PRIME MINISTER (2) AT 24/5 23 May 1985

STUDENT SUPPORT AND TRAINING LOANS

Keith Joseph has now produced a draft consultative paper on student support; he will be discussing it with various other departments before bringing it to you. Tom King is, separately, working on proposals for training loans, as commissioned by E(A).

You do not at present need to take action on either of these fronts, but - given their political significance - we thought that you might wish to be kept informed about progress.

1. Student Support

FLAG A Keith Joseph's draft consultative paper fufils the promise that he made at the time of the student grants debacle. It is a full review of student support, not just an apologia for loans. It:

- gives a short history of student finance, explaining how we have come to spend over £500m on maintenance;

- establishes the general principle that both government and the student (or his family) have reason to contribute to the cost of higher eduction, since both society and the student himself benefit;

- mentions changes that could be made in the present system, without the introduction of loans - eg a more equitable parental contribution system, special scholarships for the very clever or bursaries for the very poor.

The paper also outlines various possible loan schemes, without either favouring such schemes in principal or choosing between the options.

Some of the options are ingenious and politically sophisticated. The most attractive is probably the last, which:

Option D on page 17 of Flag A

a. leaves all students half of their present grant in the first year, replacing the other half by a loan;

b. gradually increases the proportion of loan (at 5% of the total each year) until it fully replaces the grant;

c. at the same time, gradually reduces the parental contribution (by 10% each year), so that it is phased out over 10 years;

d. allows repayments to be made over 15 years in equal real tranches, with a repayment holiday until two years after the end of the course, and with no repayment in any year when the student's income falls below 85% of average earnings;

e. despite these conditions and concessions, offers the prospect of eventual saving of over £400m p.a., but with modest increases in the early years.

In short, the draft paper is a good first try. But with the present climate of demoralisation in the university world (following the publication of the Green Paper on HE), the politics will be difficult. The details, both of the loan options and of the rest of the paper, will therefore need to be considered very carefully.

We recommend that you should wait until Ministers have had a chance to refine the drafting before you call a meeting on this subject.

2. Training Loans

FLAG B. Tom King's proposal to introduce training loans is far less controversial, since it is an addition to present provision, rather than a replacement for grants. The scheme that his officials are proposing is sensible and cunning.

Trainees would be required to find 20% of the cost of their course by themselves. They would receive a loan for the remaining 80% but would pay no interest on this until three months after the completion of their training. The banks would lend them the money. And the government would: (1) pay the interest on the loan during the time when the student was taking the course, and (2) refund the banks for bad debts up to a set percentage (eg 10%) of their total portfolio.

This system would provide the banks with an incentive to lend money to trainees who might not otherwise qualify for loans, but would also give the banks a reason for chasing up debts, since they themselves would be responsible if more than 10% of their debtors defaulted. The government would be liable for a maximum of about £10m at any given time, and this would generate £36m worth of new training opportunities.

This package, like the review of student support, is now being discussed between the various departments, including the Treasury. DES have expressed fears that even a moderated guarantee scheme of this sort might prejudice future negotiations with the banks on student loans. But we do not regard this as a serious objection, since the two projects are quite different in scale and consequently in risk. Indeed, the introduction of training loans on the model proposed would, if anything, facilitate the subsequent introduction of student loans, since it might make the idea appear more sensible and would give the banks more experience of this type of finance.

The Treasury has various detailed comments, but the Chief Secretary has signified his willingness for negotiations with the banks to proceed.

We recommend that you should await the outcome of these negotiations, and then consider training loans, (possibly at the same time as the review of student support) in a future meeting of E(A).

Oliver Letwin

OLIVER LETWIN

CONFIDENTIAL

SC/10 B/F with full response

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FROM THE SECRETARY OF STATE

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury
Parliament Street
SW1P 3AG

10 May 1985

Dear Nigel,

REVIEW OF STUDENT SUPPORT

Pt 4 attached - at flag

Following the correspondence between Ministers initiated by my letter to you of 21 December last, officials of our and other Departments have, as you know, been working on the preparation of the Consultative Paper needed to launch the Review of Student Support. They have been conscious, in tackling this, of the strong hope which I at least cherish, that the review process may lead eventually to the introduction of a loans element into the system of student support. The draft of the paper which I now send you reflects this thrust.

2. However, officials are representing that the Ministerial commitment to a move towards loans is rather too unclear at the moment for work on the paper to be taken usefully much further. I feel it right myself to ask some of my colleagues most closely concerned with this issue now to join me in seeking to settle just how we do want to take the business forward. My agenda for discussion would include

- First of all, where eventually we want to end up;
- Through what stages and on what timetable we might get there;
- Moving to the Consultative Paper, how it should be shaped to support this aim (bearing in mind at the same time public expectations of its style and our possible need for fallback positions);
- How clearly and exclusively we might put forward a particular loans package;
- Do we go firmly for loans schemes run by the banks? If so, what can the Treasury do to ensure that we reach the position of being able to do that?

Continued......

Education, Gen Policy Pt 5.

- Presentation of the matters of principle explored in Section II.

3. However we decide to proceed, I believe that it is important to make early progress in sounding out the banks on their likely response to an invitation to participate in a loan scheme. As I said in my letter of 21 December last, there is a particular problem about the participation of banks in a scheme in which every student has a right to a loan, whatever his financial prospects and circumstances, and in which some concessionary terms will have to be included. On the last occasion when we approached the banks - in December 1980 - they made it plain that a fairly comprehensive Government guarantee and commercial rates of interest would be essential requirements for them. No doubt these points would be negotiable - in particular the level and cover of any guarantee, since we need to be sure that the banks are left with an incentive to pursue defaulters. At any rate we need to get some indication now of their current thinking before we can sensibly discuss a bank-run scheme in the consultative paper. Our officials have been in touch over this, and I hope that you can now authorise an early approach to the banks.

