

H.E.L.P. UK

**A new Higher Education Loan Programme:
adding to the debate on funding**



#HELPUK

UA
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Executive Summary

We need to underpin a higher education sector that can drive the UK's competitiveness in a global knowledge economy and can anticipate a new labour market shaped by rapid changes in technology, globalisation and increased economic uncertainty. This needs to be about more than just supporting school-leavers entering higher education as the current system does. It needs to be about developing and growing global talent – supporting creativity, innovation, knowledge creation and application alongside global citizenship in all of our graduates.

HELP UK offers clear thinking and simple steps to enabling universal access to student loans for the first time, bringing down the massive cost of the current loans system and re-balancing the contribution between government and the individual to higher education. HELP UK has been developed with extensive economic modelling, student and parent surveys and workshops across Alliance universities, and comparisons of funding systems across the globe.

Our proposals have been guided by contributions from experts and leaders from across the higher education sector and beyond.

We would like to thank:

- Professor Ian Diamond, Vice-Chancellor, University of Aberdeen;
- Julian Gravatt, Assistant Chief Executive, Association of Colleges;
- Professor Bruce Chapman, Crawford School of Public Policy, Australian National University;
- Vicki Thompson, Executive Director, Australian Technology Network;
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- Vivienne Stern, (when) Head of Political Affairs, Universities UK; and
- Dr Lynne Sedgemore, Executive Director, 157 Group.

We would like to thank Dr Alison Johnston, Assistant Professor in Comparative Political Economy at Oregon State University, for her expert modelling and analysis of our loan model proposals (see Annex 1 for details). We would also like to thank the Institute For Fiscal Studies for permission for Dr Johnston to use their lifetime salary path data, which made this modelling possible. Dr Johnston was familiar with this data and had undertaken previous analysis for published articles with Professor Nicholas Barr at the London School of Economics.

Our proposals present options for further debate and consideration that University Alliance would like to progress and are not necessarily the views of these contributors. University Alliance takes full responsibility for what is presented in this publication as a model or framework proposal.

HELP UK¹: what problem are we trying to fix

There are two fundamental problems with our current higher education funding and student finance system that need addressing:

- First, that the projected public subsidy on existing student loans is too high; 45% and growing. If these projections are right, it means that for every £1 the government gives out in student loans, they will only get 55p back. The growing cost of this loan subsidy is not sustainable in the medium or long term.
- Second, that postgraduate students and two thirds of part-time undergraduate students do not have access to a student loan under the current system. We've seen a 40% drop in part-time and mature entrants since 2011-12. Again, this will ultimately lead to an underinvestment in UK higher education and an undersupply of postgraduates to the labour market.

In 2012, the first English-domicile undergraduate students went to university with a £9,000 maximum fee in the UK. Despite removing 85% of direct public funding for university teaching, we now know that this system is costing the government more than the previous system. The government is having to allocate billions of pounds to subsidise the projected non-repayment of student loans.

Our intention is to demonstrate a student loan model that carries virtually zero public subsidy and, therefore, can be offered to virtually all students. Our aim is to demonstrate a student loan model that would radically reduce the public subsidy whilst maintaining an affordable and progressive repayment system for graduates.

We also want to show that this is in line with the preferences of students and parents.

HELP UK learns lessons from our international competitors, particularly the Australian system, to identify a funding system for the UK that is fit for the future. HELP UK allows for a growing and diverse system, ranging from largely publicly-funded higher education with moderate levels of private contribution, right through to provision that is entirely market driven and privately funded. Our proposals would offer, for the first time, a system that does not differentiate between part-time and full-time students but instead treats all students in relation to their chosen workload.

Creating a well-designed higher education funding and student finance system is critical. The UK needs a truly diverse higher education ecosystem that is fit for purpose in a 21st Century economy as the labour market adapts to rapid changes in technology, globalisation and increased economic uncertainty.

¹ Higher Education is a devolved responsibility but the student loan system is UK-wide. See p23.

Transparency and the balance of contribution

We know there are significant public and private benefits to higher education. These benefits – or rates of return on investment – have been used to justify a private contribution to higher education alongside significant public investment. The introduction of £9,000 fees gave the impression that 100% of the cost for many courses would be paid by the student. Given the high levels of public return to higher education, this would not have been an optimum solution.

In some individual cases of high earners, the full £9,000 annual fee will be repaid by the individual but in the vast majority of cases this is not occurring. Despite a £9,000 ‘sticker price’ annual fee, the average graduate will actually contribute the equivalent of a £5,000 annual fee because of the high levels of loan subsidy in the system. Across the system as a whole, the balance of contribution is actually about 50:50 between the individual and the state². Arguably, the problem with the current system is not the overall balance of public and private contribution, it is the lack of transparency in a system based on high fees and high loan subsidies.

This lack of transparency is a problem in terms of students’ perception of the contribution they are being asked to make. For Government, it means they are getting very little recognition for the billions of pounds they are investing in higher education via invisible loan subsidies. Furthermore, the design of the system gives them little control over the direction of this public investment across the system in line with strategic priorities.

HELP UK: what are we proposing?

The UK Higher Education Loan Programme (HELP UK) would establish a system of publicly supported higher education loans, without these loans having to carry a public subsidy. HELP loans would maintain a progressive repayment system that protects low earners, keeping the earning threshold at £21,000 before you have to start contributing. Removing the subsidy on loans means a more transparent system with a single student loan model that would operate in support of the full range of diversity of provision of higher education; from publicly-subsidised higher education through to market-driven higher education that is entirely privately funded.

What students and parents told us they want

Following the student protests after the introduction of £9,000 fees, there has been a great deal of nervousness about changing anything to do with the current system, including the student loan system and repayment conditions. It was our contention, however, that students were protesting about the introduction of £9,000 fees and what they perceived to be the wholesale shift of the burden of cost to the student, rather than about the monthly repayment rate of the loan system.

