HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

CBP 8097, 2 October 2017

Prime Minister's announcement on changes to student funding

By Sue Hubble and Paul Bolton

Contents:

Contents

Summary

The student finance system has gone through a prolonged period of change and reform since the Labour Government introduced upfront university tuition fees of £1,000 per year in 1998.

Since 1998 tuition fees have progressively risen. In 2006, under the Labour Government, the *Higher Education Act 2004* trebled fees to £3,000 per year and introduced deferred variable fees and tuition fee loans which are repaid after graduation.

From 2006 fees rose gradually by inflation until 2012 when, under the Coalition Government, tuition fees were raised to £9,000 per year following an independent review of the student finance system by Lord Browne. The student finance reforms at this time also included raising the repayment threshold to £21,000 and introducing a variable tiered rate of interest on student loans.

Most changes in the student finance system have been made in response to a particular set of funding pressures. The cumulative effect is that England now has the highest 'public' tuition fees in the industrialised world and a complicated system of student support.

Since 2012 there have been further changes which have moved student support increasingly away from non-repayable grants and towards loans. Maintenance grants and NHS bursaries have been abolished and replaced by increased loans, the student loan repayment threshold has been frozen and interest rates on student loans have increased.

In addition to these reforms a process called the Teaching and Excellence Framework has allowed higher education institutions with high quality teaching to raise their fees by an inflationary amount to £9,250 in 2017/18 – this is the first fee rise since 2012.

The combined effect of these changes has been to increase student debt – the Institute for Fiscal Studies has calculated that students from the poorest backgrounds will accrue debts of £57,000 from a three-year degree.

In the 2017 General Election the Labour Party manifesto included a commitment to abolish tuition fees and to restore maintenance grants. This proposal proved popular among young voters.

On 1 October 2017 the Prime Minister announced that there would be changes to the student finance system: the fee cap would be frozen at £9,250, the repayment threshold would rise to £25,000 and a there would be a review of the student finance system.

The proposed freeze on fees will reduce income for universities, compared to what they expected to receive. It will also mean that the Government will need to lend, and students to borrow, slightly less.

Increasing the threshold to £25,000 reduces future repayments and hence the economic costs, or subsidy element of the loans. The proportion of borrowers with some debt written off could increase from around 70% to around 77%.The annual cost could be in the order of £1.5 to £1.7billion. However, with little detail on the timing, or scope of this change the final cost could be considerably different. Middle earning graduates are likely to gain the most from this change.

This briefing outlines the changes to the student finance system and gives background on the current debate. It also sets out the available information on the changes proposed by the Prime Minister and analyses their potential impact.

1. Overview of changes to the student funding system

The student finance system has gone through a prolonged period of change and reform since the introduction of university tuition fees in 1998. Each change to the system was made in response to a particular set of funding pressures and the cumulative effect of these changes is that England now has the highest public tuition fees in the industrialised world and a complicated system of student support.

1.1 2006 reforms

In 2006 provisions in the *Higher Education Act 2004* brought in a new system of variable deferred tuition fees. Under this system tuition fees would no longer need to be paid upfront and students could take out a tuition fee loan to cover the cost of fees which would be repaid after graduation. Tuition fees were raised from £1,175 per year in 2005/06 to £3,000 per year in 2006/07. The Act also created the Office for Fair Access to ensure that the fee increase did not negatively impact on widening participation in higher education.

This increase was highly controversial and as a concession to get the fee increase through it was agreed that an independent review of fees would be carried out three years after the fees came into operation.

1.2 The Browne Review

In 2009 the Browne Review was set up by the Labour Government. The Review was commissioned to make recommendations to Government on the future of fees policy and financial support for full and part-time undergraduate and postgraduate students - the report of the review, *Securing a sustainable future for higher education* was published in October 2010.

