 80th percentile of graduate lifetime earnings would save £7,000 in today's money compared to the current system, while those earning at the 99th percentile of graduate lifetime earnings would save £8,300 in today's money.

Figure 3.15: Net present value of annual repayments: default versus Labour proposal

Source: IFS

Of course, because of the huge uncertainty surrounding expected future graduate loan repayments, the expected increase in taxpayer contribution is also hugely uncertain. If graduates were to repay a substantially larger proportion of that final £3,000 per year of loans, then the taxpayer contribution would rise equivalently. If all loans were to be repaid, then the total taxpayer contribution of Labour's policy would rise by the full value of the increase in teaching and maintenance grants, which would amount to around £3,000 per student per year on average.

The reform itself makes only a very small difference to overall government spending on higher education as spending on student loans is replaced by spending on teaching grants, with a small increase arising from the small rise in maintenance grants. In the longer run, the proposal increases government debt by a larger amount, because none of the teaching grant gets paid back while some of the student loan spending would have been. In the long run, government debt would be around £900 million higher per cohort of students (based on an increase in the taxpayer contribution of £3,000 described above and assuming a cohort size of 300,000 students).[78]

The impact on government 'borrowing' is complicated by the different accounting treatment of loans and grants. As described in chapter 2, the former do not count towards government borrowing (as measured by public sector net borrowing) in the year they are issued (and repayments from graduates do not reduce government borrowing when they are received) since they are counted as 'financial transactions'. Only the debt interest accruing on the loans made, and any write-offs at the end of the repayment period, affect borrowing. In contrast, spending on grants counts towards government borrowing in the year they are made.

This means that the direct effect of replacing fee loans pound-for-pound with increased teaching grants would actually be an increase in government borrowing in the absence of any other policy action. If teaching grants are increased by £2,800 per student per year and maintenance grants are increased by £200 per student per year (across all students), this would result in a direct increase in borrowing of around £2.75 billion per year, assuming a fixed number of 300,000 students per cohort.[79] However, a large proportion of this increase would be offset by lower borrowing in future, arising from the lower write-offs that smaller loans would entail.

78 Note that a cohort size of 300,000 students is assumed here, which was the size of the 2012 cohort, and makes the total public cost figures consistent with those in previous IFS reports (notably Crawford, Crawford and Jin (2014)). The cohort size in 2016 is likely to be higher (around 350,000 students).

79 Accounting for the fact that non-English students are not eligible for maintenance loans.

The proposed reform increases the taxpayer contribution to higher education (since none of the teaching grant or increased maintenance grant gets paid back, while some of the loans made would have been), and therefore weakens the public finances in the absence of any other policy action. However, while the reforms weaken the public finances in expectation, they also reduce some of the uncertainty around the long-term public cost of funding the degrees of a given cohort of students, by replacing some of the uncertain cost of student loans with the certain cost of grants.

ASSESSMENT OF THE OPTIONS TO REFORM THE STUDENT LOAN SYSTEM

The previous paragraphs have set out a number of possible options for reforming the student loan system in England. In broad terms, the aims of these options have been:

- to reduce the potential long-term costs of the system to government
- to ensure that all students who have the ability to benefit from a university education can do so
- to support social mobility
- to maintain the existing world-class level of university teaching and learning provision

This list is not exhaustive and there may be additional aims that the student funding system is trying to achieve. However, these are among the most important.

Each of the options analysed would involve a trade-off of some kind and as the IFS has pointed out, the current system is progressive to the extent that any future reduction in costs to taxpayers would need to be met either by moderately increasing repayments from low and middle earners, or by substantially increasing repayments by a smaller number of very high earners. In either case, there are potential behavioural consequences on the part of students and graduates that need to be borne in mind and carefully analysed as part of any future redesign of the system (for example, the risk of potentially very high-earning graduates exiting the public funding system altogether).

The Student Funding Panel's view is that it is too early to assess the full impact and effectiveness of the changes to the student funding system introduced in 2012–13, and it is therefore too soon for a major change in policy direction or design at the current time.

The system needs to be given time to 'bed down' and work properly, and then can be fully assessed in more detail. The available evidence suggests that students have not been put off from applying to university, that social mobility outcomes have been improved, that resources to universities have been maintained in the short term, and that there is time and facility available to take action to manage the long-run costs to government if necessary.

