

# FAIRER FEES

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Reforming student finance to increase fairness  
and widen access

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– November 2017



**LE**  
London  
Economics

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## Contents

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Foreword.....	2
Executive Summary.....	3
Recommendations.....	4
1. Introduction.....	5
History.....	5
Access to higher education.....	7
Current policy context.....	11
2. Methodology.....	13
3. Reforming student finance.....	16
October reforms.....	16
Alternative policy options.....	18
4. Modelling policy outcomes.....	20
Loan debt on graduation.....	20
Lifetime debt repayments.....	21
Exchequer cost & funding.....	24
5. Discussion.....	26
Debt and the access gap.....	26
Alternative options.....	26

## Foreword

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England is once again facing a student finance crisis. Since £9,000 fees were introduced, the Sutton Trust has highlighted the consequences of a system that burdens our young people with by far the highest student debts in the English-speaking world. It is very welcome therefore, that there is now demand amongst the wider public, and in Westminster, for radical change. It is a scandal that a student from a council estate leaves university with higher debt than someone from a top boarding school. The current tuition fees regime simply isn't fair, and our young people deserve better.

However, no-one should be under any illusions that solving this issue is easy. The structure of university funding in this country is designed to share costs between the taxpayer and graduates. The loan system means that the costs of higher education are kept away from the nation's balance sheet, and deferred 30 years into the future for another government to deal with. Constant changes to the terms of student loans have shown this to be an unpredictable and unsustainable arrangement.

While the Exchequer ostensibly benefits from a system where vast amounts of debt are imposed on young people which will never be paid back, we need to move towards a system where students come first. Better access to university should be at the heart of any system of student funding. That is why we want to tackle debts by lowering fees and increasing maintenance support for those who need it most.

Our research shows that student debt could be slashed by a half, with most benefits going to the least well-off, by introducing a fee system that fairly reflects ability to pay, and by restoring recently abolished maintenance grants. Means-testing would remove fees entirely for most households earning below average household income, and lead to lower fees for all but the highest earners. This would mean those from the poorest households would leave university with the lowest debt, turning the current situation on its head, and giving these young people a much fairer deal.

Tackling student finance is crucial to addressing the access gap to university and removing barriers to participation. The Sutton Trust plays its part, supporting thousands of young people every year from low and moderate income backgrounds to access university through our Summer Schools and Pathways programmes. Our report *Admissions in Context* last month has already highlighted how universities can use contextual data about applicants' backgrounds to widen access through their admissions process.

But the role of student finance and debt in preserving the stubborn and wide access gap, especially for top universities, should not be ignored. The time has come for a change, and this new report offers a way to make that change work for the young people who need it most. Our proposals offer an affordable and fair alternative both to the current system and opposition proposals to abolish fees outright.

I am grateful to the authors for this important research, along with the team at London Economics for their economic modelling.

**Sir Peter Lampl**

**Founder and Chairman of the Sutton Trust and Chairman of the Education Endowment Foundation**

## Executive Summary

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- Students in England pay some of the highest average fees in the world. Typical fees are more than three times higher than the next highest in Europe. While increasing numbers of young people are attending university, the gap in attendance rates between those from less well-off and better-off backgrounds is not improving.
- Reforms announced in October to freeze tuition fees and increase the debt repayment threshold will save graduates on average £8,000 over their lifetime in real terms, while increasing the long run costs of each cohort of students by £2.9 billion. However, the proportion of loans that will never be repaid (the RAB charge) will increase from 27.6% to 45.1%, according to modelling by London Economics for this report.
- Nonetheless, average debts will remain at £46,000 per student, with young people from less well-off backgrounds taking on the most debt. Students from households in the lowest 40% of earners take on average debts of £51,600, compared to £38,400 in the top 20% of households.
- Introducing a system of means-tested fees and reinstating maintenance grants would cut average student debt in half (from £46,000 to £23,300), at a cost of up to £3.2 billion per year. In particular, it would slash debt among the 40% poorest students by 75%, from £51,600 down to £12,700, and mean those from the poorest backgrounds emerged with two thirds less debt than their better-off counterparts, whereas under the current regime they emerge with 34% more debt.
- This would also lead to lower lifetime repayments by graduates, reducing repayments by 39% from £25,200 to £15,400 in real terms. While the lowest earners already pay back only a small proportion of their loans, taking into account the UK's current low levels of social mobility, much of the benefits of such a change would accrue to low to middle earners. With lower debts being taken on, the RAB charge will decrease by ten percentage points to 35.2%, so the Treasury would get back a higher proportion of what it lends. In cash terms, there would be a drop from £54,900 currently to £30,200.
- October's announcements mean 81% of students will never pay back their loans, up from 72% on the London Economics model. Means-testing fees would mean 65% paying them back, while adding maintenance grants would further reduce the figure to just over half, 56%.
- Even without fees, students face on average £19,200 of maintenance debt, and much higher for young people from poorer backgrounds. Adequate maintenance levels are crucial for increasing access to university among disadvantaged groups. Restoring maintenance grants would go some of the way towards redressing the imbalance.
- Abolishing fees entirely would cost £4.6bn on top of the current system, and if accompanied by the restoration of maintenance grants, approximately £1bn more. The system of means-testing proposed here would reduce the average fee by almost two-thirds (to £3,500), along with targeting resources at those who need it most, at a substantially lower cost. This would bring down costs for most, while maintaining contributions from those who benefit most from university education.

## Recommendations

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- 1. The government should implement its promised review of higher education funding.** While the October reforms were welcome, there needs to be a thorough review of deeper reforms to the system. In particular, the crisis in part-time numbers should be addressed and bespoke solutions explored.
- 2. Our proposed solution would be to introduce a system of means-tested fees** which waives fees entirely for those from low income backgrounds, and increases in steps for those from higher income households. Significant 'cliff edges' between income bands should be avoided as much as possible.
- 3. Maintenance grants, abolished in 2016, should be restored,** providing support for those who need it most and reducing the debt burden of the least well-off, so that they graduate with lower debt than those from better-off backgrounds.
- 4. Losses to higher education institutions through lower fee income should be replaced by increased teaching grants.** While this involves greater upfront costs to the Exchequer, it also provides a lever by which government could promote the provision of courses in certain areas such as STEM. This teaching grant compensation would be adjusted to ensure that universities admitting intakes with lower average fee levels would not suffer any drop in income.
- 5. Reducing access gaps to university, especially top universities, should be at the heart of government higher education policy.** There needs to be a joined-up effort to tackle the persistent access gap for those from lower socio-economic backgrounds across all aspects of higher education, from student finance to the UCAS application process to the use of contextual data by universities in admissions.

# 1. Introduction

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Since Tony Blair's government introduced university tuition fees in 1998, the issue has become a political flashpoint for successive governments. Controversy surrounded the introduction of variable 'top up fees' in 2006 and the coalition government's increase of the cap to £9,000, which sparked widespread protests. Theresa May's current government has also come under renewed pressure over high fee levels and student debt in an economy where young people increasingly face greater challenges than previous generations. The issue has transformed into one of 'intergenerational fairness', where the current generation of young people enter the workforce tens of thousands of pounds in debt, facing a labour market characterised by flatlining wages and increasing levels of precarious, low income and casualised work.<sup>1</sup>

Nonetheless, a good degree remains the surest pathway to a good career. However, despite the expansion in student numbers over the past two decades, in part facilitated by increases in and eventual removal of the student cap, substantial inequalities in access to those opportunities remain. The gap in access to university between those from the richest and poorest households remains stubborn and wide, holding back the potentially invaluable role of higher education in facilitating social mobility. The Sutton Trust's *Admissions in Context* report this October highlighted how the admissions process can help to open doors, but this is a multi-faceted problem, and the cost of university, currently highest for those from less well-off backgrounds, plays its part.

Any system of higher education funding should aim to satisfy two principles: fairness in access, and fairness in contribution. Young people from all backgrounds should have equal opportunities to see the benefits of higher education and financial barriers to this should be minimised. The costs of that education should also be borne across the population in an equitable way. A fair system of funding would fulfil both of these principles, and this report will explore whether the current system does so, and if not, what reforms could be undertaken to satisfy these goals.

## *History*

Tuition fees were first introduced in 1998, and initially set at £1,000 per academic year. In the almost 20 years since, tuition fees have risen substantially, first to £3,000 in 2006, then to a maximum cap of £9,000 in 2012.<sup>2</sup> Fees have traditionally increased each year with inflation, but as of October 2017 are currently frozen at a cap of £9,250.<sup>3</sup>

Tuition fees were originally implemented in every UK nation, as their introduction preceded the devolution of education policy. However, following devolution, student funding policies have diverged substantially in each of the UK nations. Fees are currently capped at £4,030 in Northern Ireland<sup>4</sup> and fees are covered by the Scottish government for Scottish and other non-UK European students.<sup>5</sup> In Wales, fees are capped at £9,000 a year, but non-income dependent grants are available to cover the first £4,046.<sup>6</sup> However, after the Diamond Review, these grants will be transformed into loans, and direct support will instead focus on full maintenance grants for the less well-off.<sup>7</sup> This report however will focus on the current policy debate on fees and maintenance costs in England.

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<sup>1</sup> Resolution Foundation (2017) *Low Pay Britain 2017*. London: Resolution Foundation.

<sup>2</sup> Bolton, P. (2016) *Tuition fee statistics*. London: House of Commons Library.

<sup>3</sup> Belfield, C., Britton, J. & Erve, L. van der. (2017) *Higher Education finance reform: Raising the repayment threshold to £25,000 and freezing the fee cap at £9,250*. London: Institute for Fiscal Studies.

<sup>4</sup> ni direct (2017) 'Tuition fees'. Retrieved October 20, 2017 from: <https://www.nidirect.gov.uk/articles/tuition-fees>.

<sup>5</sup> Mygov.scot (2017) 'Tuition fees for university'. Retrieved October 20, 2017 from: <https://www.mygov.scot/tuition-fees/>.

<sup>6</sup> Student Finance Wales (2017) 'Tuition fee support'. Retrieved October 20, 2017 from: <http://www.studentfinancewales.co.uk/undergraduate-students/new-students/what-financial-support-is-available/tuition-fee-support.aspx#.WeoGZ2hSyUk>.