The balance of contribution between the state and the individual is an important issue. In a system with high ‘sticker price’ fees and then large subsidies on loans, this is a confusing issue. We believe the system could be improved for both students and government by

² See figure 4 in “HELP from Down Under: A comparison of higher education funding in England and Australia” http://www.unialliance.ac.uk/wp-content/uploads/2014/06/HFDU_Finished.pdf

removing the majority of invisible loan subsidies, making the loan system more transparent and ensuring public investment in higher education is more visible.

Based on our engagement with students, it was our contention that students and parents would actually prefer a student loan system that supported them to pay off their loans faster. This is exactly what we found when we commissioned Ipsos MORI to survey 1,000 parents and 1,000 students³. Furthermore, this viewpoint was supported by the students that we held workshops with to discuss these options in much greater detail.

From the survey we found out that:

Parents are more concerned about the size of their child's student loan (64%) rather than the terms of repayment (29%)⁴.

By a margin of almost 2 to 1, undergraduates and parents would rather a student loan is paid back quicker, with higher monthly repayments, than longer, with smaller monthly repayments⁵.

Undergraduate students have mixed views on whether a £15,000 or £21,000 threshold for student loan repayments would be preferable – 44% were in favour of each option. Parents on the other hand would rather their children began paying at £15,000 rather than £21,000 (44% against 36%)⁶.

We ran several workshops with students to find out what aspects of the current student loan system they would like to see improved or changed. What we found from these workshops was that students would prefer to pay off their student loans more quickly. Students said:

- **“It would be ideal to have my student loans paid off by the time I’m 30 so that I’m debt-free and able to buy my first house.”**
- **“I want to be able to pay it back and relax.”**
- **“The current system means more worry all of the time. How we pay back and when. Paying off loans faster would be one thing we can take out of mind.”**

³ The online study surveyed two target groups from England to understand their opinions on university fees. Target 1 was made up of male and female undergraduate students aged 18-24 and target 2 consisted of male and female parents who were aged 25+ and had a child aged under 24 years old. The survey was conducted using an online panel methodology and fielded from the 7th May 2014 to 16th May 2014 to achieve 1000 completes per target (No quotas were applied in field).

⁴ When parents were asked whether they were more concerned about the size of a student loan or the terms of repayments, 64% felt the size of the loan was the biggest concern.

⁵ When parents and students were asked whether they would prefer to pay (or their child to pay) small monthly payments for approximately 25 years (incurring more interest) or higher monthly repayments for approximately 10 years (incurring less interest) 47% of students and 40% of parents preferred the higher repayments for a shorter time, compared to 29% of students and 21% of parents in favour of the former option.

⁶ When asked which earnings threshold students preferred, £21,000 but pay for longer or £15,000 and pay off shorter, 44% were in favour of a £15,000 threshold and 44% preferred a £21,000 cap. For parents this was 44% and 36% respectively.

Part 1: Design of the Higher Education Loan Programme (HELP)

HELP UK would introduce a well-designed student loan system where the vast majority of graduates pay off their loan in full and the public subsidy is virtually zero. HELP UK would be based on a **maximum life-time loan allocation**, to enable all graduates to re-train and up-skill throughout their career; essential in a globally competitive economy.

HELP UK would ensure that all students contribute on the basis of future earnings so that university remains free at the point of use. Repayment contributions would be a progressive percentage of *total salary* and interest rates would be subsidised for low-earners so that the total loan debt cannot increase. The earnings threshold for repayment would be kept at £21,000 to protect low earners. The average repayment period would be reduced from 28 years in the current system to a much shorter period to reduce the burden of graduate debt over their lifetime.

The University Alliance / Ipsos MORI survey of 1,000 students and 1,000 parents found that these changes to student loan repayments, that would see graduates pay higher monthly repayments in order to repay their loans faster, were in line with their preferences.

Part 2: A staged roll out of HELP UK

Stage 1: Post-graduate HELP (PG-HELP)⁷

We are proposing a staged roll-out of HELP loans that would start with loans for taught postgraduate students (PGT). The University Alliance / Ipsos MORI survey found that:

60% of undergraduate students feel that having an upfront fee with no loan available makes them less likely to undertake a postgraduate degree. Two-thirds feel that access to a student loan would make them more likely to study for a postgraduate qualification⁸.

Stage 1 would be to offer PG-HELP to all UK taught postgraduate students on non-subsidised postgraduate courses (including all postgraduate students at for-profit institutions) as a maintenance loan to help cover the cost of any fees and / or living costs. PG-HELP loans would be available for all UK-domicile students that were below their life-time maximum HELP loan allocation. PG-HELP loans would be offered with a maximum loan value in any one year of £9,000 to help contribute towards fees and living costs. The in-year maximum loan value would have to be considered carefully in terms of its impact on postgraduate fees set by universities.

⁷ Wherever there is reference to PG-HELP this refers to postgraduate taught students (PGT).

⁸ When students were asked what effect the up-front fee with no loan for postgraduate study had on their likelihood to undertake a postgraduate degree 60% said it would make them less likely. When asked what effect a student loan for postgraduate study would have on their decision to undertake a postgraduate degree 66% thought it would increase the likelihood.

At first, PG-HELP loan repayments would have to be made alongside old-system undergraduate student loans. This is no change from the current system whereby anyone securing a bank loan to help cover the costs of their postgraduate education would have to start paying that loan back straight away (and alongside their undergraduate student loans if they earn over £21,000). Even as an interim arrangement, PG-HELP would be an improvement on the current system because it would protect low earners to ensure they have nothing to pay until they reached the earning threshold for repayments. If HELP UK were ever fully rolled out across the whole system, all HELP loans could be combined into a single repayment on an income-contingent basis.

Stage 2: Undergraduate-HELP (UG-HELP)

Stage 2 would be to offer UG-HELP to all UK undergraduate students on non-subsidised undergraduate courses (including all undergraduate students at for-profit institutions) as a maintenance loan to help cover the cost of any fees and living costs. UG-HELP would be available for all UK-domicile students that were below their life-time maximum HELP loan allocation. UG-HELP loans would be offered with a maximum loan value in any one year.

As with PG-HELP, at first UG-HELP loan repayments would have to be made alongside old-system undergraduate student loans until HELP UK is fully rolled out across the whole system, at which point all HELP loans would be combined and a single repayment on an income-contingent basis.

