PO-CH/NL/0224
PART A

Part. A

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Begins: 24/7/87.
Ends: 23/11/87.

PO -CH /NL/0224

PART A

Chancellor's (Lawson) Papers:

REVIEW OF STUDENT SUPPORT

Disposal Directions: 25 Years

[signature]
15/9/95.

PO -CH /NL/0224
PART A

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: C STEWART
EXTN. 7414
24 July 1987

1. MR CORLETT 2417

2. MR ISAAC 24.7

3. CHANCELLOR

TAX TREATMENT OF MAINTENANCE PAYMENTS AND COVENANTS

1. In his minute of 7 July not attached about the tax treatment of husband and wife, Mr Mace said we would be letting you have a separate note about the treatment of maintenance payments and covenants. The decision to proceed with independent taxation makes some changes essential. There are also other reasons for looking at reform in this area.

2. This note examines the whole issue of the transfer of income between individuals, and suggests how reform might be approached.
This is a politically sensitive area, because many of the reliefs discussed here are deeply ingrained in the tax system and are of financial importance to the people they affect.

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins - Parliamentary Counsel

Mr Battishill
Mr Isaac
Mr Corlett
Mr Lewis
Mr Beighton
Mr Lawrance
Mr Cherry
Mr Crawley
Mr Cleave
Mr Mace
Mr Davenport
Mr R H Allen
Mr Yard
Mr Marshall
Mr Eason
PS/IR
Mr Stewart

The case for action

3. There are two main reasons why action needs to be considered -

i. The present rules involve a number of tax penalties on marriage, which it is your general aim to remove or reduce. And under independent taxation, with non-transferable allowances, husbands and wives must be prevented from using covenants to transfer income between themselves. Otherwise, they could effectively transfer unused personal allowances and thereby undermine the new system. That would be very costly.

ii. Anomalies in the present system of relief for maintenance payments have been highlighted by a recent decision of the House of Lords, known as the Sherdley case.

date?

4. A third reason for looking at this whole area, independent of recent or prospective events, is the continuing pressure on our financial and staff resources and the need to cut out unproductive functions. Both maintenance and covenants offer considerable scope here.

Objectives

5. We suggest that the main objectives in approaching reform should be -

i. To make the transfers of income rules as "marriage-neutral" as possible. At present they are far from being so. The existing system actively disadvantages married couples in many respects. The Sherdley case is one example. The scope for divorced, separated and unmarried couples to covenant to each other without limit is another;

ii. To simplify the system and save administrative costs. The procedures for making tax effective covenant and maintenance payments are often complicated and legalistic, which the ordinary taxpayer finds difficult to understand. And we have 500 or so staff, which we can ill afford, tied up running a system which delivers support in an indirect and inefficient way;

iii. To avoid making people on low incomes significantly worse off or more reliant on social security benefits;

iv. To remove unwarranted tax benefits for the better off. The present rules are particularly favourable to divorced or separated persons with high incomes who can obtain higher rate relief on maintenance payments and ensure that the recipient, whether another adult or a child, often has no liability. The justification of these breaks needs to be considered in the context of your policy on the higher rate structure generally.

6. Some of these objectives are potentially in conflict. For example, removing penalties on marriage inevitably means that divorced and separated couples will be relatively less favourably treated than they are now, so that those on low incomes would need to be protected. The note includes suggestions about how some of these conflicts could be resolved.

7. Our starting-point is that for married couples living together, you propose to introduce independent taxation with non-transferable allowances, and retain the married allowance for the husband.

8. We look in turn at the treatment of married, divorced/separated and unmarried couples; then at the maintenance of children; and then at covenants between other individuals.

Married couples

9. At present the incomes of a husband and wife living together are aggregated. The husband gets the married allowance (£3,795) instead of the single allowance (£2,425). The wife gets the equivalent of a single allowance against earned income only. Neither gets any relief for maintenance payments to the other (in effect, housekeeping money). If one made a covenant in favour of the other, it would have no tax effect because of the aggregation rule.

10. Under independent taxation, the husband will get the married allowance, and the wife the single allowance against her own income (investment as well as earned income). As now, neither will get relief for "maintenance". But with the aggregation rule abolished, legislation will be necessary to prevent the couple reducing their tax bill by making covenants to transfer income between themselves (and so transferring their unused allowances indirectly). Otherwise there could be a revenue cost running into £billions and a manpower cost running into thousands. This is the regime against which the arrangements for other couples have to be measured.

Divorced and separated couples

11. At present a divorced or separated couple are taxed independently, and each gets the single allowance. (If however they are separated - but not divorced - and the husband wholly maintains the wife by voluntary payments, he continues to get the married allowance.) Maintenance payments made under a Court Order or legally binding agreement are effective as a transfer of income for tax purposes - ie the payer gets tax relief (including higher

rate relief) for the payments, and the recipient is taxable on them. About 500,000 people get tax relief for maintenance payments.

12. Thus on divorce or separation the husband's personal allowance is generally reduced. But instead he gets relief for maintenance payments:

- If these payments are <u>less</u> than £1,370 (the difference between single and married allowances), he will generally pay more tax than before on the same income.

- If the payments are <u>more</u> than £1,370 he will pay less tax - substantially less, if he is a higher rate taxpayer paying a high level of maintenance.

13. As his ex-wife is taxed separately, his tax bill will no longer be affected by her income. She will get the single allowance in her own right, but will be taxable on the maintenance she receives (in addition to any other income she may have).

14. It is worth noting in passing that if the maintenance payments are "small maintenance payments" - ie weekly or monthly payments under a UK Court Order up to £2496 a year (or £1296 in the case of payments to a spouse for a child) - they are payable gross and any tax on the recipient has to be assessed. (About 90 per cent of people who pay maintenance are in this category.) If the payments are above the limit, or are not "small maintenance payments" because they are not made under a Court Order, the payer deducts basic rate tax at source, and the recipient can use personal allowances to claim repayment of part or all of the tax. But this difference is simply a matter of mechanics; it does not affect the ultimate tax liability.

15. Divorced or separated couples can also use covenants to transfer income between themselves and the payer can get full relief from tax.

16. Under independent taxation, there is a strong case for making all maintenance payments between divorced or separated couples tax-neutral, as they are between a married couple. That would be an attractively simple system, but it would only be consistent with a system of independent taxation under which everyone, including married men, get the same allowance.

17. But since the proposal is to let the married couple retain the married allowance, divorced or separated couples would in fact be left significantly worse off: the husband would lose the married allowance, he would still have a legal obligation to maintain his ex-wife, but he would get no relief for maintenance payments either. This could have serious implications for the less well off. Because his tax bill would be increased, he would be less able than before to support his ex-wife, and more ex-wives would become dependent on social security benefits. And as ex-husbands would themselves be worse off than now, more of them might also become dependent on social security.

18. Continuing to give full relief for maintenance would, however, perpetuate the situation under which those making payments of more than £1370 a year (the difference between single and married allowances) get more favourable treatment on divorce than when they are married. Because there is no limit on the relief for maintenance payments, this favourable treatment applies particularly at the higher end of the income scale.. For example, over three-quarters of the relief on payments which are not "small maintenance payments" goes to taxpayers with total income over £30,000. This is a classic example of a "penalty on marriage" which is difficult to justify.

19. This suggests that the right course, in the context of independent taxation, is to continue limited relief for the husband for maintenance payments. One option would be to allow relief only up to the difference between the single and married personal allowances (at present £1,370). (There would not be an extra £1370 if he had more than one ex-wife. But it would be difficult to deny him married allowance for a new wife if he had remarried.) Thus if a divorced husband paid at least £1,370 maintenance to his ex-wife, he would get the same relief as when they were married. If he paid less, he would get less relief; but that would not be unfair because he would still be getting full relief for what he actually paid. At present about 375,000 (75 per cent) of those paying maintenance pay £1370 or less.

20. At present the recipient of the maintenance payments - normally the wife - is taxable on them. If she has no other income, she will in most cases pay little or no tax on them. But if she is working, for example, she may well be paying basic rate tax on the maintenance. This follows the "transfer of income" philosophy of the present rules. But under a new regime, there is a good case for exempting the recipient from tax on the maintenance. First, it would put the divorced or separated woman in the same position as the married woman who does not pay tax on her "maintenance". Second, it would also help people at the lower end of the scale by reducing any tax bill they may have, and saving them (and the Revenue) the trouble of sorting out the tax liabilities on the payments. This would help to ensure that the reform did not add significantly to the numbers drawing benefit. There are large numbers of divorced and separated women on low incomes; for example DHSS figures suggest that 270,000 divorced and separated women entitled to receive maintenance payments are on supplementary benefit. The change would also benefit people higher up the scale, to the extent of tax on £1,370 - for example, where the couple were both working, the husband would get some relief for maintenance payments (as now), but the wife would no longer pay tax on them.

presumably irrespective of whether over or under £1,370

21. It might be argued nevertheless that a regime on these lines was not sufficiently generous to divorced and separated couples, perhaps because they have two households to maintain. Another option, therefore would be to fix a higher monetary limit for relief for maintenance - for example the present limit for "small maintenance payments" (£2,496), or possibly the single allowance (£2,425)- though they would both be arbitrary in this context. About 88,000 people pay maintenance of between £1370 and £2496. On the other hand, that would give the divorced or separated husband the equivalent of two single allowances, so that a "penalty on marriage" would remain; and it would also be generous to people in the middle income range, where the husband would get relief on the payments but the wife would no longer pay tax on them.

22. So, to sum up, the neutrality argument points to limiting the new relief to the difference between single and married allowances (£1,370); whereas concern to minimise the impact on couples with children points to one of the higher figures.

Unmarried couples

23. An unmarried couple each gets the single allowance. There will normally be no question of Court Order maintenance payments being made between them. They can however transfer income between themselves by covenants; the payer gets basic but not higher rate relief.

24. Under independent taxation there would be specific legislation to prevent married couples transferring income between themselves in that way. To achieve marriage-neutrality, covenants between unmarried couples should also be made tax-neutral. This raises the question, to which we return below (paragraph 41), whether covenants between any other individuals should be tax-neutral as well.

? Students

Maintenance of children

25. At present a married couple get no tax relief for maintenance of their children. The old child allowance was of course replaced some years ago by child benefit. Covenants in favour of the payer's unmarried children under 18 do not qualify for relief.

26. Where a divorced or separated couple have children, the parent with whom the child is resident gets the additional personal allowance (equal to the difference between single and married allowances). Under independent taxation it is proposed to convert the additional personal allowance into social security benefit.

27. Unless they are made under a Court Order maintenance payments to a child remain the payer's income for tax purposes; in these circumstances people normally arrange for the child's maintenance to be payable to the other spouse, so that it would become the latter's income for tax purposes, and the payer gets relief. But maintenance paid direct to a child under a Court Order is treated as the child's income, and can be set against the child's own personal allowances.

28. The use of the children's own personal allowances in this way to minimise the family tax liability following divorce or separation has become increasingly common. Because it depends on getting a Court Order, it encourages people to go to Court purely to get the tax benefit, and this increases the work burden on the Courts. In most such cases, the husband will be paying maintenance to children in the wife's custody. But in the recent Sherdley case, the House of Lords decided that a divorced parent could apply for a Court Order against himself to make maintenance payments to his children in his own custody. It was admitted that the sole purpose of the Order was to get tax relief for the payments to the children, and to make use of their personal allowances. At the same time the parent

gets the additional personal allowance, because the children are resident with him. So he gets a double benefit.

29. To the layman, this seems a pretty artificial arrangement. The Lords argued that it was unfair to differentiate between payments to children in the payer's own custody, and payments to children in the other spouse's custody. There is something in that point, but the decision creates much greater anomalies between divorced/separated families and others. It means that divorced and separated parents can clearly use it to get tax relief for the normal cost of maintaining their children in their own custody.

30. It is likely that most divorced or separated parents with children in their own custody will now seek to take advantage of this. (Some people may have had Orders on these lines from local Courts in the past, but the Lords' decision clearly establishes a general precedent at the highest level.) It is possible that similar treatment may be available to others - perhaps even families living together, in view of the powers the Courts now have following the 1984 family legislation. The potential cost to the Exchequer is therefore very substantial if the Courts begin to give such orders on a large scale. And it will increase the burden on the Courts further.

Let me see these

31. This is another penalty on marriage - and one which will grow because the decision will be exploited to gain unwarranted tax benefits for divorced and separated parents. Some recent comments in the professional Press suggest that people will not be surprised by Government action to change the law.

32. One possible course might be target action narrowly to stop relief for maintenance payments to children where the payer has custody. But there would be some practical problems, particularly where there is joint custody. It would also run up against the argument of "fairness" which

seemed to influence the House of Lords. And it would still leave united families at a disadvantage.

33. Looking at the issue more broadly in the context of the issues raised in this paper, there is no obvious reason why divorced or separated parents should get tax relief at all for maintaining their children, when ordinary married couples do not. Once separated, the parents have two households to maintain; but that does not increase the cost of maintaining the children, and the parent with custody of the children already gets the additional personal allowance. All this points to making maintenance payments to children tax-neutral - ie the payer would get no relief for them and the artificial use of the child's own personal allowance would be prevented.

34. The most likely response to this would be for future Court Orders to provide for payments to be made to the other spouse for the benefit of the child. These could be allowed to qualify for relief as part of the maintenance paid to the wife, subject to the monetary limit (paragraph 19 above). (In practice it would in any case often be difficult to apportion maintenance payments made to the wife between the amount needed for herself and the amount needed for the children; for example, expenses like food and electricity can hardly be apportioned.)

Distributional effects

35. Clearly, the distributional effects of these proposals on maintenance, particularly on lower incomes, are very important. As mentioned above about 0.5m people now get relief for maintenance payments.

36. About 75% of those getting tax relief for maintenance are paying £1,370 or less. Over half of these have incomes of £10,000 or less. Thus if relief was limited to the difference between the single and married allowances, the great majority of maintenance payers should be no worse off

than now. To the extent that the recipients of the maintenance now pay tax on it, divorced and separated couples would be better off overall under the proposal to make it tax-free. (These figures include payments to children as well as payments to spouses, and we cannot separate these out. So where the payments include payments to children, people paying no more than £1,370 in total could still lose some relief, because the payments to the children would become tax-neutral. But they would probably then get the Court Order revised to provide for payment to the wife instead).

37. About 88,000 people get tax relief for maintenance of between £1,370 and £2,496. They would lose some relief if the limit was set at the single/married allowance differential (£1370), but not if it was raised to the present "small maintenance" limit (£2496). Some of these will be on fairly low incomes - eg where the maintenance needs to be enough to support children as well as the ex-wife. In some cases, but not others, there would be a tax saving to the wife because maintenance would no longer be taxable. About 34,000 people get tax relief for maintenance over £2,496; the total maintenance they pay is about £m170. These are mainly in the higher income ranges, where there are clearly some large payments being made, with tax relief going far beyond the value of the married allowance to the ordinary married couple.

38. At this stage it looks as if limiting relief for maintenance of spouses to £1,370 should not generally cause serious problems for most people in the lower income ranges, or have substantial knock-on effects on the level of social security benefits claimed. The monetary limit is more likely to restrict relief in cases where the couple have children, because the maintenance will be that much larger. But this is something we will need to examine in more detail, in conjunction with DHSS.

Exchequer effects

problem is 'justifying' the £2496 fig.

39. The present regime for maintenance payments has a revenue cost of about £m110, compared with a completely tax-neutral regime. But we estimate that the changes proposed above would be broadly revenue-neutral. They might yield about £m15 with a £1,370 limit. They could have a cost of perhaps £m10 with a £2,496 limit. (These are very tentative estimates because our data about recipients of maintenance is limited). Since the effect of the change would be to preserve relief for most payers of maintenance, it is not surprising that there is no significant revenue yield. The precise timing of any yield would depend on the transitional arrangements (paragraphs 57-60 below).

Manpower effects

40. At present the manpower cost of dealing with maintenance payments is 230 units, which is expected to rise to 250 units by 1990-91 (and could rise faster as a result of the Sherdley decision). The proposals might save about 70 staff. The saving is not larger, because the proposal involves continuing to give payers at least some relief for maintenance; the exact saving would depend on the extent of the policing.

Covenants

41. A reform on these lines raises the question whether covenants between individuals generally should be made tax-neutral. (We are assuming that covenants to charities would not be involved in this reform.)

42. As explained above, covenants between married and unmarried couples need to be made tax-neutral as part of independent taxation. Divorced and separated couples would need to be prevented from using covenants to get round the monetary limit on relief for maintenance payments.

43. If covenants between "couples" are made tax-neutral there is a strong case for making other covenants between other individuals tax-neutral as well. Any kind of "cohabitation" test would be unpopular and in practice impossible to operate; and it is in any case not obvious why unrelated individuals should be treated more favourably than "couples".

44. There are, however, three types of covenant between individuals which would be said to be specially deserving, and therefore need to be looked at in more detail.

i. Student covenants

NB links with current DES (minor) study on student loans etc

45. Covenants made to the covenantor's own minor children are ineffective for tax purposes. However, when the age of the majority was reduced from 21 to 18, and the income tax child allowance was phased out, it became possible, from the mid-1970s, to covenant to student sons or daughters and gain a tax benefit. Knowledge of this facility spread rapidly, and now around 250,000 student covenants are in existence, at a cost of something like £m100 annually in tax relief. It has virtually become capitalised into the system of higher education support, particularly for parents who are required to pay a large parental contribution.

46. The benefit of this back-door support is, however, achieved only at considerable cost:

i. It is difficult to imagine a more convoluted way of getting State support into the hands of students. First, we in the Revenue compute parental income, on the basis of which local authorities restrict student grants by reference to parental income. Then we seek to compensate for this by giving extra tax relief to parents. And then, having means-tested the student, we repay him the tax relief.

ii. To achieve this, we have to employ too many staff we can ill afford from the primary job of tax collection, and we envisage that the total staff on covenants will need to rise to 360 over the period covered by the PES bid.

iii. The repayment of tax is effected by means of legal gobbledygook in covenants, which taxpayers frequently get wrong and for which they blame their local tax offices.

iv. The tax refunded to the student is strictly due only if the parent actually makes the payment due under the covenant, but this is virtually impossible to police. Where payments are not made the tax system (as well as the parental contribution system) is brought into disrepute.

v. While it pays the parent to covenant up to the level of the student's single personal allowance to get the maximum tax benefits, covenant income, unlike grant income, is taxable in the hands of the recipient. This has unsatisfactory consequences. Either it discourages students from taking holiday jobs, because they are immediately liable on any earnings. Or, if they fail (whether deliberately or through ignorance) to declare their earnings, they are in default (and, as the opinion-formers of the future, obtaining the worst possible introduction to their responsibilities and obligations as taxpayers).

47. This wholly unsatisfactory system was carefully looked at by Treasury Ministers about 3 years ago, following a Rayner scrutiny, which sought to identify the scale of the "tax expenditure" involved in the covenanting arrangements and of the associated administrative costs. Since the bulk of student support was already provided by way of public expenditure through the awards system, the scrutineer

raised, for further consideration, the obvious question of whether it would not be more efficient for the value of the covenant relief to be channelled in that way also.

48. The recommendation was strongly supported by Sir Robin Ibbs and the Efficiency Unit, who pressed for the matter to be pursued in the search for significant administrative savings. Treasury Ministers, however, had two worries. First, there was the problem posed by conventional Government accounting, under which the efficiency gains from the switch would be achieved only at the cost of adding to both public expenditure and aggregate taxation. Second, and more importantly, they were very conscious of the serious political difficulties at that time caused by Sir Keith Joseph's suggestions for increasing parental contributions and introducing student loans. Sir Robin Ibbs concluded by saying that he would not challenge Treasury Ministers' "judgment about the suitability of its political climate for change ... but [he] would hope you will want to look at the question again when the timing is right" ?