4. Would you and/or Peter Rees be prepared to join me soon for a meeting? Would George Younger and David Young be interested too, and perhaps a Minister from each of DHSS and DE? In addition to Peter Rees, George Younger, David Young, Norman Fowler and Tom King, I am copying this also to the Prime Minister, Quintin Hailsham, Douglas Hurd, Nicholas Edwards, Patrick Jenkin, Norman Tebbit and John Wakeham (but not at this stage generally to H Committee). Any of these copy recipients would also be welcome to attend the proposed meeting.

Yours ever,

Keith.

10 MAY 1985

CONFIDENTIAL

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8.5.85

3

REVIEW OF STUDENT SUPPORT - CONSULTATIVE PAPER

INTRODUCTION

1. The Secretary of State for Education and Science announced on 5 December 1984 that the Government proposed to consider - and consult widely about - whether a radical change in the student support system, which might include loans, should be made so as better to meet the needs of students and their families whilst safeguarding the interests of the taxpayer. The terms of reference of the review are to examine financial support for students in higher education, concentrating on support at first degree and sub-degree levels.

SECTION I

THE EXISTING SYSTEM

2. The present arrangements for providing financial support for students undertaking higher education had their origins in the report of the Anderson Committee of 1960. Its principal recommendations were implemented in 1962 following the enactment of legislation which still underpins the system of student awards today. The main principles which the Committee advocated were:

- equality of opportunity of access to higher education;
- freedom of choice of institution and course (subject to an offer of admission);
- the availability of grants for the full period of any designated course.

The introduction of loans was considered but rejected by the Committee.

3. The Anderson Report prepared the way for the expansion of higher education recommended by the Robbins Committee in 1963, and the adoption of the principle 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".

4. These two reports set the scene for the massive expansion in the number of students entering higher education which accelerated in the 1960s and which has continued to the present time. A combination of demographic factors and increased opportunities to participate in higher education has led to a threefold increase in the number of award-holders between 1962 and 1983/84, and to a similar increase in the real level of public expenditure on student maintenance grants. There are now about 450,000 mandatory award-holders, and public expenditure on their maintenance is expected to total some £530M in 1985/6*. This excludes additional payments to students or their families through social benefits (around £130M) and tax concessions accruing through deeds of covenant (about £70M). There is, of course, in addition a much larger subsidy still which is given through the provision of free tuition: at an average annual cost of tuition in the region of £3500 per student, this is currently in excess of £1,500M per year. Even so, this massive expenditure on higher education is concentrated on only 1 person in 7 in the 18-21 age group in England and Wales (1 in 5 in Scotland).

5. Under the present arrangements students on advanced courses who have been ordinarily resident in the UK for the three years before their course are eligible for mandatory awards. In England and Wales these awards are administered by local education authorities and in Scotland by the Scottish Education Department. Although the Scottish arrangements cover a slightly larger number of courses, it has been the policy of successive Governments to maintain parity of treatment for students on both sides of the border so far as main rates of grant and parental contribution scales are concerned. A fuller description of the present awards system is in Annex A.

6. The essential features of the present system have remained unchanged since 1962, except that contributions from families to the payment of tuition fees ended in 1977. In particular, student support has been oriented almost exclusively towards a system of higher education which is based on full-time degree or degree equivalent study from the age of 18 (17 or 18 in Scotland). There has been some widening in the scope of courses which entitle students to an award, such as the extension to Higher National Diploma and DipHE courses

*All figures are for GB, unless otherwise stated.

in 1975. Nevertheless, there are large numbers of advanced courses which do not at present carry an entitlement to mandatory awards.

7. This pattern of support is increasingly being questioned. More emphasis is now being placed on continuing education (see Section 4 of the Green Paper on Higher Education*); and greater opportunity and flexibility are being sought in methods of study. There is growing support among educators and certain categories of students for a greater use of modular courses, interspersed with work experience. The development of distance learning since 1962 is another factor pointing to the need for more diversity in the route and modes of entry to higher education, as also has been the wider range of qualifications available. The evolution of higher education in the years ahead may be expected to develop further along these lines. The present awards system, which was designed for the needs of the 1960s, may in some respects require adaptation, if it is not to be an obstacle to securing desirable change.

8. There have also been significant changes in social mores since the 1960s, which highlight the case for reform. As long ago as 1960 the majority of the Anderson Committee recommended the abolition of the parental contribution, but this was not accepted by the Government of the day. Since then the age of adult responsibility has been reduced from 21 to 18; and social and financial independence are now expected by young people at an earlier stage than in the past. In consequence the requirement in the present system of awards that students should be financially dependent on their parents until the age of 25 is increasingly being criticised. This criticism has focussed on the concept of a parental contribution towards the cost of a student child's higher education, according to their means. It is argued that parents ought not to have to pay towards the education of young adults who have left school. The parental contribution system does not place a legally enforceable requirement on parents, and the refusal or alleged inability of some parents to pay the assessed amounts has adverse consequences for their student children. The present system also enables some parents to exercise considerable skill in order to avoid their liabilities by reducing their assessable income to a minimum.

*"Proposals for the Development of Higher Education into the 1990s"

9. The escalating cost of awards has, however, progressively made changes to the awards system of a radical nature difficult to contemplate. Abolition of the parental contribution, for example, would today cost an additional £280M, and reduction in the age of independence from 25 to 21 would cost £75M. Moreover, the public expenditure pressures in recent years have made it difficult to maintain the real value of the grant year by year.

10. Students are eligible to claim social benefits, particularly in the long vacations which the mandatory award is not designed to cover. Student claims for supplementary benefit and housing benefit have risen sharply since the 1960s and up to perhaps one half of all students are claiming housing benefit and supplementary benefit during part of the year. The Government believes that it is right in principle to aim in the long term to remove students from the benefit system, and to make support available for those in need throughout the year under the awards system.

11. For all these reasons, the time is ripe to examine from first principles the arrangements for supporting students entering higher education, both in the context of higher education policy and recent developments, but also in terms of what the country can afford.

SECTION II

UNDERLYING PRINCIPLES

12. Higher education may be regarded as an investment in the future, both for the individual student and for the community at large. The national life and the national economy stand to benefit from the contribution that suitably qualified students can make; indeed the Government believes (see the Green Paper on Higher Education) that it is vital for our higher education system to contribute more effectively to the improvement of the performance of the economy. But the individual also stands to benefit from higher education both in tangible ways - through the ability of most graduates to command higher earnings in later life - and also (less tangibly) through the opportunity to broaden horizons and through an added enrichment of life.

