

## Press Release

# Future Arrangements for Funding Higher Education

The system of higher education finance in England is currently under formal independent review. The review, chaired by Lord Browne, will be taking evidence up to May 2010.

In “Future arrangements for funding higher education”, IFS researchers, funded by the Nuffield Foundation, highlight some of the trade-offs that would be involved in reforming the current system of fees and loans applying to full-time undergraduate study<sup>1</sup>.

Our analysis shows, in summary, that:

### The current system:

- For every £1 loaned by the government to students to cover maintenance and fees, our simulations suggest that the taxpayer contributes 23p, or around £4,800 per graduate.

### Charging a positive real interest rate on loans:

- If the government were to charge an interest rate on loans equal to the government’s cost of borrowing (2.2%), this would *save* the taxpayer money. On average, the subsidy would fall from 23p per £1 loaned, to 10p per £1 loaned. The remaining subsidy would arise because all student debts are written off after 25 years.
- Under our simulations, the break-even interest rate – i.e. the rate the government would have to charge in order to have a zero-cost system – is around 3.45%. Interest rates higher than this would, assuming graduates did not change their repayment behaviour, be profitable to the exchequer.

### Raising the fee cap:

- If the government were to raise the fee cap – and provide a fee loan for the same amount – this would *cost* the taxpayer money. This occurs mainly because an increasing number of graduates will reach the 25-year threshold without having paid off the full value of their loan. For example, if the average tuition fee rose to £5,000 from the current £3,200 fee cap (at 2011 prices), the average loan subsidy would increase from £4,800 per graduate to £6,900 per graduate.
- This cost could be reduced by increasing interest rates in conjunction with increasing fees; for example, charging an interest rate of 2.2% would result in the subsidy falling to £3,600. But the interest rate

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<sup>1</sup> All our analysis is based on simulations of the lifetime earnings of a single cohort of graduates who are projected to enter full-time undergraduate HE in 2011 and to graduate in 2014 after three years of study, at the age of 22 in their first year after graduation. We assume all eligible students fully take up their entitlement to loans and fees.

### Embargo

Until 00.01 am  
Thurs 22 April 2010

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required for the loan system to be revenue-neutral rises steeply with the level of the fee.

#### **Changing parameters of the loan system:**

- Other parameters of the loan system can also be adjusted to achieve the same subsidy as the current system or a lower one, with or without increasing interest rates and/or fees. For example, changes can be made to the repayment rate, the number of years after which debt is written off and/or the threshold at which people start repaying. There are many combinations that the government could use to alter its costs.
- More regressive ways of raising revenue include increasing the repayment rate, lowering the repayment threshold and/or increasing the debt write-off period beyond 25 years. More progressive ways include increasing the interest rate in conjunction with lowering the loan repayment rate, and/or making graduates pay for a further period of time after they have paid off the full balance of their loans.
- For example, under the current £3,200 fee cap, a zero-subsidy system could be achieved by imposing a 5% real interest rate and a 5.8% repayment rate, and this would give the biggest taxpayer subsidy to the lowest graduate earners.
- Alternatively, the government could choose to introduce new features to the current system in order to save money. One such example is to offer students a discount for up-front payment of fees or early repayment of their loans. In order for such a system to be profitable for the exchequer, however, graduates who would actually lose out financially by taking up the discount would need to be induced to do so.
- Many of the reforms considered in this report involve increasing graduate contributions to the cost of going to university. This could result in important behavioural change consequences. These could take the form of graduates making overpayments to reduce their debt or students declining to take up loans, or indeed deciding not to participate in university at all. Although such changes are difficult to quantify in advance, it is essential that policymakers are aware of these possible responses when they consider different reforms.

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Notes to Editors:

1. For embargoed copies of the report or other queries, contact: Bonnie Brimstone at IF5: 020 7291 4800, [bonnie\\_b@ifs.org.uk](mailto:bonnie_b@ifs.org.uk). We are very grateful to Universities UK and The Nuffield Foundation for funding this work.
2. Further information on the Independent Review of Higher Education Funding and Student Finance can be found here: <http://hereview.independent.gov.uk/hereview/>
3. The Nuffield Foundation funds research and innovation in education and social policy and also builds capacity in education, science and social science research. The Foundation has funded this project, but the views expressed are those of the authors and not necessarily those of the Foundation.