

A report by the Higher Education Commission

**highereducation**  
Commission

# TOO GOOD TO FAIL

THE FINANCIAL SUSTAINABILITY OF  
HIGHER EDUCATION IN ENGLAND





The Higher Education Commission has spent the past nine months researching the financial sustainability of higher education in England.

Throughout this time we have spoken to over 60 experts in higher education and finance, and held focus groups with students currently at university.



We discussed:

**What should be sustained  
in the current higher  
education system?**

**What are the biggest  
threats to higher education  
in England?**

**How can providers, the  
Government and others  
mitigate these threats?**

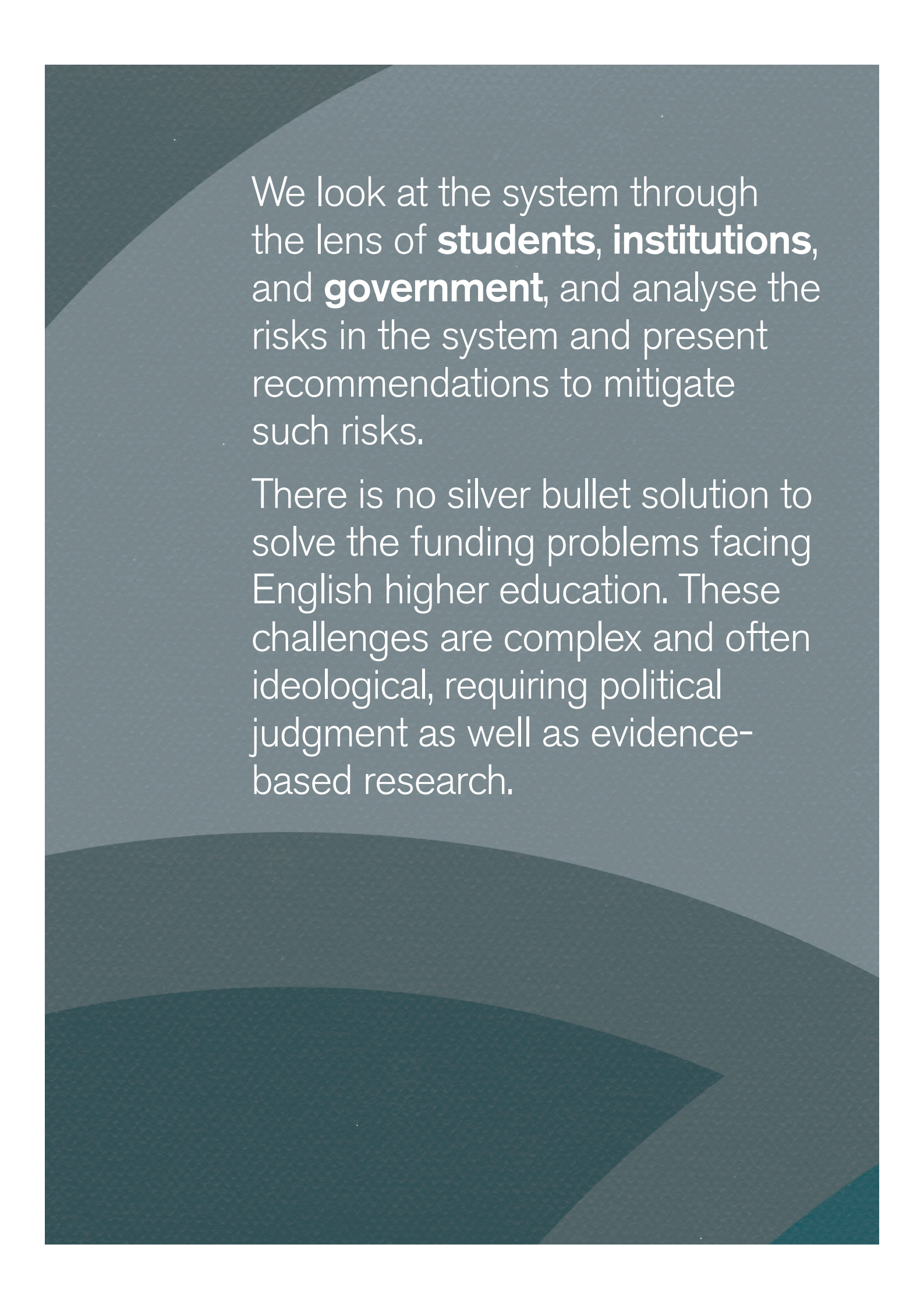




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We look at the system through the lens of **students, institutions,** and **government,** and analyse the risks in the system and present recommendations to mitigate such risks.

There is no silver bullet solution to solve the funding problems facing English higher education. These challenges are complex and often ideological, requiring political judgment as well as evidence-based research.

In our report we make 16 recommendations to help safeguard the future sustainability of higher education in England. We also present six options on funding models, weighing up the advantages and disadvantages of each.

**Higher education makes a huge contribution to the well-being and economic prosperity of our nation and it is essential that it not only survives, but thrives.**



# Co-Chairs' foreword

There has been no shortage of recent comment on the present state of higher education in England, including in the area chosen for this latest inquiry by the Higher Education Commission: the sector's financial sustainability. There is much pride in the excellence of English higher education – pride the Commission believes is fully justified. But all political parties are reticent about how they intend to safeguard and build on that excellence in the next Parliament and beyond.

This inquiry has taken place before the full impact of the reforms to undergraduate tuition fees that took effect in 2012 is known. Under the Coalition the rules governing institutions' ability to recruit undergraduates unfettered by controls on numbers have changed three times (so far). There have been hard-fought arguments about grant funding. With the exception of the support provided through tuition fees, universities can no longer rely on the state for anything but the most limited financial support for capital infrastructure investment, alongside funding for research.

An experiment is underway, with potential consequences for English HE stretching decades into the future.

In its work, the Commission has regularly asked itself what it is that we are keen to sustain. We have looked at sustainability from the perspectives of the country and the Government; of HE providers; and of the millions of students and graduates that enjoy both the measurable and less measurable benefits a university education confers.

The Commission believes that

- undergraduate courses should be free at the point of use, and the sooner this is extended to postgraduate taught degrees the better
- the system should facilitate, and certainly not damage, the ability of students to realise their potential regardless of their background
- England's academic capacity and competitiveness and its outstanding research base must be safeguarded
- the unmeasurable benefits of HE must be acknowledged, recognising that the more effectively we can identify HE's true value the more compelling will be the case for support and investment whether from public or private sources
- universities should be expected to deliver an impressive rate of return on public investment.

One conclusion that has been reiterated throughout this inquiry is the belief that – for all the cautious words that follow – our higher education system has the strength and resilience to withstand considerable turbulence and volatility. Institutions are alive to the risks and are taking steps to mitigate them. But there is more that can and must be done, brought out in the report and our recommendations.

The Commission agrees that

- higher education should be “*available for all those who are qualified by ability and attainment to pursue [it] and who wish to do so*”, as Lord Robbins put it over half a century ago



- public and private benefits flow from participation in higher education, so the cost burden should be shared between these beneficiaries
- too much reliance should not be placed on the operation of the market as the main mechanism for ensuring that HE provision of the kind we want remains sustainable
- the Government currently gets the worst of both worlds – moving funding from direct grants into support for a rapidly-growing student loans scheme has obscured the great extent to which the Government funds the system
- growing graduate indebtedness exacerbates intergenerational inequality, undermines young people's legitimate material aspirations and risks storing up unforeseen problems elsewhere in the economy and society
- some providers will struggle in the new environment, and the interests of students must be protected in those circumstances

To create a financially sustainable HE system, either graduates and students have to pay, or the Government has to pay, or universities have to do more with the same (or less). The question is how to balance these responsibilities. The Commission is concerned about graduate indebtedness and the extent of future uncertain liabilities the Government is amassing. So far universities have not taken as much of the strain, but the present unstable arrangements create risks for them as well.

The Commission has not uncovered a crock of gold or a silver bullet in the course of this inquiry.

This report sets out our analysis and findings from six evidence sessions and over 40 individual meetings, as well as written submissions and focus groups with students at three different universities. We are most grateful to the many people who have given us their time and insight, including our fellow Commissioners. In particular we thank Jessica Bridgman at Policy Connect, who has researched this complex topic with great commitment and energy and carried the burden of producing our report, with the capable support of her colleagues Thomas Kohut and Simon Kelleher.

The report presents six options for consideration. All of them have disadvantages as well as advantages. They occupy different positions on the spectrum of what is ideal and what is achievable – and we are clear that what is ideal contains a good dose of subjectivity. Our aim is to provoke more informed debate and comment.

To return to a point we make at the outset: we believe that higher education in England makes an enormous contribution to the prosperity and well-being of the country. While the questions it faces over funding are intractable, it is essential that policy-makers and politicians confront them.

The Rt Hon the Lord Norton of Louth  
Dr Ruth Thompson  
Inquiry Co-Chairs

# Executive Summary

Our goal for this inquiry was to better understand the threats to the financial sustainability of higher education, and how these could be overcome to create a sustainable higher education sector in the short-, medium-, and long-term.

What do we mean by financially sustainable? A financially sustainable sector, in our opinion, is not one that is scraping by, merely surviving. It is a thriving, buzzing centre of knowledge for England and the rest of the UK; building and expanding, producing valuable outputs, as well as receiving public investment. We believe that for the British economy to stay globally competitive, higher education is essential.

Why does higher education need to thrive? The benefits of higher education can be easily taken for granted. They are often intangible, and difficult to quantify. This inquiry has reminded us of the economic and social benefits that higher education brings to both the individuals that participate, and the taxpayers that help to fund it. Beyond increased salaries and higher tax receipts from graduates, higher education makes our citizens more politically aware, tolerant, and healthier. These spillover effects of higher education are of great benefit to society as well as creating substantial savings for the Government. The social benefits are much harder to quantify than the economic, but this does not mean they are any less important, and they should be considered seriously when looking at how HE is funded.

We spent a lot of time discussing the strengths of the current system that need to be supported to ensure our HE sector remains of high calibre. These fundamentals of English higher education are mass participation, diversity, and world class research. These should be sustained in our system; they are what make it thrive.

The Commission identified a number of areas where there is a risk to continued financial sustainability. This report considers these in sections on student numbers, students, institutions, and government. Whilst each of these risks taken separately might not present great danger, it is the cumulative impact of these risks that is most concerning.

The current funding system represents the worst of both worlds. The Government is funding HE by writing off student debt, as opposed to directly investing in teaching grants. This has created a system where the Government is investing, but not getting any credit for it, damaging the perception of the public value associated with higher education. Students feel like they are paying substantially more for their higher education, but are set to have a large proportion of their debt written off by the Government. Universities are perceived to be 'rolling in money' in the eyes of students, as their income from tuition fees has tripled, yet the cuts to the teaching grant are not well understood by students and a fixed fee cap means an annual erosion of real terms income. We have created a system where everybody feels like they are getting a bad deal. This is not sustainable.



The 2012 reforms dramatically increased the contribution from students to their tuition. Whilst the repayment conditions are generous, the Commission is concerned about the amount of debt students will accrue under the new system. According to the Institute for Fiscal Studies (IFS), students will graduate with an average of £44,035 of student debt, compared to £24,754 of debt if the reforms had not been introduced.

The IFS estimates that 73% of graduates will not repay their debt in full, compared to just 25% under the old system.<sup>1</sup> The Commission is particularly concerned that middle earners, such as health professionals, teachers or public sector workers (who need a degree to enter their profession) will not be likely to pay back their loan within the repayment period. The Commission fundamentally questions any system that charges higher education at a rate where the average graduate will not be able to pay it back.

Student numbers are a concern, specifically the rapid expansion of undergraduates and the decline of postgraduate and part-time students. The HE Commission agrees that the expansion of student numbers would bring many benefits. We do not believe that there are too many graduates. However, the impact of removing all limits on undergraduate recruitment on universities' budgets, the potential decline in quality for students, and the lack of control on public funding of student loans could prove problematic. Student numbers should be expanded, but in the current system this puts the financial sustainability of the sector at risk and the Government should monitor the impact on public finances, students, and institutions. The student loan book should not be sold to fund this expansion.

Postgraduate, part-time, and mature education, need immediate attention to ensure that our population is highly skilled and our economy remains globally competitive. The recruitment of international students should be aided by removing students from the net migration cap and short-term work visas for graduates should be restored.

Universities see cuts to capital funding grants, and the cap on tuition fees, as a threat to their continued sustainability. Demands from students and the expansion of undergraduate numbers place more importance on universities investing in new and maintaining old facilities. Universities need to find alternative sources of income to fund projects, but the costs of borrowing have increased dramatically.<sup>2</sup> The rating agencies need to ensure they are using the most up to date understanding of the sector to assess the credit worthiness of institutions. With borrowing comes increased risk to institutions' financial sustainability, as HEFCE has noted.

Likewise, with the freeze on the tuition fee cap, estimates state that by mid-2015 the £9,000 tuition fees will only be worth £8,250 in real terms.<sup>3</sup> Institutions have called for the cap to be indexed with inflation; however, the Commission has not been presented with strong evidence from universities that it costs more than an average of £9,000 to deliver good quality courses.

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1 C Crawford and W Jin, (10 April 2014) 'Payback time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?' Institute for Fiscal Studies, pg.2.

2 Grant Thornton, (2014) 'Managing through uncertainty' Financial Health of the Higher Education Sector 2014, pg. 15.

3 C Snowden, (12 September 2013) 'President's address to 2013 Members' Annual Conference: The enduring value of universities' available online: <http://www.universitiesuk.ac.uk/highereducation/Pages/PresidentsAddress2013AnnualConference.aspx#.VFACMDSsWxp>

An efficient system for debt collection is vital as the student loan book grows from £46 billion to £330 billion between 2013 and 2044. The Commission is worried about the efficiency of debt collection, and believes that steps need to be taken to improve it. Better tracking is needed to increase collection from graduates who move abroad and universities should help the Student Loans Company (SLC) and Department for Business, Innovation and Skills (BIS) trace their graduates who are not repaying.

Under the new system the student loan subsidy (Resource Accounting and Budgeting charge) has increased to 45%. This means that for every £1 lent by the Government to students for HE, 45p will not be repaid. In 2012/13, the Government issued nearly £7.4 billion of student loans; this is estimated to increase to over £12 billion of loans for 2015/16.<sup>4</sup> Estimating the long-term public cost of the loan system is very difficult, as it relies on a myriad of economic and social factors, namely guessing how much graduates will earn (and therefore repay) over their working lives. The cost will not be realised until 30 years from now when graduates have finished their repayment period and the amount remaining is written-off by government. There is a serious issue with implementing a policy that dramatically increases the costs of student loan write-off for future governments, without being able to make a strong estimate of what that write-off will be.

The 2011 White Paper and reforms that followed were supposed to lead to a more marketised system of higher education: improving standards, whilst prices were driven down, resulting in better qualified graduates for, ideally, less money. This has not happened, and many refer to what we have as a 'pseudo market'. We agree that the idea of a market is flawed. With little in the way of careers advice or access to information, students do not feel or act like consumers, brand plays too big a role in the decision of which university to go to, demand continues to outstrip supply, and there is less choice for students than is perceived. Introducing market forces to a sector that does not operate as a market puts the financial sustainability of the sector at risk; the Commission recommends retreating from this notion.

Research funding has been eroded as a result of inflation, and we are seeing research funding become more concentrated. The Commission thinks that good research, wherever it exists in the sector should continue to be funded.

The interconnectedness of the funding system makes it very difficult to adjust or amend part of the funding structure without impacting another; trying to ease the burden on one player will add burdens for another.

The Commission has made recommendations throughout the report. On funding student tuition, we heard much evidence on alternative funding structures. However, it has become clear that different funding structures will benefit different parts of the sector: students, universities, or government. It is very difficult to choose a system

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4 C Crawford, R Crawford and W Jin, (24 April 2014) 'Estimating the public cost of student loans' Institute for Fiscal Studies, pg 6.



where all benefit. Who should benefit and who should bear more burden must be a political decision.

Given the lack of sustainability of the current student finance system, further work needs to be undertaken to arrive at a better higher education funding model.

Therefore, in last chapter of the report we look at six options for funding higher education, assessing the positives and negatives of each one. We analyse:

- Maintaining the status quo with or without tweaks to the system – for instance, changes such as reducing the threshold beyond which graduates start to repay their loans; reducing the interest rate on student loans; indexing tuition fees with inflation
- The graduate tax – a progressive rate of tax on graduates' income to replace tuition fee loans
- Lowering fees, increasing government grant – a return to more HEFCE funding with a lower fee cap
- Lifting the fee cap – lifting the fee cap to a higher threshold and removing the cap completely
- Hybrid system – seeking to create incentives for differentiation and efficiency and introducing an individual lifelong learning pot
- Differential fees – for courses and institutions

# Recommendations

## Recommendation 1

The Government, with business, should remove the remaining restrictions on retraining at graduate level, reinvigorating part-time and mature learning.

## Recommendation 2

The Government should immediately address access to funding for taught postgraduate education, as recommended in the Higher Education Commission's report '*Postgraduate Education*'.

## Recommendation 3

The Government should monitor its plans to lift student number controls and be ready to reverse them if further research and experience shows they have had a damaging impact on students, universities or government finances.

## Recommendation 4

Universities need to plan for the potential volatility of the international student income stream and for the prospect that hitherto stable international markets may decline or change, possibly at short notice.

## Recommendation 5

International students should be taken out of the net migration target figure and be allowed to work in the UK for two years after graduation.

## Recommendation 6

The Department for Business, Innovation and Skills should work with the SLC to develop a strategy for debt collection for graduates who move abroad.

## Recommendation 7

The Treasury should provide additional funding for the SLC to pilot improvements in debt collection in time for effective measures be introduced in 2016.

## Recommendation 8

Universities should be placed under an obligation to help the SLC trace graduates who are not paying off their student loans.



#### Recommendation 9

Schools and colleges need to make professional and independent careers advice available to their students, exploring the full range of pathways into further study and employment.

#### Recommendation 10

The Government should not place too much reliance on market mechanisms given the absence of an informed consumer market.

#### Recommendation 11

The Government should renew its efforts, in collaboration with all types of HE providers, to ensure that a variety of HE provision can thrive.

#### Recommendation 12

Rating agencies need to have a more sophisticated understanding of universities' credit worthiness and position in the market and reflect the changing role of HEFCE and its funding.

#### Recommendation 13

The Government should not sell the student loan book to fund higher education or other spending priorities.

#### Recommendation 14

The Government should acknowledge the importance of the regulatory framework to the financial sustainability of English HE and implement the recommendations from the Higher Education Commission's report '*Regulating Higher Education*'.

#### Recommendation 15

High quality research, wherever it exists in the sector, should continue to be funded.

#### Recommendation 16

The current system fails to meet our test of financial sustainability and further work needs to be undertaken to arrive at a better higher education funding model.

# Sustaining the system

In this opening chapter, we make the case for ensuring the financial sustainability of higher education. In a nation with such an illustrious history and global reputation for higher education excellence, we must not lose sight of the myriad benefits to individuals and society of the university experience, which are at risk if the financial health of the sector declines.

## 1.1 Why sustain higher education?

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The current higher education funding system takes a mixed economy approach, meaning that both individuals and taxpayers contribute. This is reflective of the private and public benefits of higher education, which are wide-ranging and include both economic and social factors.

Nearly all commended this dual contribution and the Commission agrees that a funding regime where both individuals and the public purse contribute is best.

The logical way to calculate the contribution from private (individuals) and public (taxpayers/government) is to measure the respective benefits of both and translate these into a percentage contribution. However, some of the benefits of higher education, particularly the social ones, are intangible and difficult to measure. In describing this policy problem, one witness referred to John Maynard Keynes's *'A Treatise on Probability'*.<sup>5</sup> Here Keynes distinguishes things we can compute, things we can order, and things we can only comprehend by making complex judgements. The economic benefits are things we can roughly compute, whereas wider social benefits can only be understood through complex judgements.

### 1.1.1 Economic benefits to graduates

There are many estimates of the wage premiums that come with graduating from university. The Department for Business, Innovation and Skills (BIS) estimates that the average graduate will earn £100,000 more over their lifetime than a similar individual who has two or more A-levels, but no degree.<sup>6</sup> In 2013 BIS commissioned Professor Ian Walker (University of Lancaster) and Yu Zhu (University of Kent) to research this further, using both the Labour Force Surveys and British Household Panel Survey, which contains more information on Higher Education Institutions (HEI) type and A-Level qualifications. This research put the wage premium higher. It found that over a lifetime (net of tax and loan repayments) men would earn £168,000 more and women £252,000.<sup>7</sup> This represents a 28% wage increase for men and 53% for women.<sup>8</sup>

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5 J M Keynes, 'A Treatise of Probability' available at: <http://www.gutenberg.org/files/32625/32625-pdf.pdf>

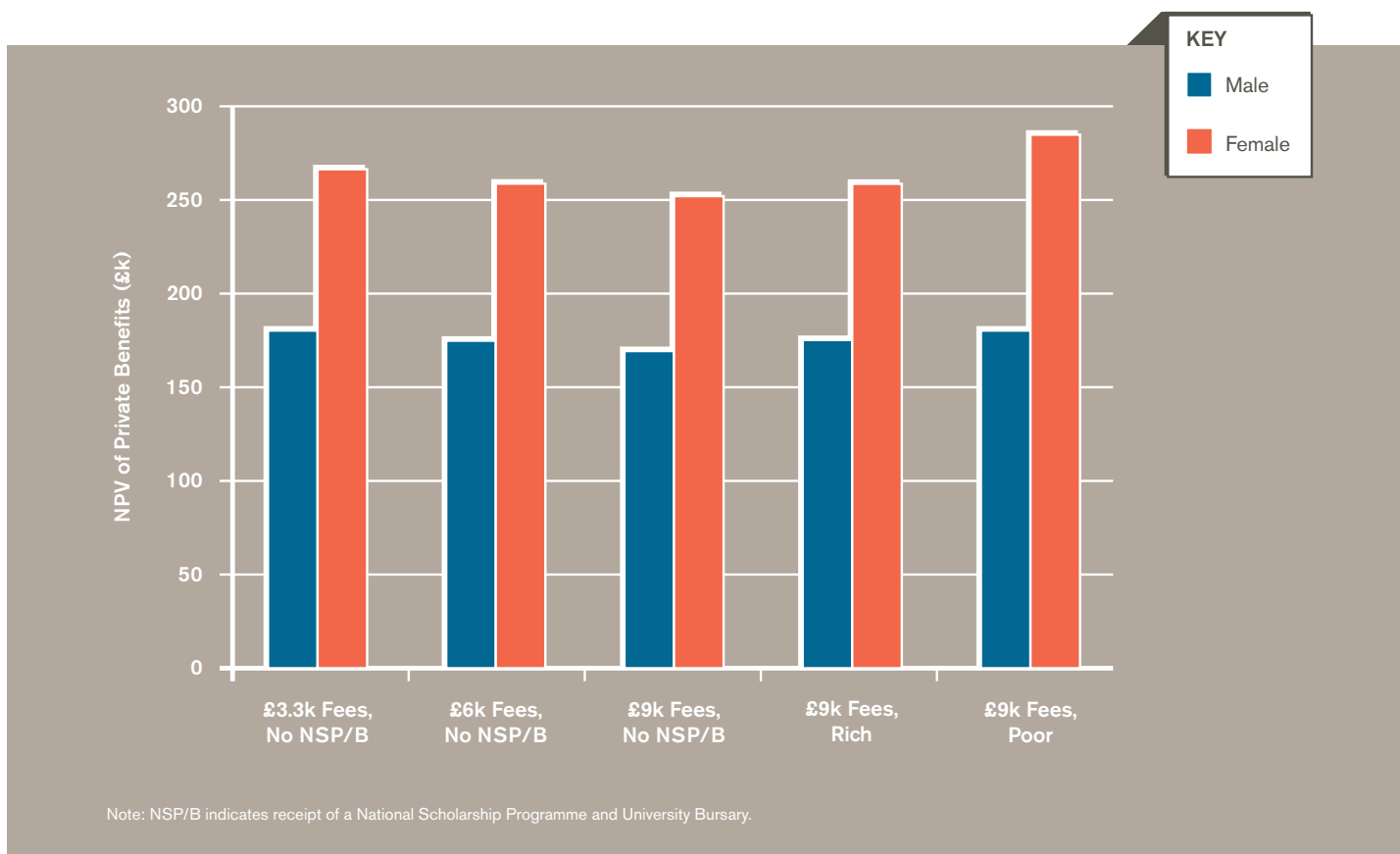
6 Department for BIS, (October 2013) 'The Benefits of Higher Education Participation for Individuals and Society: key findings and reports "The Quadrants"' BIS Research Paper No. 146. pg 45

7 Department for BIS, (August 2013) 'The Impact Of University Degrees On The Lifecycle Of Earnings: Some Further Analysis' BIS Research Paper No. 112. pg. 5

8 Ibid., 6.



Much of the data used for this research is from before the 2012 reforms; however a simulation by BIS in the chart below was developed to show the net present value of the private benefits associated with the different fee regimes:



**Figure one: Net Present Value of private benefits (£k per student): sensitivity**  
 Source: Department of BIS, The Impact Of University Degrees On The Lifecycle Of Earnings: Some Further Analysis

Not only are university graduates likely to earn more money, they are more likely to be employed. A graduate is 3.3 percentage points more likely to be employed than a non-graduate, with women receiving a 4.2 percentage point employment boost, while for men the increase is 2.1 percentage points.<sup>9</sup> Graduate qualifications are not only a regulatory requirement for specific professions such as law or medicine, but employers of all types need and like to employ graduates as they tend to be more productive, and an HE qualification confers assurance about a person’s intellectual attributes. Many HE courses are not linked directly to professions, but the key skills learnt such as problem

9 Department for BIS, (October 2013) 'The Benefits of Higher Education Participation for Individuals and Society: key findings and reports "The Quadrants"' BIS Research Paper No. 146. pg 48

solving, self-management, critical thinking, and communication, are acquired through a range of degrees, and are easily transferable.