PG-HELP and UG-HELP would ensure that there is a part of the HE system that is highly flexible, demand-driven, responsive to market forces and can expand at virtually zero cost to the public purse. PG-HELP and UG-HELP would be critical to ensuring the UK achieves a truly diverse HE system that is fit for purpose in the 21st century as the labour market adapts to rapid changes in technology, globalisation and increased economic uncertainty.

PG-HELP and UG-HELP would, for the first time, ensure that every student has access to a government-backed loan to help pay towards the cost of studying.

The new design loan system would ensure this was possible at virtually zero cost to government by drastically reducing non-repayment of loans.

Stage 3: HELP for first-time undergraduates⁹

The final stage of our proposals is to put forward a range of options for a HELP loan for those students currently studying within the £9,000 fee regime (all first-time undergraduates). In setting out a range of options for the first-time undergraduate system, we are not recommending or endorsing any particular option, rather we are seeking to contribute to the debate regarding the affordability and sustainability of funding for these students.

⁹ All first time undergraduates *and* students on equivalent or lower qualifications (ELQ) whose subject is exempt.

Option 1. Status quo

PG-HELP and UG-HELP could run alongside the existing £9,000 fee system with no changes needed.

- ✓ Stability
- ✗ Does not address the affordability, sustainability or transparency of the current system

Option 2. HELP plus £9K fee regime

HELP loans could replace existing student loans but with no changes to the £9,000 fee regime.

- ✓ Stability
- ✓ Graduates get to pay off their loans faster
- ✗ Would raise serious questions about the balance of public: private investment in HE with students carrying the vast majority of the cost

Option 3. HELP plus lower fees

Savings from loan subsidies could be re-directed into direct funding for teaching to reduce fees for students.

- ✓ Lower fees, lower debt and shorter repayment periods for students
- ✓ A more transparent system where fee levels more accurately reflect graduate contribution
- ✗ Courses possibly more at risk of reduction in direct public investment - would risk reduction in the quality of UK HE, the capacity to deliver world-class graduates and, therefore, the global competitiveness of UK HE and UK PLC

Option 4. HELP plus differentiated fee bands

Savings from loan subsidies could also facilitate a system of differentiated fees where the government set a range of fee bands by subject or groups of subjects with varying levels of direct public funding to ensure courses were fully funded.

- ✓ Even greater transparency in the system
- ✓ A highly visible balance of public: private contribution by subject
- ✗ Could become a complex system if too many fee bands are chosen
- ✗ Possible access issue for subjects in higher fee bands

Principles of a well-designed loan system

Student loans facilitate a shared contribution to the cost of studying, recognising the considerable private returns that exist alongside the public returns to higher education.

A well-designed student finance system should be based on a system of income-contingent student loans (the UK already has this in place). These loans are most likely to be government loans because of the lack of collateral involved in borrowing on the basis of human-capital and because governments will be more willing to protect low earners. Income-contingent student loans are by far the most effective way of providing a method of consumption smoothing that protects low earners and resolves issues around the upfront cost of studying.

The problem with our current income-contingent loan system is that it is not achieving high enough repayment levels, due to the repayment conditions. This makes it a highly expensive loan system for government, which is why these loans are only available to certain students. Relatively minor changes to the loan design would resolve this without the need for radical change.

A well-designed student loan system would be based on the following principles:

- Repayments must be affordable for graduates, based on income-contingent repayments and protection for low-earners
- Student loans should be available to virtually all students to cover the cost of fees
- The vast majority of graduates should repay their loans in full over time (over 85% of graduates will not pay back their loans in the current system, leading to the high cost of loans to the government)
- Ensure affordability for government by minimising public subsidy on loans

A student loan system will require public subsidy when the total amount repaid is less than the total amount owed. The current student loan system in the UK carries a 45% subsidy because 45% of the loan value will not be repaid. Our intention is to demonstrate that it is possible to design a student loan that carries much lower public subsidy (possibly even zero subsidy) and, therefore, can be offered to virtually all students. In fact, there is already such a loan operating in the Australian system that operates as a good proof of concept. Undergraduate FEE-HELP in Australia is available to all undergraduate students that are not on a publicly-subsidised course. The loan carries a 25% surcharge that gets added to the loan. The effect of this is that the loan itself carries virtually zero public subsidy.

There may be reasons to choose to subsidise a student loan system, for example to subsidise low-earning graduates, but this should be an intentional subsidy for higher education courses that the government is choosing to invest public resource towards. Certainly we should not start with a 45% subsidy on all student loans.

The level of public subsidy on student loans is largely determined by non-repayment and interest-rate subsidy. The level of non-repayment is governed by a range of factors including:

- total loan value (the higher the loan value, the higher the rate of non-repayment is likely to be)

- repayment rate (the higher the rate of repayment, the lower non-repayment is likely to be)
- earnings threshold (the higher the earnings threshold for repayment, the higher the rate of non-repayment is likely to be. This is a balance between protecting low earners and reducing non-repayment)
- interest rate (although a real interest rate should help bring down non-repayment and is highly progressive, a high real interest rate can actually increase rates of non-repayment of loan if it extends many more graduates beyond the write-off period for the loan)
- write-off period (the shorter the loan period before the loan is written off, the higher the rate of non-repayment is likely to be)

Design of the Higher Education Loan Programme (HELP)

With these principles in mind, we modelled variations of earning thresholds, repayment rates, interest rates, write-off periods and surcharges to identify various loan designs that would remove the vast majority (if not all) of the subsidy on student loans.

We have chosen one model to outline below (Figure 1) in comparison to the current system. Please bear in mind that this is an illustrative model. The modelling we undertook had to be based on historic earning projections. If any government wished to adopt these proposals, they would have to undertake more detailed and accurate modelling to identify the parameters that would deliver a non-subsidised loan system. Nevertheless, the model is an important illustration of what small changes to the loan design can deliver – and in line with the preferences of students and parents.

Figure 1 compares the repayment conditions of student loans in the current system compared to HELP loans. Please note that we have not had to reduce the earnings repayment threshold, increase the write-off period or introduce a surcharge in order to significantly reduce the subsidy on loans.