<sup>7</sup> Welsh Government (2017) 'Independent review of higher education funding and student finance arrangements'. Retrieved November 6, 2017 from: <http://gov.wales/topics/educationandskills/highereducation/reviews/review-of-he-funding-and-student-finance-arrangements/?lang=en>

**Figure 1. Timeline of higher education student finance**

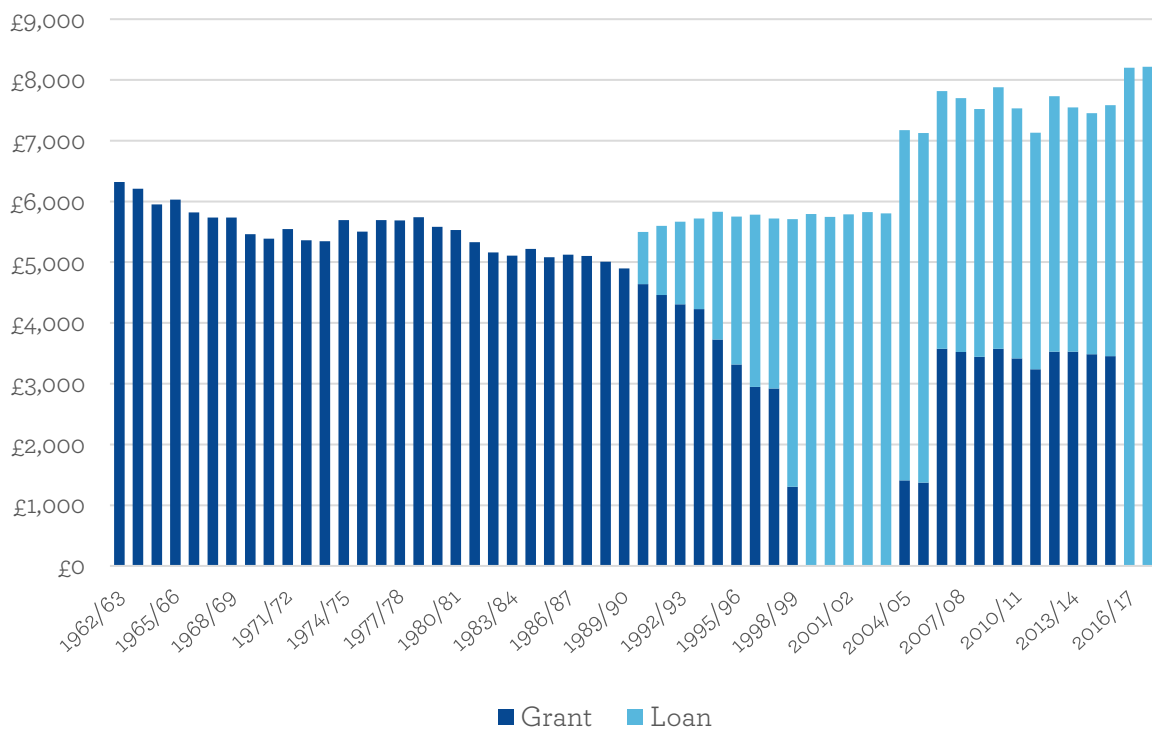
	<b>Tuition</b>	<b>Maintenance</b>
<b>Pre-1998</b>	No tuition fees	Means-tested grants for maintenance, gradually lowered/ phased out from 1990 and replaced by “mortgage style” loans
<b>1998</b>	£1,000 cap on tuition fees, with means-tested waivers available for low-income students  No loans available	Means-tested maintenance grants scrapped  Income contingent (for repayments) maintenance loans introduced
<b>2006</b>	£3,000 cap on tuition fees  Income contingent (for repayments) tuition fees loans introduced (interest rate - RPI + 1%)  Repayment threshold £15,000	Means-tested maintenance grants re-introduced  Income contingent (for repayments) maintenance loans (interest rate - RPI + 1%)  Repayment threshold £15,000
<b>2012</b>	£9,000 cap on tuition fees  Income contingent (for repayments) tuition fee loans - with positive real interest rates of RPI +3% whilst studying and RPI + 0 - 3% after graduation contingent on earnings.  Repayment threshold raised to £21,000	Means-tested maintenance grants  Income contingent (for repayments) maintenance loans - means-tested for the amount available to loan  Interest rate - same as tuition fee loan  Repayment threshold raised to £21,000
<b>2016</b>	No changes to 2012 system	Maintenance grants scrapped and replaced with additional loans, means-testing for the amount available to loan
<b>2017</b>	Tuition fees cap frozen for one year at £9,250  Repayment threshold raised to £25,000 from April 2018 (for all students since 2012)	No changes to 2016 system

When fees were first introduced, means-tested waivers were available which removed tuition fees entirely for students from families earning less than £23,000 a year. Families earning between £23,000 to £35,000 a year were charged a portion of the fees on a sliding scale related to their income.<sup>8</sup> These waivers were abolished in 2006,<sup>1</sup> and since then all students have been charged the same level of fees, regardless of their family income.

Before the introduction of tuition fees for higher education, not only was tuition free for students, but those who were less well-off could also apply for grants to cover living expenses. These grants had slowly begun to be replaced by loans during the nineties, and the remaining partial grant was abolished in 1998 with the introduction of fees. Maintenance grants were re-established in 2006, before being scrapped again in 2016.<sup>1</sup> Changes in the funding landscape and charges to students for tuition and maintenance costs since 1998 are summarised in Figure 1.

Figure 2 shows the level of maintenance support available to students over the past half-decade, expressed in constant 2016 prices.<sup>9</sup> The nineties saw the gradual replacement of grants with loans, followed by their total abolition in 1998. Student support as a whole is currently historically high on this measure, despite the recent emphasis on loans rather than grants.

**Figure 2. Student support (maintenance grants and loans) in 2016 prices, 1962-2017**



### ***Access to higher education***

The proportion of young people going into higher education has now grown to a record high of almost 50% by age 30, with the cap on numbers having been first increased, and finally removed from 2015. The proportion of 18-year-old students from disadvantaged backgrounds attending HE has also risen, opening-up access to higher education for many (see Figure 4).

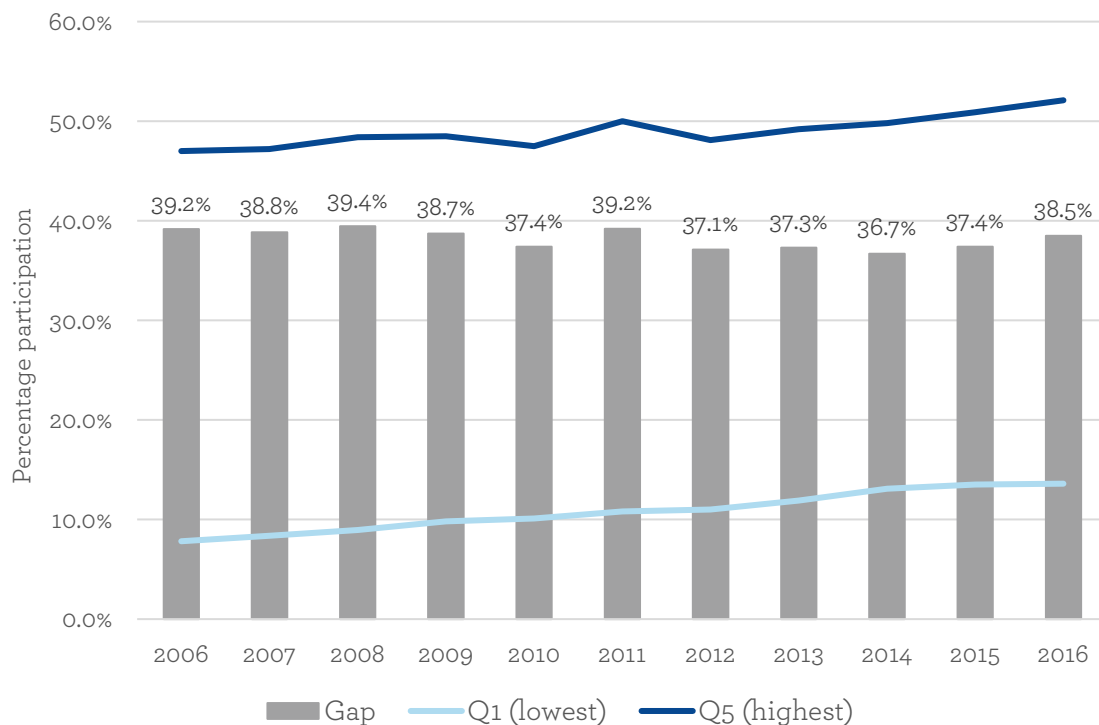
<sup>8</sup> BBC News (1998) 'Student tuition fees: costly changes'. Retrieved October 20, 2017 from: [http://news.bbc.co.uk/1/hi/education/specials/the\\_state\\_of\\_education/86754.stm](http://news.bbc.co.uk/1/hi/education/specials/the_state_of_education/86754.stm).

<sup>9</sup> Bolton, P. (2016) *The value of student maintenance support*. London: House of Commons Library.



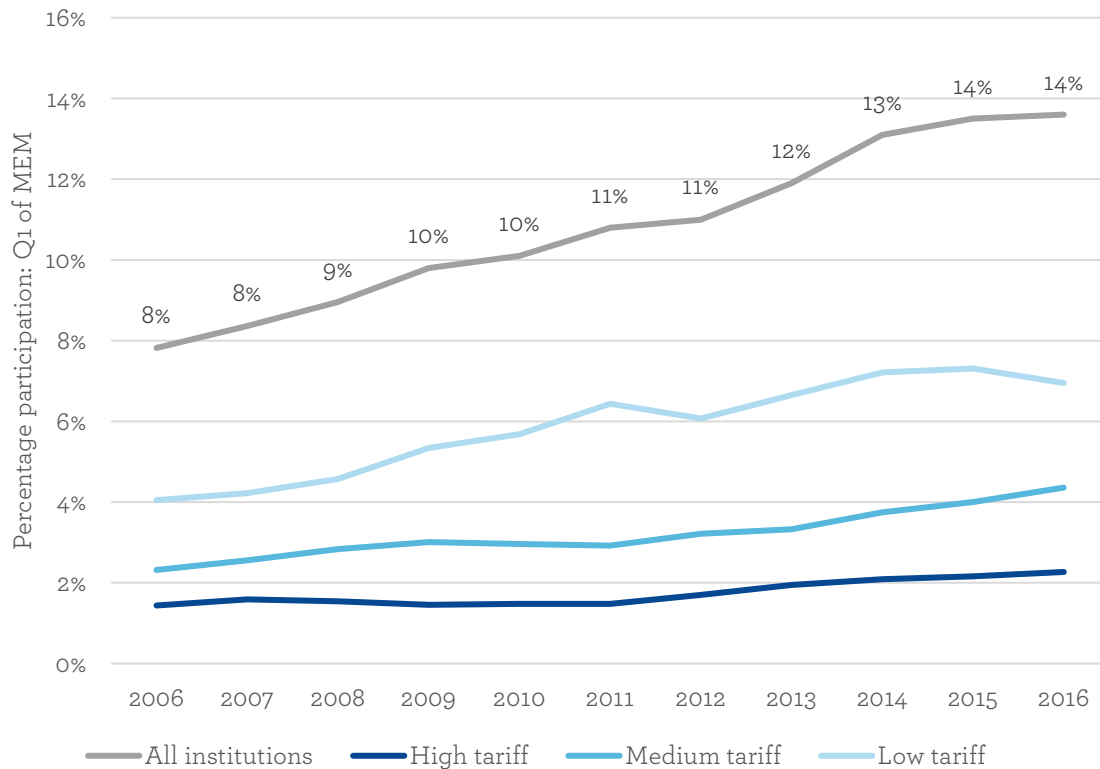
Detailed information on participation rates for students from different socio-economic backgrounds is available from UCAS from 2006 to 2016. Many different indicators can be used to measure disadvantage, but the most comprehensive is the Multiple Equality Measure (MEM) which uses several indicators, including whether someone attended a private or state school, if they were eligible for free school meals (FSM), if they are from a neighbourhood with low HE participation (POLAR3 classification), along with their ethnicity and their sex. Examining the participation rates of the first quintile of MEM (Q1, “most disadvantaged”) compared to rates for the fifth quintile (Q5, “most advantaged”), allows a comparison of university participation by socio-economic background.

