

## Fine-tuning the HE reforms

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The Higher Education (HE) Bill passed its third reading in the House of Commons on the 31<sup>st</sup> of March 2004. Whilst the overall thrust of the proposals is now firmly in place, the fine-tuning of the proposed package in the run-up to the second reading of the Bill on January 27<sup>th</sup>, made it unnecessarily complicated. It seems to us that it is now time to focus on the specific details of the proposed package. Here we suggest one way in which the implementation of the proposals can be simplified. Our starting point is to take the overall stipulations of the Bill relating to variable fees, the provision of grants, GCS loans and bursaries, as given. We focus instead on the practical interactions of the various elements of the package and how they might be simplified in such a way as to maintain the essential elements of the HE Bill.

Much of the complexity in the current proposals is due to the manner in which the various components of the package of loans and grants will be adjusted and withdrawn across the income distribution of parents. For example, in its present guise the HE grant will have two different tapers in operation: one component of it will be tapered away at family incomes of between £22,580 and £33,630, whilst the other component will be tapered away at family incomes of between £15,970 and £22,260. The maintenance loan will also have two different tapers in operation: it will be reduced by £850 at incomes below £26,000 and will then be increased linearly until income reaches £33,630, at which point the tapering will operate to reduce it again. The combination of tapers at five different income points means that the system as it stands – quite apart from being complex and difficult to understand – will also be administratively highly burdensome.

It thus seems to us that these elements of the system require modification, in order to simplify the current system and to make it more transparent. The changes could be incorporated in such a way as to make them cost neutral. The savings in administrative costs would be likely to be considerable.<sup>1</sup>

In brief, we suggest tapering only *one* component of the scheme - the HE grant - in a linear manner across parental income levels. This would simplify the practical implementation of the HE grant. Further, removing the taper on maintenance loans would mean that all students, regardless of their positions in the parental income distribution, would face the same level of government-sponsored debt upon graduation if they were to take out the maximum amount of loans available to them. Taken together, both simplifications would mean that the amount of support at university would decrease steadily with income up to £40,000 p.a., above which students would have to fund around 20 per cent of their living costs from external sources (compared to 25 per cent under the current scheme).<sup>2</sup> This renders it highly progressive - unlike under the government's current proposed scheme.

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<sup>1</sup> Note from the outset that we are unable to work out the precise income thresholds to which tapering will apply to ensure cost neutrality, so the precise income cut-offs are likely to change.

<sup>2</sup> Cost of living estimates are based on the National Union of Students figures.

## The system under the HE Bill

The full details of the proposals of the HE Bill and how the details have evolved over time, have already been analysed by the IFS (see Dearden, Fitzsimons and Goodman (2004)). The key features of the Bill as it currently stands, applicable from 2006-2007 are<sup>3</sup>

### FEES

- No upfront fees.
- Variable fees of up to £3,000 per year, for which a student can obtain a full loan - regardless of family income - repayable via the Graduate Contribution Scheme (GCS).

### HE GRANT

- Means-tested maximum grant of £2,700 p.a., comprised of
  - (a) £1,200 if family income <£22,580, tapered to zero at family income of £33,630 *plus*
  - (b) £1,500 if family income <£15,970, tapered to zero at family income of £22,260.

### MAINTENANCE LOAN

- Maintenance loan of
  - (a) *Living away from home in London*: £5,320 (£4,770) p.a. if family income <£26,000 p.a., increasing linearly to £6,170 (£5,620) p.a. if family income is £33,630, p.a. and tapered to 75% of its maximum value as family income rises to £46,200 (£44,500). p.a.<sup>4</sup>
  - (b) *Living away from home outside London*: £3,555 (£3,225) p.a. if family income <£26,000, increasing linearly to £4,405 (£4,075) p.a. if family income is £33,630, p.a. and tapered to 75% of maximum value as family income rises to £44,000 (£42,500). p.a.<sup>5</sup>

### REPAYMENT OF LOANS

- Repayment of all loans for fees and maintenance via GCS set at 9% of income above £15,375 (fixed in nominal terms until 2010–2011 and to be up-rated with inflation from then on). A zero real interest rate will apply (i.e. the amount of loan outstanding will only be increased by inflation).

