Are the Government’s recent changes to Higher Education student support well-targeted?

- The Government’s newly announced reforms to student loans and grants will increase financial support for students in higher education from families with incomes above £17,500, but not for those from families with incomes below that level.

- Almost all graduates who go to university under the newly announced arrangements stand to gain around £850 from the new loan repayment holiday.

- People who do not participate in higher education will not benefit from the reforms but will have to help finance them through the taxes they pay. This is because the reforms have a net cost to the Exchequer.

- If the Government is keen to increase the number of students from poorer backgrounds who participate in higher education, it would probably be better to spend money trying to further improve school results rather than increasing subsidies for those who do make it to university.

On 5th July 2007, the recently appointed Secretary of State for Innovation, Universities and Skills, John Denham, announced changes to higher education (HE) funding as part of a wider agenda of supporting social mobility and inclusion for the disadvantaged. He argued, amongst other things, that “we cannot be satisfied” when only 28% of HE students come from low income backgrounds.

So what do his reforms mean for students, particularly those from low income backgrounds? How will they affect taxpayers, universities and future graduates? And are these latest changes the best way of widening access to higher education?

The latest announcement follows extensive reforms introduced in the Higher Education Act of 2004, which apply to students commencing their HE since September 2006. Two key motivations for the 2004 reforms were (i) to reverse the long-term decline in funding per head for university teaching seen in England over a number of decades, by increasing graduate contributions, and (ii) to protect access for individuals regardless of background, by allowing fee deferral and increasing the level of non-repayable support to students from low-income families.

The 2004 reforms introduced variable fees, up to a £3,000 cap which will remain in place at least until 2010. They removed fee exemptions and the requirement to pay fees upfront. Instead, fees can be deferred until after graduation using government loans available at a zero real interest rate, with repayments linked to earnings (at 9% above a threshold of £15,000) and with outstanding debt written off after 25 years. Under the current system, students with gross parental income below £17,500 receive grants (up to £2,700) and bursaries (at least £300 for those paying the full £3,000 fee). Note that 23% of HE students currently receive the full grant (see note 2). All students are entitled to maintenance loans towards living expenses, with entitlement varying depending on gross parental income.
The new reforms announced last week, applicable to new students from 2008-09, add the following features to the current system:

- Increased grants for students from families with income between £17,500 p.a. and £60,000 p.a.
- Changes in maintenance loan entitlements for students from families with income above £27,000 p.a.
- A change in graduate repayment conditions, providing the option of a ‘repayment holiday’ for up to five years.
- A guarantee that all 16 year olds who qualify for Education Maintenance Allowance (EMA) will receive a minimum level of maintenance support at university.

In this note, we look at how the latest changes will affect different participants within the HE system: students, graduates, universities and taxpayers.

**Students** will be better off on average at university than today’s students, but HE students from the poorest families (parental income below £17,500) will see no gains.

This is illustrated in Figure 1, which shows the total level of support for students from grants and maintenance loans under the 2006-07 system and the proposed 2008-09 system. This figure takes grants and maintenance loans together, and therefore masks the fact that the composition of support has changed for some students. Figures 2 and 3 show respectively the changes to grants and loans for each of the systems.

From these it can be seen that the increased support for students with gross parental incomes between £17,500 and £45,000 is entirely in the form of more generous grants. In fact, students in this range with parental incomes above £27,000 are gaining overall *despite* reductions in their entitlement to maintenance loans. Between parental incomes of £45,000 and £60,000, increased support for students is through a combination of increased grants and maintenance loans, and is proportionately more of the latter above parental income of around £50,000. By way of comparison, median household income of families with children aged 16 to 18 in full-time education in the UK was around £37,000 in 2005-06. (If you lined all households up from rich to poor, the median household is the one in the middle.)
Graduates will benefit from the new option of taking ‘repayment holidays’ at a time of their choosing, for up to five years in total. As long as zero real interest rates are maintained on outstanding debt, it is in the financial interest of all graduates to take this ‘repayment holiday’. This is because the longer a loan is held by a graduate, the more the taxpayer contributes to the repayment of the loan. If graduates take this five year ‘repayment holiday’ early in their careers, we estimate that they will benefit by around £850, regardless of whether they have high or low earnings over their lifetime.

Universities’ will be slightly worse off because more students (around 33 per cent overall) will now be eligible for bursaries that universities have to pay for.

