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Higher Education finance reform: Raising the repayment threshold to £25,000 and freezing the fee cap at £9,250

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Chris Belfield
Jack Britton
Laura van der Erve

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Chris Belfield, Jack Britton and Laura van der Erve

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On Sunday, the Prime Minister Theresa May announced that the income threshold above which graduates start making repayments on their student loans would be increased from £21,000 to £25,000 for all those who started university after 2012, and that the cap on tuition fees at English universities would be frozen at its current level of £9,250.

Key Findings

- Increasing the repayment thresholds on student loans to £25,000 and removing the cash-terms freeze until 2021 is a significant giveaway to graduates. This reduces average graduate lifetime repayments by around £10,000. These benefits are greatest amongst those in the middle of the graduate earnings distribution, with some benefiting by up to £15,700 as a result of the changes. This reform increases the cash in pocket of graduates, with all those earnings more than £26,500 making annual repayments £500 lower in 2020 in cash terms. Now 83% of graduates are forecast to not fully repay their loans within the 30-year repayment period (up from 77%).

- Freezing the cap on tuition fees at £9,250 has little impact in the short-term, but has potentially significant implications if kept in place in the long-run. This reduces the forecast average debt on graduation for students starting a three-year degree this autumn, from £50,600 to £49,800. However, as most students do not pay off the full value of their debt this only reduces the repayments of the highest earning graduates.

- These reforms will increase the long-run government contribution to the cost of providing higher education by around £2 billion per year (raising the repayment threshold costs £2.3 billion and freezing fees saves £0.3 billion) This increases the RAB charge on student loans from 31% to 45% for students starting in 2017. This is entirely due to the reduced graduate repayments as a result of the higher repayment threshold (freezing fees slightly reduces the RAB). However, the impact on the deficit (PSNB) will be negligible in the short-run because student loans do not impact the deficit until they are written off after 30 years.

- Freezing the cap on tuition fees with no compensating teaching grants directly reduces university funding. Again, the impact is small in the short-term but this will grow the longer a freeze is kept in place. This raises questions about the introduction of the Teaching Excellence Framework and creates uncertainty about the long-run path of university funding. The freeze appears to continue a historical trend that higher education funding per student has consistently been characterised by gradual real terms falls over a number of years punctuated periodically by relatively sharp increases following large-scale reforms.

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Introduction

On Sunday, the Prime Minister Theresa May announced that the income threshold above which graduates start making repayments on their student loans would be increased from £21,000 to £25,000 for those who started university after 2012.

This is a significant giveaway, largely to middle-earning graduates, who are likely to repay around £15,700 less over their careers, at a long-run cost to government of £2.3 billion per year in 2017 prices. It also increases the proportion of graduates who are unlikely to repay their loans in full to 83% (from 77%) and the proportion of the loan book the government does not expect to be repaid to 45% (from 31%).

The Prime Minister also announced that the cap on tuition fees at English universities would be frozen at its current level of £9,250 (rather than allowing some inflationary increases). This is a small change in comparison to the increase in the threshold (a saving to the government of £0.3 billion in 2017), but raises major question marks around the implementation of the newly formed Teaching Excellence Framework (TEF), which would have allowed universities to increase their fees based on their teaching quality.

Background

Under the current Higher Education (HE) finance system in England, universities can charge students tuition fees of up to £9,250 per year. Going forward, the plan was to allow some universities to increase fees in line with inflation if they met certain requirements in the TEF. Freezing tuition fees at £9,250 raises questions about whether the TEF reform will still be implemented. Further, freezing the maximum level of tuition fees without additional compensating teaching grants, reduces the real value of funding universities receive. While they have seen substantial increases in their resources in recent years, this is not a sustainable way of funding universities in the very long-run.

UK and EU-domiciled students do not have to pay these fees up front, however, as they are entitled to a loan from the government that covers all tuition fees and up to around £8,000 per year for living costs (see https://www.gov.uk/student-finance/new-fulltime-students). Unlike most loans, the repayments graduates make on these loans depend on their income after they have graduated. Under the current system, graduates who started their degrees after 2012 make repayments equal to 9% of income above a threshold of £21,000 a year.

