IFS analysis of higher education funding options: FACT SHEET

IFS produced an article for the Evening Standard on Thursday 4th December which contained some figures relating to the tuition fee debate. This note explains how the figures in that article were calculated.

1. The Government calculates that they could bring in an extra £1.4 billion if all universities charged their students the full top-up.

Alan Johnson, Minister for Higher Education, in an answer to a parliamentary question from Paul Farrelly on 12 November 2003[1] provided the following table, setting out the approximate *extra* income from top-up fees if all universities set their fee for all courses at the levels specified.

Table 1. Government estimates of approximate additional income from fees[a]

Level of higher fee	£ million
£1,500	280
£2,000	660
£2,500	1,035
£3,000	1,410

[a]This is in addition to fee income to universities from the standard fee of £1,125, not including full-time post graduates (apart from PGCE students).

The government calculates these figures using their own assumption that the number of students assessed for fees will be around 750,000. The additional income from fees of £3,000 is therefore calculated as: (£3000-£1125) x 750,000 = £1,406,250,000.

2. But half of this will be swallowed up subsidising the loans that most students will take out to pay them.

The proposed introduction of the Graduate Contribution Scheme in 2006 will mean that all top-up fees will be covered by a system of subsidised loans. The loans will be set at a zero real interest rate and will only be repayable once the (former) student starts earning an income above £15,000 p.a. Repayments will be set at 9% of their income above £15,000, until the full balance of the loan is re-paid.

The cost of this loan subsidy to the government is likely to be approximately 50% of the face value of the loan. This means that even if all universities charge the full £3,000 for all their courses and raise £1.4 billion in the process, half of that will still come from the pockets of taxpayers[2].

3. If, as the Government hopes, not all universities charge the full top-up, the net amount raised would be less, perhaps in the region of £500 million.

If all universities charge £2,500, the Government estimates this will raise £1.035 billion (see Table 1). Our own simple calculations suggest if half of all universities charge the full £3,000, and the rest charge 50% of the maximum top-up, this would have a similar effect on revenue, raising approximately £1.055 billion.

Because these fees will be covered by the Graduate Contribution Scheme, 50% of the value of the fee revenue will have to come from the taxpayer in the form of loan subsidy[2]. This means that the net saving for the taxpayer from top-up fees will be approximately £500million under these scenarios.

4. This is pretty small in the context of the Government's total higher education bill next year of about £9 billion.

According to the Department for Education and Skills, total expenditure on Higher Education in England will be £9.057 billion in 2004-05[3].

5. And it is also pretty small compared with the extra £1 billion or more needed to expand student numbers by 2010 according to the Government's target.

Meeting the Government's target to achieve a 50 per cent initial entry rate implies additional student numbers of 250,000 by 2010-11 [4]. Given that each new student attracts more than £4,000 on average in teaching subsidy from the government each year, before the cost of any loan subsidies or grants are taken into account, the additional cost to the taxpayer of these new students will be considerably more than £1 billion.

6. The IFS researchers said that the cost of some of the concessions being mooted in the press would mean either less money for the universities or a bigger bill for the taxpayer. For example, increasing the income threshold at which graduates have to start repaying their loans to £20,000 would cost the same as giving a one-off grant of £900 to a student who goes on to follow a typical earnings path after graduation.

This £900 figure was calculated by comparing the difference in the net present values of the repayments made by an example graduate under a repayment threshold of £15,000 and a threshold of £20,000, assuming a government cost of borrowing of 2.5 per cent.

The example graduate leaves university with £17,000 debt, with a starting salary of £14,000 and an average graduate earnings profile, assuming no career breaks[5]. This graduate was calculated to attract a total government subsidy of around £4,100 under a system with a £15,000 repayment threshold, but a £5,000 subsidy under a £20,000 repayment threshold.

7. Across all students the cost could run into hundreds of millions.

The amount of extra government subsidy will not be the same for every graduate, but will vary depending on how well the graduate does in the labour market. For example the *extra* subsidy from raising the repayment threshold will be zero for those who earn less than £15,000 throughout their whole working life – as they will pay nothing for their loan under both schemes and have their loan fully paid by the taxpayer. Those who pay their fees up front will also not benefit from the change in the threshold. However, many graduates may benefit more than our example graduate, for example if they have lower initial and/or slower growing salaries or time out of the labour market.

If the average subsidy for all students taking up loans were £900, then the cost would be approximately £250 million[6]. The overall cost could be more than this if the average gain across all students was in fact higher, or if take-up increases as fees go up, both of which are highly probable. The cost would be less if the gains on average are below £900.

8. The new maintenance grant is much lower than the original value of those phased out in the Nineties.

The following graph shows the real level of maintenance grants and maintenance loans from the mid-1970s onwards. It shows that the grants to be introduced next year (in the darker shade on the Figure) are considerably lower than those phased out in the 1990s[7]. This graphs shows that the total level of support for living costs, *including loans*, will be higher than under previous systems.

