

The cost of the Government's reforms of the financing of higher education

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Summary

1. This report follows those produced by HEPI on the Browne Review, the Government's response and the higher education White Paper (Thompson et al, 2010a, 2010b, 2011). Our 2011 report was critical of the assessment of the cost of the proposals contained in the White Paper. Based on further information and analysis that has become available since, and in particular following the Government's welcome release of a simplified version of the model on which its calculations are based, we have carried out further analysis. Our conclusion is both that the Government's assessment of the RAB cost (the cost to the Government of the loans that it makes), which still depends on highly uncertain and optimistic assumptions, remains too low, and that the inflationary effects of the proposals (student loans form part of the basket that is used to calculate inflation) will lead to a rise in those benefits whose value is adjusted according to inflation, and so to increased government spending.

2. If we are right, the effect of these two factors will reduce any savings that will follow from the new policies, and could even mean that there are no savings to be had. The consequences will be serious. Either future taxpayers will need to increase their contribution, or other parts of the higher education budget will need to be cut, or student numbers will need to be held down even further than is planned at present, or former students will have to repay more. Annexes A to C set out the calculations and analysis in detail, of which this report provides an overview.

Background

3. In earlier reports (Thompson et al, 2011, 2010b) we looked at the claims made that the new arrangements for financing higher education would reduce the cost to the taxpayer. A key part of that analysis looked at the estimated cost of the loans that would be provided for the increased fees. Since then the only significant hard information that has become available concerns the fees that universities are charging and the fee charged net of waivers. We will not know the exact distribution of fees charged, how many students take out loans, and how much they borrow over their course, for some time, and liability to make repayments only starts in 2016. A final value of the mean net fee, and its distribution will only be possible to calculate when we have this information and when firm student numbers become available.

4. Since the publication of analysis based on admissions data (UCAS 2012a, 2012b, and Independent Commission on Fees, 2012) their findings have been widely interpreted as showing the new arrangements have reduced demand. The Daily Mail headline, 'Tuition fee rise HAS turned thousands of middle class students off going to university' gives a flavour of the comment. Though neither UCAS nor the Commission came to such firm conclusions, it is possible to see how others may have done so from the analysis they provided. This issue is central to much of the debate surrounding the new arrangements. Will the higher fees deter students and set back progress in widening participation and ensuring 'fair access'? It also has cost implications. If student demand does fall and as a result funded places decrease, the Government will make savings. In a further report (Thompson et al, 2012) we review the evidence and conclude that though it is too early to know for sure, there is no good evidence to expect a significant reduction in demand after the immediate effects of the introduction of higher fees are worked out. We think it is safe to anticipate that all the funded places the Government has planned will be filled¹, particularly as it plans to reduce the number of funded places.

5. Despite these gaps, and the provisional nature of the new information, there are several reasons to revisit the issues of the public deficit and debt. Firstly BIS have continued to develop their model for estimating the RAB cost and have recently provided details of the methods and a simplified version of the model they use. We have used this to revisit our assessment of the uncertainties and likely bias in the RAB estimate. (Annex A provides details of this assessment.) Secondly, others have looked at the new arrangements and raised issues we did not consider in our earlier review. In particular the Intergenerational Foundation 'False Accounting?' report (McGettigan, 2012), described how the impact of higher fees on inflation could affect the deficit reduction (see Annex B), and why the public debt needed to be considered as an issue in itself. Third, the OBR have published two further reports (OBR 2012a, OBR 2012b) which are relevant to the discussion. And finally, although firm figures are not available, we now have a revised if provisional value for net fees (see Annex C).

¹ This assumes that Government will not continue to pursue a policy of reducing places from highly popular universities and giving them the colleges and universities which have historically had difficulties recruiting, but which have lowered feed levels to qualify for the bidding process.