### **1.1.2 Economic benefits to the public**

Economic benefits do not stop at the individual. The wage premium that comes with a degree translates into economic benefits for society.

BIS has estimated that the net working life benefits to the Exchequer (as a result of individuals gaining a first degree compared to 2+ A levels) are £260,000 for men and £315,000 for women.<sup>10</sup>

Million+ estimated this to be lower. In their work with London Economics they found that the net Treasury benefit was £108,000 for men compared to £63,000 for women.<sup>11</sup> Even with these lower figures this represents a rate of return of 11.4% for men and 9.6% for women (taking into account direct costs of HE funding, and indirect costs such as forgone tax income during years studying).<sup>12</sup> According to this estimate the return to the Treasury over the working lives of the 2010/11 cohort of 342,500 undergraduate students at English higher education institutions would be £28.4 billion.<sup>13</sup>

For postgraduate degrees the rate of return is even better. Net benefit to the Treasury for men is £71,000, a 31.9% rate of return, and £47,000 for women, a 22.5% rate of return.<sup>14</sup>

The reformed funding system has increased the estimated rate of return to the Exchequer. However, this is not because of increased income from graduates or efficiency in the post-2012 system. The cut to HEFCE teaching grant has decreased the amount of funding the Government contributes, making the rate appear better. This is thought to have increased the overall rate of return from 10.8% to 11.3%.<sup>15</sup>

A greater population of graduates also makes for a faster growing, more productive economy, increasing our global competitiveness. BIS research shows that 20% of UK economic growth between 1982 and 2005 was the result of increased graduate skills.<sup>16</sup> In addition to this, with every 1% increase of the workforce with graduate qualifications, productivity increases by 0.2-0.5%.<sup>17</sup>

### **1.1.3 Social benefits to graduates**

A graduate is more likely to vote and feel engaged with the political process. 61% of adults without secondary education qualifications participate in elections compared to 81% of graduates.<sup>18</sup> Importantly, those who have completed tertiary education also feel like they

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10 Department for BIS, (October 2013) 'The Benefits of Higher Education Participation for Individuals and Society: key findings and reports "The Quadrants"' BIS Research Paper No. 146. pg. 36

11 Million+ (January 2013) 'What's the value of a UK degree?' pg. 8.

12 Ibid..

13 Ibid., 9.

14 Ibid., 8.

15 Ibid., 9.

16 Department for BIS, (October 2013) 'The Benefits of Higher Education Participation for Individuals and Society: key findings and reports "The Quadrants"' BIS Research Paper No. 146. pg. 38

17 Ibid..

18 Ibid., 15.

have more of a say in government (21% of without secondary education qualifications vs 42% for graduates).<sup>19</sup>

Graduates are more likely to volunteer and engage in social and civic activities (12% without secondary education qualifications vs 22% for graduates).<sup>20</sup>

They also have a longer life expectancy and are more likely to be in better health (72% without secondary education qualifications vs 89% for graduates).<sup>21</sup>

If these benefits simply correlated with participating in higher education rather than having a causal relationship, we would expect to see these dip as graduate numbers expand and more students from a range of backgrounds enter HE, but this does not appear to be the case.<sup>22</sup>

#### 1.1.4 Social benefits to the public

It can be difficult to differentiate between gains to individuals and to society, but when these individual benefits spill over into society, the scale makes it worthy of mention.

One example of this is improved social cohesion. Those educated to degree level tend to be more trusting and more tolerant of different parts of society. This links closely to reduced likelihood of criminal activity. BIS estimates that a 16% increase in the number of people with degree-level education would lead to a £1 billion annual savings in the costs associated with crime in the UK.<sup>23</sup>

A more tolerant and law-abiding society makes for a more politically stable one. Indeed, graduates are not only more likely to vote, but be less cynical about politics.<sup>24</sup>

A well-documented benefit to society is the impact of higher education on social mobility. The UK Commission for Employment and Skills estimates that by 2022, over half of jobs will require higher education (51.3%), with one in seven jobs (14.1%) requiring postgraduate qualifications.<sup>25</sup> Whilst progress has been made, we are still seeing lower than expected numbers of students from disadvantaged backgrounds getting into the top universities. The recent Social Mobility and Child Poverty Commission report reinforced the benefits of recruiting from a broad socio-economic background, and given the importance of a university degree for accessing a job, it is important that disadvantaged students have the same opportunities as their peers.

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19 OECD (September 2014) 'Education at a Glance 2014: OECD Indicators', OECD Publishing, pg. 186-7

20 OECD (September 2014) 'Education at a Glance 2014: OECD Indicators', OECD Publishing, pg. 183.

21 Ibid..

22 University Alliance (February 2013) 'University Alliance Budget representation: harnessing universities to help build a stronger economy for the future' available at: <http://www.unialliance.ac.uk/wp-content/uploads/2012/03/University-Alliance-Budget-representation-1.pdf>

23 Department for BIS, (October 2013) 'The Benefits of Higher Education Participation for Individuals and Society: key findings and reports "The Quadrants"' BIS Research Paper No. 146. Pg. 9.

24 Ibid., 11.

25 Social Mobility & Child Poverty Commission (October 2014) 'State of the Nation 2014: Social Mobility and Child Poverty in Great Britain' available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/365765/State\\_of\\_Nation\\_2014\\_Main\\_Report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/365765/State_of_Nation_2014_Main_Report.pdf)



**1. Sustaining the system**

Unit costs per year (£, 2012 prices), unless otherwise stated				
	1998 system (2003 version)		2006 system (2009 version)	2012 system
<b>Taxpayer costs</b>	5,800		8,500	7,800
Teaching grant	3,700		3,700	600
Fee grant	700			
Maintenance grants			1,600	1,600
Maintenance loan - cash	4,400		4,100	4,000
Maintenance loan - RAB	30%	1,300	42%	46%
Fee loan - cash			3,700	8,200
Fee loan - RAB			42%	46%
			1,500	3,800
<b>Graduate contributions</b>	3,100		4,500	6,600
Maintenance repayment	3,100		2,400	2,100
Fee repayment			2,100	4,400
<i>The above sources enable</i>				
<b>Universities' income</b>	5,200		7,000	8,400
Teaching grant	3,700		3,700	600
Fees - public grant	700			
Fees - private, up-front	700			
Fees - via loans			3,700	8,200
Bursaries			-400	-400
<b>Student benefits</b>	3,700		6,000	6,000
Fee costs, up-front	-700			
Maintenance grants			1,600	1,600
Maintenance loans	4,400		4,100	4,000
Bursaries			400	400

**Figure two: Balance of contributions to higher education funding**

Source: OBR, Fiscal Sustainability Report

Components may not sum due to rounding. RAB: Resource accounting and budgeting change.

**1.2 Three things to sustain**

There are many elements of the English higher education system that are the envy of the world. In this section, we focus on three essential characteristics of our system that the Commission believes need sustaining.

**1.2.1 Mass system of higher education**

Over the past century, higher education in the UK has transformed from a benefit reserved for the elite, to a system of mass participation. Latest UCAS data shows that four weeks after GCE A Level results day 422,020 students had accepted places at English universities for 2014/15.<sup>26</sup>

For the British economy to thrive and compete internationally, and for us to create a society which is fair and prosperous, a mass system of higher education is needed. Many agree that if England wants a mass system of higher education, there needs to be some form of student contribution (not upfront). The amount, and the mechanism for paying it, remains hotly contested.

26 UCAS, available at: <http://www.ucas.com/sites/default/files/UCAS-interim-assessment-of-acceptances-report.pdf> Compared to entry in 2013-14 there was an increase of 4% for 2014/15. The best figures for student numbers comes from the HEIPR Stats, however the latest statistics are for the 2012/13 academic year, which an unreliable representation given the introduction of £9,000 fees leading to a fall in student numbers. The next HEIPR stats will be out in 2015.

1. Sustaining the system

The chart on page 20 by the Office of Budget Responsibility (OBR) looks at the contributions of taxpayers and graduates under the 1998, 2006, and 2012 student finance systems.<sup>27</sup> It looks at ‘unit cost’ (costs per student). The chart allows the money to be followed from the taxpayer and graduate to the university and student. We can see how the levels of contribution have changed over the three systems. What the ideal level of contribution from the public and private should be is debated. Estimates suggest that the current system represents a 50:50 contribution from government/taxpayers and individuals, and research from University Alliance supports this (see chart below).<sup>28</sup>

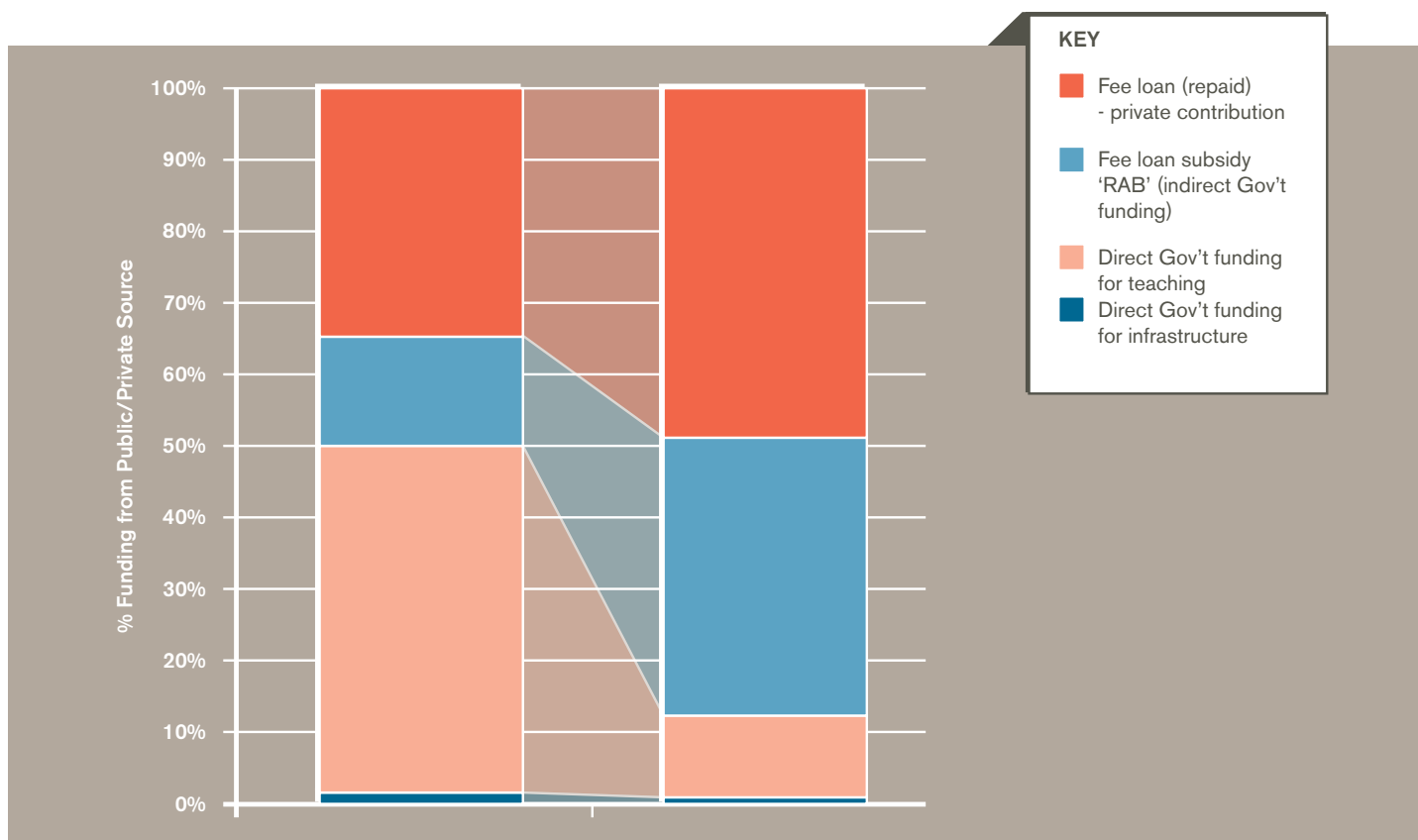


Figure three: What happened when £9,000 fees were introduced?

Source: University Alliance, H.E.L.P. UK Background evidence report

1. Figures are based on all full-time undergraduates in pre-2012 and all first time undergraduate students (FTE) in £9,000 system (approx 95% of all full-time undergraduates and 30% of part-time undergraduates). The post 2012 system changed to allow 1/3 of all part-time undergraduates to access the fee loans - those doing first degree and studying over 0.25 workload.
2. These figures are based on 100% uptake of fee loans - they do not take account of those choosing to pay their fees upfront. Our best understanding is that this is a small proportion of students and percentage paying upfront has not changed significantly in the new system compared to pre-2012 figures.
3. £9,000 system calculations are based on projections for 2015-16 when three years of students will be in the system. Based on 2012-13 student numbers. Based on an average fee of £8,425, the average fee after fee waiver in 2014-15 (OFFA, 2013).
4. Figures based on a 28% RAB charge in the pre-2012 system (BIS, 2012) and 45% RAB charge in the £9,000 system (House of Commons, March 2014).

27 Office for Budget Responsibility, (July 2014) 'Fiscal sustainability report' pg. 170 available at: <http://cdn.budgetresponsibility.org.uk/41298-OBR-accessible.pdf>

28 University Alliance (February 2013) 'University Alliance Budget representation: harnessing universities to help build a stronger economy for the future' available at: <http://www.unialliance.ac.uk/wp-content/uploads/2012/03/University-Alliance-Budget-representation-1.pdf>

If the presumption is that in a mass system all parties who gain should contribute in some way, then it is necessary to consider what other beneficiaries there are who might share in the costs. The Commission considered whether previous graduates who benefited from free higher education tuition could contribute through the income tax system and whether businesses employing graduates should pay higher National Insurance Contributions or corporation taxes. These arguments have been advanced and toyed with in the past, but have foundered because most regard them as politically very difficult. These policies could be construed as retrospective (for individuals) or burdensome and counter-productive (for employers). The Commission concluded that these were both avenues that were not as promising as they appear at first.

### **1.2.2 Diversity in the system**

A crucial element of the HE system is its diversity. We heard about the benefits of diversity, creating choice in the system, catering to range of students' needs.

A significant part of the Government's 2011 White Paper<sup>29</sup> and subsequent reforms has been devoted to facilitating more diversity in the system. In a speech to Universities UK in 2011 the former Universities Minister David Willetts MP said "*The biggest lesson I have learned is that the most powerful driver of reform is to let new providers into the system. They do things differently in ways no one can predict. They drive reform across the sector.*"<sup>30</sup>

Throughout our evidence we heard the positive case made for a diverse range of providers. One witness, when asked about the impact of diversity on the financial sustainability of the system, said that diversity makes our system more sustainable, as it prepares all institutions for an uncertain future. The Commission is inclined to agree, seeing a diverse system as building resilience to prepare against future risk.

The funding system should not only support diversity, but help the system to diversify further to protect itself against an uncertain future.

### **1.2.3 World class research**

The high international reputation of English higher education is largely thanks to the quality of research output. Recent research from BIS has confirmed that the UK punches above its weight in terms of global research. It found the UK represents just 0.9% of global population, 3.2% of R&D expenditure, and 4.1% of researchers, but it accounts for 9.5% of downloads, 11.6% of citations and 15.9% of the world's most highly-cited articles.<sup>31</sup>

It is not surprising that witnesses expressed the need for continued investment in research to maintain the UK's global reputation for excellent higher education, and

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29 Department for BIS, (June 2011) 'Higher Education: Students at the Heart of the System' available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31384/11-944-higher-education-students-at-heart-of-system.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31384/11-944-higher-education-students-at-heart-of-system.pdf)

30 D Willetts, (February 2011) 'Universities UK Spring Conference 2011' available at: <https://www.gov.uk/government/speeches/universities-uk-spring-conference-2011>

31 Elsevier, (2013) 'International Comparative Performance of the UK Research Base – 2013' Prepared for Department BIS, pg. 2.



many placed research investment on their top lists of asks, as current levels of research funding were not covering the full economic costs. The current dual support funding system is serving the sector well, and quality-related funding has provided the necessary flexibility, autonomy and opportunities for exploratory work. We heard that this system helped fund 'strategic' as well as 'blue skies' research.

A strong research sector not only attracts international students, but also the best academics from around the world. By creating a desirable research environment that has the best facilities, produces top results and is regarded to be world class, English HE will continue to attract the best researchers who will go on to produce high quality research. This makes our system more successful, and therefore more sustainable.

# Assessing the current system: risks to financial sustainability

Chapter Two examines elements of the current system that represent risks to continued financial sustainability. We then make recommendations on how to mitigate these risks.

## 2.1 Student numbers

In this section we look at the trends in student numbers, and their impact on financial sustainability. The Higher Education Commission believes that those who will benefit from an experience of higher education, and have the ability, should have the opportunity to participate. We also believe that the UK should be the destination of choice for students from across the world. However, there are growing concerns around student numbers and associated policies that risk the financial sustainability of the sector: the potential rapid expansion of undergraduate numbers, falling part-time and postgraduate numbers, and the volatility of the international student market.

### 2.1.1 Trends in postgraduate taught and part-time students

Full-time undergraduate student numbers have been increasing. However, the total number of students in HE has been decreasing due to large falls in the number of part-time undergraduates, postgraduates (full and part-time) and mature students. This is a worrying trend for HE, which, as mentioned in the first chapter, needs a diverse offer to remain financially sustainable.

The graph on page 25 shows that total student numbers have been shrinking for a few years. HEFCE reported in April 2014 that the number of part-time UK and EU undergraduates entering English HE in 2013-14 was almost half what it was in 2010-11, with overall numbers have falling by 120,000.<sup>32</sup> Over the same period part-time postgraduate entrants fell by 27% (25,000). Our evidence blames this on the economic downturn (in particular employers being less likely to support part-time study by their workers), the increase in tuition fees, and the withdrawal of ELQ (equivalent or lower qualifications) funding in 2008/09. Looking across the devolved nations, where the drop in part-time numbers was not as pronounced, it is clear that the increased fees in England have played a significant role. In the period 2010/11 to 2012/13, Scotland and Wales saw declines of 24% and 12% respectively, whereas Northern Ireland has seen an increase in part-time students of 16%.<sup>33</sup>

32 HEFCE, (April 2014), 'Pressure from all sides: Economic and policy influences on part-time higher education' available at: <http://www.hefce.ac.uk/pubs/year/2014/201408d/>

33 A report by Oxford Economics concluded that "the recent decline in part-time entrants across the UK is likely to have been driven by higher education policy changes and exacerbated by macroeconomic conditions". Oxford Economics, (April 2014) 'Macroeconomic influences on the demand for part-time higher education in the UK', Report for HEFCE, available at: [http://www.hefce.ac.uk/media/hefce/content/pubs/indirreports/2014/macroeconomicinfluencesonthedemandforthe/2014\\_ptdemand.pdf](http://www.hefce.ac.uk/media/hefce/content/pubs/indirreports/2014/macroeconomicinfluencesonthedemandforthe/2014_ptdemand.pdf)

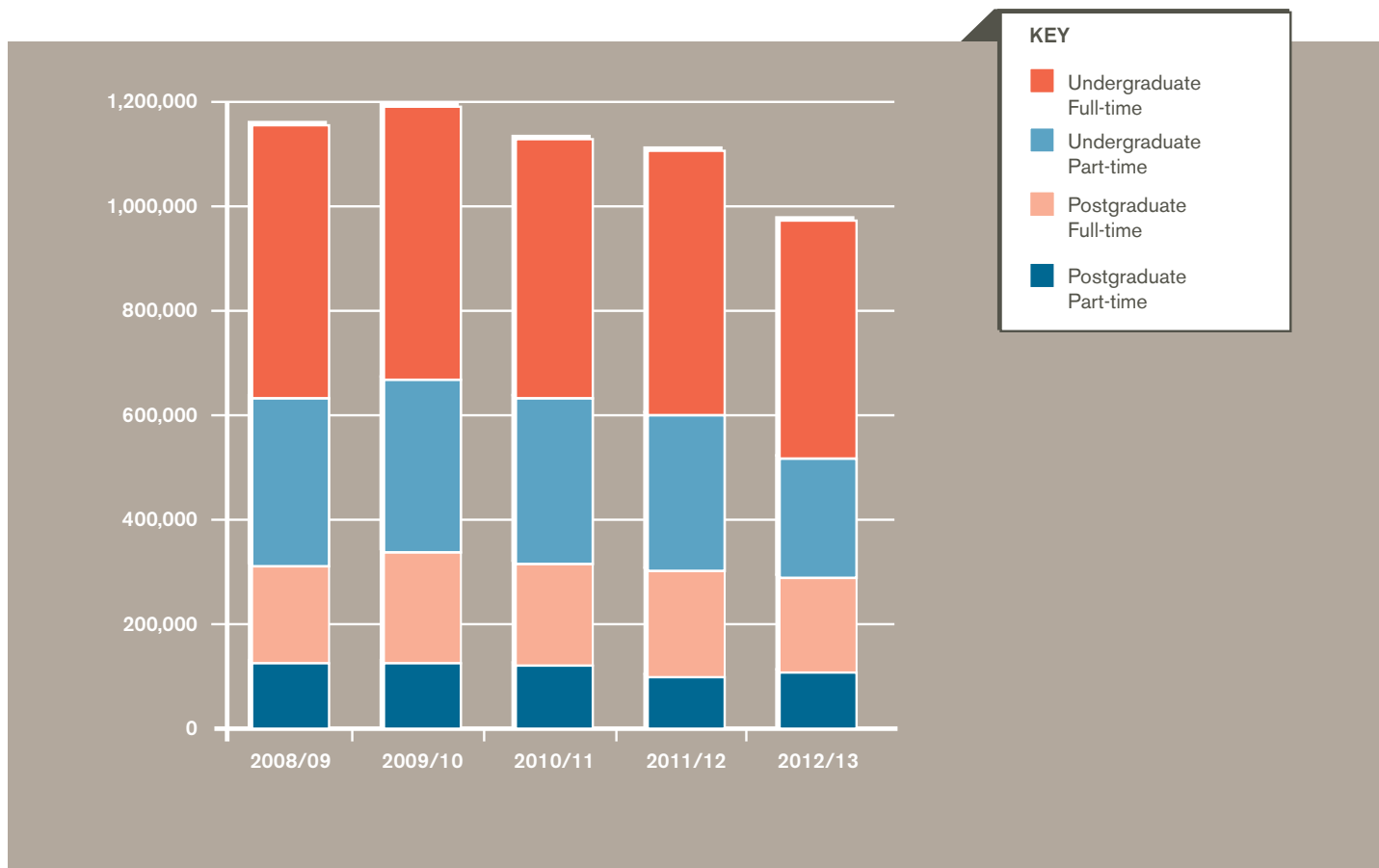


Figure four: First year students by level and mode of study

Source: HESA, Higher Education Student Enrolments and Qualifications Obtained At Higher Education Institutions in the United Kingdom for the Academic Year 2012/13

This decline is concerning for the sector as a whole, but more important is the impact on the economy. Specialist institutions that have worked to develop their part-time model have suddenly experienced a drop in students.