**Figure 3. University participation rates, most disadvantaged (Q1) and least disadvantaged (Q5), 2006-2016**



In this period, the proportion of the most disadvantaged young people attending university has risen from less than 8% to almost 14%. However, the gap between the most and least advantaged in participation has remained static (see Figure 3). Whilst a larger proportion of disadvantaged students has gone on to HE, the same has also been true for higher income students. In 2006, the participation gap between the most and the least disadvantaged by the MEM measure was 39 percentage points; 8% of the most disadvantaged young people went onto HE, compared to 47% of the most advantaged. In 2016, that gap was still 39 percentage points, with 14% of the most disadvantaged and 52% of the most advantaged going on to HE. On this measure, while the ratio has improved a little, the least well-off remain four times less likely to attend university than their better-off counterparts.

Figure 4: Percentage participation of Q1, most disadvantaged, by university type, 2006-2016



Additionally, much of this increase has been in the proportion of disadvantaged students attending less selective universities and colleges. On the MEM measure, the proportion of the most disadvantaged young people attending low tariff – the least selective – universities has risen from 4% in 2006 to 7% in 2016 (a 1.8 times increase). However, the proportion attending more selective ‘high tariff’ institutions has increased from 1.4% to just 2.3% (a 1.5 times increase). Gender and ethnicity also influence the likelihood a young person has of going onto higher education, with disadvantaged white men being the least likely to attend.<sup>10</sup>

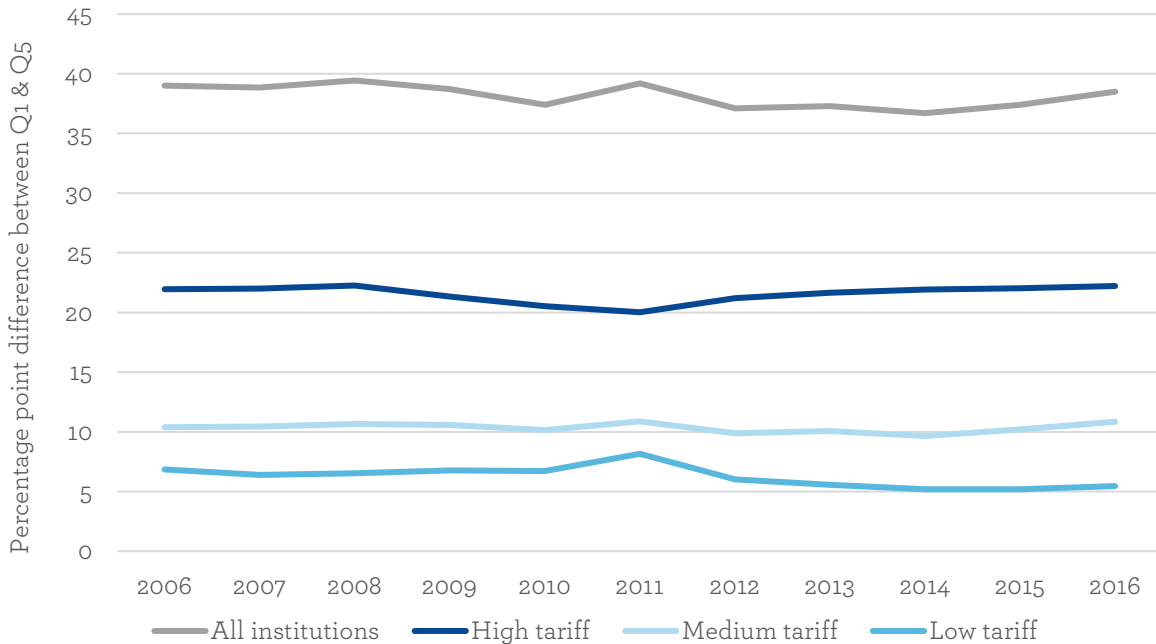
The gap in participation rates has also stubbornly remained for the most prestigious universities – which provide the biggest increase in graduate earnings – and there is some evidence the gap is widening. In 2006, the gap in participation rates at high tariff institutions between the most and the least disadvantaged was 22 percentage points. While the gap initially closed slightly, since 2011 it has started to increase again, and in 2016 was back up to over 22 percentage points. When looking at the participation rates of students who had received free school meals the picture is similar, the gap widening from 6.3 percentage points in 2006 to a high of 7 percentage points in 2016, with particular movement in this direction since 2011. While more disadvantaged students going on to HE should be welcomed, participation rates for these students at top universities are not increasing quickly enough to close the gap between them and their more advantaged peers.

It is very difficult to know whether tuition fees have had any role in affecting the participation rates of disadvantaged young people over time. Many different factors can influence students’ participation in HE, including the state of the wider economy and the provision of widening participation programmes. However, annual polling carried out by Ipsos MORI for the Sutton Trust has found that intentions to attend higher education among 11-16 year olds have been declining since £9,000 fees were introduced in 2012, reversing a long-term trend. 2017 also saw a rise in financial worries among young people.<sup>11</sup>

<sup>10</sup> UCAS (2016) *End of Cycle Report*. (2016). Cheltenham: UCAS.

<sup>11</sup> Cullinane, C. (2017) ‘Aspirations and Access’. Retrieved November 6, 2017 from: <https://www.suttontrust.com/newsarchive/aspirations-and-access/>

**Figure 5 - Difference in percentage participation between Q1 (most disadvantaged) and Q5 (least disadvantaged), by university type, 2006-2016**



There is also evidence that debt aversion impacts on young people's decisions to go to university, particularly those from less well-off backgrounds. Recent research has found that debt averse attitudes are higher among lower class students, controlling for other factors, and that this debt aversion is contributing to lower rates of planned higher education participation.<sup>12</sup> Furthermore, whilst students overall have become more willing to take on loans for higher education since 2002, low and middle-income students were more likely to be debt averse in 2015, and the link between debt aversion and planned non-participation has also increased. While it is often argued that young people's fear of debt reflects a lack of understanding of the different nature of an income-contingent student loan, the vast majority of the young people surveyed understood that future loan repayments are dependent on income and would not start until they earned over the repayment threshold.

The socio-economic gap in financial worries is also reflected in Sutton Trust polling, which has found that prospective students from low affluence families are more likely to be worried about the cost of university (66%) compared to those from high affluence households (46%).

Similar results were also found in earlier studies on debt aversion, carried out before the raising of fees to £9,000.<sup>13</sup> Fear of debt may also affect the choice of institution for low-income students. A study carried out in 2002 (when the fee cap was still only £1,100 a year), found that for students from low income backgrounds, debt aversion was associated with a desire to study closer to home, constraining their university options in a way not found amongst those from higher income households.<sup>14</sup>

<sup>12</sup> Callender, C. & Mason, G. (2017) *Does student loan debt deter Higher Education participation? New evidence from England*. London: Institute of Education.

<sup>13</sup> Callender, C. & Jackson, J. (2005) *Does the fear of debt deter students from higher education?* J. Soc. Policy, Vol. 34. Bates, P., Pollard, E., Usher, T. & Oakley, J. Who is Heading for HE? Young People's Perceptions of, and Decisions About, Higher Education. (2009).

<sup>14</sup> Callender, C. & Jackson, J. (2008) *Does the fear of debt constrain choice of university and subject of study?* Stud. High. Educ. Vol. 33.

Furthermore, high fees make university education more 'high stakes' for students and their parents, which is likely to increase the 'glass floor' effect. As there is no universal way of comparing degree results, and with an increasing proportion of the population graduating from university, the quality of a degree is, in effect, expressed by the quality and reputation of the institution. High fees, with almost every university charging the maximum, means greater incentives from the well-off to attend the most prestigious universities to maintain their status.

One area where the fees increase has made a demonstrable impact is the part-time sector, where numbers have plummeted by over 60% since 2011.<sup>15</sup> A decline that had begun with restrictions on second degrees has been exacerbated since the part-time fee cap was increased, leading to a catastrophic drop in student numbers and a crisis in the sector.

### ***Current policy context***

Following the UK general election in June 2017, the public debate surrounding tuition fees in England has shifted considerably. The Labour Party pledged to scrap all tuition fees and re-introduce maintenance grants, and many commentators have attributed to this policy, at least in part, the gap in support between Labour and the Conservatives amongst the youngest voters (estimated at 47 percentage points by YouGov in 2017).<sup>16</sup> This has led the Conservative government to begin a process of re-evaluating the system of student finance. Extensive work by the Institute for Fiscal Studies has also explored the economic impact of both parties' positions.<sup>17</sup>

In October, the government announced that it would raise the threshold at which repayments begin, so that graduates on the post-2012 loan system will only begin to repay on earnings above £25,000. This change will bring more of the lowest earners out of graduate debt repayments entirely. It was also announced that the current fee level of £9,250 will be frozen for the next year, scrapping a planned

### **Means-tested financial support at Ivy League universities**

In the United States, some elite universities provide financial aid to help all students who are accepted to attend, a process termed as "needs blind" admissions policies. Universities which offer this support, to both US citizens and international students, include Harvard, MIT and Yale. The Sutton Trust US Summer School programme has helped many students on low and middle incomes in the UK to benefit from this financial aid. Policies differ substantially by institution, but for the least advantaged students, they often involve a full scholarship to cover the cost of tuition fees and maintenance costs.

For example, at Harvard, students from families earning less than \$65,000 (just under £49,000) are given a mix of scholarship funds to cover almost all their tuition fees and maintenance costs, although students are also expected to take on some paid work on campus to cover the remainder of their expenses. For families on higher incomes, the amount they are expected to pay towards fees and living costs increases with their income. Families with incomes between \$65,000 and \$150,000 (just under £114,000) contribute from 0-10% of their income, and those with incomes above \$150,000 will be asked to pay proportionately more than 10%, based on their individual circumstances. Harvard also takes families' assets into account when determining how much a student is charged.

All first-time students from the US studying for an undergraduate degree at any US institution are also eligible for Federal Pell Grants from the government, which reach a maximum of \$5,920 per year (roughly £4,500) for students whose families earn less than \$30,000 (just under £23,000), with smaller grants available for students from families earning up to \$60,000 (just under £46,000).

<sup>15</sup> HEFCE (2017) 'Undergraduate Education'. Retrieved November 6, 2017 from: <http://www.hefce.ac.uk/analysis/HEinEngland/undergraduate/parttime/>

<sup>16</sup> YouGov (2017) 'How Britain voted at the 2017 general election'. Retrieved October 20, 2017 from: <https://yougov.co.uk/news/2017/06/13/how-britain-voted-2017-general-election/>

<sup>17</sup> Belfield et al (2017)

increase to £9,500. A full review of the higher education funding system to explore further reforms has also been promised.<sup>18</sup>

It is in this context that the Sutton Trust commissioned London Economics to analyse the effects of the October policy changes, along with a range of alternative policy options.

### Current student finance - at a glance

- For the present academic year all new full-time students attending publicly funded universities are eligible for a loan to cover the entirety of their tuition fees, which are currently capped at £9,250 per year.
- Loans available for maintenance costs are based on income, and no maintenance grants are currently available. For students living away from home, the maximum maintenance loan available is £8,430, for students whose family earn less than or equal to £25,000. The minimum available is £3,928, for students from families with incomes at or over £62,187.
- Higher maintenance loans are available for students studying in London, which are also income contingent (up to £11,002 for students from families earning less than £25,000).
- Whilst students are studying (and until April in the year their course ends), their tuition and maintenance loans accrue interest at the rate of the Retail Price Index (RPI) plus 3%, which currently amounts to 6.1%. After that point, interest rates are contingent on a graduate's earnings. Graduates earning £21,000 or less pay interest at the RPI, those earnings between £21,000 and £41,000 pay (RPI) + up to 3% (depending on income), and those on over £41,000 pay RPI + 3%.
- Graduates pay back their loans at a flat rate of 9% of their income, payable on any pre-tax income over £21,000 a year. This threshold will increase to £25,000 from April 2018. Loans are written off after 30 years (from the April after graduation).