49. One possibility would be to pick up again the particular suggestion in the 1985 Rayner Scrutiny: abolish student covenants and use the savings of perhaps £m100 to reintroduce (in effect) a minimum grant paid direct to students by the local authorities. That could in principle achieve the objectives outlined in paragraph 5: simplify the system, save Revenue staff, and remove the "earnings trap" for students dependent on maintenance from their parents. However, it has two obvious drawbacks:

i. though a change could be revenue neutral in PSBR terms, the conventional public sector accounts would show offsetting increases in both public expenditure and taxation. The point is essentially a presentational one - the treatment under the accounting conventions of cheques sent by public sector authorities (local authorities or the Revenue) to students who have not themselves paid any tax. But it is clearly sensitive and important.

ii. there could also be presentational difficulties with the parents of student children. Some may remember that a similar "minimum grant" was introduced in the late 1970's, explicitly to compensate parents for the abolition of child tax allowance in respect of student children. Subsequently, DES Ministers reviewed their expenditure priorities and abolished the minimum grant. People might fear that history would repeat itself.

50. Against that background, we have considered whether there is any way in which we could short circuit the present roundabout of payments and reliefs, whilst avoiding these problems.

51. There are a number of possible approaches here, which - if you were attracted by the idea - we should need to consider further. They would all involve retaining tax relief, but channelling that relief through local authorities direct to students, thereby largely cutting out the wasteful Revenue intervention.

52. One possibility, for example, might be to abolish covenants, but introduce a tax allowance for parents with children of 18 or over in full-time education (that is, those who at present qualify for covenant relief). Relief would be given at basic rate only and related directly to the amount of the parental contribution assessed by local authorities. We see possible scope for arrangements under which the value of that tax relief could be paid direct to students (as with the present covenant repayments) but channelled through the local authorities alongside - but of course separately from - any payments of student maintenance grant. At regular intervals the Revenue would refund local authorities for their payment, in the same way as we refund building societies etc under the MIRAS arrangements.

53. These are preliminary thoughts only, which have not yet been discussed outside the Revenue. Obviously, we should need to be careful to observe the proprieties in relation to both Government accounting and the PAC - and not expose Ministers to criticism that public expenditure was being disguised too transparently as a tax relief. And we will need to bear in mind the extra administrative cost for local authorities. However, subject to fleshing out the details of the arrangements with the help of Treasury officials, we see a prospect of a scheme that would

- not disturb the present accounting treatment, under which payments to student children are accounted for as "negative taxation"; and again
- save significant staff costs in the Revenue; and
- end the "earnings trap" for students.

Worth exploring, but dubious

54. If you see any attraction in the ideas suggested here, we should like to explore the possibilities further, initially with Treasury officials.

ii. <u>Grandparent covenants</u>

55. "Grandparent covenants" are quite frequently used by well-off grandparents - and occasionally other relatives, uncles etc - to help their children's families by transferring money direct to the grandchildren. We estimate that at present there are over 200,000 covenants in favour of children under 18, with tax relief costing £m110. About 70 per cent of these are by grandparents in favour of grandchildren. As with maintenance payments to children, they are a fairly recent development, following on the abolition of child tax allowances in the late 1970's. One common use is to help finance children's education. There is a temptation to misuse them by the parent reimbursing the grandparent. You may wish to consider whether they belong to the class of special tax reliefs, the need for which -

Common, but presumably illegal?

and indeed the value of which - will be called into question following your wider tax reforms.

iii. Covenants to the elderly and disabled

56. Covenants may also be used in other circumstances to support relatives - for example elderly parents, or disabled or mentally handicapped adult children. The statistics suggest that these are relatively rare, compared with students and children's covenants. So far as the elderly are concerned, that is not surprising, because the State pension will use up about two-thirds of the elderly person's personal allowances. So there would be little tax advantage in making a covenant. In general, particular needs such as disability should be catered for through the social security system, but it is possible there may be some hard cases in this area where covenants are used. It might be possible to allow covenants to remain tax-effective in cases like these, if they could be suitably defined.

57. Subject to that, however, the logic of the reforms is for covenants between individuals to be made tax-neutral. Overall the revenue cost of the present system is over £m200 and the manpower cost 300 (projected to rise to 360 by 1990-91).

Transitional arrangements

58. We can let you have a more detailed note on transitional arrangements for existing maintenance orders, covenants etc if you wish. The general approach, however, would be to let the present rules continue to apply to arrangements already made before the date of announcement of a change. It would be possible - but perhaps not necessary - to set a time limit such as six or seven years. Future arrangements would be drawn up with the new tax position taken into account.

59. A particular problem - which will need further thought - is that in general payers of maintenance who lose from the change will, understandably, want the old rules to continue for existing Orders etc; whereas recipients of maintenance will want the new rules to apply straightaway, since that would exempt them from tax on maintenance payments received. One possibility might be for the old rules to continue unless the couple both elect to switch to the new.

60. Some special cases would need to be considered where a shorter transitional period might be appropriate. For example, if tax relief for student covenants was to be replaced by improved arrangements for grants, it would probably be necessary to ensure that students did not get the benefit of the old and new regimes simultaneously.

61. The new rules would probably need to apply to arrangements made from the date of announcement. Otherwise there would be a risk of substantial forestalling - for example, a rush to the Courts to get maintenance Orders taking advantage of the Sherdley decision.

Summary

62. The main proposals considered here are as follows -

i. Covenant payments between married couples to be made ineffective for tax purposes, as an essential part of independent taxation.

ii. Covenants between other individuals also to be made ineffective, subject to possible preservation for deserving cases and to suitable arrangements being made for students through an alternative tax expenditure.

iii. Tax relief for maintenance payments between divorced and separated couples to be limited perhaps to £1370, or to a higher figure such as

£2425 or £2496. The figure most consistent with independent taxation would be £1370, the difference between the single and married allowances.

iv. Maintenance payments to be tax-free in the hands of the recipient.

v. Maintenance payments to a child in the payer's own custody to be made ineffective for tax as a minimum; but preferably to be made ineffective in the case of all children.

63. If you favour a general approach on these lines, we will need to do more detailed work on the full implications of the changes.

C STEWART

[redacted]

CHANCELLOR OF THE EXCHEQUER

pps let me see the minutes.

Ch/

Your note on 1(a), behind.

Enclosed, w. prev. pps.

The minutes record agreement to the proposal that:

"Covenants between other individuals [are] also to be made effective, subject to possible preservation for deserving cases and to suitable arrangements being made for students through an alternative tax expenditure".

2. Mr Stewart's minute has inverted this and made it much more definite. If you agree, I shall minute out emphasising the possible nature of any arrangements for students.

JT 17/11

CONFIDENTIAL

Inland Revenue

The Board Room
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London WC2R 1LB

This is a minefield; but there is much to be said for the reform proposed here. I should be grateful for views of Ministers & advisers. Meanwhile, I think the answer to Mr Isaac's 13(a) must be yes; 13(b) can wait a bit. N

[Not simply problem]

FROM: A J G ISAAC
24 July 1987

CHANCELLOR OF THE EXCHEQUER

COVENANTS AND MAINTENANCE

1. Mr Stewart's note below reports the promised outcome of our further work on the tax treatment of maintenance and covenants. The note shows how a number of considerations come together, to suggest a need for new legislation here, and a possible legislative route.

ISAAC TO CH/EX 24 JULY

2. First, as you know, **some legislation will be essential** following your decision to go ahead with independent taxation of husband and wife. Otherwise, there is scope for covenants between spouses, on a scale which could cost several £ billion - effectively introducing transferable allowances by a crooked path, through the back door. There is also a risk on the horizon (though not yet an established threat) of significant costs flowing from the Sherdley decision, affecting payment by parents for the support of their children.

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Jenkins - Parl. Counsel

Mr Battishill
Mr Isaac
Mr Corlett
Mr Lewis
Mr Beighton
Mr Lawrance
Mr Cherry
Mr Crawley
Mr Cleave
Mr Mace
Mr Davenport
Mr R H Allen
Mr Yard
Mr Marshall
Mr Eason
Mr Stewart
PS/IR

3. In each case it would be possible to construct a **narrowly targeted** legislative solution. This would remove any risk of tax advantage from covenant payments between spouses, and between parents and children during the continuance of a marriage.

4. However, there is on the face of it something unattractive in provisions which would necessarily say that covenants and maintenance payments are effective for tax purposes except where two people concerned have entered into a marriage contract .

5. There are also more substantial reasons for reviewing the present tax treatment in both areas.

6. Thus, in the case of **covenants**, tax relief

- rests on the taxpayer's precise conformance with a bit of legal mumbo jumbo (which can in practice be a trap for the unwary, who either lose tax relief they have been expecting, or commit what is technically fraud to secure the substance of relief, after having neglected the technical form);

- operates unfairly: in particular there is Mr Cropper's familiar "earnings trap", whereby the university student who depends on his father for his maintenance is already up to or over the tax threshold, and is liable to tax on every £ of his vacation earnings, whilst his fellow student with a local authority grant is free to earn his £2,500 a year tax free. (Again a trap for the unwary; and again the worst possible way for the tax system to introduce itself to the middle-class student, giving him reason to think it unfair, and all too often to evade it.)

- is ludicrously - and on any impartial analysis quite unnecessarily - expensive to administer, with a staff cost rising to 360 over the period of our latest PES bid , for covenants as a whole.

7. Again for **maintenance** payments,

- the tax relief works in a very skewed distributional way. For alimony (other than small maintenance payments) over 70% of the relief goes to payers earning over £30,000 a year.

- it operates (on the face of it) unfairly: for example, on the present interpretation of the Sherdley decision, a father can get tax relief at his marginal rate for the maintenance of his children, even if his children are living with him, provided that he has divorced his wife; but he has to support his children out of his post-tax income if he remains married;

- again there are significant staff costs, rising to an estimated 250 over the PES period.

8. It was against that background that we suggested, before the Election, that there was a case here for looking at the scope for some more **wide-ranging and fundamental reform.**

9. Having said that, we emphasised from the outset that this is a very sensitive area, where there are quite a lot of people in very real financial need. We would not want to recommend any kind of Ramboesque adventure. On the contrary, we have assumed that there is no scope for reform here, even if it would yield substantial staff savings, unless it could include genuinely adequate protection for deserving cases. This is the field where we have been concentrating our work in the last few weeks.

10. For **covenants**, the problem is overwhelmingly one of student support.* If it is politically possible, we should like to take an axe to the present bureaucratic jungle, and work up a way of routing through local authority channels - alongside the existing local authority support for students - the value of the present support to students through the fiscal system. This could cut out much of the Revenue's administrative costs, with perhaps no significant addition to local authority costs; and it could also remedy the present anomaly with students' vacation earnings (Mr Cropper's earnings trap).

11. One form of this approach could imply an accounting switch, under which payment orders to students would cease to be negative taxation (when sent through the post by Inland Revenue) and become public expenditure (when sent by local authorities). This would be merely a change of presentation - without substance - but it obviously could be difficult for the Treasury. We have sought to work up a variant of this approach, under which the payments might continue to be accounted for as negative taxation, on a "MIRAS" principle.

argument both ways

12. For **maintenance** payments, we see scope for a reform which continued to give tax relief for relatively modest maintenance payments (two possible variants would cover respectively about 75% or over 90% of all current maintenance payments). And (as with the student reform) the income would cease to be taxable in the hands of the recipient. The object would be to protect, and in some cases improve the position of, the low income family who may be dependent on supplementary benefit or family income supplement. It could make the tax system neutral (or in the more

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*We are proposing no necessary change in charitable covenants, and we assume that if necessary there could be a special regime for covenants towards the disabled. Following your wider tax reform, you may feel that there will not remain an essential need for "grandparent" covenants. There are few other covenants nowadays.

?

generous version only slightly more favourable) for the divorced couple, as against the married couple. It should also save some Revenue staff.

13. There would be a lot more work to be done, before we could offer you precise and detailed schemes with a full analysis of the distributional implications. In due course, in the Autumn, we should (as we have said before) need to consult the DHSS, the Lord Chancellor's Office, and the DES. At this stage, however, it would be most helpful if you could let us know whether

a. you think that the ideas on either or both students and maintenance look sufficiently attractive to make it worth our working them up for you in greater detail; and, if so,

b. whether you would like us to pursue further with the Treasury the implications of using local authority channels to deliver the present tax support for student maintenance and the possibility of continuing to account for it as "negative taxation" under MIRAS principles.

[illegible]

A J G ISAAC

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

[illegible]

C/

We have been trying to arrange a meeting for some time on student loans. The main problem has been the CST's diary which is pretty solidly packed with bilaterals etc.

Tim Burr has just produced the attached minute on student loans and tax relief on covenanted parental contributions.

If you want a meeting pre-Washington it will have to be Tuesday. Do you want us to try + fix something?

CR 18/9

1670/39

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FROM: T J BURR
18 September 1987

1. MR GILMORE

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Gilmore
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr McIntyre
Mr Parsonage
Mr Kaufmann
Mrs Pugh o.r
Mr Ashworth
Mr Cropper
Mr Tyrie
Mr Isaac - IR
Mr Corlett - IR
Mr Stewart - IR
PS/IR

Mr Burr's: A v. helpful paper, wh. suggests that this is a promising approach. I would be grateful for views of Mins & advisers; & will have a mtg ASAP after I get back from Washington

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

Has also other contributions to students - eg by grandparents

Mr J M G Taylor's minute of 13 August asked me to work up a scheme which used the value of tax relief on covenanted parental contributions to help finance a mixed loan and grant system of student support.

BURR to CH/EX 18/9

2. With the help of Mr Spackman, Mrs Pugh, and Mr Ashworth, I have now prepared the attached paper, which presents six options falling within a cost constraint of the present cost of student support and social security benefits for students plus the value of tax relief. These options are summarised in paragraph 24 and in figure 1 of the paper. They are different combinations of:

(a) either using the value of tax relief to increase support paid to students, or to ease the parental contribution scale, or both;

(b) either substituting loan for grant on which parental contribution is paid (with the result that the amount of loan varies with parental income), or not doing so (and thus having a flat-rate loan at all levels of parental income).

3. FP have made the point that, in evaluating the options, you will in due course wish to consider their impact on families alongside that of the Budget.

4. You may wish to discuss the paper with us. Mr Taylor's minute indicated that you would want to put a scheme to the Secretary of State for Education and Science. Once a preferred scheme has been identified, we will of course provide a draft letter to Mr Baker. At a subsequent stage it might be helpful to circulate the attached paper, or a development of it, to the interdepartmental Review of Student Support which is considering options for a mixed grant and loan scheme.

5. In any discussion, you may also wish to bear in mind the separate paper on the role of financial institutions in providing student loans which was submitted to the Chief Secretary with my minute of 18 June, and has now been circulated to the Review.

6. Finally, I should confirm that the paper has been cleared with FP and Inland Revenue.

T J Burr

T J BURR

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

Background

The Review of Student Support is examining the question of providing for student maintenance through a mixture of grant and loan rather than grant supplemented by social security benefits as at present. Objectives of such a reformed system would include:

(a) Greater responsiveness of students' subject choice (and of provision by institutions) to the pattern of skilled manpower requirements in the economy, as indicated by relative earnings levels;

(b) Sharper incentives for students to perform well, and thus improve their future earnings prospects;

(c) Encouragement of more self-supporting attitudes among students;

(d) As now, facilitation of the Government's policy that access to higher education should be determined by ability to benefit (and not, for example, by parental income);

(e) In the longer-term, substantial savings in the cost of student support, some of which might be ploughed back into an easement of the parental contribution.

2. It was agreed by Ministers at the outset of the Review that the cost of the reformed system on introduction should be broadly commensurate with that of the present maintenance grant and of social security benefits claimed by students. DES have circulated a paper (SSR(86)14) illustrating a scheme which meets this cost constraint and others which do not.

The proposal

3. This paper explores what would be possible if tax relief on convenanting of the parental contribution were withdrawn,

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and the present tax cost of the relief were added to the cost constraint on the review. Options have been illustrated with the aid of a student loans model developed by DES, but DES do not know this and have not otherwise been involved at this stage.

Assumptions

4. The key magnitudes can be quantified (a) or estimated (b to d) as follows:

	Annual total (£ million)	Annual average per student (£)
(a) Maintenance grants	460	1165
(b) Social security	85	215
(c) Tax relief on covenants	66	167
(d) Parental contributions net of (c)	264	668
Total	875	2215

5. No statistics are readily available for the value of covenanting made in respect of assessed parental contributions. The above figure is a DES estimate for the value of tax relief claimed in respect of covenanting. This is 20 per cent of contributions and is broadly equivalent to covenants for 75 per cent of all parental contributions due at the basic tax rate of 27 per cent. It is lower than the Inland Revenue estimate of £100 million because that estimate relates to all students (not just those in receipt of mandatory awards), and the full amount of covenanting (not just in respect of assessed parental contribution: many parents covenant more than the full parental contribution and claim tax relief). There is of course a question whether the value of tax relief transferred to the Review kitty should be limited to that in respect of assessed contributions to mandatory awards, or should include any other covenanting for students. This paper makes the former more cautious assumption.

6. It is assumed that a loans scheme would apply to new entrants

only, and that there would be a three year grace period after course completion. Repayments would therefore not begin until after year 6. The costings are constrained to be roughly equal to the present cost of maintenance grant and social security benefits for students in year 5, before repayments begin. Thereafter the flow of repayments produces an increasing net saving. No recycling of this saving into increased support and/or easement of the parental contribution has been assumed.

7. Repayment is in 3 to 6 equal instalments depending on the size of the loan, with provision for deferment in the event of low earnings. The default rate is assumed to be 10 per cent. The loans carry a zero real interest rate.

8. All options are costed at take-up rates of 100 per cent and 80 per cent. No doubt some students who wished to minimise their indebtedness would either make do without the full loan, would replace it with part-time earnings, or would secure additional help from relatives. If so, take up would be less than 100 per cent. It is difficult to judge how much less, but 80 per cent has been used as an illustrative figure. The savings which result have been used to offer a larger loan in all options, rather than to reduce parental contributions. To keep down the number of tables, the Annexes only exemplify 100 per cent take up. The options are summarised in Figure 1 and illustrated diagram~~m~~atically in Figure 2.

Option 1

9. The most obvious way in which the value of the tax relief could be used would be in an **enhanced "top-up" scheme**. In such a scheme, loans would initially replace only social security benefits for students, leaving the present combination of grant and parental contribution unchanged. But, as the figures in paragraph 4 above show, social security benefits equate to an annual loan of only £215, or less than 10 per cent of total support. Adding the value of tax relief gives a more worthwhile loan of £385, or £490 with 80 per cent take up. This option is exemplified at Annex 1.

10. The effect is to transfer the benefit of the previous tax relief from parents to students, in the form of a loan, thus increasing the total support to the latter from £2215 to £2385. This sizeable gain to students would greatly reduce any problem with those drawing above average levels of social security benefit, who would otherwise 'lose' (although no individual would suffer a reduction in entitlement because the new regime would only apply to new students). There would however still be some students with large social security entitlements (notably in respect of housing costs) who would get less than they would have got in social security. (Because of variations in housing costs, these entitlements could in theory range as high as £1000 or more in some cases. But there is insufficient information on which to assess their actual distribution.) There would of course also be a corresponding loss to parents; and unless that were compensated in some other way, they might react by making lower parental contributions or reducing other support, in which case the benefit to students would be eroded. Moreover there would be losses and gains even for families as a whole. Since better off families get more tax relief, (because they pay higher parental contributions), they would lose from a flat rate addition to grant, and vice versa for low income families.