The Commission’s first report looked in great detail at postgraduate education. It found that whilst postgraduate students have increased by about 200% since 1999, only 18% of this growth is a result of UK and EU students.<sup>34</sup> It also went into detail about the skills gap that the UK faced if it did not train enough native postgraduates. Postgraduate education has seen a decrease recently with English postgraduates dropping by 17% from 2009/10 to 2012/13.<sup>35</sup>

34 HE Commission, (October 2012) ‘Postgraduate Education’, pg. 27.

35 HESA, (January 2014) Higher Education Student Enrolments and Qualifications Obtained At Higher Education Institutions in the United Kingdom for the Academic Year 2012/13. Available at: <https://www.hesa.ac.uk/stats>





Figure five: First year PGT students by domicile, 2007/08 to 2012/13  
 Source: UUK, Postgraduate taught education: the funding challenge

In 2012/13, mature students made up 52% of UK/EU enrolments for undergraduate degrees in England. They are much more likely to be studying part-time or be in employment than ‘young’ undergraduates. Universities UK research has found that between 2007/08 and 2012/13 mature student undergraduates have fallen by 36.5%.<sup>36</sup>

The decreases in essential part-time, mature, and postgraduate students are very concerning to the Commission. Not only is this putting financial pressure on parts of the sector which specialise in this provision, but it also risks damaging the wider economy. Without high level skills across the workforce, and the opportunity for people to retrain and raise their skill levels during their working lives, the UK will struggle to maintain its role as a globally competitive economy.

### Recommendation 1

The Government, with business, should remove the remaining restrictions on retraining at graduate level, reinvigorating part-time and mature learning.

### Recommendation 2

The Government should immediately address access to funding for taught postgraduate education, as recommended in the Higher Education Commission’s report ‘*Postgraduate Education*’.

#### 2.1.2 Lifting the Student Number Controls

Chancellor of the Exchequer, George Osborne MP, surprised the public and higher education when he announced in the 2013 Autumn Statement plans to lift the Student Number Controls (SNC) on universities.

*“Access to higher education is a basic tenet of economic success in the global race. So today I can announce that next year we will provide 30,000 more student places – and the year after we will abolish the cap on student numbers altogether.”<sup>37</sup>*

– George Osborne MP, 5th December 2013

This decision was presented as a further liberalisation of higher education, which would increase the number of graduates (good for the economy), expand access to university (good for society), and encourage competition between institutions (good for students). The Treasury has estimated that every year around 60,000 students receive the necessary grades for higher education, but fail to secure a place.<sup>38</sup>

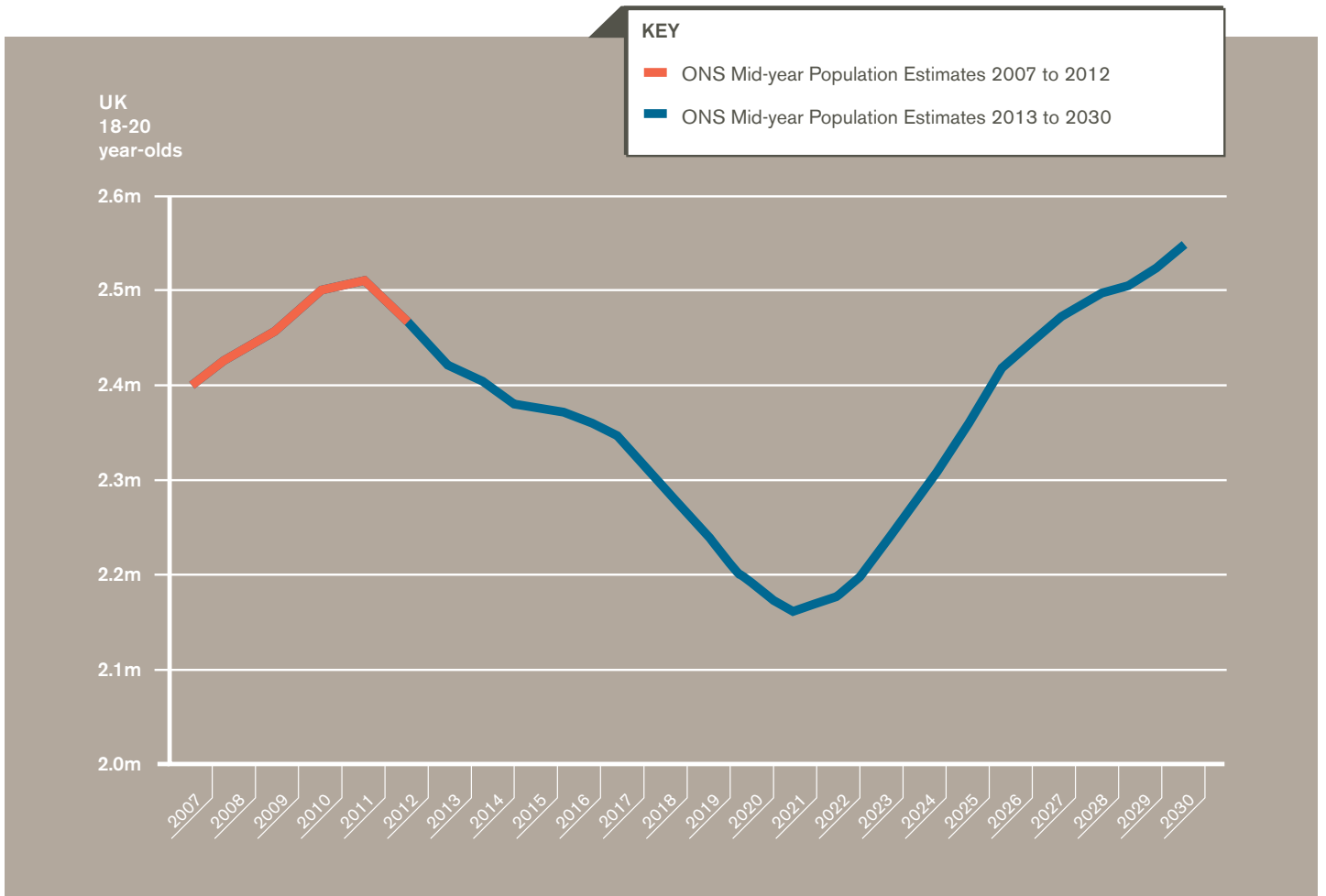
We support this goal, but there are risks attached – both financial risks, and risks to quality. The cost to government of funding extra students with loans is not the only

<sup>36</sup> Universities UK, (August 2014) ‘Trends In Undergraduate Recruitment’, pg. 18

<sup>37</sup> G Osborne, (December 2013) ‘Chancellor George Osborne’s Autumn Statement 2013 speech’ HM Treasury available at: <https://www.gov.uk/government/speeches/chancellor-george-osbornes-autumn-statement-2013-speech>

<sup>38</sup> HM Treasury, (December 2013) ‘Autumn Statement 2013’, pg. 7 available at: <https://www.gov.uk/government/publications/autumn-statement-2013-documents>

concern (the possible sale of the student loan book is discussed in section 2.4.2). The impact of unrestrained recruitment on the sector could produce unforeseen consequences that reduce the quality of provision, by increasing the ratio of students to teachers, reducing contact time, and putting pressure on facilities, all of which risks damage to the student experience. The Commission believes that the impact of this liberalisation needs to be closely monitored.



**Figure six: 18- to 20- year olds in the UK population 2007 to 2030**  
 Source: UUK, Trends in undergraduate recruitment

#### A: Demographic change and student number volatility

The volatility of student numbers is exacerbated by impending demographic changes. More young people are achieving level 4 qualifications, thanks to better attainment levels at secondary school and young people studying for longer. However, population changes mean that there will be fewer 18-20 year olds to take up places at universities – this is the age group from which the majority of students come.

The figure on page 28 shows that from 2012 to 2021 the number of 18-20 year olds is projected to decrease by 12.3%.<sup>39</sup> Past HEPI research shows that this decline in numbers will not happen proportionately across society and that lower birth-rates have been more prevalent in lower-socioeconomic groups, which have lower rates of HE participation.<sup>40</sup> However, this decline was a concern for a number of Vice-Chancellors, given that it adds another element of uncertainty to student recruitment.

Due to these changes, combined with the removal of SNC, universities will need to compete to expand in the short-term, as the present steep drop in potential students continues until the end of the decade. In 2013, before the SNC were lifted, IPPR argued the demographic change would save the Government money (based on 2011 ONS figures it estimated £1.5-3 billion would be saved in teaching and maintenance grants) as the proportion of students attending university would stay the same, but the absolute number would drop.<sup>41</sup> The announcement to lift the controls on student numbers has reduced the chance that these savings will materialise.

#### B. Impact of lifting SNC on government

Under the new fees system introduced in 2012, the IFS predicts that 73% of students are expected to have some or all of their debt written off (Government predictions are closer to 60%).<sup>42</sup> Witnesses to this inquiry warned that increasing student numbers would likely increase this proportion, as expansion would probably come at the margin, meaning growth in numbers is expected to bring in students with lower future earnings potential.

The control on student numbers has not historically been justified with reference to the economy's need for graduate skills. There is not a formula which estimates how many graduates England needs. However, it has provided a valuable control mechanism on public spending and also ensured that demand in the system slightly exceeded supply (something that has helped manage the sector's financial sustainability as a whole).

The experience of the alternative providers<sup>43</sup> demonstrates this point well. Until 2014 alternative providers had the ability to recruit students freely. Whilst their students are not allowed to borrow as much to support their tuition (only £6,000/year), the uncontrolled expansion of students at these institutions resulted in 21,500 extra students obtaining a tuition fee loan in 2012/13 compared to 2010/11. This equates to an extra £220 million spent on loan support for students at alternative providers in 2012/13 compared to 2010/11 – a 445% increase.<sup>44</sup>

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39 Ibid., 9.

40 R Coleman and B Bekhradnia (February 2011) 'Higher Education Supply and Demand to 2020', HEPI, pg. 7.

41 IPPR, (June 2013) 'A Critical Path: Securing the Future of Higher Education in England' IPPR Commission on the Future of Higher Education, pg. 118.

42 C Crawford and W Jin (10 April 2014) 'Payback time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?', Institute for Fiscal Studies, pg.2.

43 Alternative Provider as defined by HEFCE: A general term for providers of higher education which are not funded by regular government grants. They can be for-profit or not-for-profit, and of any corporate form.

44 J Grove (August 2014) 'Huge growth in public funding at private colleges' Times Higher Education: available at: <http://www.timeshighereducation.co.uk/news/huge-growth-in-public-funding-at-private-colleges/2015059.article>



This unexpected cost was responsible for the 'black hole' that appeared in the BIS budget at the end of 2013, threatening its widening access programmes.<sup>45</sup> Former Universities Minister, David Willetts MP had to halt the recruitment of students at a number of these providers to prevent the hole getting any bigger.<sup>46</sup> We would be concerned if the expansion of student numbers in HEFCE-funded institutions mirrored the expansion in the alternative provider sector; the impact of such growth would be even greater as loans available to students in the HEFCE-funded sector are larger.

### C. Impact of lifting the SNC on universities

The costs to government are one part of the potential risk here; another is the behavioural consequences of lifting SNC. Drawing on experience from Australia, which recently lifted controls on student numbers, a witness predicted that the research intensive and most selective universities in England would see minimal expansion, as they tend not to want to grow undergraduate numbers. A second group, universities whose mission embraces both undergraduate teaching and research, which typically have a mixture of some selective courses and others that are less popular, would expand student numbers. Thirdly, universities and colleges that concentrate on teaching and previously recruited heavily through clearing would lose some of their students to those institutions able to expand; as a result, they might recruit fewer students or take those with poorer qualifications.

This scenario would have a number of consequences. The first group would become more reliant on HEFCE research money, research councils, or EU grants for funding as undergraduate numbers would not grow. The second group would see rapid expansion of students, meaning that investment in infrastructure would be needed to accommodate larger numbers. There would also be an increase in the ratio of students to the numbers of staff or further squeeze on margins in an attempt to maintain the quality of student experience. The third group of universities would experience pressure to recruit, a result of losing some market share to the second group. This could lead to financial difficulty and potential failure. To avoid this, institutions may recruit students who may be under-qualified or, more importantly, might be more suited to further education or an apprenticeship. The potential for reduced quality and high non-completion rates would be very real.

These changes put pressure on in-year resourcing. Part of the additional student places will be funded through tuition fees, but the teaching grant from HEFCE will remain at the same level. For 2014/15 the £1.9 billion teaching grant will be stretched to include the additional 30,000 student places announced in the Autumn Statement. This amounts to an approximate 5.85% cut across teaching budgets.<sup>47</sup> Lifting the SNC means universities will no longer operate to tight targets for recruitment, creating uncertainty and volatility around recruitment. This changes a foundation of the higher education system. Demand for HE places outstripping supply has been an important part of the higher education environment. It is part of the reason why universities rarely

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45 S Curry (November 2013) 'Black hole in BIS budget threatens students and scientists' The Guardian available at: <http://www.theguardian.com/science/2013/nov/25/black-hole-bis-budget-threat-students-scientists>

46 Hansard (January 2014) 'Higher Education: Private Sector' available at: [http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm140123/text/140123w0003.htm#140123w0003.htm\\_snew2](http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm140123/text/140123w0003.htm#140123w0003.htm_snew2)

47 J Grove, (March 2014) 'Universities to get near 6 per cent cut to 'most teaching budgets'' Times Higher Education, available at: <http://www.timeshighereducation.co.uk/news/universities-to-get-near-6-per-cent-cut-to-most-teaching-budgets/2012060.article>

fail. As long as there is demand from students, the Government, through HEFCE, is likely to intervene in the event of financial difficulty. Spare capacity in the system may change this. According to evidence we received, a shift in this balance between supply and demand will change the overall credit outlook on the HE sector, and affect an institution’s ability to take out loans or issue bonds. It will mean that infrastructure projects will become harder to fund, departments within an institution could become underfunded and that a university that provides a valuable contribution to students and the local community could fail.

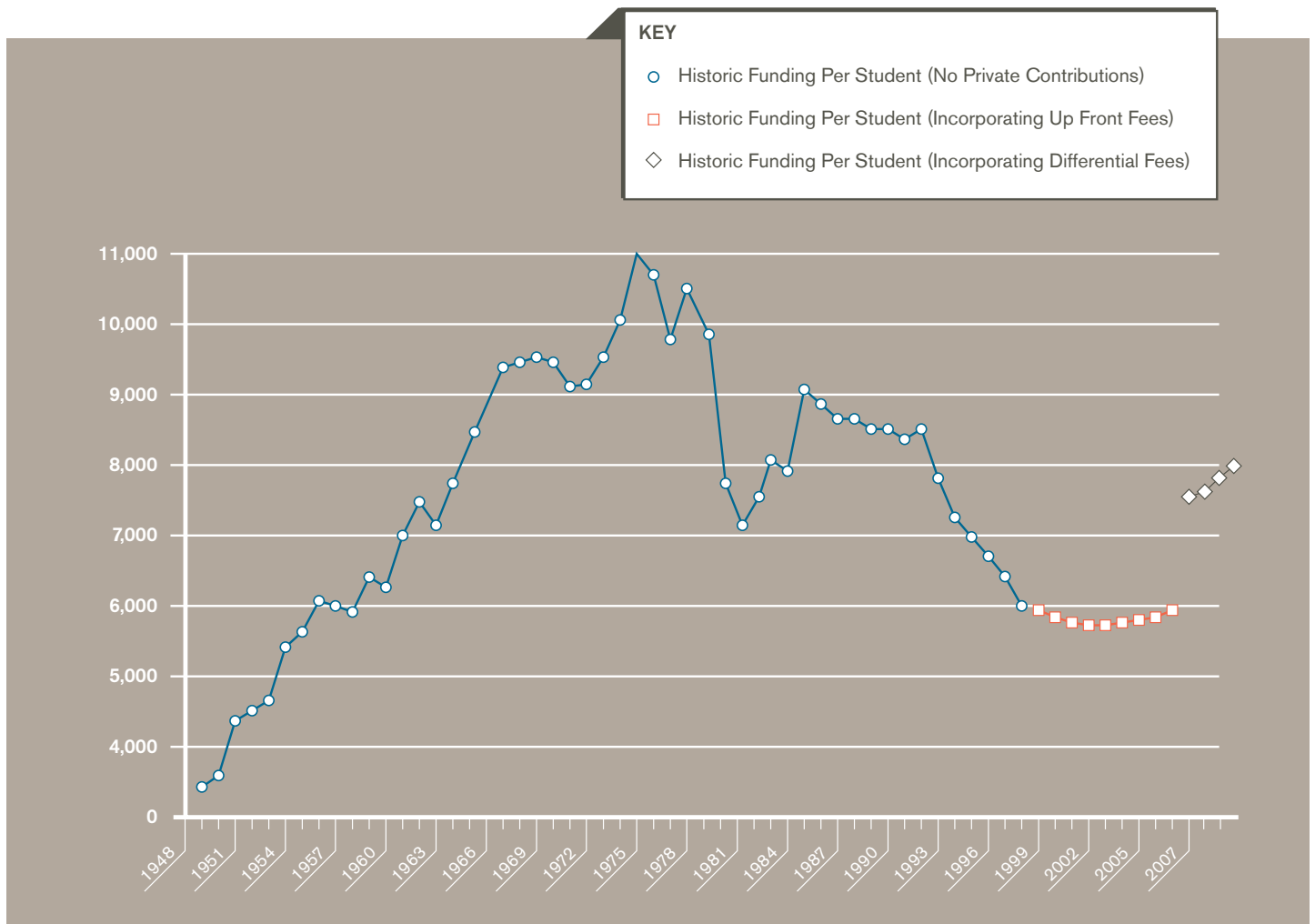


Figure seven: University funding per full-time student in the UK: 1948-2009 (2006/07 constant prices)  
 Source: Department for BIS, Review of Student Support Arrangements in Other Countries

The Commission agrees that the expansion of student numbers would be beneficial. We do not believe that there are too many graduates. However, such a lack of control on public spending is risky from many perspectives and we received evidence from several witnesses that said they expect the cap to be returned within a matter of years, as occurred in the early 1990s. When the cap on student numbers was lifted then, without additional funding added per student, there was a decline in the so-called unit of resource.<sup>48</sup> The graph on page 31 provides a picture of changes to the unit of resource over sixty years. The Commission does not think that a slight decline in the unit of resource need be detrimental, so long as it can be accompanied by efficiencies rather than reduced quality. However, the chart below shows a significant drop in unit of resource in the early 1990s which was considered to endanger quality. This resulted in the cap on student numbers being reapplied and the later introduction of tuition fees.

Whilst it is to be expected that individual universities would expand given the opportunity, we are concerned about the collective impact of expansion.

#### D. Towards expansion

For student numbers to expand the risks to students, universities, and government described above need to be reduced. There needs to be more work to predict the numbers of students that will enter, and the impact this will have on the sector, and government finances. The way that government now primarily funds higher education, through the servicing of student debt, creates long-term problems, which are greatly exacerbated by volatility in student recruitment. If the cap on tuition fees were lifted or indexed alongside the uncontrolled expansion of student numbers this would add huge sums to the amount the Government writes off for graduates, as the higher the fee the more government will end up writing off (Chapter Three looks at this). Assurances need to be in place to ensure that an expansion would not diminish the student experience or the unit of resource.

Universities need to understand the potential implications of student number expansion and the risks and opportunities it could provide to the financial sustainability of their institution. The Government should monitor the lift of student number controls and be ready to reverse them if further research and experience shows they have had a damaging impact on students, universities or government finances.

