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Research Brief

Unfair Deal

Introduction

The 2012 higher education changes promised much. Ministers said they would ensure that universities had adequate resources while saving public expenditure. There would be no up-front costs for students from low income backgrounds, and their money to spend while at university would be increased through a combination of bursaries, grants and loans. Though debts would be greater, the repayment terms ensured that former students on lower incomes would have lower repayment rates than under the previous arrangements.

Key findings

- **Changing existing loan terms is unfair on students, would undermine trust, and could prove unlawful and unenforceable if challenged**
- **If the repayment threshold were frozen for five years, as proposed, the typical borrower is estimated to repay an extra £2,800**
- **If the repayment threshold were frozen until the end of the repayment period, the typical borrower is estimated to repay an extra £11,000**
- **If the threshold freeze were extended to the end of the repayment period, women would repay an extra £12,800 and men £8,900. This is because women's earnings tend to be lower and they are more likely to be repaying across the 30 year repayment period[1]**
- **Borrowers who would have been eligible for maintenance grants will see large increases in average repayments. This is because of their average loans, which will increase to over £50,000, and the effects of the proposed five year threshold freeze[2]**
- **The uncertainty created by the proposed changes effectively forces students to write an 'open cheque'. This may discourage participation or distort decisions as to where, what and how to study**

But these features have turned out to cost more than anticipated, and so the government has announced measures to make higher education finances 'sustainable'. These include the replacement of means tested maintenance grants with means tested loans, and, subject to consultation, changing the terms of the student loans.[3] The proposed changes will increase the repayments for most students, and leave all borrowers uncertain as to what their education will eventually cost.

What are students' concerns?

The Chancellor, George Osborne, argues that there is a "basic unfairness" in "asking taxpayers to fund the grants of people who are likely to earn a lot more than them".[4] Addressing concerns that students from low income households would be discouraged, it has been suggested in the Budget Report that, "students are more concerned about the level of support they receive while studying than the long-term repayment of their income contingent loans."

The Budget Report refers to a Universities UK (UUK) survey of current home undergraduates in support of this claim. There are two relevant questions. The first asks, "how concerned are you about meeting the costs of living during your course?", with 21% of respondents saying that they are unconcerned, and 79% that they are concerned. The second asks, "how concerned are you about your ability to repay your student loan after your course?", with 37% saying that they are unconcerned, and 63% that they are concerned.[5]

While the Budget Report is literally accurate, it is somewhat misleading. Though more students are concerned about meeting the costs of living during their course than their ability to repay their loans afterwards, nearly two thirds of students are still concerned about their repayments. This echoes a recent Sutton Trust/ComRes survey of 16-18 year-olds, which showed that the majority of young people (58%) are either fairly concerned or very concerned about repaying student loans after they finish studying.[6] The UUK survey also shows that most students fully understand the significance of the income threshold, so it should not be assumed that students' concerns about repaying student loans would be the same were the terms of those loans to change.

Terms of the student loans

The loan repayment conditions for entrants since 2012 include an income threshold, set at £21,000, to be uprated annually in line with average earnings. It was this feature that enabled government and others to reassure potential students that they would not be obliged to start repaying their loans until they were earning a decent salary. But, to reduce the cost to government of loans, and to increase the rate of repayments, the government proposes to freeze the threshold at £21,000 for five years.[7]

There are two options:

- Option 1, government's preferred option, is to freeze the threshold at £21,000 for five years from 2016. This change would apply to all students starting from 2012 onwards;

- Option 2 is to uprate the threshold by average earnings until 2020, after which it will be frozen for five years. This change would only apply to students starting from 2016 onwards.

Table 1– Average repayments for students starting in 2014 with and without a payment threshold freeze (£ 2016 prices)[8]

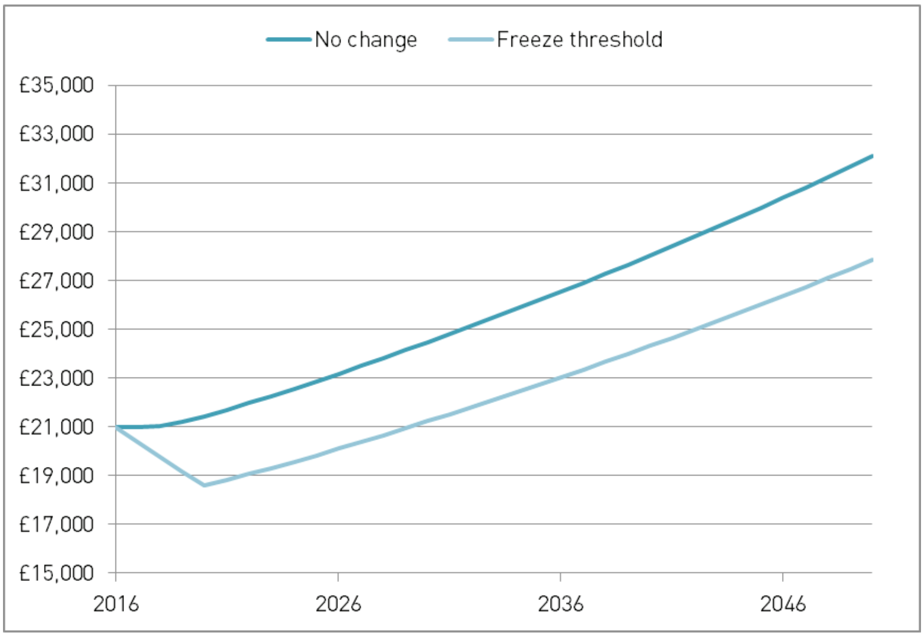
		2018-27	2028-37	2038-47	2018-47
No freeze of repayment threshold	Men	10,300	15,500	9,100	34,900
	Women	6,700	10,400	9,300	26,400
Five year freeze of repayment threshold	Men	11,800	16,500	8,800	37,100
	Women	8,100	12,000	9,600	29,700
Extra repayments from five year repayment threshold freeze	Men	1,500	1,000	-200	2,300
	Women	1,400	1,600	300	3,300