OK

Option 2

11. This option builds on the approach illustrated by option 1, but goes further and doubles the loan to an average of £800 per student, so that it replaces not only social security benefits and tax relief on covenanting, but 36 per cent of maintenance grant as well. The gross parental contribution, however, is left unchanged. The effect is that there is a parental contribution to the element of loan which replaces grant, as well as to the residual grant. Loan entitlements therefore fall with rising parental income. This option is exemplified at Annex 2.

12. All net grant entitlements have simply been reduced by 36 per cent, so the replacement loan varies with parental income in the same way as grant. There is therefore a wide dispersion

of loan entitlements around the £800 average, ranging from a minimum of £385 (the element replacing social security and tax relief) to a maximum of £1,100 a year. With 80 per cent take up the average loan rises to £1000, with the same dispersion (£585 to £1300).

13. This is a feature of all loan schemes which replace any maintenance grant, but retain the full parental contribution. In this option, the amount of loan outstanding at the end of a three-year course would vary (at 100 per cent take-up) from £1155 to £3290. The latter amount (and perhaps especially the difference of over £2000), while actually a benefit in the form of a subsidised loan, would no doubt be perceived by the student from a low-income family as a burden (which in the case of a student from a high-income family would have been substantially borne by his parents). If this perceived burden acted as a disincentive to entering higher education, there would be some tension with the Government's policy on access to higher education (paragraph 1d above).

14. Attempts can be made to meet this point by tinkering with the parental contribution scale within the cost constraint. But a clear improvement means putting money into an easement of the parental contribution scale. Another approach worth exploring, therefore, is the use of the value of tax relief to ease the parental contribution scale rather than to increase the support paid to students, as in the following options.

Option 3

15. At first sight there is nothing more than simplicity to be gained by, in effect, netting off the parental contribution and the tax relief to give a lower parental contribution scale. The net position of parents is not changed, and nor is that of students. But whereas option 1 (and option 2) use the value of tax relief to give a flat-rate addition to student support, the 'netting off' approach distributes the value of the tax relief in broad proportion to the parental contribution, and thus enables more loan in lieu of tax relief to be given higher

up the income scale. This in turn increases the amount of loan which can be given without running into the distributional problem in paragraph 13 above.

16. Option 3 reduces the parental contribution by 20 per cent at all points, the obverse of which is that no one gets less than 20 per cent of the full maintenance grant. That 'minimum grant' can then be converted into a loan which does not vary with parental income. The result is much the same as if the present tax relief were lent, rather than given, to students. Annex 3 shows that this option permits a considerably larger loan than under Option 1 (£620 rather than £385, or £770 rather than £490 with 80 per cent take up) while keeping the loan constant at all levels of parental income.

Option 4

17. Option 4 adopts the same approach as Option 3, but raises the average loan to £800, as in Option 2. It therefore shows the effect, on this approach, of replacing grant on which parental contribution is payable. The effect is to vary the amount of loan inversely with parental income, but to a much smaller extent, than Option 2, as Annex 4 shows. The amount of loan outstanding at the end of the three year course would vary between £1860 at the top of the parental income scale and £2780 at the bottom.

18. But while Options 3 and 4 both permit worthwhile loans without pronounced distributional effects, they lack positive advantages. There would be no net change in the burden of the parental contribution, nor in the total amount of support available to students. As a result, the problem of student losses and gains as compared with previous social security entitlement would be unaffected. It would look very much as if the Government had simply switched the parental contribution to a net basis, and had replaced social security benefits for students and some grant with an equivalent loan.

19. These considerations suggest that it would be worth looking at mixed options, in which some of the value of tax relief is

used to pay for a top up loan, and some of it is used to ease the parental contribution scale. Such options are discussed below.

Option 5

20. In this option the value of tax relief on covenanting is split equally between a flat rate addition of £85 to student support and a 10 per cent reduction in the parental contribution scale, creating a "minimum grant" of £200. The total "top up" loan comprises these two components and the £215 average value of social security benefits, giving a total loan of £500 (or £620 with 80 per cent take up). This option is exemplified in Annex 5.

Option 6

21. Option 6 adopts the same approach as for Option 5, but as in Options 2 and 4 increases the loan to an average of £800 and thus replaces some support provided by grant on which parental contribution is paid. The results are exemplified in Annex 6, which shows that the annual loan would range from about £500 at the top of the parental contribution scale to about £1000 at the bottom (or £700 and £1200 respectively with 80 per cent take up).

Financial effects

22. In addition to indicating the impact on individual students, as discussed above, the Annexes also show the financial effects of the options and how these change over time. All options move from a net financial impact of roughly nil at the outset to substantial net savings once the schemes are fully mature. The size of these net savings obviously depends on the extent to which grant is replaced by loan, and is highest for Options 2, 4 and 6 which all provide an average loan of £800 (or its grossed up equivalent at 80 per cent take up). These options yield net savings of around £250 million from year 15 onwards, which in the case of Option 4 (where the value of tax relief

has already been used to reduce the parental contribution) would be almost enough to pay for abolition of the parental contribution. Among the remaining options, the biggest net saving (£186 million) is achieved by Option 3 and the smallest by Option 1 (£115 million), since they have the largest and smallest loan elements respectively. The intermediate Option 5 yields a saving of some £150 million.

23. If it is desired to have a scheme which gives the same loan at all levels of parental income, the choice is restricted to Options 1,3, and 5, all of which yield considerably lower savings than Options 2, 4, and 6. But as repayments began to flow in under the odd-numbered options, it would be possible to afford an easing of the parental contribution scale, which would in turn mean that more loan could be substituted for grant while meeting the constraint that parental contribution should not be payable on loans (which is essential if the amount of loan is not to vary with parental income). In this way the odd-numbered options could ultimately be brought to yield savings as large as the even-numbered options; and by further increases in the amount of loan, total abolition of the parental contribution would be possible under any of the options.

Summary and conclusions

24. The options are summarised in Figure 1. Their main features are as follows:

(i) **Option** 1 is a minimalist approach in which there is simply a top up loan to replace social security benefits and tax relief on covenanting. The total loan over a three year course would be about £1150 (at 100 per cent take up). There would be a long-term net saving of £115 million.

(ii) **Option 2** is like Option 1, but with a bigger annual average loan of £800 which would also replace some grant on which parental contribution is paid. The amount of loan would therefore vary with parental income, and would range from about £1150 to nearly £3300 over a three year course. The long-term saving would be about £240 million.

(iii) **Option 3** would apply the value of tax relief to easing the parental contribution scale. It would therefore not increase the amount paid to students. The amount of loan would then be the maximum possible without paying parental contribution on the loan, and would be about £1850 over a three year course. It would yield long-term savings of about £185 million.

(iv) **Option 4** is like Option 3, but increases the loan to £800 a year and thus replaces some grant on which parental contribution is paid. The amount of loan over a three year course would range from about £1870 to £2780. Long-term net savings would be about £240 million.

(v) **Option 5** is a combination of Options 1 and 3, in which the value of tax relief would be equally split between an addition to the support paid to students and an easement of the parental contribution scale. The loan is then the maximum which does not require a parental contribution to it. The total loan over a three year course would be £1500. The long-term saving would be about £150 million.

(vi) **Option 6** is like Option 5, but increases the average loan to £800 so that it replaces some grant on which parental contribution is payable. The loan over a three year course ranges from about £1500 to over £3000. The long-term saving would be £240 million.

25. On the merits of the options, Option 1 does not replace any of the present maintenance grant by a loan, and arguably does not go far enough to gain the value for money benefits of loans. Option 2 shows extreme variation of the amount of loan with parental income. Options 3 and 4 do nothing to ease losses for those with above average social security entitlements, and fail to use the value of tax relief to obviously positive effect. Option 6 still has considerable variation in the amount

of loan according to parental income. Option 5 avoids this, while still converting some maintenance grant to loan and doing something to ease social security losses. At £500 a year (£620 at 80 per cent take up) the amount of loan is significant in relation to present total support of £2215; and it could be progressively expanded as repayments flowed in.

HE2 Division
15 September 1987

SUMMARY TABLE

Option	Net Parental Contribution	Increase in average annual support per student - take-up: 100%	80%	Grant	Average Size of loan - take-up: 100%	80%	Distribution of loan take-up: 100%	80%	Long-term Public expenditure saving £m/year
1	Increased by full amount of lost tax relief (£170)	£170	£285	Unchanged	£385	£490	Flat rate		£115
2	Increased by full amount of lost tax relief (£170)	£170	£370	Unchanged	£800	£1000	Much larger loans for poorer families:- (£385-£1000)	(£585-£1300)	£241
3	Unchanged	Nil	£150	20% replaced by loan	£620	£770	Flat rate		£186
4	Unchanged	Nil	£200	36% replaced by loan	£800	£1000	Slightly larger loans for poorer families:- (£620-£930)	(£820-£1130)	£241
5	Increased by half of lost tax relief (£85)	£85	£200	10% replaced by loan	£500	£620	Flat rate		£151
6	Increased by half of lost tax relief (£85)	£85	£285	36% replaced by loan	£800	£1000	Larger loans for poorer families:- (£500-£1000)	(£700-£1200)	£241

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FIGURE 1

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FIGURE 2

STUDENT SUPPORT (AVERAGED OVER ALL STUDENTS)

In all options (i) Social Security payments to cease;

(ii) tax relief on covenants ceases, and the money from both is used instead to help finance loans

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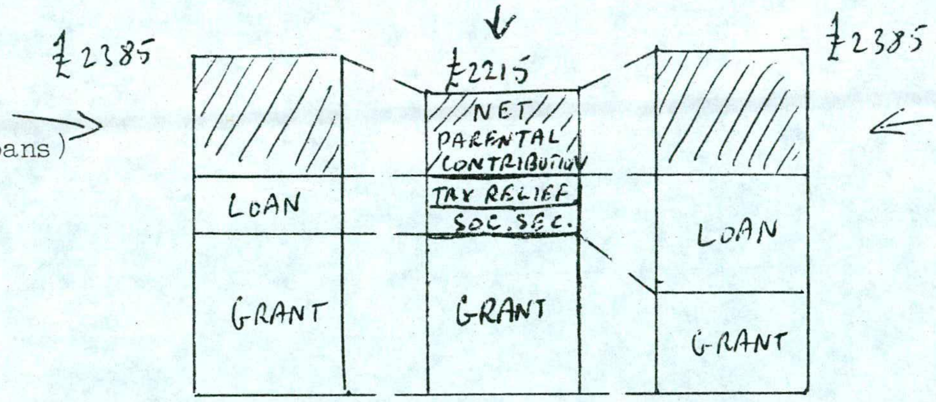
PRESENT

Option 1
(Flat rate loans)

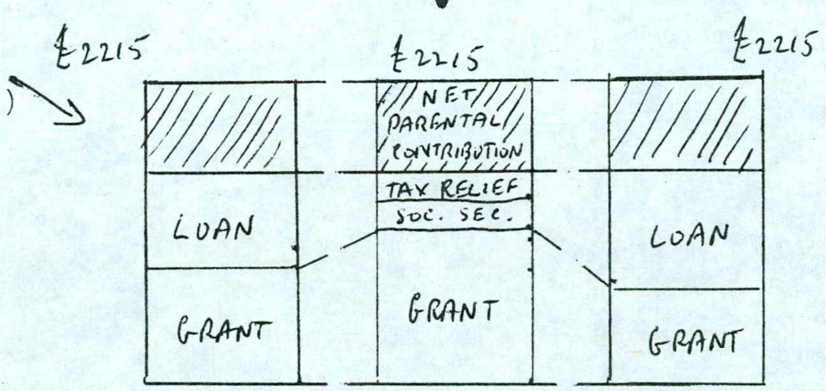


Option 2
(Larger loans for poorer families)

Parents required to maintain gross contributions, despite loss of tax relief.

PRESENT

Option 3
(Flat rate loans)

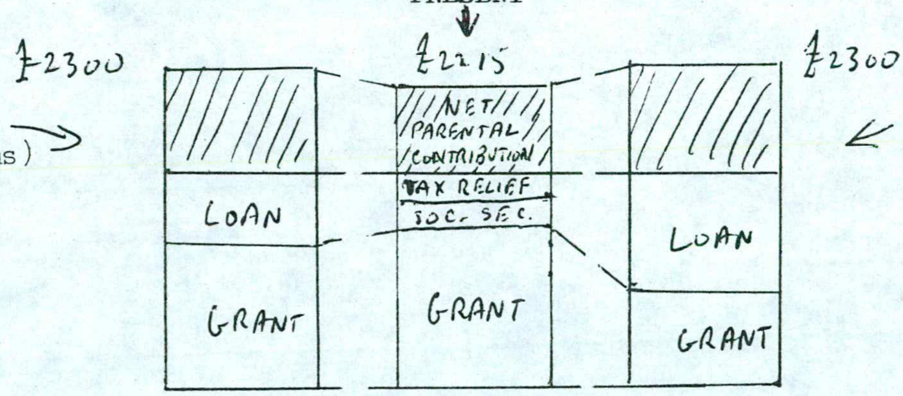


Option 4
(Larger loans for poorer families)

Parents required to maintain net contributions

PRESENT

Option 5
(Flat rate loans)



Option 6
(Larger loans for poorer families)

Parents required to increase net contributions, by half the amount of tax relief.

OPTION 1

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	0	(1)	(94)	(115)	(115)	(115)
Grant/sb/covenanting	(51)	(151)	(151)	(151)	(151)	(151)
Loan outlay	51	152	152	152	152	152
Loan repayments	0	3	95	116	116	116
Net PSBR	0	(1)	(94)	(115)	(115)	(115)

	Present Policy	New Policy
Average net grant	£1,165	£1,165
Average parental contribtution	£835	£835
Average loan	n/a	£385
Average debt for student leaving a 3 year course	n/a	£1,155

Total number of students	395,000
Take-up rate for loans	100%
Default rate	10%
Real interest rate	0%
Repayment schedule	3 equal annual instalments commencing in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

DISTRIBUTION TABLE

Parent's Residual Income	Dependent Award-holders '000s	%	Current Position Parental Contrib.	Current Position Net Grant	Proposed Option Parental Contrib.	Proposed Option Net Grant	Proposed Option Loan Facility
< £8,700	103	29	0	2,000	0	2,000	385
8700	22	6	20	1,980	20	1,980	385
9700	20	6	163	1,837	163	1,837	385
10700	20	6	306	1,694	306	1,694	385
11700	20	6	483	1,517	483	1,517	385
12700	18	5	683	1,317	683	1,317	385
13700	17	5	883	1,117	883	1,117	385
14700	15	4	1,083	917	1,083	917	385
15700	13	4	1,283	717	1,283	717	385
16700	11	3	1,508	492	1,508	492	385
17700	10	3	1,758	242	1,758	242	385
18700	85	24	2,000	0	2,000	0	385

Option 2

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	0	(2)	(150)	(233)	(241)	(241)
Grant/sb/covenanting	(106)	(315)	(315)	(315)	(315)	(315)
Loan outlay	107	316	316	316	316	316
Loan repayments	0	3	151	234	242	242
Net PSBR	0	(2)	(150)	(233)	(241)	(241)

	Present Policy	New Policy
Average net grant	£1,165	£750
Average parental contribtution	£835	£835
Average loan	n/a	£800
Average debt for student leaving a 3 year course	n/a	£2,400

Total number of students	395,000
Take-up rate for loans	100%
Default rate	10%
Real interest rate	0%
Repayment schedule	6 equal annual instalments commencing in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

DISTRIBUTION TABLE

Parent's Residual Income	Dependent Award-holders '000s	%	Current Position Parental Contrib.	Current Position Net Grant	Proposed Option Parental Contrib.	Proposed Option Net Grant	Proposed Option Loan Facility
< £8,700	103	29	0	2,000	0	1,288	1,097
8700	22	6	20	1,980	20	1,275	1,090
9700	20	6	163	1,837	163	1,183	1,039
10700	20	6	306	1,694	306	1,091	988
11700	20	6	483	1,517	483	977	925
12700	18	5	683	1,317	683	848	854
13700	17	5	883	1,117	883	719	783
14700	15	4	1,083	917	1,083	590	712
15700	13	4	1,283	717	1,283	462	640
16700	11	3	1,508	492	1,508	317	560
17700	10	3	1,758	242	1,758	156	471
18700	85	24	2,000	0	2,000	0	385

Option 3

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	0	(2)	(145)	(186)	(186)	(186)
Grant/sb/covenanting	(82)	(244)	(244)	(244)	(244)	(244)
Loan outlay	83	245	245	245	245	245
Loan repayments	0	3	146	187	187	187
Net PSBR	0	(2)	(145)	(186)	(186)	(186)

	Present Policy	New Policy
Average net grant	£1,165	£930
Average parental contribtution	£835	£665
Average loan	n/a	£620
Average debt for student leaving a 3 year course	n/a	£1,860

Total number of students 395,000
Take-up rate for loans 100%
Default rate 10%
Real interest rate 0%
Repayment schedule 4 equal annual instalments commencing in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

DISTRIBUTION TABLE

Parent's Residual Income	Dependent Award-holders '000s	%	Current Position Parental Contrib.	Current Position Net Grant	Proposed Option Parental Contrib.	Proposed Option Net Grant	Proposed Option Loan Facility
< £8,700	103	29	0	2,000	0	1,595	620
8700	22	6	20	1,980	16	1,579	620
9700	20	6	163	1,837	130	1,465	620
10700	20	6	306	1,694	244	1,351	620
11700	20	6	483	1,517	385	1,210	620
12700	18	5	683	1,317	545	1,050	620
13700	17	5	883	1,117	704	891	620
14700	15	4	1,083	917	864	731	620
15700	13	4	1,283	717	1,023	572	620
16700	11	3	1,508	492	1,203	392	620
17700	10	3	1,758	242	1,402	193	620
18700	85	24	2,000	0	1,595	0	620

Option 4

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	0	(2)	(177)	(239)	(241)	(241)
Grant/sb/covenanting	(106)	(315)	(315)	(315)	(315)	(315)
Loan outlay	107	316	316	316	316	316
Loan repayments	0	3	178	240	242	242
Net PSBR	0	(2)	(177)	(239)	(241)	(241)

	Present Policy	New Policy
Average net grant	£1,165	£750
Average parental contribtution	£835	£665
Average loan	n/a	£800
Average debt for student leaving a 3 year course	n/a	£2,400

Total number of students	395,000
Take-up rate for loans	100%
Default rate	10%
Real interest rate	0%
Repayment schedule	5 equal annual instalments commencing in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

DISTRIBUTION TABLE

Parent's Residual Income	Dependent Award-holders '000s	%	Current Position Parental Contrib.	Current Position Net Grant	Proposed Option Parental Contrib.	Proposed Option Net Grant	Proposed Option Loan Facility
< £8,700	103	29	0	2,000	0	1,288	927
8700	22	6	20	1,980	16	1,275	924
9700	20	6	163	1,837	130	1,183	902
10700	20	6	306	1,694	244	1,091	880
11700	20	6	483	1,517	385	977	853
12700	18	5	683	1,317	545	848	822
13700	17	5	883	1,117	704	719	791
14700	15	4	1,083	917	864	591	761
15700	13	4	1,283	717	1,023	462	730
16700	11	3	1,508	492	1,203	317	696
17700	10	3	1,758	242	1,402	156	657
18700	85	24	2,000	0	1,595	0	620

Option 5

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	0	(3)	(123)	(151)	(151)	(151)
Grant/sb/covenanting	(67)	(197)	(197)	(197)	(197)	(197)
Loan outlay	67	197	197	197	197	197
Loan repayments	0	3	124	151	151	151
Net PSBR	0	(3)	(123)	(151)	(151)	(151)

	Present Policy	New Policy
Average net grant	£1,165	£1,049
Average parental contribtution	£835	£752
Average loan	n/a	£500
Average debt for student leaving a 3 year course	n/a	£1,500

Total number of students	395,000
Take-up rate for loans	100%
Default rate	10%
Real interest rate	0%
Repayment schedule	3 equal annual instalments commencing in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

DISTRIBUTION TABLE

Parent's Residual Income	Dependent Award-holders '000s	%	Current Position Parental Contrib.	Net Grant	Proposed Option Parental Contrib.	Net Grant	Loan Facility
< £8,700	103	29	0	2,000	0	1,800	500
8700	22	6	20	1,980	18	1,782	500
9700	20	6	163	1,837	147	1,653	500
10700	20	6	306	1,694	275	1,525	500
11700	20	6	483	1,517	435	1,365	500
12700	18	5	683	1,317	615	1,185	500
13700	17	5	883	1,117	795	1,005	500
14700	15	4	1,083	917	975	825	500
15700	13	4	1,283	717	1,155	645	500
16700	11	3	1,508	492	1,357	443	500
17700	10	3	1,758	242	1,582	218	500
18700	85	24	2,000	0	1,800	0	500

Option 6

SUMMARY OF RESULTS

YEAR	1	5	10	15	20	Steady State
PSBR CHANGE (£m)	0	(2)	(176)	(239)	(241)	(241)
Grant/sb/covenanting	(106)	(315)	(315)	(315)	(315)	(315)
Loan outlay	107	316	316	316	316	316
Loan repayments	0	3	178	240	242	242
Net PSBR	0	(2)	(176)	(239)	(241)	(241)

	Present Policy	New Policy
Average net grant	£1,165	£750
Average parental contribtution	£835	£752
Average loan	n/a	£800
Average debt for student leaving a 3 year course	n/a	£2,400

Total number of students	395,000
Take-up rate for loans	100%
Default rate	10%
Real interest rate	0%
Repayment schedule	5 equal annual instalments commencing in the fourth year after the completion of a course with the option to defer for a further two or five years if earnings are exceptionally low.