However, if concern about the long-term costs to government of the loan subsidy increases in the short term, then some modifications to the system could be made. Of the options analysed, the panel felt that the most appropriate option would be the threshold freeze model, whereby the key parameters in the system are frozen in nominal terms for seven years (from 2016 to 2023)[80]. The advantages of this option are:

- It reduces the estimated RAB charge from around 43% to around 30%.
- It increases the future value of repayments.
- It reduces the future borrowing requirement for government to support the system.
- It adapts the current system to the prevailing labour market conditions.
- It retains the strongly progressive features of the current system.
- It is straightforward to communicate to students, graduates, and other stakeholders, in that it does not require a significant change in policy direction or design.

80 This time period is used for illustrative modeling purposes, and could of course be changed.

IMPROVING MAINTENANCE SUPPORT FOR STUDENTS

This report has already highlighted the importance of adequate maintenance support to students. This section details a series of options on how this area of provision could be improved.

In 2013, the NUS carried out research suggesting that maintenance support available from the government in the form of grants and loans was not sufficient for students to meet their costs of living. Drawing mainly upon data from the Student Income and Expenditure Survey, and comparing this to typical levels of maintenance support available, it estimated total living and study-related costs excluding tuition fees of £13,000, leaving an average shortfall of around £7,600 in 2013–14.[81]

However, concerns about maintenance support were evident before the 2012 reforms. Prior to the above study, in 2011–12 the NUS undertook detailed research on students' costs of living in further and higher education.

On attitudes to finances the study found that:[82]

- around half of undergraduates agreed that they regularly worry about not having enough money to meet basic living expenses
- around 40% disagreed that they feel able to concentrate on their studies without worrying about finances
- 73% agreed they are concerned about their future levels of debt in 2011–12 (prior to the increase in tuition fees)

On course costs the study found that:

- 69% of undergraduates stated they had been required to pay for materials, activities or other costs associated with completing their course, such as books, printing, stationery, and field trips
- More than half of students had been made aware of most costs in advance. However, the majority of those paying for the following items had not been aware of the cost in advance: bench fees (62%), musical instrument hire (59%), course-related sports facilities (53%), specialist software (51%) and studio fees (51%)

Respondents to the panel's online survey of current undergraduate students suggested that more than half (55%) meet some of their costs of living by working alongside their studies. Further to this, 69% said that any earnings they receive are essential in order to meet their living costs, compared to 22% saying they could meet their living costs without working.

There is therefore a range of evidence to suggest that an increase in funding is required for students to be able to meet their living costs. This would be a priority area for increased resources if funding could be released by making changes elsewhere in the system (assuming that funding for higher education is not increased overall).

A number of other changes to the current system could also be made to improve the position of students. Suggestions from the focus group sessions about how to improve support included:

1. **Linking changing levels of support to increases in accommodation costs:** annual increases in loans and grants were below the rates of increase in accommodation costs, which comprises the bulk of many students' expenditure.
2. **Regional variations in levels of support:** some students outside London felt that it was unfair to have one rate for maintenance loans applied across the rest of the country, especially as there were large variations in costs of living, particularly for accommodation.
3. **Greater flexibility:** more support should be available to those whose financial circumstances change quickly due to aspects outside of their control, such as changes in parental income.
4. **Not basing eligibility for loans and grants solely on parental income:** students felt that this measure does not always correlate with their needs or the levels of support that they might receive from parents.
5. **Increasing the number of loan instalments:** a common observation was that, because maintenance payments are made termly, there is some misalignment with actual monthly or weekly costs. Smaller, more frequent instalments could address this problem.

81 'NUS figures show new students face cost of living crisis' (4 October 2013) http://www.nus.org.uk/en/news/press-releases/nus-figures-show-new-students-face-cost-of-living-crisis/

82 NUS (2013) Understanding the Impact: a review of impact and effectiveness of student financial support in English further and higher education http://www.poundinyourpocket.org.uk

There is a wide range of evidence demonstrating that students feel the current levels of support available for maintenance are not adequate to meet their needs. Based on the feedback collected directly from students for the panel, as well as other research conducted and cited in the call for evidence, it is vitally important that options for increasing funding for living costs are further explored and addressed.

