

Press Release

Government reforms to HE finance currently estimated to save little but long-run impact on public finances is hugely uncertain

The government's 2012 reforms to higher education (HE) funding in England now look like they will do little to reduce the total taxpayer contribution per student. However, this depends fundamentally on what happens to graduate earnings over the coming decades.

In fact, the main impact of the reforms on the public finances has been an increase in uncertainty. Teaching grants (a certain cost to the government in the short run) were replaced by substantially larger tuition fees and an accompanying increase in student loans (the public cost of which is highly uncertain) (see note 2). Since the long-run public cost of student loans depends on the earnings and repayment behaviour of graduates for many years in the future, the government will not know for decades whether the 2012 reforms have saved taxpayers any money. This is the main finding of new IFS research published today and funded by Universities UK, with additional support from the Nuffield Foundation and the ESRC Centre for the Microeconomic Analysis of Public Policy at IFS.

The research focuses on the cohort of young English full-time undergraduate students who started university under the first year of the new HE finance regime introduced in Autumn 2012 (see note 3).

Under our baseline assumptions (see note 4):

- For each £1 loaned out to cover tuition and maintenance costs, the average long-run cost to the government is estimated to be 43p. (This figure expressed in percentage terms is sometimes referred to as the 'RAB' charge.) We estimate that the average amount lent to each student is just over £40,000 in 'net present value' terms, meaning that the average loan subsidy amounts to just over £17,000 per student (see note 5).
- Adding in other sources of government spending on undergraduates over the duration of their course (such as teaching grants to universities and maintenance grants to students) increases the total taxpayer contribution per student to just over £24,500 (see note 5). At around £7,600 per year of study (the average course length is 3.2 years), this is slightly more than the average £6,000 that government spent per secondary school pupil in 2012–13.
- This estimated total taxpayer contribution is only 5% (around £1,250 per student in 2014 prices) less than we estimate it would have been under the previous system of tuition fees and loans that was in place up to 2011–12. However, universities are now receiving around 25% more funding per student for teaching from the combination of tuition fees and teaching grants than they did under the old system.

Continues...

Embargo

Until 00.01
Thursday 24th April 2014

Contacts

Bonnie Brimstone
Institute for Fiscal Studies

020 7291 4800

Director:
Paul Johnson

Research Director:
Richard Blundell

The Institute for Fiscal Studies
Limited by Guarantee,
Registered in England: 954616
7 Ridgmount Street
London
WC1E 7AE

Registered Charity: 258815
VAT no: GB 394 5830 17

...continued

These estimates are extremely sensitive to assumptions about what happens to graduates' earnings over the next 30 years. For example:

- Our baseline estimates assume that earnings grow in line with Office for Budget Responsibility (OBR) forecasts from December 2013. If instead earnings were to follow the more optimistic path forecast by the OBR in March 2012 (see note 6), the estimated average long-run cost to the government would fall to 34p per £1 issued, rather than 43p.
- Using the more optimistic March 2012 earnings forecasts, we estimate that the total taxpayer contribution would be 15% (around £3,700 per student in 2014 prices) lower under the new HE funding regime than under the system that was in place up to 2011–12 (compared with 5% using the more pessimistic earnings growth forecasts from December 2013). What happens to graduate earnings over the next 30 years therefore matters hugely for whether, and how much, the new system saves the government money.

Increases in fee levels or student numbers would both increase our estimates of the long-run public cost of issuing student loans. For example:

- Assuming students borrow more from the government in order to cover any increase in fees, we estimate that a rise in all fees of just £500 (from the average of around £8,600 estimated for our cohort in 2012) could raise the taxpayer contribution under the new system to the same as under the old one (see note 7).
- In the 2013 Autumn Statement, the government announced that it would lift the cap on student numbers and estimated that this would mean an extra 60,000 students going to university each year. Assuming that these extra students go on to have earnings in the bottom half of the graduate lifetime earnings distribution, issuing student loans to these students over the duration of their courses would cost the government an additional £1.7 billion (see note 5).

If the government wanted to reduce the loan subsidy under the current system, it could increase the repayment rate, reduce the repayment threshold or extend the repayment period. Each of these would tend to increase the repayments made by middle-earning graduates. Alternatively, the government could choose to raise the interest rate charged, which would only affect high-earning graduates.