The review recommended removing the cap on tuition fees and allowing higher education institutions (HEIs) to charge unlimited fees with a levy on fees of over £6,000 per year. The review also recommended a more progressive interest rate on student loans. The new Coalition Government broadly supported the reviews recommendations and on 3 November 2010 it announced its own proposals in a ministerial statement – the proposals included:

- allowing universities to charge tuition fees of up to £9,000 per year in 'exceptional circumstances'
- raising the student loan repayment threshold to £21,000
- introducing a real rate of interest on student loan repayments and a progressive taper on the interest charged
- loans to be written off after 30 year

The Government also made a commitment to raise the student loan repayment threshold in line with earnings.

The proposals were passed on 9 December 2010 by 21 votes – a wider margin than the vote on the 2004 changes.

1.3 2012 reforms

The new system of student finance was brought in in September 2012. All new students starting higher education courses in September 2012 would be under the new system and the loans taken out by these students are referred to as Plan 2 Loans.

Most HEIs opted to charge fees of around £9,000 per year. The average fee at HEIs was slightly lower when fee waivers and discounts were taken into account.

Plan 2 loans have a variable tiered rate of interest applied so that students pay a rate of RPI + 3% when they are studying, this falls to RPI only when the student has graduated and is earning under the repayment threshold. The interest rate then gradually increases to a maximum of RPI + 3% when they were earning over £42,000 per year.

The Institute of Fiscal Studies analysed the new interest rate system in 2010 and concluded that it was more complicated than the old system but more progressive as higher earners would pay more on average than under the old system and that proposed by Lord Browne, while lower earning graduates would pay back less.[1]

1.4 Student finance changes since 2012

Since 2012 there have been several further significant changes to student finance.

Abolition of maintenance grants in England

In 2015 the Government announced that maintenance grants would be abolished for all English students starting courses in 2016/17. Students from low income households had been eligible for grants of up to £3,387 per year. These grants were replaced by increased student maintenance loans – the maximum amount of student support increased by £766.

Further information on these changes is in library briefing note *Abolition of maintenance grants in England from 2016/17*, 7 February 2017.

Abolition of NHS bursaries for healthcare students in England

In 2015 the Government announced[2] that NHS bursaries for healthcare students in England would be abolished for those starting courses in September 2017. The Government stated that the change in funding from bursaries to loans would provide funding for 10,000 extra training places over the parliament.

1 Institute for Fiscal Studies Briefing Note 113, *Higher Education Reforms: Progressive but Complicated with an Unwelcome Incentive*, December 2010
2 HM Treasury, *Spending Review and Autumn Statement*, November 2015 p31

NHS bursaries were a package of support which included: payment of tuition fees, a maintenance bursary and a reduced rate student loan. Under the new system students would transfer onto the standard student finance scheme of loans for fees and maintenance. It was calculated that healthcare students would have 25% more cash in hand under the new system but this money would have to be repaid unlike much of the old funding.

Up to the end of June 2017 applicants for nursing from England had fallen by 23% compared to the same time in the previous application cycle, with a particularly big drop among mature students.

Further information on these changes is in library briefing note *Reform of support for healthcare students in England*, 2 February 2017.

Freezing the student loan threshold

In the ministerial statement on 3 November 2010 announcing the new higher education funding system the Government gave an undertaking to increase the student loan repayment threshold 'periodically to reflect earnings'.[3]

Subsequently however it was announced in the Summer Budget July 2015 that there would be a consultation on freezing the repayment threshold for five years.[4] The consultation was launched in July 2015 and in November the Government published its response. Despite 84% of respondents being against freezing the threshold the Government decided to freeze the threshold for all post 2012 loans until at least April 2021.

Further information on these changes is in library briefing note *Freezing the student loan threshold*, 12 July 2016.

Student loan interest rate increases

The first Plan 2 loans taken out by students came into repayment status in April 2016. The debate on the rate of interest charged on student loans really began from this point when students received their student loan statements and became fully aware of the interest charged on loans.

All students taking out loans are advised to read a Student Loans Company publication Student Loans Terms and Conditions[5] where interest rates charges are clearly set out.