13. One way in which the awards system could be directed more closely to the economic needs of the country is to build in incentives for students wishing to study subjects yielding particular benefit to the

economy. If we are to compete successfully in international markets, we need (among others) more qualified scientists, engineers and technologists. These are subject areas which offer greater scope for sponsorship by employers, but the case for some Government intervention also through a bursaries scheme is considered below. At the same time, an awards system should have due regard to other subjects, for example in the humanities, which less clearly assist directly in the country's economic performance but are an essential ingredient in a civilised society. Deserving students qualified to pursue these subjects should not be left unsupported.

14. More generally, the question needs to be addressed whether the cost of higher education is fairly distributed between the taxpayer on the one hand and the student (and his family) on the other. Under the present system it may be thought that students who can benefit from higher education are still a very privileged minority (see paragraph 4 above), many of whom are on the way to high earnings. Higher earnings lead to higher taxes, but these cannot be counted as a repayment of student support, since the same rates of tax apply to non-graduate higher earners. Overall it remains true that the main economic benefits of higher education accrue to graduates rather than to other taxpayers. One means of measuring the contribution of higher education to the economy as a whole is the social rate of return of first degrees which, on the basis of certain assumptions*, has in recent years been in the region of 5 to 8%. The private rate of return of higher education to the student is considerably higher than the social rate, even allowing for graduates' generally higher tax payments. This is to be expected when the average direct contribution of the student and his family towards the student's higher education is only some 10% of the total expenditure in maintenance and tuition costs. As the HE Green Paper acknowledges, however, it will be necessary for the Government to use money from the taxpayer to continue to meet the greater share of the cost of higher education. Even so, there are ways in which the burden could be more fairly redistributed, taking account of the benefits from higher education that accrue to the individual as well as to society. The introduction of loans is one obvious option, but other possibilities are also considered in the sections which follow.

*Chapter 3.10 of the White Paper on Public Expenditure, 1985

SECTION III

POSSIBLE CHANGES TO THE EXISTING SYSTEM

15. Without embarking on large reforms of student support, there may be some scope for redeploying resources within its general framework. As noted in Section I, the parental contribution system has been the subject of some criticism. But it does at least provide a means of relieving the taxpayer of, and shielding the student from, a greater share of the cost of higher education. If the parental contribution is to remain, there are ways in which the scale of contributions could be adjusted to make it more progressive, thus requiring families with the highest incomes to contribute more to the benefit of students from the least well off families. Another option is to extend the parental contribution into fees (if payment of fees is not to be subsumed in the general funding of institutions*) so that some easement of the burden on middle income families could be achieved. Abolition of the parental contribution altogether - at nil cost to public expenditure - would result in a reduction in the level of the maximum grant to around 80% of the present home rate for all students. This would still be above current supplementary benefit levels.

16. There are two administrative changes which might be made to improve the parental contribution system, if it is to remain. First, parental income could be assessed on the basis of gross income, rather than "residual" income. This would simplify administration, since complicated assessments could be dispensed with. It might also be thought to provide a more equitable basis of assessment, since those parents already enjoying tax relief, eg mortgage payers, would no longer derive a double benefit by virtue of the residual income assessment. Secondly, parental contributions could in theory be recovered via the tax system, thus protecting those students whose parents are unwilling to make up the full parental contribution and ensuring that the full grant is paid to all students - although at the expense of objections from parents who refuse on

*See recommendation in the Jarratt Report (Report of the Steering Committee for Efficiency Studies in Universities, March 1985).

principle to support their children's higher education and who would no longer have any choice in the matter. Recovery from parents could be either on the basis of a flat-rate or "student tax", or it could be related to the assessment made for individual parents each year. Use of the tax system could, however, present Inland Revenue with considerable operational difficulties, particularly if individual assessments were to be involved.

17. Another area in which some adjustment could be made is in the length of courses for which mandatory awards would be available. The Green Paper on Higher Education (Section 6) refers to the Government's concern at the extra costs of first degree courses outside Scotland which last for longer than three years. This trend could be halted by limiting the scope of mandatory awards to courses with a general educational content, up to a maximum of three (or even two) years. This would leave those wishing to study purely vocational subjects to look to sponsors and potential employers, or to discretionary awards, for support. Subjects such as medicine and architecture, which comprise both general educational and vocational elements, could be supported by mandatory awards up to the point where the vocational training began. Thereafter sponsoring employers (including the Government itself in some cases) would step in. And subjects, whether vocational or not, which are regarded as of high priority in the national interest, would qualify for bursaries or other specific Government support although there are difficulties about this (see paragraph 23). Any savings from such a change could be redeployed for other awards purposes, for example in extending entitlement to students on mixed mode or other types of course for which awards are not currently available.

18. As noted in Section I, the Government believes that it is right in principle to remove students from entitlement to State benefits.* Steps are already being taken to reduce the entitlement of students to supplementary and housing benefits in term-time and during the short vacations. To carry this process further into the long vacation would require a more fundamental extension

*Reference to DHSS Green Paper.

of the awards system which at present does not provide support for the long vacations nor any machinery for the assessment of students' means during that period. Moreover, any withdrawal of benefits from those in real need would have to be made good by other means, such as a hardship scheme, possibly involving loans. These questions will need to be addressed when options for change in student support are examined.

19. Another aspect of benefit support which will need to be reviewed is the present dual system of supporting the dependants of students. Currently only the dependants of students defined as "independent" and married before their course can be supported under the main awards regulations. All other dependants are supported under a hardship scheme administered by DHSS on behalf of DES under regulations made specifically for the purpose. There is clearly a case on administrative grounds for simplifying this in line with other possible changes discussed in the previous paragraph.