There are no definite proposals for the end of the five year freeze when the threshold will be reviewed. The loan terms also include a maximum interest threshold, but the Department for Business, Innovation and Skills (BIS) have refused to clarify whether it is planning to freeze this threshold, too.

Impact on repayments

Table 1 shows the extra repayments expected from introducing a five year freeze of the repayment threshold at £21,000 from 2016. After five years the annual uprating by average earnings is resumed.

Figure 1: Repayment threshold with and without five year freeze from 2016[9]



The repayments are shown in 2016 prices, calculated using the RPI measure of inflation for students borrowing £36,000 over three years. This is a typical set of conditions, giving an indication of the pattern of repayments.

Over the first ten years, while women's proportional increase in repayments is greater than for men, in absolute terms it is slightly smaller. However, while the overall average extra repayments are £2,800, men's overall average extra repayments are £2,300, women's £3,300. This is the result of the lower average earnings for women (as estimated in the model); in general high earners are less affected by the threshold freeze, as other research has found.[10]

Apart from the case of men in the final ten years, the increases in repayments can be seen well beyond 2020, the last year of the threshold freeze. This is because the threshold values after 2020 are still lower than they would have been. Figure 1 shows how the threshold changes with and without the repayment threshold freeze.

It is quite possible that the review after five years would not resume the uprating by average earnings. Also, the figures in table 1 assumed that the maximum interest threshold would not be frozen. Table 2 shows the

Table 2 – Average extra repayments for students starting in 2014 with different changes to loan terms (£s, 2015 prices)[11]

		2018-27	2028-37	2038-47	2018-47
Five year freeze of repayment threshold	Men	1,500	1,000	-200	2,300
	Women	1,400	1,600	300	3,300
Five year freeze of repayment and maximum interest threshold	Men	1,500	1,200	200	2,900
	Women	1,400	1,700	700	3,700
Five year freeze of both thresholds and twenty five years linked to RPI.	Men	2,000	2,700	900	5,700
	Women	1,800	3,500	2,400	7,700
Thirty year freeze of repayment and maximum interest threshold	Men	3,000	5,000	800	8,900
	Women	2,800	6,600	3,400	12,800

repayments which would be expected were both thresholds to be frozen, and for different post review options.

Table 2 shows that the eventual cost to the students are highly dependent on what the review comes up with. The most costly option for students, with the freeze extended for 30 years, would lead to an overall average increase of £11,000; £8,900 for men, £12,800 for women.

Loss of grants with change in loan terms

From 2016 means tested maintenance grants are to be replaced by means tested loans, which, while increasing the income of eligible students at university by £550 per annum, bring these students' average total debt burden to over £50,000. Without other changes the impact on students' and governments' finances is not as great as might be expected; 65 per cent of those who were eligible for full maintenance grants would have no increase in repayments. The overall average increase in repayments for grant eligible students would be £3000, but with a threshold freeze this increases to £7000.[12] (NB these figures cannot be compared with those in tables 2 and 3, as they are discounted by RPI and 2.2 per cent.)

The terms and conditions for students' loans include the following.

> You must agree to repay your loan in line with the regulations that apply at the time the repayments are due and as they are amended. The regulations may be replaced by later regulations.

Few student advisers pointed out and explained the potential consequences of this clause. Government ministers went out of their way to emphasise the 'generous' repayment terms without any reference to the fact that they could be changed.

If changes are made retrospectively, then government, universities, schools and other student advisers could be said to have mis-sold loans, mostly to young people aged 17 and younger. One of those advisers, Martin Lewis, founder and editor of the Money Saving Expert website, now feels betrayed. He believes a retrospective change "would be terrible news for confidence in higher education". Changing the terms of existing loans is unfair, would undermine trust, and could prove unenforceable if challenged. The one-off saving for government from freezing the threshold for all students (option 1) compared with keeping the original terms for the cohorts starting from 2012 to 2015 (option 2) is estimated at £3.2 billion collected over thirty years.