### BURSARY

- Minimum bursary of £300 p.a. if family income <£15,970 *and* if the university charges the maximum fees of £3,000 p.a.

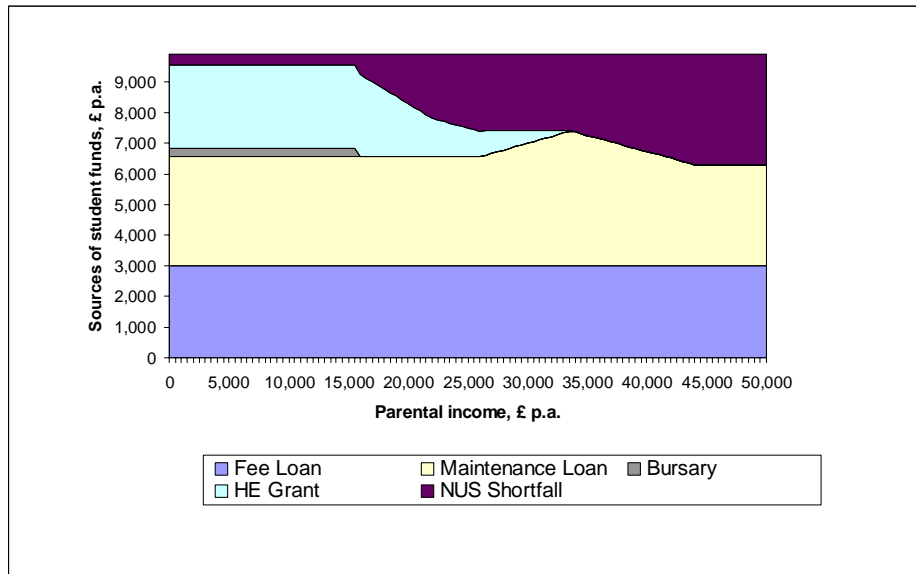
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<sup>3</sup> Note that all figures are in 2006-2007 prices. Further, note that some of the reforms, such as the basic grant of up to £1,500 per year, are to be introduced from 2004-2005 – see Dearden, Fitzsimons and Goodman (2004), Table 1: <http://www.ifs.org.uk/education/bn45.pdf> for details.

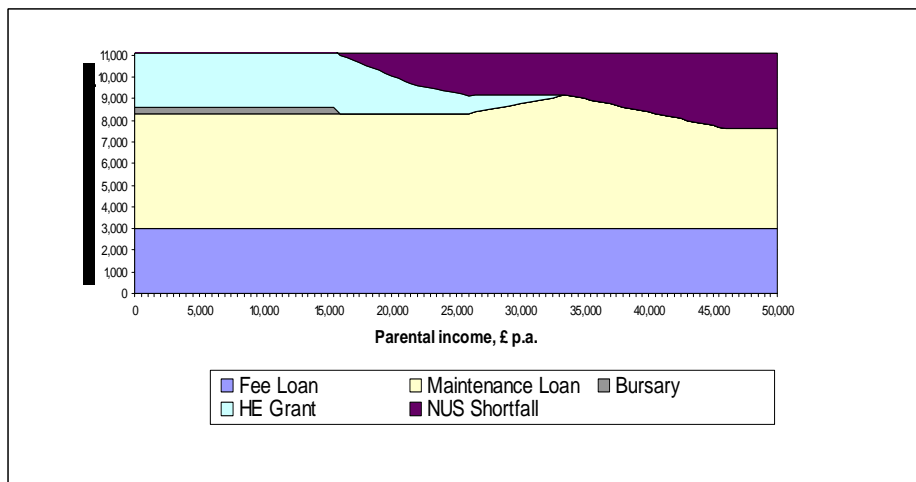
<sup>4</sup> Non-parenthesised figures refer to first- and second-year students and parenthesised figures refer to final-year students.

<sup>5</sup> Non-parenthesised figures refer to first- and second-year students and parenthesised figures refer to final-year students.

The features outlined above underline the lack of transparency of the system. It has a number of complex features, which the government might consider addressing before the HE reforms are fully implemented in 2006-2007. The quirks in the system are revealed more effectively through diagrams. Figures 1 and 2 show the sources of finance for students studying away from home outside London and in London respectively. Both figures are based on the assumption that universities charge £3,000 p.a. for tuition fees.