The reforms in 2012 increased the repayment threshold for new students to £21,000 from around £17,500. This threshold was due to increase in line with average earnings growth, but last year it was announced that this threshold would be frozen in cash terms until 2021, after which it would rise in line with average earnings. The Prime Minister's announcement on Sunday reverses this freeze, increasing the repayment threshold to £25,000 from April 2018, and rising in line with average earnings thereafter.[1]

[1] Under the current system, the interest rate charged on student loans also depends on graduate's earnings, rising from RPI if they earn below £21,000 to RPI + 3% if they earn more than £41,000. In this analysis, we have assumed these interest rate thresholds move in line with the repayment threshold. In practice this has very little impact on government cost or graduate repayments.

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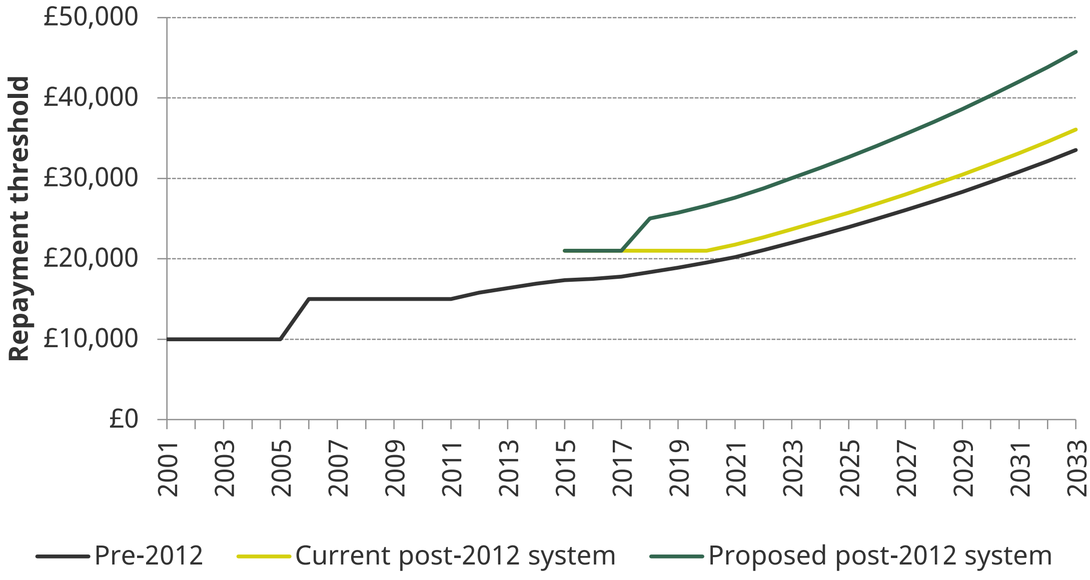
Figure 1 – Repayment thresholds under various student loans systems (current prices)



Sources: Authors' calculations based on government announcements and OBR forecasts of average weekly earnings growth (http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2017/)

Impact on government finances

For students who have just started university, the government will provide upfront funding throughout their degrees of around £17 billion. Around £16 billion, or 96%, of this is in the form of student loans, which means that changes to the student loan system – such as those announced on Sunday – can have a significant impact on the expected long-run cost to taxpayers of the higher education system. Table 1 sets out the impact of Sunday's announcements on the expected long-run taxpayer cost and compares this with the expected cost of the current system.

Freezing the cap on tuition fees at £9,250 reduces the amount of money that is lent to students. Indeed, we estimate that average debt on graduation for a student starting a three-year degree in 2017 will fall from £50,600 to £49,800 as a result of this freeze. Because very few graduates repay their loans in full, this reduction in debt results in only a small reduction in future loan repayments from graduates, meaning that both the upfront and expected long-run cost to government fall by around £0.3 billion for this cohort.

Increasing the repayment threshold to £25,000, on the other hand, significantly increases the expected long-run taxpayer cost - by £2.3bn for this cohort, from £5.6bn to £7.9bn. The RAB charge, which measures the proportion of total loans the government expects to write off, would also rise substantially, from 31% to 45%.

These figures are for the students who started HE in 2017; however, the threshold freeze affects the repayments from all graduates who started HE since 2012 which will represent an additional hit to long-run government finances.