### **Recommendation 3**

**The Government should monitor its plans to lift student number controls and be ready to reverse them if further research and experience shows they have had a damaging impact on students, universities or government finances.**

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<sup>48</sup> R Dearing, (1997) 'The Dearing Report: Higher Education in the learning society' available at: <http://www.educationengland.org.uk/documents/dearing1997/dearing1997.html>

### 2.1.3 International students

In 2012/13 there were 347,555 students from outside the UK registered at English HEIs.<sup>49</sup> Over the past half century numbers of non-EU international students [‘international students’ from here onwards] have been growing and the UK has increased its share from 10.8% in 2000 to 13% in 2011.<sup>50</sup> International students made up about 18% of the UK student body in 2012/13.<sup>51</sup>

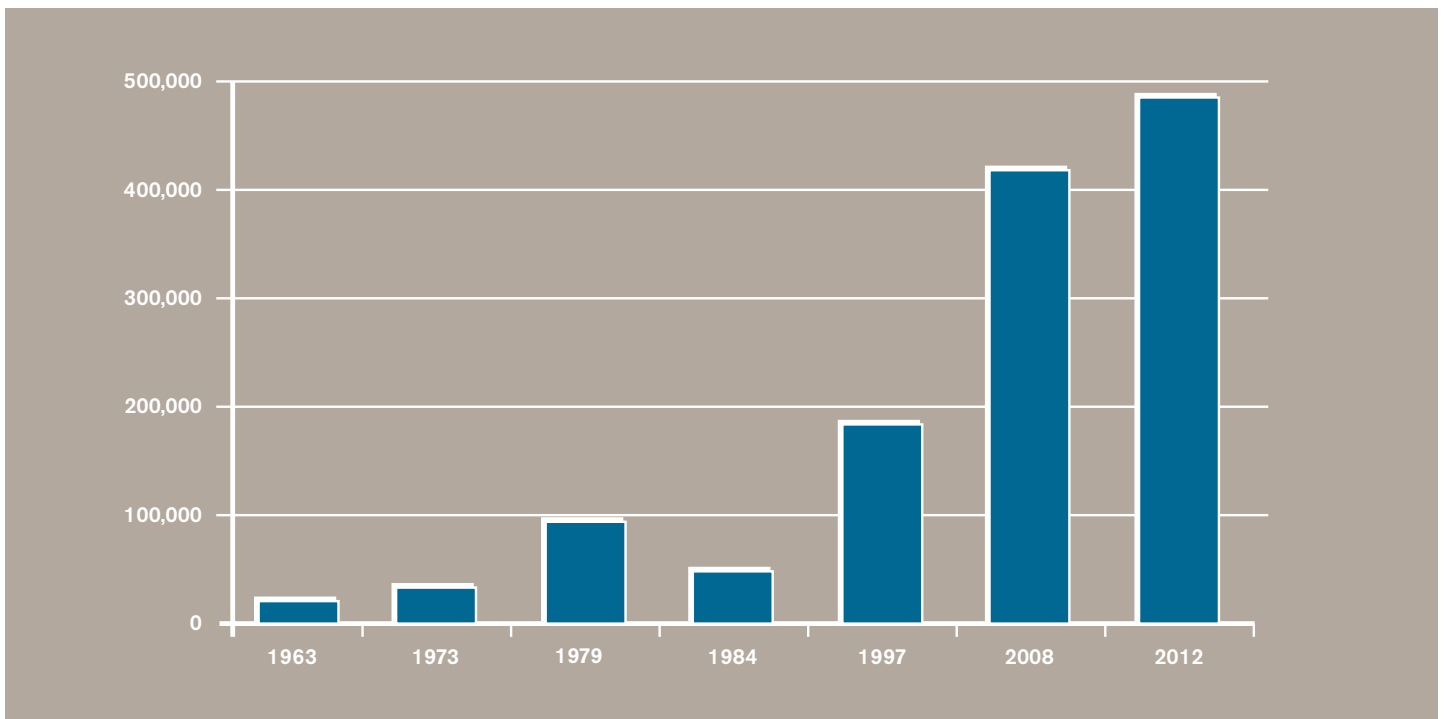


Figure eight: Trend in total international student enrolment in UK HE  
Source: Department for BIS, The Wider Benefits of International Higher Education in the UK

This is a lucrative market for universities as international students’ fees are unregulated and therefore substantially higher than home students. In 2013/14, the average fee for classroom-based courses for international students was £11,987, almost a third more than for home students.<sup>52</sup> Data from HESA shows that international students’ tuition fees amounted to £3.53 billion, which makes up about 30% of total tuition fee income for universities across the UK.<sup>53</sup> There are also no restrictions on the numbers of international students. However, they are included within the overall immigration figures, which have restrictions.

49 UKCISA, ‘International student statistics: UK higher education’ available at: [http://www.ukcisa.org.uk/Info-for-universities-colleges-schools/Policy-research-statistics/Research-statistics/International-students-in-UK-HE/#International-\(non-UK\)-students-in-UK-HE-in-2012-13](http://www.ukcisa.org.uk/Info-for-universities-colleges-schools/Policy-research-statistics/Research-statistics/International-students-in-UK-HE/#International-(non-UK)-students-in-UK-HE-in-2012-13)  
50 OECD, (September 2013) ‘Education at a Glance 2013: OECD Indicators’, OECD Publishing, pg. 308  
51 UKCISA, ‘International student statistics: UK higher education’ available at: [http://www.ukcisa.org.uk/Info-for-universities-colleges-schools/Policy-research-statistics/Research-statistics/International-students-in-UK-HE/#International-\(non-UK\)-students-in-UK-HE-in-2012-13](http://www.ukcisa.org.uk/Info-for-universities-colleges-schools/Policy-research-statistics/Research-statistics/International-students-in-UK-HE/#International-(non-UK)-students-in-UK-HE-in-2012-13)  
52 D Matthews (21 August 2014), ‘International and postgrad fee survey, 2014’, Times Higher Education available at: <http://www.timeshighereducation.co.uk/features/international-and-postgrad-fee-survey-2014/2015207.article>  
53 HESA (August 2014) ‘Finances Introduction 2012/13’. Available at: <https://www.hesa.ac.uk/intros/financesintro1213>



From 2011/12 to 2012/13 there was a 2% dip in international students (in the UK) from 435,230 to 425,265.<sup>54</sup> The context around the decreased numbers is worrying and indicative of larger problems.

Over half of international students come from India and China, where domestic institutions are quickly catching up in terms of quality and capacity. *Times Higher Education* world rankings show the rise of Asian universities – Singapore, China, Korea and Taiwan are all seeing impressive climbs.<sup>55</sup> With such a high proportion of international students coming from just two countries any educational, political, or economic developments in these countries could quickly impact on the numbers of students travelling to the UK to buy higher education provision.

There is also competition from other nations for international students. Whilst the US and UK are the most popular destinations for HE other markets such as Australia are still growing, and more favourable immigration policies are being adopted in Canada, Norway, and Finland with the intent of attracting students.<sup>56</sup> Across Europe, there has been a huge rise in institutions teaching Masters' courses in English, a large attraction for international students.<sup>57</sup>

Steep falls in recruitment have been seen from India and Pakistan, which fell 23% and 17% respectively from 2011/12 to 2012/13.<sup>58</sup> Whilst some have attributed this fall to anti-immigration rhetoric, another cause was economic. The value of India's rupee fell 17.4% against sterling from mid-May to 10 September 2013, suddenly pricing many Indian students out of UK HE.<sup>59</sup> Examples of such economic wobbles are cause for concern when we see such high proportions of students coming from only a handful of countries.

As one of our witnesses explained, international students tend to come in large groups from certain countries, and apply for certain courses at certain institutions. Therefore, any significant drops in the number of students, such as that from India, will not have a uniform effect across the system. Some courses and institutions suffer disproportionately.

BIS has been encouraging partnerships with universities internationally through their International Education Strategy<sup>60</sup> and UK Ministers have been promoting the benefits of UK HE in Asia and Latin America. However, whilst BIS is encouraging international activity, the Home Office is trying to limit the number of people coming to the UK on student visas. Students are included in the net migration target that has been capped at 100,000 migrants per year by 2015. Former HE Minister, David Willetts has argued that students should not be included in the target, as many students stay for the

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54 UKCISA, 'International student statistics: UK higher education' available at: [http://www.ukcisa.org.uk/Info-for-universities-colleges-schools/Policy-research-statistics/Research-statistics/International-students-in-UK-HE/#International-\(non-UK\)-students-in-UK-HE-in-2012-13](http://www.ukcisa.org.uk/Info-for-universities-colleges-schools/Policy-research-statistics/Research-statistics/International-students-in-UK-HE/#International-(non-UK)-students-in-UK-HE-in-2012-13)

55 P Baty, (October 2012) 'Times Higher Education Rankings' Times Higher Education available at: <http://www.timeshighereducation.co.uk/world-university-rankings/2012-13/world-ranking/analysis/asia-pacific-universities>

56 OECD, (July 2013) 'Education Indicators in Focus: How is international student mobility shaping up?' available at: [http://www.oecd.org/education/skills-beyond-school/EDIF%202013--N%C2%B014%20\(eng\)-Final.pdf](http://www.oecd.org/education/skills-beyond-school/EDIF%202013--N%C2%B014%20(eng)-Final.pdf)

57 M Brenn-White and E van Rest, (March 2012) 'English-Taught Master's Programs in Europe: New Findings on Supply and Demand' available at: <file:///C:/Documents%20and%20Settings/jessica.bridgman/My%20Documents/Downloads/English-Language-Masters-Final.pdf>

58 HESA, (January 2014) 'Free Online Statistics - Students & qualifiers Table 6' available at: <https://www.hesa.ac.uk/stats>

59 D Matthews, (September 2013) 'Indian students may be priced out of UK by falling rupee' Times Higher Education available at: <http://www.timeshighereducation.co.uk/news/indian-students-may-be-priced-out-of-uk-by-falling-rupee/2007238.article>

60 HM Government, (July 2013) 'International Education: Global Growth and Prosperity' available at: <https://www.gov.uk/government/publications/international-education-strategy-global-growth-and-prosperity>

duration of their course then return home. These calls have been echoed by the Liberal Democrats and Labour Parties pledging to take students out of the immigration cap if they come into power.<sup>61</sup> The Government has thus far refused to change how net migration is calculated.

The feeling abroad that the UK is not promoting a welcome environment for international students is growing, with internal turmoil about EU membership, rise of anti-immigration political parties, and media frenzies over illegal student visas. This rhetoric is damaging our reputation internationally. One witness said this feeling was also extending to international staff at English universities.

The Commission recommends that international students are taken out of the immigration cap and allowed to work in the UK for two years after graduation. The public do not perceive international students as ‘immigrants’ and do not think that international student numbers should be reduced. Additionally, 75% of the public believe that international students should be allowed to stay and work in Britain after graduating.<sup>62</sup>

#### Recommendation 4

Universities need to plan for the potential volatility of the international student income stream and for the prospect that hitherto stable international markets may decline or change, possibly at short notice.

#### Recommendation 5

International students should be taken out of the net migration target figure and be allowed to work in the UK for two years after graduation.

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61 A Jarvis, (30 September 2014) ‘What chance of policy change on immigration?’ WonkHE available at: <http://www.wonkhe.com/2014/09/30/what-chance-of-policy-change-on-immigration/>

62 UUK, (August 2014) ‘International students and the UK immigration debate’ available at: <http://www.universitiesuk.ac.uk/highereducation/Documents/2014/InternationalStudentsImmigrationDebate.pdf>

## 2.2 Students

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Here we look at the sustainability of higher education through the lens of those who use it: students. We look at levels of graduate contribution and student debt, and call on the Government to improve its collection of student loan debt. We then challenge the notion of a market in higher education, and the idea that students are beginning to behave more like consumers: neither of these concepts is proving helpful as guiding principles of higher education reform.

### 2.2.1 Graduate contribution and loan repayment

The level of graduate contribution has been a central theme of this inquiry. Almost all participants agreed that a mixed economy approach is best, and that graduates should make a contribution to their study. The lone voice in this debate is the NUS, which recently changed its policy to advocate for no tuition fees. This section discusses the amount of debt accumulated by students under the new system, and how financially sustainable it is for them throughout their working lives.

First, students do not appear to comprehend the nature of their loans, the amount they will pay back, nor the system into which they are entering. We believe that a healthy and sustainable HE system is one where its funding mechanisms are transparent, well-understood and trusted. Unfortunately, there is a significant information barrier in the English HE system. In our focus groups, all students understood that a change in fee level had taken place – *‘I am the first year to pay £9,000’*, *‘I feel lucky because I’m still only paying £3,000’* – but few had truly grappled with the nature of their financial undertaking in terms of repayment or total loan amount. Crucially, they did not grasp that the 2012 reforms were different from those implemented in 2006 (when fees were increased to £3,000): the 2006 reforms provided additional funding, whereas in 2012 the increase to £9,000 replaced government funding. They also did not understand how a RAB charge was a form of government contribution to their study.

Whilst these loans are not like bank loans in many important ways – graduates do not pay if they cannot afford to, the loan is written off after 30 years, collective non-repayment is built-in to the system – the Higher Education Commission is concerned with the total levels of debt graduates will accumulate. According to the IFS, students will graduate with an average of £44,035 debt, compared to £24,754 of debt if the reforms had not been introduced (this includes both tuition and maintenance related publicly-supported debt, as shown in the chart on page 37).

This means that graduates from English universities have some of the highest levels of higher education debt internationally. The USA is usually thought to have the highest levels of student tuition debt; however the average tuition debt of an American graduate of a four year degree at a public university in 2012 is \$25,600 (£15,322.51). Only about 4% of Americans graduate with debt over \$100,000 (£59,853.54).<sup>63</sup>

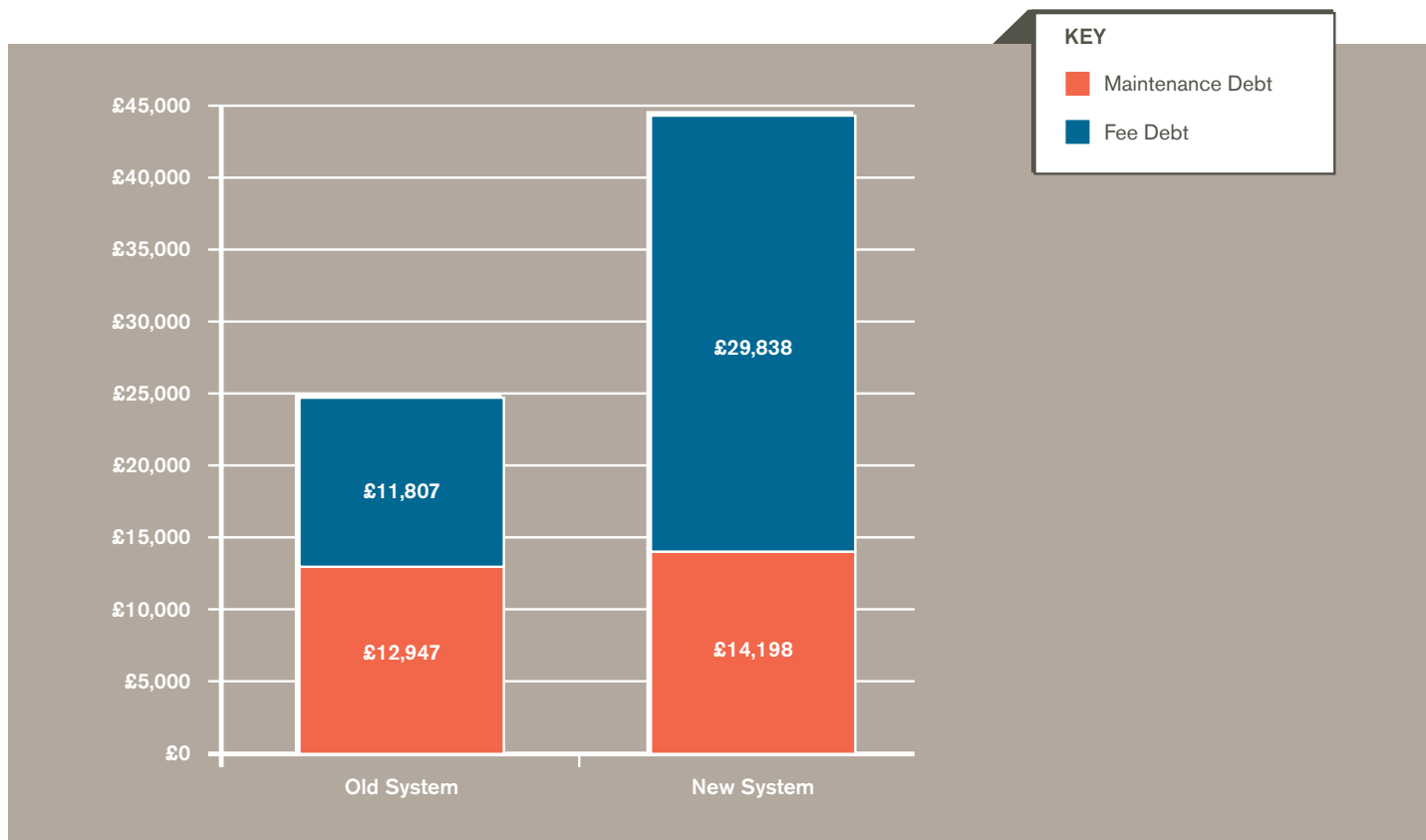


Figure nine: Average real student debt at graduation under old and new systems (in 2014 prices)  
 Source: IFS, Payback time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?

The non-repayment of loans is built in to the system as the Government’s contribution to undergraduate funding (see section 2.4.1 on the RAB charge). Non-repayment of debt is not the exception in this system; it is the norm. The IFS have shown that the median graduate, according to these models, would not pay back all their debt:

*“Real debt would fall very slowly, from £44,035 at age 22 to £43,181 at age 30, £39,069 at age 40 and £31,519 at age 50; at age 51, the remaining debt of £30,574 would be written off. By contrast, under the old system, an individual with this profile would have repaid their debt by age 42 (at which point they would still have £37,861 of debt outstanding under the new system).”<sup>64</sup>*

63 L Nelson, (25 June 2014) ‘9 things people get wrong about student debt’ Vox News available at <http://www.vox.com/2014/6/25/5839324/student-debt-isnt-just-one-thing>

64 C Crawford and W Jin, (April 2014) ‘Payback time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?’ Institute for Fiscal Studies pg. 30 available at: <http://www.ifs.org.uk/publications/7165>



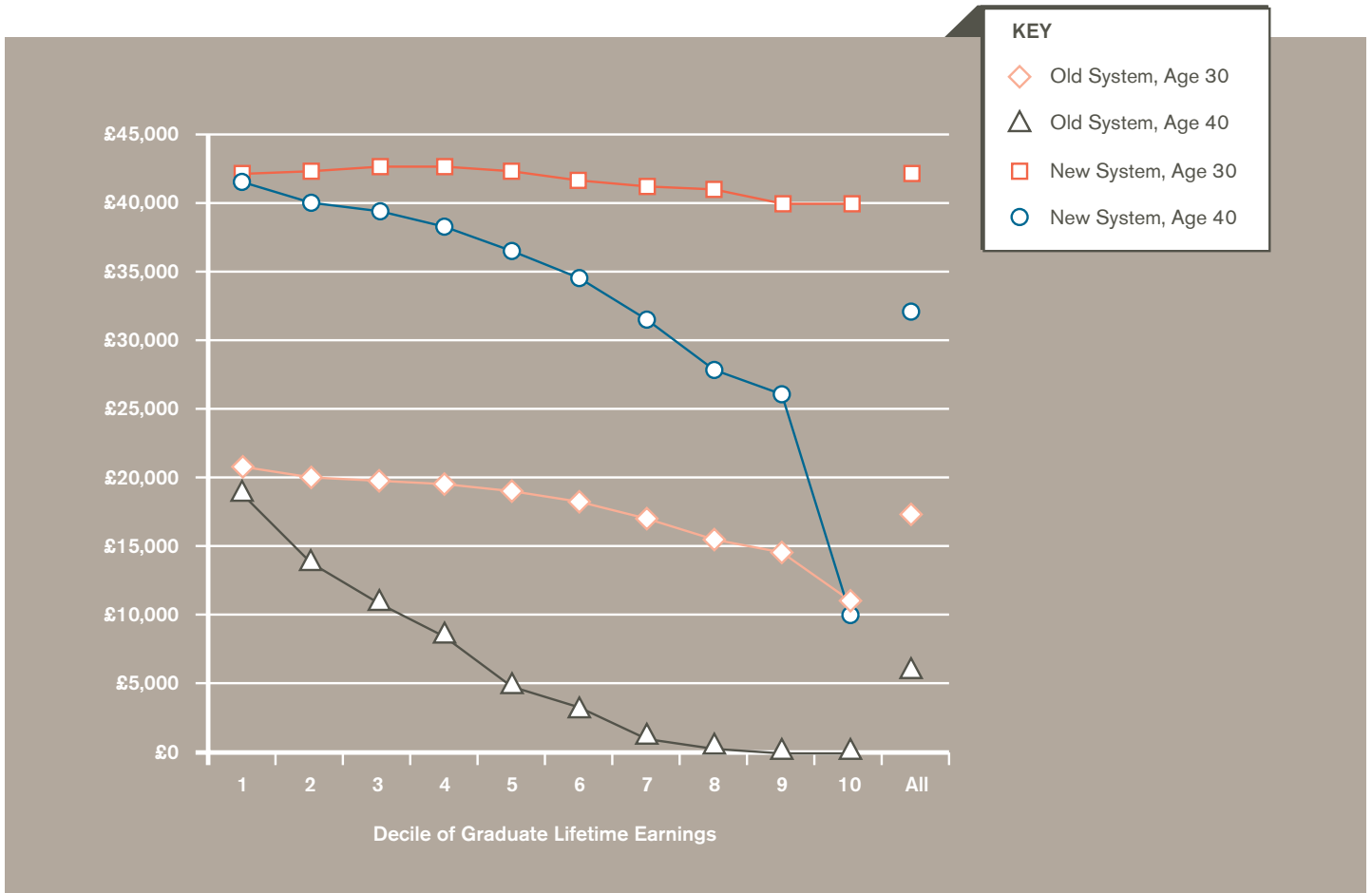


Figure ten: Real outstanding debt at ages 30 and 40 across distribution of graduate lifetime earnings (in 2014 prices)  
 Source: IFS, Payback time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?

Data varies, but the IFS estimates that 73% of graduates will not repay their debt in full, compared to just 25% in the old system; the average write offs are £29,836 for the new system, whereas they were £11,868 for the old.<sup>65</sup> However, when students start university they do not know what their future earnings will be, and therefore do not know if they will benefit from the subsidy.

Despite the fact that government forgives outstanding debt after 30 years of loan repayment, and the generous terms for low earners, the Commission remains uncomfortable with the implications of such high levels of graduate debt at a time of stagnating wages and rising house prices. The Commission is particularly concerned with what have been termed ‘middle earners’, those who earn just above £42,000 p/a when loan interest reaches its highest rate and the top rate of tax kicks in. This is much higher than the average UK salary (approximately £26,500<sup>66</sup>); however, it is a common salary level for many public service workers and publicly-serving professionals at successful points in their career: middle-earning teachers, staff in the allied health professions, and accountants. The Sutton Trust and the IFS have shown the impact

65 Ibid., 29.

66 BBC News , (2 November 2012) Average earnings rise by 1.4% to £26,500, says ONS, available at: <http://www.bbc.co.uk/news/business-20442666>

of student debt on these middle earners – many will not pay back their loans, and the level of repayment as a percentage of net monthly income is significant.

Further to that, the Commission would fundamentally question any system that charges an amount for higher education that the average graduate will not be able to pay back.

The notion that a middle-earning teacher, health professional, or manager will not be able to pay back their loan over the course of a 30 year repayment period, and once reaching a very successful salary level, raises big questions about the amount graduates are being asked to pay. It is not a small percentage of graduates in this category; in 2013, 40% of graduates worked in public administration, education and health.<sup>67</sup> These are often more regulated labour markets, requiring a higher education qualification for entry: if you want to be a teacher, you have no choice but to embark on an onerous 30-year repayment journey. The IFS has simulated the annual repayments of an average teacher and an average lawyer (see below) over their working lives.