20. The existing awards system or any new scheme of support which is introduced could incorporate features designed to encourage trends which are considered to be desirable. For example, if it is thought that students should be encouraged to take time off between leaving school and entering higher education, the level of support could be reduced or even be suspended in the case of those who had been out of school for less than a year. Equally, if it is thought necessary to encourage students to study from home, the level of the grant or other support available could be based on the present home rate. However, such measures would need to be applied flexibly if students' ability to choose when and where to study is not to be unduly impeded. Nor should they encourage students to rely more heavily on state benefits, thus running counter to the Government's general aim of removing students from benefits.

21. There are some more radical changes which might be contemplated in order to promote the Government's general objectives.

(a) <u>Scholarships and Bursaries</u>

22. The principle underlying the present system is that all those who are suitably qualified and who have been offered a place on a designated course should receive a grant <u>as of right</u>. There may be a case however for introducing more selectivity into the awards system through scholarships or bursaries, or both. <u>Scholarships</u> would be awarded on merit, perhaps on the basis of A levels (or, in Scotland, SCE Highers), or BTEC (or SCOTVEC) qualifications.

This raises questions whether candidates would need to take special A level papers or the equivalent, and in what subjects, or otherwise on what basis they should be selected. Those who met the entry qualifications of the institution but did not win a scholarship would receive free tuition, but would have to meet the full cost of supporting themselves (unless a general loan scheme provided or assisted with this - see Section IV). Alternatively the scholarship could be a supplement on a small financial scale to any general support available under the system, or it could be applied as a waiver of debt under any loan scheme.

23. Another approach would be to restrict student support to specific subjects which would be designated in the light of national needs. These might be described as <u>bursaries</u>. Students not qualifying for a bursary would have to support themselves; or - as with scholarships - the bursary could alternatively be supplementary to the general support arrangements. As noted in Section II, bursaries would enable public support to be more closely directed to those subjects which would yield tangible benefits to the economy, such as in the areas of science, engineering and technology. However it could be difficult to achieve general acceptance for those subjects deemed to be of national value; and the task of administering such a scheme would pose problems. A bursary scheme should not be a substitute for support provided by sponsors or potential employers, but rather would be supplementary or complementary to it.

24. Both scholarships and bursaries would require more administration. In the case of scholarships, this could be done centrally, or alternatively it could be delegated to the institutions of higher education who might be given an allocation from which scholarships could be awarded on merit. In the case of bursaries, the Government would specify from time to time those subject areas for which bursaries would be available, and they could be administered in the normal way by the award-making bodies. In that case care would be needed to ensure that the subject areas were sufficiently clearly described to avoid overlapping and ambiguities: this might prove to be a difficult task.

(b) <u>Higher Education Tax</u>

25. One approach which has been advocated in the past envisages the recovery of the student's contribution towards the cost of his higher education through a Higher Education tax (sometimes called a "graduate tax"). Every student would receive a flat rate grant covering maintenance, and the cost would be

recouped by a proportional tax levied through Inland Revenue on subsequent earnings. There would be a flat rate cost for each subject to avoid any bias against longer courses, although the taxable cost for subjects designated as being in the national interest could be set at a lower level. Those with low or no earnings over the requisite repayment period would pay less than the better off, or nothing at all. Alternatively grants could be made available in blocks which could be taken up according to the student's means and at his discretion. Each block would attract a cumulatively higher rate of tax, which could be for life or for a fixed period.

26. The main advantages of this approach would lie in equity, since payment for higher education would be determined by future success, and in the removal of the dependence on parents - although it would be open to parents to finance the cost of their children's higher education as an alternative to drawing on the grant. Use of the Inland Revenue for recovery of the tax would pose the same operational problems which are noted in paragraph 17 above. If these could be overcome, however, the scheme would make recovery of contributions easier and would reduce the default rate. The drawbacks in the scheme itself would lie in the scope for avoidance and evasion of the HE tax - for example by artificially depressed earnings or even through emigration or a brain drain. It is uncertain what would be the psychological impact of an earnings related tax on the will to succeed, although this factor already exists in a progressive tax system.

SECTION IV

LOANS

27. The most widely canvassed alternative to the present system is one involving loans in whole or in part. Many believe that a personal investment by a student in his or her higher education through loans would be a timely innovation. The introduction of a loans scheme could be held to be justified by the logic in Section II; could lead to greater student independence and attention to choice of study; and could help to overcome some of the difficulties in the existing system mentioned in Section I. In more detail, the justification for loans could be stated as follows:

(a) <u>Equity</u> - the majority of taxpayers do not enjoy higher education or the lifelong advantages it can bring. To consider only the tangible benefits, it can lead to better salaries, conditions of work and choice of occupation. Although higher earners pay more in tax than others, not all of these are graduates. And it is nevertheless true that, overall, there is a net flow of resources from non-graduate taxpayers to those who have benefited from higher education. Loans could go some way to equalising the burden of student support. They could also serve as a substitute in suitable cases for the benefits on which many students currently rely.

(b) Simplicity - the present grant system is extremely complex. This is partly because of the need to ensure consistency of treatment of students by over 100 local education authorities responsible for its administration and partly because, for reasons of justice and proper use of resources, each individual's grant must meet but not exceed his or her needs. In a loan system it might be possible to dispense with much of this fine tuning. Simplicity would also be greatly increased by the abolition of the parental contribution to the award, which is complex and time-consuming to administer.

(c) Independence - the parental contribution to the grant is widely resented for prolonging the dependence of students on their families beyond the legal age of majority. The savings that would accrue from introduction of a loan scheme represent the only practical way of working towards gradual reduction or abolition of the parental contribution system.

(d) Choice - the present system contains no incentive to students to look carefully at higher education opportunities in considering what will offer them the best available personal and career opportunities. The introduction of loans could be beneficial in encouraging students to take more care in deciding whether they want to go into higher education. It could also influence choice of subject and institution, and encourage a greater degree of commitment by students to their studies. This in turn could help to increase the standards and variety of provision offered by the institutions themselves.