Fees less waivers

6. When the Government first announced its proposals it described a fee level of £6000 pa as the “basic threshold” which would “act as a discipline on universities and will ensure that they have to hold down their costs.” The maximum £9000 fee would only be charged in “exceptional circumstances”. (David Willetts, Minister for Universities and Science, House of Commons, 3 November 2010.) We did not share this expectation and wrote that we had, “every reason to expect – not immediately but over time – most universities to increase their fees towards £9,000” (Thompson et al, 2010b). Over the months that followed it became clear that this was nearer the mark, and indeed it looked as if it would not take as long as we had expected for £9000 to become the norm. By the time the White paper was published, despite pressure from the Government through OFFA to introduce fee waivers, we estimated the average ‘fee less waivers’ to be £8228.

7. With the White Paper the Government attempted to gain control over fee levels through a system of allocating student places which would reduce student numbers for universities that charged more than £7500 and were unable to increase their recruitment of a limited number of highly qualified students. It proposed to make these cuts year after year. We concluded nevertheless that even those universities which would be likely to see significant reductions in their student numbers would be very reluctant to reduce their fees. Accepting that the university was unable to recruit enough high- achieving students would be damaging, the high fee in itself being taken as indicating prestige. Even those universities with the lowest proportion of highly qualified students seemed likely to take a ‘wait and see’ stance. We concluded, “if universities with these characteristics believe that the Government will make margin cuts year on year, their best policy is to reduce fees without delay. If they think a change of policy is possible, they may be inclined to put off the decision.”

8. ‘Putting off’ seems to be what most universities did. Our estimate of the average fee less waivers using OFFA’s most recent data is £8234, within the margin of error of our earlier estimate. This uses historic student number data and so does not reflect the distribution of students across fees level in 2012-13, but we would not expect the final estimate to be too different. (See Annex C.)

9. It is unclear what the Government’s position is now. It has not tightened the ‘core plus margin’ incentive for fee reduction with the numbers confiscated from institutions charging £7,500+ reduced from 20,000 for 2012-13 to 5,000 for 2013-14. Perhaps it thinks that widening the ‘high achieving’ threshold of students outside the quota controls from ‘at least AAB grades at A-level or equivalent’ to ‘at least ABB grades’, as is now proposed, will result in pressure to reduce fees. If so, it is mistaken.

Most universities will judge their higher fee levels an asset in recruiting these students.

10. It seems that the Government is going to absorb the costs of the higher than expected fees², mitigated by an unstated policy of not up-rating it at all and allowing the real value of the maximum fee to fall³.

The RAB Estimate

11. The Resource Accounting and Budgeting (RAB) cost is the long-run real-terms cost to the Government of the loans that it makes.

12. The main features in determining the RAB are the size of the loans and the earnings of former students in the future (which, together with repayment terms will determine the rate of repayment). These are the features which we were able to explore using the BIS simplified model, and which are central to our assessment of the RAB estimates. It needs to be noted that the simplified model only considers full-time home students who graduate within three years, and who repay their loans at the minimum rate. The actual costs will depend on other factors, some by impacting the RAB, some in other ways. The resulting uncertainties are even greater than those arising from the scope of the simplified model. These include:-

- The repayments from those who do not qualify. On the one hand their loans will be lower, but their future earnings on average will also be lower. The information on future earnings of students who do not qualify is very limited.
- Loans will be available for part-time students for the first time. Take up rates and repayment profiles are highly uncertain.
- Repayments from non-UK EU students. It is only since the introduction of loans for fees, with those entering in 2006, that EU students have been able to take out loans. Information on their propensity to repay is therefore very limited, but given that those returning to their home countries will not have repayments collected by HMRC, the risk of defaults is higher.

² We estimate these to be about £350 million pa using the costing model at Appendix 1 of our report on the White Paper (Thompson et al, 2011).

³ Both maximum fee levels and maintenance loans will be frozen at 2012-13 levels in 2013-14 for those under the new arrangements. However, maintenance grants will be increased in line with inflation. This was announced in the House of Commons on 8 March 2012. To our knowledge, no statement has been made about Government's longer term plans.

- The long timescale for repayments means that we should expect a higher proportion of home students to emigrate before completing their repayments. Repayments for these former students also cannot be collected by HMCR.