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<sup>18</sup> The Telegraph (2017) 'Theresa May's tuition fees revolution to win over students'. Retrieved 6 November, 2017 from: <http://www.telegraph.co.uk/news/2017/09/30/theresa-mays-tuition-fees-revolution-win-students/>

## 2. Methodology

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London Economics was commissioned by the Sutton Trust to analyse the cost to graduates, higher education institutions and the Exchequer associated with a range of student support scenarios, including combinations of: means-tested tuition fees based on household income; the re-introduction of maintenance grants to 2015/16 levels before their abolition; and changes to the interest rates associated with student loans.

The analysis estimated the impact of the October changes to the repayment threshold, along with these policy options on the 2017/18 cohort of undergraduate English-domiciled students (studying anywhere in the UK), as well as EU-domiciled students studying in England, focused on those at higher education institutions (HEIs) only. To demonstrate a more complete picture of the impact of these changes, both full-time and part-time students are included, as well as other undergraduate qualifications below degree level. It should be noted that the population of students included in this analysis is wider than that of recent IFS work in the area, including *Payback Time*, published by the Sutton Trust in 2014, particularly the inclusion of part-time students, and will thus lead to different estimates.<sup>19</sup>

Long run Exchequer cost, student loan debt on graduation and expected lifetime loan repayments were calculated for each scenario, along with the impact on university funding. It is assumed that income lost through the lowering of fees would be replaced through the direct teaching grant, so as not to affect university funding levels in the short term.

All figures refer to the cost of the 2017/18 cohort through their full course of study, and are presented in 2017 prices.

### ***Student profile***

The model considers the total number of full- and part-time English domiciled first-year students undertaking undergraduate HE qualifications at any institution in the UK, as well as EU-domiciled first-year students undertaking undergraduate qualifications at English HEIs. The number of first-year students is based on HESA information for the 2015-16 academic year (the most recent year for which this information is currently available) – we assume the same cohort characteristics for the 2017-18 academic year as for 2015-16. The 2015-16 cohort comprises 491,075 students (466,265 English and 24,810 EU-domiciled students; 388,855 full-time and 102,220 part-time).

Amongst full-time students, 95% are undertaking first degrees (33% part-time), with 1% undertaking HNCs/HNDs (3%), 2% undertaking foundation degrees (5%), and 2% engaged in other undergraduate qualifications (59%). Part-time students are estimated to study at 40% full-time intensity.

The analysis is undertaken separately by gender. For full-time students, the gender split is 48/52 for other undergraduate qualifications, with the corresponding estimates for HNCs/HNDs, foundation degrees and undergraduate degrees standing at 53/47, 40/60, and 42/58 respectively.

The average age of enrolment for full-time students undertaking other undergraduate qualifications, HNCs/HNDs, foundation degrees and undergraduate degrees was 28, 21, 25 and 20 respectively. The corresponding estimates for part-time students were 36, 27, 30 and 31 respectively. The continuation rate per year was estimated to be 92.6% for full-time students and 82.3% for part-time students.

The average duration of qualification attainment for full-time students undertaking other UG qualifications, HNCs/HNDs, Foundation Degrees and undergraduate degrees was one, two, two and three

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<sup>19</sup> Crawford, C. and Jin, W. (2014) *Payback Time?* London: Sutton Trust.

Belfield, C., Britton, J. and Erve, L. van der (2017) *Higher Education finance reform: Raising the repayment threshold to £25,000 and freezing the fee cap at £9,250*. London: IFS.

years respectively. Based on their study intensity, the corresponding estimates for part-time students stood at two, five, five and seven years respectively.

### ***Student support funding***

Based on HESA data, to determine the size of maintenance loans received, first-year students are categorised by gender, location of study, study intensity and living arrangements whilst in study. We assume that all students take out the maximum available loan to which they are entitled, and we estimate eligibility for loans using information from Student Loans Company Statistical First Releases on the proportion of students in receipt of full, partial or no (eligible but not entitled) maintenance grants (using information for the 2015-16 academic year). For example, the estimated average maintenance loan received by a full-time first degree undergraduate student stands at approximately £6,540 per student per annum.

The average gross tuition fee in 2017-18 is £9,250, but, as a result of access agreements and the provision of bursaries and fee waivers by universities and colleges, the net tuition fee (and associated loan taken out) is lower (£9,100). Based on average study intensity, the average part-time net tuition fee was estimated to be £3,610 per annum. We have assumed that fees do not increase over the duration of students' courses.

We have modelled loan eligibility – by location of study (that is: living at home (21%), living away from home outside of London (67%), and living away from home in London (12%)) - using historical information from HEFCE.

### ***Repayments***

Loans accumulate interest at RPI +3% during the period of study. After graduation, loans accumulate interest depending on earnings, with individuals (in the post-October baseline) earning up to £25,000 incurring a 0% real rate of interest, increasing to 3% real rate of interest on earnings of £45,000 per annum or above. For part-time students, we apply current SLC rules in relation to the accumulation of interest during study – where part-time students become liable for repayment upon graduation or 4 years after they started their course – whichever comes first.

In the baseline scenarios (pre and post October 2017 reforms), for a full-time undergraduate student, the average fee and maintenance loan balance on graduation – including accumulated interest - was estimated to be approximately £51,700 in cash terms (including £4,800 in accumulated interest), which is equivalent to £46,000 in discounted real terms.

In the baseline scenarios, there are no maintenance grants. In the scenarios including grants, we have assumed that level of maintenance grant that would be received is equivalent to the level of maintenance grant that is available to 2015-16 cohort continuing students in 2017-18 (an average of £1,740 per student per annum, with a maximum of £3,455). In this scenario, there is a reduction in maintenance loan availability – declining from £6,540 to £4,440 per student per annum.

We assume that all thresholds increase in line with average nominal earnings growth (with forecasts taken from medium-term and long-term OBR forecasts).

We assume that loan repayment is 9% of earnings in excess of £25,000 per annum (frozen for four years in the pre-October 2017 baseline, and increasing with average nominal earnings growth otherwise) and that all loans are written off 30 years from the statutory repayment due date.

### ***Exchequer funding***

In relation to funding council teaching grants, the average grant per student is derived by dividing the total teaching grant funding in each home nation by the total number of students in the given academic

year. The average teaching grant per full-time equivalent student in England, Wales, Scotland, and Northern Ireland was estimated to be approximately £1,150, £450, £5,520, and £2,700 per student per annum, respectively.

In relation to the estimation of the resource, account and budgeting (RAB) charge and other financial flows, we assume a real discount rate of 0.7% as per the Government's official loan repayment model. We have adopted OBR forecasts in relation to expected Retail Price Index, which were as follows between Year 1 and Year 6: 3.7%, 3.6%, 3.1%, 3.1%, 3.2% and 3.0% (Year 6 onwards). We have also taken OBR forecasts in relation to expected nominal earnings growth between Year 1 and Year 6: 0.0%, 2.7%, 3.0%, 3.4%, 3.6% and 4.3% (Year 6 onwards).

### ***Higher education institution income***

Under the multiple stepped fee scenarios, the average gross fee for full-time undergraduates was estimated to be approximately £3,500 per student per annum. Under the low-income fee waiver scenarios, the average gross fee for full-time undergraduates was estimated to be £5,160 per student per annum.

### ***Sensitivity analysis***

The headline analysis assumes that there is no correlation between a student's household income decile and the earnings decile where a graduate is positioned post-graduation. However, there is a wide range of evidence to suggest that such a relationship exists, though up-to-date estimates on the extent of this correlation are not available. The nature of this association is also likely to affect the distribution of debt repayments across the population, particularly in the context of fees that vary by parental income. In the sensitivity analysis, we assume the opposite extreme - namely that there is a 1-1 mapping between household income decile and graduate earnings decile. This assumption enables the analysis to be replicated to allow for the debt on graduation to vary by graduate income decile (rather than being an average across all students in the headline analysis).



### 3. Reforming student finance

#### October reforms

During the October 2017 Conservative Party conference, Prime Minister Theresa May announced two major changes to the student finance system: a freeze in the level of tuition fees at a maximum of £9,250 per year, combined with an increase in the loan repayment thresholds, from £21,000 to £25,000, a level which will now resume rising with inflation. While the effects of the tuition fee freeze are minimal in the short term, the change in threshold, which will also apply retroactively to those who graduated post-2012, is a significant shift which will have substantial consequences for both graduates and the Exchequer. Sutton Trust research at the time of the threshold freeze warned of the negative effects this policy would have,<sup>20</sup> and it is encouraging that this has now been reversed.

Analysis conducted by London Economics for the Trust shows that the long-run Exchequer cost of the newest changes will run to £2.9 billion per cohort, in 2017 prices. The cost of student support as of September 2017 for the 2017/18 cohort would have been £5.6 billion, but will now rise to £8.5 billion. As a result of the raised threshold and diminished repayments, an estimated 81% of students will never repay their loan in full, an increase of nine percentage points. This long-term cost to the Exchequer is estimated using the resource, account and budgeting (RAB) charge, effectively the percentage of loans that will never be repaid. Under the new regime, the RAB charge increases from 27.6% to 45.1%. In other words, almost half of all student debt will now never be repaid.