DISTRIBUTION TABLE

Parent's Residual Income	Dependent Award-holders '000s	%	Current Position Parental Contrib.	Current Position Net Grant	Proposed Option Parental Contrib.	Proposed Option Net Grant	Proposed Option Loan Facility
< £8,700	103	29	0	2,000	0	1,288	1,011
8700	22	6	20	1,980	18	1,275	1,006
9700	20	6	163	1,837	147	1,183	969
10700	20	6	306	1,694	275	1,091	933
11700	20	6	483	1,517	435	977	887
12700	18	5	683	1,317	615	848	836
13700	17	5	883	1,117	795	719	785
14700	15	4	1,083	917	975	591	734
15700	13	4	1,283	717	1,155	462	683
16700	11	3	1,508	492	1,357	317	625
17700	10	3	1,758	242	1,582	156	561
18700	85	24	2,000	0	1,800	0	499

RC2.81 CONFIDENTIAL

NP

FROM: CATHY RYDING
DATE: 21 September 1987

MR BURR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Gilmore
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr McIntyre
Mr Parsonage
Mr Kaufmann
Mrs Pugh o.r.
Mr Ashworth
Mr Cropper
Mr Tyrie
Mr Isaac - IR
Mr Corlett - IR
Mr Stewart - IR
PS/IR

CR to BURR 21/9

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

The Chancellor was most grateful for your minute of 18 September.

2. The Chancellor has commented that this very helpful paper suggests that this is a promising approach. He would be grateful for the views of Ministers and Advisers, and would like to hold a meeting as soon as possible after he returns from Washington.

3. The Chancellor has also noted on paragraph 1 of your minute that any scheme will need to cover other covenants to students - eg by a grandparent.

CR

CATHY RYDING

For assoc^n with other pps., + for Ch. to see o/r

yes

CONFIDENTIAL

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

FROM: A J G ISAAC

22 September 1987

ISAAC to CHEX 22/9

CHANCELLOR OF THE EXCHEQUER

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

1. As Mr Burr has said, the note of 18 September has been drafted in consultation with us. You have already noted that it offers the prospect of a promising approach, and we have little to add.

2. As you know, we have two policy objectives in mind, in addition to the five objectives noted in paragraph 1 of the Treasury note. That is

- ending the "earnings trap" for students (students who receive their "grant" by way of covenant may be liable to tax on virtually every pound of their vacation earnings);

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cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Burr
Mr Gilmore
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr McIntyre
Mr Parsonage
Mr Kaufmann
Mrs Pugh o/r
Mr Ashworth
Mr Cropper
Mr Tyrie

Mr Isaac
Mr Corlett
Mr Stewart
Mr Davenport
PS/IR

- simplification of the operational system, and consequential savings in manpower and administrative costs.

3. I think it follows that we might have been tempted to be less dismissive of Option 3 ("nothing but simplicity" . . . "lacks positive advantages"). If there is a possible reform which could get rid of the earnings trap and save us the cost of a couple of hundred staff (which covers grandparent covenants also, of which there are only a negligible number), without significantly affecting the real position of either parents or students, that is not something to be despised. We are conscious that, for a variety of reasons, there may be an opportunity for reform this year, which we cannot foresee coming again soon.

4. Having said that, I entirely accept that these objectives have to be balanced against the other Treasury objectives. And (though I have to declare a personal interest, thrice) I can understand very well the arguments for increasing the total level of student maintenance, in the context of a package which might substitute a flat rate of support for something varying so widely - between different universities - as housing benefit.

A J G ISAAC

4375/25

CONFIDENTIAL

FROM: FINANCIAL SECRETARY
DATE: 1 October 1987

CHANCELLOR

cc Chief Secretary
Paymaster General
Economic Secretary
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Gilmore
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr Burr
Mr McIntyre
Mr Parsonage
Mr Kaufman
Mrs Pugh
Mr Ashworth
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac IR
Mr Corlett IR
Mr Stewart IR
PS/IR

C/ we now have a meeting on this in mid October

CR 2/10

will try to hold on 12/10

FST to CH/EX 1/10

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

1. You asked for comments on Mr Burr's submission of 18 September.

2. My views are very provisional since I have not given much thought to this issue before now.

3. Perhaps I could just make a few general points.

(i) I think that the ultimate objective should be to substitute loans for the entire student grant (and other means of student support).

(ii) A top priority must be to get students out of the DHSS system. The present arrangements are a scandal and have gone on far too long. The benefits culture is as harmful to students as to school leavers. No wonder students do not appreciate what society provides for them!

(iii) I am not as pessimistic as others that loans would be politically unpopular. I do not think that the level of indebtedness we have in mind in these proposals would be considered to be prohibitively burdensome - even though in some cases students will have "private-sector" debts (over-drafts, credit cards and so on) to service in addition.

(iv) An important point is that no-one will actually lose from these proposals. They will only be worse off than they would have been had the existing system been continued. I think that this is an important point since it distinguishes the current proposals from some previous (abortive) attempts at reform of the student support system (most recently Keith Joseph's proposals on the extension of parental contributions).

(v) The DES will probably argue that more money needs to be put into the whole area of student support to make the proposals acceptable. We need to consider that.

(vi) We need to think about the parental contribution. Does it work? Is it really true as the NUS suggest that many parents do not pay the full parental contribution, perhaps because they have not made adequate provision for their children's higher education. Should loans substitute for parental contributions?

4. Turning to the specifics of the schemes put forward by Mr Burr, I think that there are several key issues.

(a) "Neutrality": First, Option III is the most "tax neutral" as far as parents are concerned. Here tax relief is abolished and the money used to reduce parental contributions. This should be contrasted with, for example, Option I. Under this, wealthier parents (ie. those earning more than £18,700) might lose £540 in tax relief (27% of £2000), and they would gain nothing (although the average student would enjoy an increase in support of £170). I do not think this is a significant problem, because as I said above, people will not actually suffer a cash loss, they will simply be worse off than they would have been under the existing system. Nevertheless, it is worth considering and for this sort of reason, I think, Option III is the Revenue's preferred option.

(b) Flat-rate loans vs. Variable Loans: I think we need to be clear whether we want flat-rate loans or loans inversely related to the parental income level. In principle, I would prefer a loan related to income, because I think we should direct help at the most needy. But I can see that there are political dangers here. The student lobby are against loans partly because of the alleged disincentives to students from poorer families going into higher education. A proposal to force the poorer students to take out bigger loans than wealthier students would, therefore, be greeted with a great deal of criticism from the Opposition. In order to get the principle of loans accepted, it might be advisable in the first instance to go for flat-rate loans which would be less controversial.

(c) Housing Benefits: I think that the most serious unresolved issue is the question of how to compensate students who, under the current system, would be in receipt of well-above-average social security benefits (especially housing benefit). Under Mr Burr's proposals all students would get the equivalent of the average £215 social security payment (in loan form). Some students. I understand, might be receiving £1000 p.a. of social security payments. Thus, some students, particularly those living in high housing-cost areas, would be significant "losers" (in the sense described in (iv) above). I do not think this problem can be dissregarded. There are perhaps two ways in which compensation may be provided:

(i) Raising the amount of student support for all students (Options V and VI do this to the tune of £85, Options I and II, to the tune of £170). This approach is, of course, a fairly blunt instrument - all students benefit, but not by much and not enough to deal with the most expensive housing costs.

(ii) Making available needs-related top-up loans for students with high cost housing. This is more promising but some complex administrative questions would have to be addressed. Whatever the solution, the administration of a needs-related system should not be done by the DHSS as we need to get students away from the DHSS.

5. My provisional preference, amongst the proposals on the table, would be for Option V in Mr Burr's paper. This option, by splitting the tax relief money between parents and students:

- goes some way towards meeting the "neutrality point"
- does something to compensate for the loss of housing benefit.

It also gives a relatively high flat-rate loan (£500) which would be a worthwhile start in the direction we wish to go in, and would ease the introduction of the scheme (as I suggest in (b) above).

6. However, as a fall-back, one might consider a rather less ambitious two-stage procedure - along the lines of Option III.

(i) abolish tax relief and use the money to finance a 20% cut in parental contributions right down the scale. This would be announced at the time of the Budget.

(ii) Make a further announcement, at the same time, that it was our intention in due course to convert the £400 minimum grant (implied by the proposal at (i)) and the average level of student social security payments into a flat-rate loan.

7. I do think there would be advantages in abolishing the tax relief for covenants at Budget time, even if we had not fully worked up the loans proposal. But it would mean that we could not use part of the saved tax relief to boost the level of student support (as in Option V), since that would need to be synchronised with the withdrawal of social security benefits for students and their replacement by loans.

M.

NORMAN LAMONT

021/3647

pwp

CONFIDENTIAL

FROM: A G TYRIE

DATE: 5 OCTOBER 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Burr
Mr Isaac
Mr Cropper
Mr Call

TYRIE TO CH/EX 5 OCT

STUDENT LOANS

You asked for comments on Tim Burr's 18th September submission. Like the Financial Secretary I would like to see loans eventually (grants? fully replaced by other forms of students maintenance funding (these are another, and more complex matter). But full replacement is not on the political agenda for this term. Only a 'top up' scheme would be feasible.

I also agree with the Financial Secretary that loans would be a useful vehicle for getting students out of the social security system.

Where I part company with him and with Tim Burr's paper is in thinking that the replacement of grants with loans can or should be done in a public expenditure neutral manner. As soon as we consider options which replace grants (or full parental contribution in substitution for it) I think that the introduction of loans should embody some genuine new discretion for students, that is, an opportunity to accept a higher level of indebtedness. This means a higher loan ceiling. Clearly the vast majority of students would not borrow more than they think they need, even at preferential rates. (Although, I would have some sneaking sympathy for the most entrepreneurial among them who tried to make money out of preferential loan rates!)

Of the options themselves some of them are already at a level of intricacy which would require a degree to understand. We must have greater transparency in the student funding system if we are going to change it radically.

I think the most politically feasible would be option 2: replacement of social security benefits and covenanting plus replacement of a slice (option 2 suggests 36% but initially it could be less) of parental contribution by loans. But unlike Mr Burr and others I do not think it is reasonable that the loan entitlement should fall with rising parental income. The 'self reliance and money sense' frame of mind we are trying to inculcate is hardly stirred by keeping students dependent on parents.

R C Johnson.

pp A G TYRIE

3974/40

pwp

CONFIDENTIAL

FROM: P J CROPPER
DATE: 6 October 1987

CROPPER TO CH/EX 6 OCT

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Burr
Mr Isaac
Mr Tyrie
Mr Call

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

Mr Burr and colleagues have made a useful blueprint, responding to the remit they were given - i.e. a rearrangement within the student support system, at nil cost. Subject to the public expenditure aspects, I would prefer to have approached by another route.

2. Would it not be possible to start off by removing covenant tax relief and at the same time making loans available optionally for the <u>whole</u> of the amounts presently covered by parental contributions and tax relief? I do not believe that many parents would initially want to push their offspring into borrowing: it would take time for the idea to sink in. So the public expenditure cost would start out at a manageable level. (I refrain from tilting at the public accounting rule that repayable loans count as public expenditure at the front end.)

3. The advantage of this approach is that students would only be pushed into debt where the parent decided it should be, or had to be so. There would be a voluntary element about it, but where the parent wanted to get out completely from under the burden, he or she would be free to do so.

4. Replacement of the DHSS social security element by loans is more difficult. Until the need has been assessed (by

somebody) we do not know how much loan should be offered. And needs, being mainly to do with accommodation, vary from university to university, town to town. My inclination would be to push this element onto the loan market quite early on, but I fear that the process of assessing need will remain.

5. Later on - or perhaps at the same time - the State would withdraw from the maintenance grant business entirely, leaving student support to be met from either loans or from non-tax-relieved parental contributions.

6. Finally, presumably, the State would cease to pay for tuition. Though that might be a long way off.

7. The essence of my proposal is to tackle the parental contribution first, the needs element next, then maintenance grants and finally tuition. And to give parents and students as much freedom as possible to determine how much money to borrow. It is inevitable that poorer students will be under more pressure to borrow than rich ones. I cannot see any way of avoiding that, but I imagine most people would end up in the loan market if they were able to borrow on a nil real interest basis.

DM Gable

pp P J CROPPER

143.25

CONFIDENTIAL

FROM: B T GILMORE

DATE: 9 October 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr Burr
Mr McIntyre
Mr Parsonage
Mr Kaufmann
Mrs Pugh
Mr Ashworth
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac IR
Mr Corlett IR
Mr Stewart IR
PS/IR

STUDENT SUPPORT

You are holding a meeting on Monday 12 October to discuss Mr Burr's submission of / inter alia 18 September about student loans and tax relief on covenants to students.

2. This is part of two wider exercises, one of which is the Government's full review of student support, now under Mr Jackson's chairmanship. For Monday's meeting you should know of developments in that review. Formally it has made little progress, mainly because DES are reluctant to proceed within the cost constraint which they themselves proposed for it. The Treasury paper on the involvement of private sector banks which you saw (Mr Burr's submission of 18 June to the Chief Secretary) was put to the group in June, but has yet to be discussed. Informally, however, Mr Jackson himself has asked to discuss that paper and his review generally with the Treasury representatives on his group, without his own officials. His own thinking starts from a strong 'supply side' approach to higher education, including the eventual objective of replacing grant entirely by loan. But we know that he also wants to create 'room for manoeuvre' by buying out the parental contribution in one go - immediate cost over £250 million. For ease of reference I attach a one-page summary of the Treasury objectives, constraints and main orders of magnitude in this review. In accordance with these, our immediate objective has been to substitute loan for benefit and <u>some</u> grant, to get things moving and return to further changes as we start to see results from that.

3. You will not necessarily want to go far into the wider issue of student support at your meeting on Monday. In terms of the next steps on covenants, however, you may wish us to report back about Mr Jackson's thinking (and our assessment of it) before you raise covenants with them. There is also of course a problem about confidentiality (not DES's strong point).

BTG

B T GILMORE

143.24

CONFIDENTIAL

STUDENT LOANS

1. Objectives

   a. quality - to reduce dependent mentality (in particular to take students off DHSS benefit and replace grant by loan to the greatest practicable extent);

      - to improve output of higher education (through incentives to students to work harder and to demand better and more relevant education);

   b. cost - to reduce public expenditure in the long term;

   c. simplification - to remove complex administrative problems from Revenue, DHSS and possiibly DES and local authorities.

2. Constraints

   a. short term cost;

   b. acceptability (particularly in relation to equal opportunity, parental contribution, high housing cost in some places).

3. Orders of Magnitude

	Total (£m)
Paid to Students	
a) Maintenance Grants	460
b) Social Security	85
c) Parental Contributions (assessed as grant reductions)	264
Paid to Parents	
d) Tax Relief on Covenants	66+
Paid to Universities	
e) Tuition fees (home)	193.9
f) Other Current Grant (UGC)	1,454.4

CONFIDENTIAL

FROM: S P JUDGE
DATE: 12 October 1987

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Scholar
Mr Gilmore
Mr Burr
Mr Cropper
Mr Tyrie

PS/Inland Revenue
Mr Isaac - IR

STUDENT LOANS

The Paymaster General has seen the various papers that the Chancellor is discussing this morning. Although the detail is complicated, he thought Mr Burr's submission of September 18 was very clear - the diagram was particularly helpful. He adds that it was encouraging to see how much could be done within the precise cost constraint.

Given the objective of taking students out of the social security system, the Paymaster thinks we shall need more information about the incidence of usage (appreciating that the Financial Secretary mentions some recourse up to £1,000). He is as much preoccupied by where it occurs as in what amounts to whom. He adds that when £50 was added to the grant, in place of students charging travel costs above £50 to LEAs, 56 per cent were gainers but 30 per cent of students were losing more than £50 - with a particular incidence at Lancaster, Warwick, Edgehill/Ormskirk, Kent, UEA and London. A year later this had not significantly affected UCCA applications to London, but seriously (eg) to Lancaster. The Paymaster thinks that removal of social security will hit London particularly hard (he appreciates London students already enjoy a grant margin) and therefore we shall need better information on geographical implications. He is not clear whether

PS/PMG to PS/CH 12.10.87

DES or DHSS or both will fill out this aspect.

As to reactions within the student community, the Paymaster notes that (regardless of which option is chosen) the NUS has a similar "broad church " problem to the CBI. They represent, similarly, those on maximum grant and those on no grant at all - this does complicate their response to particular proposals. They would however make particular mileage out of any proposal that those on full grant should have a loan substitute, on the grounds that this will discourage working class applications at a time when DES is forecasting increased overall take-up. The Paymaster beleives working class participation has in fact improved since 1979, and that the numbers on full grant look surprisingly high. (This used to reflect an income of two-thirds of average earnings or less, for a man with two children.)

The Paymaster thinks we should not under-estiamte the proportion of parents who fail to make their assessed contribution. The NUS calculated this in 1983 as 43 per cent (this of course excludes students on full grant, some of whom, ironically, do receive parental contributions). The Paymaster saw nothing which suggested that this figure was excessive. He adds that it is relevant to those options which transfer the benefit of cove~~yenance~~nants from parents to students, and thinks that we should assume that this will occasion extra forced student indebtedness as parents will reduce their contributions.