The interest rate issue received more attention in 2017 when it was announced that the rate applied to student loans in 2017/18 would be 6.1% - this reflects the increase in RPI in the year to March 2017.

In July 2107 the Institute for Fiscal Studies published an analysis of the student finance system, *Higher Education funding in England: past, present and options for the future*. Their analysis showed that students

3 HC Deb 3 November 2010 c924
4 HM Treasury Summer Budget 2015, HC 264 July 2105 p59
5 Student Loans Company, Student loans - a guide to terms and conditions 2016/17

on average would accrue £5,800 in debt while studying due to the interest rate on loans.[6] The report also said however that many low paid graduates would never earn enough over 30 years to pay off the interest so this would just be written off.

1.5 The Teaching and Excellence Framework (TEF) and fee increases

The Government has introduced a process called the Teaching and Excellence Framework (TEF). The TEF aims to measure the quality of teaching in HEIs and to reward those with high quality teaching.

The TEF was introduced in 2016 and in the first year all HEIs with a past satisfactory quality assessment report qualified for a TEF award and were permitted to raise their fees by an inflationary amount in 2017/18. As a result fees at most HEIs rose to £9,250 in 2017/18.

In the second year of the TEF assessments were based on a set of metrics, other contextual data and a qualitative submission. Awards were made at three levels, bronze, silver and gold. All HEIs receiving an award were to be allowed a further inflationary increase in fees in 2018/19 and fees were set to rise to £9,500.

It is anticipated that the TEF will develop further over time. A lessons learned exercise is being conducted on the TEF and subject level pilots are being carried out.

Further information on the TEF is in library briefing note *Teaching and Excellence Framework (TEF)* 22 June 2017.

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.

IFS Briefing Note BN 217, 3 October 2017

1.6 The Higher Education and Research Act 2017

The Higher Education and Research Act 2017 received Royal Assent on 27 April 2017. The Act will bring in significant changes to the regulation and administration of the higher education sector. The Act will also put in place arrangements that will allow the operation of the TEF.

As the *Higher Education and Research Bill 2017* the Act had a bumpy ride through its parliamentary stages and many amendments were made to the Bill. Significantly, with regard to fee levels, in the last stages of the Bill an amendment was agreed by the Government which, when commenced, would make all future changes to fee levels subject to the affirmative resolution procedure. This means that all fee changes would have to be agreed by both Houses of Parliament. At present annual fee regulations are subject to the negative resolution procedure which means that real terms fee increases go through automatically unless an objection is tabled and even when this occurs it is very unusual for a proposed change to be overturned.

6 , IFS, *Higher Education funding in England: past, present and options for the future*, July 2017 p3

2. Student funding debate

Since 2012 there has been considerable debate about the level of university tuition fees and student finance. In November 2015 a survey of 34 countries by the OECD showed that England had the highest average public undergraduate tuition fees in the industrialised world.[7]

However the debate around student funding has intensified since 2016 when maintenance grants and NHS bursaries were abolished and the student loan repayment threshold was frozen. The recent increase in interest rates on student loans and the resulting increase in student debt has further heightened debate on student funding.

2.1 Labour Party 2017 Manifesto

Tuition fees became an area of debate in the 2015 General Election when the Labour Party included in their manifesto a pledge to abolish university tuition fees:

> Labour will reintroduce maintenance grants for university students, and we will abolish university tuition fees.[8]

2.2 Lord Adonis comments

Lord Adonis was education minister and head of policy in the Labour Government when tuition fees were raised in 2006. In July 2017 Lord Andrew Adonis made statements in which he criticised the current level of tuition fees and suggested that fees should be abolished:

> Tuition fees of £9,250 and rising won't survive. Nor do they deserve to. The only question is whether they are abolished entirely or whether cross-party support can be built to keep fees to between £1,000 and £3,000, as per their introduction 13 years ago.
>
> How did we get from the idea of a reasonable contribution to the cost of university tuition – the principle of the Blair reform of 2004, for which I was largely responsible – to today's Frankenstein's monster of £50,000-plus debts for graduates on modest salaries who can't remotely afford to pay back these sums while starting families?