FUNDING FOR PART-TIME STUDENTS

As noted in preceding sections, one of the key trends in recent years has been the significant reduction in demand for part-time provision. A number of factors that are likely to have contributed to this decline were highlighted, including: the economic downturn and its impact on unemployment and reduced employer funding; reductions in public funding and public sector employment; and increased fees and issues related to eligibility for loans as a result of the most recent reforms to student funding. It is likely that the reduction in part-time study is a result of the combined impact of these factors over a number of years.

Options for reform to part-time student funding provided in response to the panel's call for evidence included:

1. **Ensuring equity in maintenance support:** There should be greater equity between maintenance support provided to part-time and full-time students. It was noted that the flexibility of part-time study is of particular significance for widening participation in that it facilitates a second chance for adult learners who had not progressed to higher education at 18, with these students more likely to be affected by any loss in earnings while studying part time and having greater costs in, for example, travel or childcare.

   Evidence suggested that that the immediate costs of study are much more significant in influencing the decision-making of potential part-time students than the longer term impact of the fees loan, and the absence of support for living costs is thus a major disincentive to part-time undergraduate study. Any increase in maintenance funding to part-time students would, however, have a direct impact on short-term costs to government (all other things being equal).

2. **Restoration of ELQ funding:** Respondents to the panel's call for evidence felt that the removal of funding for students studying equivalent or lower qualifications (ELQ), and their ineligibility for loans within a high fees environment, had put further study out of the reach of many potential students.

   Proposals submitted to the panel, and responses to UUK surveys on this issue, have suggested that consideration should be given to extending eligibility for tuition fee loans to all ELQ students. From 2015-16 exemption to the policy will be restricted to those studying for qualifications in computer science, engineering and technology. It is unclear what impact this may have on the long-term cost to government (RAB charge) of issuing loans to these students.

   Estimates of the loan subsidy for part-time students more broadly vary considerably. In response to a question on 28 April 2014[83], David Willetts gave a figure of 65% as the current BIS estimate of the RAB charge for part-time students, which is considerably higher than the current estimate of 45% for full-time students. On the other hand, London Economics has estimated that the RAB charge for fee-loans to part-time students completing their studies is -7.5% (-29.8% for males and +11% for females)[84]. This is put down to: the smaller size of loans for part-time students; the positive real interest rate charged (as with full-time students); and the fact that part-time students are more likely to be combining work and study, and therefore to be above the repayment threshold upon graduation. A greater understanding of the long run cost of extending loans to part-time students would be needed if this option were to be implemented.

3. **Eligibility for loans and intensity of study:** Responses to the panels call for evidence suggested that lowering the study intensity for loan eligibility below the current 25% may attract more demand from learners who are dependent on flexible provision and may in turn incentivise teaching innovations. As with extending loans to those on equivalent or lower qualifications, further information would be required regarding the long-term costs of government subsidies on loans for these students.

83 http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm140428/text/140428w0006.htm,
84 Million+ (2013) Higher education funding in England: do the alternatives add up?

4. **Employers Funding:** Feedback to the call for evidence suggested that incentives for employer-funded places (such as the tax incentives recommended in the CBI manifesto[85]) could be a driver for the teaching innovations needed to meet the evolving demands of part-time students, particularly those who combine learning around or within work.
5. **Credit transfer:** A submission to the panel proposed the need for a flexible and diverse system that allows for credit transfer and accreditation of prior learning. It was felt that this would encourage more demand for part-time higher education uptake and lead to greater up-skilling and re-skilling of the workforce.

LONGER-TERM OPTIONS FOR STUDENT FUNDING

The options for making changes to the student funding system outlined in the previous sections have focused largely on the medium term. They have also accepted as given the basic structure of the current system: that student funding should be supported through a combination of private contributions and public funding provided by government; that public funding should only be targeted to areas where there is evidence of potential market failure; that the cheapest source of loan finance is public funding, channelled through public institutions; and that income-contingent loans are the fairest and most progressive means of securing repayments from graduates.

Looking to the long term, there may be opportunities to revisit some of these assumptions and to analyse more advanced options for reforming the system. Candidate areas for reform which have been looked at since 2010 include the following:

- tying university funding to the earnings of their graduates
- privatising the provision of loan funding

1. **Tying university funding to the earnings of their graduates:** a significant amount of analysis and discussion has taken place around potential options to forge a closer link between student funding and the future earnings of graduates on an institution-specific basis. A number of different versions of this idea have been in circulation, variously labelled 'institutional RAB charges', or 'university risk-bearing' schemes.