The climate towards indebtedness has changed because it is now much easier for a student to find a summer job than it was in the early 1980s, when we were first cutting grants. The Paymaster adds that it was Mr Radice's private view that loans were the only resolution to the rising scale of student support.

The Paymaster has no doubt that the parents of students on no grants, and the students themselves, resent the earnings trap to which Mr Isaac refers: of course this has implications for students seeking to reduce indebetedness via summer earnings.

Although the removal of the minimum grant changed parental contributions from being regressive to being progressive, there was no progressiveness above an income of around £20,000 (in 1985), unless the student's grant need is above the standard rate (eg London and medical students etc). A disproportionate burden of the scale therefore fell on incomes between £12,000 and £20,000 (in 1985 terms).

The Paymaster recommends that, of the options we have available, he would go for option V.

The Paymaster would like to raise one matter, which has not come up - perhaps because it occurs at LEA level rather than in the Revenue. This is the considerable resentment of parents on PAYE who see neighbours on different tax arrangements with off-spring receiving full grant, and with Jaguars in the drive-way, who have accountants who can minimise their incomes for the crucial years. He thinks this may also explain the surprisingly high incidence of full grant students in Mr Burr's tables.

S P JUDGE
Private Secretary

Papers PSO

FROM: P D P BARNES
DATE: 13 October 1987

PS/CHANCELLOR

I should be grateful for views of CST & Pmh.

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Gilmore
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr Burr
Mr McIntyre
Mr Parsonage
Mr Kaufman
Mrs Pugh
Mr Ashworth
Mr Cropper
Mr Tyrie
Mr Call

Mr Isaac - IR
Mr Corlett - IR
Mr Stewart - IR
PS/IR

B/EST TO PS/CH 13.10.87

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

The Economic Secretary has been following the papers on this subject.

2. The Economic Secretary thinks it may be worth considering changing the social security rules so that benefits to students become loans. He thinks the advantage of this would be to translate the social security cost into a loan and still relate the amount each student receives to his need.

3. I mentioned this suggestion to Mr Burr, whose initial reaction was that it would be administratively complex and could have unwanted policy consequences. The Economic Secretary nonetheless thinks that it may be worth exploring the

ramifications of this proposal a little further alongside other options.

PB

P D P BARNES

Private Secretary

ps2/41R

CONFIDENTIAL

B/F 9/11

BTF 4/11R

BTF 3/10 24/10 29/10

FROM: CATHY RYDING

DATE: 16 October 1987

PS/ECONOMIC SECRETARY

~~Have we had anything else.~~

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Gilmore
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr Burr
Mr McIntyre
Mr Parsonage
Mr Kaufman
Mrs Pugh
Mr Ashworth
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac - IR
Mr Corlett - IR
Mr Stewart - IR
PS/IR

b/f 10/11

APS/CH To PS/EST 16.10.87

STUDENT LOANS AND TAX RELIEF ON COVENANTED PARENTAL CONTRIBUTIONS

The Chancellor has seen your minute of 13 October and would be grateful for views from the Chief Secretary and Paymaster General.

CR

CATHY RYDING

cc Mr Jeffery
Mr Johnstone
Mrs A C Jeffery
Mr Bird
Mr Chamier
Mr C A Clark
Mr Baker
Mr Sanders
Ms Bartman

12

JACKSON PAPER

MR SUMMERS

1. I attach Mr Jackson's first sketch of the Student Support Review Report.

2. Mr Jackson would like to aim to complete the Report by Christmas. He has therefore asked that two meetings of the Committee should be scheduled between 18 November and 18 December, although he hopes only one will be necessary.

3. He further asked that officials should put work in hand refining the first two chapters immediately: so that first draf are available for 18 November.

4. Mr Jackson has also commented:

"Obviously the whole argument turns on the figuring. From the DES I would like a paper on paragraph 66: the cost of Mandatory grant for students from low income backgrounds. From the Treasury I would like advice on how to take the proposals for loans forward (paragraphs 71-78). I would like these papers in advance of our 18 November meeting, so that we are in a position to discuss, and agree, the elements outlined in Chapter 3.

I will be discussing my sketch privately with the Ministerial members of the Committee."

5. Mr Jackson will send the paper to Mr Burr at the Treasury tomorrow (30 October).

PW

for SHIRLEY BIDEWELL
Private Office
29 October 1987

1

STUDENT SUPPORT REVIEW

CHAIRMAN'S FIRST SKETCH

CHAPTER 1 - INTERNATIONAL PERSPECTIVES

1. Over the period since 1945 all advanced countries have experienced a vast increase in the numbers of students undertaking higher education beyond the stage of compulsory schooling. The financial arrangements for maintaining students during these studies vary widely from country to country, and everywhere they have been subject to evolution and sometimes to radical revision. These varying arrangements reflect differences in institutional structures, cultural traditions, and political choices. Eight principal means of student support can, however, be identified, each of which is to be found in every country but in varying measures and combinations.

2. These eight means of student support are:

   a. grants to students from tax-payers' funds;

   b. loans from or backed by public funds;

   c. general income support from public funds (social security etc);

   d. public subsidies to student facilities;

   e. parental support;

   f. current student earnings;

   g. scholarships and bursaries;

   h. sponsorship by public or private bodies.

Grants

3. Grants to students from public funds may cover all or part of the cost of tuition, or all or part of the assumed cost of student maintenance.

Comparisons:

The British case: free tuition - the vestigial fee; maintenance grants related to parental means.

4. Grants may be mandatory - attached to the award of a place in a recognised institution; or discretionary - awarded at the discretion of a public body empowered to make grants.

Comparisons:

The British case: mandatory contribution to student maintenance for first degrees; discretionary awards for second and postgraduate degrees.

5. Grants are always related to parental means and sometimes to student earnings.

Comparisons:

The British case: grants related to parental means; disregard of student earnings (but liability to tax over £2,000).

6. The relationship between the level of grant and parental means/student earnings may be more or less generous from the point of view of the student.

Comparisons:

The British case: What principles determine the slope of the taper?

Loans

7. Loans may be advanced by public bodies - central, provincial, or local government, special student loan agencies, or by the educational institution itself, drawing upon public funds; or by commercial lenders.

Comparisons:

The British case: no loans from public bodies; evidence of growing private resort to commercial agencies.

8. Loans may be <u>guaranteed</u> by the tax-payer in varying degrees.

Comparisons:

The British case: no loan guarantees backed by governmental agencies.

9. Loans, whether from public bodies for from commercial agencies, may attract varying degrees of <u>interest-rate</u> subsidy from the tax-payer.

Comparisons:

The British case: no loans - no subsidy.

10. The arrangements governing the <u>repayment</u> of loans may be more or less flexible.

Comparisons:

The British case: commercial loans are subject to privately negotiated repayment arrangements.

11. Experience of <u>default</u> varies widely.

Comparisons. Causes.

General Public Income Support and Welfare Benefits

12. All advanced countries have general arrangements to provide income support and other welfare benefits from tax-payers' funds for those perceived to need them. Students may or may not be entitled to qualify for access to such systems.

Comparisons:

The British case:

13. The main types of such general income support are: (a) supplements to income - in Britain, "supplementary benefit"; (b) payments to the unemployed - as students may be entitled to describe themselves during academic vacations; (c) support for housing costs - in Britain, "housing benefit".

Comparisons:

The British case: NB The Government;s decision to withdrawn entitlement to [these] benefits from students.

Public Subsidies to Student Facilities

14. Student housing and refectories may be subsidised from public funds.

Comparisons:

The British case:

15. Other facilities - eg sports etc?

Parental Support

16. The age at which students are no longer deemed to be entitled to parental support varies.

Comparisons:

The British case: students up to the age of 25 are regarded as being entitled to parental support at least to the level of the maximum grant for maintenance.

17. Parental support may be encouraged by the tax regime.

Comparisons:

The British case: tax relief on covenanted gifts.

18. How much do parents actually pay?

Comparisons:

The British case: evidence that there is a growing shortfall in parental support up to the level of the maximum grant (?)
? Netherlands: A legal obligation to pay?

Current Student Earnings

19. Some countries regard "working one's way through college" as natural and desirable; others regard it as a distraction from study.

Comparisons:

The British case: original conception of the grant as an alternative to paid work, except in the long vacations; evidence of growth of student earnings, both in vacation and during term.

Bursaries and Scholarships

20. Bursaries and Scholarships are conceived to be merited by some special quality in the student. "Scholarships" are usually attached to academic merit. "Bursaries" are usually attached to the student's choice of course of study, or to some feature of his background.

Comparisons:

The British case: no government-funded scholarships or bursaries at undergraduate level (except for overseas students); very limited non-governmental provision of bursaries (the engineers' fellowships?) second- or postgraduate-degree discretionary awards may be conceived as bursaries; bursaries for science teachers.

Sponsorship

21. Sponsorship differs from the award of a bursary by virtue of some condition attached to the sponsored payment to a student.

Comparisons:

The British case: very limited government sponsorship (MOD - officer training); very limited private sponsorship.

Summary of British Arrangements

22. Against the background of this analysis of the various means of student maintenance in advanced countries we may now summarise the distinctive characteristics of these arrangements in Britain.

- British student support is concentrated to an unusually high degree on grants from public funds, to cover fees and towards maintenance;

- the level of the maintenance grant assessed against parental means is unusually high;

- British arrangements are relatively more dependent than those elsewhere upon deemed parental contributions;

- loans for student support are unusually little-used in Britain, and borrowing is very unorganised - with no public guarantees or specialized loan agencies, interest rate subsidies, or arrangements for the privileged management of repayment obligations;

- ?the sources of general public income support and other welfare benefits are unusually accessible to students in Britain;

- ?public subsidies to student facilities run at about the same level in Britain as elsewhere;

- ?students in Britain are less dependent than those elsewhere on current earnings;

- bursaries and scholarships are (much) less in evidence than in some cases elsewhere, notably the United States;

- ?there is (much) less reliance on sponsorship than in some cases elsewhere.

CHAPTER 2 - BRITISH ARRANGEMENTS EVALUATED

23. The growth in student numbers in advanced countries since the Second World War has been motivated by a variety of purposes each of which can be identified in varying degrees everywhere. Increasingly common to all countries, at the same time, has also been the desire to realise these purposes at the lowest possible economic cost, and especially at the lowest possible cost in terms of the expenditure of tax-payers' money.

24. The purposes motivating student support in advanced countries may be summarised under three headings:

a. economic benefits;

b. social promotion;

c. cultural development.

Our evaluation of the strengths and weaknesses of the British arrangements described in the first chapter is set out in terms of these three conceptions of their purposes.

<u>Economic Benefit</u>

25. In the post-war period it came to be generally believed in advanced countries that economic benefits to the nation as a whole could be derived from expanding higher education. Examples. The British case: cite Robbins, Anderson, etc.

26. The growth of higher education provision has, however, been accompanied by a debate about the economic returns from this substantial investment. Describe. This debate has led to a growing recognition that the returns to the national economy from a generalized expansion of provision are doubtful. Expand.

27. If there are links of causality leading from investment in higher education to greater national prosperity they seem to be

strongest in respect of education and training for specific economy-related purposes. Amplify. But most countries have concluded that "manpower planning" in higher education is not, in general, feasible - cite Robbins. "Shortage subjects", and cases of "oversupply", can, however, be identified and encouraged/ discouraged: examples.

28. The pursuit of public economic returns from investment in higher education thus seems to indicate arrangements which (a) support general provision and student discretion; but which (b) encourage the student's awareness of the economic costs and potential benefits of his studies, both for him personally and for the national economy; (c) facilitate the "targetting" of support for "shortage subjects".

29. From this point of view the present British arrangements for student support in Britain are relatively poorly designed to promote economic returns to the nation.

30. The unusually heavy reliance in the British system on "free" tuition and the mandatory grant for maintenance gives a relatively large and economically un-motivated discretion to the student in his choice of course and in his application to study. Amplify. [International comparisons of the distribution of students by subject : correlated with student support regime?]

31. These arrangements to an unusual extent deny students in Britain the opportunity - or protect them from the obligation - to form attitudes which reflect economic factors, costs and benefits. They may indeed encourage the reverse: (relatively unusual) access to the social security system. (Evidence?)

32. Moreover, the comparative generosity of grant provision makes the cost of attempting to influence student choices and behaviour by providing bursaries relatively expensive. Britain's arrangements for student financial support thus make it relatively difficult for government to promote "shortage subjects" by targetting support for them. Evidence: International comparisons.

33. For the same reason the relatively high cost of sponsorship in Britain has led to the paucity of provision of this type of student support in Britain. This again underlines the relatively poor state of the links in Britain between higher education and the economy.

Social Promotion

34. One of the chief reasons for the expansion of higher education in the advanced countries in the post-war period was the widely-held belief that this would be a powerful motor for social promotion: the enhancement of the "life-chances" of those from poorer or less privileged backgrounds, held back by social class, gender, or ethnic background. Examples. The British case: cite Robbins, Anderson.

35. The comparison and evaluation of the experience of the advanced countries in this matter has led, however, to the growing recognition that the ability of educational provision to change deeply-rooted class structures or relationships between the genders or the races must not be over-estimated. Amplify.

36. It is frequently argued that the British system of student support - with its "free" tuition and relatively heavy reliance on comparatively generous mandatory grants related to parental means - makes a strong contribution to social promotion. International comparisons suggests that this is not the case. (a) The relatively high cost of student support in Britain is one of the factors leading to relatively low numbers overall in higher education in Britain. At the same time, (b) the proportion of the age-group entering higher education in Britain has increased pari-passu with the deterioriation of the value of the grant; [so also has the participation of students from lower-income backgrounds and of women and ethnic minority students(?)] (c) The participation-rate of students of these types does not seem to be higher in Britain, with its especially favourable grant arrangements, than in Sweden, West Germany or France, with their much less generous provision. And indeed it is less than in

the United States. Amplify, especially with regard to female participation.

37. It is a notable feature of the British system of higher education that it involves a relatively small proportion of part-time students, including mature students - many of whom, in other countries, originate from the under-represented groups. Evidence. One of the causes of this situation is probably the way in which Britain's relatively generous arrangements for student support have reduced the pressures experienced elsewhere for higher education institutions to facilitate part-time and "in-and-out" study and to encourage opportunities for student employment: "free" fees and generous mandatory maintenance have reinforced a predisposition deeply rooted in the British university culture to concentrate on providing selection-entry full-time courses for 18-22 year olds.

38. British institutions of higher education are remarkably detached from the process of channelling financial support to students: student support comes from the rate-and tax-payer through the Local Education Authority, and from parents. In other countries the educational establishments have a larger role: examples. A larger measure of involvement by the institutions providing higher education in the channelling of student support should lead to greater responsiveness on the part of those institutions to the needs of individual students, to more flexibility and innovation - and thus, perhaps, to enhanced access.

Cultural Development

39. Higher education originated long before governments began to take an interest in the economic benefits and opportunities for social promotion which were identified in the post-war period. The origins and history of the university revolve around three central ideas: transmission, criticism and creation. These functions are necessarily in a condition of permanent tension. The transmission function is qualified by that of creation:

Revelation must nod to Reason; "Ancient" bows to "Modern"; the teaching vocation must recognise the vocation to research. Similarly, both transmission and creation must come to terms with criticism: does higher education serve the world, or stand apart from it? Is "objectivity" desirable, or even possible? If the academic must be engaged, which are the right engagements - whether political or vocational?

40. The post-war governments which have everywhere in the advanced world promoted the expansion of higher education certainly attached great importance to these wider cultural dimensions of their project - although, not surprisingly, they have preferred not to engage too closely with the controversies surrounding it. The general line has been to emphasise the democratic values of pluralism and academic freedom; to endorse both generalism and specialism, both teaching and research, both vocationalism and detachment; and to view academic political radicalism with indulgence, so long as it does not subvert free debate.

41. The present arrangements for student support in Britain were conceived with these considerations in mind. Cite Robbins, Anderson, etc.

42. Certainly, the British system of "free" tuition and generous mandatory grants is well designed to extend the greatest freedom of academic choice. Compared with the situation in other countries, both the "producers" and the student "consumers" of higher education in Britain are unusually unconstrained in following their own preferences against the background of relatively generous and undiscriminating tax-payer subsidy.

43. It must, however, be an open question whether this unusual degree of detachment from the play of influences external to higher education is desirable. It has given great weight to the views and interests of the academic "producers", thus helping to promote what appears to have been a shift in the balance between the transmission and creation functions - the teaching and

research vocations - of higher education. It may also be reflected in the institutional conservatism which was such a striking feature of the post-war expansion of British higher education: this may perhaps be described as a weakening of the critical function. There can be no definitive judgments about the implications of the British system of student support for subjective feelings of commitment to learning and teaching on the part both of students and their teachers; but one of the advantages claimed for systems which require a greater financial commitment from their students - and therefore a sense of greater accountability of the teachers to their students - is that they enhance the engagement to study.

Public Expenditure

44. In pursuing their broad purposes in expanding higher and further education, the governments of all the advanced countries have been increasingly concerned to proceed at the lowest possible cost in economic terms and in terms of public expenditure. How does the British system of student support compare with that in other countries in this regard?

45. Britain is notable for the very high rate of completion of undergraduate degrees, and for the relatively short length of the undergraduate course of study. These circumstances maximise the economic benefit which may be afforded by higher education, and minimise the opportunity-cost of the labour-power not available to the economy. Although these advantages derive from the pre-war history of British higher education, which has for centuries been unusual in its selectivity and its orientation towards short undergraduate degree courses, there is no doubt that they have been sustained through the period of post-war expansion by our arrangements for student support. At the same time there is growing concern that the British focus on selectivity and high-cost full time study may be keeping participation in higher education below the desirable level; and there is anxiety that our emphasis on higher education for 18-22 year olds may make our system less responsive than it should be to the increasing need for adult and continuing higher education.

46. Moreover, the economic benefits of selectivity and full-time post-adolescent study have to be paid for in terms of relatively high public expenditure costs. The "unit cost" per student in Britain is relatively high: amplify. Under the British system this cost falls almost exclusively on the tax-payer.

47. There may, in short, be a trade-off between economic costs and public-finance costs, such that the former are minimised at the expense of the latter. If this is the case the limit of public finance costs will fall to be decided by the consideration of its affordability.

48. Affordability is essentially a political judgement, turning on a view of the appropriate overall level of taxation and public borrowing, and on views about priorities in public expenditure. Judgment may, however, be assisted by analysis. The following figure plots the trend of student support costs in constant prices from 1962 to 1986, compared with the trend of public spending on higher education, of education spending, and of public spending at large. The comparison of these trends suggests that (in spite of some rectification since 1979) student support is probably consuming more than its appropriate share of education spending in general and of higher education spending in particular.

49. Another relevant consideration is whether public spending on student support may not be substituting more tax-payers' money than is necessary for expenditure which would otherwise have been undertaken by private individuals. The following figure plots the increasing number of students in higher education against the decreasing value of the student mandatory award. Coupled with our knowledge of experience abroad, this figure suggests that public provision may have been permitted to replace private investment to an unnecessary degree.

50. Distributive equity is also relevant to the judgement of priorities for public expenditure. The following figure plots the trend of average incomes as compared with the average incomes of

the parents of students in higher education, and the average income of graduates ten year after graduation. Since .. per cent of taxation is paid by those at or below average income levels it is clear that a substantial transfer of resources from the less well-off to the present and future better-off is involved in the present British system of student support. This may not in itself be objectionable, but it does sharpen the question how far public expenditure of this type is both necessary and justifiable.