Figure 1: A comparison of student loan repayment parameters (illustrative)

	Current system	HELP loan
Earnings threshold	£21,000	£21,000
Real interest rate	Up to 3%	Up to 4%
Repayment rate	9% of earnings over £21,000	4%-8% of total earnings once over threshold
Write-off period	30 years	30 years
Surcharge on loan	0	0

See Annex 1 for details of modelling and methodology

HELP loans would facilitate loan access to all students for the first time, including a lifetime loan allocation to assist re-skilling and up-skilling in a changing economy. In terms of the repayment system, Figure 1 demonstrates the relatively minor adjustments to some of the variables that allow HELP loans to achieve a much lower subsidy. Although not a like for like comparison with the current UG system, we have been able to deliver a PG-HELP loan with virtually zero public subsidy and an average repayment period of just over 8 years. Again, this model is illustrative. There are numerous ways to adjust the graduate repayment variables to achieve this outcome. Indeed, we have also modelled for including a 10% surcharge, which allowed us to bring the real interest rate down to a 2% maximum (lower than existing loans) and achieve the same outcomes of an average repayment period of just over 8 years and zero subsidy on loans.

We have demonstrated a model that we believe is in line with student and parent preferences but more detailed modelling would be required if HELP loans were to be implemented.

HELP graduate repayment system

Figure 2 illustrates HELP graduate repayment levels by earnings. No graduate earning under £21,000 will be asked to make a contribution, as in the current system. Rates of repayment are then between 4% and 8% of total earnings, on a progressive basis, in order to ensure repayments are affordable. This repayment system would allow graduates to finish repaying their loans much sooner compared to the current system.

Figure 2: HELP graduate repayment system (illustrative)

Annual salary	Repayment rate	Annual HELP contribution	Monthly earnings after tax ¹⁰ (net income)	Monthly HELP contribution	Monthly HELP contribution as % net income (progressive)
£20,000	0%	£0	£1,380	£0	0%
£21,999	4%	£880	£1,436	£73	5%
£24,999	4%	£1,000	£1,651	£83	5%
£29,999	5%	£1,500	£1,935	£125	6%
£34,999	6%	£2,100	£2,218	£175	8%
£39,999	7%	£2,800	£2,502	£233	9%
£50,000	8%	£4,000	£2,997	£333	11%

See Annex 1 for details of modelling and methodology

¹⁰ Based on 2013-14 tax system <http://www.thesalarycalculator.co.uk/>

For those concerned about the high marginal tax rate involved in moving to a system based on a progressive percentage of *total* salary, in comparison to the existing system which takes a percentage of salary above the earnings threshold, please note that the Australian system operates the same system of 4% - 8% of total earnings. Research based on the Australian system has proven that some 'bunching' does exist just below the thresholds but it is very short lived as graduates seek to progress through their career and earn higher salaries (Bruce Chapman and Andrew Leigh¹¹).

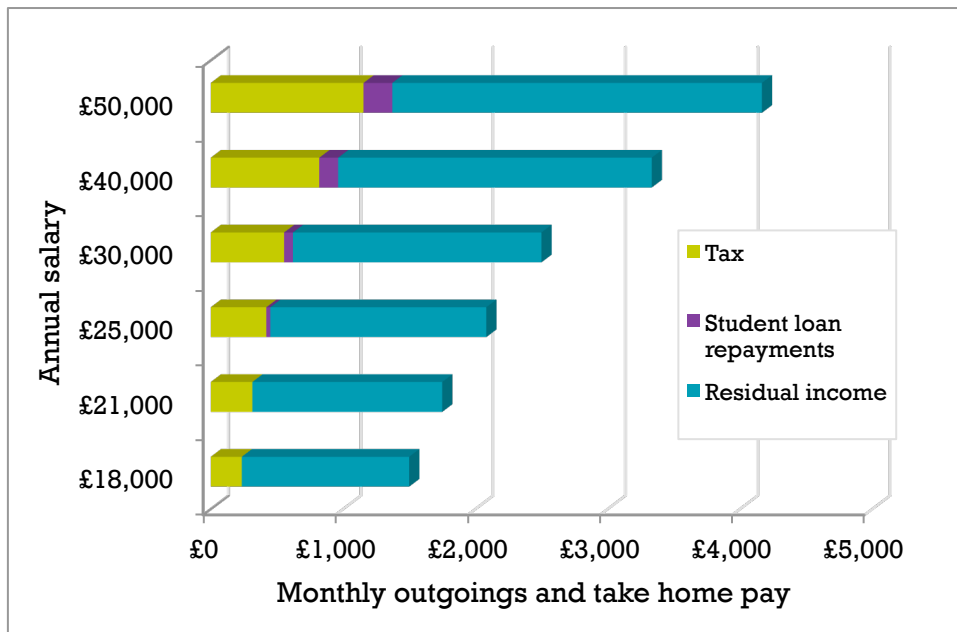
Progressivity and affordability assessment

The final column of Figure 2 above demonstrates the monthly HELP repayment level as a percentage of monthly net income after tax for different salaries. Figure 2 clearly demonstrates that this is a highly progressive contribution scheme; designed as such to ensure affordability for lower earners. At the lowest level of earning just above the repayment threshold (£21,999 annual salary), the HELP repayment contribution is less than 5% of net monthly income after tax. A separate affordability assessment / comparison has been undertaken for PG-HELP and UG-HELP (compared to the repayment rates of a private bank loan – the only alternative for these students) and if HELP loans were offered to first-time undergraduates in place of current student loans (using data on average rental costs in Greater London) to demonstrate affordability of monthly HELP contributions.

Figures 3 and 4 compare the student loan repayments for the current system and HELP system for different annual salary points. They illustrate the level of tax, loan repayment and then take home pay (residual income) for different annual salary points. These figures illustrate the slight increase to monthly repayments of HELP loans compared to the current system. They also, however, demonstrate the very small difference this makes to take home pay. They demonstrate that both affordability and progressivity of the current system is maintained in the HELP loan system.