28. Replacing the present grant system, wholly or partly, by a loan scheme should produce substantial net savings in the medium to long term. Some of these could enable the Government to find the necessary resources with which it could progressively make desirable reforms, including extending mandatory support to other groups in higher education. The amounts and timing of savings

would of course depend on the terms of repayment, any concessions offered to particular groups, the incidence of default, and administrative costs. In the short-term there would certainly be no reduction in cost and possibly a significant increase, for example if there were no parental contribution to loans as there is at present to grants.

29. Loans have already proved a practical proposition elsewhere. Indeed the UK system of student support, being based entirely on grants, is virtually unique in the western world. Although there is a great diversity of systems elsewhere, most countries support students through loans to a greater or lesser extent. West Germany switched in 1983 from a part loan/part grant-based system of student support to one based predominantly on 100% interest-free loans administered by the Federal Government. In Sweden, the small basic grant received by all students is supplemented by a loan, which now amounts to 90% of the total award. The complicated Federal and State arrangements for student support in the USA also give prominence to loans, with limited value grants available for the most needy. Caution is necessary in making international comparisons, since the interaction of the higher education, student support, social benefits and tax systems varies from country to country. But there is much in the experience of these countries that should encourage us to look to loans as a possible way forward in the UK.

30. The case for loans is not unanswerable. There is concern that loans might discourage potential students from participating in higher education at all. Some point to the social implications of the burden of debt and to the sheer impossibility of repayment for women raising families and for those on low incomes. They believe that there will be great administrative difficulties and costs as a result of a loan scheme. These points are considered below in more detail.

31. <u>Participation</u> - A consequence of giving students, through the introduction of loans, more incentive to consider carefully the costs and benefits of higher education might be that some would conclude that it was no longer worthwhile. Others might simply be deterred by the responsibility of servicing a loan. Some of these effects would no doubt be transitory and would decline as loans became accepted as the normal means of financing higher education. However, the effects on participation of the introduction of loans simply cannot be accurately predicted. Experience from other countries serves as only a limited guide here since the introduction of loans abroad has often been linked to increases in public support available for education and has

opened up access to higher education for many for whom it would not otherwise have been available. There is also no precedent for a change from a universal system of grant as of right to one of loans or loans and grant in combination. Nevertheless, other countries do experience high participation rates. In West Germany 73% of students qualified to do so enter higher education: this is 18% of the relevant age range.* And it must be supposed that other countries are satisfied that their respective systems produce the number and type of graduates that they need. The experience of other countries also shows that many students are prepared to participate in higher education even without any grant or loan support. For example, in the USA and Canada around 50% of students receive no support. In Sweden 20% receive only the small basic grant, while under the relatively new West German scheme over 60% of students fall outside the scope of the loans scheme.

32. Repayments - The extent to which loans would produce savings in public expenditure will depend upon the level of repayments that can in fact be collected. Inevitably there will be a wilful or negligent minority of defaulters the pursuit of whom may involve disproportionate difficulty and expense. (A grant recovered by a Higher Education tax (paragraph 25) would remove this problem.) Experience of other countries provides useful lessons on how a loan scheme can be tailored so as to minimise default at acceptably low administrative cost. And there is no reason to believe that experience in the UK would be very different from that abroad, namely that the great majority of students can be expected to meet their obligations.

33. Careful thought would have to be given to setting interest rates and repayment periods at levels that were geared both to what the taxpayer could afford through Government expenditure and to the former students' ability to repay the loan. In some countries interest rates are subsidised compared with commercial levels. In West Germany no interest is charged unless there is default by the borrower; and good examination results can also reduce the amount to be repaid. Repayment periods may, however, be quite short, for example 10 years in the USA. It is difficult to gauge what the optimum

*Measures for Great Britain do not allow exact comparisons to be made; but the present qualified participation index of around 80% and age participation index of around 14% do indicate broad similarities with the position in West Germany.

levels for a UK system might be but, if repayments were to be spread over 15 years, and if no repayment were required until the second year after course completion, this might justify an unsubsidised rate of interest which could average 3% in real terms. Large burdens might prove especially hard to bear for students from poorer families, who have hitherto been heavily reliant on grants and who would not have a ready made source of subsidy to draw upon. Similarly, the position of students aiming at the less well-paid careers, and those on longer than average courses (especially in Scotland where about half of all students are on courses of four years or longer) would need to be given particular attention. Consideration would also have to be given to the modifications that might be appropriate for those on low incomes and women raising families. One option here might be to defer payments in years when income has fallen below, say, 85% of average earnings (currently £170 per week gross) . In cases of death or retirement debts could be written-off altogether.

34. <u>Administration</u> - A major consideration is how a loan scheme would be administered. Responsibility for making the loans, monitoring repayments, authorising deferments, recovering from defaulters and writing off debts, might lie either in the public or the private sector. There would be a welcome avoidance of public sector bureaucracy if the commercial banks, for example, were to prove willing to take on the administration of a loan scheme. It might nonetheless be necessary for the Government to finance a bank administered scheme, or to provide guarantees or subsidies in the terms of loans, in order to ensure that loans were available as of right to all students qualifying for admission to higher education, regardless of the level of commercial risk of each borrower. On the question of administration, international experience varies. In Sweden, administration of the scheme has passed from the banks to a state agency, partly because of the Government's determination to pursue bad debts and partly to maintain interest rate subsidies. This is also the case in West Germany. In the USA, however, reliance on Government agencies has been minimised through the operation of a variety of schemes administered by the banks but guaranteed and underwritten by the Government, although these have not been without their problems.

35. A feature of virtually all loan schemes is, to varying degrees, and depending on take-up rates, some additional expenditure in the short-term, in return for the prospect of significantly reduced expenditure later on. For macro-economic purposes, decisions about whether banks or the Government should administer and finance a loan scheme have no effect on the costs or savings resulting

from the scheme, in the short term or later. The real public expenditure implications of bank schemes can therefore be taken to be similar to the Public Sector Borrowing Requirement effects of identical Government-financed schemes. Proper comparisons of bank and Government schemes would, of course, depend on the exact terms on which the banks would be prepared to participate in a loan scheme.