**Figure 1: Non-London student finances under the Higher Education Bill, with fees of £3,000 p.a.**



**Figure 2: London student finances under the Higher Education Bill, with fees of £3,000 p.a.**

The figures are somewhat elaborate largely as a result of the following features of the system

- *The tapering of HE grants.* There will be two tapers in operation. One component of the HE grant will be tapered away at family incomes of between £22,580 and £33,630, whilst the other component will be tapered away at family incomes of between £15,970 and £22,260.
- *The tapering of maintenance loans.*<sup>6</sup> The complexity of the maintenance loan system came about through the abolition of the fee exemption in the government proposals of January 19<sup>th</sup>. It was announced that in place of a fee exemption, eligible individuals would be able to obtain a grant. This meant that savings needed to be found elsewhere in order to ensure the cost neutrality of the proposals. This was achieved through reducing the generosity of maintenance loans. More specifically, it was proposed to reduce the amount that a student could borrow for maintenance by £850 below family incomes of £26,000 p.a. The £850 loan reduction will then be tapered to zero at family incomes of £33,630 p.a., so that the maximum maintenance loan will only be payable to students from families with income of exactly £33,630 p.a.

## **Proposed simplifications**

The following suggested amendments to the practical allocation of the HE grant and the maintenance loan would render the system more clear-cut, more transparent and more progressive. Further, it would be administratively less complicated than the current system. It could also be customised in such a way as to ensure its revenue neutrality.

### **1. HE Grant**

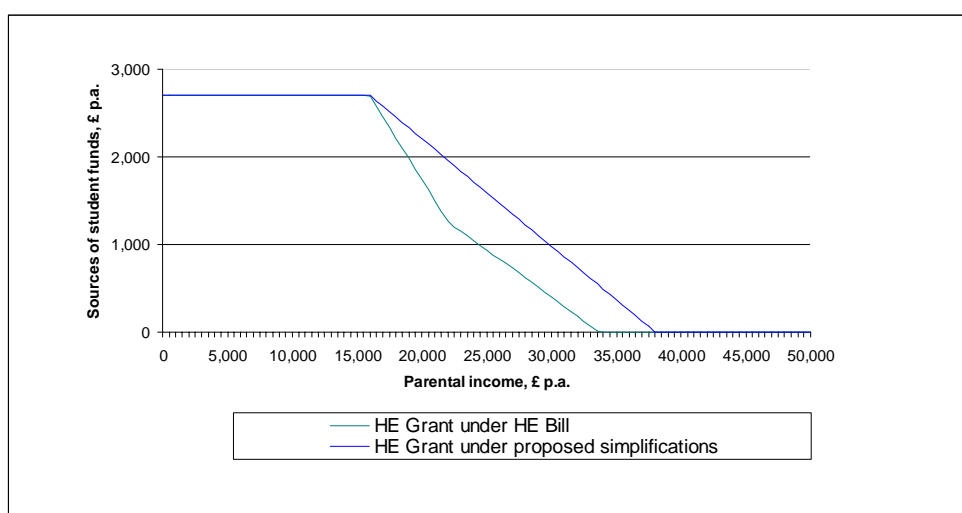
One simplification would arise through combining the two components of the grant and subjecting them to a common linear taper. This could be achieved by offering a means-tested maximum HE grant of £2,700 p.a. if family income <£15,970, tapered to zero at family income of £38,000 p.a. if the student is studying outside London; tapered to zero at family income of £40,000 if the student is studying in London.<sup>7</sup>

Figure 3 compares the level of the HE grant (for non-London students) under the HE Bill and our proposed simplification. Compared to the HE Bill, the grant would be more generous at all income levels between £15,970 p.a. and £38,000 p.a. (the upper limit is £40,000 p.a. for London students) under the proposed change. The costs of this could be offset by the following suggested modifications to maintenance loans.

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<sup>6</sup> Note that the maintenance loan amount is based on median student living expenses.

<sup>7</sup> As discussed already, the cut-offs would need to be worked out precisely in order to ensure cost neutrality of the suggested simplifications.