   The models share the same fundamental concept: that individual universities (or groups of universities) are able to access private loan financing outside of the public system through demonstrating that their graduates are more likely to find well-paid future employment than the average (and that therefore their graduates would collectively attract a lower RAB charge than the average). This would potentially allow those institutions to fund their undergraduate education at a higher level than the public system (although in practice it is still likely that universities would be funded through a combination of public and private finance). It is argued that universities would, as a result, bear more of the risk of ensuring their graduates achieved positive employment outcomes, and would also bear some of the financial risk associated with the student loan system (which is currently shared between graduates and taxpayers).

   The most well-developed version of this model is that advanced by Professors Barr and Shephard (in their 2010 paper 'Towards setting student numbers free'). However, at the present time, this option faces significant barriers to implementation:

   a. It is not obvious that individual institutions could attract loan finance on more favourable terms than that which is available to government, or that there are appropriate incentives in place for them to do so.

   b. The proposal has significant potential to incentivise the recruitment only of those students who are currently most likely to achieve highly-paid future employment outcomes: such as, privately-educated male students.

   c. The proposal theoretically depends on institutions having perfect foresight of future employment outcomes of their graduates (otherwise the risk of making incorrect pricing decisions in the present becomes too great).

85 http://www.cbi.org.uk/media-centre/news-articles/2014/09/manifesto-sets-out-business-vision-for-better-britain/

d. There is a strong risk of adverse selection arising as a result of some institutions exiting the public funding system: i.e., the cohort risk premium attributed to those students remaining in the public system could potentially be higher than at present, driving up the cost of the loan subsidy to government. This is because, theoretically, the graduates with the 'best' employment outcomes (who would therefore be most likely to pay back their loans in full) would have exited the public system, leaving only higher-risk students on average.

e. The proposal would be difficult to implement and communicate to stakeholders.

In spite of these barriers, the concept underpinning this option is worth exploring further in the medium term (that is, that universities could bear a greater proportion of the financial risk of the student loan system), and that methods of linking graduate outcomes more closely to student finance should continue to be developed and assessed. It is therefore recommended that work along these lines should continue.

2. **Privatising the provision of loan funding:** another area that has received some policy attention in recent years is the privatisation of the student loan financing system[86]. This option would involve seeking private sector funding (most likely from the capital markets) to finance the outlay on student loans each year. This could, in theory, reduce the government's long-term exposure to debt and risk, thereby strengthening its future balance sheet.

   However, in practice, such a proposal currently faces significant practical and financial difficulties. The most significant of these is that, in any circumstance, the government would still need to bear some of the financial risk of the student loan system, otherwise the cost of securing external private finance would be prohibitive. The government's cost of borrowing still remains low enough to make public funding support the most cost-effective financing option for student loans, achieving the best value for money for all parties, and there is currently no incentive to change this position.

86 This is different from options to sell the existing student loan book to the private sector, which is current government policy (provided that value for money can be achieved).

CHAPTER 4: CONCLUSIONS AND RECOMMENDATIONS

Getting the design of the student funding system in England right is crucial. The system connects learners, universities, taxpayers, policy-makers, and wider societal and economic interests. Designed effectively and efficiently, it can support critical policy goals in relation to skills growth and social mobility (among others). The system also needs to balance a number of sometimes competing interests – those of students, graduates, taxpayers, government, and universities. More often than not these are aligned, but there are also often compromises that need to be made, especially during a period of severe fiscal austerity such as the one the country is currently experiencing (and which is likely to last at least for the period of the next parliament).

The reforms to the student funding system that were in introduced in England in 2012–13 sought to balance some of these competing aims: ensuring that universities could continue to receive the revenue they needed to support high-quality education in an expanded system; that scarce public funding was targeted as efficiently as possible; that students would not be put off from applying to university for financial reasons; and that the government could meet its policy objectives in terms of deficit reduction. While there are undoubtedly difficult challenges ahead, the first three years of operation of the system could be said to have been broadly successful.

In terms of university and policy timescales, the reforms are still very new. Universities have been successful in adapting to a radically-altered operating environment in a short space of time. They have adjusted to a changed financial environment, to increased competition and deregulation, and to increasing demands from students. Demand for student places has remained strong, and progress is starting to be seen in widening participation to university. The reforms have enabled government to pursue a policy of expanding entry to university, which is the right thing to do, while using the strength of its balance sheet to fund the system in an innovative way, and to provide insurance for graduates against the long-term costs of their student loan repayments. Student satisfaction levels remain strong on the whole, although there are concerns to be addressed around maintenance support, value for money, and the consequences of long-term debt repayment.