13. The new terms of the loan, in particular the real interest rates, may affect the proportion paying 'up-front' or repaying at an accelerated rate, and our expectation is that the higher interest rates will lead to an increase in both of these. (The current loan rate for student starting in October 2012 could be about 6 per cent, far higher than available for a savings account, and even higher than the best buy mortgages.) The most likely impact of this would be to reduce the Government's costs, but not necessarily so. If up-front payments are made disproportionately from those future high earners, and if accelerated repayments are mostly made by former students as their earnings put them in the high interest level, the income generated from these high earners would be reduced, increasing the cost of the scheme overall⁴. As early repayments will be made by those from the wealthiest backgrounds, this also has implications for social equity, but this is not considered here.

14. The White Paper quoted a figure for the RAB cost of 30 per cent, though the BIS costings published in conjunction with the White Paper used 32 per cent for full-time student loans and 65 per cent for part-time. The discrepancy has never been explained, although ministers have continued to speak of a 30 per cent RAB cost. As we pointed out last year, the difference between a RAB cost of 30 per cent and one of 32 per cent amounts to £190 million per annum. The current official estimate, taking account of the upward pressures on the RAB discussed below (the reduced assumption about future earnings for example) stands at 32 per cent (BIS, 2012). For reasons discussed below, this remains optimistic, and seriously understates the likely cost of the Government's policies.

15. Since the Government first announced its proposals for the reform of the financing of higher education in November 2009, we have consistently pointed out that the cost of the policy is likely to be higher than it admitted. Initially, when the Government's plans were first announced, we pointed out the implausibly high average salaries that followed from their assumptions, in particular that the average male graduate would earn £99,500 per year in real terms 30 years after graduation. As described above we also challenged the assumption that

⁴ The White Paper set out proposals for a levy to be paid by those making 'early' repayments. This was to ensure that the contribution from high earners would be available to 'offer significant protection to those who do not earn high wages or who have periods out of employment'. However, these proposals were not adopted.

£9000 fees would be exceptional. This is important because the higher the fee the greater the loan cost.

16. As far as average earnings are concerned, BIS have now developed a new model to estimate the RAB cost, and have moved from the previous Treasury assumption of an average increase in earnings of 2 per cent per year to the latest OBR long term projections which can be interpreted as 1.3 per cent. This, with other changes, means that male graduates at the end of the repayment period are expected to earn £76,500 pa on average, rather than £99,500 pa. Though still very high, this is a move in the direction of greater realism.

17. The impact on the RAB estimate of the new assumption about long term average earnings is not as great as might be imagined because the repayment thresholds change with average earnings annually. We estimate that this change increases the RAB costs by 1.7 percentage points.

18. Though the new BIS model reduces the long term average earnings growth assumption, it, like earlier models assumes that that growth applies equally across all earnings levels. We have modelled various alternative scenarios of the distribution of salary increases, including one where 75 per cent of the salary increases are achieved by the top 20 per cent of earners, and 25 per cent of the increases are spread equally among the others. On that scenario the RAB cost increases by a further 4.2 percentage points. This may seem counter-intuitive; the RAB increase is greater than reducing the long term growth to zero for everyone. But this is because a redistribution of earnings leaves the average, and the thresholds, unchanged. This is something we return to in considering the career growth in earnings.

19. The new model continues to assume that the average fee loan, net of fee waivers, is about £7500 (actually £7579), despite the evidence using data from OFFA that average fee levels are substantially higher than this. Our most recent estimate was £8234. The Government has decided that rather than revise their assumptions with every new estimate of fee levels, it will make changes, if required, when the level of fee loans is known for certain, sometime towards the end of 2013. It is expected that the final revisions will include late information about fee waivers and reduced loans as a result of non-completion. In itself the decision not to update the assumption about fees and loans until final information is available may be a reasonable one, but it must be understood that it leads to a RAB cost that is significantly lower than it should be. Our current estimate of the average net fee – £8234 – would add 1.4 per cent to the RAB cost, other things being equal.

20. So both the reduced long term earnings assumptions made for the latest BIS model, and the higher level of fees than are assumed in the model, impact on the RAB estimate, though as mentioned the impact is not as great as might have been imagined. However, there are other even more compelling reasons for concluding that the RAB estimate is uncertain, and in general optimistic.