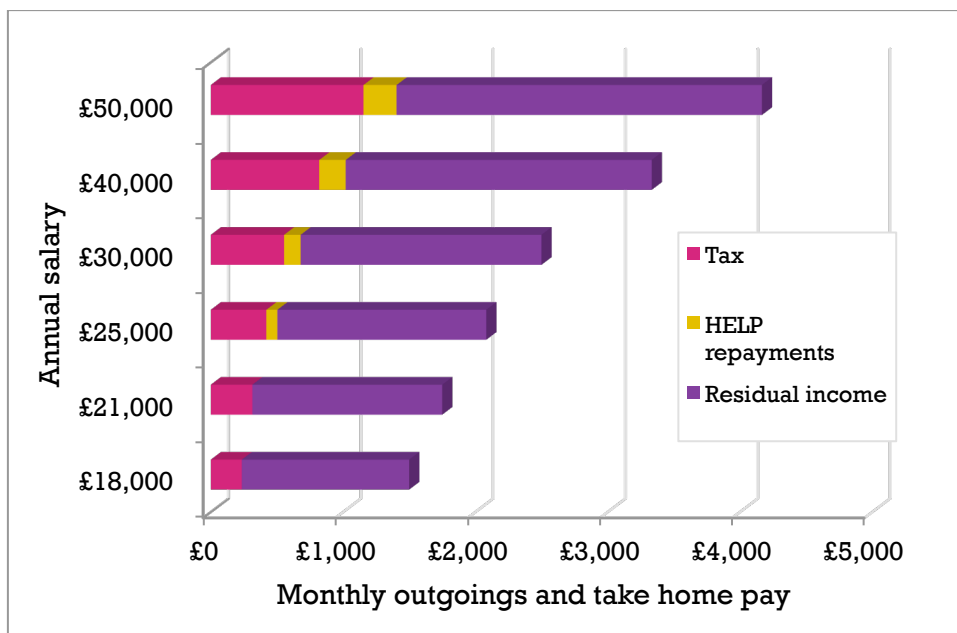
¹¹ <http://ideas.repec.org/p/auu/dpaper/521.html>

Figure 3: Current student loan repayments - 9% of earnings over £21,000



See Annex 1 for details of modelling and methodology

Figure 4: HELP repayments - 4%-8% of total earnings, once earning over £21,000



See Annex 1 for details of modelling and methodology

Stage 1: PG-HELP

HELP loans would, for the first time, make government loans available to postgraduate students with protection for low earners and income-contingent repayments. PG-HELP would apply to all UK-domicile students studying on a taught postgraduate course, including low-intensity part-time postgraduate courses and all courses at for-profit, private institutions.

PG-HELP

- Students would be charged a fee to cover the full cost of their programme.
- Fee levels would be decided by the institution, controlled only by market forces and no student number controls would exist in this part of the system.
- PG-HELP would be available to cover the cost of fees and living up to an annual maximum of £9,000 and a lifetime maximum to be decided by the government.
- The HELP graduate repayment system remains the same for all HELP loans, including a £21,000 earnings repayment threshold.
- PG-HELP loans could have a 10% surcharge added to the loan to bring the real interest down to a maximum of 2% if this was thought to be preferable.
- This system is projected to run at zero cost to government in the long-term providing a part of the HE system that can expand at zero cost to the public purse.
- Regulatory requirements would exist to manage new providers entering the system in order to protect the public interest. In light of lessons learnt from other countries, entry thresholds / requirements would be maintained at a high level with the Higher Education Funding Council for England (HEFCE) and Quality Assurance Agency (QAA) then able to support and regulate new entrants to the market.

Affordability assessment for PG-HELP

There is no government loan available for postgraduate students at present so, for an affordability comparison, we shall consider repayments for a private bank loan shown in Figure 5 below. The loan value we have assumed is £9,000 for a 1 year postgraduate.

Figure 5: example of private bank loan

Loan value	Average interest rate (fixed APR)	Length of repayment	Fixed monthly repayments	Total amount repaid
£9,000	6%	5 years	£174	£10,439

Figure 6: (condensed) HELP graduate repayments (illustration)

Annual salary	Repayment rate	Annual HELP contribution	Monthly earnings after tax ¹² (net income)	Monthly HELP contribution	Monthly HELP contribution as % net income (progressive)
£20,000	0%	£0	£1,380	£0	0%
£24,999	4%	£1,000	£1,651	£83	5%
£34,999	6%	£2,100	£2,218	£175	8%
£60,000	8%	£4,800	£3,480	£400	11%

See Annex 1 for details of modelling and methodology

Figure 5 and Figure 6 demonstrate the key differences between a fixed term private bank loan and a HELP government loan based on income-contingent repayments. The most significant difference is risk. With a fixed repayment schedule and fixed repayments, postgraduates have to start paying back their loan immediately (regardless of earnings) and at a fixed level of repayment (regardless of earnings). This is a significant risk to take, particularly in the current job market. A small percentage of postgraduates will be able to access a Professional Career Development Loan (PCDL), where the government covers the interest rate until the point of graduation and secures a favourable interest rate but, again, the loan still has to be repaid as soon as you finish your studies (regardless of income) and at a fixed level of repayment (regardless of income).

HELP loans would, for the first time, make government loans available to postgraduate students with protection for low earners and income-contingent repayments. This transfer

¹² Based on 2013-14 tax system <http://www.thesalarycalculator.co.uk/>

of risk from the individual to the government is a critical element of supporting fair access to postgraduate education regardless of personal wealth or guaranteed future earnings. The repayments would not reach the levels of an equivalent private bank loan until the postgraduate reached annual earnings of £35,000. With average postgraduate starting salaries of around £24,000 (2008)¹³, this would suggest many postgraduates would benefit from HELP income-contingent repayments compared to a fixed term loan but the removal of risk for very low earners is far more important.

Stage 2: UG-HELP

UG-HELP would apply to all UK-domicile students studying on an undergraduate course that fall outside the publicly-supported system (estimated 10-15% of all undergraduate courses), including low-intensity part-time undergraduate courses and all undergraduate courses at for-profit, private institutions. All part-time student would have access to HELP loans on a pro-rata basis in accordance with their study load. The same life-time maximum loan allocation would apply to allow flexibility for the student whilst also ensuring there is a cap on government liability.