Against this background, and in light of the detailed and comprehensive analysis carried out in the course of its work, the main recommendations of the Student Funding Panel are:

- The current system of student funding in England is broadly fit-for purpose, does not require wholesale reform, and needs to be given time to work.
- Prospective and current student understanding of the system needs to be improved, and the description and communication of the system need to be clarified and simplified.
- Some of the parameters in the student loan repayment system may need to be modified over the medium term to reduce the long terms costs to government.
- Funding for maintenance support needs to increase and be targeted more effectively.
- Loan recovery mechanisms need to be improved and options for improving student loan collection should be analysed and implemented as a priority.

The panel's overall assessment of the impact of the current system on major stakeholders since its introduction in 2012–13 is as follows:

- There is no evidence that the funding reforms have deterred students from applying to university: numbers of applications from all socio-economic groups have been increasing steadily.
- Numbers of part-time and mature students have, however, declined. This may be due to a number of factors, of which the changes to the student funding system is one.
- The structure of the reformed student funding system means that there is greater uncertainty over the long-term costs. These will be influenced by such factors as: graduate employment outcomes; future labour market conditions; graduate repayment behaviour; and wider economic factors which influence the cost of living.
- While the RAB charge is a useful means of comparing estimates of the long-run costs of the system in the present, it is misleading to focus on this as the most significant indicator of the impact of the reforms. This is due both to the uncertainty surrounding the calculation, and the treatment of the RAB charge in the public accounts. Of much greater significance in policy terms are the factors that drive the estimates of the RAB charge, since they now drive the costs of the system.
- The 2012 reforms have increased income to universities. This has compensated for reductions in funding from other sources (for instance, capital funding), and the need to cope with increased capacity. It is a continuation of the policy of restoring funding to universities following the historic decline in the period leading up to the late 1990s.

The panel also looked at a number of options for reforming the student funding system. The broad aims of the options were: to reduce the potential long-run cost to government; to ensure that all students who have the ability to benefit from a university education can do so; to support social mobility; and to main the country's world-class level of university teaching and learning provision.

The options that were evaluated were:

1. modification of the parameters of the current system
2. freezing the current thresholds from 2016 to 2023
3. making repayments on total income once above the repayment threshold
4. a 'pseudo' graduate tax
5. the Labour Party proposals

As noted above, all of the options involve trade-offs and compromises. However, it was the panel's view that freezing the thresholds in the current system for a specified period of time was most likely to achieve the optimal balance of outcomes for students, graduates, government and universities.

In the long term it may be important to find ways in which universities can bear more of the risk from funding student loans. One method for doing this (the so-called 'Barr-Shephard' model) was considered by the panel, but the technical and practical difficulties associated with implementing it were thought to be too significant for it to be feasible at this stage.

Finally, the panel felt that the efficiency of the student funding system overall could be enhanced by improving the loan recovery mechanisms, which would in turn reduce some of the long-term costs.

ANNEXE 1: MEMBERSHIP AND TERMS OF REFERENCE OF THE PANEL

Terms of Reference

- To consider the design of the current student fees and loan system in England, and review its ability to deliver value for money for students, be financially sustainable for government and to allow universities to support high quality teaching and deliver an outstanding learning experience for students;
- To draw on the expertise of key stakeholders on proposals and models for student finance in England, and to assess the feasibility of these proposals and models;
- To consider the potential impact on Scotland, Wales or Northern Ireland of proposals in relation to England, and vice versa;
- To provide a forum to build a broad political consensus for a stable and sustainable system of funding for the long term; and
- To make recommendations on the student finance system in England up to, and immediately following, the General Election in May 2015.