Figure 6. Lifetime student debt repayments, by decile of graduate income

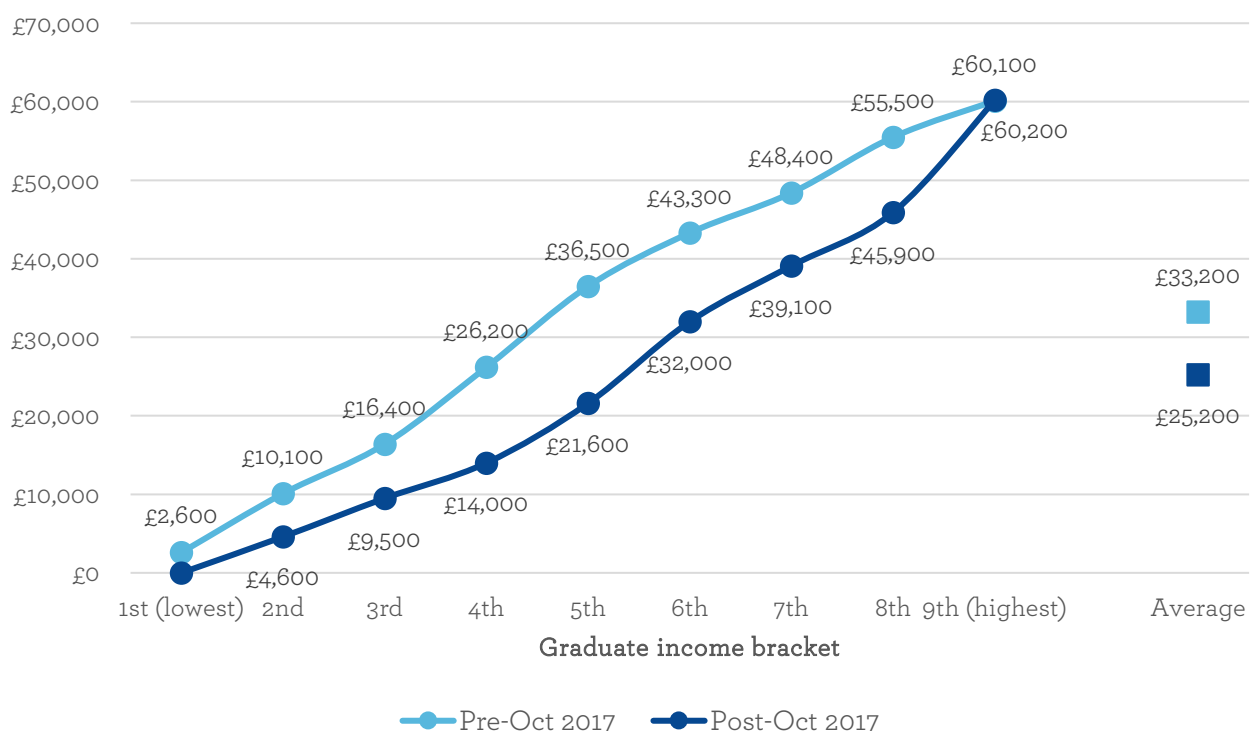
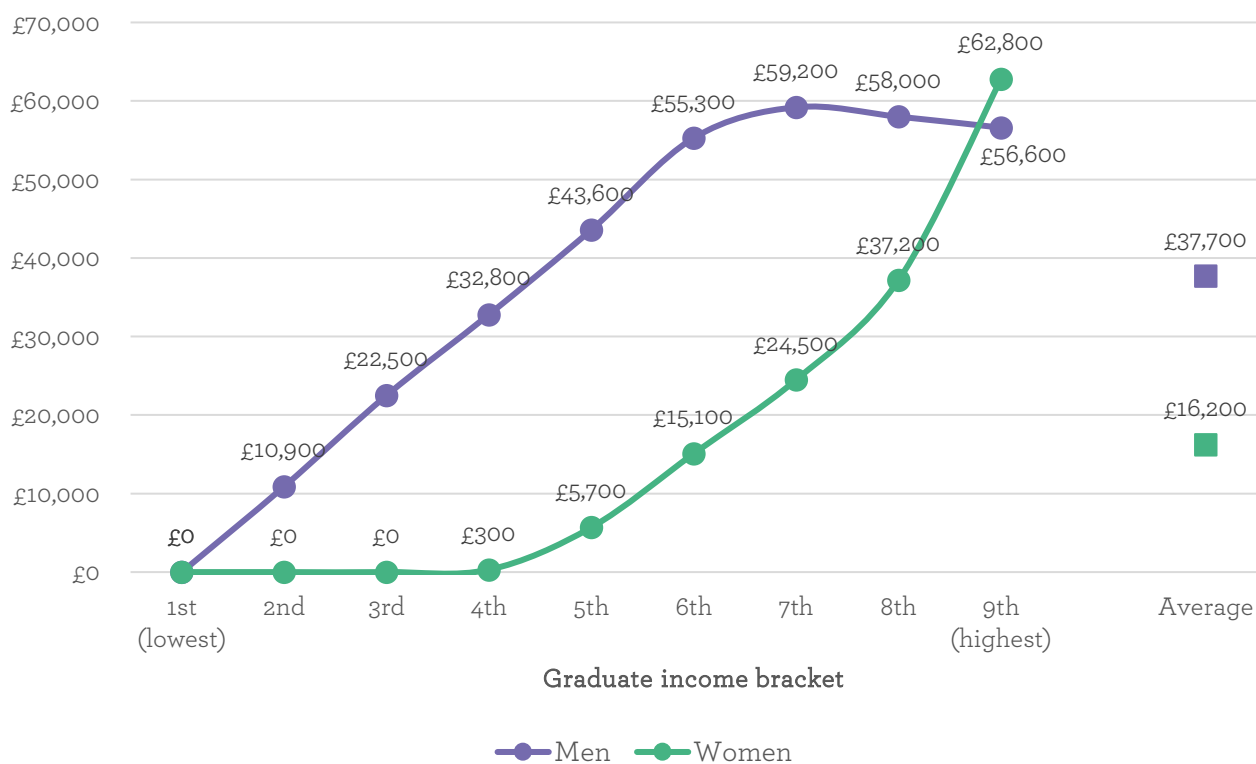


Figure 6 shows the estimated distributional effect of the October changes on lifetime repayments by decile of graduate earnings, with repayments reduced substantially for all but the very top earners. Most

<sup>20</sup> Thompson, J. (2015) *Unfair Deal*. London: Sutton Trust.

of the benefits accrue to middle earners. The pattern of the distribution has also changed, with a steeper curve showing that higher earners will pay a greater share of all repayments in comparison to others than before. Making the distribution of repayments more progressive in this way is certainly a step in the right direction.

**Figure 7. Lifetime debt repayments under the post-October fee regime, by gender**



While Figure 6 shows the average repayments across the whole population, this obscures substantial differences by gender. Figure 7 displays the differential pattern of repayments for men and women, showing that women pay off less than half as much of their student debt as men, with the lowest earning graduate women paying off virtually none of their debt. It is only in the middle range of the earnings spectrum where repayments start to rise. This is reflective of large numbers of women who work in low wage jobs, work part time, or who take a career break for family reasons, and thus never earn enough to exceed the new repayment threshold. October's policy changes will mostly accrue to middle and low earning men, and middle to high earning women.

While the freeze on tuition fees will start to impact revenues if it remains in place for several years, these changes otherwise have no short-term effect on university funding, with the costs to the Exchequer delayed until the debts of the 2017/18 cohort are written off in 30 years' time. This highlights one of the substantial benefits to government of the current higher education funding system: costs are largely delayed far into the future without affecting the current balance sheet or the deficit. What is effectively an accounting manoeuvre thus makes reform difficult, as any other system would introduce up-front costs which would have knock-on effects on expenditure and the deficit. While a convenient facet of the funding environment for the Treasury in the short run, this does not mean the system is the best one for students or graduates.

While the October reforms are to be welcomed, they nonetheless have the appearance of a short term political sticking plaster, and fail to address the deeper issue of a system built around high debt and high levels of non-repayment. As has been evidenced by recent public debate on the issue, there is a significant appetite for deeper reform, which is why the Prime Minister has announced a full review of

the system. The remainder of this report will turn to the question of how the current arrangement could be reformed to transform the financial prospects of young people, and tackle the problem of exclusion from higher education.

## ***Alternative policy options***

### *Interest rates*

Since 2012, student loan interest rates have been set at a stepped rate between inflation as measured by the retail price index (RPI), and RPI plus an additional 3%. Until October this year, this meant that graduates earning less than £21,000 paid interest at RPI level, rising gradually to RPI +3% for those earning more than £41,000.<sup>21</sup> Those thresholds will change under the new policy, but most graduates will still be paying interest rates above inflation. There are two main causes for concern. Firstly, the RPI is a higher measure of inflation than the, more commonly used, consumer price index (CPI), which means interest rates on student loans. Secondly, the increase in inflation since the EU referendum has led to the highest rate of interest on student loans rising to 6.1%, compared to 4.6% last year. These rates are much higher than many other types of loan, at a time when the Bank of England interest rate sits at 0.5%. As interest rates have increasingly come under fire, the government has expressed a willingness to reconsider, though did not include any such measures in the October overhaul.

For all those with student debt before 2012, interest rates remain at RPI (currently 3.1%). Our analysis shows that reducing interest rates back down to this level would lead to approximately an average £3,100 reduction in lifetime repayments, and £1,200 less debt on graduation, depending on other policy changes at the same time.<sup>22</sup> This would add approximately £1bn per year in long run costs. However, as four fifths of people do not pay off their debts before they are written off after 30 years, the benefits of reduced rates would mainly accrue to those at the higher end of the earnings spectrum. If we are to improve fair access, more radical change is needed.

### *Means-testing fees*

Tuition fees in England are extremely high in an international context. Sutton Trust research in 2016 demonstrated that English students faced the highest debt in the group of Anglophone countries, and among the highest average debts in the world.<sup>23</sup> A more recent EU report on student finance has further demonstrated England's outlier position on fees.<sup>24</sup> England (together with Wales and Northern Ireland) is one of only a handful of countries where all full and part-time students pay fees, and it is also the only European country with typical fees over €3,000 per year (around £2,600). At £9,250, fees in England and Wales dwarf every other country in Europe. Both the level of fees, and the proportion of those paying, need to be tackled to create a fairer system.

We had two objectives with the modelling we commissioned from London Economics: first to reduce the overall debt burden on students, and second, to increase fairness in the system, so those from the poorest backgrounds are no longer expected to incur the same level of fee debt as those from the richest households. A system which recognises the widely differing backgrounds of young people, where those from less well-off homes would pay lower fees than those from better-off homes, could address both of these objectives, increasing fairness, and lowering fee debt for most students.

Means-testing was a feature of tuition fees in England from 1998 to 2006 but has become an unfashionable term of late. However, in an environment of limited resources, particularly in the context of the economic uncertainty surrounding Brexit, it remains a powerful way of balancing the cost of services in a progressive manner according to ability to pay. Provision and benefits of higher education are different in many ways to school education and the health system, not least in their extremely

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<sup>21</sup> Rates for everyone are at RPI +3% level for the duration of their study, leading to students accumulating up to £6,000 of additional debt before they enter the workplace

<sup>22</sup> This represents the average marginal cost of lowering interest rates in the context of the other policy changes outlined below

<sup>23</sup> Kirby, P. (2016) *Degrees of Debt*. London: Sutton Trust.

<sup>24</sup> European Commission (2017) *National Student Fee and Support Systems in European Higher Education*. Luxembourg: Publications Office of the European Union.

unevenly distributed nature. In the absence of the ‘comprehensive university’,<sup>25</sup> this points in the direction of a system of cost-sharing which reflects these differential payoffs, but one that also must ensure that university education is open to the widest range of young people, regardless of background. Two options for means-tested fees are considered here. The first method is a full waiver for students from households earning below £25,000 per year, with all others paying the same level of fee as currently; the second, a graduated system of stepped fees ranging from none for those under £25,000, to a highest fee of £12,250 for households earning over £100,000. This is just one example of a means-testing system to illustrate the effects of such a scheme, but income thresholds and fee levels could be fine-tuned further to achieve a workable structure.

**Figure 8: Means-tested tuition fees – bands**

Household income	Tuition fee level
≤ £25,000	£0
≤ £50,000	£3,250
≤ £75,000	£6,250
≤ £100,000	£9,250
> £100,000	£12,250

### *Maintenance grants*

In addition to high levels of overall debt, the English system is also characterised by a regressive pattern of debt accrued by students by the time they graduate. Students from the least well-off homes actually leave university with higher levels of debt than those from better-off backgrounds. This, to a substantial extent, is due to the abolition of maintenance grants in 2016, which has played a significant part in adding to the debt burden of the least well-off.

Reducing tuition fees for those on lower incomes is unlikely to be enough on its own to minimise the effect of financial worries on students. Even without fees, students face on average £19,200 of debt from maintenance costs. So here we also explore the effects of the reintroduction of maintenance grants of up to £3,500 a year, the same level as before they were abolished in 2015/16. Students would also continue to be entitled to maintenance loans - up to £6,000 (outside of London), and up to £8,432 for those living away from home in London. While the issue lies beyond the scope of this report, it is important to note that there may be an argument that this should be raised further for the least well-off, as this level is not sufficient on its own in many cities to live without financial stress. Financial stress among students has been associated with lower levels of mental health and higher drop-out rates.<sup>26</sup> The importance of adequate maintenance levels to increasing access and student well-being has been underlined by the widely welcomed Diamond Review in Wales.<sup>27</sup>

We now turn to a detailed look at how these policies would affect the system in three different areas: student loan debt on graduation, lifetime debt repayments, and effects on the Exchequer and higher education funding.