36. The following paragraphs describe some options for the introduction of a loan scheme. The public expenditure costs and savings arising from each of the examples are set out in full in Table 1 in Annex B. The assumptions underlying the calculations are central to the assessment of the costs and savings produced by each option. In particular, the rate of interest chosen for any scheme is crucial. The options all envisage that the loans are repayable at an unsubsidised interest rate assumed to average 3% in real terms. (Higher rates in real terms would increase the longer term savings while lower rates might significantly reduce them.) Other assumptions include concessions on the payment terms so that repayments which would be spread over 15 years in equal real tranches, would not begin until two years after the end of the course and would be deferred when income fell below 85% of average earnings. Deferrals would be revalued in line with inflation and debts would be written off in cases of death or retirement. A default rate of 10% is assumed. Administration costs are excluded from the calculations, but these could increase the cost by around £5M to £10M a year in England and Wales, and a further £1M to £2M in Scotland, depending on the scheme.

37. The four options below cover the main grant/loan/parental contribution permutations which the Government believes represent a reasonable starting point for public debate on loans. In each case it is assumed that continuing students will not be affected by the introduction of loans but will carry on under the existing arrangements. For new students the level of support made available through loans or mixed grants and loans would be equal to current grant levels. The number of students qualifying for support is also assumed to be constant at the present England and Wales figure of 380,000. However, take-up rates for the loan elements of support are hard to predict and experience from abroad shows that take-up and participation are not invariably linked. In the UK it is estimated that around 80% of award-holders will receive some state contribution to maintenance in 1985/86 (the remainder will be assessed to receive a maximum parental contribution). But this is not a conclusive guide to the likely take-up of loans in the UK, and therefore Table 1 of Annex B exemplifies a spread of possible take-up rates for illustrative purposes.

Table 2 illustrates repayment rates for individual students with varying rates of interest, and Table 3 shows how higher or lower rates of interest would vary expenditure effects.

Option A

Loan available for up to 100% of assessed maintenance costs; parental contribution abolished immediately.

This option has two main advantages. First, it would have the immediate benefit for new students and their families of abolition of the parental contribution at a stroke (existing grant and parental contribution arrangements would apply to continuing students). Second, there would be significant long-term savings on current expenditure amounting to over £430M pa. However, any radical shift of this kind from present arrangements would not be without its difficulties. The effects on participation and take-up rates of a total switch from grants to loans would be most uncertain. The short-term expenditure implications if 100% of students were to avail themselves of a maximum loan would be substantial, rising to over £250M pa as early as the third year of the scheme, and declining only very slowly till savings were made in year 13. If the take-up rate were 80% the short-term costs would be up to £111M pa until the scheme's tenth year when repayments would begin to cover the cost of new loans. Only if take-up rates fell to around 60% could the problem of short-term costs be avoided.

Option B

Loan available for up to 100% of assessed maintenance costs; initially parental contribution retained but reduced by 10% each year from the present scale.

This option would lead to the same long term savings of £430M pa as Option A. Like that option, it would also involve the abolition of the parental contribution except that this would be achieved by phased reductions of 10% annually. This phased approach would result not only in lower costs and higher savings than Option A, but might also be regarded as more equitable as between new and continuing students. Parental contributions would be only 90% of present levels in year 1 reducing to 80% in year 2 and so on until complete abolition was achieved in the tenth year of the scheme. The loan element would rise each year to replace the parental contribution element foregone. However,as with Option A, any sudden shift to a 100% loan scheme must cause great difficulties in predicting participation and take-up rates under this option. A take-up rate of 100% would result in increased short-term costs of up to £140M pa and new loans would not be financed by repayments until year 14 of the scheme.

[An] 80% take-up rate, which is certainly more realistic in the circumstances, would lead to only very small short-term increases in expenditure, of less than £20M pa, and in the first few years of the scheme there would actually be small savings of around £30M pa. Lower take-up rates would also result in immediate savings ultimately increasing to over £430M.

Option C

Loan available up to 50% (with grant for the remaining 50%) of the amount of assessed maintenance costs; initially parental contribution retained on grant and loan elements but reduced by 10% each year from the present scale. This is less radical than options A and B in that 50% of the grant would be retained. It would have the great advantage that a substantial grant element would still be available to students from poorer families, thus reducing the risk of an adverse effect on participation. The parental contribution would be phased out in the same way and over the same period as described under Option B. Until abolition was complete, the contribution would be assessed against both the loan and grant elements of support. The long term savings produced by this option would amount to less than £100M pa. However there would be a rising trend of expenditure in the short-term until year 10 as a result of the phased abolition of the parental contribution, even on a low take-up figure.

Option D

Loan available for up to 50% initially (with grant for the remaining 50%) of the amount of assessed maintenance costs, with a 5% increase annually in the loan element until grant replaced by 100% loan; initially parental contribution retained but reduced by 10% each year from present scale.
The main advantages of the preceding options are combined in this option, which would:

(i) achieve the same long-term savings of over £430M per annum as options A and B;

(ii) lead to abolition of the parental contribution by year 10 of the scheme; and

(iii) lead to the gradual introduction of 100% loans by year 11, and thus avoid the worst effects on participation which an immediate switch to 100% loans scheme might bring.

The annual 5% increases in the loan element would affect all students (except those few who began courses before year 1 of the scheme who would carry on under existing arrangements). A take-up rate of 100% would lead to a pattern of short-term expenditure increases similar to option C, increasing to £168M pa in year 10, but savings would be achieved after year 15. An 80% take-up would greatly limit these short-term expenditure increases to a maximum of £40M to £50M in years 5 to 10 of the scheme. Lower take-up figures would produce significant savings in all but a few years of the scheme and any take-up of less than 70% would lead to savings throughout.

38. The Government believes that, of the options illustrated, Option D is to be preferred. It strikes a fair balance between the taxpayer and the student and his family, in reducing public expenditure over a period, at the same time as phasing out the parental contribution. Moreover, the deterrent effect on access of a switch from grants to 100% loans is cushioned by the phasing out of grant over a 10 year period.