CHAPTER 3 - TOWARDS NEW ARRANGEMENTS

51. A radical overhaul of the British system of student support is now overdue. This should start from first principles.

52. "Free" education at the charge of the taxpayer originated, historically, with the legislation which made schooling compulsory. "Free" provision was the counterpart of compulsion. But higher and further education has never been compulsory. So in this case "free" provision at the expense of the taxpayer must be justified not by an implicit contract but in consideration of certain public benefits. In fairness to the taxpayer these benefits should be specified as clearly as possible, and they should be secured at the least possible charge. It should also be remembered that the nature of these benefits - which we have defined as economic growth, social promotion, and cultural development - is such that the engagement of private interests is positively necessary for their realisation, and that society's ability to realise them may even be damaged by over-dependence on public funding and the narrowing of engagements which it entails.

53. The terms of reference of this review preclude an examination of the question whether the provision of "free" tuition at the taxpayers' charge is a precisely calibrated instrument for the realisation of any clearly conceived public benefit. In our review of support for student maintenance we have, however, taken as our starting-point the proposition that this should be a personal financial responsibility, in support of which contributions levied on the taxpayer should be rigorously calculated. We believe that the taxpayer should be generous, but only when the cause is justified.

54. In Chapter 2 we analysed the public benefits to be derived from public investment in higher education. We summarised these under the headings of support for the economy, for social promotion, and for cultural development. The pursuit of each of these purposes has implications for the targetting of public

support for student maintenance against the background of a general system of personal financial responsibility. We will consider below how this targetting of public support for specific purposes should be arranged. We will then consider how to ensure that students in general are in a position to assume personal responsibility for financing their maintenance in higher education.

[A] Targetted Support

Economic Provision

55. The principle that student maintenance should be a personal responsibility of the student will, by itself, have profound effects in enhancing the economic consciousness of students. Discretion in the choice of courses and careers will become, perhaps for the first time, a discretion properly informed as to economic costs and benefits. By itself this development should enhance the disposition to pursue courses which are more desirable from the personal and therefore the national economic point of view. It will also create a new context in which there will be a sharply enhanced sensitivity on the part of students to any possibilities of reducing the personal cost of their investment in higher education. The arrangements we envisage for student financial support will afford new ways for bodies both public and private to address this problem.

56. With the objective of economic formation in mind we propose, accordingly, that public funds be provided for bursaries and sponsorships to encourage students to undertake studies in "shortage subjects". These funds should be administered by the appropriate government department. They could be provided at the point of entry into study, either directly to the individual student or indirectly through the higher education institutions: this would impact most immediately on student choices. Or they could take the form of the paying-off of all or some of the borrowings incurred by the student in the course of his studies: this would not only influence student choice but also give an incentive to good academic performance. A mixture of "up-front" money and loan relief seems indicated. A bursary would entail no

obligations beyond that of successfully completing a particular course of study; sponsorship would entail some obligation of future employment in an agreed career.

57. These public funds might also be deployed on a basis which seeks to match public finance with private. "Matching funds" appears to be a promising way of encouraging private munificence and, indeed, investment in sponsorship. We believe that it should be a matter of public policy to encourage the diversification of the sources of funding for student maintenance, and to promote the closer engagement of private sources of funds with students, and of students with such private resources. Amplify.

58. Possibility of replacing by these means the existing cumbrous machinery for government manpower planning eg for teacher supply.

59. We have not found it appropriate to make a study of the economy's need for particular categories of students - hence we do not seek to specify how much public money should be allocated in support of these categories. As a rough indication, however, a bursary of £500 p.a. for each of the .... science students proposed for the system in 1990 would cost £......; for each of the .... projected engineering students would cost £.......; for each of the .... projected medical students would cost £........; and for each of the .... projected teachers would cost £....... .

Support for Cultural Development

60. Scholarships to encourage academic performance. These could take the form of awards either at entry or upon graduation or both, encouraging good academic performance either both in the schools and in degree work. The amount of each scholarship and the number awarded must obviously be arbitrary. As a rough indication 50,000 scholarships of £500 each would cost £25 million p.a. (there will be ...... students in the system in 1990 ie ..... % would have academic scholarships on this assumption).

Support for Social Promotion

61. Every country requiring students to contribute to their own support by borrowing has recognised that this may deter some potentially desirable aspirants for higher education. The categories which it is commonly argued might be differentially deterred from access to higher education are:

a. 17-18 year olds from lower-income families: where there is no family tradition of higher education, and perhaps little grasp of its potential as a personal investment; where parental income and capital is not sufficient to assist; where the possibility of parental loan guarantees is limited; and where the extent of the borrowing required for student support may seem more daunting than it does to those from more comfortably-placed backgrounds;

b. Mature Students - those over 23(?): who may have acquired commitments based on earnings from employment which will be foregone during their period of study;

c. Young women contemplating marriage and the raising of a family after graduation, and concerned about their ability to repay borrowings to finance their studies.

d. those intending careers in relatively low-paid occupations.

62. The problems which the general principle of private responsibility for student maintenance are likely to present for each of these categories are different, and a variety of methods of providing targetted public support are therefore called for.

63. The arguments in favour of providing mandatory finance are that such arrangements are relatively simple to administer, and that their clarity imposes no barrier to potential applicants. On the other hand, mandatory finance is essentially passive. Because it merely responds to demand it contains in itself no incentive to increase access from any desired or under-represented categories to higher education. This points, we believe, towards a mixture of mandatory and discretionary financial provision for these target categories.

64. There is no reason to suppose that only the offer of a grant will seem to attract the categories in question. The experience of other countries shows that loans to cover a proportion of the cost of maintenance do not constitute a differential deterrent to access; and where mandatory grants tested against parental means are provided elsewhere they are substantially less generous than those available in Britain with no apparent ill effects upon access. We believe that potential students from lower-income families would not be deterred in significant numbers by a requirement to borrow part of the cost of their maintenance, provided that the loan-finance is available - as we propose that it should be. And we believe that the general argument that students should have brought home to them some part of the cost of their higher education applies also to students from low-income backgrounds.

65. We propose, accordingly, that there should continue to be mandatory provision of grants for student maintenance from public funds for those from low-income families, to be supplemented by loans on the same basis as they are generally available for students.

66. We shall discuss later (paras) the principles which should govern loan provision. The amount of the mandatory grant should be calculated on the following basis. Develop: as seen in para 6, the discussion about the level of student grants and the

slope of the taper appears to be an essentially arbitrary one although it should be monitored for its efforts, and corrected accordingly. As a rough indication, a mandatory grant of £1000 p.a. for a student whose parental income is £0, falling to £500 p.a. for a student with parental income at the national average (£...... p.a.), would be £.......m p.a.

67. At the same time we believe that the access to higher education of mature students could be promoted - along with that of potential students from other desired categories (blacks, disabled etc) -if there were provision from public funds for discretionary awards for students in those categories. The purpose of these awards should be to increase the access of these categories to higher education by providing special incentives not only to them to seek it, but also to the institutions of higher education to recruit them. We propose, therefore, that in addition to the funds for bursaries, sponsorship and scholarships already referred to in the context of economic promotion and cultural development, limited funds should also be provided for discretionary awards to selected individuals to further social promotion on the basis of agreed criteria. The total amount of these funds must be an arbitrary decision: As a rough indication 25,000 bursaries at £500 p.a. would cost £12.5m; 25,000 at £1000 p.a. would cost £25m. (There are .... thousand mature students currently in the system).

68. We are persuaded, moreover, that the most serious barrier to access from lower income families is not to be found at the threshold to higher education, at the age of 18, but at the age of 16 when the decision to try to qualify for higher education has to be made. We propose therefore that a proportion of the sum at present allocated to mandatory student support should be made available to the schools and colleges of further education to provide scholarships for 16-18 year olds from poor backgrounds to encourage them to stay at school. This could be administered along the lines of the Assisted Places Scheme: ie a quota fixed for each school with the headteacher nominating individuals against that quota. A scholarship of £10 a week for two years for 100,000 young people would cost £100m.

69. It is sometimes argued that personal financial responsibility for student support might differentially deter young women from entering higher education because of their uncertainty about their ability to repay borrowings in the event of their withdrawing from employment in order to raise a family. It is notable, however, that this consideration does not feature in the student support policies of any of those countries which rely on some element of student borrowing. No need to make special provision for this case: amplify the argument. (Advantages of incentives to highly educated female participation in the economy?)

70. It is also sometimes argued that personal responsibility for student finance is a deterrent to access for those intending careers in low-paid occupations. This case must be distinguished from that of those who find that their earnings after graduation are insufficient to repay their borrowings (see para 78 below): here we are concerned with a potential deterrent to borrowing on the part of those who know before embarking on their studies that their intended career may not be sufficiently remunerative.

71. It is significant that no country using loans makes provision for such cases. It may be however that a career may be both poorly paid and estimable. And although the judgment on the latter point is not one which should be made in detail by public agencies, the existence of a problem should be recognised. Insofar as a solution cannot be found in increasing the earnings of those in estimable careers, an approach to a solution may be found in the proposed provision of bursaries and sponsorships matching public and private funds.

[B] Student Personal Responsibility

72. The principle adumbrated in the Robbins report, that "courses of higher education should be available for all those who are qualified by ability and attainment to pursue them and who wish to do so" has never been understood to comprise the principle that anybody qualified and wishing to embark upon higher education should be enabled to do so by the provision of finance for their studies. The present British arrangements for student support do not, for instance, offer any assistance to students whose parents refuse to pay their deemed parental contribution. Nor do they offer facilities for students refused a discretionary award for second or postgraduate degrees.

73. We believe that Britain should now aim at an ambitious extension of the Robbins principle to ensure that finance is available for all those who are qualified for higher education and wish to undertake it. This objective will be realized by ensuring that loan finance is available for all students who wish to borrow against their future earnings.

74. Obviously those parents who wish to contribute to the maintenance of their student offspring will continue to do so. But the government will no longer expect a parental contribution to student maintenance, and our proposal for loan finance is intended to replace the deemed parental contribution.

75. As we saw in para 7 loan finance for students in other countries is provided either by public agencies or by private agencies, or by a combination of the two. Arguments for and against. We believe that loan finance for students should normally be provided by private agencies, backed up in a very limited number of cases by lending facilities from public bodies (ie the higher education institutions).

76. Which private agencies - not just banks, also building societies etc. Advantages of diversity and competition.

77. As we saw in para 9 other countries which expect students to borrow towards their maintenance, whether from public or private agencies, offer a wide range of approaches to the subsidization of their borrowing. Some offer no subsidy: examples - US upper income backgrounds. Others offer limited subsidy: examples -Dutch interest rate ½ per cent below the commercial rate. Others offer extensive subsidy: examples - German interest-free loan. Arguments for and against subsidy. We believe that loan finance for students should not normally be subsidized, although the government should endeavour to ensure that the interest rates payable on this form of borrowing are as stable and predictable as possible.

78. Repayment arrangements vary between countries: ep paras 10 and 11. Describe. Correlation of inflexibility with high default. We believe that arrangements for the repayment of student borrowings should be a matter for private agreement between the student and the lending agency.

79. When lending is made by a private agency it may be subject to guarantee from public funds: eg para 8. In order to ensure that all intending students are able to attract loans, such guarantees usually cover 100 per cent of the value of the loan. Examples.

80. We do not believe, however, that the objective of universal access to loan finance dictates a requirement for an automatic 100 per cent guarantee to lending agencies. We believe that our objective can be largely attained [among other methods] by offering partial guarantees on portfolios of loans, with the guarantees so calculated as to cover the foreseeable rate of default. With this provision, the competition between private lending agencies for access to the important student market should both ensure the availability of finance on commercial terms for almost all students, and ensure that those terms are as favourable as possible to the student.

81. As in other countries where government-supported loans are provided for student finance, the provision of that support must be limited. We envisage, therefore, an upper limit on the amount of borrowing by each student subject to the government's partial guarantee. Amplify.

82. The public expenditure costs of such arrangements will obviously depend upon the total borrowing and the rate of the partial portfolio guarantee. As a rough indication; if we assume that each of the 400,000 students borrows £2000 p.a. and the guarantee covers 10 per cent of that borrowing, the public expenditure cost will be £80m p.a.

83. It may be, however, that some students with the offer of a place may appear so uncreditworthy that, even with the portfolio guarantee against default, no private agency will be prepared to venture a loan. In this case we believe that the responsibility for realising the objective of universal access to loan finance for all students with a place should fall on the higher education institution which has offered that place to such a student. The institution should have to draw upon its general resources for this purpose.

84. In the various systems of student financial support around the world there are many different approaches to the sourcing of that support, and, in particular, to the role of the higher education institutions in its provision. Comparisons. In the British case, the tradition of local authority responsibility for education has led to arrangements which have imposed the obligation to support students from public funds on the local authorities, thus lifting all responsibility in this matter from the shoulders of the institutions. We believe that this is damaging to the relationships which ought to exist within an institution of higher learning, of responsibility on the part of the institution to its students, and of the students to the institution in which they study. Our proposals for new arrangements for student support will offer a welcome opportunity to rebuild those relations of mutual responsibility between the institutions and the student.

85. We see the higher education institutions playing a major role in the administration of our targetted support schemes. In support of economic promotion, they should act as intermediaries and/or as partners with government departments and the corporate sector in running our proposed bursaries and sponsorships. In support of cultural development they must be the agencies for the administration of scholarships. And they should be the agencies charged with administering both mandatory grants and the discretionary bursaries we propose for social promotion, and to increase the access of under-represented categories to higher education. We also see the institutions doing much more to help students to increase their current earnings, both in the vacations and in term time.

86. The institutions should also have a role in respect of our proposals for facilitating access by students to private loan finance. We expect that they will normally act as intermediaries between their students and the financing agencies to negotiate standard "packages" of finance backed by the government's partial guarantee, which they will propose to their students. Students would, of course, be free to negotiate their own terms; but the bargaining power of the institutions should help to ensure not only the availability of finance for all those who are offered a place, but also that the terms are as favourable as possible to the students - and that the arrangements are as simple as possible.

87. In consideration of these enhanced responsibilities to their students, additional finance should be provided from public funds to assist the institutions in setting up the necessary student support services.

2451/1

CONFIDENTIAL

FROM: T J BURR
30 October 1987

1. MR GILMORE 30/X

2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr McIntyre
Mr Parsonage
Mr Kaufmann
Mrs Pugh
Mr Cropper
Mr Tyrie
Mr Call
Mr Isaac - IR
Mr Corlett - IR
Mr Stewart - IR
PS/IR

Ch/ A somewhat long-winded way of saying "no further action at present"! 30/10

Agreed.

BURR TO CH. 30.10.87

STUDENT LOANS AND COVENANTS

At your meeting on 12 October, I was asked to consider what approach should be made to DES to acquaint them with the proposal that tax relief on convenanted parental contributions should be abolished and the resulting additional revenue used to reduce the parental contribution (Option 3 of my paper of 18 September). One purpose of approaching DES was that they might wish to argue that some of the additional revenue from abolishing covenanting should be used to increase the amount of support paid to students rather than to reduce the parental contribution (on the lines of Option 5 of my paper) in order to reduce the number of losers which would result from replacing social security entitlement with a flat rate loan on the introduction of a student loan scheme. If that was the DES reaction you would not rule it out, but the key question would be whether they would be able to introduce student loans on a timescale consistent with what was envisaged for the removal of tax relief on covenants.

2. Since then, I have had the benefit of a discussion with the DES higher education Minister, Mr Jackson, about his thinking

CONFIDENTIAL

on the way in which the review of student support should be taken forward (since I am the Treasury representative on the review). His ideas may or may not prove realistic, and it is not entirely clear whether they will ultimately prove acceptable to Mr Baker. But Mr Jackson is clearly anxious to pursue them further, and while he is doing so, we see little to be gained by acquainting DES with your intentions on covenanting.

3. The reason for this is that Mr Jackson envisages a more radical overhaul of the student support system than previously contemplated. He would like to get away from any general presumption that the Government is responsible for supporting students, and restrict any state maintenance grant to specified target groups who either could not be expected to fend for themselves or whom the Government wanted to assist, perhaps by scholarships or bursaries, to study priority subjects. In practice, Mr Jackson recognises that some modest grant might need to be available for all students, but it would be at much lower levels than the present grant and would not represent the main source of support for the normal run of students. For them, the Government's main role would be to establish arrangements under which most students would be able to obtain funds from financial institutions. Probably some degree of Government guarantee would be needed if a reasonable proportion of students were to be able to get loans in this way, although Mr Jackson would want to keep the level of guarantee as low as possible even if that left some students unable to get loans. He points out that even the present system does not ensure that everyone gets support, notably where assessed parental contributions are not paid. There would be no assessed parental contribution under his scheme, because there would be no mandatory rates of grant to which it could be related. The extent to which students were helped by their parents would be entirely a matter for them and their parents.

4. Needless to say, a good deal of careful thought will need to be given to these ideas before they can be regarded as a firm basis for future policy. I have told Mr Jackson that there

are a number of aspects which the Treasury would need to consider critically, not least the proposed role for the financial institutions. The feasibility of getting them involved in student support on such a large scale with a low level of Government guarantee would need to be established with reasonable assurance before such a scheme was launched. Mr Jackson believes that much can be achieved by competition between financial institutions for student business, but I have cautioned against undue optimism on that. Nevertheless, there are clearly strands in Mr Jackson's thinking which are attractive, and which we may want to encourage whether or not the overall scheme proves feasible or desirable.

5. Mr Jackson is himself writing a paper on the above lines, which will be considered at the next meeting of the student support review on 18 November. That meeting will also consider the Treasury paper on the role of financial institutions in the provision of student loans, which the Chief Secretary approved in July. We will report to you after that meeting, when it may be easier to judge how Mr Jackson's ideas are likely to develop.

6. For the present purpose, however, the key point is that, in the context of Mr Jackson's thinking, it scarcely matters whether tax revenue from the abolition of relief on covenanting is used to reduce parental contributions or to increase student grants. Under his proposals, both would disappear in their present form. Thus we see no operational need, at this stage, to tell DES that you are thinking of proceeding on the lines of Option 3; or any likelihood that, if we did tell them, they would respond by arguing for Option 5.

7. In any case, further consideration of the legislative implications of introducing student loans makes it look extremely unlikely that they could be introduced at the start of the next academic year, which is what would be needed in order to tie in with a withdrawal of tax relief on covenanting in the next Budget. While it is difficult to pinpoint a specific aspect

of introducing student loans which would require main legislation (even the withdrawal of social security benefits from students could be done by regulations), DES are in no doubt that it would be unrealistic to expect to be able to make such a major change without legislative cover. We think that this must be right; and since the next legislative opportunity would be in the 1988-89 session, the 1989-90 academic year is in practice the earliest in which student loans could be introduced. That is too late for a package based on Option 5 and announced in the 1988 Budget, since it would only achieve its purpose if the increase in student support financed from savings on covenanting broadly coincided with the replacement of social security for students by loans.

Administration

8. The above arguments therefore point towards pressing ahead with Option 3; and not saying anything to DES until nearer the Budget. But we need to watch the administrative implications. The Inland Revenue are considering these, and have not yet reached firm conclusions. But it is possible that Option 3 will entail using two parental contribution scales for a transitional period, one for people who retain tax relief which they had before the Budget, and a reduced scale for those who can no longer get relief following the Budget. Applicants for grant would then need to be asked whether they were benefitting from a covenant on which tax relief was claimed, which would be an additional task for local education authorities who award the grants.