Membership

- Professor Sir Christopher Snowden, Universities UK President and Vice-Chancellor, University of Surrey (Chair)
- Professor Dame Glynis Breakwell, Vice-Chancellor, University of Bath
- Professor Janet Beer, Vice-Chancellor, Liverpool University
- Sir David Bell, Vice-Chancellor, University of Reading
- Will Hutton, Chair of the Independent Commission on Fees, Principal of Hertford College, Oxford
- Paul Johnson, Director of the Institute for Fiscal Studies (IFS)
- Emran Mian, Director of the Social Market Foundation
- Professor David Latchman, Master of Birkbeck, University of London
- Professor Paul O'Prey, Vice-Chancellor, University of Roehampton
- Mike Rowley, UK Head of Education, KPMG
- Professor Sir Steve Smith, Vice-Chancellor, University of Exeter

ANNEXE 2: FINDINGS FROM THE CALL FOR EVIDENCE

Background

In autumn 2014 the panel published a call for evidence on the student fees and loans system in England. Evidence collected from submissions to the panel's call for evidence, meetings with stakeholders and meetings of the panel with selected 'witnesses' has been used to inform the work of the panel and the development of this report.

This annex provides a summary of relevant evidence collected through the panels call for evidence across the three main areas:

1. Value for money for students
2. Sustainability to government
3. Sustainability for higher education institutions

Main findings from the call for evidence

Value for money for students

Does the current student fees and loan system in England deliver value for money for students?

The majority of respondents to the call for evidence expressed the view that the current system delivers very good or fairly good value for money for students. However, some respondents said general conclusions are difficult to draw given individual student experiences will vary widely, and the difficulties involved in identifying reliable indicators of quality. It was acknowledged that the graduate premium represented a factor in assessing value for money. A wide variety of views were expressed on value for money of the loan and repayment system - the progressive nature of the system was recognised but the total amounts to be repaid were considered to be very significant amounts.

Respondents were asked how the reforms have changed the factors that prospective students take into consideration when making their decisions about entering higher education. Factors identified included the increasing importance of employability and the increased complexity of higher education finance with the introduction of the reforms, though understanding of the system may have improved over time. A number of responses saw the reforms as a contributing factor to the decline in part-time and mature undergraduate students. Many highlighted that other developments occurring alongside the reforms, such as the recession, could also have impacted on recent trends in recruitment.

Responses were mixed on whether the reforms have improved the quality of the student experience. While the new system was felt to increase student expectations and increase competition between institutions, it was not clear whether increased competition had translated into improvements in the student experience and teaching quality.

Responses were also mixed on whether public funding is effectively targeted at students with the greatest need of support. The funding of activity as part of OFFA access agreements and student opportunity funding were regarded as making positive contributions to the system. However, the NUS has expressed concerns on the ability of students to sufficiently meet their living costs. Some respondents argued that recent trends in part-time students suggest the need to revisit the targeting of public funding for part-time study.

Sustainability to government

Is the current student fees and loan system in England financially sustainable for government?

The vast majority of respondents expressed the view that:

- The current system is unsustainable for government. Views varied over whether the operation of the current system should be improved, the parameters of the loan system should be changed, or whether more significant reform is required.
- The 2012 reforms have resulted in shifting the balance too far from teaching grants to fees and loans. The current system is regarded as complex, with a lack of transparency on the taxpayer contribution to higher education, compared with a system with a greater proportion of teaching grant.
- Lifting the cap on student numbers has the potential to be financially unsustainable to government, due to uncertainty over the extent of the increase in student numbers that would occur, and a lack of clarity of how the expansion would be funded (whether it be by the sale of the student loan book or not). Many expressed concerns over the potential impact on the student experience.
- Actions are necessary to reduce the Resource Accounting and Budgeting (RAB) charge. Views varied between whether parameters of the system could be changed to achieve this, or whether more significant reform is needed.

Sustainability for higher education institutions

Does the current student fees and loan system in England allow and encourage universities to support high quality teaching and deliver an outstanding learning experience for students, which is financially sustainable?

The majority of respondents expressed the view that the current system:

- Allows and encourage universities to deliver an outstanding learning experience that is financially sustainable. However, concerns were raised over the lack of transparency in how fee income is spent. Responses from institutions differed from the majority view, and emphasised that the reforms had delivered little increase in the resources for teaching.
- Allows and encourages institutions to access resources to grow their student numbers. However, it was emphasised that whether an institution could expand or not depended very much on the courses offered and an institution's specific financial circumstances.
- May not encourage institutions to fund and pursue innovations in teaching. Many said there was little evidence that the current system encouraged or incentivised innovation in teaching and that it was difficult to ascertain the impact of the reforms on teaching quality. Some also mentioned that the reforms had resulted in a decrease in flexible and non-degree higher education courses.
- Allows and encourages institutions to fund measures that widen access and improve participation. Some mentioned the importance of activity undertaken by institutions as part of their access agreements with OFFA. Many, however, felt that the removal of, and pressure on, public funding streams that support widening participation presents challenges.
- Allows and encourages institutions to fund measures to improve the employability of graduates. Many felt that the reformed system, with increased competition, was a key driver behind a greater focus by institutions on employability.