2.3 Damien Green comment

In July 2017 the First Secretary of State Damian Green in a speech to the think tank Bright Blue, said that the debate on university tuition fees needed to be reopened in a "national conversation".[9]

2.4 Institute of Fiscal Studies report July 2017

In July 2017 the Institute of Fiscal Studies published a report *Higher Education funding in England: past, present and options for the future*,

---

7 "England has highest university tuition fees in industrialised world, survey finds", *The Guardian*, 24 November 2015
8 Labour Party Manifesto 2017, For the many not the few p43
9 "Damian Green admits Tories may need to review tuition fees", *The Guardian*, 1 July 2107

in which they showed the increased level of debt among students caused by policy changes and increased tuition fees. The key findings of the report were:

- There has been a big shift in the way government funds higher education (HE) from up-front grants to student loans.
- This has dramatically reduced deficit spending, while also reducing the expected long-run taxpayer contribution.
- The long-run taxpayer contribution has become considerably more uncertain.
- Students now graduate with average debts of £50,000 – and even more for the poorest students.
- Student loans differ from private loans, as repayments are proportionate to income.
- Positive real interest rates increase debt levels for everybody – but only the repayments of the highest earners
- The benefits from high interest rates appear to outweigh the costs.
- Recent reforms have considerably changed the landscape for UK universities.
- Cutting fees while protecting university funding would increase the deficit and the long-run taxpayer contribution, but would also increase flexibility.

2.5 Universities UK (UUK)

In September 2017 UUK published a Parliamentary briefing: *The undergraduate funding system in England* in which they asked the Government to consider the option of providing targeted maintenance grants for those most in need of this support and reducing the interest rate payable specifically for low and middle-income earners through changes in earning thresholds to which interest rates apply.

UUK have published a response to the proposed changes - *Response to Conservative proposals on tuition fees*,[10]

> **Alistair Jarvis, Chief Executive of Universities UK**, said:
>
> "The tuition fees system in England has allowed universities to offer a world-class education, provide the economy with highly skilled graduates, and transform the lives of students from all backgrounds, but it is right to look at ways to ensure it is affordable and fair."
>
> "We're pleased the Government is looking at ways of addressing students' money concerns. Raising the loan repayment threshold will put extra cash in the pockets of many graduates starting their careers. Universities UK would like to see the Government going further by reintroducing maintenance grants for those most in need and reducing interest rates for low and medium earners. We also need to do more to reverse the worrying decline in the numbers of part-time and mature students."

[10] Universities UK, *Response to Conservative proposals on tuition fees*, 1 October 2017

2.6 Parliamentary debate

The tuition fee increase for 2017/18 was brought in under *The Higher Education (Basic Amount) (England) Regulations 2016* SI 1205 and the *Higher Education (Higher Amount) (England) Regulations 2016* SI 1206. These regulations were laid on 15 December 2016. In January 2107 the opposition tabled two Early day Motions[11] calling for these regulations to be annulled.

On 19 July 2017 there was an emergency debate on Tuition Fees which considered the increase in tuition fees implemented by the regulations.

On 13 September 2017 the Opposition were granted a debate on the regulations - The Higher Education (England) Regulations. The Opposition won the vote on the motion that the regulations should be revoked. This vote however has no binding effect.