The taxpayer contribution to the costs of HE will rise because of the more generous grant and the repayment holiday. The cost of increasing the generosity of grants in terms of new year-on-year spending will be £202m in 2010-11 compared with 2007-08, after accounting for economy-wide inflation. This new spending commitment will be found within the tight settlement for education already announced for the 2007 Comprehensive Spending Review and will account for about 5-10% of the planned increase in non-schools spending between 2007-08 and 2010-11.\footnote{The frequently quoted costing of £400m in fact refers to the cumulative sum of new spending in cash terms in 2008-09, 2009-10 and 2010-11.}

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Comment on the reforms:

The current HE finance system was designed to protect access for individuals regardless of background, by allowing fee deferral, by providing heavily subsidised maintenance loans and by increasing the level of non-repayable support to students from families with income less than £37,000 per annum (around one half of HE students).

The latest reforms announced by John Denham increase the level of support (via grants and maintenance loans) for almost all HE students coming from families earning above £17,500 p.a. The Government estimates that approximately two thirds of students starting HE from 2008-09 will receive some grant each year, though we believe this estimate may be a little low given data on the parental incomes of children aged 16 to 18 in full-time education in the UK in 2005.

Emla Fitzsimons from the Institute for Fiscal Studies commented that: “The latest reforms announced by John Denham only benefit students from families with incomes over £17,500 p.a. This clearly stands to benefit many young people below average incomes, but does nothing to help those from the poorest backgrounds”.

For students from the poorest backgrounds, the only increase in support comes via the new EMA guarantee, which ensures 16 year olds who qualify for EMA that HE financial support will not be lower than EMA support. It is welcome to see the Government recognising the need to provide help while individuals are still of school age, if they wish them to go on to university. But this reform is not likely to affect many of those who do continue into HE (unless their parents have a sudden jump in income), because at university, government support is already available.

Other research currently being undertaken at the IFS\(^2\) shows that while young people from poorer backgrounds are less likely to participate in HE compared to those from better-off backgrounds, this gap almost disappears when you compare people with the same A-level results. For this reason, it is unlikely that the announced changes to the system of loans and grants will have much direct impact on the proportion of students who come from low income backgrounds.

Haroon Chowdry, a researcher on this project at the IFS said: “The most effective way of increasing participation in higher education among children from poorer socio-economic backgrounds is to improve their academic results in school. This is not an easy task, but taxpayer resources would be better utilised trying to solve this continuing problem.”

Most students see a financial return from going to university in the form of higher earnings after graduation, but the size of this return is uncertain. Graduates, like non-graduates, also see their earnings fluctuate over time. The HE funding system implemented in 2006-07 includes an insurance element to protect graduates if they end up doing relatively badly in the labour market. This is because repayments are directly linked to earnings and any outstanding debt is written-off after 25 years.

The repayment holiday provides additional insurance, intended to alleviate temporary financial pressures when buying a house or starting a family. But these pressures are faced not just by graduates, but also by non-graduates. This raises the question as to whether it is fair only to help graduates cope with these expenses. It is also debatable whether the student financial support system is the best way to provide such insurance.

Lorraine Dearden from the Institute for Fiscal Studies said “The proposed repayment holiday will benefit almost all graduates who take it – high earners and low earners alike. It would be a much better use of taxpayer money to target those who most need this type of help directly, regardless of whether or not they are graduates”.

\(^2\) This research forms part of the ESRC’s Teaching and Research Learning Programme (TLRP) Widening Participation in Higher Education project.
One undesirable feature of the current system that will remain after the reforms is the somewhat arbitrary link between parental income and maintenance loan entitlement. Rather than being driven by any economic rationale, the quirk appears to be due to the desire to provide the same overall support to students with parental incomes between £35,000 and £60,000. To achieve this, the tapering away of the grant across this range has to be offset by increasing loan entitlement.

A simpler and more efficient system would remove the link between maintenance loans and parental income (as is the case for fee loans). This would not harm the poorest students, who would retain maintenance grants, and it would not harm the poorest graduates, who would continue to be protected by the income repayment schedule.

*** ENDS ***

Notes to editors:

1. All figures quoted in this press release are in 2006-07 prices.
2. According to Government estimates, around 29% of applicants to the Student Loan Company in 2006-07 receive the full grant (parental income below £17,500). A caveat is that these figures are based on applicants, or around 80% of English domiciled HE students. Expressing the number of HE students receiving a full grant as a proportion of the total number of HE students rather than as a proportion of applicants, means that around 23% are from families earning below £17,500.
3. The researchers at the IFS who have been involved in this work are Haroon Chowdry, Lorraine Dearden, Emla Fitzsimons, Alissa Goodman, Greg Kaplan and Luke Sibieta.