**Figure 3: HE Grant under the HE Bill and the proposed simplifications**

## 2. Maintenance Loan

One simplification would arise through offering students the same maintenance loan amount, *regardless of parental income*. Again, the precise details would need to be worked out to ensure revenue neutrality, but the scheme could be along the lines of

- A maximum maintenance loan of £4,936 for all students living away from home in London, regardless of family income (i.e. 80 per cent of the DfES estimate of median student basic living costs in London), reduced to £4,628 in the final year (i.e. 75% of the DfES estimate of median student basic living costs in London).
- A maximum maintenance loan of £3,525 for all students living away from home outside London, regardless of family income (i.e. 80 per cent of median student basic living costs outside London), reduced to £3,304 in the final year (i.e. 75% of the DfES estimate of median student basic living costs outside London).

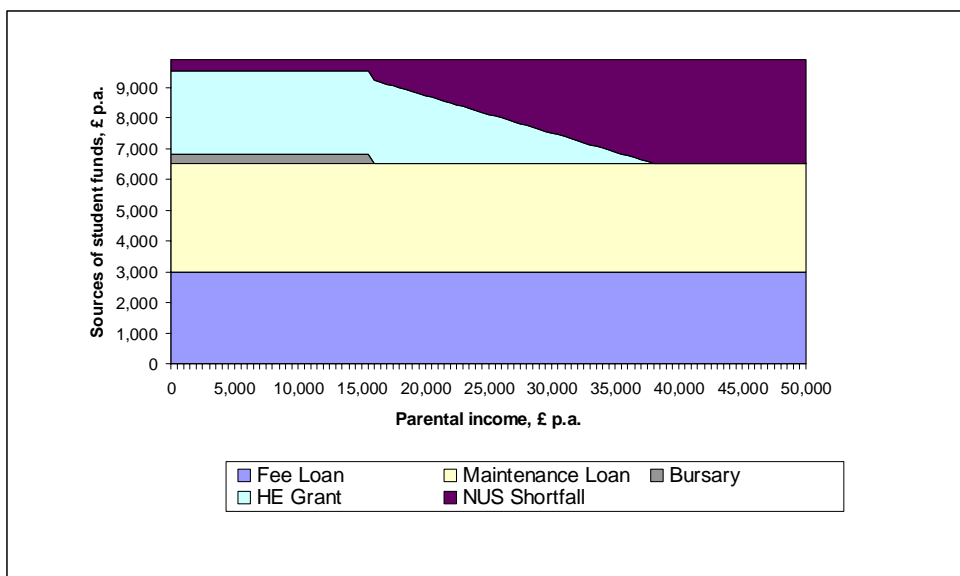
The novel feature of the proposed simplifications is that the tapering would only apply to the level of the HE grant. Fee loans would remain unrelated to family income, whilst maintenance loans would now also be independent of family income. All students would therefore be entitled to the same overall loan amounts. This means that family income, through affecting the HE grant entitlement, would only determine the amount of the shortfall which students would have to make up *whilst they are studying*. It would *not* determine the maximum loan repayable under the GCS after graduation. This would be the same for all graduates regardless of income, assuming that as students, they take out the maximum available debt.<sup>8</sup> Furthermore,

<sup>8</sup> As discussed in Dearden, Fitzsimons and Goodman (2004), students would be well-advised to take out the maximum level of debt available to them, and to save any money they could have put towards

the subsidy that graduates would receive from the taxpayer for these loans would be determined solely on the basis of their monetary success in the labour market once their studies have been completed.<sup>9</sup>

Figures 4 and 5 show the various components of the sources of finance for students under the proposed simplifications, for students living away from home outside London and in London respectively. Both figures again assume that universities charge £3,000 for tuition fees per year.

The relative merits of the suggested simplifications are revealed through comparing figures 1 and 2 with figures 4 and 5. The latter two are less complex and therefore relatively easier to decipher. Further, unlike in the proposals under the HE Bill, the funding shortfall - the difference between the National Union of Students (NUS) cost of living estimate (inclusive of fees of £3,000 p.a.) and the maximum government support for students – would increase as family income increases. Under the HE Bill on the other hand, the funding shortfall does not increase with family income for students from families earning between £22,360 p.a. and £33,630 p.a.<sup>10</sup> The proposed simplifications therefore also embody greater progressivity.