Chancellor of the Exchequer evidence to Economic Affairs Committee September 2017

On 12 September 2017 the Chancellor of the Exchequer gave evidence to the House of Lords Select Committee on Economic Affairs in which he said that the Government were looking into student funding and interest rates on student loans:

> Let me try to explain some of the logic behind that. First of all, let me recognise that the whole issue of the value-for-money proposition to students in higher education is clearly of concern. We have heard that message, and we are looking carefully at the overall proposition that students face, which is not just about the financing of higher education but about the value proposition presented to students.
>
> The interest rate charged on a student loan is not like the interest rate charged on a commercial loan from a bank. This is a loan, the repayment of which is income-contingent. We know at the outset, by design, that a significant proportion of loans will not be repaid. When we know that the loan will not be repaid, the interest added to it is, in a sense, notional. It will not be repaid if the borrower turns out to be a low-income graduate.
>
> By design, the system has an element of transfer, a redistribution from higher-income graduates to lower-income graduates. That was how the system was always intended to operate. As I said at the beginning, I recognise that questions have been raised about the overall proposition, and we are looking carefully at how it works to make sure that the way it operates is justifiable.

[11] EDMs 850 and 851

3. Prime Minister's October 2017 announcement on student funding

On 1 October 2017 the Prime Minister announced[12] that there would be changes to the student finance system including:

- freezing tuition fees at the 2017/18 level of £9,250
- raising the student loans repayment threshold from £21,000 to 25,000 and
- a review of the student finance system

Other ideas allegedly being considered by the Government are:

- cutting the interest rates on loans
- introducing lower fees for students studying certain subjects, such as engineering where there is a skills shortage and
- a graduate tax

12 "Theresa May pledges help for young on student fees and housing", *BBC News*, 1 October 2017

4. Possible impact of the October 2017 announcement

The Government has so far not published much detail on the changes to student finance announced on 1 October. This section looks at the potential impact and will be updated when more detail is published and the Government produces its own analysis.

4.1 Freeze on tuition fees

Compared to a situation where the fee cap was increased in 2018/19:

- Fee income for institutions will be lower. Income per undergraduate (on regulated fees) will be lower than 2017/18 levels in real terms and lower than previously expected/planned.
- The 2018/19 maximum fee level will be around £550 below the 2012 level in real terms.[13]
- Students will need to take out slightly smaller loans to cover fees
- Some graduates will repay their loans a little sooner and repay somewhat less in total.
- The Government will need to lend less in fee loans and will therefore save a (relatively) small amount in public expenditure terms (after repayments are taken into account).

Any further freeze on the fee cap in future years will magnify these impacts. However, even if it is increased in the future it would still be below the level it would have been with no policy change unless the cap is increase by more than RPI to 'catch-up'.

4.2 Increase in loan repayment threshold

The impact of this change will depend to a substantial degree on when it is implemented, which borrowers it applies to and whether the increase to £25,000 will be followed by a freeze to at least 2021, as with the previous policy. This section assumes that the threshold will be frozen at £25,000 until 2021 and subsequently increased in line with average earnings.

Raising the threshold in this way has no direct impact on the amount of cash the Government needs to lend to students. It only affects loan *repayments* which will be lower in the future. This means the subsidy element of loans is increased –a smaller share of their face value will be repaid on average.

The figures below are based on the latest public version of the Government's Student loan repayment model. This was published in July 2015 before the changes to student finance announced in the Summer Budget 2015.[14] The model has been adapted where possible to reflect these changes, but its underlying assumptions about graduate

13 2018/19 prices. Values adjusted using September 2017 GDP deflators.
14 Specifically freezing the repayment threshold at £21,000 for at least five years and replacing maintenance grants with loans.

earnings and employment have not been changed. In addition no account has been taken of variations in loan amount by income introduced by the ending of grants. The Government uses a much more complex (and now up to date) repayments model to produce its accounts.

