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Education

Prime Minister

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DEPARTMENT OF EDUCATION AND SCIENCE
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FROM THE SECRETARY OF STATE

22 January 1982

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1P 3AG

Dear Geoffrey

STUDENT LOANS

I have been looking again at the possibility of introducing student loans in partial substitution for the present system of awards. If we abandoned the immediate abolition of the parental contribution and were able to introduce private sector finance, a viable scheme need not involve all the short-term costs to public expenditure which were entailed in the scheme my predecessor put forward last year. Indeed, I believe that there is the prospect of a substantial saving to public expenditure. I should therefore like to explore rather more fully than was done in the past the possibility of bank participation in a scheme.

2 My ideas are still at a very tentative stage, but I am thinking in terms of a mixed system of grants and loans, in which the loan element would be increased progressively to a maximum of, perhaps, 50% of the total award. It is essential that loans should be available to all students currently eligible for mandatory awards under the 1962 Education Act. (This may prove the major problem with the banks, who on the last round made it clear that they must retain their present freedom to discriminate between applicants for loans.) Loans would initially be for maintenance alone, though I would not exclude the possibility of extending them eventually to fees as well. The grant, but not the loan, element would be subject to parental contribution which would gradually be reduced as the proportion of loan to grant was increased. The necessary legislation would have to be enacted early in the 1982/83 Session if the scheme were to be introduced in this Parliament.

3 If the banks were to take this on, I believe that the savings by the time the scheme had been running for about 5 years could amount to between £100m and £200m annually, even after taking account of the cost

of indemnity against losses, the waiving of repayment in cases of hardship, and a subsidised interest rate. The clearing banks are certainly anxious to secure and retain student custom. I believe that this gives us a basis on which to discuss the terms on which they might be prepared to participate. Our next step, assuming that you were content with the basic approach, might be to ask David Young and your officials to take informal soundings with the banks on the basis of the scheme outlined in the annex to this letter. Once we knew their initial reaction a more detailed scheme could be drawn up and costed.

4 I would of course welcome the opportunity to discuss the issues informally with you, if you felt that this would be helpful.

Yours,

Keith

STUDENT LOANS

OUTLINE SCHEME FOR PRELIMINARY DISCUSSION WITH THE BANKS

The suggested scheme would initially make loans for maintenance only, though consideration might later be given to their extension to fees. Initially, /say 25% of the current maintenance grant would be replaced by loan. The proportion of loan to grant would be increased progressively to say 50% within say 5 years of the inception of the scheme.

2. Loans would not be subject to parental contribution. The aim would be to introduce them in the academic year 1983-84 for new entrants to higher education: those already on courses would continue to receive full grants. Similarly, successive increases in the proportion of loan to grant would apply only to new entrants to higher education: ie, those embarking on courses during the period in which the proportion of loan was being increased would be guaranteed the same proportion of grant to loan throughout their courses.

3. Assuming loans of about £400 per student for an estimated 137,500 new entrants to higher education, the banks' total commitment in the first year of operation would be about £55m. By the time the scheme was extended to say 50% loan, the banks would be lending students rather more than £200m annually.

4. The conditions on which loans were extended to students by the banks would be subject to detailed negotiation, but should ideally include the following -

(a) Participating banks would be indemnified against losses arising from bad debts provided that all reasonable steps had been taken over a period (perhaps 12 months from the date at which repayment was due) to secure repayment.

(b) It would be <u>essential</u> for interest to be charged to students at substantially less than commercial rates, perhaps half. It would be <u>highly desirable</u> for the banks to share with Government on a fifty-fifty basis the cost of the resultant subsidy, but the % shares would be open to negotiation.

(c) An income threshold for repayments, which might commence when an individual's earnings reached 80% of the national average and be deferred during any period in which they fell below this level, would be <u>highly desirable</u>. Since however the banks would almost certainly require to be indemnified in such cases the potential costs would need careful examination. The banks might however be sounded on the administrative practicality. Subject to this, interest at the subsidised rate would be payable by students 9 months after completing their courses. Before this, interest would be paid to the banks by the Exchequer.

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