Respondents listed the following as the main challenges facing institutions in relation to long-term financial sustainability:

- Funding the costs of infrastructure, including the funding of capital investment, maintenance and running costs
- Increasing institutional liability for pensions
- Real-terms decreases in research funding
- Government policies on immigration and initial teacher training.

No responses said that the increased income, in aggregate, to the higher education sector under the reforms was sufficient to deal with the long-term challenges facing the sector. Many respondents said that the £9,000 fee cap, introduced with the reforms, was problematic in constraining the ability of institutions to meet the challenges to long-term sustainability.

Respondents expressed that the increasing divergence of higher education policy between England and the devolved administrations presented challenges, with concerns over funding gaps occurring between England and the devolved nations.

List of witnesses

Professor Nick Barr, London School of Economics

Professor Anna Vignoles, University of Cambridge

John Denham, former secretary of state for Innovation, Universities and Skills (2007 to 2009)

Nick Hillman, Higher Education Policy Institute

Toni Pearce, National Union of Students

David Willetts, visiting professor in Policy institute at King's College London (former minister of state for universities and science (2010 to 2014))

Respondents to the call for evidence

Deaglan McArdle (Personal Capacity)

StudentFunder Ltd (Juan Guerra)

John Peters (Personal Capacity)

Ryan Ward (Personal Capacity)

University for the Creative Arts - UCA (Tony Peoples)

Alison Barnard (Personal Capacity)

Dan Cook (Personal Capacity)

Hilary Thomson (Personal Capacity)

Stephen (Personal Capacity)

Simon Kaye (Personal Capacity)

Supporting Professionalism in Admissions - SPA (Dan Shaffer)

Association of Colleges (Julian Gravatt)

University Alliance (Matt Robinson)

University of Oxford (Helen Watson)

National Association of Student Money Advisers (Phil Davis)

Ravensbourne (Anita Bailey)

Durham Johnston Comprehensive School (Steve McArdle)

Institute of Education, University of London (Emma Wisby)

Birmingham City University (Tim Openshaw)

Imperial College London (Katherine Bayliss)

Engineering Professors' Council (Susan Kay)

Liverpool Hope University (Jeanette Jones)

Plymouth University (Claire Daniells)

The Open University (Carol Rowland)

Association of Graduate Recruiters (Stephen Isherwood)

Confederation of British Industry - CBI (Guy Parker)

Prof Claire Callender

Dr Gill Wyness

Higher Education Funding Council for England - HEFCE (Nolan Smith, Nicholas Dibley & Zoe Mackey)

Supporting Professionalism in Admissions - SPA (Janet Graham & Dan Shaffer)

Sutton Trust (Conor Ryan & Liz Johnston)

Universities and Colleges Admissions Service - UCAS (Helen Thorne)

University Alliance (Liz Shutt)

Higher Education Commission (Ruth Thompson)

million+ (Alan Palmer & Pam Tatlow)

Association of Teachers & Lecturers - ATL

British Medical Association - BMA

Higher Education Strategic Planners Association - HESPA

Quality Assurance Agency - QAA

Russell Group

University of Exeter

GuildHE (Andy Westwood & Alex Bols)

Martin Lewis

Universities Scotland (Kirsty Conlon)

Prof Neil Shephard

Andrea Simpson (Personal Capacity)

Lizzy Pollard (Personal Capacity)

Lesley Green (Personal Capacity)

Adele Frost (Personal Capacity)

Vivienne Sykes (Personal Capacity)

Louise Meredith (Personal Capacity)

Andrew Perry (Personal Capacity)

Andrew Stanley (Institution of Civil Engineers)
Sarah Henderson (SAE Institute)
Louise Elliott (Personal Capacity)
Louise Miles (Personal Capacity)
Catherine McKeown (Personal Capacity)
Lynndi Walsh (Personal Capacity)
Ben Goose (Personal Capacity)
Helen (Personal Capacity)
Sarah Parkes (Personal Capacity)
Garmon ap Garth (Personal Capacity)
Hilary Jellie (NASMA)
Lynne Fardon (St Mary's University)

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