<sup>25</sup> Blackman, T. (2017) *The Comprehensive University: An Alternative to Social Stratification by Academic Selection*. London: Higher Education Policy Institute.

<sup>26</sup> THE (2016) ‘UK students’ mental health affected by financial worries’. Retrieved November 6, 2017 from: <https://www.timeshighereducation.com/student/news/uk-students-mental-health-affected-financial-worries>

Richardson, T., Elliott, P., Roberts, R., and Jansen, M. (2016) *A Longitudinal Study of Financial Difficulties and Mental Health in a National Sample of British Undergraduate Students*. Community Mental Health Journal, Vol. 53.

<sup>27</sup> WonkHE (2016) ‘Diamond giveth, and Diamond taketh away’. Retrieved November 6, 2017 from: <http://wonkhe.com/blogs/policy-watch-diamond-giveth-diamond-taketh-away/>

## 4. Modelling policy outcomes

### Loan debt on graduation

When the effects of the stepped means-tested fee system are evaluated using the London Economics model, it is estimated that it would reduce average student debt from £46,000 to £29,500 per year, a drop of around 36%. Reintroducing maintenance grants to 2015/16 levels at the same time would cut average debt even further, to £23,300, cutting all student debt by almost half compared to the current system. This would lead to an average fee of approximately £3,500 per annum, and bring England substantially closer to other countries when it comes to the debt profile of graduates. However, as important as the overall level of debt is the question of whether that debt falls fairly on young people from different backgrounds.

Figure 9. Effects of fees change on student debt on graduation, by decile of household income

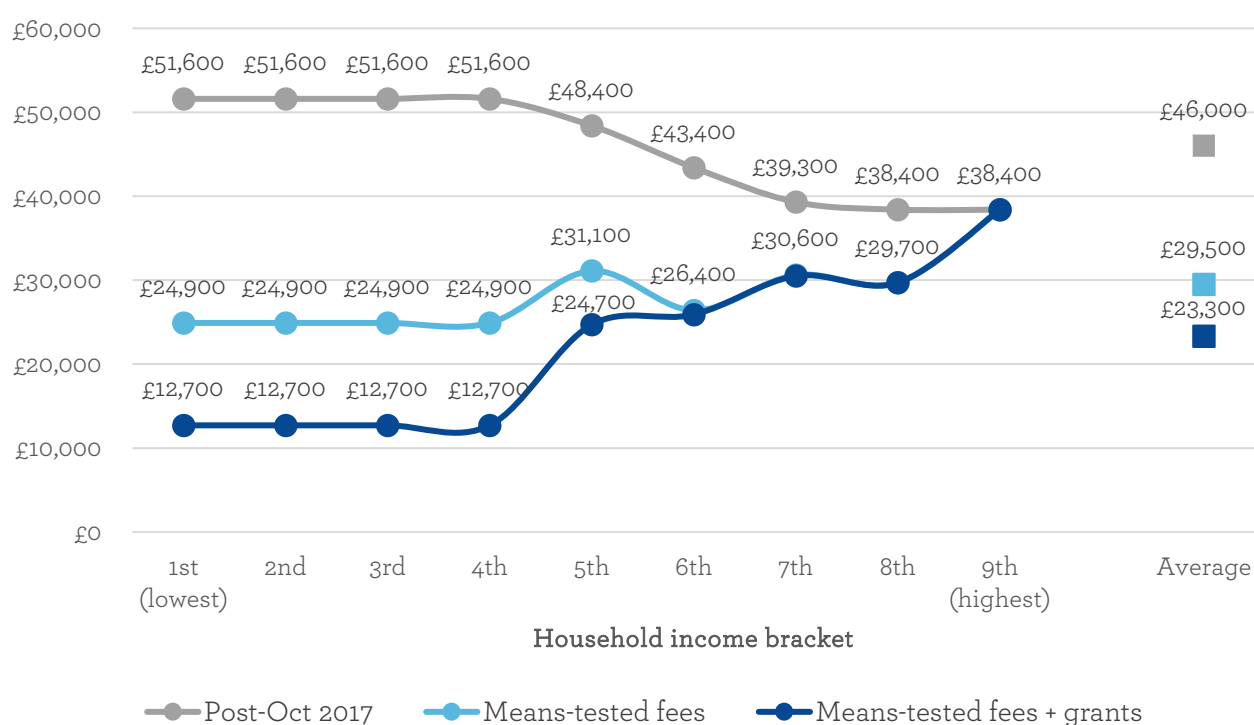


Figure 9 shows how debt is distributed across students from different levels of household income and demonstrates that a means-tested fees system, especially one also accompanied by the re-introduction of maintenance grants, would change the pattern of debt substantially. At present, the debt profile is regressive: those from the least well-off households accrue more debt on graduation than those from the best-off households: £51,600 compared to £38,400. This is predominantly because those with fewer resources have to take out larger maintenance loans while they are studying. However, reducing fees through means-testing profoundly changes the pattern, with poorer students taking on the least debt, and those from better-off households taking on the most, though the pattern is broadly even across all households.

Adding maintenance grants to the picture benefits those from the poorest homes much more. In fact, the combination of means-tested fees and the reintroduction of maintenance grants would slash debt among the 40% poorest students by 75%, from £51,600 down to £12,700, and mean those from the poorest backgrounds emerged with two thirds less debt than their better-off counterparts, whereas under the current regime they emerge with 34% *more* debt.

**Figure 10. Percentage reduction on current baseline of debt, by decile of household income**

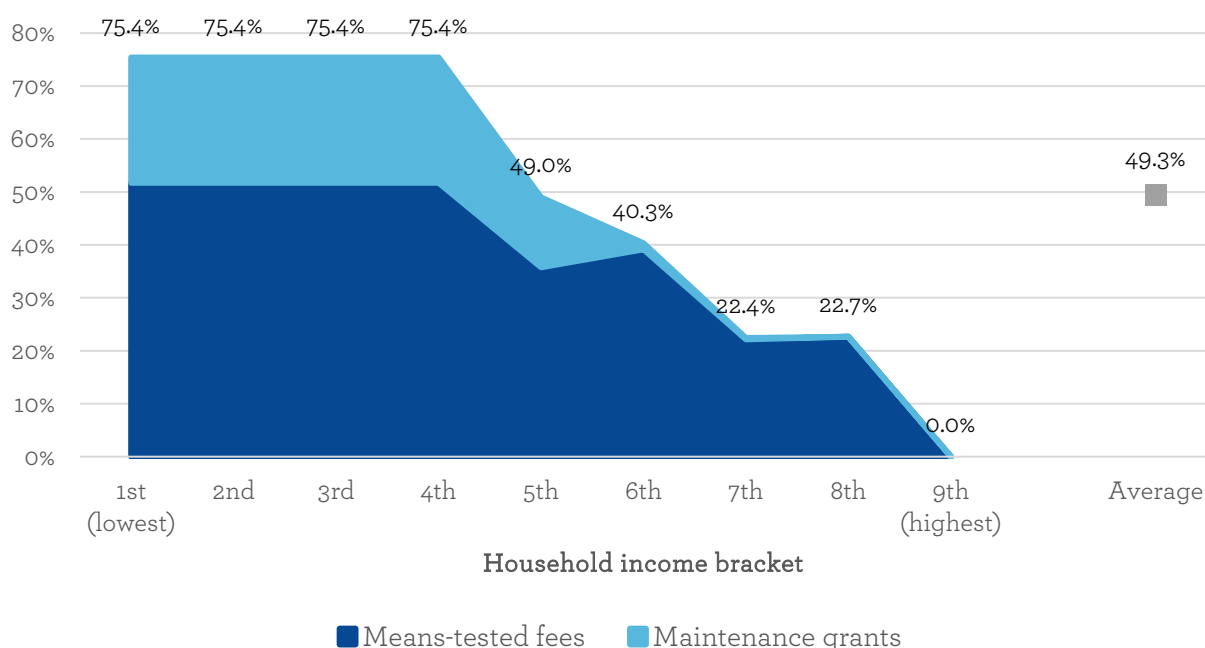


Figure 10 demonstrates that the largest benefits of the stepped means-testing plus maintenance grants regime would go to the least well-off. While average debt would almost be cut in half, those from households in the bottom 40% of incomes would benefit from a cut of 75% (almost £39,000). Those on middle incomes would also receive a substantial cut of between 40-50% (around £20,000), while those from better-off homes would have their debt reduced by just over 20% (around £9,000).

A low-income fee waiver along with maintenance grants would have a similar effect on the less well-off, with those in the bottom 40% of incomes taking on £12,700 of debt, as above. However, this would shoot up sharply to £42,100 for those just above this level, in the fifth decile of incomes, and remain largely flat around the same level for those from the highest incomes. While this helps the least well-off, this almost £30,000 debt gap creates a particularly steep ‘cliff edge’ for those earning just above the £25,000 threshold, which would be problematic both in terms of fairness and in terms of enforcement. Therefore, while a cheaper option for government, it looks less attractive and more unfair on middle earners than a stepped system.

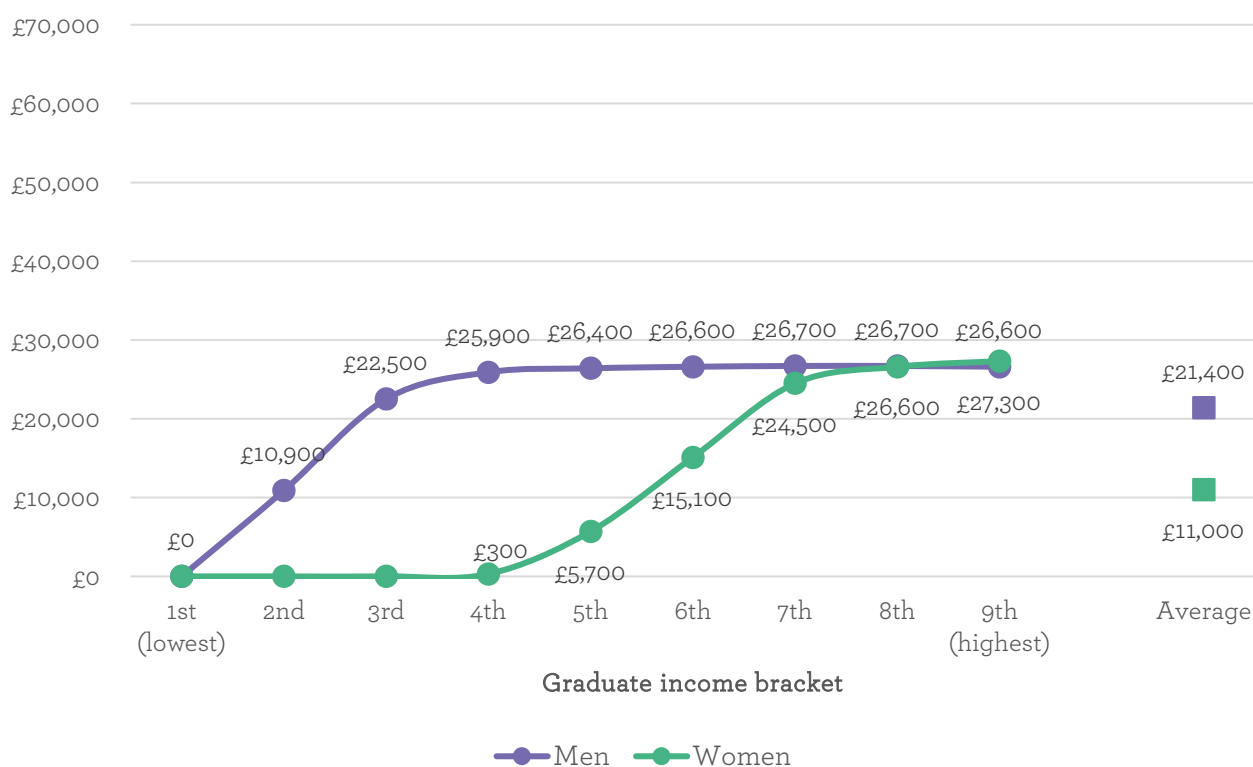
### ***Lifetime debt repayments***

Proponents of the current student finance regime focus on the progressive nature of lifetime repayments, showing that those who earn the most end up paying the most back. So what kind of effects would means-testing and maintenance grants have on lifetime repayments?