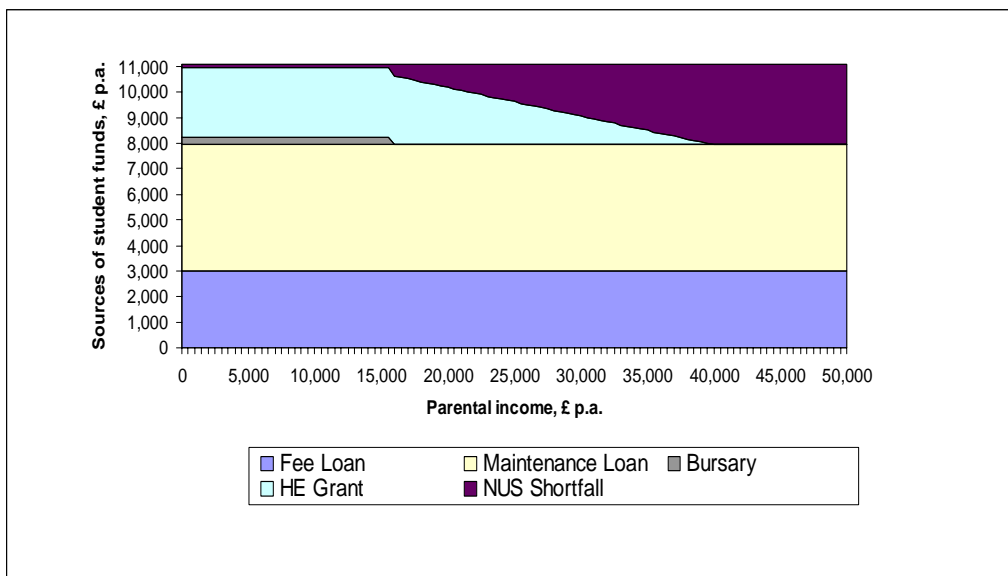


**Figure 4: Non-London student finances under the proposed simplifications, with fees of £3,000 p.a.**

fee repayment in an interest-bearing bank account. This is due to the large government subsidies involved in the loan repayment terms.

<sup>9</sup> In Dearden, Fitzsimons and Goodman (2004), we show that those who receive the largest subsidy are those who are the least successful in terms of labour market earnings.

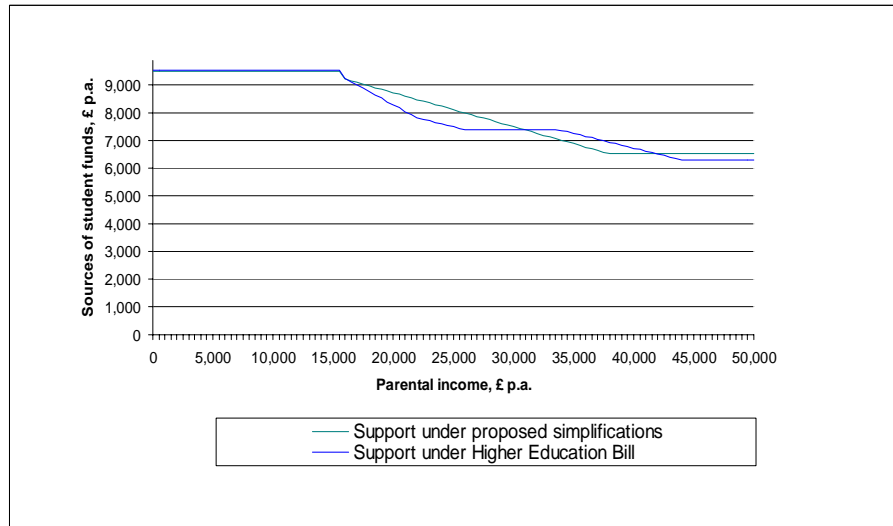
<sup>10</sup> For London students the shortfall is £1,923 per year across this income range. For non-London students it is £2,485 per year.