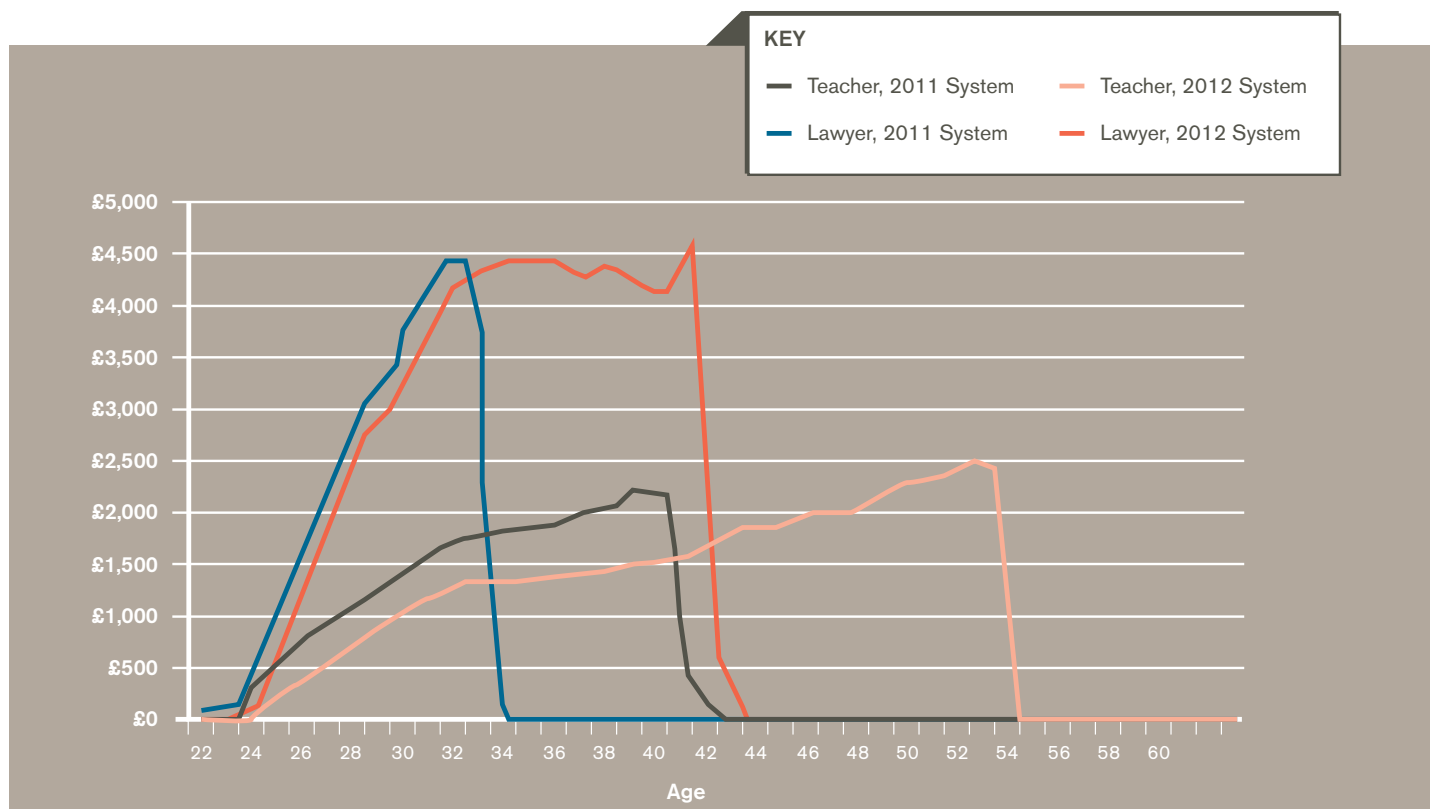


Figure eleven: Annual real repayments (in 2014 prices): average teacher vs average lawyer  
 Source: IFS, Payback time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?

67 Office for National Statistics, (19 November 2013) 'Full Report - Graduates in the UK Labour Market 2013' available at: [http://www.ons.gov.uk/ons/dcp171776\\_337841.pdf](http://www.ons.gov.uk/ons/dcp171776_337841.pdf)

The following graph shows just how prolonged the high levels of repayment are with the new system, stretching from the ages of 30 to 50 for the mean and median graduates. It is not yet known how these periods of high debt repayment will impact on graduates' life decisions. The Financial Conduct Authority recently changed its rules for mortgage applications, meaning that such monthly outgoings as student loan repayment, gym membership, and the amount spent on socialising will come into play when assessing an applicant's eligibility for a mortgage. We are deeply concerned that the Government may have created a loan repayment system where, for example, a teacher is unable to secure a mortgage at age 35 because of the high level of monthly loan repayment.

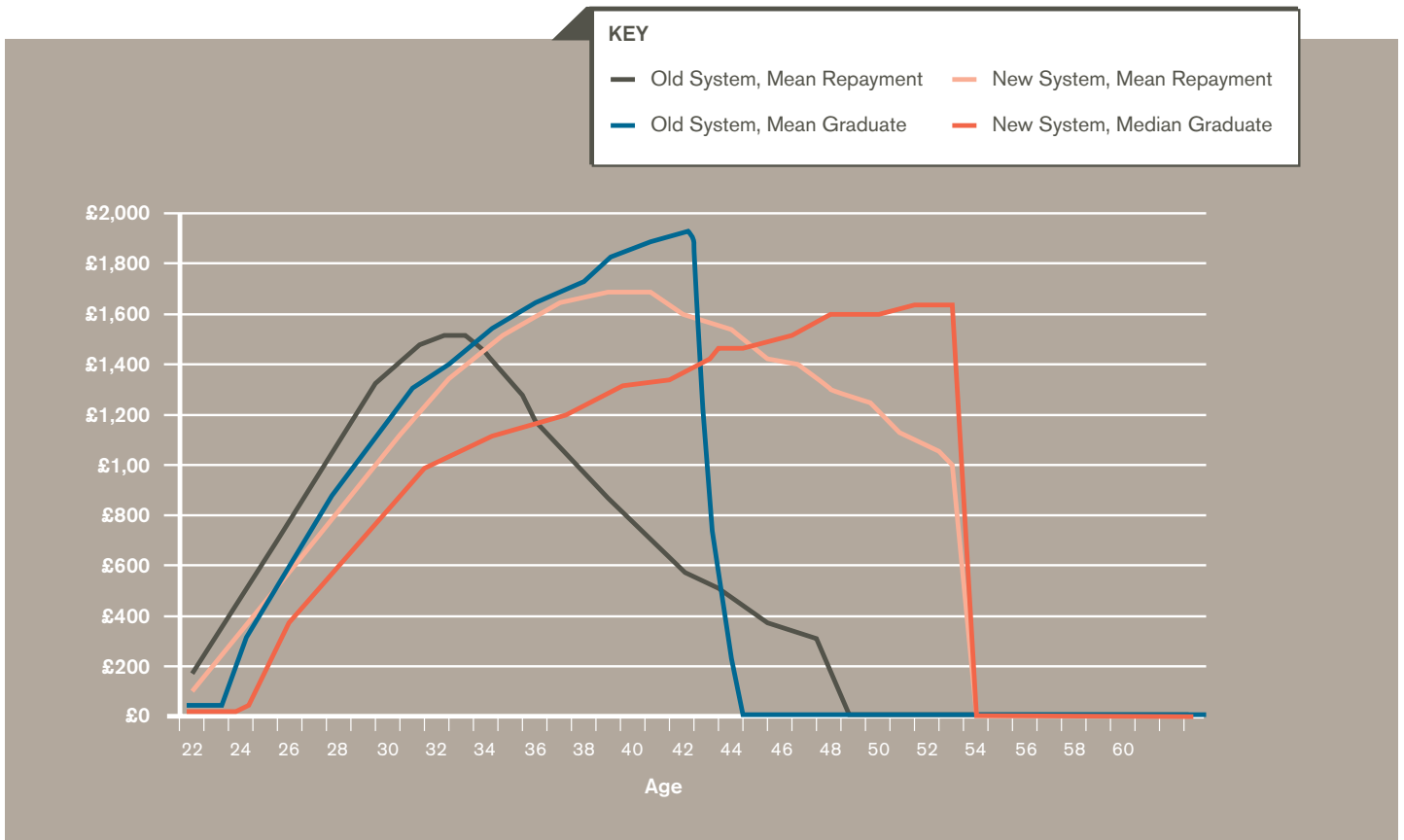


Figure twelve: Average real annual repayment over the life cycle (in 2014 prices): all graduates  
 Source: IFS, Payback time? Student debt and loan repayments: what will the 2012 reforms mean for graduates?

Beyond the impact of debt on graduates' lives, the Commission shares the concerns of the British Academy<sup>68</sup> and others that high levels of debt will dissuade graduates from continuing to further study at postgraduate level, particularly when funding provision for postgraduates is so woeful, and often involves taking out a commercial loan. The HE Commission predicts that numbers of UK students taking postgraduate courses will decline, just at a time when we are in desperate need of postgraduate level skills. As we discuss in section 2.1.1, the decline in part-time students is due to fee levels as well as the recession and austerity that has followed. It is difficult, however, to isolate which factor has had the main effect on part-time students' motivations.

One concern raised by students in our focus groups was the impact of the fee system on underrepresented groups at undergraduate level, and the perceived barriers to entering university. On this evidence it would seem that the welcome news that the numbers of students from underrepresented groups has remained buoyant, has not filtered down into the whole student community.

### 2.2.2 Student loan collection

A crucial part of any loan system is the repayment and collection of debt. The student loan book is set to grow to nine times its present size over the next 30 years, from £46 billion to £330 billion. The question of collection will thus be far more significant to the public finances in future than it has been up to now.

BIS, in partnership with the Student Loans Company (SLC) and HMRC, administers and collects graduate loan repayments through the PAYE tax system. This is generally perceived to be an efficient method for loan collection, as it does not require graduates to take action to make repayments, but collects what is owed automatically. In 2012/13 82% of graduate loan repayments were collected this way and 18% were collected directly by the SLC (for those not in the UK tax system and on old mortgage style loans).<sup>69</sup>

The collection of student loans was criticised by the BIS Select Committee, which found it to be inefficient and noted that BIS consistently over forecast the amount it expected to reclaim by about 8%.<sup>70</sup>

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68 British Academy, available at: [http://www.britac.ac.uk/policy/research\\_and\\_he\\_policy.cfm](http://www.britac.ac.uk/policy/research_and_he_policy.cfm)

69 House of Commons Business, Innovation and Skills Committee, (July 2014) 'Student Loans Third Report of Session 2014-15' pg. 7 available at: <http://www.publications.parliament.uk/pa/cm201415/cmselect/cmbis/558/558.pdf>

70 Ibid., 10.

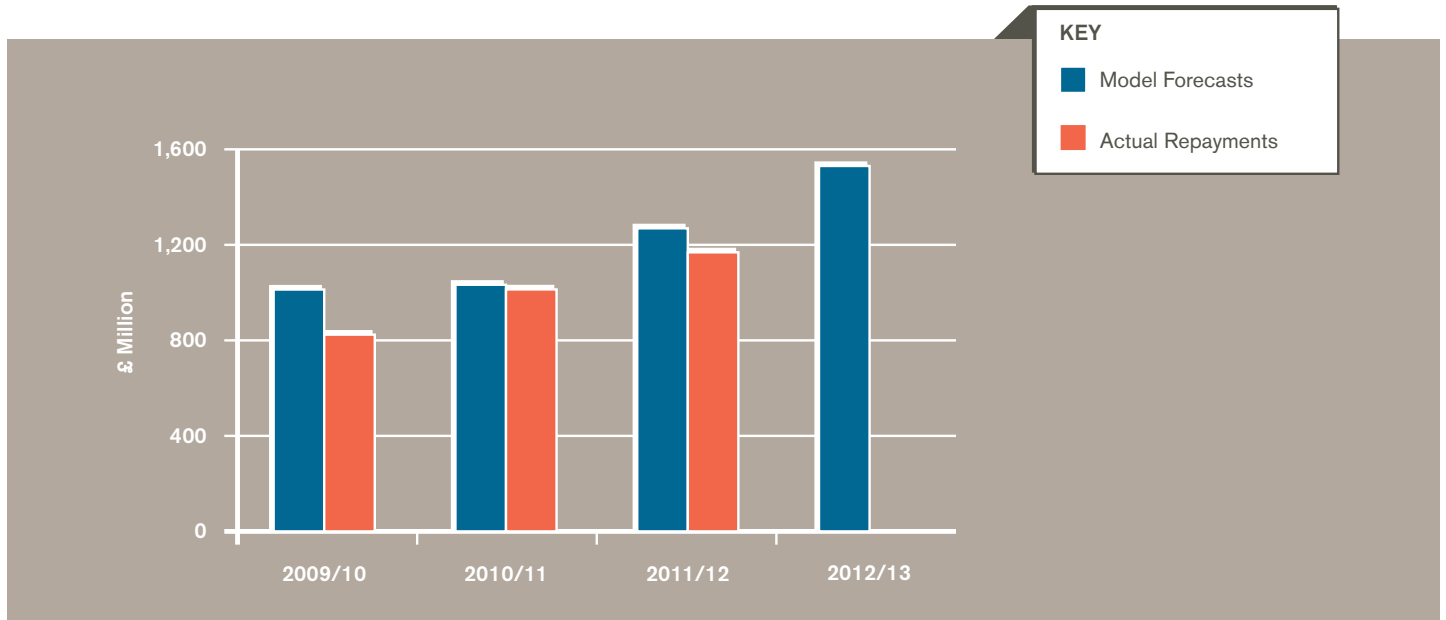


Figure thirteen: Comparison of model forecast to actual repayments

Source: NAO, Student loan repayments

1. Data excludes voluntary early repayments, which are more volatile and difficult to forecast, and only includes repayment based on earnings.
2. Actual repayments are taken from published SLC data from 2012 and 2013. Actual data for 2012-13 is not yet available, as HMRC confirmation takes place later due to processes in the tax systems.
3. Forecasts were made by BIS using the HERO model developed by Deloitte in 2011, excluding 2009-10 which was produced using the Student Loan Repayment model.

We believe that BIS needs to work closer with HMRC and the SLC, sharing data where possible to aid the collection of graduate debt. There is clearly a disconnect in the system: the SLC reported to have met targets for collections, whereas the NAO found some evidence to the contrary.

The Commission is concerned about the levels of non-repayment by students who move overseas after graduation, and subsequently fall out of the repayment system. These students only represent about 2% of total borrowers, but their loans are already worth about £400 million.<sup>71</sup> Much of this is also in arrears. As the world becomes more globalised, and more graduates work abroad this will certainly increase. It is likely that more could be done at the EU level to help with loan repayment, and this avenue should be explored.

The SLC has limited power or resource to track down this debt. As the new cohort of £9,000 fee graduates graduate and move away starting next year; this level of non-repayment will have a far greater impact. BIS must work with the SLC to develop a strategy for debt collection for graduates who move abroad.

71 Ibid., 17.



There are a number of options. The Treasury should provide additional funding for the SLC to pilot improvements in debt collection. This pilot could allow for more investment in tracking of graduates, or more private debt collectors across the world. The method that proves most successful should be scaled up as soon as possible to be active by the time the 2012 cohort start to repay their loans in 2016.

An improved system of recovery of debts is essential for the sustainability of UK HE as it is for public finances. For this reason, universities should be placed under an obligation to provide all reasonable assistance to the SLC in its efforts to trace graduates who have left the country and who are not repaying what they owe.

#### Recommendation 6

The Department for Business, Innovation and Skills should work with the SLC to develop a strategy for debt collection for graduates who move abroad.

#### Recommendation 7

The Treasury should provide additional funding for the SLC to pilot improvements in debt collection in time for effective measures be introduced in 2016.

#### Recommendation 8

Universities should be placed under an obligation to help the SLC trace graduates who are not paying off their student loans.

### 2.2.3 Students in a market

The 2011 White Paper and reforms that followed were intended and expected to lead to a more 'marketised' system of higher education. However, this idea of higher education being suited for market-like mechanisms was disputed by some witnesses and many of the students we met.

There are elements of the HE system that, theoretically, lend themselves well to aspects of market forces:

- Students have a choice, and developments like the Key Information Sets (KIS), the multiplicity of league tables and social media, mean there is much more information at their disposal when it comes to making that choice;
- Institutions currently compete for the best students;
- Liberalised student numbers allow successful institutions to expand;
- Changes to the entry requirements for institutions wishing to become universities encourage alternative providers to enter the market.

According to the theory, this should lead to greater competition and higher quality, whilst prices are driven down, and as a result we get better graduates for, ideally, less money.

This has not happened, and many refer to what we have as a 'pseudo market'.

One reason for this is the type of money that is exchanged in the system. Tuition fees bear little resemblance to what students actually repay. The income contingent nature of the loan creates a 'buy now pay later' mentality. Students are not obligated to pay back loans if they do not earn enough to reach the threshold, and will have the loan wiped out after 30 years if they have not earned enough to repay it. This means there is little price sensitivity in the system. Using a simple online student repayment calculator we can see that a full-time undergraduate student starting a three year course who takes out £9,000 tuition loans and £6,500 maintenance loans each year, will pay £75,127 over their lifetime if their starting salary is expected to be £25,000 (this includes the interest payments). If we keep all the variables the same and change the tuition fee to £8,000 the total repayment is £68,332. These are of course rough estimates, but the 12.5% increase in fees from £8,000 to £9,000 fees is not reflected in the lifetime repayment differential which is only 9.9%.<sup>72</sup>

The income contingent loan and graduate repayment system mean that there is very little sensitivity in the tuition fee market. This creates an incentive for universities to charge higher fees; they receive whatever fee they charge, and for their graduates the total repayment will not differ in line with the fee. Students we spoke to in our focus groups said they felt very detached from the money they spend on tuition. The mechanics of the system do not allow the students to see the money; it never lands in their bank accounts. Students had never seen £9,000 before; indeed, one commented "*If I had £9,000 in my hand right now, I don't think I would spend it on higher education.*" This comment was reflected in other focus groups. The 'buy now pay later' nature of the money dilutes the effect of the market mechanism.

An 'HE market' relies heavily on students acting as informed rational consumers purchasing a commodity. However, education is unlike many other commodities: it is usually a one-time purchase, there is no refund clause, the consumer plays a critical role in the success of the purchase, and the benefits of the purchase will not be immediately realised. There are no protection laws in place covering the purchase of higher education, comparable to those that govern major purchases like cars or holidays. By framing HE as a commodity, it is being viewed as an investment, making the value come from the return on investment. This neglects the wider benefits of higher education we spoke about in the first chapter. It also ignores the broader goals of higher education such as the development of cultural life and raising the brainpower and skills of a population generally.<sup>73</sup>

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72 Complete University Guide, Student Loan Calculator, available at: <http://www.thecompleteuniversityguide.co.uk/student-loan-repayment-calculator>

73 A McGettigan, (2013) 'The Great University Gamble' Pluto Press, pg. 65.

Related to this is the so-called Veblen effect, whereby the value of a product is, to some extent, determined by its price – the more expensive a product, the more valuable it is perceived to be. Higher education is such a product, and degrees from ‘cheap universities’ are not thought to have the same quality or value as those from a more expensive one, leading students to be willing to pay high fees. This turns normal market theory on its head.

Another element necessary for a HE market to operate is consumer information and the ability to make better choices through this information. Indeed former Universities Minister David Willetts MP said, “*Improving information for prospective students is a priority for the Government, and is a key part of our plans for higher education. We want empowered students to make their study choices based on better, more transparent information.*”<sup>74</sup> This has been implemented by means of better data on universities and the KIS returns from universities, allowing students to compare data. However, when speaking to students, the perceived lack of choice was apparent. Not only did they feel that going to university was not a choice (going to university was the ‘default’), but many felt restricted by the courses on offer, which universities were the best in their fields, and the price of tuition.<sup>75</sup>

The key source of information for students – careers advice – was devolved from local authorities to schools in 2012. Ofsted inspections following this move found that three quarters of schools visited were not properly providing independent information, advice and guidance (IAG) to students.<sup>76</sup> This has left a large proportion of students relying on parents and family for information about careers and potential pathways to employment.

This is particularly worrying for those who: may not be suited to university; are not sure if they want to go to university; or, might decide to go to university as it appears to be the only option.

### Recommendation 9

Schools and colleges need to make professional and independent careers advice available to their students, exploring the full range of pathways into further study and employment.

### Recommendation 10

The Government should not place too much reliance on market mechanisms given the absence of an informed consumer market.

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74 UUK, (16 July 2011) ‘Universities to provide key information for students’ available at: <http://www.universitiesuk.ac.uk/highereducation/Pages/KeyInformationForStudents.aspx#.VC7aumddVWxo>

75 Price of tuition was noted by students as something which they felt they didn’t have enough choice on. However, we are aware that we have also argued that there is little price sensitivity in tuition fees as a result of the income contingent repayment. These came up in our evidence and our focus groups and represent some of the contradiction we heard when speaking to student

76 Ofsted, (September 2013) ‘Going in the right direction?’ available at: <http://www.ofsted.gov.uk/sites/default/files/documents/surveys-and-good-practice/g/Going%20in%20the%20right%20direction.pdf>

## 2.3 Institutions

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In this section, we look at the institutions providing higher education and how they spend the money they receive. We highlight the need to increase and maintain diversity in the system, alongside ensuring that universities behave in ways that are efficient and sustainable.

### 2.3.1 Diversity

In chapter one, we spoke of our support for a diverse sector, and the benefits of diversity to maintaining financial sustainability.

Alternative providers and others were often quick to claim the system was not as diverse as the political rhetoric made out. Barriers to entry in the system include: students can only access a maximum of £6,000 tuition loan per year; restrictions on the designation of courses; and application of student number controls from 2014/15. These all make it very difficult to offer new and innovative provision. The only way to navigate these barriers (according to witnesses) is to emulate what is already happening in the traditional system.

One provider described the barriers to their institution through the following analogy:

*“The equivalent of entering this system is like Google going to Apple and saying ‘would you give me permission to create a Googlepad?’ and Apple responding ‘well, only if it looks exactly like mine, isn’t quite as good, and by the way we will cap your fee so you can only sell it at a lower price and then you can invest less, which means you will be at the lower quality end of the market – so we can keep our high positioned good.’”*

For example, student number controls were recently applied to alternative providers, to control the amount of loan outlay to students. Witnesses from a number of alternative providers told us the numbers were capped at much lower levels than they expected: one provider’s cap was lower than the amount of students who had gained places on their courses, meaning they would have to turn away students after accepting them.

Another barrier was access to research funding. The lack of funding for research means that alternative providers are not able to compete equally with traditional universities.<sup>77</sup> If there were a stringent application process for funding, and if it were for the public good, why does it matter what type of institution receives public research funding? Further debate was needed on whether not-for-profits or for-profit providers should have access to research funding. This would be a logical next step on the path to a more liberalised HE sector.

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77 Some others didn’t feel the need to enter research as much, seeing their role as a teaching institution with a focus on graduate outcomes.