UG-HELP

- UG-HELP would operate in exactly the same way as PG-HELP including an annual maximum to support fees and/or living costs and a lifetime maximum of HELP loans.
- More detailed modelling would be required to assess the likely non-repayment level from this cohort. If levels of non-repayment were higher than other cohorts, such as postgraduate students, it would be possible to add a surcharge onto UG-HELP to cover any additional non-repayment across the cohort. This would ensure that UG-HELP was a non-subsidised loan system, if that was considered necessary.

Affordability assessment for UG-HELP

UG-HELP is designed for those undergraduate students for whom there is no government loan available. Therefore the comparison should be made to private loans (see Figures 5 and 6 above).

¹³ http://www.suttontrust.com/public/documents/1Sutton_Trust_Postgraduate_report_01032010.pdf

Stage 3: Options for first-time undergraduates

Having achieved a well-designed student loan system, the 4 options set out below look at how HELP loans could be applied to the existing system of £9,000 fees to address issues of affordability, sustainability, flexibility and transparency in the system. Our aim is to contribute to the funding debate rather than to endorse any particular option.

Option A: Status Quo

It is important to recognise that nothing need be changed regarding the £9,000 fee system and this would not affect the feasibility of introducing PG-HELP and UG-HELP elsewhere in the system to provide student loans where there are currently none available. The advantage of this approach would be to provide some stability in the part of the HE system that has experienced significant change in recent years in moving to the £9,000 fee regime. The disadvantage of this approach is that it does not address questions about the sustainability or transparency of a system investing billions of pounds into invisible loan subsidies.

Option B: HELP plus £9K fee regime

One option would be to maintain the £9,000 fee regime but to introduce HELP loans to replace the existing student loan design. This would significantly reduce the subsidy on first-time undergraduate student loans from 45% to around 15%, based on our best-guess modelling, creating a more sustainable and more transparent system. Introducing HELP loans would also allow graduates to repay their loans faster, through slightly higher monthly repayments, allowing them to be free of student debt at a younger age.

This approach would, however, raise serious questions about the balance of public:private investment in the provision of higher education. Despite the £9,000 headline fees, our current system achieves an approximate 50:50 balance of private:public investment in higher education provision because of the 45% subsidy on loans. If this subsidy was removed, or significantly reduced, without a reciprocal increase of direct public investment in higher education provision, this would significantly change the balance; resulting in much higher proportion of private investment and lower public investment. Given the significant rate of return on public investment to higher education, this would be difficult to justify.

Option C: HELP plus lower fees

Another option would be to introduce HELP loans to first-time undergraduates and re-direct some of the savings in loan subsidy back into direct public investment for teaching. This is not a like for like exchange (because you would be re-directing savings in a non-cash adjustment into direct public funding) and would not be done on a like for like basis, but it is both legitimate and possible to suggest that some increase in direct funding for teaching might be possible through this approach.

The benefit of doing so would be to reduce fees (slightly) for undergraduates and, therefore, to reduce the length of loan repayment for graduates. Indeed, a combination of lower fees and higher monthly HELP loan repayments would allow graduates to repay in a much shorter period of time compared to the current system. Because the loans would carry much less subsidy, this approach would also offer the most transparent and visible demonstration of shared contribution towards the cost of studying; in other words, the sticker price fee will be a much more accurate reflection of an individual's contribution towards the cost of studying over time. This might help to restore the social contract between students and government, based on shared contribution towards the cost of studying, that has been lost through the confusing £9,000 fee regime with high sticker price fees alongside massive but invisible loan subsidies.

Re-directing public spending in higher education back into direct funding for teaching would also allow for more strategic investment in priority areas or subjects. The added value, or return on investment, from Government spending in higher education would also be more visible, helping to protect this investment.

Others might argue that the disadvantage of this system might be a risk to the level of direct public investment in higher education in future years given university funding is not a protected area of government spending. Consequently, this would mean a risk to the unit of resource of funding to high quality higher education programmes. To reduce this investment would not only risk the international competitiveness of UK HE as an important export good but also risk the quality of HE provision and training and therefore risk the future prosperity of a nation whose economy is dependent on highly skilled, innovative graduates.

In assessing this risk, however, we need to consider that public investment in higher education is not necessarily any safer through the subsidy of student loans. The case for public investment in higher education will need to continue to be made regardless of the funding mechanism used to direct that funding. A more transparent system that demonstrates the return on investment in strategic priority areas for Government may be no bad thing.

Option D: HELP plus variable fee bands

Similar to Option C, introducing HELP loans to first-time undergraduates (saving billions in loan subsidy) would also allow for a system of variable fees where the government set a range of fee bands by subject or groups of subjects. This would be similar to the current Australian system of three fee bands. These would then sit alongside a range of public funding bands to ensure that each course is fully funded.

The benefit of this approach is even greater transparency. A highly visible share of private and public contribution towards the cost (or value) of a course that varies by subject. The government would determine the balance of contribution. In the current Australian system this is decided on the basis of a combination of cost of delivery, market return for that course, and political factors (e.g. increasing the proportion of public investment for strategic subjects or vice versa). Differentiated fees would also allow for the possibility that some fees might be above £9,000 for some courses.

The possible disadvantages of this approach would be around complexity, stability and, most importantly, whether access to some courses might be affected by higher fees. This has not been the case with £9,000 fee regime but it is at least possible that some students might be more price sensitive in terms of subject choice.

Given the range of options available for first-time undergraduates we have not modelled these various options, although it would be possible to do so against the parameters set out here. It would be necessary to do detailed modelling based on the best data available in order to compare and assess these options.

Alongside these options, it would be possible for government to choose to keep a small level of public subsidy on loans to cover non-repayment of lower earners in public service roles, in recognition of the public value of these roles.