9. Since both the deadline for grant applications, and the formal notification of grant rates and parental contribution scales to LEAs, are not until May/June, we do not believe tht the LEAs would face any insuperable difficulty in handling this task following a Budget announcement. But the goodwill of DES would be needed to secure LEA co-operation, and this might be lost if DES felt that they had been given inadequate notice of the change. If DES made difficulties of this kind, and no other way of implementing Option 3 could be found, there might be a risk of having to withdraw this measure from the Budget at a late stage.

10. There is therefore a trade-off between the risk of premature disclosure if DES are involved at an early stage, and the risk of upsetting DES and possibly having to drop the change if they are told too late. We are in no doubt that the balance of advantage lies with not saying anything to DES at this stage. But we will need to take stock in due course in the light of the Revenue's own conclusions on admiistration, and the progress of the student support review.

11. It is relevant that the DES will expect to announce the amount of the uprating of the student grant and the parental contribution scale in a few weeks' time, in accordance with the longstanding practice of giving parents and students as much notice as possible. But since there is no way in which that announcement could either be avoided or modified to reflect Budget proposals, it is not a reason for involving DES at this stage. The Budget would have to indicate that this announcement was being modified.

Conclusion

12. The conclusion is, therefore, that there is no need to say anything to DES for the present. But we will in any case be reporting developments following the next meeting of the student support review in mid-November, and can take stock again then.

T J Burr

T J BURR

Mr Burr and I have considered this advicc together and I agree with it. Mr Jackson's position means that the prospects for the student support review will need careful assessment in their own right. His line of thinking is ambitious. If, when formed, it seems too ambitious, we may have to take the view that some early progress on the ground is better than a grand design without progress on the ground. For the present, however, we should try to encourage him to move on into the practicalities of thinking along these radical lines. A less radical version will still improve the outcome. And on the immediate question of covenants I agree that, for the reasons given, it is not necessary to consult DES at this stage: so the wider context makes it undesirable.

30/x

1. Papers PSE
2 Prayers Folder
(see X)

CONFIDENTIAL

PAYMASTER GENERAL

FROM: S P JUDGE
DATE: 5 November 1987

APS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr F E R Butler
Mr Anson
Mr Gilmore
Mr Pratt
Miss Noble
Mr Burr
Mr Cropper
Mr Tyrie
Mr Call

C/ See X

CL 5/11

Ch/ Mr Burr's submissions, referred to below, are voluminous and we have not troubled you with them yet. We shall put them into the w/e box.

5/11

STUDENT LOANS AND COVENANTS: PRAYERS TOMORROW

Mr Burr will be putting up advice on this tonight - further to his submission of 30 October. The Paymaster will be discussing this with officials at 8.30am tomorrow.

Mr Burr will be recommending that the Paymaster attends the next meeting of the Student Support Review, at 10.00am on Wednesday, 18 November. This clashes with a meeting of the Royal Mint Advisory Committee, and the Paymaster will wish to discuss at Prayers tomorrow which meeting he should attend, and which Minister (if any) should attend the other. We understand from the Deputy Master that the meeting at the Palace will discuss relations with artists, and their remuneration - and not coin designs.

X

Mr Jackson has also asked to see the Paymaster privately: we have set this up provisionally for next Thursday, 12 November.

S P JUDGE
Private Secretary

PMP-

2451/7

CONFIDENTIAL

FROM: T J BURR
5 November 1987

PAYMASTER GENERAL

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr McIntyre
Miss Noble
Mr Parsonage
Mr Pratt
Mr Kaufmann
Mrs Pugh
Mr Cropper
Mr Tyrie
Mr Call

BURR TO PMG 5.11.87

REVIEW OF STUDENT SUPPORT

As you may have seen from my submission of 30 October to the Chancellor, the DES Minister for higher education, Mr Jackson, has been formulating some radical proposals on student support, which he outlined to me at a meeting in his office a few weeks ago. He has now prepared a paper in which these proposals are further developed. He has made it clear that he intends these proposals to be the focus of the review of student support, which has so far been inactive since the Election but which is meeting for the first time on 18 November. It is not certain that the paper will be discussed at that meeting, since DES officials are arguing that it needs further work and is not ripe for discussion with other Departments. But Mr Jackson may overrule them.

2. He rightly regards the Treasury as having a major interest in key aspects of his proposals, and is anxious to enlist our support. It therefore seems right that we should show you the paper immediately, and seek your views on it. Copies are attached for you and other Treasury Ministers. (In fairness to Mr Jackson and DES I think that we should exercise some care in handling

the paper, which is no more than a preliminary draft.)

3. If the paper is taken at the 18 November meeting (and this should become clear in the next few days) we would recommend that you should attend. We understand that Mr Jackson is seeking a private word with you anyway. This submission is intended to serve as basic briefing for both occasions, which we can supplement with any necessary briefing on specific points.

The Paper

4. Mr Jackson's ideas have developed somewhat since he first described them to us, although there is still a good deal of scope for further refinement. He originally envisaged that the Government should cease to assume responsibility for supporting students in general. Instead, Government support would be made available on a targeted basis, to meet specified needs and objectives. Thus there might be specific help for disadvantaged students or those studying priority subjects, probably in the form of scholarships or bursaries. For other students, the Government would not necessarily provide any assured means of support, although realistically it might be necessary to retain a much reduced student grant. What it would do would be to make arrangements with financial institutions, probably incorporating some element of guarantee, which gave most students a reasonable prospect of at least some access to loan finance, although the terms would vary from case to case. To the extent that this was insufficient, or students wished to minimise their indebtedness, they would need to supplement it with part-time or vacation earnings and assistance from their parents. There would be no formal parental contribution, and students would be excluded from the social security system (although Mr Jackson does not specifically address the difficult issue of housing costs and housing benefit).

5. Mr Jackson has been made aware of the Treasury's position on the use of bank loans to finance student support. This may, perhaps, be most easily explained by describing two alternative cases:

Case 1. The Government sets the terms by which loans will be offered to students; guarantees repayments against default; and subsidises the repayments. In return, the banks agree to offer loan finance to any student who applies for it, provided they meet criteria set out by the Government. These criteria would relate to the students suitability for further education, rather than their credit-worthiness.

Case 2. The banks are free to accept or reject any individual applicant for a loan and to set whatever terms they may feel appropriate in individual cases. Those terms may well vary from individual to individual. The Government might offer a subsidy and, perhaps, partial guarantees but would have no influence over the size or terms of any individual loan nor would they guarantee to ensure that every individual student who qualified for further education received a loan.

In case 1 the banks are, in effect, lending to the Government. The Government is, in practice, determining how much of the national income should be devoted to student support. In these circumstances, we should consider bank lending to students as akin to public expenditure and would wish to control the total resources devoted to it.

6. In case 2, the banks are engaged in their normal business on their own initiative. Even if the Government subsidised the loans to some extent, the Government is nevertheless not determining the total quantity of national resources devoted to student support. Since they are not required to give loans in any case, how much student lending banks do is purely a matter for their commercial judgement. It is therefore a private sector initiative and there will be no need for the Government to control the total resources.

7. Mr Jackson's starting point was to devise a scheme which is as close as possible to case 2; and there is no Treasury reason to oppose that. However, he is clearly sensitive to pressures which could make the eventual scheme more like

case 1 (for example pressure to ensure equitable treatment between different students so that every student gets some sort of help, perhaps on specified terms. In that event, total resources to the scheme would have to be controlled. This would make it essential to limit the overall level of support to students and make it impossible to increase the level of student support (for example by reducing the level of parental contribution, or introducing new forms of targeted support).

8. Against this background, Mr Jackson's paper is rather less promising than it could have been. He lays emphasis on ensuring that all students should have access to loans from financial institutions; and when he telephoned me to discover my immediate reactions to the paper he stressed the political importance of this. The paper does not say whether all students should be able to get the same amount of loan. When I asked Mr Jackson about this, he said that a partial guarantee would be available to all students on loans up to a common limit. He seemed prepared to contemplate a situation in which some students would not be able to get a loan of as much as this limit, but to hope that such cases would be exceptional. He fairly obviously envisages that nearly all students should be able to get loans sufficient to cover their basic maintenance needs.

9. His paper is very optimistic on the level of guarantee which might be needed to achieve this result. It refers to a portfolio guarantee of 15 per cent. I had supposed that this meant a guarantee of up to 15 per cent of a financial institution's entire portfolio of student loans, so that it would only lose if defaults exceeded 15 per cent. Such an arrangement would probably give participating financial institutions a high degree of security in practice and might therefore achieve the desired result; although it would then be necessary to consider whether the scheme was sufficiently a matter of private risk and initiative to fall outside the cost constraint. But the paper only envisages a guarantee of 15 per cent of each individual loan, though Mr Jackson told me that it might be necessary to increase this to 20 per cent. Participating financial institutions would then be at risk on the remainder for every default that occurred. There is clearly room for doubt as to

whether financial institutions would be prepared (and they could not be compelled) to extend loans to all students on that basis, even if full allowance is made for the likely effects of competition between institutions in generating willingness to accept risks. Parental guarantees might help, but might not be available to many students.

10. As regards the terms of the loans, the paper takes the line that, subject to the availability of an element of guarantee, these would be left to be settled between financial institutions and the students to whom they lent, although a possible role is seen for higher education institutions in negotiating special terms on behalf of their student body. In itself that is fine from a Treasury point of view, provided that there is no question of higher education institutions accepting contingent liabilities on behalf of their students. But there must be some doubt whether Mr Jackson has fully considered the implications. Previous consideration of student loans has been based on schemes with a zero real rate of interest, a repayment holiday during the period of study and for several years afterwards, and provision for deferred repayment if the student's income fell below a threshold level. As argued in the Treasury paper on the role of financial institutions in providing student loans (which has been circulated to the Review and is also likely to be discussed on 18 November), competitive pressures between financial institutions would tend to improve the range of terms available to students. But it is nevertheless doubtful, to say the least, whether they would be prepared to offer terms of the kind so far envisaged without a subsidy. If on the other hand there is no subsidy (and apart from the guarantee, Mr Jackson does not envisage one), it is likely that loans would only be available to many students on terms which they would find unattractive and might indeed be unable to afford. That would have some difficult implications for education policy, in that it would be hard to present as facilitating access to higher education on the sole criterion of ability to benefit from it.

11. Conscious of this tension, Mr Jackson is beginning to set objectives for his scheme, like near-universal coverage, which tend to make it more in the nature of a state scheme designed

to deliver support to a predetermined class of beneficiaries rather than leaving the extent and distribution of finance to private sector initiative. While there are elements of Mr Jackson's thinking which we would want to preserve, it is beginning to look questionable whether a scheme exists which could both be regarded as private and as adequately meeting education policy objectives.

12. If that is so, Mr Jackson probably does not have the financial headroom for doing all the things discussed in his paper. He is in effect be trying both to provide at a reasonable level for all students (without the present parental contribution), and have selective schemes as well. The selective proposals in the paper have yet to be properly quantified, but they include bursaries and matching funds for sponsorship for shortage subjects; scholarships to encourage academic performance; mandatory support for students from low income families; discretionary awards for students from social groups with below average participation in higher education (such as racial minorities and the disabled); scholarships for 16-18 year olds from low income backgrounds to enable them to stay at school and thus improve their prospects of access to higher education; and bursaries and sponsorships for those intending careers in "estimable" but low paid occupations. This is a potentially expensive shopping list, and Mr Jackson recognises that it is only realistic if the cost of existing student support can be eliminated for the purposes of the cost constraint (of existing expenditure on student support and social security benefits for students) on his review. That would not be impossible to achieve, but it would probably mean leaving the generality of students to fend for themselves to an extent which Mr Jackson would be reluctant to accept.

No! X

Next steps

13. Mr Jackson has indicated that he is looking to the Treasury to advise on how his proposals for student loans should be taken forward. If his paper is discussed at the 18 November meeting, he will be hoping to receive our advice by then, ideally in the form of a paper circulated beforehand. But we cannot sensibly

start considering arrangements for involving financial institutions in a loan scheme which has not yet been adequately specified, and agreed to be at least broadly realistic. There need, therefore, to be firm proposals on such matters as

(i) The proportion of students which the arrangements should aim to cover;

(ii) Any minimum amount of loan which that proportion would need to be able to get;

(iii) What would be regarded as acceptable terms for such loans;

(iv) The extent and nature of the Government guarantee;

unless, of course it was genuinely believed that any of them could simply be left to be determined by the market.Conclusions on these points would need to add up to a consistent and realistic whole, so that we were not, for example, aiming for both a very high level of coverage and very easy loan terms without Government subsidy. It is for Mr Jackson and DES to take the lead in getting these points clarified and agreed with you and other Ministers concerned.

14. The lead would move to the Treasury if we reached the point of approaching financial institutions to explore how far they might be prepared to co-operate. Mr Jackson is anxious to proceed to that stage. But before we did so, it would be necessary not only to have resolved the points in my previous paragraph, but also to have established that Mr Jackson's broad approach was one which the Government was prepared to see tested in this way, bearing in mind that consultations outside Government would carry a risk of publicity.

15. The question whether Mr Jackson's approach is the right one in any case needs to be resolved fairly quickly. There is a risk that the next few months could be spent developing ideas which Mr Baker (who has not so far focussed on them) is ultimately unwilling to support. Work would then need to resume

on less radical options, but it might by then be getting too late for legislation on student loans in the 1988-89 Session. Legislation in the following Session would be likely to mean that student loans could not be implemented until October 1991, or around the date of the next Election. For obvious reasons, this timing could prove unattractive, and the possibility of a student loan scheme could therefore be lost for this Parliament.

Line to take

16. Thus if Mr Jackson seeks a discussion with you, or if his proposals get discussed at the 18 November meeting of the Review Group we would advise you to make the following points:

(a) The proposals have attractive features, but it will be necessary to reach a fairly early conclusion on the broad political acceptability of this kind of approach(which is not what was in the Manifesto), so that time is not lost pursuing ideas which are going to be ruled out in the end. What is Mr Baker's view?

(b) The proposals need to be further clarified, in particular on the points in paragraph 13 above.

(c) Both (a) and (b) would have to be done before there was any question of approaching financial institutions, on which the Treasury would need to take the lead.

(d) As Mr Jackson recognises, proper quantification is also needed.

(e) The affordability of the proposals within the cost constraint depends on whether the proposed loans are essentially a private arrangement between financial institutions and students, or a directed scheme for ensuring that all students get help. The answers to the point in paragraph 13 above are clearly relevant here.

(f) The risks to education policy objectives of a scheme which left the scale and allocation of support to the market would need to be understood and accepted from the outset. Later introduction of safeguards to protect those objectives could change the whole nature of the scheme to one which was geared to a Government-determined coverage and level of support. The scheme would then have been agreed on a false prospectus of much reduced Government involvement (placing it outside the cost constraint) when in fact it entailed a high degree of intervention in the allocation of resources.

T J Burr

T J BURR

I am v. unhappy about much of this. It is far too complex. Many of the ideas eg X – are unacceptable. As I see no alternative to a private sector loan scheme: I agree with Mr Cropper's paper 7(6/11).

M.

3976/40

pmp.

PRIVATE AND CONFIDENTIAL

FROM: P J CROPPER
DATE: 6 November 1987

Cropper TO PMG 6.11.87

PAYMASTER GENERAL

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Mr Tyrie
Mr Call

I agree with much of this! N.
(see also main paper below)

STUDENT LOANS

Surely our friend at Education is making too much of a meal of this in his paper. The issue is fairly straightforward, for a change.

2. The costs involved in Higher Education can be divided neatly into two - tuition and maintenance. They are totally separate.

3. In the case of tuition the choice is between:

(i) Open entry, with a place for everybody who can pay for it. (The student would have to pay, otherwise the State would have committeed itself to an open-ended liability.)

(ii) Selective entry to a limited number of places (as at present) in which case it is possible for the State to go on paying because the liability is finite.

4. The issue here is one of principle, coming well in advance of the question whether students should or should not pay for their own tuition. It would be perfectly reasonable to retain free tuition, while taking the State right out of maintenance.

5. Turning to maintenance, there is no argument in principle: we already require some students (or their parents) to find the cost of maintenance while they are at university.

6. There is no fundamental problem about switching to a 100% student loan system for maintenance. The question is one of terms. At a time of highish interest rates it does not seem to me that students can be expected to repay all the rolled up interest on their loans. At 15 per cent, which might be the present minimum student loan rate in the market, a debt doubles in five years. The idea of a nil real rate of interest has always appealed to me.

7. I would not have thought it was necessary to go over to private sector loan financing straightaway. It would be "dirty lending" in any case, from a public finance point of view, because of the guarantees necessarily involved. So I would have thought we might have started off with loans from a public sector institution, moving on to privatise the system once it had settled down.

8. As you said this morning, the great advantage of effecting reforms in student finance is that the generations move across the stage so fast. The students of 1992 will have no recollection of how things were done in 1987.

9. I do not see the need for all the scholarships, bursaries etc, listed in Robert Jackson's paper. Medicos and other people on long courses might need special help; women marrying and having families shortly after graduation might need special help. But not people like teachers and graduate medical auxiliaries; it is fully within the power of the State to ensure that the salary scales of such people reflect the cost of acquiring the necessary qualifications.

10. The argument about students coming from poor families is a bit of a red herring. They will repay their loans out of their own (enhanced) earning power, not out of that of their parents.

11. In short it does not seem to me that this is one of the more difficult reforms to bring about. And the advantages are legion.

P J CROPPER

for meeting folder 11/11?

CONFIDENTIAL

FROM: S P JUDGE
DATE: 6 November 1987

PS/PMG to BURR 6.11.87

MR BURR

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Gilmore
Mr Spackman
Mr Turnbull
Mr McIntyre
Miss Noble
Mr Parsonage
Mr Pratt
Mr Kaufmann
Mrs Pugh
Mr Cropper
Mr Tyrie
Mr Call

Re 7, a steer [illegible] Mr J towards a [illegible] scheme [illegible] (paras [illegible])

STUDENT SUPPORT REVIEW (SSR)

The Paymaster General discussed your submission of 5 November this morning with Mr Gilmore, Miss Noble, Mr Pratt, you, Mr Cropper and Mr Tyrie.

2. The Paymaster General said that Mr Jackson was seeking to move away from the traditional pattern. He applauded this, but thought that the way he was doing it might oblige Treasury Ministers to be more generous than they would wish to be. Mr Gilmore added that the cost constraint should not necessarily be held to in the short term. A better structure, with stronger incentives, would give better value for money and lead to savings in the long run. The risk was that a private sector loan scheme proved unsustainable: adding this to Mr Jackson's add-ons (paragraph 12 of your note) could lead to a doubling of the present level of public expenditure.

3. The Paymaster General discussed the Manifesto entry (attached). He thought it contained a degree of circumspection,

which could limit action on loans. Mr Tyrie said that Mr Baker had made it very clear during the campaign that he saw loans being used only as a top-up. The Paymaster General wondered whether loans would reduce throughput to levels more in line with other European countries. Mr Gilmore thought not: Mr Tyrie mentioned the higher leve l of attainment at 18 in the UK.

4. You said that option 3 in your paper of 18 September (using tax relief on covenants to reduce parental contributions) was free-standing, and could be done independently of any action on loans. Some of the other options involved increasing payments to students, and should only be implemented in the context of a move to student loans and, in particular, students' removal from the social security system.