Part-time learning is another indicator of diversity, as discussed in section 2.1.1. Whilst undergraduate student numbers have grown, demand for part-time learning at undergraduate and postgraduate level has plummeted. Our system is becoming less diverse as universities struggle to maintain part-time courses. There has also been a significant drop in other HE qualifications (by approximately 60%) such as Foundation Degrees, HNDs and HNCs which make up an important part of technical programmes.<sup>78</sup> These trends are very concerning.

The risk is that a one-size-fits-all system is emerging. The Commission has heard this referred to as a ‘cycle of conservatism’ and ‘homogenisation’ of the system. The 2012 reforms, which were supposed to drive and enhance diversity, have resulted in zero price variation, little expansion of new offers for students and minimal innovation in teaching and learning. For example, throughout our whole inquiry hardly any witnesses referred to MOOCs. The rhetoric does not match the result, and this could cause our system to become less financially sustainable than it might be with greater diversity of provision.

The three year full-time honours undergraduate degree is becoming totally dominant in the system, when we were supposed to be seeing learning models diversify. The rush of universities to charge £9,000 fees has come to the detriment of other forms of provision, as this is where universities are receiving the majority of their income. This is the most expensive form of HE provision, and as a result, the taxpayer is paying more for fewer graduates.<sup>79</sup> This is inefficient and unsustainable.

The Commission supports a diverse range of provision – meaning full-time, part-time, postgraduate, private, public, honours degree, non-honours – because it creates a healthy eco-system of higher education that will be more resilient to economic shocks and social change, and responsive to future labour market changes. The one-size-fits-all model currently emerging is not sustainable, and steps must be taken to change the environment to prevent this taking root.

### Recommendation 11

The Government should renew its efforts, in collaboration with all types of HE providers, to ensure that a variety of HE provision can thrive.

### 2.3.2 Efficiency

Throughout this inquiry we have been looking at financial sustainability at an institutional level and at a sector level. We have found that institutional failure would have a direct impact on the sustainability of the rest of the sector: if any institution were to fail there would be significant reputational damage to the whole sector. This would create problems with student recruitment, but also issues with regulation, and financing. A drop in confidence in UK HE could impact even the most prestigious universities.

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<sup>78</sup> A Westwood, (July 2014) ‘Quality, quantity or diversity?’ Higher Education Academy, pg. 11.

<sup>79</sup> Ibid., 9.



Universities have made excellent progress to become more efficient and therefore more financially sustainable. According to its own calculations from 2005 to 2011 the sector delivered efficiency savings worth £1.38 billion.<sup>80</sup> This beat the £1.23 billion target set in the Comprehensive Spending Review.<sup>81</sup> The most common areas where institutions were making efficiencies include: academic departments, estates, ICT, staff costs, procurement, and academic support services.<sup>82</sup> Much of this new found efficiency came from adopting the Diamond Review recommendations.<sup>83</sup>

Another source of efficiency savings come from the Wakeham Review, which looked into research funding.<sup>84</sup> Whilst universities said the recommendations from the report could be burdensome, a progress report from the Research Councils has shown that they have met the target of £82.2 million of savings for 2012/13.<sup>85</sup> This has been achieved through equipment sharing programmes (the N8 partnership has been particularly successful working through joint research projects), and using TRAC data to better cost research projects. That said, some institutions noted that research funding was covering a lower proportion of the full costs of research, which puts the global competitiveness of UK HE at risk.

### 2.3.3 Cost of staff

In our focus groups, almost all students named teaching staff as their priority for university spending, and also as a measure of good value for money. This was reflected in the 2014 HEA/ HEPI student academic experience survey.<sup>86</sup>

Staff costs are a university's largest single outlay. In 2012/13 staff costs represented 52.8% of institutions' income. This is down significantly from 2008/09 when staff costs were 55.8% of income.<sup>87</sup> This drop has been attributed to cuts made during the economic downturn that saw institutions exercise pay restraint (over the past five years the average cost of a member of staff has only risen by 5.3%, significantly below inflation).<sup>88</sup>

These trends have been fairly consistent across institutions, but there is variation within the system. For example, in institutions that appear in the top of the rankings the average annual costs per member of staff is £49,458, 15.6% more than the £42,779 at other institutions.<sup>89</sup>

Universities have achieved savings through freezing pay and slowing recruitment, but some witnesses feared that such freezes were creating a 'pressure cooker'. As the

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80 UUK, (November 2013) 'Working for a smarter, stronger sector' pg.3 available at: <http://www.universitiesuk.ac.uk/highereducation/Documents/2013/WorkingForASmarterStrongerSector.pdf>

81 Ibid..

82 Ibid., 5.

83 UUK, (September 2011) 'Efficiency and Effectiveness in Higher Education' available at: <http://www.universitiesuk.ac.uk/highereducation/Documents/2011/EfficiencyinHigherEducation.pdf>

84 UUK and RCUK, (June 2010) 'Financial Sustainability and Efficiency in Full Economic Costing of Research in UK Higher Education Institutions' available at: <http://www.rcuk.ac.uk/RCUK-prod/assets/documents/reviews/fec/fECReviewReport.pdf>

85 UUK, (November 2013) 'Working for a smarter, stronger sector' pg.26 available at: <http://www.universitiesuk.ac.uk/highereducation/Documents/2013/WorkingForASmarterStrongerSector.pdf>

86 HEPI and HEA, (May 2014) 'The HEPI-HEA Student Academic Experience Survey 2014' available at: [http://www.hepi.ac.uk/wp-content/uploads/2014/05/HEA\\_HEPI-Report\\_WEB\\_160514.pdf](http://www.hepi.ac.uk/wp-content/uploads/2014/05/HEA_HEPI-Report_WEB_160514.pdf)

87 Grant Thornton(2014) 'Managing through uncertainty' Financial Health of the Higher Education Sector 2014, pg. 10

88 Ibid..

89 Ibid..

economy recovers and once public sector pay starts to rise again, there is a worry that universities will be forced to increase pay rapidly which could have a negative impact on finances.

Staff pensions liabilities loom large for institutions. The Universities Superannuation Scheme (USS) was reformed in 2011 to prevent new joiners from receiving a final salary pension. However, the pension fund is still estimated to have a deficit of £8 billion that is predicted to grow to £13 billion. If the deficit were to reach this level, in order to save the scheme, contributions would have to increase from 16% to 25.1% for employers and 7.5% to 12.3% for employees.<sup>90</sup> This huge increase would threaten institutions' sustainability. One witness said this could easily add 2-3% to a university's cost base, wiping out surpluses for many.

USS employers have been working to address these issues. In October 2014, they published proposals to maintain the sustainability of the pension scheme.<sup>91</sup> This would create a threshold of up to £50,000 for direct benefits; above this benefits will be based on a direct contribution element.<sup>92</sup> They also suggest that employers increase contribution from 16% to 18%. In response to these changes University College Union (UCU) has voted in favour of industrial action.<sup>93</sup> The questions raised by the need to alter pensions are compounded by accounting changes (FRS102) due in 2015/16 that will alter the presentation of pensions liabilities in universities' accounts. While these are technical changes, they will be noted by bankers and lenders to HE.

### 2.3.4 Costs of infrastructure

Universities are planning for expansion and improving student facilities, and are thus predicting a large increase in expenditure on capital infrastructure. The sector is planning to invest over £15.2 billion in infrastructure projects during the next four years. This is nearly 50% higher than the previous four-year figure (2009/10 to 2012/13).<sup>94</sup>

Cuts to capital funding grants have seen universities turn to borrowing to fund projects. This has been steadily increasing since 2001/02 when the level of borrowing was 18.4% of total income; by the end of 2012/13, this had risen to 25.7%. This is projected to reach 28.4% by the end of 2016/17.<sup>95</sup>

Increased borrowing will provide universities with cash, but there is risk attached to this. As a witness reminded us, institutions will have to pay out interest charges before they can make any payments on facilities for learning, teaching and research. The investment secures the future by making the institution attractive, but also makes it vulnerable to volatile income flows. This is highlighted in a recent HEFCE memorandum that shows interest payments are expected to increase, from

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90 J Grove, (22 May 2014) 'Is it the end for USS final salary Pensions?' Times Higher Education available at: <http://www.timeshighereducation.co.uk/news/is-it-the-end-for-uss-final-salary-pensions/2013456.article>

91 UUK, (13 October 2014) 'Employers outline proposals for reform of USS pension scheme' available at: <http://www.universitiesuk.ac.uk/highereducation/Pages/reformofUSSpensionscheme.aspx#.VEeCJSFL-xo>

92 Written evidence, UCEA.

93 UCU, (20 October 2014) 'University staff vote overwhelmingly for industrial action in pensions row' available at: <http://www.ucu.org.uk/7250>

94 HEFCE, (October 2014) 'Financial health of the higher education sector 2013-14 to 2016-17 forecasts' pg. 2 available at: [http://www.hefce.ac.uk/media/hefce/content/pubs/2014/201426/HEFCE%202014\\_26.pdf](http://www.hefce.ac.uk/media/hefce/content/pubs/2014/201426/HEFCE%202014_26.pdf)

95 Ibid., 26.

£357 million in 2012/13 to £444 million in 2016/17. It states “*this rise in ‘fixed costs’ could put pressure on any institution that fails to constrain other costs or to increase income.*”<sup>96</sup>

HEFCE guidelines state that no institution’s interest costs should exceed 4% of its income. However, Grant Thornton found that three institutions’ interest costs exceeded guidance in 2012/13 and four in 2011/12. Interest rates are expected to increase (or at least not fall) and with the planned changes to the accounting system, this could create a number of problems for institutions.<sup>97</sup>

### **2.3.5 Alternative sources of income**

Offering students a better experience at university inevitably requires investment from universities, not only in teaching quality, but in teaching and research facilities and accommodation to secure future recruitment levels. Evidence from student focus groups showed us that students value high quality teaching. They want money to be spent recruiting the best lecturers and academics across disciplines. Students also appreciated having a nice environment in which to work, be it an updated library or student accommodation. They felt that this contributed positively to their experience and had a good influence on their academic work. One student recognised that they would benefit from future investment in facilities at their institution even if this took place after they graduated. Graduates want their university to continue to be impressive in stature, beyond the time they spend there. They will be a student of the university for a limited time, but they will always be a graduate.

#### **A. Bonds**

The use of bonds as another form of borrowing to fund projects has increased following cuts to capital expenditure grants. Bonds available to universities are issued over a longer period of time than corporate bonds, and low interest rates make them more affordable.

As pressure on university finances continues, the demand for bonds will increase amongst universities that value the financial autonomy that comes with them.

One particular interest to the Commission was the credit rating mechanisms used to assess institutions looking to place bonds. These appeared to be heavily reliant on public information, such as newspaper university rankings, and in some cases and assumption that the Government would bail out an institution in difficulty. The Commission recommends that rating agencies continue to seek more nuanced information and familiarise themselves with the current position of HEFCE, acknowledging the salience of the role it gives to university leaders and governors when an institution faces financial pressures.

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<sup>96</sup> Ibid.

<sup>97</sup> Grant Thornton(2014) ‘Managing though uncertainty’ Financial Health of the Higher Education Sector 2014, pg. 15.

HEFCE is monitoring borrowing within the sector in light of the increased need for universities to have recourse to their own borrowing to replace government grants. The risks associated with this were recently consulted upon in the Memorandum of Assurance and Accountability with institutions.<sup>98</sup> For universities that are able to meet the annual costs of borrowing, and reserve a surplus, there are unlikely to be any problems. Universities with smaller and/or more volatile surpluses, which may not be able to cover the annual costs of borrowing, will face difficulty.<sup>99</sup> What would happen if a university were to default? This has not yet happened, but the increasing amount of bond funding, and its spread into less financially secure parts of the sector makes the likelihood of a default greater.

### Recommendation 12

Rating agencies need to have a more sophisticated understanding of universities' credit worthiness and position in the market and reflect the changing role of HEFCE and its funding.

#### B. Philanthropy

Philanthropic giving is becoming a more sustainable income source for universities, albeit a small one. From 2010/11 to 2012/13 the amount of money donated to UK universities in total grew from £535 million to £660 million.<sup>100</sup> Compared to the USA, where donations to universities reached an all-time high of \$33.8 billion in 2012/13, the UK still has a lot of room to grow this source.<sup>101</sup>

Successful universities tend to fundraise for causes, like scholarships for disadvantaged students, or specific facilities and research projects, as opposed to the maintenance of existing activities. Universities should not see this type of funding as a way to make up for cuts to budgets, as this is not perceived to be a good sell to alumni or donors.

Recruiting good fundraising staff is a challenge, as the culture of philanthropic giving to universities is still developing in the UK. Universities should try to develop this culture of giving back whilst their graduates are still at university. This needs to not only be built with students and graduates, but with university staff, academics, and researchers.

Due diligence is vital when accepting donations or gifts, especially significant ones. Universities recently topped charitable foundations/trusts as the top destination for donations over £1 million. Yet, there is a risk of funding coming from unsavoury sources. Practice is not currently uniform across the sector. Given that this is fairly new territory for English HEIs, as gifts becomes larger it would be useful for a best practice guide, such as the ones from CASE, to be distributed to prevent any potential scandals.<sup>102</sup>

98 HEFCE, (July 2014) 'Memorandum of assurance and accountability between HEFCE and institutions' available at: [http://www.hefce.ac.uk/media/hefce/content/pubs/2014/201412/HEFCE2014\\_12.pdf](http://www.hefce.ac.uk/media/hefce/content/pubs/2014/201412/HEFCE2014_12.pdf)

99 A McGettigan, (2013) 'The Great University Gamble' Pluto Press, pg. 141.

100 CASE, (May 2014) 'Giving to UK Universities Reaches All-Time High' available at: [http://www.case.org/About\\_CASE/Newsroom/Press\\_Release\\_Archive/Giving\\_to\\_UK\\_Universities\\_Reaches\\_All-Time\\_High.html](http://www.case.org/About_CASE/Newsroom/Press_Release_Archive/Giving_to_UK_Universities_Reaches_All-Time_High.html)

101 M McDonald, (12 February 2014) 'Colleges Raise Record \$33.8 Billion Exceeding U.S. Peak in 2009' Bloomberg available at: <http://www.bloomberg.com/news/2014-02-12/college-donations-rise-to-record-as-stocks-gain-fueled-giving.html>

102 CASE, 'Fundraising fundamentals' available at: [http://www.case.org/Publications\\_and\\_Products/Fundraising\\_Fundamentals\\_Intro.html](http://www.case.org/Publications_and_Products/Fundraising_Fundamentals_Intro.html)

### C. Entrepreneurial activity

The Commission discussed some of the entrepreneurial activities of universities, often known as the third stream of income. These included intellectual property, commercialisation of research, consultancy services and a myriad of other activities. Whilst these were mentioned in some evidence sessions (the Higher Education Innovation Fund was particularly commended for the support it gives) the amount these activities generated was not thought to be enough to make a difference to the balance of financial sustainability and unsustainability.

As with philanthropy, the amount of income received from this stream varies greatly between institutions. Most would indicate that this is an activity they intend to develop.

#### 2.3.6 £9,000 fee cap

When introduced, £9,000 tuition fees were planned to be the exception. The Treasury estimated the average fee to be about £7,500 and as a result, had based all its calculations of long-term costs on this figure. Vince Cable, Secretary of State for Business, Innovation, and Skills told Parliament fees would be capped at £6,000, “rising to £9,000 in exceptional circumstances.”<sup>103</sup> The Government incorrectly believed that OFFA would have the power to negotiate fee levels with individual universities on the basis of their access agreements, and thus the planned mechanism to control the increases in fees was not there.<sup>104</sup>

The fee cap has not risen with inflation. The current Universities UK President, Sir Christopher Snowden has been vocal about this concern on behalf of universities and has estimated that by mid-2015 the £9,000 tuition fee will only be worth £8,250 at 2010 prices. There have been calls for this cap to be indexed.<sup>106</sup>

The fee cap can remain as it is, but someone will need to make up for the shortfalls. There is a concern that the unit of resource, or amount of funding per student, will decline as the net value of tuition fees is eroded and it is not clear whether universities will make up the difference by using their surpluses or cross-subsidising from courses that are less costly to teach.

In addition to universities’ understandable concern, the Commission is keen that quality should not be impacted. However, universities have seen increases in income and in surpluses, and the Commission has not been presented with strong evidence that it costs more than an average of £9,000 to deliver good quality courses.

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103 Hansard, (9 December 2010) ‘Higher Education Fees’ available at: <http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm101209/debtext/101209-0002.htm#10120946000003>

104 A McGettigan, (2013) ‘The Great University Gamble’ Pluto Press, pg. 23.

105 UUK, (12 September 2013) ‘President’s address to 2013 Members’ Annual Conference: The enduring value of universities’ available at: <http://www.universitiesuk.ac.uk/highereducation/Pages/PresidentsAddress2013AnnualConference.aspx#.VAWcZdddWxo>

106 J Morgan, (31 October 2013) ‘Interview: Sir Christopher Snowden’ Times Higher Education available at: <http://www.timeshighereducation.co.uk/news/interview-sir-christopher-snowden/2008521.fullarticle>



## 2.4 Government

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The Government has many levers to pull in shaping the higher education landscape. In this section we look at decisions the Government has taken, or avoided. We assess whether these are financially sustainable solutions, and suggest where alternatives might be needed. We also make the case for continued government investment in higher education, and research, to ensure our global competitiveness.

### 2.4.1 RAB Charge – Student Loan Subsidy

Part of the Government's role in funding higher education is a promise to write off any remaining graduate debt after the prescribed repayment period ends. Under the new loan system, students repay 9% of their income over £21,000 annually, for 30 years. The loan bears a rate of interest that increases progressively, starting at RPI for those earning £21,000 and increasing to RPI+3% when earnings reach £42,000. Any loan left after the 30 year repayment period is written off by the Government. The Government refers to the cost that it bears as a result of this write-off as the 'RAB charge' and the term is used by many commentators. However, the Commission believes this is a confusing term and will refer to this write-off as the 'student loan subsidy'.

The theory behind the English loan repayment system is quite progressive. The income contingent nature of repayment acknowledges that some graduates might not benefit from investing in their education as much as others, or might choose to enter lower paid jobs. However, it is very difficult to estimate how much the Government will spend writing off loans.

Currently the estimate of the student loan subsidy is around 45%. This means that for every £1 lent by the Government to students, 45p will not be repaid. This estimate has steadily increased over the past few years ranging from 28% to 45%. This reflects the very sensitive nature of the student loan subsidy calculations, which include predicting graduate employment, graduate earnings, economic performance, and the cost of government borrowing.

The calculation of the student loan subsidy is important. It is part of the Government's estimates for the long-term costs of student loans, and of higher education. The estimated student loan subsidy is recorded in the BIS budget as a cost for the year the loan is given. This provides an early indicator of the amount that is expected to be written off, allowing the Government to set aside an amount for future non-repayment of loans.

Witnesses did not agree as to how rigorously government should calculate the student loan subsidy. Most agreed it was an important calculation, however some thought that given the sensitivities in the figure that it should only be considered an estimate.

Recent revisions to the student loan subsidy have caused the BIS Select Committee, among others, to criticise the BIS calculations for repayment and collection of student debt. The Select Committee's report on student loans says that not only did BIS miscalculate the subsidy, but also ignored warnings from other organisations about the errors.<sup>107</sup> It recommended "*as matter of urgency, the department conducts a full review of all the financial assumptions underpinning the Department's RAB model.*"<sup>108</sup> The Select Committee did not underestimate the difficulties in calculating the subsidy, but noted that BIS' model was excluding crucial data such as subject studied or university attended.

An efficient loan collection was discussed in section 2.2.2 and is vital as the student loan book is set to grow from £46 billion to £330 billion between 2013 and 2044.<sup>109</sup> Given this growth, it is worrying that BIS is struggling to accurately forecast the amount of loan repayments it expects to collect. Poor estimates will lead to miscalculations of the student loan subsidy, creating problems for future governments.

Some estimates have been made to establish at what point the student loan subsidy would be as expensive to government as the pre-2012 £3,000 tuition fees plus grant to universities.<sup>110</sup> This has been referred to as a 'tipping point' in literature and throughout evidence sessions.<sup>111</sup>

The current level of subsidy is very high. Whilst the Government was commended for creating a system where those who cannot afford to pay do not have to, the sustainability of 45% of student loans not being repaid was questioned. The Government is in a situation where it is heavily subsidising higher education, but the public and students are unaware of this, as the subsidy is realised through the servicing of debt.

We believe this currently represents the worst of both worlds.

Some thought that this indirect way of government funding higher education, through writing off loans, was not desirable given the difficulties in estimating what the write off would be; direct funding of higher education through the teaching grant was preferred by these critics.

#### **2.4.2 Sale of the student loan book**

The Government announced plans to sell tranches of the income contingent loan book in the 2013 Autumn Statement. In section 2.2.2 we described the difficulties with estimating debt collection; this also impacts the ability to value the student loan book. In the 1990s the Labour Government sold two £1 billion tranches of old mortgage style loans; these were sold off at a heavily discounted rate.<sup>112</sup> However, the income

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107 House of Commons Business, Innovation and Skills Committee, (July 2014) 'Student Loans Third Report of Session 2014-15' pg. 7 available at: <http://www.publications.parliament.uk/pa/cm201415/cmselect/cmbis/558/558.pdf>

108 Ibid.

109 Ibid.

110 J Thompson and B Bekhradnia, (December 2013) 'The cost of the Government's reforms of the financing of higher education – an update' HEPI, available at: <http://www.hepi.ac.uk/2013/12/17/the-cost-of-the-governments-reforms-of-the-financing-of-higher-education-an-update/>

111 S Coughlan, (22 July 2014) 'Student loan system reaches 'tipping point', warn MPs' BBC News available at: <http://www.bbc.co.uk/news/education-28405544>

112 A McGettigan, (2013) 'The Great University Gamble' Pluto Press, pg. 178.

contingent loans are more complicated and harder to value than the mortgage style loans, because every graduate's repayment schedule will be different.

The Government hoped to achieve three objectives by selling the student loan book:

- Lower Public Sector Net Debt (PSND)
- 'De-risk' the Government's balance sheet
- Raise funds to finance an expansion of undergraduate places<sup>113</sup>

The Government stated that the loan book should only be sold if it "*represented value for money for the taxpayer*" and that the terms and conditions were not changed for existing borrowers.<sup>114</sup>

Witnesses to this inquiry have convinced us that a sale would be undesirable.

The Government hoped that the first tranche would be sold by 2015/16 and generate £12 billion of income over a five year period. The problem with selling the loans is that the borrower's costs are fixed prior to the sale of the loan book. The interest rates are fixed for the duration of the loans, at RPI or base rate plus 1%, whichever is lower. The Commission agrees with arguments given by Dr Andrew McGettigan in his evidence to the BIS Select Committee and to this inquiry that a private investor would be very unlikely to buy an asset that paid a dividend lower than inflation.<sup>117</sup>

Rothschild, the Government's advisors on the sale of the loan book, estimated that they might be able to sell £1-2 billion under the contracted conditions, much lower than the aim of £12 billion. With the option of changing the terms and conditions for borrowers ruled out, the remaining option would be to create a 'synthetic hedge' to generate more sales. A synthetic hedge is a financial instrument where the Government agrees to pay the difference between the interest levels on the loan repayments and the current level of inflation, so investors do not lose out as a result of low interest levels. David Willetts MP, in an evidence session with the BIS Select Committee, noted that this option is currently being explored.<sup>119</sup>

Not only would the Government likely sell the student loan book at a discounted price – foregoing a valuable future income stream – but it would also commit to paying an unquantifiable amount of interest to the private investors for the foreseeable future.<sup>120</sup>

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113 A McGettigan, (December 2013) 'Briefing prepared for BIS Select Committee appearance, 17 December 2013' pg.1 available at: <http://andrewmcgettigan.files.wordpress.com/2013/12/bis-select-committee-submission.pdf>

114 Department for BIS, (June 2011) 'Higher Education: Students at the Heart of the System' pg. 23 available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31384/11-944-higher-education-students-at-heart-of-system.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31384/11-944-higher-education-students-at-heart-of-system.pdf)

115 G Osborne, (December 2013) 'Chancellor George Osborne's Autumn Statement 2013 speech' HM Treasury, available at: <https://www.gov.uk/government/speeches/chancellor-george-osbornes-autumn-statement-2013-speech>

116 *Ibid.*, 84.