Maximum value of maintenance grants and maintenance loans
(£ p.a., 2003–04 prices)
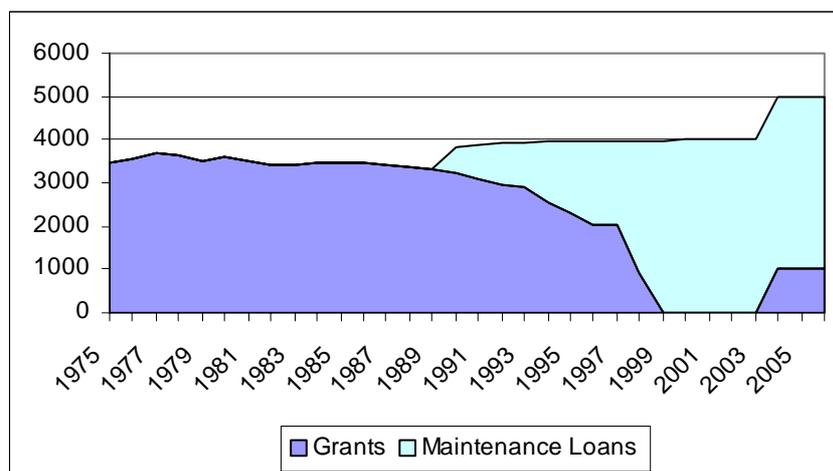
Notes: These are the levels that apply for students with full eligibility for grants. Loan amounts are for a first-year student living away from home outside London. The loans for fees that would be available under the GCS if the White Paper proposals were introduced are *not* included in this

graph. All figures are expressed in the 2003–04 academic year's prices, using the RPI(X) price index and assuming 2.5 per cent annual inflation on this measure from 2003 onwards.

Source: Authors' calculations based on National Union of Students (2002) and Office for National Statistics (www.statistics.gov.uk/downloads/theme_economy/RPIX.pdf).

9. Australia, whose system of variable fees and loans is often cited as a success, has a much more generous grants system, with a maximum of £3,375 per year.

In Australia a means tested Youth Allowance is paid to all individuals in full-time education from the age of 16. The full allowance is paid to children of families earning below a minimum of $A27,700 per year (about 70% of average earnings) depending on number of dependent children. A student aged 18 or over living away from home whose family income is below the threshold receives $A8,062.60 per annum which is around £3,375 using an exchange rate of 42 pence to one Australian dollar[8].

Some General Concluding Comments

- The fact that the current set of proposals for top-up fees will not save the tax payer much money relative to the overall cost of higher education does not in itself imply that the principle of charging top-up fees is flawed.

- The loan system being proposed is very generous to students, and this is why half the money raised from top-up fees will be swallowed up by the higher costs to the taxpayer. The loan scheme does however mean that students who do not benefit as much from higher education through higher earnings get a much larger subsidy from the taxpayer than those who benefit the most. This makes it progressive. Indeed graduates who decided never to enter the labour market would receive a 100 per cent subsidy from the taxpayer.

- When thinking about alternative fee proposals it is important to consider the loan system that will be available alongside them, as this will affect the revenues raised considerably. For example, some favour a scheme where ALL students pay fees (i.e. there are no exemptions) and where the extra revenue is used to pay for more generous grants to low income students. If, however, these poor students are allowed to borrow more to pay for these extra fees with no reduction in the amount they can borrow to support living costs, then the revenue raised to pay for the more generous grants will be halved.

ENDS

Notes to editors:

1. Hansard Written Answers for 12th November 2003 (pt21), Column 354W.

2. Barr, N. (2002) provides a range of estimates of the value of the loan subsidy on today's student loans, which are less generously subsidised than the Graduate Contribution Scheme will be. Paragraphs 35 and 36 of this document set out independent sources suggesting that for every £100 the government lends, only £50 is repaid. Because of the increased generosity of the new Graduate Contribution Scheme, our 50 per cent rule of thumb is consistent with less than full-take up of new loans for top-up fees.

    Barr, N. (2002), 'Funding higher education: policies for access and quality' in House of Commons, Education and Skills Committee, Post-16 Student Support, Sixth Report of Session 2001-02, HC445, London: TSO

    http://econ.lse.ac.uk/staff/nb/Barr_Selcom020424.pdf

3. See p.19 of Department for Education and Skills (2003), The Future of Higher Education, Cm. 5735, London.

    http://www.dfes.gov.uk/highereducation/hestrategy/foreword.shtml

4. Source: Department for Education and Skills

    For the purposes of the Government's target, participation is measured using the Initial Entry Rate (IER). This is the sum of all the individual entry rates (new HE entrants as a percentage of the population of each age group) for each year group between 18 and 30. The figures are based on students domiciled in England who enter full or part time higher education in the UK. The IER includes all courses of one year or more, above A level and its equivalents, that lead to a qualification awarded by higher education institutions or widely recognised national awarding bodies. - Department for Education and Skills press notice 2002/0033

5. The average starting salary for a 22 year old graduate in the latest Labour Force Survey is approximately £14,000. The typical earnings path for a graduate was also estimated using Labour Force Survey data.

6. National Statistics First Release SFR 32/2003, 27th November 2003 Table 2A shows that 1.016 million students were eligible for loans in 2002/03, of whom 82 per cent took up a loan. Assuming 3 years of HE, this implies that around 278,000 individuals per cohort currently take up a student loan.

7. Source: Goodman, A. and Kaplan, G. (2003), "'Study Now, Pay Later' or 'HE for Free'", IFS Commentary 94 (http://www.ifs.org.uk/education/comm94.pdf).

8. Source: http://www.centrelink.gov.au