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Table 1 – Impact of student finance reforms on government finances for the 2017 cohort (2017 prices)

	Current forecast	*With fee freeze*	*Increasing the threshold and freezing fees*
Total up-front government spend	£17.0bn	£16.7bn	£16.7bn
Long-run taxpayer subsidy	£5.9bn	£5.6bn	£7.9bn
RAB charge	31.4%	30.7%	45.0%

Note: All figures are given in 2017 prices, in net present value terms using the government discount rate of RPI + 0.7%. These figures apply to young full-time English-domiciled students studying at the 90 largest universities in England starting in 2017–18. We assume that all students taking out loans do so for the full amount 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. This assumes cohort size of 365,700 based on 2015–16 Higher Education Statistics Agency (HESA) estimates of English-domiciled first-year full-time undergraduates. We assume 10% non-take-up of loans, approximately in line with Student Loans Company (SLC) data on loan uptake.

Source: Authors' calculations using IFS's graduate repayments model.

Impact on graduate repayments

Figure 2 shows how the freezing of the tuition fee cap and the increase in the repayment threshold affect the expected lifetime loan repayments of graduates.

Because very few graduates repay their debts in full, only the very highest earners are likely to see their repayments fall as a result of the tuition fee cap being frozen.

Increasing the repayment threshold, however, is a significant giveaway to graduates. Next year, students with income above £25,000 will be obligated to repay £360 less in cash terms per year (9% of £4,000 – the difference between the old and new repayment thresholds). Because under the previous plans the threshold was set to be frozen at £21,000 until 2021 – and under the new plans will rise in line with average earnings between 2018 and 2021, the reduction in repayments will increase over time, as the wedge between the two thresholds increases, such that by 2020, all graduates earning more than around £26,500 will have annual repayments £500 lower in cash terms under the new system compared to the old one.

For high earning graduates – those who would go on to repay their loans in full - this merely defers repayments until later in their careers and so has little impact on their lifetime repayments. However, most graduates do not fully repay their loans, and so for low and middle earning graduates the increase in the threshold will reduce the total amount they repay. Indeed, we estimate that repayments will fall by £10,000 in 2017 prices, on average, and by £15,700 for graduates with earnings in the middle of the distribution. This will increase the proportion of graduates not expected to repay their loans in full to 83% (from 77%).

Finally, because these announcements only apply to post-2012 loans this reintroduces a wedge between the repayment threshold under the pre and post-2012 loans systems (as shown in Figure 1). This means that the lowest income 40% of graduates are actually better off under the new system than they would have been had they faced the 2011 system instead.

Figure 2a – Expected average lifetime repayments by decile of graduate lifetime income for 2017–18 cohort (2017 prices, non discounted)