117 House of Commons Business, Innovation and Skills Committee (July 2014) 'Student Loans Third Report of Session 2014-15' pg. 28 available at: <http://www.publications.parliament.uk/pa/cm201415/cmselect/cmbis/558/558.pdf>

118 A McGettigan, (December 2013) 'Briefing prepared for BIS Select Committee appearance, 17 December 2013' pg. 1 available at: <http://andrewmcgettigan.files.wordpress.com/2013/12/bis-select-committee-submission.pdf>

119 House of Commons Business, Innovation and Skills Committee, (14 January 2014) 'Oral evidence: Student Loans' available at: <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-innovation-and-skills-committee/student-loans/oral/5316.html>

120 A McGettigan, (December 2013) 'Briefing prepared for BIS Select Committee appearance, 17 December 2013' pg. 5 available at: <http://andrewmcgettigan.files.wordpress.com/2013/12/bis-select-committee-submission.pdf>

The motivation to sell the student loan book to help lower PSND remains a strong pull for the Government. PSND does not include illiquid assets, like student loans. This means that the money owed to government, an asset, does not reduce PSND, only the Government's borrowing to finance student loans in the first place counts. Cash raised from the sale of loan books can be used to reduce PSND.

Dr McGettigan sums up the political implications of this:

*“The headline statistics – the debt and the deficit – are used to present macroeconomic competency to the public and so there is a political gain to be had from selling the loans even if it means foregoing significant income streams, committing future governments to subsidy payments and thereby resulting in a net long-run economic loss.”<sup>121</sup>*

The Commission's evidence supports the BIS Select Committee and Dr McGettigan's views that the sale of the income contingent student loans is not viable. It will be poor value for money for the taxpayer, and this is not a sustainable method for funding higher education. The amount of student debt is set to rise dramatically over the next 10 years and continually selling off tranches of debt to fund higher education is going to be very difficult. There are few organisations that can buy this amount of debt, the market will begin to saturate, and more extreme financial engineering will be needed to sell off the debt. Several witnesses reflected on this argument, noting the similarities to events in the run up to the financial crisis.

The Commission has heard almost unanimously that the sale of the student loan book to fund HE is not a good idea. The Government will find it hard to get value for money and the loan book is a valuable income stream. Holding onto it will protect students and provide future opportunities for the Government.

### **Recommendation 13**

**The Government should not sell the student loan book to fund higher education or other spending priorities.**

#### **2.4.3 Regulation**

The lack of a coherent regulatory framework for English HE is a major risk to the financial sustainability of the sector. In our last report, we discussed the need for a Higher Education Bill, to create a legislative framework for higher education which could apply to all institutions. The levels of money invested in higher education from students, the Government, and taxpayers, and contribution of HE to the economy and society merit proper protection for all through a legislative framework.

A liberalised and expanded student numbers regime will create more volatility in the

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<sup>121</sup> Ibid., 6.

system (as discussed in 2.1.2) and fit for purpose regulation will become even more important.

The Commission is still very concerned about the lack of protection for students. Students at alternative providers still have no access to redress, and key information is not available at all institutions. Students have little financial protection in the event of an institution failing.

Liam Burns, former president of the NUS, told the *Guardian*:

“Without proper legislation you have more financial protection on a holiday to Magaluf than you do taking out a £27,000 loan and going to university for three years.”<sup>122</sup>

Rating agencies are still making credit ratings based on the assumption that HEFCE will bail out an institution in the event of a failure. In our last report we argued that HEFCE is no longer in a position to bail out institutions, as it does not have the resources to do so. We are worried that this is leading to an inflated market, where universities are being judged as more stable than they potentially are, because of an assumption being made by the rating agencies. As more universities start to take out bonds to invest in infrastructure or maintenance we see this problem growing.

As mentioned in section 2.1.2.c., as long as there is demand in the system, it is presumed by rating agencies that HEFCE would bail out an institution. One witness believed that they would be more likely to bail out an institution with strong student demand and poor finances, than an institution with reasonable finances that was struggling to recruit students. This could spell trouble for areas that have a high concentration of institutions.

Better, targeted regulation of the whole system would create a more financially sustainable sector. Without this, the sector is at risk of failing.

#### Recommendation 14

The Government should acknowledge the importance of the regulatory framework to the financial sustainability of English HE and implement the recommendations from the Higher Education Commission’s report *‘Regulating Higher Education’*.

#### 2.4.4 Investment in higher education

It is often noted that the UK invests less than other countries in higher education provision.<sup>123</sup> OECD on page 58 show that UK spends 1.2% of GDP on tertiary education compared to the OECD average of 1.6%.<sup>124</sup>

122 S Littlemore (30 January 2012) ‘Is shelving the higher education bill good news or bad for students?’ The Guardian.

123 Although the OECD reports on all the UK nations together, given that England is 85% of the UK – and in Scotland public investment is much greater than in England - this can be taken roughly representative of England.

124 These figures could be misleading, as they are from 2010 (the previous funding system), and only measure direct investment. The shift of higher education funding from direct grants to universities to support through the loan system does not appear, as what the Government invests in the form of debt write off is not interpreted as investment by the OECD. Therefore the ‘Education at a Glance 2015’ report will likely show the UK even lower on the levels of public investment in HE as direct investment has reduced again since 2010. OECD (September 2014) ‘Education at a Glance 2014: OECD Indicators’, OECD Publishing. pg. 232.



Part of this is to do with the way we fund higher education, through a mix of public and private investment, as discussed in previous chapters, moreover these figures relate to 2011. Government’s direct investment in teaching (through the HEFCE teaching grant) has reduced since the 2012 reforms and many courses no longer receive any direct funding.<sup>125</sup> Instead these are funded through tuition fees paid by students. The Government invests in teaching through the write off of student tuition loans, but this is deemed to be an indirect investment, and therefore does not score in OECD figures.

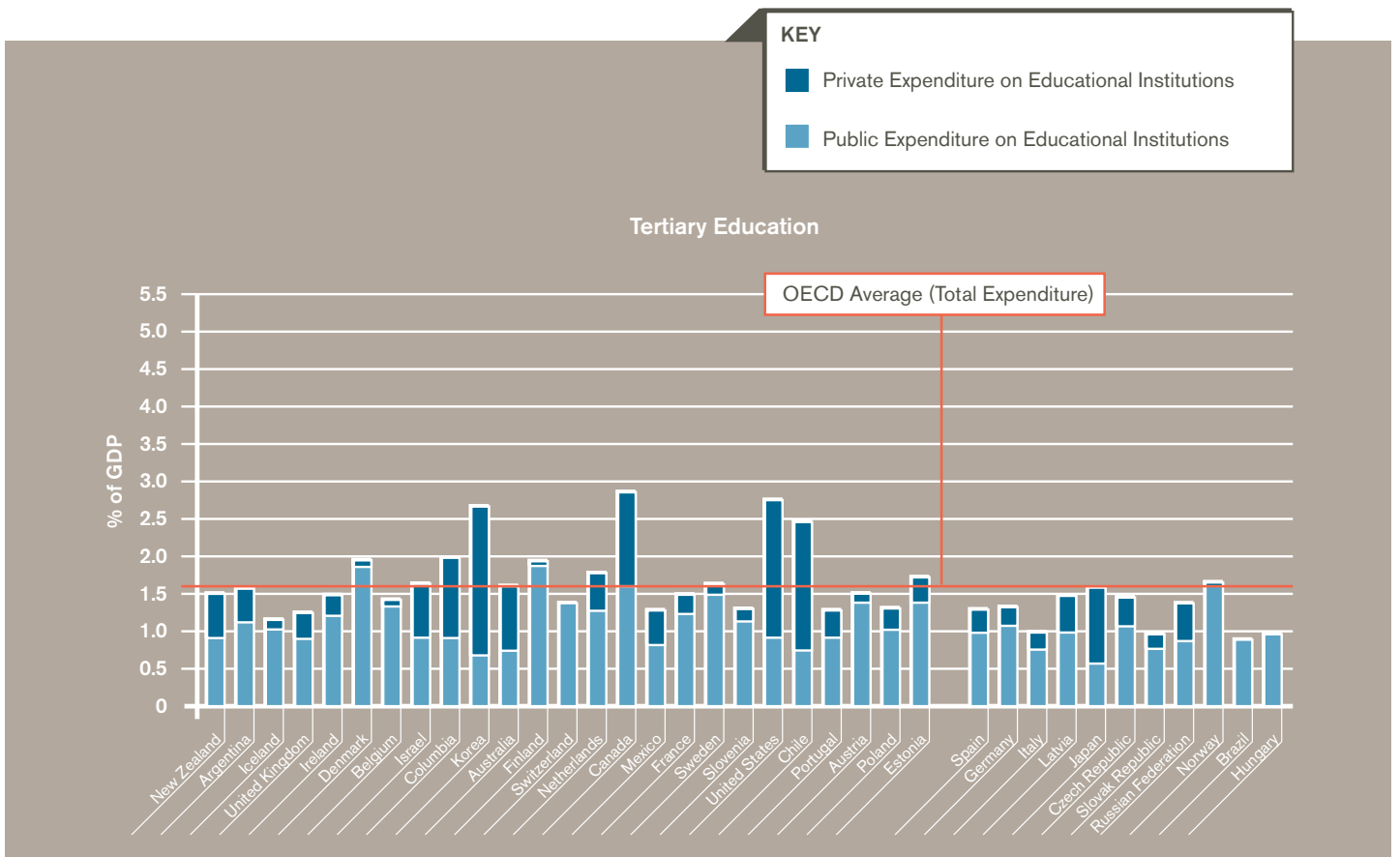


Figure fourteen: Expenditure on educational institution as a percentage of GDP (2011)  
 Source: OECD, Education at a Glance 2014

There is a group of subjects that still receive direct funding from the Government through HEFCE. These tend to be science or engineering subjects that cost more to

125 A McGettigan, (2013) 'The Great University Gamble' Pluto Press, pg. 26-7.

put on than classroom based subjects, and certain other Strategically Important and Vulnerable Subjects (SIVS). Without the grant for SIVS some universities may struggle or be reluctant to offer these courses. The residual grant for SIVS is not necessarily a mark of greater value attaching to these courses, but is a recognition of market failure. However, some of our witnesses commented that the lack of direct investment in teaching across a broad range of courses failed to take account of the levels of public good that come with higher education.

This means the Government's investment in teaching (through HEFCE) decreased from £4.3 billion in 2011/12 to £1.6 billion in 2014/15.<sup>126</sup> This is a decrease of about 63%. This is likely to decrease further when the remaining students from the 2006 tuition fee regime graduate in 2015 and 2016.

We praise the Government's ring-fence on the science and research budget throughout this period of austerity. However, we were told that funding did not cover the economic costs of research. The freeze in cash terms has led to erosion in real terms value, and many said they would like to see government and other funding for research begin to increase as the economy recovers, to maintain our global competitiveness. The Russell Group said in written evidence that the public funding levels were worth between £420 million and £560 million less in 2015/16 than if they had been indexed to inflation since 2009/10.<sup>127</sup>

Views on the importance of research funding and the need to increase this were unanimous. However, how we fund research and how research should be prioritised were not. There is not a consensus about how concentrated funding should be: whether funding should focus on the most research intensive institutions with the greatest amount of research activity, or whether efforts should be made to distribute research funding more evenly, wherever excellence is found.

This concentration is demonstrated in a recent Universities UK report on research that found from 2013/14, UK institutions in the fifth quintile (the upper 20% of the funding distribution) received 75% of all mainstream quality-related funding from the funding councils, compared to 73% in 2010/11.<sup>128</sup> Many believe that further concentration will be the result of the funding allocations that emerge following the imminent publication of the results of the Research Excellence Framework.

Whilst concentrating research funding may be more efficient in terms of economies of scale, and enhancing the reputation of a subset of English universities, spreading research funding to wherever excellence is found allows for an element of dynamism in the system and more opportunities for early career researchers to prove themselves. The Commission would recommend that good research, wherever it exists in the sector, continues to be funded.

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<sup>126</sup> HEFCE, Annual funding allocations for 2014-15 available at: <http://www.hefce.ac.uk/whatwedo/invest/institns/annalocns/>

<sup>127</sup> Written evidence, the Russell Group

<sup>128</sup> UUK, (June 2014) 'Research and Postgraduate Research Training' pg. 17 available at: <http://www.universitiesuk.ac.uk/highereducation/Documents/2014/ResearchAndPGRtraining.pdf>

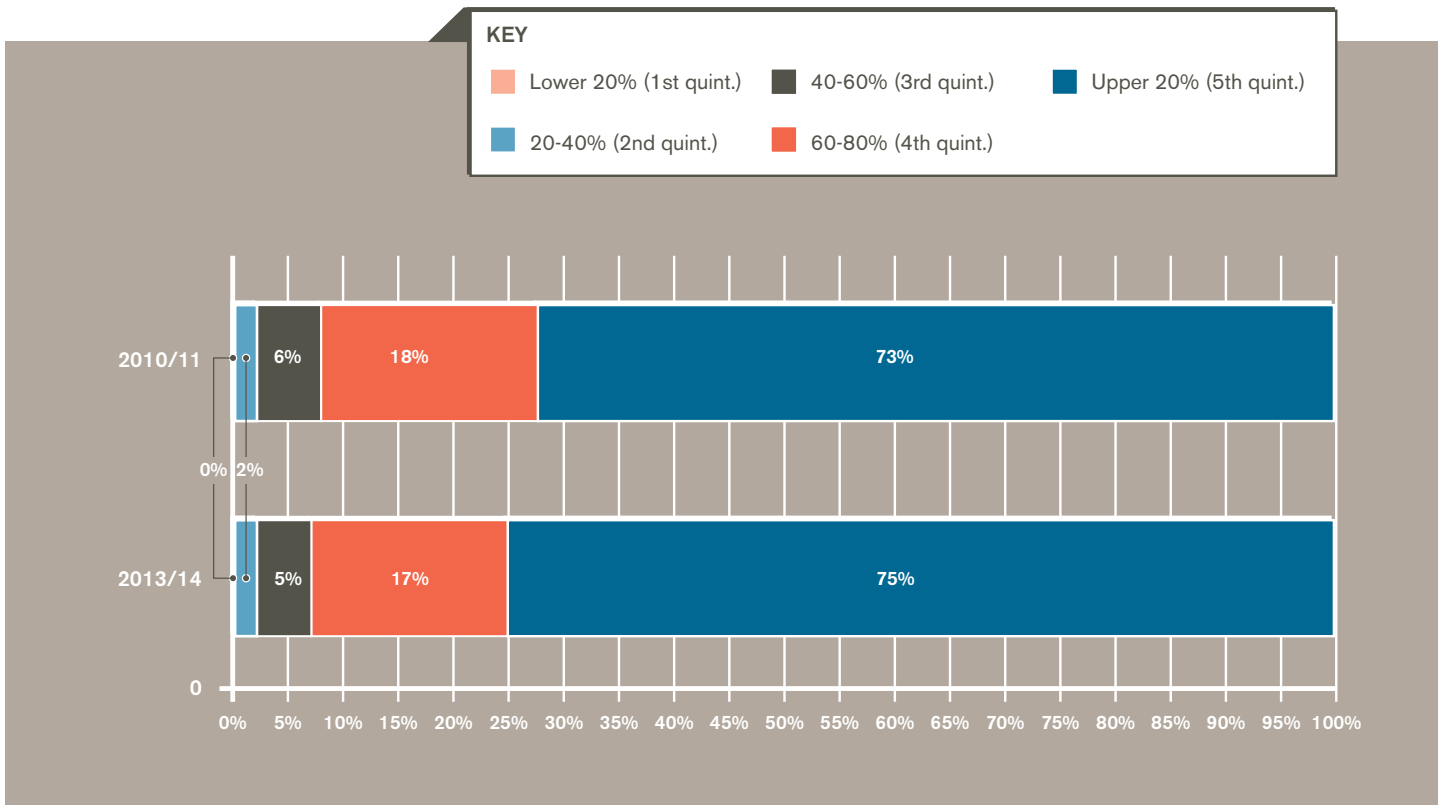


Figure fifteen: Distribution of mainstream quality-related (QR) funding across UK higher education institutions (quintiles), 2010/11 and 2013/14  
 Source: UUK, Research and Postgraduate Research Training

**Recommendation 15**

High quality research, wherever it exists in the sector, should continue to be funded.

# What are the alternatives for funding higher education?

The Commission believes that a financially sustainable higher education system is achievable in both the short- and long-term. Following our earlier analysis, and recommendations contained therein, we have devised guiding principles for a sustainable system. These are set out below.

Sustainability does not just mean the sector simply stands still and survives. Sustainability should also contain the ambition for expansion, innovation, and development. Thus our guiding principles for financial sustainability cover those essential to survive as well as thrive.

For survival the system needs:

- Financial contributions from both principal private and public beneficiaries (students and the taxpayer)
- Institutions that operate with enough surplus to meet their needs as set out in sound business plans
- Fair fees and progressive repayment mechanisms for students

For the kind of sustainability that allows the sector to thrive and develop:

- All who wish to and have the ability to participate are able to do so
- We maintain a world-beating, healthy, well-financed research sector
- Our system is well-regulated, accountable to the Government and students
- Government promotes diversity of provision and providers

In the run-up to the 2015 election, we urge political parties to embrace these guiding principles, as they represent a strong degree of consensus that exists in the often fraught higher education policy debate.

However, there remain great ideological differences on how to fund taught undergraduate HE. One damaging result of the 2012 reforms has been to leave political parties and universities nervous about yet further reform in the sector. This anxiety is characterised by differing opinions and mistrust. These are not limited to funding, but also bear on the value of university and the structure of the sector.

The intergenerational impact of the present funding policy is also of concern. This argument is twofold. Those who participated in higher education when there were no fees, are assumed to contribute to higher education through higher general taxation, whereas those entering higher education now will pay twice, through both fees and higher general taxation. This argument runs for future generations as well: those who enter HE in, for example, ten years time, will pay tuition fees, contribute through tax, and will likely have to fund the write off of fees from the generation before. The costs of higher education are being passed along to the next generation, as was acknowledged

by Business Secretary Vince Cable at Liberal Democrat Conference in 2014. He said:

*“These losses crystallise in 30 to 40 years’ time - when I’m well over 100. I shan’t be sitting round, spending the rest of my life worrying about what happens in the year 2000-and-whatever-it-is. If you are terribly fastidious about accounting then the fact that the default rate is now estimated to be higher than it was when we introduced the scheme is something [that worries some people].”<sup>129</sup>*

This concern was reiterated by one of our witnesses, saying that whilst students do not necessarily understand or feel a connection to the money they are spending on tuition now, how long will it be until they do? What future unsustainability could this system have created? Political parties must remain tuned to this increased intergenerational discontent.

Previous chapters have discussed the questions raised by the current funding system, and the problems that it is creating for government, universities and students.

The Commission have not considered in detail changes – major or minor – to the financial support for maintenance the Government provides to full-time undergraduate students. It is true that this support is quite generous when compared to what exists in other countries. However, short of a radical shift, the savings that accrue are unlikely to be large enough to make a big difference in financial terms, certainly not in the short-term. Big changes would hit students, and most potential changes tend to exacerbate the existing inequalities that disadvantage students from lower socio-economic groups seeking to enter higher education.

In addition, during the course of our inquiry proposals for alternative models of higher education, including funding options, were made by John Denham MP in a speech to the Royal Society for the encouragement of Arts, Manufactures and Commerce and Shadow Universities Minister Liam Byrne MP in a pamphlet for the Social Market Foundation.<sup>130, 131</sup> Given that both these options depend to some extent on promotion and acceptance of a different model and ethos for tertiary education in England, the Commission did not examine them in detail. However, in that they envisage a more diverse system and include ideas that could bear down on the costs of higher education to government and students, they are relevant to the arguments set out in this paper and should be taken into account in future debates.

We have set out options below that we felt had the most merit and best addressed the problems with the system that emerged in the evidence. In every case there were advantages and disadvantages to the proposals and we have included a full analysis of the positive and negative implications of the different models. In each case, we point to what we believe to be the best evidence available on the impact these different options

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129 B Wheeler, (7 October 2014) ‘Vince Cable ‘not losing sleep’ over unpaid student loans’ BBC News, available at: <http://www.bbc.co.uk/news/uk-politics-29515808>

130 J Denham, (January 2014) ‘RSA Lecture – The Cost of Higher Education’ available at: <http://johndenham.wordpress.com/articles-speeches-and-essays/rsa-lecture-the-cost-of-higher-education/>

131 L Byrne, (28 August 2014) ‘Robbins Rebooted: How we earn our way in the second machine age’ Social Market Foundation.

for reform would have on the system as a whole. Where the evidence is lacking, we call for more work from the public policy and academic communities.

However, the Commission does not select one option. Our analysis is that the current system is not sustainable and it is our intention to inform the present debate, and make clear what is achievable in a time of austerity, as well as what might be desirable in the long-term. We understand that the Government have rejected the BIS Select Committee's recommendation that an urgent review of the financial sustainability of higher education takes place. We would urge the Government to reconsider this. It is imperative that political parties listen to our analysis of the problem – the result of nine months of rigorous engagement with all parts of the system – and make a political judgement on the levers to pull to ensure our exceptional higher education system has the in-built sustainability to continue to thrive.

#### **Recommendation 16**

The current system fails to meet our test of financial sustainability and further work needs to be undertaken to arrive at a better higher education funding model.



# Option 1

## **Maintaining the status quo with or without tweaks to the system**

Maintaining the status quo may prove the most politically attractive option, as it does not require an increase in up-front funding. Undergraduate degrees will continue to be funded through the servicing of debt, remaining fraught with all the uncertainty described in earlier chapters.

Options for tweaking would not require dramatic changes to the mechanics of the system. These would be simple changes to one part of the existing mechanism, to achieve part of our aims (e.g. helping HEIs, lifting the burden on students, etc.). Without injecting more funds it is very difficult to help everyone, and therefore these tweaks tend to lift the burden on one part of the system at the expense of another part.

Options to lift the burden on government:

- Reduce the graduate earnings threshold for repayment from £21,000 to £15,000 a year
- Stop the repayment threshold increasing in line with earnings
- Increase interest rate on student loans

Options to lift the burden on institutions:

- Index tuition fees with inflation

Options to lift the burden on students:

- Reduce the interest rate on loans

## **Positives**

Universities have spent a great deal of time and resources adapting to the new system, adjusting business plans and structures internally to meet requirements. Likewise, the Government has invested heavily in the changes, including communicating them to students and others. Maintaining the overall system would provide stability and continuity that most institutions would like.