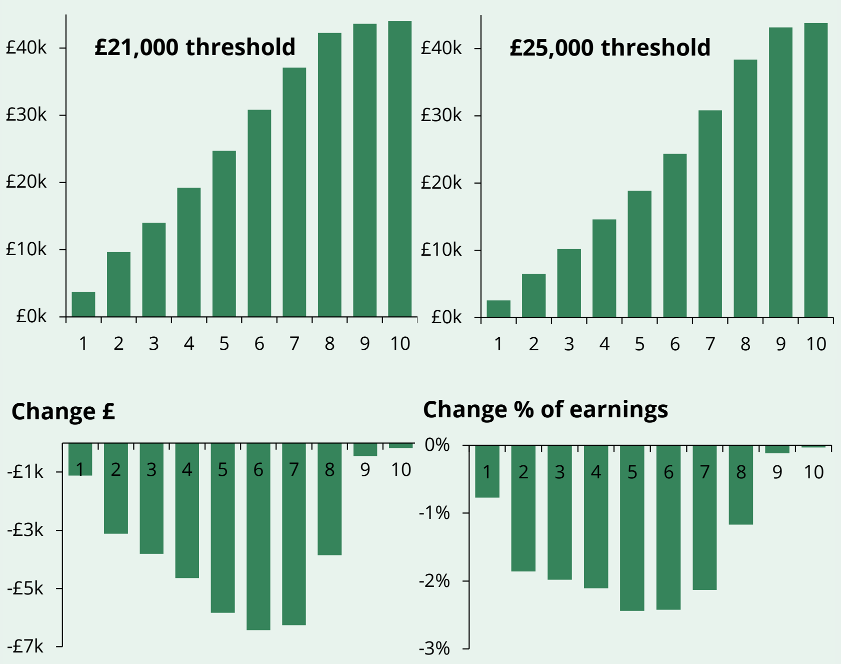
Increasing the threshold to £25,000 reduces future repayments and hence the economic costs or subsidy element of the loans. The model forecasts that **the subsidy element could increase by 9-10 percentage points**.[15] With an assumed *annual* loan outlay of around £17 billion **the economic cost would be in the region of £1.5 to £1.7 billion**. This cost could vary considerably depending on the timing of this change, as well as the underlying uncertainty in the modelling. One way of interpreting this cost is as the present value (discounted) of the loss of repayments from borrowers.

It is important to note that this economic cost would not affect the fiscal deficit as it would be a change to what is classed as 'financial transaction' rather than spending on services. It would increase the size of the national debt in the future as cash repayments would fall.

The charts below shows how the model forecasts repayments could vary by income decile.[16]

MIDDLE EARNING GRADUATES GAIN MOST FROM HIGHER THRESHOLD

Present value of repayments by 'lifetime' income decile



The group who benefits the most from raising the threshold is, generally speaking, middle earning graduates. They would on average see their

15 Percentage of the face value of loans

16 Where decile 1 is the lowest. Income groups based on earnings over 30 years, discounted to 2016 values.

repayments fall by £5-7,000 over the duration of their loan. Higher earners are not greatly affected as nearly all still repay their loans in full and savings[17] are almost balanced out by higher interest payments on loans which are repaid for longer.

Many of the lowest earning graduates make no repayments under the £21,000 threshold. Even where they do the model suggests these will be modest and/or sporadic. This means that increasing the threshold to £25,000 only reduces the repayments of a minority of this group, so relatively few benefit.

More graduates in the middle deciles (4-7) would make repayments under the £21,000 threshold and the increase therefore reduces how much they repay each month. Repayments are shifted towards later on in their working lives and worth less now in discounted terms. In some cases it means they no longer repay their loans in full, also reducing their lifetime repayments.

The model forecasts that **the proportion of borrowers with some debt written off at the end of its 30 year term increases from around 70% to around 77%**.[18]

4.3 Institute for Fiscal Studies analysis of the proposals

The Institute for Fiscal Studies have published and analysis of the possible impact of the proposals – *Briefing Note BN 217, Higher Education finance reform: Raising the repayment threshold to £25,000 and freezing the fee cap at £9,250*, 3 October 2107.

The key findings were:

- 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

17 In present value terms
18 *Student loan repayment model*, BIS and House of Commons Library estimates

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.

The Summary of the report made the following comments:

> 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.

BRIEFING PAPER
Number
2 October 2017