SECTION V

CONCLUSIONS

39. This paper has argued that there is a need to re-examine our system of student support in order to measure it against developments in higher education that have taken place in recent years and which may be expected in the years ahead. Changes may also be called for in the light of the escalations in expenditure that have taken place since the system was introduced in 1962 and in the current national interest. It is the Government's view that a more rational and fairer system of supporting students should now be seriously considered; and one which places more of the financial burden on those who benefit from higher education, and less on the taxpayer at large. The introduction of loans would be one way in which greater equity could be achieved, and the Government sees considerable attractions in this approach. There are, however, other possibilities, some of which could be adopted in combination with a loan scheme. There is also the possibility of modifying the present system.

40. The Government would welcome the widest possible public debate on these propositions. In particular, it invites views on the following questions:

Sections I and II

(a) What adjustment in the burden of student maintenance should be made as between the taxpayer on the one hand and students and their families on the other?

(b) Should entitlement to mandatory support be extended to other types of courses? If so, which ones?

(c) Should students be financially less dependent on their parents? If so, is the priority a reduction in parental contributions across the board, or should any reduction be directed at achieving more independence for the 20 to 25 year olds?

Section III

(d) If the parental contribution system is to remain, what if any adjustments should be made?

(e) Equally, should either of the two administrative changes described in paragraph 16 be introduced, viz -

(i) a switch to gross income assessment and

(ii) recovery through the tax system, if workable?

(f) Should entitlement to mandatory support be based on a standard period (with exceptions)? If so, should the period for support be reduced in the case of vocational courses?

(g) If benefits are no longer to be available to students, what kind of hardship scheme (with or without loans) should be set up, and who should administer it?

(h) Should the existing arrangements for the support of students' dependants be unified? How should any new system be administered?

(i) Should students be encouraged through the support arrangements to study at a local higher education institution?

(j) Should the support arrangements encourage students to take a year off between school and entry into higher education?

(k) Should awards be applied selectively on merit as with scholarships, or according to national needs, as with bursaries? If so, how should the schemes be administered and by whom?

(l) Should the cost of student support be repayable by means of a Higher Education tax levied on the former students? If so, should the tax be assessed -

(i) individually according to actual expenditure; or

(ii) on a flat rate basis?

Section IV

(m) Should loans be introduced? If so - should they cover all, most or part of a student's needs? In the latter case, should the difference be made up with grants?

(n) Should the loan terms be subsidised heavily, moderately or not at all? In particular -

(i) should there be reductions and/or deferrals of repayments when former students are on low incomes or unemployed?

(ii) should the interest rate be unsubsidised?

(iii) should the standard repayment be 10 to 15 years, or longer?

(o) Should any loan scheme be administered and/or financed by the Government, or by the banks on acceptable terms?

(p) Taking account of public expenditure constraints, which of the options illustrated in Section IV is to be preferred?

[Note - Some of these questions will be omitted or amended when the paper is agreed.]

STUDENT AWARDS: BACKGROUND

1. Mandatory awards are made to students on designated courses of AFE. These are full-time degree or degree comparable courses: DipHE courses, HND courses run by BTEC, and courses of initial teacher training. Awards for other courses - other than for certain postgraduate study - are discretionary. Each individual award-making body decides the number of such awards it can make and the rates and conditions of grant and bears the full cost itself. The remainder of this note will concern mandatory awards.

2. A student has a right to an award for only one attempt at a basic advanced qualification (irrespective of whether an award was received for that study or not) and so those who have undertaken previous advanced study are rendered ineligible. Students must also satisfy certain residence conditions to be eligible for support.

3. The award covers a student's maintenance and fees. For those resident in the parental home the basic maintenance grant is £1435. For those living outside of the parental home it is £2100 for those in London, and £1775 for those elsewhere. Those receiving free board and loding are entitled to a grant of £755. The grant is assumed to cover the Christmas and Easter vacations and 30 weeks of term-time. In addition to the basic maintenance grant, the student may also be eligible for additional maintenance. The main supplementary allowances are for extra weeks of study and for dependants.

4. The cost of maintenance is shared between the State, students and their families. Students aged 25 or over, or who have supported themselves for 3 years before the start of their course are regarded as independent of their parents for awards purposes, and their parents are not assessed to make a contribution towards their maintenance (although, if married, their spouse would be). A parental contribution is assessed for all other mandatory award holders.

5. The parental contribution is based upon the parents' residual income: the income of both parents is taken into account in its calculation. Residual income is defined as the parents' gross (taxable) income in the preceding financial year less certain deductions including those for other dependants, interest payments (including mortgage interests), superannuation, life insurance and pension scheme contributions. After residual income has been calculated, and parental contribution assessed, a further deduction is made in respect of any other dependent children of the family: £225 if the child is an award holder, or £80 otherwise.

6. A nil parental contribution is asssessed where parents' residual income is less than £7600. At £7600 a contribution of £20 is assessed; contributions are then assessed at the rate of £1 for each £7 of additional income to a residual income of £9700, at which point the scale changes to £1 in £6.

7. For the spouses of independent students the contribution is again based on residual income. No contribution is assessed on incomes below £5900. At £5900 a contribution of £10 is assessed; contributions are then assessed at £1 in £5 to a residual income of £9000, and beyond that contributions increase at the rate of £1 in every £10.

8. The student's contribution is not based on residual income. On incomes (net of tax, national insurance, child benefit and vacation earnings) beyond £400 the student is assessed to contribute pound for pound towards his grant. However, scholarship income to a limit of £1200 (or £1500 in the case of an Industrial Scholarship) is disregarded.

9. The maximum contribution towards the grant from whichever source(s) is limited to the maintenance element of the award. Fees are met in full by the State, and are not subject to parental or other contributions. They are paid direct to the college by the award-making body.