The long term differences between the two options are small and will depend on what would be decided at the five year reviews.

Government's priority is to reduce the national debt in the relatively short term; they point out that option 2 "would not contribute to the government's fiscal objective of bringing down debt in this Parliament". The contribution by option 1 would be less than 0.03 per cent of the national debt. Is this a price worth paying for the loss of trust, as more than a million borrowers see their loan terms change?

Long term loan terms

Even with option 2, there can be no assumption that the terms and conditions will remain unchanged for 2016 and subsequent starters. After the review, further changes through the repayment period are likely. If the principle of varying terms were established there would be a risk that future governments would go further, and use student loans as an easy way to raise revenue by increasing interest rates, introducing early payment charges, or extending the repayment period, and so on. So, there will have to be a much clearer health warning, and those advising students will not be able to provide the assurances they have hitherto.

Impact on social mobility

The freezing of loan thresholds

will significantly increase the average cost of higher education, particularly for students from low income backgrounds who are currently eligible for maintenance grants. Yet even bigger risks arise from the uncertainty that has been created. The danger is that this will have an adverse effect on the willingness of young people to take out the student loans.

The decision to go to university is usually made with the expectation that it will lead to a better job. But there is no guarantee of that, and students that drop out often have worse prospects than if they had got a job after A-levels. Even those graduating have no guarantee of a good job. So far the student loan terms have been seen to create a safety net: if a borrower ends up earning below the repayment threshold, there will be nothing to pay. But as this brief has outlined, this safety net might not be so safe in the future. To the extent that employers are using degrees to signal ability, the cost of not going to university could remain high and students may decide they have little choice, so that participation rates continue to rise. But students concerned by debt often work long hours during term time, which can lead to lower academic achievement. They may also choose their second best course if it has lower fees or allows them to live at home. Students from disadvantaged backgrounds are known to be more likely to reduce costs like this, which threatens to make the conditions of study more unequal, with most students taking longer to complete their studies, with a lower chance of success.

Failure to complete, reduced academic achievement, delay in graduating or graduation from a less prestigious university, may all impact social mobility, adding to the difficulties students from disadvantaged backgrounds find in accessing elite professions. Successive governments have pledged to put social mobility at the heart of everything they do. The changes to the terms of student loans outlined in this brief risk undermining that commitment.

Recommendations

- No retrospective changes to loan terms should be made, but that is not enough to restore trust. The 'get out' clause should be removed and legislation to guarantee the loan terms should be introduced
- Freezing the threshold for five years introduces an unnecessary level of uncertainty, which then leads to the need for a review at the end of the freeze. To reduce this uncertainty the threshold levels, both for repayment and maximum interest, should be set in terms of a percentage of average earnings
- New borrowers should be given definite terms, which should apply for the whole repayment period. The longer term risks should be borne by government, not individual students who cannot be sure of being amongst those successful graduates in well paid jobs

References

[1] This and the two previous estimates are based on a borrower undertaking a three year course, with loans of £36,000. The latter is the default parameter for the BIS simplified model, but it should be noted that analysis using different estimates and assumptions will give different figures. See, for example, Institute for Fiscal Studies (IFS) (Britton J, Crawford C, & Dearden L). (2015). Analysis of the higher education funding reforms announced in Summer Budget 2015 (IFS Briefing Note BN174). London: Institute for Fiscal Studies.
[2] IFS (2015).
[3] The Budget also confirmed further sales of the student loan book, increased maximum tuition fees and announced a review of the discount rate used in calculating the impact of student loans on the budget deficit. These are discussed in an extended version of this brief
[4] Chancellor George Osborne's Summer Budget 2015 speech, House of Commons, 8 July 2015.
[5] Universities UK (UUK). (2015). Student Funding Panel: An analysis of the design, impact and options for reform of the student fees and loans system in England. London: Universities UK
[6] ComRes interviewed 1,017 young adults in the UK aged 16-18 online between May 25 and June 5, 2015. Data were weighted to be representative of all young adults by age, sex and region. Full data tables can be found at: http://comres.co.uk/. ComRes is a member of the British Polling Council and abides by its rules.
[7] Department for Business, Innovation and Skills (BIS). (2015b). Freezing the student loan repayment threshold. London: Department for Business, Innovation and Skills.
[8] Based on: BIS. (2015a) with default parameters apart from changes to threshold updates. Repayments to nearest £100. Simplified student loan repayment model. London: BIS.
[9] BIS (2015b).
[10] BIS. (2015b); UUK. (2015) and IFS (2015).
[11] Ibid.
[12] Figures in this paragraph taken from IFS (2015) and McGettigan, A. (2015). IFS provide revised figures for HE financial changes, http://andrewmcgettigan.org/2015/07/22/ifs-provide-revised-figures-for-he-financial-changes/.[13] BIS. (2011). Student Loans – A guide to the terms and conditions 2012/13. London: BIS.
[14] BIS. (2015b).
[15] Ibid.
[16] Estimated from the chart in BIS (2015b: para 58).

This research brief was written by higher education consultant John Thompson.