With substantially lower debt, repayments also decline, but by slightly less. With lower debts, more graduates end up paying back their loans in full. The number of graduates that never pay back would drop from 81% to 65%. Under the current system, average lifetime repayments are £25,200, with the introduction of means-testing that figure would drop to £18,700. The reintroduction of maintenance grants reduces this further to £15,400. So, on average, students will save almost £10,000 over their lifetime, a 39% reduction.<sup>28</sup> The proportion of borrowers that do not fully repay would also drop further to 56%. Figure 11 shows how repayments would be distributed by gender and by level of graduate earnings.

<sup>28</sup> These figures are presented on constant 2017 prices. In cash terms, average repayments before the October changes came to £69,500, falling to £54,900 after the dropping of the threshold. Stepped means-tested fees would reduce this further to £38,200, and the combination of means-testing and maintenance grants would bring average repayments to £30,200 over a lifetime in cash terms.

**Figure 11. Lifetime debt repayments under a regime of stepped means-testing and maintenance grants, by gender**



A similar pattern to Figure 7 is observed, but with substantially lower overall levels of debt. As lower earners of both genders benefitted substantially from October’s changes to the repayment threshold (and the bottom 40% of female earners pay back almost nothing), they do not benefit much additionally from our proposals, with most benefits accruing to middle and high earners.

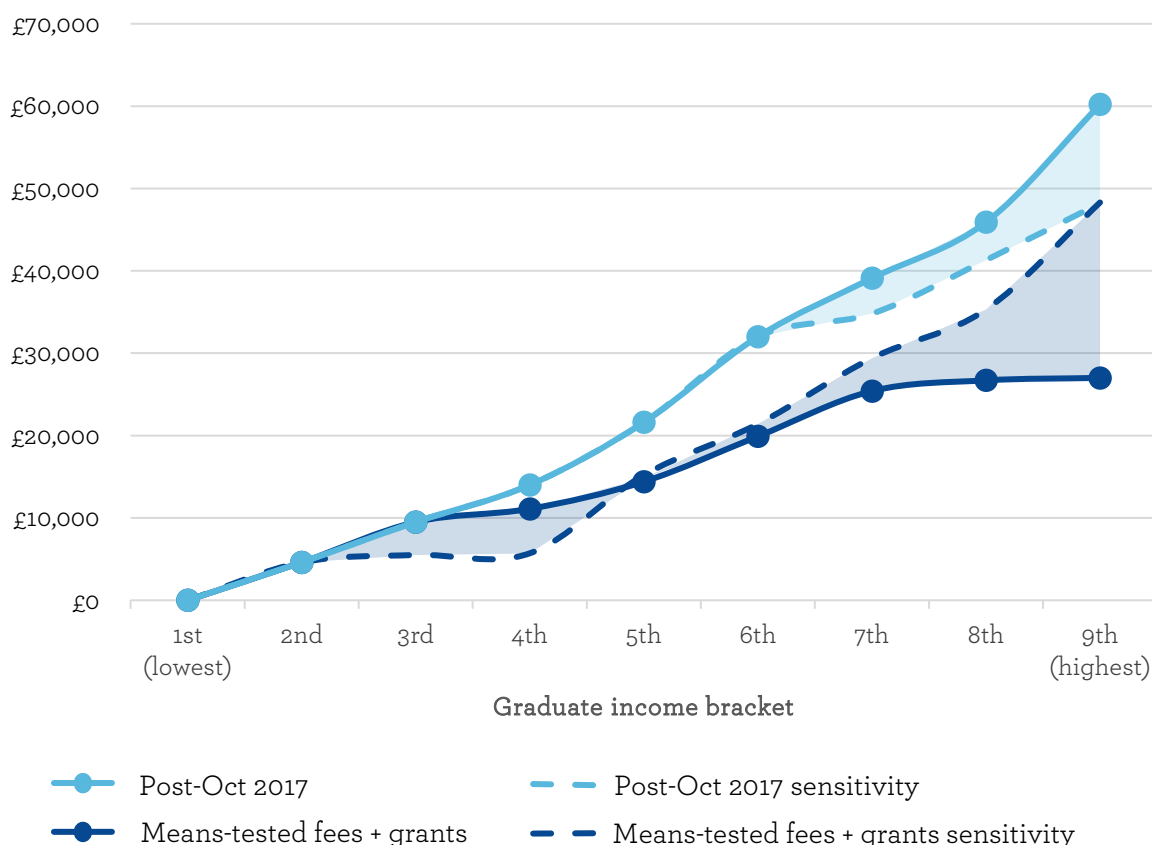
These headline figures are based on a model which assumes that graduates across the earnings distribution take on the same level of debt. However, as Figure 3 displays, in reality, levels of debt vary substantially by household background. This is important both under the current system and under a proposed means-testing regime, particularly as the pattern of debt changes substantially between the two. While the effect of social background on earnings has long been identified as a problem in the UK, recent research has also shown that for those who do attend university, graduate earnings are also ultimately linked with household background.<sup>29</sup> Those who earn most as graduates are more likely to have come from better-off homes, and are thus likely, under the current system, to have taken on less debt. As Figure 8 shows, under an alternative means-testing regime, however, they would be more likely to take on *more* debt. As those who earn the most are most likely to pay off their debts, this assumption likely underestimates the repayments of those at the higher end of the spectrum.

To test this, a sensitivity analysis was performed. Under the headline figures it is assumed that there is no link between graduate earnings and household background: if you are from a poor background, you are equally likely to be a high graduate earner as a low graduate earner. In the opposite scenario, it is assumed there is a perfect correlation between earnings and background: perfect intergenerational immobility. Those from the richest households are destined to be the richest graduates, and so on. This implies a correlation of 1 between parental earnings and graduate earnings, compared to a correlation of 0 under the original assumptions. This allows us to test how this assumption affects the results,

<sup>29</sup> Britton, J., Dearden, L., Shephard, N., and Vignoles, A. (2016) *How English domiciled graduate earnings vary with gender, institution attended, subject and socio-economic background*. London: IFS.

particularly on the distributional consequences of the baseline versus the proposed policy. As both scenarios are implausible in actuality, the truth is likely to lie somewhere in between. There are no accurate figures for the current intergenerational earnings correlation in the UK, but previous work has estimated figures between 0.1 and 0.5.<sup>30</sup> Figure 12 shows the results of this sensitivity analysis, comparing distributions of repayments under both assumptions.

**Figure 12. Lifetime debt repayments, current system versus a regime of means-testing and maintenance grants**



The solid lines represent the headline estimates, while the dashed lines show the results if perfect social immobility were the case. The true values are likely to lie with the shaded areas, where the solid and dashed lines diverge. As can be seen in the graph, under the current system, payments by the highest earners are likely to be an overestimate, as they are more likely to have taken on lower levels of debt in the first place. Under the means-testing regime, the analysis has two effects; firstly, lower earners in deciles 3 and 4 are likely to have lower repayments, because means-testing will have reduced their debt burden. Secondly, those in the highest earning three deciles are likely to repay substantially more, as they are more likely to have come from advantaged backgrounds in the first place and have paid the full fees. Therefore, the headline analysis is likely to have overestimated the progressiveness of the current system, and underestimated the progressiveness of the alternative system.

<sup>30</sup> OECD (2017) *The only way is up?* Paris: OECD Publishing.  
 OECD (2010) *A Family Affair: Intergenerational Social Mobility across OECD Countries*. Paris OECD Publishing.  
 Blanden, J., Gregg, P. and Machin, S. (2005) *Intergenerational Mobility in Europe and North America*. London: Sutton Trust.  
 Chowdry, H., Dearden, L., Goodman, A. and Jin, W. (2012) *The Distributional Impact of the 2012-13 Higher Education Funding Reforms in England*. Fiscal Studies, Vol. 33.

OECD (2010), OECD (2017) estimate it for the full population as around 0.5, Blanden et al (2005) estimated it as around 0.4. Chowdry et al (2012) estimates the correlation specifically for graduates as 0.1. However, this is based on the 1958 birth cohort, at a time when the university population was substantially less socio-economically diverse than it is now, thus the current figure is likely to be substantially higher.



While this analysis establishes upper and lower bounds for the link between earnings and background, the outcomes will lie somewhere in between. Nonetheless, it indicates that, because of the UK's lack of social mobility, the benefits of means-testing will likely, in actuality, accrue to those in the middle and lower end of the earnings distribution, as well as the top.

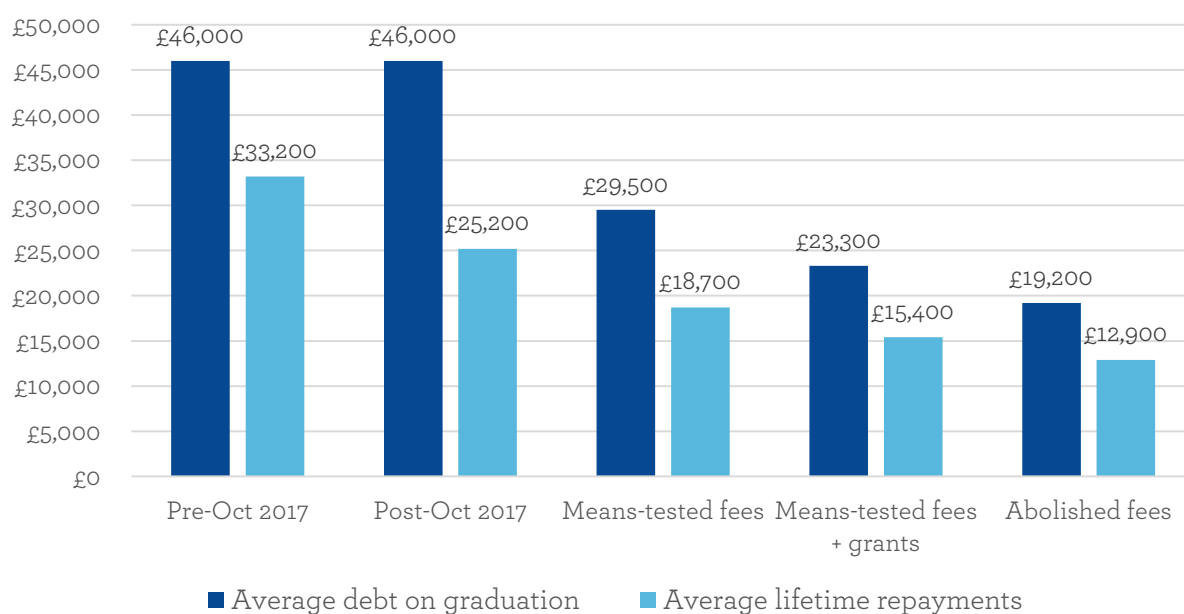
Furthermore, as those at the top are more likely to pay back their loans, the sensitivity analysis implies that the cost of this policy to the Exchequer would also be lower in reality.