Wenchao Jin, a Research Economist at IFS and one of the authors of the report, said “The public cost of the student loan system is highly uncertain. It depends on graduates' earnings and repayment behaviour many years into the future, which we – and the government – can only estimate. Our baseline estimates now suggest that the total government contribution per student has fallen slightly as a result of the government's reforms, but that even a small real increase in fees would wipe out these gains. Whether these reforms have reduced the taxpayer subsidy will remain unknown for many years to come.”

Rowena Crawford, a Senior Research Economist at IFS and another author of the report, said “The government's changes to the higher education finance system have not reduced the total taxpayer contribution per student substantially. The net effect on the public finances is primarily an increase in uncertainty, with the certain cost of teaching grants replaced by the uncertain

costs of providing student loans. If future graduate repayments come in lower than expected, then a future government will have to accept higher-than-expected levels of public sector debt, or offset this by increasing taxes or cutting spending either on higher education or elsewhere.”

ENDS

Notes to Editors:

1. *Estimating the Public Cost of Student Loans* by Claire Crawford, Rowena Crawford and Wenchao Jin of the Institute for Fiscal Studies will be published on Thursday 24 April. For embargoed copies of the report or other queries, contact Bonnie Brimstone at IFS: 020 7291 4800, 07730 667 013, bonnie_b@ifs.org.uk.
2. Before the 2012 changes, universities in England covered the cost of teaching students through a combination of tuition fees (capped at £3,375 in 2011) and teaching grants from the government. From September 2012 onwards, teaching grants were largely abolished and were replaced by allowing universities to charge higher tuition fees (up to £9,000 per year). Under both systems, most students covered the cost of tuition fees and living costs by taking out student loans from the Student Loans Company.

Under the pre-2012 system, students would start paying back these loans when they started earning £15,795 or more (in 2012 prices), would be charged an interest rate equivalent to inflation (i.e. no real-terms interest) and would have any remaining debt forgiven after 25 years. Under the post-2012 system, students will start paying back when they start earning £21,000 or more in 2016 prices (with the threshold rising in line with earnings), will be charged an interest rate of 0–3% above inflation, depending on their earnings, and will have remaining debt forgiven after 30 years. They will also be charged a 3% real interest rate while studying.

3. While similar, our estimates of the long-run cost of student loans are not directly comparable to those of the government (the ‘RAB’ charge estimated by the Department for Business, Innovation and Skills) since we focus only on a particular cohort – those enrolling in university in 2012 – and a particular type of student – young English-domiciled full-time undergraduate students.
4. We assume that earnings will grow in line with the Office for Budget Responsibility forecast for average economy-wide earnings growth from the July 2013 *Fiscal Sustainability Report* and December 2013 *Economic and Fiscal Outlook*; specifically, 12.3% nominal earnings growth between 2012 and 2016, an average of 0.5% per year real earnings growth from 2016 to 2020 and 1.1% per year real earnings growth from 2020 onwards. We assume that all students take out the full amount of the loans to which they are entitled and pay them back according to the repayment schedule (with no early repayments and no avoidance). We use the government’s approved discount rate for assessments of the student loan system of 2.2% above the rate of inflation (as measured by the retail price index).
5. These figures are in 2014 prices and have been discounted back to 2012 using the government’s approved discount rate for the student loan system of RPI+2.2%.
6. In March 2012 the OBR forecast that nominal average earnings would grow by 18.8% between 2012 and 2016. This was revised to 12.3% by December 2013. In its July 2011 *Fiscal Sustainability Report* the OBR forecast 1.5% per year real earnings growth in the long run, while in its July 2013 *Fiscal Sustainability Report* the OBR forecast an average of 0.5% per year real earnings growth from 2016 to 2020 and 1.1% per year real earnings growth in the long run.
7. Assuming the fee cap is increased to £9,500. This is one of the few circumstances in which the cost of the new system increases relative to the cost of the old system in a straightforward way. Changes to other assumptions that affect the estimated long-run cost of loans under the new system (such as graduate earnings growth or repayment rates) would affect the estimated cost of loans

under the previous system as well. As such, there is no simple 'tipping point' for the cost of student loans above which government spending on undergraduate students would be higher under the current funding regime than under the previous regime.