ANNEX B
TABLE 1

STUDENT LOAN SCHEMES - PRELIMINARY EXEMPLIFICATIONS

EXPENDITURE EFFECTS £M (1985/6 PRICES) ENGLAND AND WALES

	YEAR 1	2	3	5	7	10	15	STEADY STATE
OPTION A								
Loan available up to 100% of assessed maintenance costs; no parental contribution								
Take-up rates								
100%	+85	+170	+255	+255	+201	+ 93	-121	-434
80%	+37	+ 74	+111	+111	+ 68	- 18	-189	-439
60%	-11	- 21	- 32	- 32	- 64	-129	-257	-445
OPTION B								
Loan available up to 100% of assessed maintenance costs; parental contribution reduced by 10% each year from present scale								
Take-up rates								
100%	+ 8	+ 34	+ 76	+127	+138	+129	- 66	-434
80%	-24	- 34	- 31	+ 10	+ 18	+ 11	-145	-439
60%	-56	-103	-139	-108	-102	-108	-224	-445
OPTION C								
Loan available up to 50% (with grant for the remainder) of assessed maintenance costs; parental contribution (reduced by 10% each year from present scale (set against both grant and loan)								
Take-up rates								
100%	+ 9	+ 34	+ 77	+128	+157	+186	+ 86	- 90
80%	-10	- 4	+ 18	+ 65	+ 95	+128	+ 48	- 92
60%	-28	- 42	- 41	+ 3	+ 33	+ 70	+ 10	- 95
OPTION D								
Loan available up to 50% initially (with grant for the remainder) of assessed maintenance costs, with a 5% increase annually until grant replaced by 100% loan; parental contribution reduced by 10% each year from present scale (set against both grant and loan)								
Take-up rates								
100%	+ 9	+ 34	+ 77	+127	+153	+168	+ 1	-434
80%	-10	- 7	+ 7	+ 41	+ 54	+ 49	- 91	-439
60%	-28	- 49	- 63	- 45	- 45	- 69	-184	-445

NOTE:

The following assumptions are common to all schemes:

(a) The student population is a constant 380,000 and all are on 3 year courses.

(b) Loans are for new students only - continuing students carry on under existing arrangements.

(c) Loans are repayable at an unsubsidised interest rate assumed to average 3% in real terms.

(d) No repayment is required until the second year after course completion.

(e) Repayment is over 15 years in equal real tranches.

(f) Repayment is deferred in years when income falls below 85% of average earnings.

(g) Deferred payments are revalued in line with inflation.

(h) Debts are written off on death or retirement.

(i) Ten per cent of repayments are defaulted.

(j) Administration costs are excluded.

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REPAYMENT PROFILES

REPAYMENTS AS PERCENTAGE MEDIAN GRADUATE SALARIES

REPAYMENT YEAR	A. LOAN = 50% MAINTENANCE 3% FEMALE	3% MALE	0% MALE	6% MALE	B. LOAN = 100% MAINTENANCE 3% FEMALE	3% MALE	0% MALE	6% MALE
1	3.4	3.1	2.4	3.8	6.8	6.2	4.9	7.6
2	3.1	2.9	2.3	3.5	6.2	5.7	4.5	7.0
3	2.8	2.7	2.1	3.3	5.5	5.4	4.3	6.6
4	2.6	2.5	2.0	3.1	5.3	5.0	4.0	6.2
5	2.6	2.4	1.9	2.9	5.2	4.8	3.8	5.8
10	2.4	1.8	1.4	2.2	4.9	3.6	2.9	4.4
15	2.3	1.5	1.2	1.9	4.6	3.1	2.4	3.8
AVERAGE REAL TERMS DEBT AT START OF REPAYMENT PERIOD	2828	2828	2828	2828	5655	5655	5655	5655
ANNUAL REAL TERMS REPAYMENT (£)	237	237	188	291	474	474	377	582
TOTAL REAL TERMS REPAYMENT OVER 15 YEARS	3555	3555	2820	4365	7110	7110	5655	8730

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/NOTES

NOTES:

(1) The figures above are expressed in "real terms" which means that they are at 1985/86 prices and ignore the effects of inflation.

(2) The interest rates shown in "real terms" represent the extent to which actual interest rates exceed the rate of inflation. For example, an actual rate of interest of 9% would, if the inflation rate were 6%, produce a "real terms" interest rate of 3%. Because the gap between interest and inflation rates is unusually high at present real interest rates are currently higher than shown. It is more realistic, however, to base costings covering a long period on a real terms rate of 3%, which experience suggests is a good estimate of the average cost of long-term Government borrowing. This can be regarded as an unsubsidised interest rate although commercial rates might, of course, be higher.

(3) The repayments are expressed at constant 1985/6 prices. They would be made over 15 years beginning 2 years after graduation and are assumed to have the same real terms value annually throughout the life of the loan. The annual cash amounts to be repaid would, of course, be higher than those shown because of the effects of inflation on the outstanding debt and actual interest rates. For example, a student taking out a 100% loan and incurring a real terms debt of £5655 could face a cash debt of some £7550 by the time of his first year of repayment if inflation is assumed to be 6%. The cash repayment would continue to be affected by interest (a real terms interest rate of 3% is assumed) and inflation rates during the repayment period such that the total cash outlay over 15 years would be about £15,650 compared with the real terms figure shown in the table of £7,110.

(4) The calculations are based on graduates from 3 year courses earning median graduate salaries (estimated from the 1982 General Household Survey) assuming no real growth in salaries over time. Salaries vary widely around the median. Repayments will vary in proportion to course length.

TABLE 3

EFFECT ON COSTINGS OF INTEREST RATE VARIATIONS

£M 1985/6 PRICES

	real interest rate	YEAR 10	YEAR 15	STEADY STATE
OPTION A	(0%	+33	+77	+141
	(6%	-38	-86	-158
OPTION B	(0%	+25	+65	+141
	(6%	-29	-74	-158
OPTION C	(0%	+14	+34	+ 71
	(6%	-16	-39	- 79
OPTION D	(0%	+18	+52	+141
	(6%	-20	-58	-158

NOTES:

(1) The figures show the effect on the Table 1 costings for each option of varying the interest rate from the figure of 3% in real terms used in the main exemplifications. Positive figures indicate increased spending (or reduced savings) as compared with using a 3% rate and negative figures indicate reduced spending (or increased savings).

(2) All the above figures are based on 100% take-up rates. The equivalent figures for lower take-up rates would be proportionately lower.