### *Exchequer cost and funding*

While students should be the focus of any higher education funding regime, the effect on national finances and universities themselves remains an essential element of finding a system that works. As discussed above, the government's October reforms have cut the average student's lifetime repayments, while increasing the proportion of debt that will never be paid off (the RAB charge) from 27.6% to 45.1%. While this doesn't have any short-term Exchequer effects, it will nonetheless have a substantial long-term effect. The cost of student support for this year's cohort in the long run is estimated to rise by more than 50% due to these changes, from £5.6bn to £8.5bn. This is also a considerable underestimate of the total cost of the policy, as it also applies retrospectively to all those who have entered university since 2012. This, by any measure, is a substantial overhaul.

Similarly, on the other end of the spectrum, the overall long run cost of student support in a system where fees had been abolished would come to £13.1bn, an additional £4.6bn. Restoring maintenance grants at the same time would add a likely further cost of over £1bn. The major impact of such a move would be the need to substantially increase the level of HEFCE teaching grants by £9.8bn, in order to compensate universities for the lost fee income. A means-testing and maintenance regime would also have an impact on the teaching grant, but with a substantially lower cost. These measures increase short-run costs to the Exchequer, but as the IFS has pointed out, there are advantages to the teaching grant making up a higher proportion of university funding. Including allowing government to target funding for certain sectors, such as STEM, or particular groups of students, such as those from disadvantaged backgrounds.<sup>31</sup>

**Figure 13. Financial impact of various funding regimes on students**

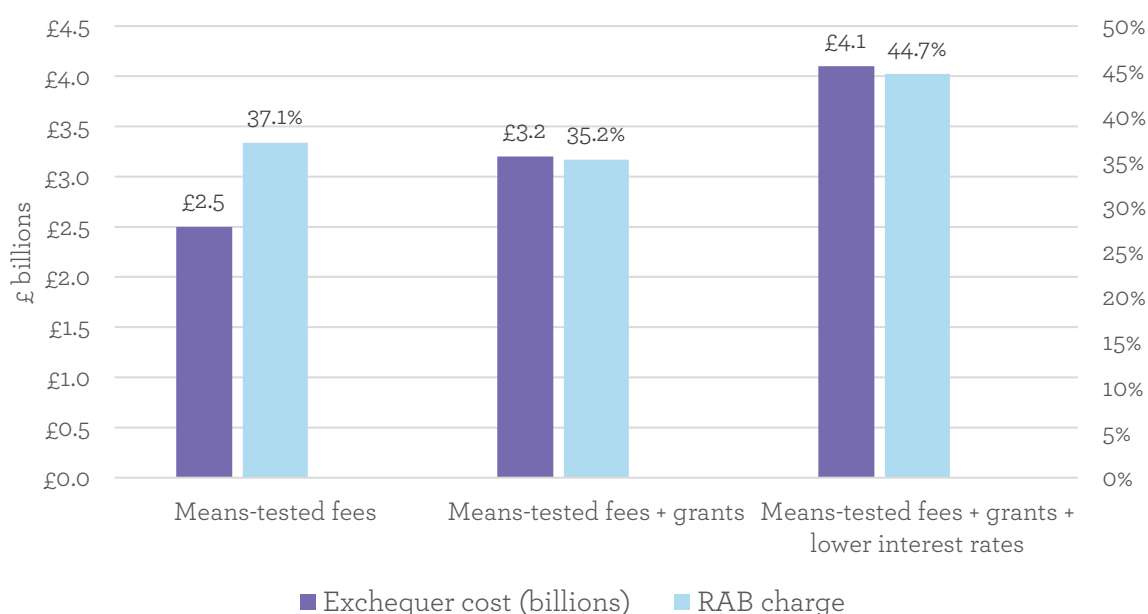


<sup>31</sup> Belfield et al (2017)

Figure 13 compares the effect of these scenarios on student finances in detail and Figure 14 looks at effects on the Exchequer. As the figures show, introducing means-testing alone would substantially cut student debt and average repayments in comparison to the current system, at an additional cost of up to £2.5bn for the duration of the current cohort. This would in fact be cheaper than the reforms announced in October, which cost £2.9bn.

Adding maintenance grants increases the cost by £700m, but brings the reduction in debt to almost half, and in lifetime payments almost 40%, offering graduates a much lighter burden as they move into the workplace. The total cost of both would come to up to £3.2bn for the cohort.<sup>32</sup> This is comprised of a £6.1bn cost of increased teaching grants and £1.6bn in maintenance grants, offset by reducing the Exchequer cost of loan support by £4.5bn through a drop in the RAB charge from 45.1% down to 35.2%, as more graduates successfully pay off their lower levels of debt.

**Figure 14. Net financial impact of policy changes to the Exchequer**



As discussed above, reducing interest rates to the level of inflation would add another £900m, bringing a total cost of implementing the three policy changes to £4.1bn, with a RAB of 44.7%, almost the same as the current level. Means-testing fees only for the lowest income households (the low-income fees waiver), alongside maintenance grants, is a less expensive option, coming to £2.2bn, but with the undesirable cliff edge scenario it creates for those from moderate income backgrounds.

Increasing the teaching grant to compensate for lost fee-loan revenue would result in a substantial short-term impact on the Exchequer's bottom line, as the long-term costs of written-off loans would be converted into up-front costs in the form of maintenance grants and an increased level of teaching grant to universities. However, as discussed above, this is virtually unavoidable due to the unique accounting virtues of the current system. Nonetheless, these increased up-front costs would phase in slowly, as they would only apply to one third of the undergraduate cohort in the first year, two thirds in the second, followed by almost all of the cohort in the third year. The additional upfront costs involved in the means-tested fees plus maintenance grants scenario would come to approximately £2.6bn in the first year, eventually rising to £7.8bn. Though it should be reiterated that much of this cost is merely converting long term expenditure to short term expenditure.

<sup>32</sup> This is an upper estimate, as the sensitivity analysis in the preceding chapter would indicate, the cost of the current system is likely under-estimated, and the cost of the alternative system over-estimated, due to the link between household background and graduate income. The cost of a means-testing plus maintenance system could be up to £700m cheaper than estimates here, as high earning graduates will pay back higher levels of debt.

## 5. Discussion

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There are two principles of fairness at the heart of the student funding issue: fairness in access, and fairness in contribution. It should be acknowledged that the current system goes some of the way towards addressing the latter; lifetime student loan repayments are broadly progressive, based on ability to pay, and reflect the differential gains to university among different groups. The changes to the repayment threshold in October have also made the pattern of repayment more progressive. Proponents of the system would also argue that it hasn't harmed participation rates. The question however, is whether this is enough?

### *Debt and the access gap*

It is not just loan repayments which matter to fairness. Debt also matters. It is not necessarily enough that a system ends up approximating some degree of fairness over a period of 30 years. The system should embed fairness from the beginning. Justice must be done, but it also must be seen to be done. And the current system of fees fails on the latter. There is a straightforward answer to a system which is predicated on imposing vast amounts of debt which will never be paid back by most, and that is to impose lower debt in the first place.

When a young person looks at the costs of university, they don't know which income decile they will end up in. What they do see is the debt and the interest. Furthermore, the extent of repayment does not capture the full costs of debt. Debt imposes a psychological burden as well as a financial one. It constrains and shapes life choices, from decisions on which university to attend, which course to apply to, through to decisions on which job to take, and whether a mortgage, a car or pension contributions can be afforded. These burdens also fall unevenly, with those from poorer households more likely to experience financial worries and have concerns about debt. They are also more likely to be in lower paying jobs after graduation and still be paying off student debt into their fifties.

Those in favour of the current system often point to the fact that increasing numbers of disadvantaged young people are attending university. But this has occurred in a context where student numbers overall have been increasing for some time, and universities have invested huge amounts of money in outreach to target those from disadvantaged backgrounds. And yet the gap between the less well-off and the better-off has remained substantial and largely stable, even if the ratio has slightly improved. More people from disadvantaged backgrounds are going, because more young people are going as a whole, but the gap in participation has remained. While the OFFA-enforced rule compelling universities to spend a proportion of fee income on outreach should be acknowledged, if universities have to run merely to stay still, then it is a stretch to say that the system is currently working for disadvantaged young people.

Just because the access gap has remained stable doesn't necessarily mean that fees are doing no harm to equality of access. With university outreach efforts and larger labour market and social pressures to attend university acting as countervailing forces to the effects of the high fees system, there is nothing to say that access to university among the least well-off would not be higher or improving at a faster rate in the absence of high fees.

### *Alternative options*

One response to this is to propose that fees should be abolished entirely. This is the position that the main opposition took at the last general election. However, while attractive on its face, such a policy has problems both of practicality and principle. In an environment of limited resources for educating the population, it is far from clear that those resources are best spent subsidising university attendance for those from the richest backgrounds. Early years funding and school budgets are just as, if not more, crucial for safeguarding the life prospects of young people. It is difficult to imagine the level of spending required to abolish fees would not have an impact on these areas. The costs of university are currently shared between those who benefit from it most financially and taxpayers as a whole. While this balance clearly needs to be addressed, abolishing fees would mean wider society, including many on low incomes or who never attended university, taking on the full burden.

While higher education is certainly a public good – training the doctors, nurses, lawyers and other professionals from which all of society benefits – it is also a private and positional good. That is to say, its benefits are highly unevenly distributed: the career and earnings boost from attending Oxbridge is to a significant degree contingent on the fact that most people do not. University provision, and its benefits, are highly differentiated across institutions and subjects. Without transformational reform of higher education into a comprehensive system, the more natural approach to funding would be one of cost-sharing that reflects these differential payoffs, but one that also ensures that university education is open to young people regardless of background.

Our analysis shows that this could be achieved, by tackling both high fees and maintenance provision. Removing fees and providing maintenance grants for those who need it most can be achieved at a significantly more moderate cost than full abolition. A system of stepped fees based on ability to pay would reduce average levels of debt substantially, and clear fee debt entirely for those from low income households, reducing that barrier to entry, while nonetheless sharing the cost amongst those with the greatest ability to pay. This can be done while maintaining university funding by compensating universities for lost fee income through increased teaching grants. While it is yet to be demonstrated that the recent lifting of the student cap has had a beneficial effect on access for disadvantaged students, any reintroduction of a cap on numbers should allow headroom for further expansion, and in particular ringfence additional access for students from such backgrounds.

While the focus of public debate is frequently on fees, maintenance is just as important to ensure young people from disadvantaged backgrounds are supported into university education. Having enough money to live day to day is a much more immediate concern for young people. Restoring maintenance grants, at least to the levels before their recent abolition, would reduce levels of debt further for those from the poorest backgrounds, and begin to redress the balance of fairness in a system where they currently must incur more debt for their education than those from well-off backgrounds.

There is an increasing recognition both among the public and in Westminster that something needs to be done on this issue, and it has become a lightning rod for broader issues of intergenerational justice. Young people need a fairer deal, and tackling the problem of student finance in a way that is sustainable, encourages equal access to university and ensures equity in cost contribution would be one way to start.

### **About the report**

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The analytical modelling contained in this report was undertaken by London Economics ([www.londoneconomics.co.uk](http://www.londoneconomics.co.uk)); however, the responsibility for the content of this report and the views expressed within it remain with the Sutton Trust and do not necessarily reflect the views of London Economics.



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