Making small changes by tinkering with the system would make funding higher education more affordable for government and/or universities without the upheaval that is associated with changing the system entirely. The changes are small and targeted and it is plausible that there wouldn't be the same risk of unforeseen implications as would result from more fundamental system wide changes.

## **Negatives**

In our evidence, the majority of the small changes proposed focussed on taking the burden off universities and the Government and placing more of it onto students. The Commission is already concerned at the level of indebtedness affecting today's

graduates and the likely actual levels of repayment that will be required especially of middle earners. Such changes would add to the difficulties for graduates. Tweaking the system that is already felt by many to be on the wrong path would only exacerbate the problems, and continue the policy along a journey that has been rife with disagreement and worry.

**Find out more**

The Institute for Fiscal Studies have produced impressive modelling on this kind of ‘tweaking’ in their paper *Estimating the public cost of student loans*.

# Option 2

## Graduate Tax

A graduate tax has been considered by the Government on more than one occasion as a potential route to reform higher education funding. The most extensive recent work on this has been modelled by London Economics for Million+. Here a graduate tax applies to tuition fees only, with maintenance loans continuing to operate under the current income contingent system.

This model envisages a progressive graduate tax over a 30 year period.

<u>Annual Earnings</u>	<u>% tax payable</u>
Below £10,000	0
£10,000-25,000	2
£25,000-42,000	2.75
Over £42,000	3.50

Under this system, tuition fees would be abolished and the HEFCE teaching grant would be increased to £7.34 billion a year to prevent a drop in institutions' unit of resource. The Government would need to borrow £4.1 billion to fund this. It is assumed that the revenues from the graduate tax would be hypothecated (dedicated) to help meet the costs of higher education. The abolition of tuition fees would greatly reduce the student loan subsidy to approximately 29.4%, saving the Exchequer £3.16 billion per cohort of students.<sup>132</sup>

## Positives

This is argued to be the most progressive funding regime as students' contributions are directly linked to the financial benefits they reap as a result of higher education. It would be transparent, as graduates will be paying back into the system to fund higher education as a whole. This system does not need to be uprated with inflation. This system would keep barriers to entry down, as there would still be no upfront costs for tuition and indebtedness would fall away, to be replaced by a future tax liability.

## Negatives

This example has the payment level starting at a very low salary level (below even a full-time job on the National Minimum Wage, which would command a salary approaching £13,000 a year). A more realistic payment threshold of £15,000 to £20,000 would reduce the revenue and increase the borrowing requirement. To transition to a graduate tax system would require the Government to put more money into universities for a number of years to make up for the shortfall in university income. The tax would be paid to the Exchequer along with all other taxes. Hypothecation has not been common or successful in the UK tax system and without it funds might be diverted to other government priorities, leaving universities underfunded.

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<sup>132</sup> Million+ and London Economics, (May 2013) 'Do the alternatives add up?' pg. 17 available at: [http://www.millionplus.ac.uk/documents/reports/HE\\_Funding\\_in\\_England\\_-\\_Do\\_the\\_alternatives\\_add\\_up.pdf](http://www.millionplus.ac.uk/documents/reports/HE_Funding_in_England_-_Do_the_alternatives_add_up.pdf)

Those who move overseas after graduation would fall out of the payment system unless a separate system was retained perhaps based on income contingent loans, to try and track and receive these payments after graduates move abroad. This system means that there is no direct relationship at all between what the graduate pays back and what their tuition costs.

**Find out more**

Million+ in partnership with London Economics in their paper *Do the alternatives add up?* have continued to provide strong evidence on the graduate tax option.

# Option 3

## Lowering fees, increasing government grant

Lowering fees and increasing the HEFCE grant has been publicly debated in the run up to the 2014 Autumn Party Conference season.

Again, Million+ have undertaken recent modelling on this solution with London Economics. If fees were reduced to £6,000 a year, it is predicted that universities would lose approximately £2.03 billion in income. This reform has been estimated to increase student numbers by 10,098, which would cost an extra £200 million. By reducing fees to £6,000, universities would no longer be required to pay a percentage of fees to OFFA to fund bursaries and scholarships, a saving of £356 million.<sup>133</sup>

The Government would need to make up the difference between the lower fees and the present £9,000. If lower fees set at £6,000 were introduced the estimated to cost to the Government would be £1.72 billion. In Million+'s modelling, the gap between £6,000 and £9,000 fees could be bridged because the student loan subsidy would fall to 27.9% and the interest rates on student loan repayments could be increased.

### Positives

Lower fees would mean that students graduate with less debt. A greater percentage of students would pay off their loans entirely and less money would have to be written off by the Government. An increase in the HEFCE grant would represent public interest in higher education in a more transparent way, than using money to service student debt. The UK would rise in international rankings such as the OECD *'Education at Glance'* reports, as direct investment in HE is recorded by their metrics whereas writing off debt isn't. Students, in our focus groups thought direct investment in universities was preferable to indirect subsidy through debt write-off. Under this system the Government would have more control of its own finances, as the student loan subsidy would be lower and less volatile, allowing for more stable financial planning.

### Negatives

Universities, generally, prefer to receive money from students in the form of tuition fees, rather than grants from government.<sup>134</sup> They argue that income through fees is more reliable and gives them more control and autonomy than grants from governments, as they are subject to political vagaries. Tuition fee income allows them to make longer-term financial plans.

This proposal benefits the better off, in that higher earning graduates have less debt to repay whereas lower earning graduates would repay a higher proportion of what they borrow. The money saved from a reduced student loan subsidy is accounted for differently from the money the Government would be required to raise to restore HEFCE grant to make up for the loss of tuition fee income, casting doubt on whether

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<sup>133</sup> Ibid., 13.

<sup>134</sup> Some VCs have indicated privately that they would be happy to change to more HEFCE grant, but acknowledged this view wasn't too popular with their colleagues

it would be made available. It is unclear whether the Government would make up the full difference, or if they would attach requirements to the funding. This is a particular concern of Vice-Chancellors, as this would be a good opportunity for the Government to reassert some leverage it lost with the reduction of the teaching grant. Students' influence within an institution could decrease correspondingly with the decrease in fees, as they might be less able to use high fees as leverage for better teaching, facilities etc. For the students that had £9,000 tuition fees some sort of amnesty would probably have to be offered, likely in the form of loan forgiveness, adding cost to the proposal.

**Find out more**

Once again, Million+ in partnership with London Economics in their paper *Do the alternatives add up?* have completed the most comprehensive work on this option.



# Option 4

## Lifting the fee cap

An increase or removal of the tuition fee cap has been advocated by a range of universities in England, citing that their provision costs more than the current £9,000 fees.

Universities also argue that the £9,000 fee cap should increase, as inflation is imposing a real terms cut. It has been estimated that the £9,000 cap imposed in 2012 is now equivalent to £8,200 as a result of inflation.

## Positives

Universities would be able to increase their fees, and cover the costs of provision. Fees could be differentiated at the discretion of universities reflecting their own teaching costs or what the market might bear in terms of employment outcomes for their graduates. Universities would be able to compete on a global scale as increased income would enable them to recruit more and/or better staff and support research outcomes. If the Government used this as an opportunity to cut its funding further it could lead to reduction in PSND, given the mechanics of accounting for student loans.

## Negatives

Lifting the fee cap will increase student debt and the number of students who have debt written off, as well as the total amount of money needed by government to subsidise the loans. IFS modelling shows that lifting the tuition fee cap would substantially increase the student loan subsidy; an increase to £12,000 would increase the student loan subsidy from 43.5% (their baseline) to 50.1%, meaning the Government would be writing off more than it was receiving in payments. This adds substantially to the costs to government.

It is unclear what impact this would have on student demand (it is more the 'unknown' factor that scores as a negative here). Previous experience shows that increasing fees led to an increase in student demand the year before the fees went up and a dip in entrants in the year of the fee increase. This soon returned to the pre-reform trend of increases in undergraduate demand. The lack of price sensitivity in the system also means that students might not be as aware of the increase and the related debt.

Universities are saying that the £9,000 fee cap is not covering average costs; however there has been little evidence to support this, and evidence from alternative providers and FE providers makes it clear that certain courses can be delivered for substantially less.

**Find out more**

There is some work from the Institute for Fiscal Studies on this option, but the best evidence will likely come from Australia, where the Government plans to deregulate fees.

# Option 5

## Hybrid system

Through our work a hybrid system emerged that seeks to combine elements of a number of models. Under this system, students would have a yearly allocation of undergraduate tuition fee loan of, say, £6,000 each year for the number of years their course lasts. In addition, all citizens would have a lifelong learning pot of, say, £15,000 to be used for any level 4 and above qualification over the course of a person's life. Students could use this for postgraduate education, retraining later in life, or upskilling through CPD courses. This would be comparable to Australia's 'lifetime loan allocation'.

Universities would be able to charge tuition fees over £6,000, but for every £1,000 charged above this 'soft cap' they would be required to pay back to the Government a proportion of the sector-wide student loan subsidy – a form of levy. The aim would be to incentivise universities to take collective responsibility for ensuring efficiency and value for money.

To avoid the levy amount shifting dramatically from year to year, this figure would be a reflection of the student loan subsidy and not an exact calculation. The Government would have to decide and justify the level at which this is set.

The levy would grow as tuition fees increased above £6,000, reflecting the fact that higher fees and fee loans increase the costs to government and lead to higher rates of non-repayment from graduates. This growth – rather like that proposed in Lord Browne's review<sup>135</sup> – would create a natural cap that universities would not exceed, as the marginal rate of the levy would leave them receiving very little additional money.

This suggestion requires further work, including on modelling levels of repayment and interest rates and on the likely behaviours of universities and students in this system.

## Positives

For students, this could incentivise universities to keep their prices low, reducing their fees from current levels, and corresponding debt. There should be more variation in fee levels according to costs and to the likely benefits to graduates from attending particular institutions or studying particular courses. Not only does a levy keep fees lower, but universities would want their best students to stay on to study at postgraduate level. If their fees are substantially higher than £6,000, students would have to use their lifelong learning pot to make up the difference. High fee universities would be less able to recruit these students.

The proposal brings in elements of a government backed postgraduate loan system. And the proposal offers a long-term way through to remove the recent ELQ policy that contributed to the decline in part-time students.

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135 'Securing a sustainable future for higher education: An Independent Review of Higher Education Funding & Student Finance' (October 2010) The Browne Review available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31999/10-1208-securing-sustainable-higher-education-browne-report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31999/10-1208-securing-sustainable-higher-education-browne-report.pdf)

### 3. What are the alternatives for funding higher education?

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Businesses could be encouraged to aid employees with extra training. The lifelong learning pot means more leverage for employees to ask for match funding or top-ups to make up for any differences in tuition and loan available.

#### **Negatives**

This proposal relies on universities and students responding to nuanced incentives, which historically has not happened as policymakers have intended. Students told us that they were not keen to see the fee differentiation that would probably result. The proposition is complex.

Students would have to be very savvy with their funding pot under this system. Inexperience with finances and/or poor careers advice could lead to students making decisions based on poor information. Our evidence shows that students are not eager to take on additional financial responsibility.

Institutions with strong reputations could increase fees to the maximum as a way of passing the costs of the levy on to students. The arrangements could thus emphasise the existing stratification in the HE system, disadvantaging universities with weaker reputations.

The proposal would require more detailed work on the right level to pitch the lifelong learning pot, the likely costs of funding fees over £6,000 and the spending consequences over time for Government of entitling adults to an amount of money without restriction on when they choose to deploy it.

#### **Find out more**

The notion of a levy on universities is seen in the Browne report *Securing a sustainable future for higher education: an independent review of higher education funding & student finance* and the lifelong learning pot is discussed in the University Alliance in their report *HELP UK: A new Higher Education Loan Programme adding to the debate on funding*.

# Option 6

## Differential fees

Differential fees across courses and/or institutions would allow for the costs of provision and potential graduate earnings to be better reflected in tuition fees.

Employment outcomes vary considerably across courses and institutions.

The current HEFCE subject bands could be used to set different tuition fee levels. The lowest subjects, in band D that receive no support from government could have a fee cap of £7,000 and this could increase by £1,000 with each band increasing the tuition cap on band A subjects to £10,000.

The forthcoming project *Estimating the Human Capital of Graduates* by Professor Anna Vignoles, Professor Lorraine Dearden and Professor Neil Shephard, could be used to indicate the student loan subsidy as it applies to individual institutions across the UK. The data has the potential to help differentiate between institutions with the best employment outcomes and which universities should be able to charge greater fees as a result.

## Positives

Differential fees for courses would allow universities to charge rates that better reflect the cost of subject delivery. This would create a more transparent system with less cross-subsidy between subjects.

Students with higher employment prospects would be charged more, yet would be more likely to pay off their loans, as a result of the graduate earning premium. Students who are likely to earn less would have less debt and those likely to earn more would have more debt. If fees were to differ between institutions, the costs of provision for different systems (such as the Oxbridge college system) would be recognised, and there would be incentives for institutions to increase the employment prospects of graduates as they would then be able to increase fees as a result.

## Negatives

This proposal implies a substantial degree of state control and intervention on the prices universities may charge. If fees differed for courses, this could lead to a decrease in recruitment for STEM subjects as the sticker price for these courses would be higher. As an area that has been identified as a priority for the nation to remain economically competitive, this would be detrimental.

Different fees across institutions would risk creating a two-tier system in higher education. There is a fear that this would have repercussions for social mobility. Whilst we are still awaiting the research on student loan subsidies for institutions, BIS research has shown that once A-level grades and background are accounted for the difference in graduate earnings between the 'elite' and 'post-1992' universities is minimal. Differential fees would exacerbate these perceptions.

Our evidence has shown that students do not like differential fees. This is because of the association of high cost equalling high quality and a notion that a degree, as a qualification, is what they are paying for as opposed to a career.

**Find out more**

The research undertaken by Professor Anna Vignoles, Professor Lorraine Dearden and Professor Neil Shephard on *Estimating the Human Capital of Graduates* could help universities decide where to set their fees. This project is funded by the Nuffield Trust is due to finish in March 2015.

More work needs to be done on differential fees for different courses, and the likely behavioural impact on students of such variation.



# Contributors

## Evidence Sessions

### Scoping Seminar:

<u>Professor Simon Marginson</u>	<u>Professor of International Higher Education, Institute of Education</u>
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<u>Rt Hon the Lord Baker of Dorking CH</u>	<u>Former Secretary of State for Education and Science</u>
<u>Rt Hon Charles Clarke</u>	<u>Visiting Professor, School of Politics, Philosophy, Language and Communication Studies, University of East Anglia</u>
	<u>Former Secretary of State for Education and Skills</u>
<u>Nick Hillman</u>	<u>Director, HEPI</u>

### Session two:

<u>Paul Clark</u>	<u>Director of Policy, Universities UK</u>
<u>Steve Egan CBE</u>	<u>Deputy Chief Executive and Director of Finance and Corporate Resources, HEFCE</u>
<u>Professor Dame Julia Goodfellow</u>	<u>Vice-Chancellor, The University of Kent</u>

### Session three:

<u>Andy Gannon</u>	<u>Director of Policy, PR and Research, 157 Group</u>
<u>Professor Terence Kealey</u>	<u>Vice-Chancellor (now retired), University of Buckingham</u>
<u>Dr Lynne Sedgmore CBE</u>	<u>Executive Director, 157 Group</u>
<u>Roxanne Stockwell</u>	<u>Vice President of Higher Education Awards and Principal, Pearson College</u>

### Session four:

<u>Lori Houlihan</u>	<u>Executive Director of Development and Alumni Relations, University College London</u>
<u>Kate Hunter</u>	<u>Executive Director at CASE Europe</u>
<u>Professor Sir Tim Wilson DL</u>	<u>Author, A Review of Business–University Collaboration</u>
<u>Louise Wren</u>	<u>Policy Adviser, Wellcome Trust</u>

### Session five:

Internal Higher Education Commission Session

### Session six:

<u>Hugo Foxwood</u>	<u>Associate Director, Standard &amp; Poor's</u>
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### Session seven:

<u>Dr Claire Crawford</u>	<u>Research Fellow, IFS</u>
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<u>Professor Paul O'Prey</u>	<u>Vice-Chancellor, Roehampton University</u>
<u>Liz Shutt</u>	<u>Head of Policy, University Alliance</u>

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UCEA  
Universities UK  
University of Hull

**Focus Groups**

**Focus Group one**

Somerville College, University of Oxford

**Focus Group two**

Oxford Brookes University

**Focus Group three**

University of Hertfordshire

# Acronyms

<u>BIS</u>	<u>Department for Business, Innovation and Skills</u>
<u>CPD</u>	<u>Continuous Professional Development</u>
<u>ELQ</u>	<u>Equal or Lower Qualification</u>
<u>EU</u>	<u>European Union</u>
<u>FE</u>	<u>Further Education</u>
<u>GDP</u>	<u>Gross Domestic Product</u>
<u>HE</u>	<u>Higher Education</u>
<u>HEFCE</u>	<u>Higher Education Funding Council for England</u>
<u>HEI</u>	<u>Higher Education Institution</u>
<u>HMRC</u>	<u>Her Majesty's Revenue and Customs</u>
<u>IAG</u>	<u>Information Advice and Guidance</u>
<u>KIS</u>	<u>Key Information Sets</u>
<u>MOOCs</u>	<u>Massive Open Online Courses</u>
<u>NAO</u>	<u>National Audit Office</u>
<u>NICs</u>	<u>National Insurance Contributions</u>
<u>NSS</u>	<u>National Student Survey</u>
<u>NUS</u>	<u>National Union of Students</u>
<u>OBR</u>	<u>Office of Budget Responsibility</u>
<u>OECD</u>	<u>Organisation for Economic Co-operation and Development</u>
<u>OFFA</u>	<u>Office for Fair Access</u>
<u>PSND</u>	<u>Public Sector Net Debt</u>
<u>R&amp;D</u>	<u>Research and Development</u>
<u>RAB</u>	<u>Resource Accounting and Budgeting</u>
<u>SIVS</u>	<u>Strategically Important and Vulnerable Subjects</u>
<u>SLC</u>	<u>Student Loans Company</u>
<u>SNC</u>	<u>Student Number Control</u>
<u>STEM</u>	<u>Science, Technology, Engineering and Mathematics</u>
<u>UCAS</u>	<u>Universities and Colleges Admissions Service</u>
<u>UCU</u>	<u>University and College Union</u>
<u>UUK</u>	<u>Universities UK</u>

# What is the Higher Education Commission?

The Higher Education Commission is an independent body made up of leaders from the education sector, the business community and the three major political parties.

Established in response to demand from Parliamentarians for a more informed and reflective discourse on higher education issues, the Higher Education Commission examines higher education policy, holds evidence-based inquiries, and produces written reports with recommendations for policymakers.

The Higher Education Commission is chaired by Lord Philip Norton, a Conservative peer and academic. The Higher Education Commission's work is generously supported by the University Partnerships Programme.

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<u>Dr Ruth Thompson</u>	<u>Deputy Chair of Governors, Birkbeck, University of London and</u> <u>Governor, Staffordshire University</u> <u>Advisory Board Member, Higher Education Policy Institute</u> <u>Former Director General, Higher Education at the Department for</u> <u>Innovation, Universities &amp; Skills</u>

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# Acknowledgements

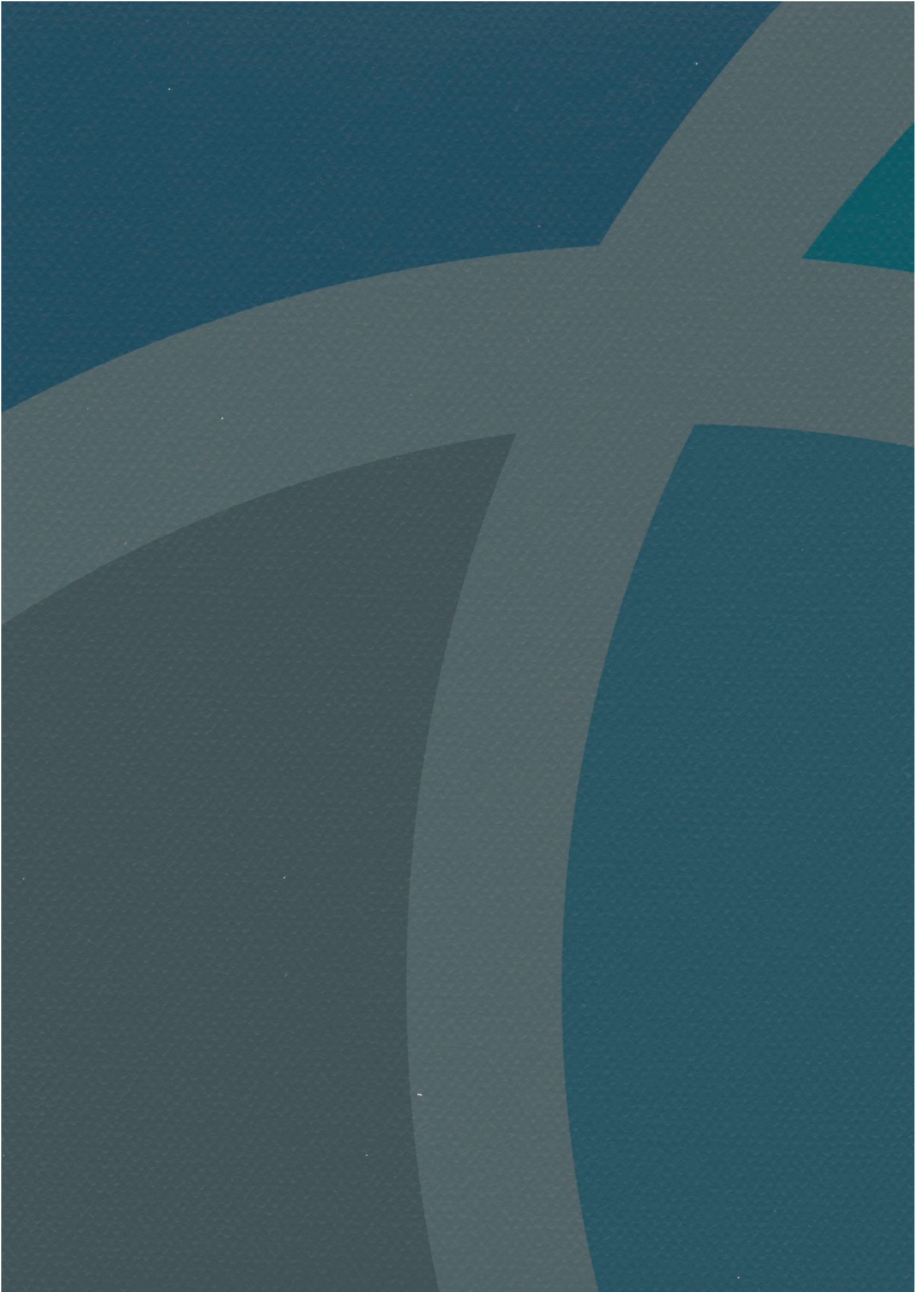
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