Affordability assessment for HELP loans for first-time undergraduates

For the 12 months up to, and including, January 2014 the median weekly rental costs for a room in a shared house was £109 and in many areas was less than this¹⁴. Within greater London, it was possible to rent for as little as £46 a week in 2013-14. Clearly there are monthly bills, expenses and travel costs to consider but based on £21,999 earnings and £1,436 net monthly income, we would consider £73 a month for a HELP contribution to pass the affordability test as outlined in Figure 7. We would, however, recommend that this regularly reviewed to ensure HELP contributions are affordable for earners just over the earning threshold.

Figure 7: Affordability assessment for HELP loans for first-time undergraduates

Annual salary	Monthly earnings after tax ¹⁵ (net income)	Monthly HELP contribution	Median room rent in Greater London	Net monthly income after HELP and rent costs
£19,000	£1,323	£0	£436	£887
£21,999	£1,436	£73	£436	£927
£24,999	£1,651	£83	£436	£1,132
£34,999	£2,218	£175	£520 (1)	£1,523
£60,000	£3,480	£400	£1,040 (2)	£2,040

See Annex 1 for details of modelling and methodology of HELP loans

- (1) Based on upper quartile of room rental costs in Greater London <http://www.london.gov.uk/rents/>
- (2) Based on median rental costs for 1 bedroom flat in Greater London <http://www.london.gov.uk/rents/>

¹⁴ <http://www.london.gov.uk/rents/>

¹⁵ Based on 2013-14 tax system <http://www.thesalarycalculator.co.uk/>

The application of proposals

Student support

PG-HELP and UG-HELP student support

Stage 1 and stage 2 would see the roll out of PG-HELP and UG-HELP on the basis of an annual maximum (£9,000 at PG level) and a lifetime loan allocation maximum to be decided by government. The HELP loan could be used towards either fee or living costs. PG-HELP and UG-HELP would see both fee help and student support in place for these students for the first time on the basis of non-subsidised loans. Given that we know that upfront cost is a barrier to entry (including living costs) this would be a hugely progressive step to widen access to higher education at all levels. The lifetime loan allocation also provides a more flexible system driven by student choice with the opportunity to up-skill and re-skill throughout their lifetime and career.

Student support for first-time undergraduates

If HELP loans were to be introduced into the first-time undergraduate system, student support available for these students would not have to change from the current system of grants and loans.

Types of providers

These proposals intentionally do not distinguish between types of providers across the system. The only exception is that we would recommend that for-profit providers (or their students) remain solely within the PG-HELP and UG-HELP systems to ensure that these providers are not in receipt of public subsidy – either through direct investment or loan subsidy.

Within the PG-HELP and UG-HELP system students at for-profit providers should have access to loans on a like for like basis with all students on the basis that these loans do not carry any public subsidy. This would include the same life-time loan allocation for these students and with no fee caps or student number controls for the providers in this part of the system.

Eligibility: EU students

Approximately 10% of all UK students are non-UK EU students and these students make a significant contribution to academic life as well as the economic and social benefits to the UK whilst they are studying and if they stay on to work.

EU student have access to fee loans on a like for like basis with UK students, including the conditions for repayment. EU students do not, however, have access to the maintenance support that is offered to UK students within the UK, including maintenance loans. PG-HELP and UG-HELP have been categorised as maintenance loans in this report, so that they could be used towards the cost of either fees or living costs but this may need reviewing in terms of the impact on EU students.

Devolved Nations

PG-HELP and UG-HELP

Higher Education is a devolved responsibility and Wales, Scotland and Northern Ireland operate their own fee and funding system. The student loan system, however, is UK-wide. HELP UK is primarily aimed at reforming the design of student loans and the impact of doing so would, therefore, be UK-wide. These proposals have been written on the presumption that PG-HELP and UG-HELP would also be offered in Wales, Scotland and Northern Ireland to their own students studying within these countries but this does not necessarily have to be the case and would be up to the devolved nations to decide if their students should have access to these loans. If PG-HELP and UG-HELP loans were adopted in England, these loans would be available to all UK students studying in England and all English students studying in the devolved nations.

HELP for first-time undergraduates

HELP loans could, in theory, be rolled out as a UK-wide framework across the devolved nations for all first-time undergraduates to replace the current system. The method of loan repayment, including maintenance loans, would switch to HELP loan repayments should HELP UK be adopted by the UK government. The devolved nations would be no more obliged to set fees for their domestic students as they are now. Wales and Scotland could continue to subsidise Welsh and Scottish students respectively studying within country should they choose to.

Cost to government

PG-HELP would have negligible impact on public borrowing and public debt

This system has been designed to facilitate access, growth and sustainability of the HE system whilst controlling costs for government.

PG-HELP loans have been designed to be fully recoverable. Based on our modelling, we estimate these loans would carry no public subsidy and that over 50% of the total loan value would be repaid for PG-HELP within 7 years. Because our government uses accrual accounting methods, the entire value of these zero-subsidy loans would sit as long-term asset on Treasury's accounts.

It is essential that these proposals have little or no impact on both public sector net borrowing (PSNB) and public sector net debt (PSND). PSNB, or public borrowing, was around £85bn in 2012-13 down from £120bn the previous year. The coalition government have been determined to bring down public borrowing through controlling public spending and would see this as an issue of fiscal responsibility. PSND is about the total public debt, which is around £1,185 billion in 2012-13, or 75% of total GDP.

PG-HELP proposals would have a negligible impact on PSNB or PSND. This is because HELP loans would be fully recoverable. Because the UK government has moved from using cash to accrual accounting methods in line with international best practice, this means that these HELP loans would sit on government books as a long-term asset, not as a cash outgoing. The asset is the value of the loan that will be repaid. The predicted cost of non-repayment is then recorded as a non-cash cost or resource accounting and budgeting charge (RAB), which is in effect the subsidy on loan. In accounting terms this is similar to

depreciation value. In our model, all of the student loan value would sit as a long term asset on government books because the non-repayment, or RAB, is zero. Our understanding is that because the RAB is so low, there would be very little impact on either PSNB or PSND.

There would, however, be an initial impact on the Public Sector Net Cash Requirement. Introducing PG-HELP loans would see an initial increase to this measure that would then level off over time as the loan repayments started coming in. Within a relatively short period of time these loans would be self-funding in cash terms once repayment levels had built up but there would have to be an initial increase to the Public Sector Net Cash Requirement.