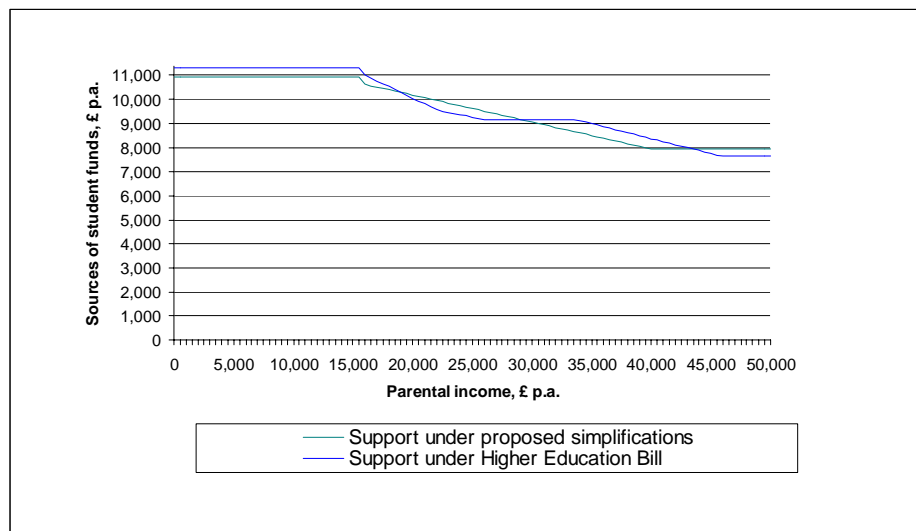
**Figure 5: London student finances under the proposed simplifications, with fees of £3,000 p.a.**

## Who gains and who loses under the proposed simplifications?

In order to ensure that the proposals are revenue neutral, there will inevitably be winners and losers, relative to the proposals set out in the HE Bill.<sup>11</sup> This is illustrated more clearly in figures 6 and 7, which show the maximum level of support available to students under the government and the proposed changes, for students living away from home outside London and in London respectively.



**Figure 6: Non-London student support: Higher Education Bill and proposed simplifications**



**Figure 7: London student support: Higher Education Bill and proposed simplifications**

<sup>11</sup> It is important to point out that all students gain relative to the current (2004-2005) system. However, under both our proposed simplifications to the system and the government proposals, graduates will have higher maximum debt levels due to increased tuition fees, compared to the current system.



Figure 6 shows the gainers and losers for students living away from home outside London under the proposed simplifications. Individuals who gain are from families with incomes between £15,000 p.a. and £30,000 p.a. and those who lose are from families with incomes between £30,000 p.a. and £42,500 p.a.

As shown in figure 7, the gainers and losers living away from home in London, are slightly different. It is worth noting that under the HE Bill proposals, the maximum support for those with family incomes below £15,970 p.a., in fact exceeded the NUS cost of living estimates. If the government were instead to provide support exactly equal to the NUS level, students from families earning below £20,000 p.a. would face modest losses. Students from families earning between £20,000 p.a. and £30,000 p.a. gain, and those from families earning between £30,000 p.a. and £45,000 p.a. lose out. Both in and outside of London, students from families earning above £45,000 p.a. gain slightly. This is due to our having proposed increasing the maximum maintenance loan from 75% to 80% of median living costs (to ensure simplicity).

### **Are any other changes worth considering?**

Under both the government proposals and our suggested simplifications to the proposals, there are significant funding shortfalls for students from families on medium to high incomes. Whilst it is reasonable to expect these families to make up for some of the shortfall, this will be much more difficult for those with other dependent children in full-time education, especially if they have more than one child in higher education.

We believe that the government should consider the possibility of taking family size into account in assessing the amount of the HE grant paid to students. The following suggestion is based on the current Australian system<sup>12</sup>

1. Reduce all income thresholds for grants by approximately £2,000
2. Allow families to reduce their assessable income by
  - a. £500 for the first child under 18 in full-time education.
  - b. £1,000 for each additional child under 18 in full-time education.
  - c. £1,500 for each child 18 or over in higher education and living at home.
  - d. £2,500 for each child 18 or over in higher education and living away from home.

As with our other proposals, the exact details would need to be adjusted in order to ensure revenue neutrality, but we believe that this is an important issue that requires further consideration.

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<sup>12</sup> See [http://www.centrelink.gov.au/internet/internet.nsf/payments/parent\\_income\\_iat.htm](http://www.centrelink.gov.au/internet/internet.nsf/payments/parent_income_iat.htm)