5. Mr Gilmore thought it would be quite possible to act now on covenants, and then publish a Green Paper contemplating reform on the lines envisaged by Mr Jackson. In discussion of this, the following points were made:

i. a longer timescale might be appropriate for such a significant change in culture;

ii. loans would then not be introduced in this Parliament, and possibly never. Those on full grant now would complain loudly;

iii. introducing such reforms in the mid-1990s would be criticised as inconsistent with the Government's policy of widening access to HE to counteract the decline in student numbers which would otherwise take place for demographic reasons;

iv. although slow reform was often easier, it was important to remember that the gap between student generations was short. Hardly any current undergraduates had been affected by the 1984 change to the travel element of the grant;

v. introducing loans at the bottom end could choke off demand amongst those who were now on a full grant;

vi. there was a possibility of some helpful statistics emerging from countries with loan systems on their access record for low income groups, the disadvantaged, and women.

6. Mr Gilmore said that it would be very damaging to go anywhere

near the financial institutions until the Government had a firm idea of what it wanted to do, and a clear resolve to secure it. It was doubtful that the banks would provide loans in the free market at a level which met Mr Jackson's educational policy criteria. Mr Pratt said that if the pressures to make loans more equitable were so strong that the banks were in effect lending to the Government, it could well be cheaper for the Government to operate the loan scheme itself. Miss Noble said that the mechanics of consulting the financial institutions were straightforward: we would only have to contact the Bank and the Building Societies Commission.

7. Concluding the meeting, the Paymaster General thought the choice was between:

a. stopping this initiative now; and

b. getting Mr Baker to focus on this subject and, if he agreed to the proposals (which was far from certain), proceeding to draw up detailed cost estimates.

8. The Paymaster General subsequently discussed this with the Chancellor at Prayers, and it was agreed that:

i. the Chancellor would have a meeting early next week within the Treasury;

ii. the Paymaster General would then see Mr Jackson privately;

iii. the Paymaster would probably attend the meeting of the SSR on 18 November.

S P JUDGE
Private Secretary

NM/286

(1) As part of our aim to widen access to higher education we have begun a review of student support which is the most generous in the western world. We need to modernise this system which has not changed for 25 years. The purpose of the review is to improve the overall prospects of students so that more are encouraged to enter higher education. No final conclusions have been reached, but we believe that top-up loans to supplement grants are one way,

(2)

among others, of bringing in new finance to help students and relieve pressure on their parents.

We will take care to ensure that the best aspects of the present system are retained in any new proposals which we bring forward.

CONFIDENTIAL

PMG

FROM: MOIRA WALLACE

DATE: 9 November 1987

PS/PAYMASTER GENERAL

cc
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mrs Lomax
Mr Scholar
Mr Spackman
Mr Turnbull
Mr McIntyre
Miss Noble
Mr Parsonage
Mr Pratt
Mr Kaufmann
Mrs Pugh
Mr Cropper
Mr Tyrie
Mr Call
Mr Gilmore
Mr Burr

REVIEW OF STUDENT SUPPORT

The Chancellor has seen Mr Burr's minutes of 30 October and 5 November. He is unhappy with much of Mr Jackson's paper. He feels that it is too complex, and that many of the ideas put forward - for example, scholarships for 16 to 18 year olds to enable them to stay at school - are unacceptable. He also sees no attractions in a phoney private sector loan scheme: this will be 'dirty lending' from a public finance view, because of the guarantees involved. It might be preferable to start off with public sector loans and privatise the system once it had settled down.

MPW.

MOIRA WALLACE

ps3/35T

CONFIDENTIAL

Folder for mtg on 25/11

JMGT
To
PS/FST
16-11-87

FROM: J M G TAYLOR

DATE: 16 November 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Mr Cropper
Mr Tyrie
Mr Jenkins (Parly Counsel)
Mr Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
Mr C Stewart - IR
PS/IR

TAX TREATMENT OF MAINTENANCE PAYMENTS AND COVENANTS (BUDGET STARTER 150)

The Chancellor has seen Mr Stewart's minute of 13 November.

2. He awaits the Financial Secretary's views. However, he is not too happy about the specification of the various options. Option 2 ought to be the single allowance, and Option 3 the married allowance. What would be the cost of Option 3 as thus specified?

J M G TAYLOR

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: C STEWART
DATE: 20 NOVEMBER 1987

STEWART TO FST 20.11.87

FINANCIAL SECRETARY

TAX TREATMENT OF MAINTENANCE PAYMENTS AND COVENANTS
(BUDGET STARTER 150)

1. The Chancellor has asked about the specification of the options in my note of 13 November (Mr Taylor's note of 16 November).

2. For each of the options we have assumed that in any event the divorced or separated husband and wife would each get the single person's allowance as they do now. The relief given to the husband for maintenance payments would then be in addition to his single person's allowance. So he would get -

Option 1 - Single allowance (£2425) plus maintenance relief up to £1370 (the difference between single and married allowances); in total he would thus get the equivalent of married allowance.

---

cc	Chancellor	Mr Battishill	Mr J C Jones
	Chief Secretary	Mr Isaac	Mr Martin
	Paymaster General	Mr Corlett	Mr Eason
	Economic Secretary	Mr Lewis	Mrs Fletcher
	Sir P Middleton	Mr Beighton	Mr Stewart
	Mr Scholar	Mr Calder	PS/IR
	Mr Culpin	Mr Easton	
	Mr Riley	Mr Mace	
	Mr Cropper	Mr Davenport	
	Mr Tyrie	Mr R H Allen	
	Mr Jenkins (OPC)	Mr Yard	

Option 2 - Single allowance plus maintenance relief up to £2500; £2500 was taken as a round figure, but if Ministers decided to fix the limit at about that level, we agree that it would be sensible to peg it to the single person's allowance. Thus the husband would get the equivalent of two single allowances.

Option 3 - Single allowance plus maintenance relief up to £3250. If this option was varied, as the Chancellor suggests, so that the husband got maintenance relief equal to the whole of the married allowance (£3795), in addition to his ordinary single allowance, the eventual cost would be £m15.

CS.

C STEWART

The figures for total relief assume that the husband is a single man, as he will be immediately after the divorce. If he remarries, he will of course get the MCA plus the allowances described by Mr Stewart.

CLE

20.1

CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: C STEWART

DATE: 20 NOVEMBER 1987

1. MR ISAAC 20·11

2. CHANCELLOR OF THE EXCHEQUER

COVENANTS
STEWART
→CH of 2/

TAX TREATMENT OF MAINTENANCE PAYMENTS AND COVENANTS (BUDGET STARTER 150)

1. This note is concerned with covenants. At the Chancellor's meeting of 12 October, it was agreed that covenant payments between individuals should be made ineffective for tax purposes, subject to possible preservation for deserving cases and suitable alternative arrangements being made for students.

2. This note looks in more detail at what would be involved, and in particular at how the arrangements for students might operate during the transitional period. The broad intention was that covenant relief for students would be replaced by a reduction in parental contributions to student grants. Depending on the timing, these might or might not be linked with other changes which might emerge from the current review of student support.

---

cc	~~Chancellor~~ Financial Secretary	Mr Battishill	Mr J C Jones
	Chief Secretary	Mr Isaac	Mr Martin
	Paymaster General	Mr Corlett	Mr Eason
	Economic Secretary	Mr Lewis	Mrs Fletcher
	Sir P Middleton	Mr Beighton	Mr Stewart
	Mr Scholar	Mr Calder	PS/IR
	Mr Culpin	Mr Easton	
	Mr Riley	Mr Mace	
	Mr Cropper	Mr Davenport	
	Mr Tyrie	Mr R H Allen	
	Mr Jenkins (OPC)	Mr Yard	

Numbers involved

3. We estimate that there are now about 350,000 students with covenants. We think the tax cost may now be about £m150; but we have recently been carrying out another survey to get a more up to date estimate of the cost, and the results should be available very shortly. In addition there are over 200,000 covenants in favour of children under 18, of which 70% are by grandparents in favour of their grandchildren. Tax relief on these costs £m110. There are also some covenants between unmarried couples, though we do not know how many. Our minute of 24 July said that the staff cost of dealing with covenants was estimated to rise to 360 over the PES period; but we are currently re-examining that estimate in the light of the latest information we have.

Treatment of existing covenants

4. The basic proposal is that covenants made on or after Budget Day between individuals would be ineffective for tax purposes. (Charitable covenants would continue to qualify for relief, as now.) We suggest that the new rules should probably apply to covenants made on Budget Day itself. Otherwise we could expect a rush to make covenants on Budget evening.

5. Covenants made before Budget Day would continue to get relief under the present rules.

6. There would be operational advantages in limiting the continuing relief to a fixed period of years. Since a covenant has to be capable of running for more than 6 years if it is to qualify for tax relief under the present rules, the transitional period could hardly be less than 6 years. Allowing relief to continue until the end of the tax year 1993-4 would allow a period of 6 years plus a few weeks from Budget Day. There are however likely to be some pre-Budget covenants which run for longer than that and there would be criticism that a legally binding obligation undertaken before the Budget was being upset. With a 6 year transitional period, there would also need to be provisions to require payments under any longer covenants to be made gross from 1994, and the obligations under the deed of covenant to be re-interpreted accordingly. Depending on how this was done, it could increase the covenantor's payments. This

could in itself be a controversial addition to what will in any event be a controversial change. On balance, therefore, we think the arguments suggest that there should be no fixed limit on the transitional period, and relief should continue until the covenant expires in the natural course of events. Most covenants will probably run out over 6 years or so, but to the extent that longer covenants continue to get relief thereafter, the full staff and revenue savings will be delayed.

7. Normally covenants will be to pay a fixed amount before or after tax. But some may be based on a formula - for example linked to the single personal allowance, or to the student grant level. The original payment may thus increase after the Budget. In some of these cases, the increase will not be effective for tax purposes, because the increase will not be capable of running for more than 6 years, even though the original amount of the covenant is. But when a "formula increase" is effective for tax purposes we suggest that relief for it should be allowable under a pre-Budget covenant. This is consistent with the treatment of LAPR in 1984.

8. In line with similar precedent, there would be no relief when there is a discretionary increase after Budget Day in a covenant made before Budget Day.

9. There is clearly a danger that people will make covenants after the Budget and purport to backdate them in an attempt to get tax relief under the old rules. That would be fraudulent, but we know from experience that backdating is both regrettably common and very difficult to prove. We suggest that there should be a rule that pre-Budget covenants would only be accepted for tax purposes if they have been submitted to the Revenue within 3 months of Budget Day - (say) by 30 June 1988. This will not of itself prevent backdating. At least, however, it will limit the time over which people will be tempted to backdate - and therefore the volume of likely backdating; and it will save our offices the hassle of arguing the bona fides of "late submitted covenants" submitted in 12 months or 2 years' time. Taxpayers who have genuinely made covenants before the Budget should have no difficulty in submitting them within that time limit. There

will be some staff cost in checking suspected backdating; and to the extent that some backdating goes undetected, there will be some transitional revenue cost.

Compensation for students

10. In general there would be no "compensation" x for people who would not in future be able to benefit from relief for new covenants, including -

a. students who are not eligible for grants;

b. people covenanting to grandchildren or other relatives;

c. unmarried couples where one partner makes covenants in favour of the other.

11. Ministers agreed, however, that as covenants have become so well established as a means of paying the parental contribution to student grants, there should be some compensation through the grant system. They favoured the general approach in Mr Burr's Option 3, but recognised that the loan element might be a longer-term development. In effect, covenant relief would be replaced by a reduction in parental contribution. To give full compensation, parental contributions would have to be reduced by 27% (at the present tax rate).

Sr?

12. The saving on tax relief would not, of course, exactly match the cost of increased grants on that basis. For example -

(a) some students receive a grant but have no covenant;

(b) some will have a covenant but will not be eligible for a grant (eg because their course does not qualify for a mandatory grant);

(c) some students will have covenants for more than the parental contribution (for example, the parent may have covenanted for the full amount of the single personal allowance).

x other than from any wider Budget changes
CHL

These would only get compensation for (at most) relief on the parental contribution.

13. As we have said, we hope to have a revised estimate of the cost of relief for student covenants very shortly, but we have no information about the numbers in these 3 particular categories; for example we do not know what the assessed parental contribution is in an individual case. Some broad assumptions will therefore have to be made about the amounts involved. We shall need to discuss this with the Treasury.

14. The main question to be resolved is how the transitional period should be handled.

15. If you agree with the recommendation in paragraph 5, students with pre-Budget covenants will continue to get covenant relief. One option would be to give them the benefit of the increased grants at the same time. This would be generous and could be costly, because the Exchequer would still be meeting a substantial part of the cost of covenant relief. On the other hand, it would be simpler for everyone, because the local authorities could operate the same contribution scale for all students.

16. If Ministers wished to adopt a more revenue-neutral approach, there would need to be provisions to prevent students getting both benefits simultaneously. Again, if you accept the recommendation that relief should continue to run for old covenants - which may be for more than the amount of the student grant - this would mean that local authorities would need to operate two contribution scales during the transitional period:

- an "old" scale (without a minimum grant); and
- a "new" scale (incorporating the new minimum grant).

The "old" scale would apply for students with a pre-Budget covenant, on which they are entitled to claim tax relief. The "new" scale would apply for all other students. There would be an option for any student to elect to have the "new" scale of grant, if he or she either certified that they had no covenant, or renounced any existing covenant. In effect, therefore, a student could either remain on the "old scale" with the benefit of a pre-Budget covenant, or move over to the "new scale" without the benefit of tax relief on covenants, whichever was the more favourable to him.

17. We need to do some further work on the precise mechanics of the option. But the broad idea would be that the if the student applied to the local authority for a "new scale" grant, he would be required to renounce the covenant. The local authority might then pass this information on to the Revenue; or alternatively, the Revenue might require students who continued to claim covenant relief to produce a statement from the local authority showing that their grant was assessed on the "old scale". We envisage that the necessary paperwork between student, parent and local authority could be incorporated in the existing procedures for students claiming maintenance and other awards.

18. Without consulting DES we cannot be certain that local authorities could operate a system on these lines, with two different contribution scales, without undue difficulty. But unless there is an insuperable problem with it, it does seem to offer a way of avoiding "retrospective" withdrawals of tax relief without giving students double benefit for the next 2 or 3 years. How many students opted for the increased grant and renounced their covenant would depend on the amounts of their covenants and whether the increased grant would give full compensation for the loss of tax relief on the parental contribution.

Questions for decision

15. The questions for decision on covenants therefore are -

a. Should the new rules apply to covenants made on or after Budget Day (paragraph 4)?

b. Should relief on pre-Budget covenants continue for 6 years, or indefinitely (paragraph 6)?

c. Should "formula increases" in payments under pre-Budget covenants be allowed where they would get relief under the present rules (paragraph 7)?

d. Should pre-Budget covenants be required to be submitted to the Revenue by 30 June 1988 if they are to qualify for continuing relief (paragraph 9)?

e. Are Ministers prepared to contemplate continuing covenant relief for pre-Budget students as well as increased grants (paragraph 15)?

f. If not, should we work up in more detail the arrangements outlined above for giving pre-Budget students a choice between continuing covenant relief and increased grants (paragraphs 16-18)?

CS

C STEWART

CONFIDENTIAL

Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

PS I hope FST is thinking of options, too - esp those in the maintenance paper.

Ch/ Re Mr Isaac's para 4 - I think an annotated agenda would be helpful. 20/11

FROM: A J G ISAAC

20 November 1987

I agree. PSr among...

CHANCELLOR OF THE EXCHEQUER

Also, let us have costings for the various options. (The PX cost as well as tax cost)

ISAAC TO CH. 20.11.87

COVENANTS AND MAINTENANCE

1. Mr Scholar's earlier forward look pencilled in a possible meeting on covenant and maintenance, for the week beginning 23 November.

Fixed for 4.00 on 25/11

2. You have had Mr Stewart's note of 13 November, reporting the results of some further work on the distributional implications. - below

3. We are sending you today three further papers: - all behind

- On covenants, in particular dealing with the transitional arrangements and possible compensation for students.

- On maintenance, and in particular again the transitional arrangements.

- On maintenance payments to children: an issue that arises independently (whether or not you change the tax treatment of covenants and maintenance generally), but needs to be tackled alongside the general issues.

---

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Riley
Mr Cropper
Mr Tyrie
Mr Jenkins (OPC)
Mr Battishill
Mr Isaac
Mr Corlett
Mr Lewis
Mr Beighton
Mr Calder
Mr Easton
Mr Mace
Mr Davenport
Mr R H Allen
Mr Yard
Mr J C Jones
Mr Martin
Mr Eason
Mrs Fletcher
Mr Stewart
PS/IR

4. If your diary does leave space for a meeting on these papers, you may feel it would be helpful to have an annotated agenda. If so, we should be glad to prepare one, in consultation with Mr Scholar.

A J G ISAAC

3977/13

Not a good system, certainly!

FROM: P J CROPPER
DATE: 23 November 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Gilmore
Mr Burr
Mr Tyrie
Mr Call

STUDENT LOANS

This week's "Economist" carried the attached note on American experience. It looks decidedly patchy. The moral I would draw is that we need to do the thing universally if we do it at all. It is no wonder America gets a high default rate if loans are restricted to students coming from homes with a family income below $30,000 a year - which, presumably, is not very much by their standards.

2. I note that interest on student loans is paid by the federal Department of Education.

P J CROPPER

THE ECONOMIST

21 - 27 NOV. 1987

Student loans

To be repaid

LENDING young people money to help pay their way through college and thus increase their earning capacity later is popular with students, their families and universities. Though the money—about \$2,500 a year for each of the first two years, and \$4,000 for each of the next two—is not generous for those attending expensive private colleges where the average cost is about \$12,000 a year, it is a real help at public colleges, where the cost is about \$6,000.

The money is distributed by the universities, but it is lent by banks and other financial institutions and by state governments. The interest is paid by the federal Department of Education, which also guarantees the loans. The institutions run no risk and get generous interest of 8%. In 1981 and 1982, the most recent years for which figures are available, about 30% of college students were given loans, to be repaid over ten years. In order to qualify for a loan, a student had to show that he came from a family whose income was below \$30,000 a year.

For the government the price is proving unacceptably high. Nearly 1m graduates have failed to meet their obligation to repay their loans within ten years. Defaults add up to \$1.6 billion. Now the government is warning defaulters that they will have to pay the heavy costs of employing collectors to force repayment to the government, even though this may prove an empty threat if the defaulter has no money. Many of the universities are also worried.

The government has itself partly to blame. Last year it made deep cuts in the programmes giving outright grants to students from very poor families. To make up the difference, many young people took on loans that they could not repay.

Mr William Bennett, the secretary of education, is now threatening to disqualify colleges where the student default rate is above 20%. About a third of the participating schools and colleges would no longer be able to offer loans to their students. The axe would fall not only on those hoping to become mechanics and hairdressers (defaults are most common at two-year community colleges and trade schools), but on a number of venerable black institutions such as Howard University in Washington, DC and Morehouse College in Atlanta and on colleges such as those that make up the City University of New York. This would be bound to bring charges that the poor and members of racial minorities were being made to bear the brunt of the cuts. The alternatives, such as allowing defaulting students to work off their obligation as, say, teachers in poor neighbourhoods, might prove less controversial.

Ten years to pay

ps3/53T

CONFIDENTIAL

Folder for mtg. on 25/11

JMGT To ISAAC 23.11.87

FROM: J M G TAYLOR
DATE: 23 November 1987

MR ISAAC - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Riley
Mr Cropper
Mr Tyrie
Mr Battishill - IR
Mr Stewart - IR
PS/IR

COVENANTS AND MAINTENANCE

The Chancellor has seen your minutes of 20 November, and Mr Stewart's of the same date. He looks forward to discussing these on 25 November.

2. He thinks an annotated agenda would be helpful. He would also like costings for the various options, which should include the public expenditure cost as well as the tax cost. I should be grateful if you could arrange for these to be prepared, in consultation with Mr Scholar.

J M G TAYLOR