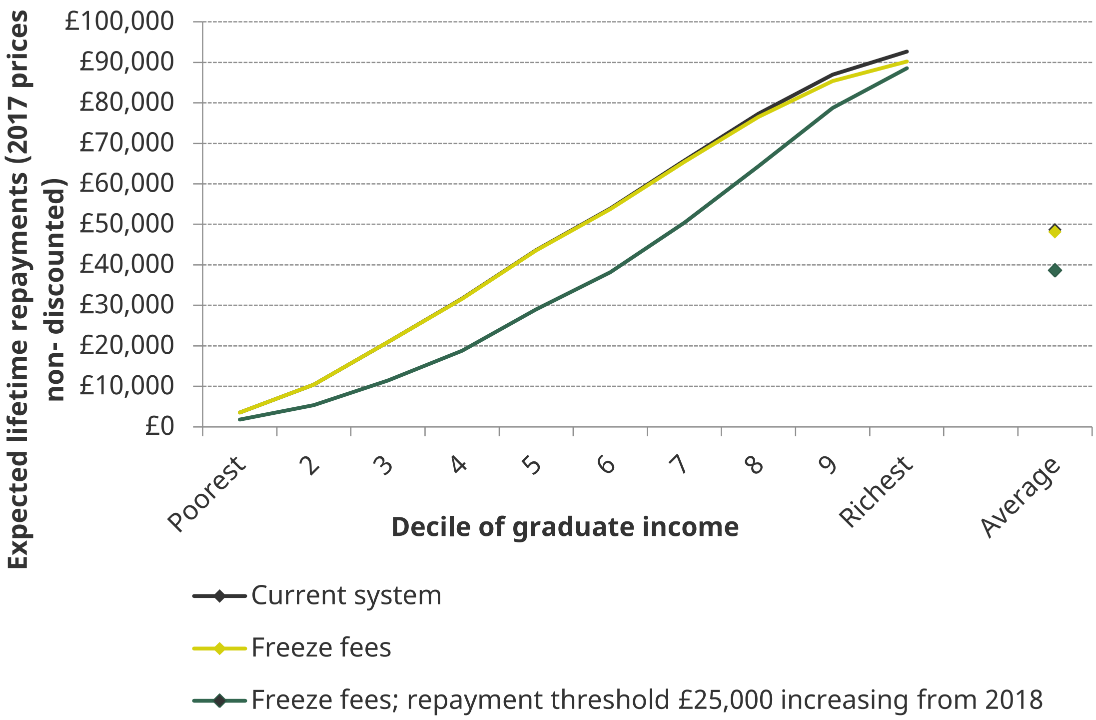
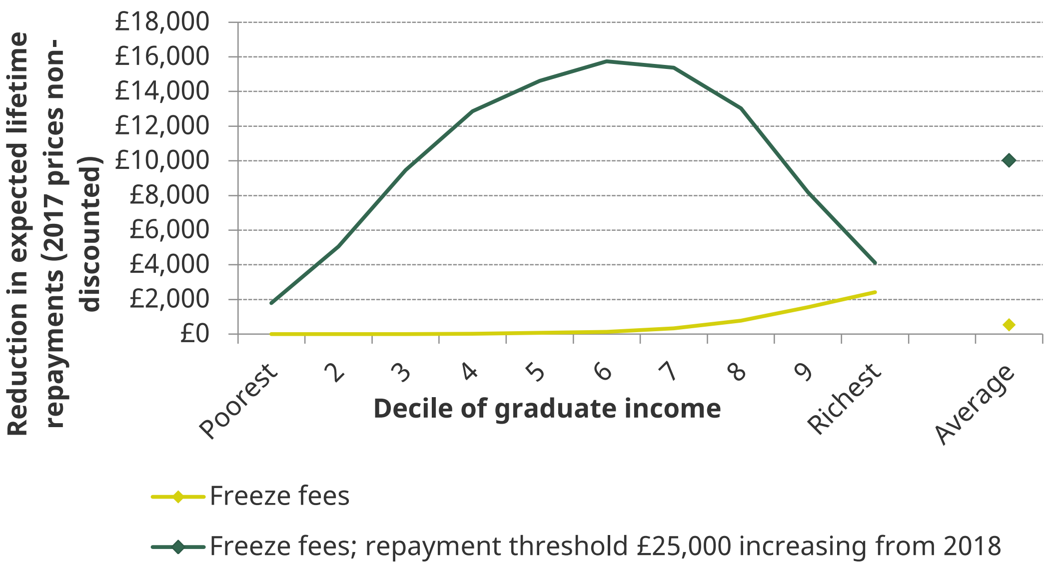


Figure 2b – Impact of reforms on expected average lifetime repayments by decile of graduate lifetime income for 2017–18 cohort (2017 prices, non discounted)



Notes: Figures in 2017 prices, deflated using CPI inflation, not discounted. These figures apply to young full-time English-domiciled students studying at the 90 largest universities in England starting in 2017–We assume that all

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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: Authors' calculations using IFS's graduate repayments model.

Summary

Sunday's announcements represent a significant giveaway to recent and future graduates, with those with income in the middle of the distribution benefitting most. This giveaway comes at a cost; the combined impact of the announced reforms is expected is to increase the long-run taxpayer cost of HE by around £2.0 billion per year. Further, freezing the level of tuition fees in cash terms creates uncertainty about the future level of university funding and the implementation of the Teaching Excellence Framework. This continues a historical trend in university funding noted in previous IFS research, that higher education funding per pupil has consistently been characterised by gradual real terms falls over a number of years punctuated periodically by relatively sharp increases following large-scale reforms. This is not a sensible path for university funding, not least because it makes it difficult for universities to plan effectively for the future.