21. Because the repayment thresholds were set for 2016 in cash terms, to be followed by annual updates in line with average earnings, the costs are highly dependent on the growth in cash, not real, average earnings between now and 2016. Low inflation implies higher RAB charges. Though it may not have the same impact over the longer term, evidence from the Destination of Leavers from Higher Education (DLHE) survey show that the earnings of newly qualified graduates have seen very low growth in recent years, even in cash terms, and this suggests that at least for the early years of the scheme repayments will be lower than expected.

22. What were and remain the most uncertain – and doubtful – assumptions are

a. That the 'career' growth in earnings with age and experience that most graduates are estimated to have enjoyed historically will be repeated over the next thirty years.

b. That this will not only be true on average, but that the distribution of earnings will remain the same. This seems unlikely, as has become more apparent since our original analysis with evidence that shows the difference between high and low graduate earners is increasing.

23. These assumptions are key to the estimates made by BIS. Unlike some of the other assumptions we have discussed, the RAB is sensitive to their modification. It is the 'career' growth in earnings over their working lifetime which puts former students above the repayment threshold and into the high interest levels. Without this, the RAB would be much bigger. We cannot of course say what the future will bring, but it is incumbent on those making decisions about public policy, and particularly ones that have such significant cost implications, to make the most realistic assumptions they can. Both of these assumptions are critical and both are probably wrong.

24. As far as earnings growth is concerned, it is far more plausible to assume that those who are going to university in 2012 will not, on average, see the same growth in earnings relative to the population as a whole over their working lifetime as those who entered in the late sixties and seventies when the participation rate was less than half what it is

today, and when so many changes have taken place in the wider economy. (As discussed in Annex A, the method of estimation may have even exaggerated the career growth that has occurred historically.) It is the case that after the last rapid expansion, in the late 1980s and early 1990s, the 'graduate premium' held up better than most would have anticipated in the early part of those graduates careers that followed the expansion. But there are signs that the premium is weakening, and some are arguing that the protection that graduate employment has had from outsourcing and other forms of competition cannot be expected to continue over the next decades. In any case the relevant statistic is not the graduate premium, but the difference between the earnings of former students and the whole working population, including former students. Even if nothing else changes, this difference will diminish as the proportion of former students in the working population increases, unless non-graduates see large decreases in their earnings relative to graduates.

25. As we have seen in the context of assumptions about long term growth in average earnings, the distribution can be more important than the average level. It seems to us that, even if the career growth in earnings is maintained on average, it is likely that the spread in the career growth of earnings will increase. That is, while top earners may see an even bigger growth in earnings over their lifetime, those in the lower range of earnings will not see a career growth that has been typical, at least for men, for those in 'graduate' jobs in the past. In the USA⁵ only high earners have seen increases in real earnings over three decades, and in the UK increasing dispersion of graduate earnings is now being observed.

26. As we pointed out last year, the fact that top earners earn very much more does not mean that they will pay any more by way of loan repayments, and their high salaries will not compensate for the lower salaries and consequently lower loan repayments of others. And if median and low earners earn less than has been assumed then that will reduce the loan repayments, and increase the cost to the Government. If so, then assuming, as the Government has done, that the career growth in salaries will be maintained not just on average, but for all earning levels of former students, will lead to an overstatement of the loan repayments that the Government will receive and an understatement of the RAB cost. The simplified model can illustrate this. In the model the average earnings for the lowest 90 per cent of males shows an increase of 315 per cent

⁵ Among the US college educated only those "in the higher earner category (90th percentile) enjoyed any significant growth in real income since 1973, as they accelerated away from the rest since 1989." (Brown et al, 2011). Over a shorter period increasing dispersion of graduate earnings has been found in the UK (Green, et al 2010).

over the 30 year repayment period. However, if the earnings growth of the bottom 90 per cent is reduced to 204 per cent, and the savings passed on to the top 10 per cent, so that the average graduate premium remains unchanged, the RAB cost for men increases by 7 percentage points⁶.