Is it possible to re-direct RAB savings into direct funding for teaching?

In some of our options outlined for the first-time undergraduate sector (those operating under the existing £9,000 fee regime), we suggest that savings in loan subsidy could be re-directed into direct funding for teaching – although not on a like for like basis. It is important to understand whether or not this is possible.

If you significantly reduced RAB, could you use some of these savings to increase direct public funding for teaching (the Departmental Expenditure Limit (DEL) for the Department for Business, Innovation and Skills(BIS))? In strict accounting terms, this is not a like for like transfer. RAB savings (non-cash) would not create an automatic transfer of funds into DEL (cash). However, this is all government expenditure on higher education. Whilst there would be no automatic entitlement to increase DEL based on RAB savings, there would be a very strong case for doing so.

If we take the reverse situation, we know that when RAB increases, DEL has to come down. Not only did we see this on a large scale when £9,000 fees were introduced (and direct public funding for teaching cut by 85%), we have also seen it happen more recently on a smaller scale. The most recent RAB adjustment saw Treasury having to remove around £200M from the BIS budget to compensate for the increase in RAB (on the back of declining wage projections). There is no reason why the same logic would not apply in reverse.

In our opinion, a policy decision that reduces the RAB charge would create a strong case for the DEL budget to be increased. It is on these grounds that we are able to propose some of the options outlined in our HELP system for first-time undergraduates based on a re-balancing of visible investment between the student and government without increasing the total government expenditure on higher education.

Regulation

Our recommendations would be in line with the recommendations of recent reports on HE regulation, particularly the report from the Higher Education Commission, *Regulating Higher Education*¹⁶, and the Higher Education Policy Institute (HEPI) *Unfinished Business?: Higher Education Legislation*¹⁷. Please also see the recently published University Alliance report, *How do we ensure quality in an expanding HE system*¹⁸.

We recommend that HEFCE should be established in statute as the overall regulator of all forms of higher education provision in the UK regardless of whether the provider is in receipt of any public funding or whether their students have access to loans. HEFCE should have responsibility for designating those institutions (including private, for-profit) that can offer PG-HELP and UG-HELP courses. HEFCE would establish and maintain entry thresholds for becoming an HE provider and then for delivering publicly-subsidised courses, with delegated authority to approve new providers in the system. QAA would continue to be commissioned by HEFCE to undertake the quality assurance part of the regulatory process and would continue to do so on a co-regulatory basis when it came to providers in receipt of public funding.

¹⁶ www.policyconnect.org.uk/hec/sites/site_hec/files/report/333/fieldreportdownload/hecommission-regulatinghighereducation.pdf

¹⁷ www.hepi.ac.uk/wp-content/uploads/2014/02/Unfinished-Business.pdf

¹⁸ www.unialliance.ac.uk/blog/2014/05/21/how-do-we-ensure-quality-in-an-expanding-he-system/

Annex 1: Details of loan modelling

The modelling of loan subsidy and debt forgiveness was simulated using lifetime salary path data for 20,000 graduates of undergraduate degrees, from Dearden, Fitzsimons, Goodman, and Kaplan (2008). These salaries paths, presented in 2006/07 prices in the authors' work, have been updated to 2012 prices using OECD inflation data. Estimations are for obligatory payments only (i.e. they do not consider voluntary repayments that a graduate can make in order to hasten loan repayment, as it is impossible to determine how voluntary repayments would transpire for these simulated salary paths).

Everything is in real terms, so this assumes that all parameters (debt, the repayment threshold, earns etc.) is subject to the same inflation adjustment (CPI). Inflation adjustments happen annually so the threshold would grow every year with inflation. The £21,000 threshold is only adjusted for inflation and not earnings growth as in the present system.

There are two caveats of using this data for the debt repayment simulations. One is that these salary paths are of graduates for undergraduate degrees not graduate students, as rich salary path data for the latter are currently unavailable. Because undergraduate salary paths are likely to be lower than those with graduate degrees, our estimates of loan subsidies are likely to be more **overstated** under this caveat than if we used graduate salary path data. The second caveat with the data is that these salaries have not been adjusted to take into account the recent lull in earnings during the Great Recession. Because of this, earnings paths will be inflated in graduates' early earning years, which will cause our loan subsidy calculations to be **understated** to current estimates.

In regards to graduate debt, we assume that students go straight into a one-year graduate degree program after the completion of their undergraduate degree, and finish their studies within a year (hence, debt repayment begins at the age of 23). Students repay their graduate debt on top of what they repay for their undergraduate loans. We utilize a Government discount rate of 2.2%. This discount rate has been used consistently in the policy literature (Chowdry, Dearden, Goodman, and Jin, 2012, A-2; Dearden, Fitzsimons, Goodman, and Kaplan 2008, F109; Johnston and Barr 2013, 173).

We run the loan subsidy computations under three different repayment systems. These systems include:

1. The current repayment system for undergraduate loans (£21,000 threshold, with a 9% repayment rate and a 30 year debt write off. For loan repayment plans with a real interest rate rather than a surcharge, graduates receive a targeted interest subsidy so that real debt cannot rise.
2. An Australian variant repayment system where repayment rates are progressive according to income bracket and apply to the graduate's entire income, rather than that above a certain threshold. Repayment begins once a graduate's income is higher than £21,000 (see Table 1 below for the precise repayment rates). Like the plan above, there is a 30 year debt write-off, and a targeted interest subsidy so real debt cannot rise.
3. An Australian repayment system identical to that in plan 2, but with a 10% surcharge added to the loan, which reduces the real interest rate needed to reach zero subsidy. There would still be a targeted interest subsidy so that real debt cannot rise.

Table 1: Repayment rates under the £21,000 threshold Australian variant system

<i>Income</i>	<i>Rate of Repayment for total income</i>
<i>21,000-24,999</i>	4%
<i>25,000-29,999</i>	5%
<i>30,000-34,999</i>	6%
<i>35,000-39,999</i>	7%
<i>40,000+</i>	8%

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