27. The Minister for Higher Education, in providing evidence to the Business, Innovation and Skills Committee, said, "I read lots of accounts of how, for example, the RAB charge, which we have estimated at 30%, is going to be very different. . . we have had those estimates checked by the OBR and the IFS have done their estimates " (Willetts 2012a). And in an article in the Times Higher he claimed the Institute for Fiscal Studies (IFS) "following a more sophisticated methodology, estimates the resource accounting and budgeting (RAB) charge to be around 30 per cent" (Willetts, 2012b).

28. Although we do not have access to the IFS model, and they have not answered our requests for information about it, the results of their modelling have been published. Assuming long-run average real-terms earnings growth of 2 per cent per year (the Government's original assumption), they estimated a RAB cost of 33 per cent. This was their central estimate, and even that was 3 percentage points higher than the RAB cost claimed in the White Paper and 1 percentage point higher than that contained in the papers that accompanied the White Paper. For a "pessimistic" estimate the long term average real earnings growth was reduced to 1.5 per cent per year, and the medium term earnings growth replaced OBR estimates with IFS's own 'pessimistic' values. The IFS "pessimistic" long term assumption is probably (it depends on exact definitions used) actually less pessimistic than the most recent OBR assumptions used by BIS (for example, the IFS assumed average real-terms annual salary increases of 1.5 per cent compared to the 1.3 per cent which is probably the equivalent figure using OBR's assumption). This "pessimistic" RAB cost came out at 37 per cent.

29. This "pessimistic" estimate of the IFS, which leads to a 37 per cent RAB estimate compared to the department's present estimate of 32 per cent, is still based on the broad assumptions that the graduate growth in career earnings will be maintained on average, and that the dispersion of these earnings will stay the same. IFS are fully aware of these uncertainties and they warn that predicting the earnings of future graduates poses severe difficulties.

⁶ These figures were derived using the calculations for different long term earnings growth distributions. See annex A for more details.

30. The Minister for higher education should stop saying that the IFS has endorsed the Government's estimate of a 30 per cent RAB cost. Its estimate was always higher than the Government's, and the projection that most closely incorporates the Government's present assumption of long term earnings growth has a RAB cost of at least 37 per cent. The difference between a RAB cost of 30 per cent and one of 37 per cent amounts to £0.68 billion per year⁷.

31. The Minister's reassurance that the OBR had checked their estimate of the RAB, turns out to be potentially misleading. While the OBR were given the opportunity to challenge the methodology and underpinning assumptions of the model, they, so far as we can establish, did not go further than this.

The impact of fees on inflation

32. Tuition fees are included in the calculation of the both the Retail Price Index (RPI) and the Consumer Price Index (CPI). The Office for Budget Responsibility (OBR) has estimated that the increase in fees is expected to add 0.2 per cent to the CPI as the first cohort pays the new fees in 2012 (OBR, 2011). This increased inflation will lead to bigger rises in various state benefits and Civil Service pensions which are updated annually in line with the CPI.

33. This much is generally accepted. What is not agreed is the size of the additional expenditure that will be generated. A cost of up to £2.2 billion pa. has been claimed. We do not believe this credible and think the range should be £420 million pa to £1.14 billion pa. (See Annex B for details.)

34. Our higher figure assumes that the higher fees will continue to increase inflation beyond the initial increase arising from the entrants starting in the autumn of 2012, and that this continuing impact will give rise to increased public expenditure . This may not happen for two reasons:

a. Firstly, the Bank of England's Monetary Policy Committee may take addition measures to ensure that this inflation pressure does not lead to inflation after the impact of the 2012 intake.

b. Secondly, the Government may decide not to continue to update benefits in line with the CPI after 2013. There have even been suggestions that benefits will be frozen from 2014

⁷ Using the costing model at Appendix 1 of our report on the White Paper (Thompson et al, 2011).

35. If the higher figure came about this would take most of the £1.3 billion pa savings the changes are projected to make using the assumptions made for the White Paper costings. Even without any changes to the underlying assumptions about future earnings, repayments etc, just increasing the fee assumption from £7500 to our estimate of £8234 would mean that the 'savings' would increase costs by £150 million pa.

The impact on the Public Sector Net Cash Requirement (PSNCR) - the deficit -and the Public Sector Net Debt (PSND) - the debt

36. So long as the Government bases its calculations on a RAB cost of 32 per cent it can claim that the deficit will be reduced because it will be spending less to make direct grants to universities through HEFCE. The expected savings would be even greater if the RAB cost of 30 per cent quoted in the White paper were used. However, if as seems apparent the RAB cost is much higher, and public spending increases because of the inflationary impact of fee rises, then the reduction in the deficit will be much less – perhaps less than zero. If, as we expect, it becomes evident that the RAB cost has been underestimated, it is unclear what would trigger a decision to revise it - perhaps a decision from the Treasury or a different part of Government, a challenge from the OBR or ONS, or else an attempt to sell the loan book. However if, as appears clear, the real cost of the loans has been underestimated by the Government, at some point there will have to be an adjustment.

37. Although expected future repayments reduce the deficit at the time that the loans are made, and so the RAB cost impacts on the extent of the deficit, the debt is different. Repayments only reduce the PSND at the time they are paid (if they are paid), not before. Because of the sums involved, and the long time period for repayment, and therefore the uncertainty of repayment, the impact of students' loans on the debt is of concern, irrespective of the RAB cost. The most recent OBR projections show the PSND from student loans will peak at 6.1 per cent of GDP in the early 2030s and will only fall off slowly to 4.4 per cent by 2061-62, still a high figure (OBR, 2012b, paragraph 3.61⁸).

38. Given the size of this contribution to the debt, it is not surprising that OBR wishes to refine these estimates, and it has commissioned BIS to model projections of loans and repayments over the next 50 years.

⁸ These figures are from the online version (downloaded 19 October 2012) which corrected those in the print version. The online Executive Summary (page 10) still shows the original incorrect values. The earlier incorrect figures were also quoted in the printed summary of this report.

"We have commissioned the Department for Business, Innovation and Skills (BIS) to model projections of loans and repayments over the next 50 years. Our key assumptions here are that student numbers are assumed to be flat at their current numbers and the initial average fee loan per student is £7,000. We also assume that the tuition fee cap and maintenance grants and loans are uprated in line with earnings after the forecast period." OBR, 2012b, paragraph 3.60

39. These key assumptions on student numbers, fee loans and the uprating of fees, loans and grants are of interest for two reasons. Firstly, given what we understand about the RAB estimates, should they be viewed as representing the most likely outcome? Secondly, we can assume they reflect Government policy and expectations, or at least what OBR think are Governments policies and expectations. Taking each in turn in reverse order.

Fees and loans uprated with earnings

40. This is assumed to occur after the forecast period, that is after 2016-17. In their modelling BIS are assuming that they will increase with inflation before then. Both of these assumptions seem pessimistic - that is they will inflate the debt to more than seems likely. (We do however, entirely accept the point that, if income does not increase in line with earnings, it is difficult to see how quality could be maintained, given the high proportion of higher education costs taken up by salaries.)

Average fee loan per student is £7,000

41. BIS have assumed an average fee loan per borrower of £7777 and 90 per cent take up. The fee per borrower takes into account those who take loans of less than 100 per cent, and those who do not pay the full fee through non-completion. The Government and the OBR assumptions in this respect differ. That of the OBR is more pessimistic - we would consider it to be more realistic, in that it is based on the actual fees reported by OFFA - than that currently used to estimate the RAB charge.

Flat student numbers⁹

42. The change in population size means that even with flat numbers the participation rate will rise until about 2020, and from then it will fall

⁹ Flat' means continuing with the numbers planned for the current spending review, which means a cut of 1.7 per cent compared to 2011-12.

dipping below current rates around 2026 – 2027.¹⁰ This does not seem plausible.

43. Much attention is being given to the impact of the new arrangements on the demand for higher education, but these constraints on supply, if followed, maybe of more significance

44. So long as student numbers do indeed remain flat these assumptions look balanced - if anything they may give an over-estimation of debt. But if, as seems likely, BIS estimate the level of repayments using the same assumptions about future earnings as they have for the RAB, then we would view them as optimistic. It is to be hoped that the OBR, in line with its intention to 'probe the robustness' of its central forecasts, will ask BIS to produce projections of loans and repayments under a range of assumptions about the growth in the earnings of former students.

Conclusion

45. One of the main arguments used to justify the introduction of the present reforms, was that they would reduce public expenditure, reduce Government borrowing, and put the future funding of higher education on a sustainable footing. There may be other arguments in favour of the reforms, but this justification does not stand up. A reduction of the PSNCR on the scale claimed by the Government is unlikely - it is even possible that there will not be any reduction whatever. Further, given the size of the loans and the repayment period, the PSND will be increased substantially over the first half of the twenty first century.

46. In conclusion therefore, it is likely that the Government's budgetary assumptions have seriously understated the cost of the new policies as:

- a. Loan repayments will be less than anticipated, and so the RAB cost will be higher; and
- b. There will be additional expenditure from other departments' budgets, as inflation leads to an increase in benefits.

47. To put a figure on the extent of that shortfall would entail making predictions about what is unpredictable, but it is likely to be substantial. For example, taking the lower value of the inflation impact (£0.42 billion), and a RAB value, say equal to the IFS pessimistic estimate of 37 per cent, and a more realistic fee loan assumption of £8000 – the increased cost

¹⁰ Based on population projections published in HEPI Demand report, December 2008.

will be over £1 billion per year. This sort of cost would very largely eliminate the savings that the Government claims its policies will generate of £1.3 billion per year. A slightly higher RAB cost or a slightly greater inflationary effect than the most optimistic that we have considered here would mean that the present policy is actually more expensive than the one it has replaced.

48. The shortfall may not be apparent right away, and it is clear that the Government continues to deny it despite evidence to the contrary. That will mean that the consequences will be some other Government's problem to resolve. But the problem will not disappear, and the books will need to be balanced in due course.

49. What measures will be available to balance the books in future? When we have discussed this previously, we have identified three candidates for meeting the shortfall.

a. The remaining HEFCE grant could be reduced. As a large part of this is in respect of research funding and funding for STEM subjects, and the beneficiaries of that funding are disproportionately among in the old universities, the effects of such actions would impact most on those.

b. Student numbers could be held down. Numbers were already being cut, and the reductions in enrolment through UCAS this year, if repeated, might represent a significant cut in student numbers, (although we believe that the reduction is almost certainly a temporary first year effect). Reduced numbers will mean reduced loans, and therefore reduced loan subsidies by the Government. The RAB cost will not reduce, but the total cost to the Government will do so because volumes will be lower.

c. Loan subsidies provided by the Government could be reduced. The reason that the RAB cost is so high is because the loans are subsidised. The greater the subsidies, the greater the RAB cost. If the interest rate increased, the repayment threshold were reduced, the percentage of salary taken to repay the loans were to increase or the 30 year cut-off beyond which loans are forgiven were lengthened, then the RAB cost would reduce, but at the expense of those former students who had taken out loans. The reason that the Government has been unwilling to give commitments about honouring in the future the conditions under which students are presently taking out loans is to leave this option open as a means of balancing the budget.

50. In setting out the last of these we previously had in mind modifications to the repayment conditions for new students. But every student seeking a loan has to sign up to the following condition:

“You must agree to repay your loan in line with the **regulations that apply at the time the repayments are due** and as they are amended.” (Emphasis added)

51. This is not a new condition, but the size of the loans, and the time it will take for them to be repaid increases the risk that it will be invoked.

52. In its response to criticism of its calculations of the RAB cost, the Government has responded that estimating what will happen so far into the future is an uncertain business. The Minister for Higher Education told the Business, Innovation and Skills Committee that “nobody can know” what the RAB charge is going to be. (Willettts, 2012a). That is true, but indeed that is one of the main criticisms of the Government's actions. Quite apart from the likely underestimate of the costs, discussed above, is the fact that the Government is implementing a policy about whose cost, on its own admission, it can have no clear idea and which is potentially building up large liabilities for future generations to redeem.

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